Newton's Laws of Money

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Introduction

When you were in school, you probably learned about **Newton's Three Laws of Motion**. First published by Sir Isaac Newton in 1687, these laws explain how physical objects move. They are so important—and easy to understand—that most of us still remember them even decades later. I was thinking about these laws when I came upon a realization: each of these laws can also be applied to finance.

Now, I know this isn't quite the same as watching an apple fall from the tree and developing the theory of gravitation. But I'm a financial advisor, not a scientist, so to me, it's equally interesting! That's why, I'm going to share what I call: **Newton's Laws of Money**

Newton's First Law.

An object at rest tends to stay at rest, and an object in motion tends to stay in motion, unless acted on by an outside force.

Here's my version:

A financial plan at rest tends to stay at rest, while a financial plan in motion tends to stay in motion, unless acted on by an outside force.

What exactly do I mean by "financial plan?" While there's no one definition of what a financial plan really is, in general, it works like this:

1. First, you look at your current financial situation. What is your income, what is your cash flow, how much do you pay in taxes, etc.
2. Second, you determine what you want your *future* financial situation to look like. What goals do you want to accomplish? What treasures (be they people or possessions) do you want to protect?
3. Finally, you lay out all the individual steps necessary to get you from your current financial situation to your *desired* financial situation. What exactly do you need to do to reach your goals? When do you need to do them?

Put these together and you have a basic financial plan.

In my experience, most people agree that having a financial plan is valuable. But there's a widespread problem: *most people procrastinate when it comes to creating OR implementing a financial plan.* It's not uncommon to hear excuses like "I'm too busy right now to create a plan; I'll do it next year when life settles down." Or, "I want to wait until I have a better job/the elections are over/the stock market goes up. There's just too much uncertainty right now."

Let's go back to the First Law of Finance: *a financial plan at rest tends to stay at rest.* People who procrastinate, who delay, who act passively, will usually continue to do so indefinitely. "Next year" never comes. Life never "settles down." Uncertainty never goes away. And so, a financial plan never gets created, and things just sort of stay the same. Forever.

The good news is that the First Law of Finance also says: *a financial plan in motion tends to stay in motion.*

It's amazing to see this Law at work. People who actually get the ball rolling, who *act*, who put in the energy to create *and* execute their financial plan … they start to build momentum. Suddenly, things start *happening* … and they *keep* happening! Their savings grow. Their tax situation improves. Their goals are reached, not just once, but over and over. I've literally seen people go from, "I feel like I'll never retire" to "I retired much sooner than I thought I would!"—all because they stayed in motion.

What we're really talking about here, is *inertia.* Whether you're moving or standing still, people are like all physical objects: they find it easier to keep doing what they're already doing. If you procrastinate, you'll find it easy to keep doing so. But if you start *working* toward your goals, you'll discover it's much more doable than you ever imagined.

All of this is important, because a proper financial plan with help you:

- Know how much money you'll need to meet your expenses *and* reach your goals.
- Choose the right investments to provide the income you need, at YOUR specific level of risk.
- Potentially minimize taxes for both yourself and your heirs.

- See what areas of your finances are stable and which may need improvement.

Let's look at the First Law of Finance one more time:

A financial plan at rest tends to stay at rest, while a financial plan in motion tends to stay in motion, unless acted on by an outside force.

YOU are that outside force. YOU hold the power in your hands to get the ball rolling. And it's a mighty power indeed—because it's a fundamental law of nature.

Call us at 1-800-277-0025 to take advantage of our Retirement Planning Software in our Wealth Toolkit to make sure your retirement plan is in motion, and that it stays in motion.

Newton's Second Law.

The acceleration of an object as produced by a net force is directly proportional to the magnitude of the net force, in the same direction as the net force, and inversely proportional to the mass of the object.

While that's probably as simple as 1+1 for someone with a physics background, it's not exactly easy to remember, is it? That's why most of us plump for this handy little equation:

F=ma, or force equals mass times acceleration.

Basically, the greater the mass of an object, the greater the amount of force needed to accelerate the object. If you hit a baseball with a bat, the ball will go flying. But if you hit a car with the same bat, the car won't move at all. You need a much greater force to cause the car to accelerate.

This law is a little tricky to apply to finance, but here's my version:

Retirement potential equals <u>amount</u> of savings & investing times <u>length</u> of saving & investing.

First off, let's define some terms.

Retirement potential means the type of retirement *you* could potentially enjoy. After all, not all types of retirement are equal. Some people retire from their main jobs, but still must work part time to make ends meet. Others won't have to work anymore, but don't have the means to travel or spend time on anything but the most inexpensive hobbies. But some people, of course, will be able to enjoy the type of retirement they always dreamed about.

Savings, of course, equals how much money you have set aside specifically for retirement. Essentially, it's the portion of your income reserved for *tomorrow* rather than today.

Length of saving & investing is the amount of time spent saving *and* growing your money for retirement. In other words, did you start investing for retirement at age twenty-five … or did you wait until age forty-five?

What this law says is that your retirement potential is based off the amount of money you save and invest multiplied by how long you have saved and invested. In other words, *you can personally control* the type of retirement you'll enjoy by maximizing the amount of money you save for retirement and by investing those savings as early as possible.

Now, some caveats. Obviously, there are other factors we must contend with. How the markets perform, for example. Unexpected expenses, health care costs, loss of a job … life has many curveballs to throw, and each can have an impact on your retirement potential. But when it comes to planning for retirement, or *any* financial goal, it's best to focus primarily on what we can control. And what we can control is how much we save, how much we invest, and when we start doing both.

Basically, a person who saves $5,000 a year for retirement, and starts investing at age 30, has far greater retirement potential than someone who only saves $1,000, or someone who starts investing at age 40. You can play with the numbers as much as you want, but the fact remains that retirement potential goes *up* the more you save and the longer you invest.

Another way of looking at it: just an object with greater mass needs more force to get moving, a retirement with greater potential needs more savings and investing to get moving.

Remember, retirement is about more than just picking a day to stop going to work. It's about where you want to live, what activities you want to enjoy, and how much money you'll need to accomplish both while still taking care of basic needs and expenses. It's about what *dreams* you want to fulfill.

So, to increase your own retirement potential, ask yourself: should I be saving more than I am? Should I be investing more than I am? Should I be *doing* more than I am? And if you have any friends or loved ones—especially younger folks who may not have even started saving or investing yet—be sure to tell them about Newton's Second Law of Finance.

Call us at 1-800-277-0025 to take advantage of our Retirement Planning Software in our Wealth toolkit to be Retirement potential is as great as it can be.

Newton's Third Law

For every action, there is an equal and opposite reaction.

This law is easy to understand. Imagine shooting a cannonball. The ball will fly in one direction, while the cannon will roll backwards in the opposite direction. The same principle applies when firing a gun. The "kick" you feel is just Newton's third law saying hello.

So how do we apply this to finance? Like this:

For every financial action, there is an opposite reaction.

Or, to put it another way: for every financial decision you make, there is the potential for an unintended consequence.

Here's what I mean. Let's say you own 100 shares of XYZ Corporation. The value of your shares has gone up recently, so you decide to sell. You'll make a nice profit, and have a quick infusion of cash that you can use however you want.

You've also triggered a capital gains tax.

Or, let's say you decide to allocate more of your investment portfolio to bonds instead of stocks. Bonds are traditionally thought of as providing more safety than stocks, and who doesn't want more safety?

But you also miss out on next week's stock market rally.

In the first scenario, you turned a profit, but also generated taxes. In the second scenario, you traded in growth for safety.

For every financial action, there is an opposite reaction. One aspect of your financial life goes in one direction, a second aspect goes in another direction.

Of course, you could flip these scenarios around. Maybe you decide to hold onto your XYZ stock, because you *don't* want to trigger capital gains taxes. But next week, the stock falls sharply in price. You avoided taxes, but not losses.

Maybe you decide to allocate most of your portfolio to stocks and have very little in bonds. You'll give yourself more opportunity for growth … but take on more risk, as well.

The point of all this, is that when people make a financial decision, they often make it without truly thinking about the consequences. They act without understanding the inevitable *re*action. They want something, so they decide to get it. They fear something, so they decide to avoid it. It's not that those decisions are necessarily *bad*. It's that they're made without seeing the whole picture.

Put it this way: an experienced gun owner always braces for the kick before he or she fires.

Whatever financial decisions you decide to make, it's critical that you *brace for the kick*. Every decision has consequences. Some are positive, some are negative. Some are intended, some aren't.

For every action, there is an equal and opposite reaction.

Financial advisors like me often use the word *holistic* when we describe what we do. For instance, *holistic* financial planning. *Holistic* investment management. "Holistic" simply means that we understand that the individual parts of something are interconnected, and they must always be seen that way. They are parts of a whole. Newton's Third Law of Finance shows exactly why the word "holistic" has meaning. Whenever you make a financial decision, you must make it with *the whole of your financial situation in mind.*

Example: when you make a decision regarding your investments, it can also affect your taxes. Your estate. Your cash flow. Everything.

So, how do you obey Newton's Third Law? Well, whenever you need to make a financial decision, always ask yourself: what are the pros and cons of this decision? What are the benefits? What are the risks? How will this decision affect my entire financial life?

It sounds simple. But it's also the best way to *brace for the kick.*

*S*cientists have long used the original Laws of Motion to better understand and control the world around them. By understanding the Laws of Finance, you can better understand and control your finances.

"Truth is ever to be found in simplicity, and not in the multiplicity and confusion of things." **- Sir Isaac Newton**

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