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The Paradox of \$1 Million

Once when my daughter was 13 years old, she asked me how much our house cost. I responded, “I’m not going to tell you.”

Daughter: “Why not?”

Me: “Because you don’t have any reference point for the dollar amount – you won’t understand.”

Daughter: “Yes, I will. Tell me.”

Me: “Ok. We paid \$20,000 for it.” (Our house cost way more than \$20k.)

Daughter: “Wow, that’s a lot. Are we rich?”

It’s a funny story, and I chuckle when I think back on it. It seared on my mind how hard it can be to have a handle on the value of money until you’re out in the world, making your own money and paying your own bills.

Helping younger generations understand the value of money is essential. Best practices include getting an allowance for chores, having a summer job, and bearing the responsibility for certain expenses.

A helpful exercise for young people from wealthy families is to work through the “paradox of a million dollars.”

Saving \$1 Million is Hard

On the one hand, \$1 million is a vast sum of money. According to the New York Times, having \$1 million puts you in nearly the 90th percentile of household wealth in the U.S. (the 50th percentile is \$127,000).

It’s not surprising that most people don’t have \$1 million because unless you make a ton of money, it is tough to save that much. I can best illustrate this with an example. Assume Greg graduates from college at 22 and gets a job with a starting salary of \$50,000, translating into a take-home pay of \$38,000 or \$3,166 per month. Greg has always been a big saver, so he scrimps on luxuries and, with a bit of help from his parents, can sock away \$1,000 per month, which he invests prudently. If he averages a 7% return on his investments, it will take him 27 years, saving \$1,000 per month, to accumulate \$1 million.

Having \$1 Million Doesn’t Make You Rich

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Yes, \$1 million is a lot of money, and I think we'd all choose to have \$1 million versus not. Yet, on its own, it doesn't make you rich. Using Greg as an example again, let's assume that when he turned 22, he inherited a cool million, decided not to take a job, and just live off the money.

If we use the general rule of thumb that 4% is a safe withdrawal rate to preserve the real value of a portfolio, Greg will get \$40,000 per year. That's right about his take-home pay from a job paying \$50,000 per year. Which is great. But it's not enough to afford a big house, send his kids to private school, or take luxury vacations. It's less than the median U.S. household makes (which was \$67,521 in 2020, according to the Census Bureau). It's enough to fund a modest lifestyle at best.

We can draw similar conclusions from larger sums of money — \$2 million produces about \$80k of portfolio withdrawals and \$3 million \$120k — amounts that are solidly middle class but hardly get you on *Lifestyles of the Rich and Famous*.

Of course, Greg would be best off if he took his \$1 million inheritance, invested it wisely, *and* took the job paying \$50,000. If he could live mostly off his salary and let the \$1 million grow, it would be worth \$2 million in his 30s, \$4 million in his 40s, and \$8 million in his 50s. It will be worth even more if he adds his savings to it.

The Lesson

Learning that \$1 million is a huge amount of money yet can't fund a luxurious lifestyle is usually revelatory for young family members. This knowledge helps them put wealth in perspective and set expectations for their financial futures.

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