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MISTRAL MYERS: Welcome to the Talks at Google podcast, where great minds meet. I'm Mistral, bringing you this wonderful episode with Paula Pant, founder of the award-winning website and podcast of the same name "Afford Anything." Talks at Google brings the world's most influential thinkers, creators, makers, and doers all to one place. Every episode of this podcast is taken from a video that can be seen at YouTube.com/TalksatGoogle. Paula is, in addition, a writer and speaker, specializing at the intersection between managing money and designing your lifestyle. She speaks to audiences about the philosophy of money, what purpose does it serve in our lives and how can we manage it in a more thoughtful and conscious way.

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In this interview, Paula Pant discusses a range of financial topics, including the antibudget, growing the gap, whether it's better to build a side hustle versus to try and get a promotion, the three biggest spending drains, her love for index funds, how to build better habits, cognitive biases and behavioral finance, and why you should never delay gratification. You can learn more from her website affordanything.com. In conversation with Googler David Motlz, here's Paula Pant, "Afford Anything."

PAULA PANT: Thank you.

DAVID MOLTZ: Cool. So let's start with your blog and your podcast. You call it "Afford Anything." Where did that name come from?

PAULA PANT: So the concept of "Afford Anything" is really the concept of opportunity cost. It's this notion that you can afford

anything but not everything and every decision that you make is a trade-off against something else.

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And this concept doesn't just apply to your money, even though the word afford conjures up images of money immediately. It also applies to your time, your focus, your energy, your attention because we all have limited cognition, limited mental bandwidth. So really, it's this notion of recognizing that most of the resources that you deal with on a day-to-day basis are limited resources. And we need to be extremely conscious, I would say even ruthless, about how we allocate them. And that means, number one, allocating our resources with more intention and, number two, deeply reflecting on how, at a 30,000-foot level, what is actually a priority to us in our lives, to each individual, not what does society say ought to be or what are the default priorities that we've been taught.

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DAVID MOLTZ: Very nice. And you're best known, you know, kind of in the personal finance community for talking and writing a lot about financial independence. So what is financial independence? And how does it relate to your story?

PAULA PANT: Okay, so financial independence is an interesting concept, and it's one that's gained a lot of popularity in the past few years. I define financial independence as the point at which your passive income typically, but not always, through investments is enough. And when I say enough, I mean that it's enough that it creates at least some type of a safety net underneath you, some type of a floor or a foundation such that you know that, in a worst case scenario, in a black swan situation, you would be okay. And so let's unpack that a

little bit because there's a lot going on in that concept. Now, first of all, so financial independence is the point at which your passive income, typically through investment--so what do we mean by that?

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So passive income is income that does not come through exchanging time for money directly. So for example, if you have access to a 401(k), and you make contributions of your income into your 401(k), that money will hopefully grow, right? That money will grow both through capital gains and through dividends, and then that growth will compound. So that would be an example of passive income. Regardless of whether or not you harness it, right? It's income in the sense that it fuels your net worth, and it makes your balance sheet bigger, your personal balance sheet bigger, regardless of the fact that you are not actively pulling money out of your 401(k) on Tuesday in order to pay for a pair of shoes. It's still yours, right?

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Same thing with if you make contributions to an IRA or to a health savings account or if you use that money to buy a personal residence or a rental property, assuming that those appreciate or if the rental property does well. In all of those examples, you have a source of passive income coming in that's fueling your net worth, despite the fact that you're not actively trading dollars for it. Now when we talk about--so the last portion of the definition of financial independence is this concept of enough. And that leads to a fairly big philosophical question, which is how much is enough. And this is a source of endless debate within the financial independence community, which is abbreviated as the FI community.

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But at a bare bones, basic level, enough is, as I see it, enough such that, in a worst case scenario, you would at least be okay, you could feed yourself, you could keep the lights on, you could have some type of a reasonable human shelter. It might not be what you prefer, but you know that you would be okay. And the example that I often like to use is--so a lot of people conflate financial independence with extreme wealth or big, other highfalutin, pie-in-the-sky ideas. The example that I like to give to kind of bring it down to earth a little bit is let's say that you had a brother or a sister.

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And today, in an hour from now, you get a phone call, and you find out that your sibling just got diagnosed with a terminal illness, and they have one year left to live. And you want nothing more than to take a one-year leave of absence, unpaid leave of absence from work so that you can spend that last year or that last six months with your sibling. And you can't do that locally because your sibling lives on the other side of the country or they live in a different country, right? So you need that time. Financial independence is the state of having enough passive income so that, when you're doing that, when you drop everything to be with your sibling for those critical moments, you'll be okay. You know, you're not going to be going to Disneyland. You're not going to be having $400 steak dinners, but you'll at least be okay. And there's a lot of freedom that comes with that.

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A lot of people who reach financial independence--and I reached it when I was 31. We'll talk about that in a minute. But a lot of people who reach financial independence often find that nothing in their life necessarily changes. The day to day of their life might look exactly the same post-FI as it did pre-FI. But the psychological relief that comes from knowing that you've built your own safety net is valuable.

And so sometimes, I joke that FI is an extremely elaborate anxiety reduction measure. So in my own life, so my own story is I graduated from college when I was 21. This was in 2005. And shortly after, a few months after that, I got my first job at a newspaper. And my starting salary was $21,000 a year.

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And I worked at that job until 2008. And at the time that I left, my salary was $31,000 a year. By the way, I know it's unusual to like to sit on stage with a microphone revealing your salary, but I'm a blogger and podcaster. And I've made this very, very public for years. So I'm comfortable sharing all these numbers. So at the time that I left my job, which was in 2008, I was making $31,000 a year. And I had a lot of anxiety at that time. Like being in my early 20s, I could live like a college student. So it was fine, but I knew that, later in my life, I was going to need something more, something bigger, something better, especially if I ever wanted to have a family or ever wanted to own a home or anything like that. And so--so I became really obsessed with saving and obsessed with investing.

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I started making money--while I was still in the newspaper, I was making money on the side as a freelancer, and I continue to grow that. And I became just extremely aggressive about saving and investing, largely fueled by honestly fear, which, you know, I wanted to make sure that I would be okay. And so over the course of the next--basically, throughout the rest of my 20s and into my early 30s, myself and also my husband at the time, soon to be ex-husband, Will, who shares my same like enthusiasm for saving and investing, we lived on oftentimes about 50% of our combined income and invested the rest of it. And we invested in a combination of 401(k)--I have a Roth Solo

401(k). He has a simple IRA. We both had Roth IRAs, which later turned to backdoor Roth IRAs. We had HSA accounts.

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We had the whole alphabet soup going on. And so we put a lot of money there. And then we put a lot of money into rental properties as well. We lived with roommates until we were 31. And I mean, our net worth at the time that we stopped living with roommates, our combined net worth was over $1 million at the time. So we were millionaires living with roommates so that we could save 50% of our income and just shovel that into investments. And that was the level of our dedication towards investing. So that was how I reached FI.

DAVID MOLTZ: Wow. Over $1 million and financially independent by 31, which brings us to a very important question. Please share with us your investing philosophy and some tactics and strategies that you use.

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PAULA PANT: Sure, at a high level, my investing philosophy is one that is very fond of passively managed investments. So there is this thing called index funds that was created by John Bogle, who's the founder of Vanguard. And an index fund is a fund that tracks a market, a broad market index. So for example, an index fund might track the S&P 500 Index. And when you invest in an index fund, that fund attempts, to the best of its ability, to mirror everything in that index. And that means that it will do as well as or as poorly as what it's tracking. So if you invest in the total U.S. stock market index, you will do as well as or as poorly as the total U.S. stock market, no better and no worse.

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And what they found is that, statistically speaking, over the long term, over about a 15- to 30-year time span, you are, statistically speaking, more likely to do better trying to match the market than you are trying to outperform the market. You will sometimes, occasionally, in the short run, have funds or fund managers that momentarily outperform. But then they tend to, over time, revert to the mean. So you're better off just taking the passive approach. And similarly, with real estate investments, I'm a big fan of rental properties. And with rental properties as well, I favor a passive approach of, you know, don't try to constantly be flipping home, in my view. There are other people, of course, who do it differently than me.

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But I don't want to be spending all of my time trying to flip homes or trying to go into extremely sophisticated tactics because that's not what I do full time. I have a different fulltime job. And I want to focus on that other fulltime work because that's my core competence. And so I want to make my real estate investments as passive as possible so that they take up as little of my cognition as possible, again, because you can do anything but not everything.

DAVID MOLTZ: Right. And you write and talk a lot about growing the gap. So what do you mean by growing the gap?

PAULA PANT: So growing the gap is the result of a big--an argument, a debate that is popular among people in the personal finance community and in the FI community, which people love to argue about whether it is more efficient to earn more or spend less. It's that classic like chocolate versus vanilla, peanut butter versus jelly debate, right?

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And so--and people often tended--they'll choose a side, they'll pick a camp. It's almost like you have a favorite sports team. "I'm on the earn more side." "Well, I'm on the save more side." And the way that I was able to find a bit of compromise between those two is I asked myself, "What are we actually trying to do here? Like, forget what camp you're in, what's the goal?" Well, the objective is to increase the gap between what you make and what you spend. And when you think of it in that terms, you know, growing the gap is--the objective becomes more clear, right? You're not caught up in endless penny-pinching.

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You're not caught up in like trying to shrink your way to greatness nor, on the other side, are you caught up in just, you know, going for promotion after promotion and raise after raise, trying to make as much money as possible but being super careless about your spending. Like, growing the gap is that recognition that you can earn more, you can spend less, you can do a combination of both, but ultimately, your approach or your tactic matters less than the size of the gap.

DAVID MOLTZ: So on the saving side, there's a cliche that says, you know, don't buy lattes. Or said another way, don't pay $5 for a cup of coffee. Do you agree with that?

PAULA PANT: So that was coined by David Bach. And David Bach, he's a best-selling author. And he very much meant that as a metaphor for don't be mindless about your spending.

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The $5 a day, you know, the buying a latte, if it is done with intention, if you sit down, and you think, you know, "I really value this. I value this moment in my morning where I can drink a latte and write in my journal and reflect on what's coming up in my day," that conscious, intentional spending is very different than mindlessly buying a $5 coffee every morning and then, at the end of the week, complaining that you don't have enough or wondering why you're still in credit card debt. Those are same action, but the thought behind it is the differentiator. That being said, in the world of saving money, there's what I call the big three, housing, transportation, food.

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And if you can get those big three right, then you can actually make a lot of small--you can get a lot of small things wrong, if you get those three things right because, for the average American, housing, transportation, and food are going to be your three biggest expenses.

DAVID MOLTZ: And actually, this is as a follow-up on that same concept of like how do you think about making budgeting and--budgeting and spending decisions, especially for certain categories. So to come up with a budget, how do you decide for these categories, "Oh, my budget is gonna be $50 or $100 or $200 a month?" Is it arbitrary? And then also, like how do I decide how much to spend versus how much to invest? You know, if I have X amount of dollars, you know, from my paycheck, how do I decide where to allocate that money?

PAULA PANT: So it's interesting that you ask about different categories because I'm gonna take a step back for a second and question the premise.

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What is the point of allocating your budget into specific, granular, line-itemized categories, right? Ultimately, a budget is a tool that people use in order to make sure that you are saving enough. So again, let's take that step back and ask what's the objective here. If the objective is to make sure that you're saving enough, well, let's start with that. So you take whatever your take-home income is, your after-tax income and, from that, decide how much you want to save. And when I say save, I mean that very broadly, I mean that as anything that improves your net worth. So how much money do you want to put into retirement accounts, use as additional payments on a debt, so maybe additional payments towards a student loan or a mortgage? And then savings could also be literal savings in a savings account, right?

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So take your income, then ask yourself, "How much of this do I want to save?" Meaning any improvement my net worth. Yank that off the top. And then whatever is left over is yours to spend. And there isn't actually any reason to line itemize it any further than that. Now if you want to, if you're the personality type who loves tinkering with spreadsheets, and that sounds like a really fun way to spend a Friday night, then go for it, you know, if that's what you want to do. But to a lot of people, a lot of people believe that they can't stick to a budget because they create these incredibly granular budgets where they've allocated precisely $37 a month for dog food. And then it turns out that they've spent $42 that month. And then they throw up their hands in despair and decide that, "Budgeting is not for me. And I'm just not very good at money," right?

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And so the concept of what I call the anti-budget, which is what I've just described, which is this very simple two-category budget of save, spend, the anti-budget was something that I developed in order to address that concern that a lot of people had, that problem that a lot of people had because so many people were giving up on the notion of budgeting, thinking that it had to be more complicated than it is.

DAVID MOLTZ: So for people that do want to increase their savings rate, as you're talking about, what are some ways to go about doing that?

PAULA PANT: Ooh. So again, if you think of savings more broadly as growing the gap, then you can earn more, you can spend less, you can do a combination of both. So let's talk about each of those. So earning more, you can do that--and it depends on really where you are in life, like what your life situation is.

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For some people, like, if you have the opportunity, if you're at a company that is large enough to have the opportunity for promotions and raises, then hitting it really hard at work and making yourself extremely valuable to your company so that your company reciprocates with rewarding you with some of that value that you are giving to them, that can be an incredibly powerful way to save because if you keep your current standard of living exactly where it is, and then you earn more, you get raises, you get promotions, you earn more, and then you bank all of those raises. So you just keep living exactly where you are today and save every single raise. That, over the span of ten years, assuming that you continue to get raises and promotions over the next ten years, that alone can be rocket fuel on your finances.

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Of course, that assumes that you are at a company that has those types of opportunities. You know, in my case, I worked at a very small newspaper, where, like I said, my maximum salary was $31,000. And at that company, the highest paid person at that company was making about $60,000. You know, it was just a small company that didn't have those types of opportunities for advancement or at least those opportunities for--I didn't have the opportunity for a six-figure income where I worked. And so in that situation, developing some type of a side hustle or a side business could be a good approach. And I'll divide that actually into two different levels because, in terms of side businesses, you have the gig economy stuff, right? You have driving for Uber, driving for Lyft, renting out a room on Airbnb, walking dogs on Rover, renting out your car on Turo.

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Those are all gig economy types of ways to make some extra income. The benefit is that that income is immediate, but the drawback is that you can't--well, with the exception of Airbnb, you can't really distinguish yourself very much. You don't have much of a competitive advantage. And so while you have some immediate income, your upside potential will be limited. The other type of side income would be something like freelancing, consulting, something where you have unique value that is your market differentiator. And so the advantage to that type of side income is that you can potentially make a lot more. The disadvantage is that that can take a while to build into scale. So that income is not necessarily going to be immediate. So--

DAVID MOLTZ: Very nice. And another thing you say is never delay gratification. So what does that mean?

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PAULA PANT: So that very much applies to the thinking or the mental construct around saving money and investing money. A lot of people refer to saving money as delayed gratification. And I think that that's a huge mistake, especially because, you know, you're trying to encourage people in their 20s and 30s to save, especially to save for retirement because the longer your money is--time in the market is far more important than timing the market. And compounding growth is, you know, a wonder of the universe, right? So when you tell someone in their 20s to delay gratification, that sounds pretty awful. But if you reframe that mental concept, and if you say, "You know what, I'm not delaying gratification. I am super gratified by watching my net worth grow."

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"Like, I am super gratified by looking at the numbers in this account and watching them get bigger and tracking my net worth and watching that line go up, that's super cool. And that brings me far more of a sense of satisfaction than some cheap plastic junk or a car that is marginally nicer than the one that I already have," right? Like that's a way that you can reframe gratification, rather than delay it. The other aspect of that is to have a very strong why that motivates you. So you don't want to be unhappy in the present for the sake of a future. You do want a future that you look forward to, you want a strong, compelling like why in the future, but you also want to frame that saving and investing in a way in which you're enjoying the present moment.

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So for example, when I lived with roommates, like my thinking at the time, my mentality was like, "Cool, I've got built-in friends, you know? I've always got people to eat dinner with." And, you know, so there were, of course, certain drawbacks with that like sharing a refrigerator. But I mentally focused on the advantages rather than the disadvantages. And that made it feel like an immediately fun option rather than as a sacrifice.

DAVID MOLTZ: And so yeah, we talked about kind of saving and investing. How about investing versus paying off debt? So, you know, most people have some sort of debt, whether it's a mortgage or student loans or whatnot. And how do you think about whether, if you do have some extra cash, do you pay down debt quicker? Or should I do the minimum payment and then invest that in the stock market? And there seems to be arguments both ways. What are your thoughts on that?

PAULA PANT: That's an excellent question. Now first of all, both of them are fantastic options.

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Anything that improves your net worth is awesome. So regardless of which one you choose, either way, it's great. In terms of how to think through that question, there are a couple of different approaches. First of all, I'm gonna differentiate between high-interest debt versus low-interest debt. Now we know that, historically, the U.S. stock market, depending on the years that you're looking at, the time frame that you're looking at, historically, the U.S. stock market has returned somewhere between 7% to 10% ish as a long-term aggregate average. Warren Buffett has predicted that the U.S. stock market might--to the extent that anybody can ever predict anything about the future, has predicted that the U.S. stock market may produce 7% returns in the

future, moving forward. Of course, projection is just a fancy word for guess, but we can use that as a ballpark figure as we're kind of thinking through this decision.

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So if you have a debt that has double-digit interest rates, right, if you've got a debt that's 10% or more--or I would argue, personally, 8% or more, pay that off because you're not likely to do better in an index fund, in a broad market index fund. Now if you have a debt that has a high single digit--we'll say somewhere between 5% to 8% interest rate--there's still a strong argument for paying that debt off. Although, the argument is a little bit less strong. But when you talk about investment returns, you want to think of them in the framework of a risk-adjusted return.

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And what that means is that getting a return of 8% in a treasury bond is very different than getting a return of 8% in Bitcoin, right, like two totally different types of risk that we're talking about. So if you're thinking about arbitraging, the difference between the interest rate that you're paying on a loan versus the return that you could get in an investment, you want the potential gap to be big enough, you want that spread to be big enough to justify the added risk. So for example, if you have a mortgage at a 3.5% interest rate, and you have $10,000 that you got as a bonus, and you're wondering, "Should I apply this $10,000 towards my mortgage or should I put this $10,000 into the stock market?"

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Well, at that point, we were talking about a spread that is large enough that there would be, in many cases, a pretty valid argument

for putting that 10 grand into the market. If the spread is really small, then it's just not worth it. So that being said, the other thing that I'll say is that there are many people who are proponents of getting rid of debt as quickly as possible because there are a lot of emotional and psychological benefits to getting rid of that debt. And so in addition to the math of it, in addition to the opportunity cost and the expected value, you also do want to think about, you know, we're not machines. We're not robots. And if that psychological benefit to being debt-free is going to help you get a better night's sleep, well, then there's added value in that.

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DAVID MOLTZ: Yeah, so you've obviously made a very compelling argument like why you should invest. There are seasoned investors in the room. And so people, low correlation assets or assets in which when one move this way, we the other getting started. And I guess one challenge that I still have is trying to figure out my ideal asset allocation. Everyone disagrees with it. You know, some people would say, "You're very young. You should be all stocks." Some people will say, "You should have your age in bonds." Some people should say, "The market's been very volatile, you should have real estate in your portfolio." And others would say, "Cash is king." So with so many different asset classes, how do you make a decision on how--you know, based on things like risk tolerance and how do you decide for you specifically, rather than just some rule of thumb, like how do I decide what my personal asset allocation should be?

PAULA PANT: That's also a good question. So when people diversify their investments, the idea behind diversification is to have an assortment of what are known as low-correlation assets.

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And so low-correlation assets are assets in which, when one moves this way, the other doesn't move or it moves, you know, inverse. So like stocks and bonds, that's an easy example. They tend to have an inverse correlation with one another. When one goes up, the other goes down. And so having that mix of stocks and bonds smooths out the ride in your portfolio. And really what it does is when you rebalance, the idea behind rebalancing is that you sell some of the winners and buy more of the losers, you know, you buy things that underperform--you sell things that are doing really well and buy more of what's underperforming. Rebalancing a portfolio forces you to do exactly that. It forces you to sell the winner, harvest the winners, and buy the underperformers.

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And as a result, the whole concept of rebalancing forces you to take a contrarian approach and move in the opposite direction of the market. It forces you to be greedy when others are fearful and fearful when others are greedy, to paraphrase that famous quote. And that's the reason why asset allocation and buying an assortment of like different assets and then rebalancing periodically is so well regarded among many people. That being said, it's not necessarily the only way to do it.

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There are plenty of people who make the argument that, particularly, when you're young, having an all-equities portfolio, you know, balanced out with a strong cash reserve would be better than putting a portion of your portfolio in bonds since, historically, over a 40-year time span, those equities are going to do better. And so there are people who will argue that having any type of a bond allocation means that you are giving up some returns in exchange for that smoother ride. So if you talk to 100 different people about asset

allocation, you're going to hear 101 different responses. The way to think through it for yourself is, first and foremost, again, what's gonna help you sleep more easily at night because your behavior and your contributions are the single biggest determinant of market performance. They've found that people often underperform the funds that they are in.

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And on the surface, that sounds impossible. Like, if you're in a fund, how could you possibly underperform the fund that you're in? But the reason that that happens is because people get nervous, and then they dance in and out of the fund. And as a result, they underperform what they're already holding. And so they've actually found that dead people actually outperform the living when it comes to investment returns because they just don't touch--they don't touch their portfolio. And so actually, I learned that through JL Collins who gave a great talk at Google. And so that's the first question that I would ask yourself, right? Like the math of it is one thing, but the behavioral component cannot be understated.

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So if having that bond allocation or having some portion of your portfolio in commodities or in real estate or just keeping an excess in cash beyond what most financial advisors might recommend, if that's what helps you hold steady through market declines and hold steady through a recession, then it's worthwhile.

DAVID MOLTZ: So speaking of JL Collins and other industry titans like Warren Buffett, Jack Bogle, they all say U.S. stocks. You know, put your money in either the S&P 500 or the total U.S. stock market and don't touch it for a really long time. What are your thoughts on

U.S. versus international investing? So should people be investing in international stocks? So I guess could you talk about kind of home-country bias and then whether or not you recommend investing internationally as well?

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PAULA PANT: So I do, yes. I think that it is a very good idea. Again, this is one of those controversial topics where there are some people, JL Collins being an example--he makes the argument that, if you are invested in major companies that are based in the United States, like Google or Nike or, you know, many of the big companies based here do business in countries around the world. And so he and many other people make the argument that, simply by virtue of investing in large-cap U.S. companies, you necessarily have international exposure indirectly through them.

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And his argument is that, for that reason, international funds are unnecessary, they also, oftentimes, depending on the specifics of the type of plan that your company offers, these funds can often be more expensive. And there's also currency risk because you're using U.S. dollars to invest in companies that operate in different currencies. And so in addition to all of the risks that you have when you become an investor in a company, which is what happens whenever you buy a stock, you also have currency conversion risk to contend with as well.

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So for that reason, there is a camp of people who think that international investing is unnecessary. Personally, I disagree. I think that it is important to have an international component to your portfolio. And so there are three subsets, major subsets, to

international investing. There's developed markets, emerging markets, and frontier markets. And I would argue that, at a minimum, developed markets, which are well-established, stable markets, should be a piece of your portfolio.

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Emerging markets, probably, you know, they tend to be a little bit more volatile, but if you have the stomach to withstand that volatility, I think that's also an excellent addition. Frontier markets might be a little bit too volatile for a lot of people. So I wouldn't necessarily go there.

DAVID MOLTZ: Got you. And several of your episodes have gone into kind of behavioral finance, which I know a lot of us find very interesting. And so can you kind of share some key lessons you've learned on how psychology impacts investing and maybe what we should do about it?

PAULA PANT: So first, there's this notion of loss aversion. And loss aversion is the concept that losing money feels worse than making the equivalent amount of money.

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If you invest $5,000, and you lose $1,000, and now you're down to $4,000. That feels a lot worse than the joy that you would feel if that $5,000 went up to $6,000. And so loss aversion and, you know, its closely related cousin negativity bias, highlights how we often can spend more time playing defense than we do playing offense, right? We spend more time and energy trying to protect ourselves from the downside than we do trying to pursue opportunities. And that's something, as you feel yourself emotionally reacting to your

investments--like if you make a practice of tracking your net worth, and you do this quarterly--

DAVID MOLTZ: Daily.

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PAULA PANT: You're probably--you're going to have some quarters--unless you're very lucky, there might be quarters where your net worth goes down, perhaps significantly. And when that happens, you will feel that sense of that. Seeing your net worth decline feels a lot worse than the joy you felt the previous quarter watching it go up. And that's that moment to check in with yourself and say, "Am I about to do something stupid. Am I about to make an impulsive decision based on this feeling that I have right now?" So that's one of the components, loss aversion is one of the behavioral components of managing yourself as an investor. I would argue that managing yourself and managing your own mindset is the precursor to managing money. You can't effectively manage your money until you've managed your mental space.

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So in addition to loss aversion, sunk cost fallacy is another popular fallacy that people get hung up on. Sunk cost fallacy is this notion that, "I'm already in it, I may as well stay in it. I've already put in so much time and effort, I may as well keep doing it." I see this a lot when people buy rental properties, right? You'll make ten offers on properties. None of them get accepted. You make the 11th offer, it finally gets accepted. And then you send an inspector out to the property, and the inspector finds something completely unanticipated. And you think to yourself, "I've put in so much work just trying to find this property, plus I've paid $400 for the inspector, you know,

this has already cost me so many hours of my time. Let's just buy the thing." Right? And that's sunk cost fallacy. Now that you're this deep into it, you don't want to give it up.

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But that's not an effective framework for making that type of six-figure decision. Anchoring is another one. So anchoring is this notion of, "Well, I paid $100 for this stock. And so now I'm price anchored to it at $100. The stock has dropped to $70. I'm just gonna wait until it gets back up to $100, and then I'll sell it." Right? That's a tempting thought to have. But in reality, it's completely illogical. The stock does not care what you paid for it. So those are all examples of very, very common mental fallacies that we can fall into as we think about how to manage our money.

DAVID MOLTZ: And so knowing that psychology has such a major influence on investing, one thing I'd like to hear from you is, so going back to the asset allocation, if you're young, if you're in your 20s or 30s, you should be predominantly all stocks.

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So it seems like--and some people are even preaching be 100% stocks for example. And that's extremely aggressive, especially because a lot of millennials have never--they haven't gone through 2008, for example, with money and the market.

PAULA PANT: Right.

DAVID MOLTZ: So I guess my thought is knowing--again, going back to the loss aversion and things like that, do you actually

recommend maybe young people have a more conservative allocation until they see how they react going through volatility or a bear market and making sure they can handle that sort of, you know, volatility or loss? And then once they do that, maybe they could actually then take on a more aggressive allocation, knowing they can handle it.

PAULA PANT: I would not recommend that for all young people, but I would ask each individual person to know yourself. If you think that there is a reasonable likelihood that you might panic the next time that we have a recession, then put those safeguards in place that will save you from yourself.

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And so the tactic that you just cited, which is have a heavier bond allocation or a heavier cash allocation when you're young so that you can see how you react at the next recession, that's an example of a way that you can build a safeguard in which you protect yourself from yourself. That's one of many examples. You could also work with an advisor and give them clear instructions to like, "No matter--when we have our next pullback, no matter what I tell you, right, don't let me shoot myself in the foot, right? Don't let me be my own worst enemy." That might be another way, another tactic that allows you to save yourself from yourself. But at the end of the day, what you want to do is really know yourself and then put those safeguards in place that allow you--that they compensate for your weaknesses.

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DAVID MOLTZ: Great. I have one more question. And then I think we actually might have time for a few audience questions, so if you want to think about anything you might want to ask. But first, before we get there, let's talk about habits 'cause that's a huge component.

You chat a lot about that on your podcast, habits and habits building. You've had some great guests come on and talk about that. And one of the things you said that stuck with me is that basically habits beat willpower any day. And I think that's fascinating. Right? It's like it's very hard to walk by like a donut or something and not grab it. But if you, in advance, develop a habit to not walk by the donut, it's very easy. So can you chat more about building the habits?

PAULA PANT: Oh, this is one of my favorite topics. Okay, so first of all, yes, habits beat willpower. The notion is willpower is kind of like a muscle.

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It tends to be--for most people, it tends to be strongest in the morning and weakest at night, which is why a lot of people have--they stick to their eating plan for the whole day, and then they have that late night snack, you know, that they never intended to have. But it's 11:00 p.m., and you're tired, and this seems like the perfect moment to eat that donut, right? When you create habits, those habits are largely unconscious, right? When I wake up in the morning--when I pick up my toothbrush, the next thing that I do is I pick up my tube of toothpaste and I put the toothpaste on the toothbrush. That's not a conscious thought. I don't pick up my toothbrush and then stand there looking at it wondering what to do next, right? It's muscle memory. It's a habit.

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This is the trigger or cue--picking up my toothbrush is the trigger or cue that precedes the next immediate action, which is picking up that tube of toothpaste. And so in order to form a habit, things to be conscious of, and this comes from Charles Duhigg in his book "The

Power of Habit," is time, location, immediately preceding action, emotional state, right? And if there's a particular habit that you're trying to break, he gave the example of he would always get up and start--around 3:30 in the afternoon, he would get up, and he would eat a cookie. And he just kept doing this. And then he kept eating cookies. And he started gaining weight. And so then he noted the time, he noted the location, he noted the emotional state that he was in, which was kind of bored or restless or wanting a break around that time.

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And he was able to replace getting a cookie with just taking a walk and, you know, satisfying that emotional state, satisfying the state of like boredom restlessness without the cookie. So he kept the cue or trigger, and then he kept the reward, which was the satisfaction of his restlessness, like that entertainment and distraction. And he replaced the action in the middle. So if you break down a habit into cue, action, reward, then keep the cue, keep the reward, switch out the action. There's this notion also called habit stacking. And that is to build habits on top of other habits.

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And so the reason that habit stacking works so well is, because every habit needs a given cue, if you have a cue already because that cue is a habit that you're already doing, then since you're already doing it, you know that you can stack another habit on top of that. So for example, every morning I make a cup of coffee. Earlier this year, I decided that I wanted to create a habit of writing in a journal. And so I now stack my journal writing habit with my coffee habit. I will never forget to drink coffee in the morning. That's impossible. And so when I have that cup of coffee, that is now the cue or the trigger that tells me, "Time to write in a journal." And then the next habit that I will

form, and it's typically most effective to only form one habit at a time. A lot of people will try to stack on too many habits all at once, and then the whole thing collapses.

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So choose one habit. For me, it was writing in my journal. Stick with that for 30 to 60 days. And then at the end of that, then add in another one. So right now, it's the end of February. I started the journal habit. It's been about 60 days. And now that that has been pretty consistent, now I can add on the next habit. And so the next thing I'd like to do is meditate for about 10 minutes. And my intention is, again, that habit stacking, coffee, journal, meditate. So each one is a cue or a trigger for the next.

PERSON: How do you think about cash flow investing with real estate? Are you like an LP in a fund? Or are you a sole proprietor and you buy apartment buildings, and you manage them yourself? What do you do?

PAULA PANT: So I personally--again, I want to spend as little time on real estate as possible for myself.

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And of course, every real estate investor is going to have a different strategy based on what your career is, what your business is, you know, how much time you have. For myself, with that passive philosophy, I want to spend as a little time on it as possible. So I only buy residential rental properties in the United States. It's the only thing I'm interested in. And that does not necessarily mean that that is better or worse than any other type. You know, so that is in no way--I'm in no way implying that that's better than commercial buildings or

warehouses or storage units. It's just I want to keep it as simple as possible so that I can focus the vast majority of my time and energy on my business and my career because that's where I can make the biggest gains.

[00:50:04]

PERSON: Hi, Paula. I have a question going back to the asset allocation discussion that David started. And it's also coming off that real estate comment. What is the recommended percentage of your net worth that you would invest in index funds versus rental properties? Because it seems like all the research I've done on all the dialogue from the financial independence community is basically split into those two schools of thought, like do index fund investing or buy rental properties. And if I may outline, it seems to be the rule of thumb for index fund investing is the 4% safe withdrawal rate. And then the rule of thumb for rental property investing would be the type of cap rate you're going for. And a going rate for the cap rate might be like 7%. So is that a 7% rule versus a 4% rule that accelerates your date to FI or am I off there? Just curious.

DAVID MOLTZ: That is a pretty specific question.

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PAULA PANT: So first of all, to the first half of your question, which is what is the proper asset allocation. Again, I don't think that there is any specific correct one, right? Like, at the end of the day, at a big picture level, what you're trying to do is increase your net worth in a risk-managed way. And so however you can increase your net worth in a way that is comfortable to you is the way to do it, right? The best--the "best strategy" in the world is the one that you'll actually stick to because, ultimately, regardless of whether your contributions are

going to rental properties versus index funds, your contributions are going to be the single biggest determinant of your success. And so if you--and again, humans can play these psychological tricks on themselves, right? We have this tendency to compartmentalize money.

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Like if you think about it, money is money. You've got this big pool of assets, and it's all money. But if we compartmentalize it mentally, if we think this is the batch that's going to be used for my kids' college fund, well, we're less likely to take the kids' college fund batch and spend it on caviar and champagne, even though we might take a batch from this other bucket and spend that on caviar and champagne, right? Ultimately, it's all your net worth. It's all your money. But compartmentalizing is very powerful. And so that, really, in terms of asset allocation, is what I would encourage you to do. If you can compartmentalize like, you know, maybe the income that I make from--you know, the income that I make from this freelancing that I do on the side goes towards rental properties, but the income that I make from my primary job goes towards index funds or vice versa, whatever.

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You know, it doesn't matter what the decision is. That compartmentalization can often be a motivator that helps you increase contributions. And I think that is far more important than the tactic of nailing a proper asset allocation.

DAVID MOLTZ: Nice. All right, one last one. Who wants it? All right.

PERSON: Hi. First, thanks for coming out and talking with us. So my question has to do with asset allocation to a degree but also real estate and equity. So ultimately--

PAULA PANT: Popular topic here.

PERSON: Yes. Yeah. You know, if you're noticing that a substantial portion of your net worth is in home equity, what are kind of the key points to factor into the decision of whether or not to pull the equity to invest? So, you know, ultimately, you discussed 4% and change.

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If it's a home equity line, if there's a variable versus fixed, what are you looking for as far as, you know, you mentioned 7% or 8% return, kind of that gap? What's that spread that you kind of look for to decide whether or not it's meaningful to actually pull money out of investments?

PAULA PANT: Oh, that's an excellent question. So the concept of, if you have a significant amount of home equity in your personal residence, pulling that home equity out to invest, now first thing I'll say is a lot of people have a knee-jerk reaction to this where they think, "Oh, no, don't do that. That's not a good idea."

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But if you think about it logically, right, what is the difference between--what is the difference between taking money that you would otherwise use to make accelerated mortgage payments and using that for an alternate purpose versus having a good amount of home equity and then borrowing against it for same said alternate purpose, right?

At a functional level, those are exactly the same actions. But a lot of people will say, you know, person A will say, "I'm not making any accelerated payments towards my mortgage because I would rather put that money into investment X." And person B would say, "I am making accelerated payments towards my mortgage. And now, look, I've got all of this home equity. I'm gonna borrow against it and put that money towards investment X." Right? Like, it's the same thing.

[00:55:18]

So the first thing I'll say, and I'm saying this for the sake of everyone who's listening is, you know, don't have that knee-jerk reaction against borrowing against the equity in your personal residence because, in many ways, many of us are already doing it through opportunity cost. So then to answer your specific question, how would I think through whether or not to do it for a given investment? The first thing that I would ask is not the potential return on that investment, but I would ask what is the risk of ruin, right? What are the chances that that money that you withdraw could go down to zero?

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On something like a broad market index fund or a rental property, the chances of that falling, sure, that's there, but the chances of that dropping by 50%, you know, or losing a very significant amount of money is, historically speaking, not that likely to happen. You know, so in that regard, your downside is, at least, historically speaking, limited. And to that extent, that makes it safer than, say, taking out that same HELOC and using it to start your own business, which could go down to zero.

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So--so that's the way that I would approach it is manage the downside, manage the risk of ruin because so long as that money, in a worst case scenario, so long as--even if you don't make any returns, if, at the end of the day, you break even, and then you're mad at yourself because you've just paid a bunch of closing costs, that's not gonna be a deathbed regret, right?

PERSON: Thanks.

DAVID MOLTZ: All right, well, that's all the time we have. Last question for Paula, for those that are interested and want to learn more about you and "Afford Anything," where should they go?

PAULA PANT: So my podcast is called "Afford Anything." So you can find it wherever podcasts are found. And my website is affordanything.com.

DAVID MOLTZ: Great. Well, thanks, everyone. Thank you, Paula.

[00:57:39]

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