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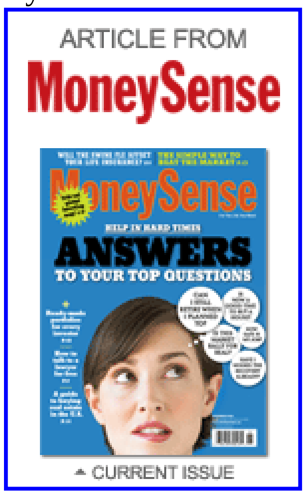
How I got rich on a middle-class salary

Real life secrets of financial success.

By Andrew Hallam



Picture this: A 27-year-old school teacher shows up at Robb Road Elementary School in Comox, B.C., on a bicycle, towing a trailer filled with a week's worth of dirty laundry, and skulks into the Home Economics class to do his weekly washing before any of his colleagues can see him. After cycling 55 km through pelting Vancouver Island rain, he's tired and wet, but his day's just beginning. After a full eight hours of work, he'll load his clean laundry into his trailer, and start the long bike ride home, completing a 110 km circuit for the day.

This guy's not poor. In fact, he and his wife, also a school teacher, have the money for a second car, for a washing machine, and for a decent apartment close to work. But he'd rather scrimp and live in a dingy basement apartment with his long-suffering spouse because he's bent on saving enough to retire at 45.

Sound frightening? I agree — and I should know, because that was me only nine years ago. I was a leading candidate for Cheapskate of the Decade, because I was obsessed with retiring early. I was a nut, no question about it. But I eventually came to see a better way, one that will allow my wife, Katherine, and I to retire in seven years — when we'll be 43 — but not to live like serfs until then.

I was inspired in all of this by an unlikely financial adviser. When I met Russ Perry, he was a 46-year-old guy with two kids, who worked as a bus mechanic at BC Transit in Victoria. He was the garage legend — a millionaire who hadn't received a stitch of financial assistance from anyone. A fabulous investor, Russ made his money from stocks and real estate while scrimping on mundane expenses. I was fortunate enough to work with him for three summers. I was going to university at the time, but I got my real education from Russ. When he talked money, I hung on to every word.

Russ guided me to think unconventionally. One favorite piece of advice was to never lose money on cars. "New cars are for suckers," he would say. Then he would cite figures about how quickly new cars lose their value while making loud sucking sounds with his mouth.

After owning a dozen older Japanese cars over the years (just as Russ instructed me), I've actually managed to turn a profit from owning cars. My last Toyota van was a great example. I paid $3,000 for this low-mileage beauty, drove it from British Columbia to Guadalajara, Mexico, and back, then sold it for $3,500.

You can do much the same. I've always bought low-mileage Japanese models, sometimes paying a premium for a 15-year-old garage-kept gem with less than 100,000 km. I've always been able to sell my cars a couple of years later for the same price I paid. Patience, an eye for bargains and five minutes a day spent browsing through the local classifieds is all it takes.

A lot of other money-making maneuvers are equally simple. Russ always said that few people are wired to think about money. Most of us buy stocks or real estate when those goods are rising in price, not when they're cheap. If you're prepared to do the opposite, you can do very well.

In 2002, Katherine and I took Russ's advice to heart, buying an acre of oceanfront that Katherine spotted on Vancouver Island for $147,000. Real estate prices had been flat in the area and the sellers were motivated, because they were freshly divorced. As a result, they sold us the land below its tax-assessed value. Today it's worth about $400,000 — and it's mortgage-free.

I learned a lot from Russ, but by the time I was 27 and bicycling 110 km back and forth to work every day, I was beginning to think that maybe saving money wasn't everything. As focused as Katherine and I were on early retirement, we had come to realize that we weren't prepared to miss out on some of life's finer things, such as exotic vacations and fine restaurants.

I decided to learn about great investors, like Warren Buffett. If I could master their strategies, maybe I could both live well and build wealth.

I became obsessed with investment books, churning through more than one hundred titles. Then, in 1999, at the height of the dotcom bubble, I read something by Michael O'Higgins, the guy who invented the Dogs of the Dow strategy, and it fit in perfectly with what Russ had been telling me. O'Higgins said that everything has a value — and the price doesn't always reflect it.

O'Higgins wrote in his book *Beating the Dow with Bonds* that stocks were overpriced. He showed that price-to-earnings ratios for stocks were far above their average levels over the preceding 100 years. Whenever price-to-earnings ratios had reached such high levels in the past, stocks performed poorly over the decade that followed, as valuations reverted back to historical norms.

That book saved me a small fortune. I'd like to say that I wasn't at all swayed by the dotcom mania, but the truth is that I saw the easy money that my friends were making and I dabbled in some of the worst disasters-in-the-making, like Nortel Networks and JDS Uniphase. Fortunately, the wisdom I'd gleaned from Russ and O'Higgins kept my mistakes to a minimum.

For the most part, I bought old, boring businesses. Mindful of costs, I bought lots of Johnson & Johnson, Caterpillar and Investors Group shares when they weren't popular. Each of these businesses has since gained nicely from their 1999 levels, and the bear market of 2001 and 2002 brought a plethora of further opportunities. I ventured into low-cost European indexes, Berkshire Hathaway, Men's Wearhouse and The Gap. Always mindful of costs, I bought and held these businesses instead of paying commissions and capital gains taxes. Since the market's peak, I'm up 76%.

I've learned over and over again the truth of what O'Higgins wrote. You can't assume that the market's price for any investment is a true reflection of value. One of my best investments, for instance, was United States Gypsum, a wallboard manufacturer. It had been hit by lawsuits related to its use of asbestos and joined the rest of its industry in Chapter 11 bankruptcy in 2001. Its stock plummeted.

What caught my eye was that Buffett was buying it. It was also the largest wallboard manufacturer in the U.S. and, unlike most bankrupt companies, it was still making plenty of money, with close-to-record profits. I bought a chunk of stock at $4.35 per share. Selling this stock at $34 last year may have been my biggest mistake. As I write this, it trades at higher than $80 — and Buffett still owns it.

The money we'd accumulated from savings and investing allowed Katherine and I to take a round-the-world trip in 2002. When we returned, we assessed our position. We had been lucky not to lose when the market collapsed, and we had zigged while others zagged, but we still weren't on target to retire at 45.

So we decided to make another unconventional move — this time, out of Canada completely. We found jobs teaching at an elite private school in Singapore. By doing so, we reduced our cost of living, increased our salaries and slashed our taxes. We are now saving $100,000 a year and are on the fast track to financial freedom — while we enjoy the luxury of 13 weeks off a year to travel everywhere from New Zealand to Sri Lanka.

Our investment goal is to retire when we have enough cash flow to live off. We don't want to dip into our capital, but live off our dividends and capital gains. Assuming we can make 4% a year on our investments, we calculate that we are on track to retire at 43.

The funny thing is that as retirement becomes more and more a reality, our notion of what freedom means keeps changing. Katherine and I are not the type of people to just kick back and play golf. Our goal is to keep working, but to work in needy areas of the world, for free. If our investing profits exceed our living cost, we plan to donate the excess to charitable organizations in the Third World. Compared to most expatriates we know, we're still living frugally. But we now are happy to have a goal that goes beyond serving our own needs — and that knowledge makes a monsoon-like rain easy to tolerate from the seat of the bicycle that I ride to work in Singapore.

How you too can retire at 43

I've found many simple strategies for building wealth that you can put into practice with little or no effort. Here are some of my favorites.

On saving

Remember that even modest savings can translate into the equivalent of a big pay raise. That's because you earn your salary or wages in before-tax dollars, but you pay your bills in after-tax dollars. So if you're in a 40% marginal tax bracket, saving $1,000 over the course of a year is the equivalent of increasing your annual earnings by more than $1,650.

If you're a renter looking for a new place, don't just accept what the market has to offer. Instead, put the word out about your good qualities. Great tenants are hard to find. My wife and I placed an ad in the local paper stating that we were two responsible teachers looking for a quality long-term rental. We mentioned the price we'd pay and the exact specifications we sought. Another teacher answered the ad, and offered her place for $180 per month less than nearby apartments. That saved us more than $8,000 over four years — equivalent to a $12,000 pre-tax bonus.

You can apply a similar strategy when buying cars. First, identify exactly what you're looking for and what you expect to pay. Then let your fingers do the walking. Three years ago I thumbed through the Victoria Yellow Pages and found the listings for used car dealerships. I waited until the final week of the month — so salespeople with quotas to meet would be as motivated as possible — and made my calls. I told each dealer I wanted a rust-free Japanese car with original paint, a manual transmission, and less than 140,000 km on the engine for $3,000, including all taxes and fees. Sure it was a tall order, and I was told that I was crazy by at least a dozen dealerships, but it paid off. An elderly couple had just traded in their mint 1991 Toyota Tercel at a VW dealership. It arrived a few hours before I called, met my requirements, but hadn't been checked or detailed. The dealer offered it to me for $3,000.

I'm a huge believer in paying off debts, including your mortgage, before investing. Today's low interest rates provide an opportunity to rapidly pay down your principal, before rates return to historical norms. Over your mortgage's lifetime, chances are that the interest rate you pay is going to exceed an average of 8%. So extra payments that you make today are likely going to be equivalent to an 8% after-tax guaranteed return over the long term. If you're in a 40% marginal tax bracket, and you're investing outside of your RRSP, you would need to make 10% annually on your investments just to match the returns of the person who aggressively pays his mortgage.

On investing

Low-cost index funds beat most actively managed mutual funds over the long haul. So when financial planners try to put you into an actively managed fund, tell them thanks, but no. Sure, you might get lucky and pick an actively managed fund that does beat the market, but it's nearly impossible to pick winners ahead of time. Looking at past performance doesn't help: the top performing funds of one decade usually lag in the next decade.

If you want to buy individual stocks, check out GuruFocus.com. It tracks top U.S. investors. Pick a guru who buys and holds stocks for long periods (so you don't end up buying after the guru has sold) then emulate what he's doing. Warren Buffett would be my choice. His most recent large investments have been in Anheuser-Busch and Wal-Mart. Once you buy, hold on and be patient.

How we did it: Real life secrets of financial success
How I got rich on a middle class salary | How I turned my hobby into my career | How I cured my debt addiction How we paid off our house in three years | How I survived divorce | How I escaped the rat race |
How we retired in luxury