Anders Långberg

The Flip

Your Blueprint to Financial Independence

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Foreword

I’ve wanted to afford nice things and become financially independent for almost as long as I can remember, but the idea really took form during high school around the turn of the millennium. I remember lusting after an Aston Martin and discussing with my dad on how much capital it would take to retire. At that time our idea was basically to get a set amount of capital in mutual funds and skim all or parts of the profit each year to use as income for a level of living we saw as sufficient.

Although a viable strategy, there are much better ways to generate passive income from financial investments, something I would find out and explore over the coming years. During university I started digging deeper into stock investing, triggered by reading *The Intelligent Investor* by Benjamin Graham and also reading about a medical scientist and his wife that had donated their life savings to an institution at the university where I went. The donation was in the ultra-high net worth territory, something I couldn’t fathom came from a salaried worker. He was obviously well-educated but still on a normal salary. They had amassed this fortune by investing steadily on the Stockholm stock exchange. I started calculating on the effects of compounding interest and realized that with time and diligence almost anyone could get richer than they could even dream about.

During this time I also learned to play poker and started developing robots that traded foreign exchange. This began to form how I viewed trading systems - the overall strategy and approach - and how to evaluate and adapt based on past performance. Another side was learning how to live with risk, downswings and money management, something that for a gambler or professional trader is a big part of everyday life. The short version is that money management and managing (but not avoiding) risk is the most important factor to be and stay a professional gambler, and that this is hard to get consistently right.

As a result, I started searching for other ways to generate income that is more regular and less proportional to the invested time. I found out about dividend growth stocks that could provide this through a regular and growing dividend which over time would be significant compared to the invested amount. For me, this seemed like a good fit and I started developing an overall strategy for my investments and how to live off the generated passive income, with the goal to entirely eliminate the stress of money.

In 2012 I got to work on a project out of town. I traveled during the weeks and with a bit of time for myself on the evenings a significant piece of the puzzle fell into place: how to actually choose which stock to invest in each month. I had thought about how to evaluate stocks and tried to find different attributes that I put into a big table before I weighed the different options and chose what to buy.

I looked at things like historic earnings growth, the dividend yield and historic dividend increases and also tried to find some indication of the fair value to know if the stock was overvalued or a good buy at the given time. I realized that there’s basically three dimensions of a stock, all equally important for ownership: the financial fundamentals of the company (how healthy it is), the dividend returns (what you get from simply owning it) and finally fair value compared to the price (if it makes sense to buy it for the current price).

This was my lightbulb-moment, together with the insight that by buying dividend growth stocks I never had to have a bad stock trade again - as long as I owned the stock it would continue to provide me with the value I bought it for, so no need to ever sell a stock and take a loss if it had fallen in price (in theory anyway, there are situations when selling is the right thing to do).

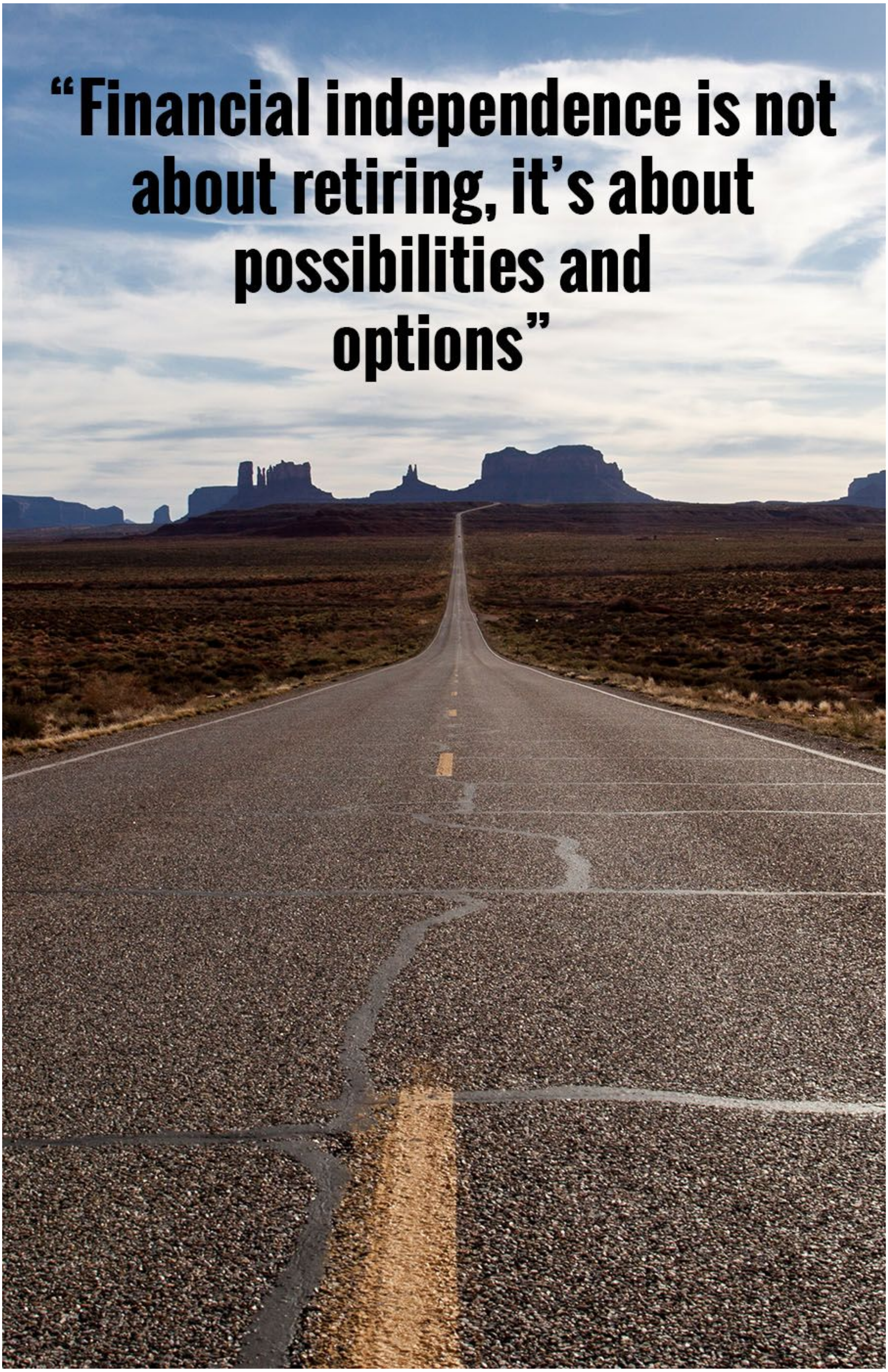
Finding some measures for these attributes and then assigning points and thresholds made it quite easy to analyze some interesting stocks and then simply buy the one with the highest score. With this my method to reach financial independence was taking shape. But, some crucial parts were missing.

How to adapt a lifestyle that allowed for setting aside a sum that would lead to my financial goals, for example. Over time this has fallen into place. I've used insights from my professional life as well as personal experiences and experiments to fill out the rest of the method to provide a framework that can be used for achieving any goal. Figuring out where you want to go and how to program yourself to take the right choice in the moment are the next components that are equally important to picking the right stocks. This is what I have now refined and give to you in this book.

This book is not about investment advice or stock trading, but I know what value I want from my investments and how they fit the overall picture for my long time goals. It's this blueprint that I give you. A blueprint to reach financial independence using nothing more than a regular salary and the right choices along the way.

I'm not sure if you'll want to follow this approach to the letter, but you'll learn a method that can be used for personal finance, economy and investing. With this knowledge you have the tools to adapt this method to your own situation and any other goal you might want to achieve.

Anders Långberg
Oslo, Norway, August 2016


“Financial independence is not about retiring, it’s about possibilities and options”

The Flip

What does financial independence mean to you? Finding the courage to take more risks in your career? Reduce the number of hours you work? Quit your job and do something completely different? Have the financial security to start your own business?

The Flip is a two-stage method to reach financial independence with three main goals:

- Peace of mind over financial matters, in everyday life and in case something unexpected happens.
- Eliminate social and household friction due to economy.
- Financial independence - the choice to live the life you want to live.

To accomplish this we take a two-stage approach:

1. Establish a personal finance platform that gives complete control over our economy.
2. Create a passive income stream through dividend stocks that support our chosen way way of life.

This book will describe both of these in separate sections. They can be used independently but are way more powerful when used together.

Being financially independent means having income streams that are independent from the daily work - i.e. you don't have to work for money. Simply having a big number in a bank account does not qualify as being financially independent, living means a constant rate of expenses so even if you own your house you still need to pay for food, electricity, heating, transportation and so on. Having a lot of money accessible means that you have a buffer, but not an income. The most common way of retirement planning is to save up a pile of money, calculate for how many years this is supposed to cover and then skim the pile to use for expenses. This is basically a glorified buffer which will give disappointing results if we live longer than anticipated, want to increase our means over time or simply want to retire really early.

We all have our own reasons for wanting to become financially independent, each as valid as the other. But in order to make it happen we need one or more income streams that are independent from salaried work. In order to really make sense these income streams needs to be passive, meaning that they only need minimal work to actually generate income after they've been set up. It could be land or housing that's rented out, royalties from music or books, owning a business or equity investments such as stocks and bonds that has a yield.

One of the most accessible ways to create a passive income stream for financial independence is to create a dividend growth stock portfolio that over time will provide a big enough income to live on. By carefully choosing stocks that has committed to not only pay dividends but also increase them over time you will get a regular, automatic raise simply by owning them. Stocks has a very low barrier to ownership making it easy to build our way to financial independence gradually and using compounding returns to accelerate our progress. Buying stock in a company puts you in a position of being an owner of the business, having other people work, challenge and stress themselves to provide you with returns on your capital.

Each person has their own level of expenses to live the life they want - housing, food, transportation and other expenses - and this is also the threshold for financial independence. But what happens when you reach this threshold? Do you just quit working and go drink margaritas on a beach?

Probably not, most of us work not only to make money but also to get a challenge, develop ourselves and feel valuable. Reaching The Flip, as we call the threshold for financial independence, allows us to:

- Continue to work but with substantial increase in income - and with a full safety net
- Reduce the number of work hours per week
- Start working on our own projects or startups
- Take a time-out and maybe study something new
- Change career without thinking about salary
- Do voluntary work
- Devote time to hobbies

Or something completely else. We call it The Flip because that's when we break free from the notion that we have to work for a salary. This paradigm, and that we're stuck in it unless we become a C-level executive or win the lotto, is one of the most prevalent in our society. But it isn't true. You have the option to not work and still have an income to pay the bills. Or you can continue working, having your work salary and boosting it with your passive income.

Financial independence is not about retiring, it's about possibilities and options. If your dream is to work as a dolphin trainer and race supercars on the weekends, you can. It's going to take a while, but combine our method for a personal finance system with the investment strategy and you'll be surprised how good you can live while working towards your Flip and what opens up after the threshold point.

The Flip is a long term commitment

Everyone knows that in order to get a really ambitious undertaking completed the progress needs to follow a plan. But plans also needs to be able to change and adapt to new circumstances, otherwise they'll fail. The process is more important than the actual plan, and The Flip is no different.

Finding out your goals and what you want to achieve is the foundation for actually making them become reality. We all have dreams, but to be able to feel them and know how to reach them significantly increases the probability of doing so.

To find out what it is that you want, use some brainstorming and prototyping sessions to generate ideas and then refine these into clearly stated goals with a described purpose. Knowing the purpose will make it easier to remember why you work towards your goals during the daily grind. Next, sketch out some timelines for yourself, finding different ways for how to achieve these goals. This is effectively storyboarding your own future and a powerful tool to visualize your goals and the road forward, which is a key component to actually achieving them.

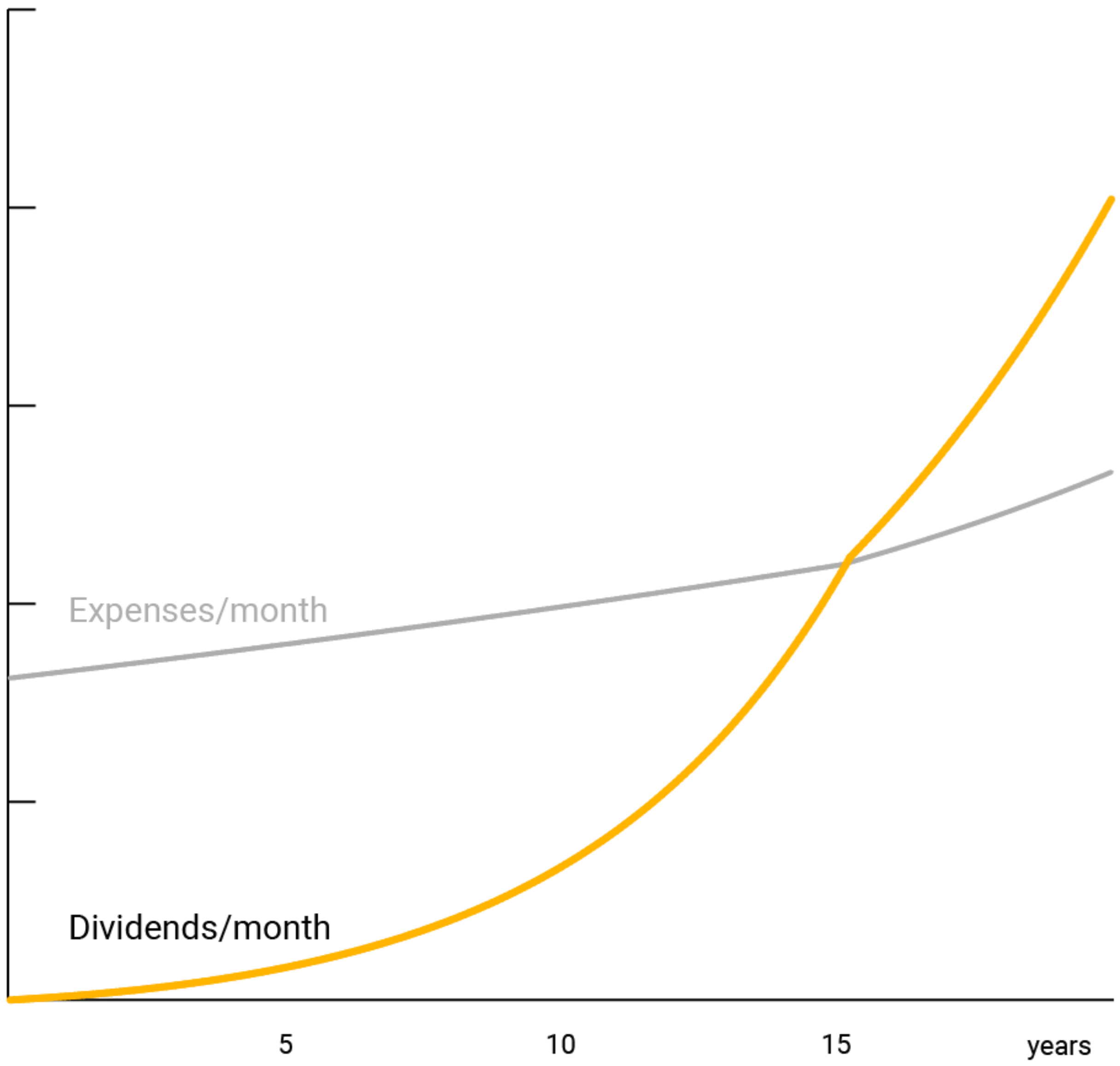
Creating plans for your goals - what you want to achieve both personally, professionally and financially - is one of the most powerful tools you have. Set up a roadmap with five year, two year and six month milestones for how to achieve your goals on a high level and then break these down into tasks and routines for progress on an everyday basis.

But, of utmost importance is a mechanism to be able to adapt this plan over time by changing it into a process. Lots of things can happen in the timelines it takes to become financially independent or really excel at something else: finding a partner and getting kids, changing jobs and getting promotions, moving and/or changing careers or lifestyle. Some of these will boost the available income, some will lower it. Some will introduce another party into the equation.

See the plan more as a framework and revisit it two to four times per year, for example at New Year and Independence Day or before the startup of school semesters. Evaluate how you're doing, if you need to adjust the path to a goal or even modify the goal itself. If you want to change a strategic goal altogether it might be better to set up a new plan. That's ok, this is just something you use to help yourself and nothing anyone will hold you accountable for.

Setting yourself up for financial independence is not easy, otherwise everyone would've done it. Reaching The Flip is in most cases at least a ten year project if starting from scratch, so what you're doing definitely needs to be evaluated from time to time and adapted to changes in external conditions as well as personal priorities. Be aware of this, but use this opportunity to also consciously design other aspects of your life to become the person you want to be and have the life you want to have.

When your passive income is greater than your expenses, you've Flipped



How The Flip works

As mentioned earlier, there are two main stages of The Flip method to reach financial independence:

1. Designing a structured personal finance system that supports your life priorities
2. Creating a passive income source through dividend growth stock investment that covers living expenses

In order to build a perpetual, passive income machine you need to have funds - so the foundation to all of this is getting your private economy structured in a way that lets you set aside enough money each month to create the machine in the timeframe you want. Reaching The Flip won't come without some sacrifices, nor will it happen overnight - but it is within reach for anyone with a bit of time and dedication.

The personal finance system will be almost automatic, so this is not hard, just something you can't do without actually committing. Setting aside money now for your future self is a sacrifice for the moment for a future reward, but also a cash flow buffer which gives an increased safety margin and allows you to relax more from financial worries.

The investment strategy is basically a method to invest in dividend growth stocks that will power our passive income machine through their dividends. A key aspect is that by reinvesting the dividend returns during the build-up phase, having the companies raise their dividends and getting some trading wins we will get compounded returns and have an exponential increase of the generated dividend. With this approach time is our friend and the sky's the limit, even with relatively modest amounts of investments each month.

When we have more passive income than expenses, we're financially independent and have Flipped.

Both of these stages are summarized in blueprints that details each and every step needed to accomplish them. Incorporate these into your life and success will be inevitable. These two first components, the personal finance system and the investment strategy, are all that's needed to reach financial independence.

The third section describes the background and theory behind tactics used in The Flip, for greater insight and also for you to be able to adapt the practices to your situation, goals and personality type. We use and adapt methods and practices from for example corporate leadership, software development, psychology and neuroscience to increase our effectiveness in everyday life. This is about becoming aware of the world around us and the incredible things humans can do; figuring out how we work to use for our advantage. We also explore how to establish good practices and routines that support our goals and the continuous development of ourselves - and finding the goals in the first place.

THE FLIP

Your blueprint to financial independence

1. Define the life you want

Do I know how I want to live my life?

NO

- If time wasn't an issue, what would I do?
- If money wasn't an issue, what would I do?

2. Find out what you need to do

Figure out:
How much money or free time you need to for the life you want

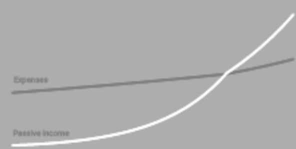
$900/month
$150/month
3 hours/week
$350/month
2 hours/week
$650/month

3. Design your monthly routine

Design the routines you'll need to get to where you want to be

For example, save and invest every month to build passive income

Fixed	42%
Other	18%
Saving	12%
Spending	28%



4. Make it a habit

Last Saturday of every month...
...go through your routine...
...and go to a nice dinner!

TRIGGER + ROUTINE = REWARD

A brief summary of The Flip method

The Flip is not about pushing hard for one major change and then having everything set. It's about doing the small things that takes you to financial independence; again and again, year after year - and keep doing so even after you've reached your initial goals. The Flip is about continuous progress and success, right now and in the future.

As such, the basic idea of The Flip is a monthly routine where you evaluate how you're doing and take necessary action to get to your goals. Throughout each and every month, hundreds of small decisions help you in staying true to your path, all working towards becoming the person you want to be and the life you want to have.

Start by creating a set of structures and habits that helps you live the life you want to live. Included in these are the two stages of The Flip; a personal financial system that automates a budget supporting your desired lifestyle and continuous investment towards financial independence. With the savings, dividend growth, reinvestment of dividends and expanded capital base through successful trades we generate an exponential growth of the income stream. Dividend growth stocks is the preferred method to build the passive income machine, but other sources such as land and real estate could also be used.

The Flip Method

1. **Define** and break down what it means to live the life you'd like to live. What are the specific items and activities you want to have the time, energy and budget for? For example, how many trips, days of travel and what budget do you need to "travel and see the world"? How much do you need to invest to become "financially independent in 10 years at my current expense level"?
2. **Find out** what you need to do to live the life you want and achieve the goals you've set out for yourself. Automate and create routines in order to stick to the actions that takes you towards your goals. For example, create and prioritize budget posts for "travelling" and "long term savings" to which you automatically transfer funds every month.
3. **Design a monthly routine** with daily or weekly practices to take you to your goals through continuous improvement and increasing efficiency. For example, for financial independence (adjust for other goals):
    a. **Review existing practices and routines**, and ask yourself what you've done well, what could've been done better or more efficient, what's holding you back and what you'll change from now on. This could for example be budget discipline. Switch up or change routines if needed to avoid boredom or plateauing.
    b. **Track current progress** and adjust the model predicting the future based on real performance. **Evaluate past decisions** and whether the current trajectory is in accordance with your goals for financial independence. Adjust if necessary.
    c. **Evaluate your investment portfolio**, see if there's any position you should exit or follow closely. **Read up on news** and whether the stocks seems probable to keep paying dividends.
    d. **Screen for investment candidates,** according to the risk and reward criteria you've decided is right for you.
    e. Based on your existing portfolio and available candidates, **decide on the right combination of investments for the month**. Plan which trades to do and perform at earliest convenience, both new investments and any re-balancing.
    f. **Plan for when to do the next monthly review** and reward yourself something you really appreciate for performing the monthly routine, establishing the routine as a positive habit. Do so by specifying a time when it's triggered and a reward strong enough so that you just can't skip it. For example, go to a good restaurant on the last Saturday of each month, after having done the monthly routine.


"How would you feel if money simply wasn't an issue in your life?"

The personal finance system

Money, the enabler of trade and specialization, is what makes our society and current standards of living possible. It's one of the fundamental innovations of mankind that has allowed each and every one of us to focus on what we're most productive and suitable at, instead of having everyone running around in the forest trying to gather berries and trap an elk. With money it's possible for two parties to trade who wouldn't otherwise have anything of use for one another. This has allowed society to progress to the point where we are now, where basically any service or product available anywhere on the globe is available to you - as long as you can pay the market price.

Whether you like it or not, money influences almost everything, working both as force of empowerment but also as a source of restriction, frustration and friction between people. This is especially evident in relationships where the use of money is often a touchy subject in the best case and a source of distrust, jealousy and animosity in the worst case.

So, how would you feel if money simply wasn't an issue in your life? Something that allowed you to fulfill your goals but otherwise stayed out of the way?

With a structured and balanced economy you've come a very, very long way. The rest is up to how you think and communicate about money.

A big income doesn't equal a good personal financial situation. It's the combination of financial awareness and expenses that are balanced to the income that sets the foundation for a sound household economy that has the flexibility to support your goals, interests and chosen way of life.

If you live alone in your household, then it's only one person that needs to be onboard. If you have family or some other part of your economy that's shared with other people then they need to be aware, accept and support it as well. Reducing friction due to economy is all about communication and making sure that the needs of every person is taken into account. Reducing jealousy, internally in a household and also externally, is mostly down to the realization, and acceptance, that you can't spend money that are outside the designated budget - but also that any use is ok as long as it's been budgeted for.

This section starts off by introducing a couple of powerful concepts when it comes to personal finance, after which we'll start looking at how to set up a household budget. This is approached as a design problem and just by defining it you'll probably get more insight into how you want to live your life than you've ever had before. Then, we'll see how it can be implemented in practice, automating as much as possible and finding ways to make sure that we stick to the plan.

Spend less for success

There's a growing number of people enabling an early retirement, we're talking about being in the 30's, simply by taking financial control and reducing their overall expenses as the main driver. A passive income is of course also needed, but if expenses are not kept in check it doesn't matter how big the income is - whether it's salary, dividends from stocks or a retirement nest egg that's being sold off gradually. What's important to understand is that it's not spending less in itself that's the driver, it's having control over the expenses and using money where it's needed.

Most wealthy people live frugal lives well below their means. In the book *The Millionaire Next Door*[1] authors Thomas J. Stanley and William D. Danko paints a picture of the typical American millionaire:

> *We live well below our means. We wear inexpensive suits and drive American-made cars. Only a minority of us drive the current-model-year automobile. Only a minority ever lease our motor vehicles*.

There's really no need to buy inexpensive clothes or to live cheap in order to become a millionaire, but the point is to be aware of how income and expenses matches up. Or, to come up with a system that automatically makes sure that it's only possible to spend what is designated for spending so that enough is put away for long term savings.

Let me repeat that, only spend what you have planned and budgeted to spend.

Wealth and resources are relative, the average income and corresponding cost of living will be significantly higher in New York City compared to Escalante, Utah. But the same is also true within a city or peer group, choosing to live in a modest apartment while your peers have moved to penthouses puts you in a position with significantly more economic flexibility.

"The quickest way to reach financial independence is simply to spend less"

The quickest way to reach financial independence is simply to spend less. Incidentally this is also the easiest way to afford anything you want - focus your resources and save up on what you really want to get and use less money on the things that's not prioritized. Creating a priority list is a good way to make sure that you actually get what you set out to get in the first place.

Another key is to be a conscious consumer, that lets us experience the very best there is while keeping the amount of spending in check. There are some things that are simply out of

[1] The Millionaire Next Door: The Surprising Secrets of America's Wealthy, Thomas J. Stanley and William D. Danko: https://www.nytimes.com/books/first/s/stanley-millionaire.html

reach for almost all of society except for the very richest (owning famous art pieces, private jets, superyachts, etc.), but almost everything else the top 0.1% of our society buy is available to everyone. There's no reason not to have the best there is when it comes to products and experiences. The best restaurants in the world are just as open to you as they are to billionaires, but it usually takes some time to understand what you're looking for and how to source it. Other experiences, like the natural parks and nature in general, don't differentiate the slightest bit of who's visiting.

When buying something, whether an experience or a product, there's always a choice. Making an informed choice makes it possible to own and use things that are literally as good as it gets while still on a budget.

The trick is to geek out about things that you choose to spend money on. Some producers are only interested in making a buck. Other truly care about what they produce, making things that are both well designed and of the highest possible quality without breaking the bank for their customers. The price difference is often minimal because there are so many who don't give a damn about what they buy, forcing the good producer to keep their prices down to be competitive.

"Whenever you have to spend money to buy a service, learn how to get value"

Whenever you have to spend money to buy a service, for a meal at a restaurant while on vacation for example, is a golden opportunity to learn how to get value. Read reviews beforehand and try to figure out which reviewers taste corresponds to your taste. Are there any restaurants which you have to book in advance? It might be a good idea to do so and keep other choices more open. It's fun to be spontaneous but you'll miss out on high value experiences where you only needed to prepare one thing. For being spontaneous, have a list grouped by location indicating which places you know has a greater chance for providing a good experience than a random choice while energy levels are falling low will.

Learn about the things you consume and what makes a product great. Find out about the manufacturers and how they produce their products. After becoming informed, decide your "minimum quality level" and find out if your budget can over this. If you can't afford what you want right now then it's better to wait until you do. Don't buy junk just because you can't afford what you want, what happens is that you postpone what you really want and settle for less. Instead, write a priority list of things you want to buy and work your way from the top or whenever a good opportunity to buy something at discount appears.

"we're basically designing our own life"

Understanding and buying a high quality product from someone that has given their soul and passion into creating it is an experience in itself, and something that will make you realize how much worthless crap that's produced. Cutting spending on low quality items and taking care of your things will make it possible to experience the very best there is, even on a budget.

In an extension, by finding out what we want to get, prioritize it and then source it we're basically making sure that what we want to happen also becomes reality. Something that can be applied to all aspects of life.

A good way to practice this is through grocery shopping. Cooking your own food is often faster, cheaper and more nutritious than take-away or pre-prepared food at the grocery store. But, coming to the store without a clear idea of that you want to make, and without a plan for the next couple of days, will lead to buying things not really needed. So, decide what you feel is appropriate for you, make a shopping list and then go to the store. The same goes with clothes, shoes, kitchen knives and cars. Identify your need or what you lust after. What is required in order to prioritize and fulfill your plan? When you have a clear plan, execute. Once this is becomes a habit, you'll soon live a frugal life with the very best things there are around you.

Key takeaways

- **Keeping spending in check** is the key to increasing relative economic wealth and being able to live off a passive income.
- Decide and **plan** what to buy and how to spend money **in advance.**
- **Good doesn't have to be expensive**, and many of the best things and experiences available costs little to nothing.
- Make a conscious, informed decision of what you buy to get as much value and quality as possible. **Buy high quality once** and **take care of what you have**.

Getting an (un)fair economic advantage

All societies and communities have rules, laws and taxes that encourage some behaviors and discourages other. For example, many of the larger Western European cities have made it very expensive to own and regularly use a car. In London, UK, Oslo, Norway, and similar cities there are congestion fees and relatively high costs for taxes, parking, fuel and insurance to dissuade from using a car in the city center, aside from the costs of ownership and maintenance. In Oslo, central parking spaces usually cost as much as a luxury car. Combined with a heavy tax on CO2 emissions and VAT the upfront cost of buying a nice car is around three times what it is in most U.S. locations. In addition there are congestion charges and a fuel price that's also again roughly three times higher than in the U.S.

If you choose an electric car you don't have to pay the taxes and can use much cheaper electricity. Better, but still a clear indication from society that car ownership is a luxury that you'll have to pay a disproportionate amount for - owning and using a car is usually as expensive as the total housing costs for a household. At the same time the public transportation system is well functioning.

In this situation, choosing to forego car ownership and renting one whenever needed is clearly the sound economic choice.[2] The transportation time is usually quicker with the public system than it is in a car anyway, so it's a win-win from all practical perspectives. In other cities a bike or scooter is the most efficient way to get around, using the public system as backup in really bad weather.

> *"By paying rent, you're paying for the owner's cost of mortgages, fees and return on capital"*

For housing it's usually the other way around. As long as property prices are not declining, which they usually don't do, except for areas from which people migrate and after housing bubbles, it's a much better deal to own rather than rent housing. By paying rent, you're paying for the owner's cost of mortgages, fees and return on capital. Owning the property means that you don't have to pay for someone else's profits, and in addition you can benefit from appreciating house prices with leveraged money.

Over time it's not unusual for the rising prices to net a total profit after costs for mortgages and fees. In a simple example taken out of thin air, for a family that rents an apartment for $1,000/month and another household that owns a house that appreciates $1,000/month

[2] In the U.S. a car is needed in many location and in those circumstances the type of car you choose to own can have a similar impact. For example it might be reasonable to own a small and efficient car and renting a bigger one when actually needed.

over time, the difference is a $2,000/month advantage for the household economy that owns their housing compared to the one that rents.

> *“taking the right decisions will give your economy a clear advantage by only doing what society asks you to do”*

Making conscious lifestyle decisions like these are very important. Not owning a car, or owning an economical one, puts you in a very favorable position compared to the rest of the society. Owning your house puts you in a favorable position against those who rent. Salary and living costs are usually balanced, so taking the right decisions will give your economy a clear advantage by only doing what society asks you to do.

Apart from housing and transportation, there are a few more areas that are usually worth a more detailed evaluation:

- Alcohol and cigarettes
- Taxes and fees, especially on investment and stocks
- Education, child care, parental leave, public safety nets

Just as with cars, there are two more areas where most societies have very clear standpoints: alcohol and cigarettes. Some jurisdictions choose to tax all alcohol very heavily, some have reduced tax on wine and some on beer. Most makes it beneficial to consume at home versus eating out. Take this as an opportunity to cook and enjoy great wines and drinks in your home, invite some friends and share an experience that would otherwise be many times more expensive out on the town[3].

All countries have their own laws and tax rates for investments, profits from trading or owning stocks and stock dividends. Some are more or less beneficial to specific types of investments, favoring funds that are locked to retirement or similar. Getting a good overview and finding out what rules that apply to you and how you can minimize your taxes, by only doing what the lawmakers have decided that they want to encourage, is of major importance when investing.

For example, in Sweden there are two types of investment accounts, defined by the government, which lets you pay a flat tax based on the total value of your investments instead of a tax on profitable trades and dividend payouts. Having this opportunity is extremely beneficial for Swedes who invests in stocks, but other types of plans that can be used for similar benefits is worth exploring in other jurisdictions. IRA’s, Roth’s and 401(k) plans are available in the U.S. and could be useful vehicles depending on your age,

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[3]When it comes to smoking, just don’t. It’s expensive, detrimental to your health and a major irritation to the people around you. It’s the shining example of how you get a clear disadvantage in life by doing something that’s a bad practice. Think of all the things you’ll want to do once you’ve reached financial independence, by smoking you’re limiting the amount of time you’ll have for this as well as the quality of life for your present and future self.

employment and other circumstances. Research as much as you can on your own and then find a professional to assist you in your situation.

Also figure out the best bank and stockbroker for you, as the fees they charge, the services provided and access to different markets can vary immensely. And as a final point make sure to find out how well you're covered in case the financial institution(s) you choose goes bankrupt.

> *"designing your life for maximum efficiency using the opportunities that are around you"*

Some big life events also have a major impact on the financial situation. Higher education later in life is one such factor, where you can quite easily do a quick prognosis if it's a beneficial move in the long run to have a reduced income and/or pay tuition during a period to set yourself up for a higher salary in the future. If this is something that you strive after, could it be an idea to have this as a goal after becoming financially independent? Finding a partner and sharing a household is a big one, which is usually very beneficial when going from a single household economy.

Getting kids is another event that some societies have chosen to premiere and others have chosen to penalize. If you choose to have kids without the infrastructure in place (income supplementation, housing, day care, transportation, etc.), there will be an impact to your economy and lifestyle. Thinking about finding a partner and getting kids from an economic impact perspective can sound very cold, but having made draft budgets based on these changes to your household will make you prepared and able to have more informed discussions about your present and future. Maybe the only impact of getting kids is that you'll not be able to travel as you've been used to doing - which would've been impossible with an infant anyway?

Putting together a clear picture over your life and how you want to live it, now and in the future, will make it possible to see what's encouraged or discouraged in your society. Use this knowledge to your advantage by designing your life for maximum efficiency using the opportunities that are around you.

Key takeaways

- **Research** the taxes, laws and behaviors **affecting your economy**.
- Find out how you can **use the economic framework and constructs** around you **to your benefit**.

Debt isn't always bad

Many people who actively save money for the long term and want to reach financial independence start by paying down their loans with the reasoning that this will eliminate the largest fixed expense in the household. While this certainly lower the total costs for interest and reduces the risk for increased interest rates, it might not be the most effective use of funds. There are three main areas to consider:

- Lost returns from paying down a mortgage instead of investing
- Economic flexibility
- Tax deductions or other benefits

The first point is simply about cash flow and expected future returns. If you get a higher yield through some kind of investment than the interest rate you pay, it makes sense to have the funds generate more money for you. This is not a signal that you should use leverage or remortgage your house to invest, but realize that paying down the mortgage ahead of time can very well be an action with a negative expected value compared to investing these funds instead. A missed opportunity for a return of capital is just as bad as lost capital when your goal is to maximize return.

The second is flexibility, having paid off a loan means that those funds are effectively gone, just as when you buy any other service. Going into retirement with a fully paid down house but no money in the bank means you're rich on paper but without the possibility to generate cash flow or use the funds in a controlled manner. While it's often possible to take out a new loan against a home with a partially paid down mortgage, there's no guarantee that this can be done when these funds are needed. Having these funds available and easily convertible to cash, for example in stocks, mutual funds or similar, gives the flexibility to use them as a buffer if it ever comes to that.

The third is taxation. Many jurisdictions allow you to deduct interest expenses from your income as an incentive to own your own real estate, lowering the effective interest rate. Loans can also often be counted against your total net assets, lowering the amount you'll have to pay in wealth tax. As long as you have a salary this can cut your tax quite drastically, especially in a progressive tax system.

"try some ideas on paper and take an informed approach for your situation"

How this actually play out from a cash flow perspective is very much dependent on the overall economy. If the rates on mortgages are low and blue chip dividend stocks have yields several percentage points higher, it's quite often an easy choice. Do some calculations with different scenarios for interest, income and funds allocated for saving and paying down your loans. Just as with other aspects in your economy, and way of living in general, try some ideas on paper and take an informed approach for your situation.

However, when it comes to debt you need to be absolutely vigilant that you're the one in control over the relationship with your lender. Just as a corporation, look at your assets to debt level relationship and the cash flow needed to serve your credits. Never, ever take out a credit to fill a cash flow deficit - this is what buffers are for - and make sure that you can fulfill the payments of a loan even if the interest raises or your income drops. As with so many other things, make sure that you're in balance and have thought through both plausible and implausible scenarios beforehand.

Key takeaways

- **Funds used to pay down a mortgage are locked**, giving you a paper investment that's hard to use.
- Find out how you can **use loans and mortgages** for **cash flow and taxation purposes** while also increasing your **economic flexibility**.
- **Always be in control over your debts**; by the very least make sure that your overall debt is in balance with your assets and that you can cover any (un)reasonable interest rate raise.

Buffers and financial security

Financial security is the ability to support the household's standard of living now and in the foreseeable future. In the day to day life this usually means that two things need to be in place:

1. A positive household cash flow capable of covering the budget during normal income swings
2. A cash buffer capable of covering any unexpected expense

Depending on where you live and your work or type of income, you have different safety nets and different types of swings in your income - both positive and negative. For example, if your income can be reduced due to sick days or if a significant part of your salary is provision-based you need to leave headroom for this in your budget.

Having a cash buffer around capable of covering the largest unexpected expense you can foresee is also a way to buy yourself some true peace of mind. If you live in a house and drive a car to work you have vastly different needs for this buffer than someone who lives in a condo and uses public transportation. Try to figure out the two biggest single items that can fail for you and what it costs to fix them, this is the amount that you need to have in a cash buffer.

Have this buffer in its own account and try to build it as soon as possible. Hopefully it will never be needed, and you shouldn't use it unless absolutely necessary, but it's one of the best things you could ever save up to.

> *"have three months of expenses available in funds"*

Taking this to the next level is making sure that you can keep your standards of living and have time to do a controlled revision of your economy even if there's a big, income changing event, like losing a job, or a longer drought if you're self-employed, a professional sports bettor or working with something else where you can't count on getting paid every month.

A good benchmark is to have three months of expenses available in funds since this will give time to find a new job or re-adjust your economy if needed. Depending on how probable the use for this buffer is, the amount can be scaled up further and there's also the choice of how these funds are stored. If the use of them are highly improbable, i.e. you have a stable job and a safety net from society, your long term investment account is probably safety enough. On the other hand, if you have a job with a highly periodic income then a cash account with three months of income buffer and three months in the long term investment account is more appropriate. When the three months of cash buffer is out, then you know that some bigger adjustments must be made.

Either way, building towards financial independence through dividend stocks means that you'll get a bigger and bigger investment account over time, so reaching three months of expenses covered in the total value is only the first goal. Soon you'll have one year covered and eventually all your expenses only through dividends, at which point you'll have perpetual financial security.

Key takeaways

- Make sure to have a **positive cash flow in your budget**.
- Build up a **cash buffer account** that can **cover any unforeseen expense**.
- Figure out and **save up** to the time you need to **be able to cover** in case of a **change in income** and financial situation.

Setting a household budget framework

As soon as you start some kind of project or program where financing and economy is non-trivial, as it is in your household economy, budgeting is necessary. It provides a system and framework that guides you to take the choice you've decided is the one that leads to your financial goals, instead of guessing every time you make a transaction. At its core, personal budgeting is quite easy but an incredibly important tool for you to live the kind of life you want in a sustainable way.

Just like for a project, a budget is an enabler. Having a budget for something means that it's prioritized. Not being able to set aside funds for a specific purpose only means that there are other, more important uses for those funds. Finding out how lifestyle choices translate into budget posts is the most important part of making a budget. This will enable your life priorities and the budget will almost make itself once you've defined these.

Start by writing down and describing how you want to live your life and what this means for you. Next, identify all items that need a budget, such as the type of living or activities, and also the ones that don't. Make your ideal list where you put a cost or allowance to lifestyle choices. If you want to "live an active lifestyle", for example, define what this means. One hiking trip out of town per month? Funds set aside for gear? Membership fees? Courses and training?

Sort these in priority with the highest on top and then work your way down to the less prioritized. When you already have fixed expenses, like most of us do, also list these and where they come in the prioritized list - making sure they are covered even though they aren't fun.

If you're more than one person sharing the economy in the household, the very first step is to agree on the economic goals and the way the economy is shared. Do you pool all income, divide expenses according to the ratio of income or simply share expenses 50% each? Deciding this is a cornerstone of your shared economy and the first major step in reducing potential relationship friction due to economy. Unless all parties agree to the same economic goals and overall plan the finances will be a constant source of irritation and distrust that will either sabotage the relationship, or if just ignored, make the goals impossible to reach.

The second step is to allow for a personal economy within the shared economy. Treat this as any other type of expense when setting up the shared budget, what these funds are used for is entirely up to the individual and that person should be the only one with access to the account.

There are a couple of expenses each month that are more or less necessary; housing, whether mortgage or rent, and food are the two prime examples. Where these differ is that food is usually a series of expenses throughout the month while housing costs comes as a pair of big bills at the end of the month.

As a result, we have chosen to define two main types of expenses: Fixed and Other. Housing is defined as a Fixed cost, we know that a bill is coming and how big it is, while food is a cost of the Other type where we allocate money for later use.

The Fixed expenses have a specific allocation per item that's known beforehand each month, the Other expense posts are all divided into general groups and specific purposes but the exact payment details are not known when the money is set aside. They are pooled for later use. Some examples of sub-groups and types of expenses within these two main expense categories:

Fixed expenses
- Housing: rent, mortgage, home association fees, electricity, taxes
- Transportation: car loan, leases, public transportation, taxes
- Long term savings: financial independence, income buffer, retirement portfolio
- Internet and communication: internet, cable TV, mobile phones, subscriptions
- Family: child care, recurring activities, membership fees
- Financial: recurring taxes, tax/financial advisory services, student loans

Other expenses
- Food and household: Groceries, lunch-packs, take-away, family activities
- Spending: Lunch, coffee, clothes, haircuts, drinks, restaurants, vanity - and anything else
- Housing: Maintenance, home improvement, furniture
- Transportation: Fuel, congestion fees, maintenance
- Savings for specific purposes: Personal, car, children's education, etc.
- Travels

In addition to the expenses you also have the funds you set aside for personal spending and long term savings. By dividing your personal spending money into one pool for day to day spending and one pool for things you need to save up for you make it easier to actually buy the really nice things you want, even when on a budget. This makes our main budget categories look like this:

- Fixed expenses
- Other expenses
- Long term savings
- Personal spending

This list, and any other posts you add to it, is basically where you design your life and what you want to enable through the use of money. Some lifestyle decisions are cheap or even free while other require a substantial financial commitment. Being aware of how much things cost and how you prioritize is the foundation of a sound household economy. Approach this as a design problem where you define what you want to achieve, research and collect needed information, generate and analyze ideas, develop the solution, retrieve feedback on it and finally improve on the solution. We'll do this step by step in the *Blueprint to getting a personal finance system in place chapter*.

By creating a complete list of your current fixed expenses and an idea of what other posts you want to allocate funds to, this information can be used to create budget ideas. Start with the most important posts and work your way down in priority. Create multiple versions and see how one change reduces flexibility or opens up possibilities. If possible, include all household members in this work so that everyone is equally committed once you decide on the final household budget. Test this practice for a couple of months and revise if needed.

> *"dedicate at least 10% to long term savings and the road towards financial independence"*

A good benchmark is to stay below 40% of the total cash flow in expenses related to housing, such as mortgage, fees, electricity, taxes and so on. With food below 8-10% of the total it should be possible to dedicate at least 10% to long term savings and the road towards financial independence, if that's what you strive for.

When starting out their adult life most people need to set aside more funds for their housing, either to save up for a down-payment, to pay off a down payment loan or similar. Fixed expenses should still be kept below 60% of total cash flow and reduced as soon as possible. It's very beneficial to start investing early since compounding interest gives an exponential return on investment over time, so even on a tight budget a long term saving component should be prioritized, and the bigger the better for the first couple of years.

If you think it's unrealistic to fit your living expenses within these ratios, you're usually living in the wrong place for your income level or live a lifestyle that you can't afford. There's no judgement in this, just facts that you need to be aware of and adjust to. Without a budget you're basically flying blind when what you need is control. With this control you can design your personal finances to support how you want to live, without proactive planning you simply can't.

Key takeaways

- A **household budget** is both a **plan** for the household economy as well as a **tool** to aid in economic discussions and priorities in a shared economy.
- All stakeholders **must agree to the same economic goals** and the plan to get there.
- **Identify your Fixed costs** and divide these into groups, **then add** all your desired **Other allocations** to this list as well as **Long term savings** and **Personal spending**.
- When creating a budget, **start with the highest prioritized items** and work your way down. **Create multiple versions**, evaluating the changes, before agreeing on one.
- Look at the **macro ratios** in your budget. **Do these make sense**?

Separating accounts

While making a budget is quite easy, actually adhering to one can be more difficult. The key to moderating the actual spending to conform to a budget is to use separated accounts for different kinds of expenses. Use separate debit cards for personal spending and grocery shopping and you have a foolproof way of ensuring that you stick to your budget.

Most modern banks have made this process very easy by allowing for an unlimited number of accounts and the ability to connect debit cards to these accounts. The trick is to use one account to which all income goes, but not to use this account for any actual expense other than the fixed, recurring posts. All budget posts in the Other category, as defined in the household budget framework, have their own accounts to which funds are transferred. These are budget costs where we keep separate buffers since we don't know exactly how much is needed at what point in time, so unless we actually earmark money it is way too easy to use funds for purposes they were not intended to.

It all starts with the Hub account. This is where salary and other income comes in and all fixed expenses are taken from. By default, most people - and banks - connect the first debit card to this account. Don't do this. This account is a buffer through which all other income and expenses go.

If you have more than one person in the household with economic responsibility, try to split up the fixed expenses and then settle the final balance from one person to the other. Having everyone take economic responsibility increases the awareness, transparency and emphasizes the shared responsibility.

> *"only use your money for what they were intended"*

From the hub accounts transfers are made to the other accounts, preferably automatic, when main income gets to the account every month according to the household budget. The personal spending account should probably have a debit card connected to it, and so should the food and groceries account. The rest don't need one.

When a large purchase is made funds can be transferred to one of the card-connected accounts in advance of the actual purchase. For example, when traveling the food and groceries account could be used for expenses and for larger personal transactions the spending account is suitable. The point is to make the actual transfer from the dedicated saving account just in time for the use and not try to sort out everything after the fact. Working proactively is much easier to reactively - and this makes sure that you only use your money for what they were intended.

Credit cards can certainly be useful, especially for corporate expenses to be reimbursed, merchant reserves or when you get additional benefits such as flight points or improved insurance. The problem is that they limit the amount of control you've worked so hard to build up using your budget and the separate accounts.

Keeping track of exactly which expense should come from which account, and making these internal transfers, is extremely time consuming and sometimes close to impossible when the different merchants have an entirely different legal names from their operating names. Even if a card is only used for a single type of expense, like food and groceries, keeping track of how much you've spent during the month becomes difficult, prone to error and without the safety net of a declined transaction when the account reaches zero.

Some credit card companies also make it very hard to see the total amount you actually owe them, choosing to highlight minimal amount to pay and the total purchases for this month but keeping the total amount obfuscated. Keep a credit card around and use it when you have a clear benefit, but don't use it as part of your everyday routine.

Key takeaways

- **Have one "hub" bank account where all income goes** but that's only used for fixed expenses and **not connected to a card**.
- **Create separate bank accounts** for all other types of expenses, with **their own debit cards** when needed - this includes shared accounts for things like food.
- **Don't use credit cards** for any type of ordinary spending or shopping.

Revisiting your budget and keeping expenses under control

Your budget is a living plan. While it's designed to support your long term goals and your desired lifestyle, circumstances change and it's much better to proactively revise your budget than having to use funds designated for one purpose for something else. If your costs spiral out of control, even for a single budget post, you don't have a sustainable economy and need to fix it right away. Otherwise this unbalance will spread into other posts and the plan you so carefully set up will break apart.

This is why the use of separated accounts with their own debit cards is so good. When an account is empty it's a clear signal that something is wrong. With a credit card and a buffer you should still be able to take care of the situation, but it's a clear signal that either the budget or your spending habits needs to be revised right away.

It doesn't matter how much money you make in total. As long as any expense is bigger than allocated funds you're effectively living above your means and are on your way to financial meltdown.

"keeping the fixed costs stable and getting more income gives a lot of flexibility"

On the other hand, life is also full of positive economic surprises. A raise, a bonus, lowered interest rates and many other things can positively impact your economy and warrant a revisit of the household budget. You'll soon realize that keeping the fixed costs stable and getting more income gives a lot of flexibility to allocate funds for other purposes - either increasing your living standard, dedicating funds to something specific or saving more money for the long term.

Even without a trigger, it's a good practice to periodically revisit your budget and change it according to evolving priorities. Look it over two to four times a year to make sure it's followed and also updated according to changed priorities. This makes sure that it's up to date and realistic, the two cornerstones of making sure it's a tool that can actually be used, using minimal maintenance. See any trigger event, like the purchase of a car, a home renovation or when you get a raise, as a reason to go through the budget. This as a chance to sit down and really think about what you'd like to prioritize, lay out some different scenarios and choose your overall path forward until the next review. Treat yourself when doing this, whether you're by yourself or together with a spouse, to create a positive habit. Look at this as your household board meeting, a place where you'll reaffirm or tweak your strategic direction and decide how to implement it until the next review.

Key takeaways

- Set up a **recurring meeting** for talking through and taking high level decisions for the **households economy**, making sure you allow for changes in priority as well as economic situation.
- Work diligently to **stick to your budget and designed economic plan**, if you're unable to do this then redesign the budget with the new input.
- When getting a raise or there are lowered costs, **make a conscious decision** of how to allocate these funds and to **rebalance the budget**.

Blueprint to getting a personal finance system in place

By now, you should have some ideas for how you'd like your economy to work and how to get there. To help you along the way I'll give a brief summary and also an example from when my wife and I moved to Oslo, Norway in 2013 and how we decided to create our household budget and finance system at that point in time. This was a significant economic event for us since we sold our previous apartment, got new jobs with new salaries and bought a new home - something that gave us a good opportunity to think about all aspects of our economy and shape it to support the lifestyle we wanted.

Step 1: Definition

Define the parameters for your personal finances and what you want to achieve. This should include the type of housing, jobs and income, how much to save, how to split income and costs, what activities to support, etc. If "have a social life and meet friends out on the town" is a priority, break it down and find out how much money is needed, the same for "have an active lifestyle". Use structured brainstorming sessions to generate ideas and put these together to different sets of budgets. Choose one and go forward, but if this doesn't work out come back and generate another set of parameters.

One of the main parameters is how to pool income, split costs and distribute personal allowances for a household economy. Having everyone on board this decision is paramount for the success of the economic plan and to eliminate household grievances due to economy. If it's not possible to reach a clear agreement on this there's no ground for a shared economy.

> *Together, we talked a lot about how we wanted to live and what we saw for ourselves in the coming years. First decision to take was where we actually wanted to live. We had both lived in Stockholm for the majority of our lives but with a project assignment in Oslo I had gotten to know both the city and colleagues at the company I worked for. With job offers in both Stockholm and Oslo we looked at the attractiveness of the jobs themselves before we even started mixing it up with financials. Once we did that it became clear that from both a professional as well as financial perspective we would get a significant advantage by moving west to our neighboring country.*
>
> *We had been living in a studio apartment and wanted something bigger, but not yet a place where we could live the rest of our lives. More important was to be part of the city life, close to restaurants and other activities, with good communications and short travel distances for any central work locations.*
>
> *Centrally located single homes are not that common in Oslo and were out of the question (too expensive) so we set our eyes on finding an apartment. One priority was to live in a nice building so we wanted to find a really old one or a new build, but this was prioritized lower than the location and neighborhood. We were still in the establishment phase in our property career and knew that the down payment were probably going to be the limiting factor rather than cost of the mortgage itself, but we wanted to keep climbing that ladder rather than rent something.*

With good public transportation, and a city where using a car for daily transportation is discouraged, we wanted to use the public transportation system for getting around and also have room in the budget for physical activity. We knew that food and groceries were more expensive in Norway than they were in Sweden, but in addition to this we also wanted to increase the amount of money we could spend on food every month to support one of our biggest common interests.

For a start, we had no big items or travels we wanted to include or focus on, a new home was more than enough to chew for a while and the rest of our purchases would have to be filled within our personal saving and spending allowances. Not were all opportunities and fun though, we also realized that with two people working corporate jobs we couldn't keep our Dobermann Dante so we had to find a new home for him and also sell our fifteen year old Volvo V40.

Step 2: Gather information

Find out how to transform the parameters into actual budget posts. Things like "being able to take a coffee with my friends" doesn't need it's own account - it should be covered by personal spending - but you need to be aware of it and make sure that you have the flexibility and live in such a way that this is possible.

Some lifestyle decisions have a huge impact on the type of housing or transportation needed, so these need to have a thorough breakdown of all included costs. Things like having a second home or going car racing on the weekends have lots of secondary costs that needs to be found out.

With an idea of what we wanted to achieve, we started researching how things work and cost in Oslo and in particular apartment prices, neighborhoods, taxes, mortgage terms and similar. We quickly found out that we really wanted to live in the Grünerløkka neighborhood within one block of the Birkelund park, in an up and coming neighborhood, priced vastly lower than the established "nice" locations, with a vibrant restaurant, coffee and bar scene and good connections to the rest of the city. Almost all of the buildings were built at the turn of the 20th century, an added bonus for us.

One of the limiting factors for us would be to actually have cash for the down payment. With a bit of a gap from when we got the proceeds from the apartment we sold and also moving up the property ladder we weren't sure we were going to cover this without digging too deep into our long term savings, so we were prepared to seek some extra financing for this.

Having these specifics in place we started looking at apartment sales and what was offered to get a sense of how expensive different sizes and standards of apartments got, how much the final price differs from the initial price and what seemed like god buys.

Things like the monthly cost for buses and trams, gym membership and similar is very easy to find out nowadays. When living a scaled down lifestyle without lots of expenses this is an easy exercise. With more subscriptions and things to care of this can be exponentially more time consuming, but needed nonetheless. All of this information was noted in spreadsheets for future reference.

Step 3: Generate and analyze ideas

In a professional, creative setting brainstorming sessions and workshops are often used to generate and evaluate ideas. They work both for deliverables that are truly creative, like user interfaces and functionality, but also for more technical and analytical problems.

While the first two steps of this process can work out fine as spontaneous sessions, this step really benefits from a structured approach where all parties can focus on the task at hand and contribute with their input. One of the main goals of The Flip is to eliminate interpersonal friction due to economy and for this to happen a safe space where wild ideas are encouraged and no one is judged is needed.[4] Without this the system will fail before it's even started.

Using the data gathered in Step 2 it's a breeze to set up a quick spreadsheet that lets you explore different scenarios in a structured session - but if you're more comfortable with pen and paper or post-it notes then those work just as fine as well. Important is to focus on the task and use the defined parameters from Step 1, if you realize that they don't work or that more information is needed, there's nothing wrong by going back and then have another session - or to generate different budgets on your own and then having a session to discuss pros and cons of different versions and agree on a final solution.

> *For us, we had a basic idea of how much we could borrow from the bank so it was mostly about finding the sweet spot for how much to spend, how much to save for different price ranges of apartments. If you realize that you're looking at housing that's out of your league, or that you have more available that you want to spend than you originally thought, then you can go back to Step 1 and redefine the problem.*
>
> *As a starting point we wanted to see how much headroom we had while keeping within our comfortable amounts for food, long term savings and personal spending and saving. We used online loan calculators to find the sums for the main mortgage, with the lower threshold set for a 2.5 MNOK ($425k) apartment and the higher for a 3.0 MNOK ($510k) apartment. We had found that we should be able to find a nice 2 room apartment within this range and explored how this would affect the different aspects of our economy.*
>
> *See next page for the example budgets, at the time 1 USD = 5.8768 NOK.*

[4] OpenIDEO Blog: 7 Tips on Better Brainstorming: https://challenges.openideo.com/blog/seven-tips-on-better-brainstorming

	Alt. A		*Alt. B*	
Income after taxes (NOK)	*NOK*	*%*	*NOK*	*%*
Me	*6,288*	*60.71%*	*6,288*	*60.71%*
My wife	*4,070*	*39.29%*	*4,070*	*39.29%*
Sum	***10,358***	***100.00%***	***10,358***	***100.00%***
Fixed expenses				
Condo maintenance fee	*596*	*5.75%*	*510*	*4.93%*
Mortgage	*2,127*	*20.54%*	*2,723*	*26.29%*
Down payment financing	*340*	*3.29%*	*425*	*4.11%*
Extra down payment paydown	*851*	*8.21%*	*851*	*8.21%*
Electricity	*153*	*1.48%*	*153*	*1.48%*
Phone	*0*	*0.00%*	*0*	*0.00%*
Internet	*97*	*0.94%*	*97*	*0.94%*
Tv	*34*	*0.33%*	*34*	*0.33%*
Transportation (public)	*211*	*2.04%*	*211*	*2.04%*
Home insurance	*13*	*0.13%*	*13*	*0.13%*
Student loan payments	*255*	*2.46%*	*255*	*2.46%*
Gym membership	*153*	*1.48%*	*153*	*1.48%*
Sum	*4,831*	*46.64%*	*5,426*	*52.39%*
Other expenses				
Food and groceries	*851*	*8.21%*	*766*	*7.39%*
Sum	*851*	*8.21%*	*766*	*7.39%*
The outcome				
Fixed expenses	*4,831*	*46.64%*	*5,426*	*52.39%*
Other expenses	*851*	*8.21%*	*766*	*7.39%*
Long term savings	*1,276*	*12.32%*	*1,276*	*12.32%*
Total personal savings	*4,587*	*16.41%*	*4,544*	*13.95%*
Total personal spending	*4,587*	*16.41%*	*4,544*	*13.95%*

Two alternative household budgets with a more expensive condo in alt. B.

Step 4: Implementation

Once a budget is decided it's time to find out how it can be implemented in practice. Automate as much as possible and decide on routines to allow for transparency and to handle irregularities. Start by setting up accounts in your bank to separate funds dedicated for different purposes and find out if it's possible to do automatic transfers. Decide on who pays which bills and how to even out the balance.

Also decide on a routine for quality assurance of the budget and its implementation. If, for any reason, there are unbudgeted invoices or costs that are bigger than anticipated they need to be handled and the budget revised. Otherwise the whole structure will start to break down very quickly. Small adjustments are part of the process and something good.

> *I'm a firm believer that every person needs some funds that they can spend entirely as they choose without any judgement at all. This is what the personal spending allocation is for. In order to leave a little incentive for a good salary and working the extra hours also within the relationship we decided to split our personal funds based on our relative income.*
>
> *We also decided to use the personal spending money for lunch since the amount varies quite a lot from day to day. We used to bring leftovers for lunch in Stockholm but it's common to have reasonably cheap lunch restaurants in connection to the work places in Oslo which makes it more practical to buy lunch out. But, with no real reason to hold back for the individual it's easy to put blame on the other party if or when the shared food account becomes empty. The base philosophy here is to be pragmatic so that any conflicts of this kind is eliminated before it even has a chance to become an issue.*
>
> *I set up the following account structure:*
> - *Hub account*
>   - *Personal buffer*
>   - *Personal spending account (with a debit card)*
>   - *Personal savings account*
> - *Food and Groceries account (shared, each with a debit card)*
> - *Long term savings account (separate bank specialized as a stockbroker)*
>
> *Automatic transfers were set up between the accounts with all fixed expenses paid from the Hub account, where possible those were also automatic. We also set up an automatic internal transfer so that the net result on the hub accounts were according to plan.*
>
> *We agreed that by the end of every month we had a common walkthrough of our costs and decided where to invest our long term savings.*

Step 5: Evaluate and revise the budget

Small adjustments to the budget can be made as part of the regular walkthrough. However, 2-4 times a year, or in connection to a an economic event, it's a good exercise to evaluate the defined parameters of the budget and see if any needs to be changed, removed or added. There might be lifestyle choices you have thought or talked about that needs to be explored or incorporated. Find a way to trigger this discussion whenever needed.

We managed to find an apartment that came in at the lower end of our range and was able to pay off the down payment loan very quickly. This left us with a very positive problem after just a couple of months, what to do with the excess?

The first priority was to increase the amount that went to long term investments. Roughly $1000 (12% of our combined income) is a good amount but at the beginning of an investment career it's always better to save more if possible. Due to compounding returns more savings will have a proportionally bigger benefit over time.

One thing we found out was that without a dedicated budget there was a resistance to travel to see our friends and family in Sweden. Taking the train, airplane or renting a car is not that expensive at all and takes just a couple of hours - I had been commuting for a year so I even had the routine in place - but having to prioritize that against other things didn't make it as easy as it should've been. We briefly looked at getting a car, again by finding the total costs and expenses and putting into a draft budget, but found that the costs would've been disproportional for the use we would've gotten from it.

Instead we adjusted the budget and opened another shared account, a Travel account, to which we also initiated an automatic transfer. The purpose was to allow ourselves to rent a car whenever we felt the need for it (instead of getting one), and any money left on it would go towards other travels. After counting on it, renting a car for all the activities we saw ourselves using it for would be much cheaper than to own one in the long run.

See next page for the adjusted budget.

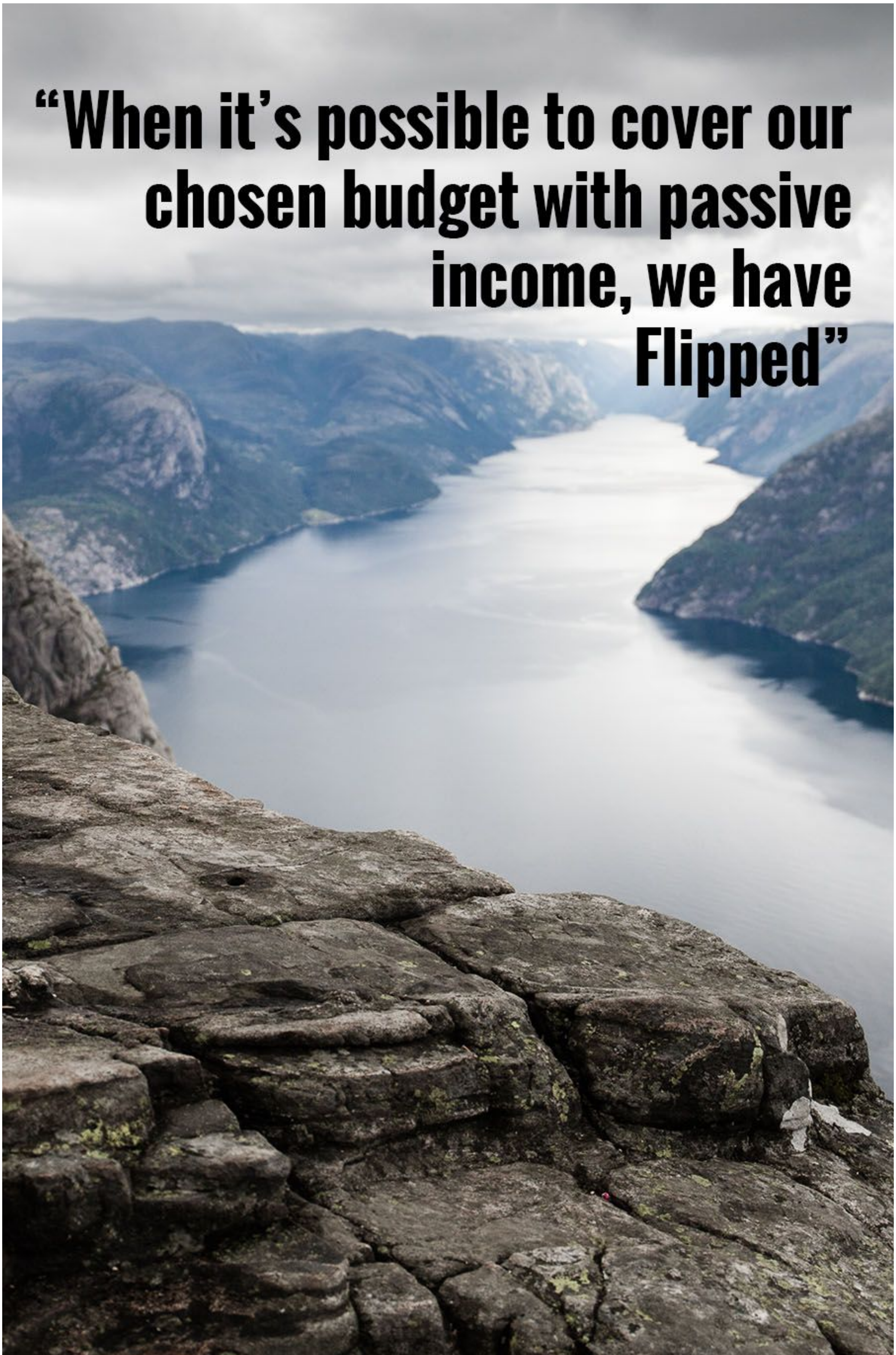
Income after taxes (NOK)	*NOK*	*%*
Me	*6,288*	*60.71%*
My wife	*4,070*	*39.29%*
Sum	***10,358***	***100.00%***
Fixed expenses		
Condo maintenance fee	*596*	*5.75%*
Mortgage	*2,127*	*20.54%*
Travel account	***510***	***4.93%***
Electricity	*153*	*1.48%*
Phone	*0*	*0.00%*
Internet	*97*	*0.94%*
Tv	*34*	*0.33%*
Transportation (public)	*211*	*2.04%*
Home insurance	*13*	*0.13%*
Student loan payments	*255*	*2.46%*
Gym membership	*153*	*1.48%*
Sum	*4,150*	*40.07%*
Other expenses		
Food and groceries	*851*	*8.21%*
Sum	*851*	*8.21%*
The outcome		
Fixed expenses	*4,150*	*40.07%*
Other expenses	*851*	*8.21%*
Long term savings	*1,276*	*12.32%*
Total personal savings	*4,645*	*19.70%*
Total personal spending	*4,645*	*19.70%*

Adjusted budget.

This wasn’t so hard, was it? Now you have a personal finance system setup to support your lifestyle and your goals. It will eliminate anxiety about affording to live and friction due to economy within a household. It’s also the foundation for making it possible to live on passive income and boosting the overall personal economy, and that’s what we’ll take a look at next.

Summary

1. **Define** how you want to live your life, setting the boundaries and parameters that describe this.
2. **Gather information** on the parameters that define how you want to live and create budget posts for these.
3. **Explore** different possible scenarios for the complete budget, trying out different combinations of the budget posts. Maybe it makes more sense to skip a higher prioritized choice to allow for multiple, less resource intensive lower prioritized choices?
4. When a budget is decided and has been set, **implement** it as a system with as much automation as possible and all accounts in place to separate funds dedicated to different purposes.
5. **Regularly review and revise** the budget with all stakeholders.


“When it’s possible to cover our chosen budget with passive income, we have Flipped”

The passive income machine

The overall goal of The Flip is to generate passive cash flow that will support a chosen lifestyle and eliminate any money-induced stress. In the personal finance and budgeting section a set of methods was presented to define a desired lifestyle, transform this in into a budget and then making sure that it's followed and periodically revised to support changing boundary conditions.

Now, we'll take this to the next level by introducing a method to generate the cash flow needed to support our desired lifestyle. When it's possible to cover our chosen budget with passive income, we have Flipped and are financially independent - it's as easy as that!

There are many possible sources for passive income, some more suitable for some people than other. Buying real estate and renting it out is one way, starting a business and becoming a passive owner is another, but one that has a very low threshold to entry and where you get to share the rewards of other people's hard work is by investing in dividend growth stocks. After a company has started paying out part of its profit as dividends it's usually a very tough call to lower them and a significant signal to the stock market that the current leadership has failed. This makes dividends sticky, and many companies have made a commitment to continually increase them in a sustainable manner. This provides their owners with an ever increasing passive source of income.

Many see the stock market as risky and stay away from it out of fear for losing their money. Caution and skepticism are a good traits for an investor, but staying away from stocks altogether is usually not the best way to accumulate personal wealth. Risks can be managed, both by diversification but most of all by being interested in what the companies you own actually do.

There are ways to screen and diversify the risk of investing in public companies, which we'll use, but the most important thing to remember is that we're not speculating on any value increase in the stocks we buy. The goal for us is to accumulate cash flow from stocks to provide our passive income. For our purposes we look at three dimensions of a stock:

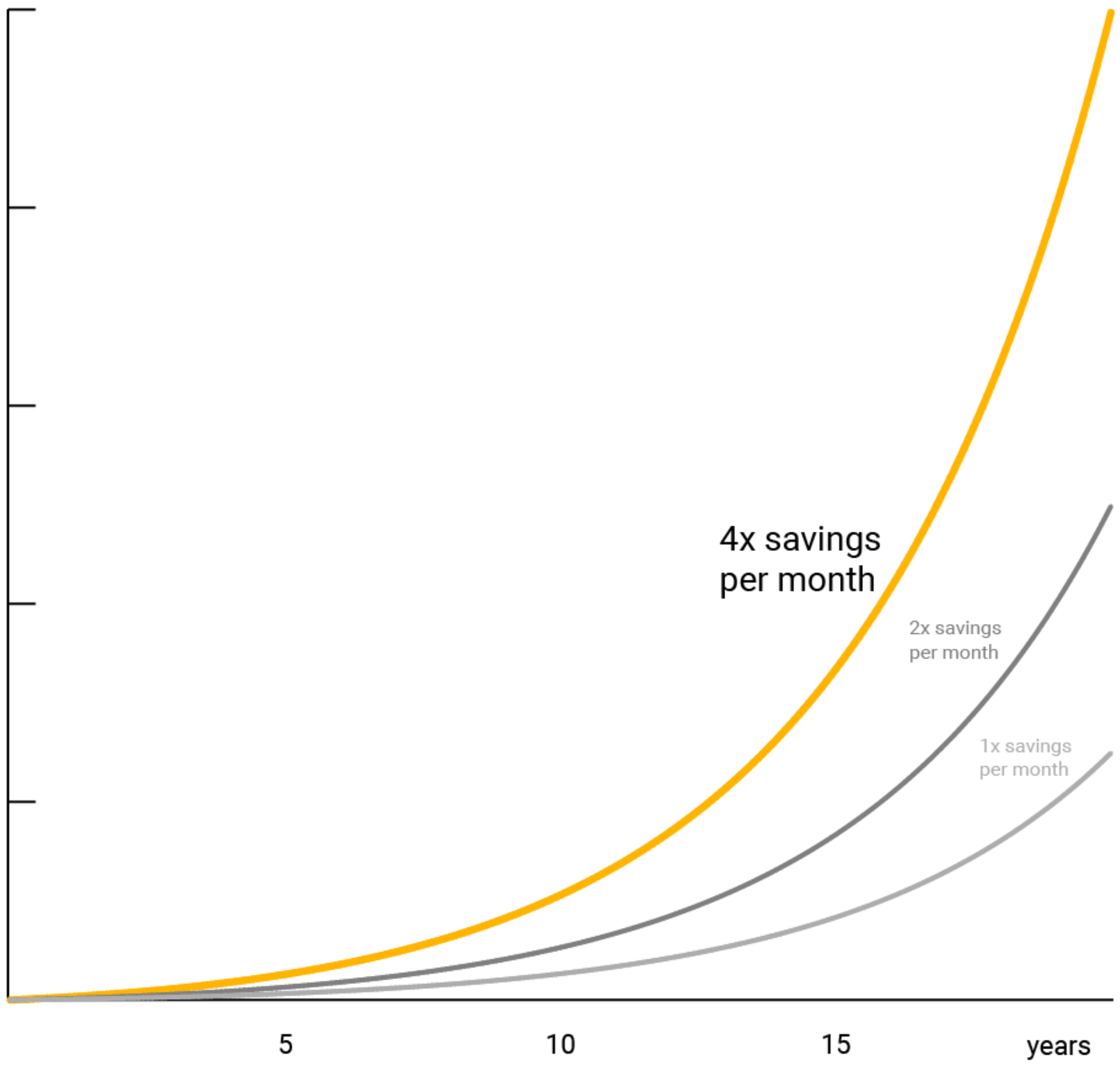
- The **fundamental health** of the company and its ability to keep growing the dividend
- The **value it provides us owners** in the form of a dividend cash flow
- The **current price** of the stock **in relation to the fair value** of the company

Choosing stocks this way is then used in our strategy to build and live off a passive income machine. Every month:

- Save and invest money, along with any dividends received, to build compounding interest over time
- Evaluate and review the portfolio

This, combined with the practice of creating and sticking to a budget, is what'll provide financial independence for us.

Saving more will lead to a bigger dividend income over time, with the first years being most significant



A budget is a plan for your future

Like we saw in the first section of The Flip, making and living after a budget is one of the most basic and fundamental tools to achieve financial success. But after getting a balanced budget catering to your desired way of life, how do you find out how much to save and what's the consequence for the rest of the available funds?

Saving money for investments is not only about setting yourself up for financial independence but also to provide a cash flow buffer and a cushion for any large, unexpected expenses or changes in income. Knowing how big this monthly buffer should be depends to a large degree on how you would like to live in the future. By saving and investing you're taking means from your present self and give to your future self, and with the help of returns and time you'll be handsomely rewarded.

> *"you first have to find how much it costs for you the live the life you want to live"*

To answer the question on how much you should save, you first have to find how much it costs for you the live the life you want to live. When you make that amount from passive sources you're financially independent. Next is to find out when you want this freedom, is it in five years? Ten years? 20 years? Is your present living standard your goal or do you aim towards a more expensive standard of living? Many people who become financially independent do so by drastically reducing their living costs, is this an option?

By knowing the size of the passive income stream and when it's wanted it's possible to build a savings and investment model to predict The Flip, when your financial flexibility at once increases significantly. Time is our friend when building a dividend income stream which means that you don't need to stress if starting from zero, but simply realize that it's going to take a while.

> *"what really matters is money invested and reinvested over time"*

If you need $50,000 per year in present day value for your chosen standard of living, it's probably going to take somewhere from 12-20 years depending on how much you want to set aside each month. In the example shown on the previous page we use $500/month in savings for the 1x line, a 3% average dividend yield, 12% dividend increase per year and a 5% turbo-boost factor from quickly appreciating stocks. This is just a simulation so actual results will vary, but it gives an idea of how the amount of new savings influence the passive income stream down the line.

It obviously helps if you don't have to start from scratch, $10,000 in starting capital will cut about a year from both the $500/month and $1,000/month examples[5]. How much to save as well as the prognosed performance of your portfolio are all interlinked and sets the premises for how aggressive you need to be, both when it comes to saving but also in the investments you choose.

If possible, invest more during the first and second year after starting out and then reduce to the calculated amount, this will cut several years from reaching The Flip. One way of doing this is to reduce the amount that's used to pay off a mortgage to the minimum during the first years of investing and only then start focusing on eliminating debt, if that's also a goal in itself. As you can see, what really matters is money invested and reinvested over time.

"start by calculating how much you want to set aside for your future self"

As time passes the amount you put in will be small compared to the reinvested dividends. At some point it even doesn't make sense to invest more, even if you have the possibility to do so. This might tempt you to cut your monthly savings. But saving is not only about setting yourself up for the future, it's also about mitigating risk for the near future. If you have uncertainty in your employment situation, for example that your employer risks closing down, you work on a contract or you can be fired easily, you need to devote more of your salary to short- and long term saving to act as a cash flow buffer. This way you can live off your short-term buffer, freeze new long-term savings and keep your living standard while looking for a new job.

So when you plan your personal budget and how much to invest each month, start by calculating how much you want to set aside for your future self. Only then do you know how much you really have available to spend on your current self.

Key takeaways

- **Setting a budget** and making sure that available cash flow covers this budget is the foundation of financial success.
- To know **how much to save** you first need to **find out how much a desired lifestyle costs** and when it's wanted, then it's possible to approximate how much to save for it.
- **Time is the key factor** when building a dividend growth portfolio, the overall yield will become very significant over time due to compounding interest.
- **Saving more in the beginning** can be very beneficial and cut several years from the time needed to reach financial independence.

[5] Use the progress tracker and simulator tool to experiment with different scenarios, both on how much to save and the characteristics of the investments such as yield. It's possible to create a stepped scenario with more saved in the beginning by directly entering values in the cells, just save a copy of the tool first.

Dividend growth stock investing

A stock is the certificate of ownership for a share of a company. It can be publicly traded, in which case the stock is listed on a stock exchange, or be for a privately held company. Being listed on one of the major stock exchanges means that there are lots of rules that the company has to adhere to, especially when it comes to how results and other information is reported to the public. But it also opens up opportunities, especially raising cash and using company minted stock as a way of compensation for employees. Getting employees invested in the company they work for is usually a good thing, but it also makes it possible for outsiders to be owners of something they support, even if they don't work for the company. Making it easy to convert this ownership into cash, and the other way around, is one of the main reasons for being publicly listed.

The ultimate purpose for most companies, especially publicly listed ones, is to reward its owners. One way of doing so is to pay a dividend to its shareholders. Shares in companies which have made a commitment to increase their dividend year after year are called dividend growth stocks. These are one of the best and most accessible investment types available for creating a passive income source for financial independence. These companies have chosen to reward their owners rather than to to maximize the stock price, which only rewards those who choose to sell their share of the company

> *"stable, profitable companies that reward its shareholders is the key to building passive income portfolio"*

Being a stock owner means that you own part of the company. Indirectly, the employees are working for you, stressing and agonizing about what they can do to meet the targets set by the company leadership who in turn answer to you and the rest of the owners. Being interested in the business, reading up on the market and being aligned with the rest of the owners is one of the fundamental criteria that needs to be fulfilled before investing in a company.

Dividend Aristocrats

A large number of companies have an outspoken goal of increasing their dividends every year, those who have succeeded in doing so for more than 25 years are called Dividend Aristocrats or sometimes Dividend Champions. These companies have demonstrated financial stability, growth over time and commitment towards shareholders during multiple cycles of market ups and downs. Many of these companies have streaks of increasing dividends that lasts 40 years or more, showing a resilience against financial turmoil, IT-busts, housing bubbles, global political squabbles as well as the ability to evolve their business with the times.

Investing in and creating a portfolio of these companies is a great way to build an ever growing passive income stream. The most important thing to remember is that it's not really the value increase of the stocks that's interesting when owning these. The goal with dividend growth investing is to accumulate cash flow from stocks, in our case for financial independence. As long as the company continues to grow its earnings it will also be possible for them to increase the dividend - and this is where it's important to pay attention as a stock owner, to make sure that the company will continue to perform in the future as it has done in the past.

> *"a fund is an easy way to invest in stocks but might not be the optimal way for every individual"*

Fortunately there are quite a few of these companies, making it possible to always have a selection available when it's time to invest. A number of the U.S. based dividend growth companies can be found in two stock indices: the S&P 500 Dividend Aristocrats[6] and the S&P High Yield Dividend Aristocrats[7]. These indices track companies in the S&P 500 that have increased their dividend for more than 25 years and companies in the S&P 1500 with more than 20 years of dividend increases, giving a quick overview over companies that are interesting for a dividend growth stock portfolio. There are mutual funds available that mirrors these indices, giving a very easy way of investing in dividend growth stocks.

While a fund is an easy way to invest in stocks it might not be the optimal way for every individual. Buying company stock directly puts the investor in the driver's seat and makes it possible to tune the investment portfolio according to different parameters. For example, you might want to stay out of certain stocks or markets and a broad index fund won't let you do that.

Investing in dividend growth stocks

Before investing in any stock proper due diligence on the current situation of the company and future prospects needs to be undertaken, understanding the market the company is operating in and whether they have a positive outlook. Listening in on or reading the transcripts from the quarterly earnings calls is a good way to hear how the company leadership look at the situation as well as how both positive and critical analysts look at the company and the existing opportunities as well as challenges ahead of them.

We must also ask ourselves if we can stand behind the company and the products or services it produces. Once we've accepted what they do, or are perhaps even enthusiastic

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[6] The S&P 500 Dividend Aristocrats:
http://us.spindices.com/indices/strategy/sp-500-dividend-aristocrats
[7] The S&P High Yield Dividend Aristocrats:
http://us.spindices.com/indices/strategy/sp-high-yield-dividend-aristocrats-index

about it, we need to find out if it's a stable enterprise that can continue to grow its profits and an ever increasing dividend.

One way of finding out if it's a suitable stock for a passive income investment portfolio is to evaluate it based on:

- Fundamentals of the company, like payout ratio and years of dividend increases
- Dividend returns, what you get for owning the stock
- Fair value, the price in relation to the value per share

When all of these are within the thresholds we've set for a company, it's a good fit for our portfolio.

The fundamentals

Our main reason to own a company is to receive dividends - and for the company to be able to distribute profits it must be profitable, now and in the future. There are a number of financial metrics that can help us evaluate the current and expected future performance of the company. We call these metrics *fundamentals* since they're the very foundation of a healthy and thriving company.

For a company to keep increasing its dividends it needs to generate more earnings per share and the most sustainable way to do this is by expanding the business and increasing earnings. So find out if the company growing or does it have a unique position to gain market share in a static or contracting market? Can it expand by moving into new markets? Are there threats to the overall market that can jeopardize the very existence of the company?

There are lots of examples of companies that have succeeded in changing with the times, like IBM, and other companies which haven't, like Kodak. We have to use our judgement in finding out if the company is of the type that can adapt decade after decade.

The longer dividend growth streak a company has, with suitable future outlook, the more certain you can be that you'll receive your yearly income increase, without having to do anything at all also in the future. The Dividend Aristocrats all have more than 25 years of dividend increases, a very good benchmark showing the commitment from the majority owners and the Board over a long period of time.

> *"A low payout ratio means there's room to distribute dividends and even increase them even if it's a bad year"*

There are also companies with shorter streaks that are interesting. For example, in 2016 Apple has one of the biggest cash piles of any entity on earth and a business with an unparalleled sustained operating cash flow making them interesting even after only couple of years of dividend payouts.

For a company that distributes some of its profits to owners the amount of money distributed in relation to earnings is called the payout ratio. A low payout ratio means there's room to distribute dividends and even increase them even if it's a bad year. Just like living well below one's means, it means that the company has financial flexibility and can adapt; put extra resources into R&D or its sales organization, perform strategic acquisitions or some other action if needed.

The dividend is usually declared in dollars per share and for most companies listed in the U.S. the dividend is distributed every quarter. To be able to sustain increasing dividends per share a company needs to also increase its earnings per share (EPS) or the payout ratio will get worse until the company pays out all, or more, than its earnings to its stockholders. That's not a sustainable situation and unless the company can take action to increase its earnings and weather out the storm, they will eventually have to cut their dividends.

Another option to increase the earnings per share is to reduce the number of stocks in circulation while keeping the amount distributed for dividends at the same level. Stock buybacks, as they're called, can be a good way of using earnings in combination with a dividend. The opposite - diluting the stock - is a bad move that will spread the earnings over more shares and also increase the cost of the dividends without actually increasing them for current owners. This is a clear warning sign for dividend growth stocks.

"Without enough trading activity it'll be hard to sell the stock if ever needed"

Although not a significant indicator in itself, the overall market capitalization and resulting activity of the stock on the exchanges is also important. Without enough trading activity it'll be hard to sell the stock if ever needed and the price will also fluctuate more. A certain lower threshold is good to have, even if a too big company size itself is almost a bane that will make it harder for the company to continue growing at the same pace as it has done historically. Many mutual funds uses a combination of market cap and daily trading volume as one of the criteria for inclusion even if it's based on an index, just to ensure enough liquidity.

Key points when evaluating the fundamentals of a company:

- When **evaluating** a company for investment, **start with the core business and the values** of the company - can you stand behind it?
- **Look at the future prospects of the company**, where's their main market heading and have they shown that they can **adapt and evolve** with the times?
- The **years of dividend increases**, **payout ratio**, **earnings per share growth** and **market cap** provide good **indicators** for the fundamental health of the company.

The dividend

The dividend is the value we get from owning a stock and the reason for owning it in a passive income stock portfolio. There are two main components to look at, the dividend compared to price when we buy it (yield) and the expected future dividend growth.

Since the yield will change with the price of the stock it's possible to get vastly different yield on invested capital for the same company depending on whether the price was high or low when the stock was bought - with the actual dividend per stock remaining at the same level. As stocks come in and out of fashion, which can happen several times per year, opportunities will arise to buy solid companies at a good price and with a stronger dividend than usual. However, a yield for a stock that's way out of proportion and much higher than its peers is usually a sign that the investment market is weary of the stock due to looming problems or uncertainty for future prospects.

> *"Most salaried workers would be very happy with a 10% raise year after year, and so should we be if we can find companies that can provide this"*

With the yield being the driver for current value from owning the stock, the dividend growth is the driver for future returns. Most salaried workers would be very happy with a 10% raise year after year, and so should we be if we can find companies that can provide this. Many companies have stints of higher increases than so, and to be able to capture these leads to very good yields on the original investment.

It's the combination of yield and dividend growth that provide powerful returns for the investor, so both of these indicators are important. Also important to remember is that as long as the original investment is still tied up in the stock it's the yield on cost that's important and not the yield on price. If the price of the stock goes up or down has no impact for the owner.

Key points when evaluating the dividend returns of a company:

- The **dividend is the main reason** why we have stocks in a passive income portfolio.
- The **dividend** and expected **future dividend growth** are the most important **indicators** for the total dividend returns the stock will provide.

The fair value

No matter how great the company is, a stock won't be a good buy if the price is too high. The yield will be relatively low compared to what it could be and upwards room for price increase is reduced as well. Many companies has share prices that fluctuate more than their average yearly dividend increases, so buying at the wrong time basically sets you back one year of dividend growth.

So how do we know when we have a good price? While one cornerstone of modern financial theory, the efficient-market hypothesis, states that the stock price always reflect all relevant information and thus reflects the fair value for a share, this is simply not true. The market is driven by a media-fueled herd mentality just as much as sober evaluation of the facts by individual investors. This leads to opportunities when the market overreacts to news which has no impact on the underlying fundamentals.

One such example was the Brexit vote in Great Britain in 2016, when the news that the British people had voted to leave the European Union shook the world's stock exchanges over the next week. However, once reality had settled in, that there's no immediate danger and that the world as we know it won't end right there and then, the markets rebounded to even higher levels.

Not all situations has to be that dramatic and sometimes a stock simply loses favor with investors. Maybe there's a more exciting competitor or there's a lack of news that filters through, this will lead to a reduced price simply from the fact that fewer people are interested in buying the stock. This is market economics at work, where the price is what the market is willing to pay. This has nothing to do with the underlying fair value of the stock though.

"The historic mean P/E ratio, from the 1870's to 2016, has been 15.6"

What the stock should cost, given the earnings and assuming information on the future growth, can quite easily be approximated. The most basic way is to look at the price to earnings ratio (P/E ratio). The historic mean P/E ratio, from the 1870's to 2016, has been 15.6. What this means is that we're paying on average 15.6 times the profit when buying a stock. What this doesn't take into account is the growth rate of the company, for a company that grows its earnings per share faster than the average there's a good case to be made that it should also command a premium valuation compared to its peers.

For a slow growing stock, one with a growth of less than 5% on an annual basis, Benjamin Graham and David Dodd presented a formula[8] to calculate the intrinsic value in *The Intelligent Investor*. The formula still stands and works fine for utilities and other companies with a slow growth rate.

*Fair value (GDF) = EPS * (8.5 + 2*G)*

Where EPS is earnings per share for the last 12 months and G is the expected long term growth rate (seven to ten years) in percentage points. 8.5 is a base constant for the P/E of a no-growth company.

[8] Benjamin Graham Formula: https://en.wikipedia.org/wiki/Benjamin_Graham_formula

For fast growing companies, where the growth rate is above 15% annually, a formula using the price to earnings growth ratio[9] (PEG) is a good approximation.

*Fair value (PEG) = EPS * G*

Where EPS is earnings per share for the last 12 months and G is the expected long term growth rate (five years) in percentage points.

If the estimated future growth falls between five and 15 percentage points, which is often the case, the two formulas can be used in combination by subtracting the PEG result from the fair value calculated by the GDF formula.

*Fair value (GDF-PEG) = EPS * (8.5 + 2*G) - EPS * G*

With these three formulas the tricky bit is finding out the expected future growth. For most companies listed on the big exchanges analysts publish 12 month and five year expected growth numbers. These are a good start but needs to be taken skeptically. Evaluate if these seem current, plausible and if there are any other circumstances that might affect the future growth prospects. Perhaps calculate a range with a certain margin of error.

Stocks will usually follow these approximations of value and then deviate from it, going in and out from being priced at the fair value. Some stocks always command a premium compared to the formulas, especially the blue chip dividend growth aristocrats.

Whenever the price is below this value the stock is effectively on sale and a potentially good buy. When it's above the fair value it's momentarily overvalued. Most stocks snaps in and out of alignment with the fair value curve so a powerful technique to get strong returns is to buy stocks on rebate and then sell them once they've re-aligned themselves with the fair value. The returns are usually not huge but can materialize quite fast which creates strong profits on a yearly basis. Of course, sometimes the stocks continue down and sometimes they're stuck in an undervalued position for years at a time. Nothing to do then but to reap the benefits of the dividend, not too bad that either.

Key points when evaluating the price and fair value of a company:

- **Price** of a stock is **only relevant** when looking at it **compared to the fair value** of the company.
- Find or **calculate the fair value** of a company **before investing in it**, making sure you're not overpaying for the stock.
- Even a **low growth stock** can provide **fast gains in value** when the price snap back to alignment **after** a period of **being undervalued**.

For some people investing is like a black art that they shy away from, fearing that the risk to lose their money is too big. While not without risk in the individual investments we do, to actually invest and own companies and other assets has been the most successful way to

[9] PEG ratio: https://en.wikipedia.org/wiki/PEG_ratio

become and stay rich over many centuries. With the markets now available and open across the globe, investing has never been easier or more accessible. It allows anyone to earn money with money, something that for a long time was reserved to nobility.

The fundamental rules have remained the same though; know what you invest in, how much you should be willing to pay and what your return from owning the asset is. If you do this the risk will be in proportion to your reward and you'll have an army of other people working for your financial independence.

Key takeaways

- **Stocks** in companies that have committed to **giving dividends to their owners**, and continually **raising** them, are very well suited for building a **passive income machine**.
- **Mutual funds are an easy way** of investing in groups of companies, but **flexibility and precision is lost** compared to investing in **individual stocks**.
- **Stocks have a low threshold to ownership** compared to other forms of investment, providing the opportunity to build a stock portfolio serving the needs of the investor.
- Evaluate stocks based on the **fundamentals of the business**, the **value they provide** you as an owner and the **price compared to fair value**.

Building a diversified stock portfolio

Our overall goal is to build a stock portfolio that will continue to generate and grow its cash flow in perpetuity, through good and bad economic times. Just like a sports team coach that figures out how to assemble a team of individuals that will be greater than just a collection of players, we will build our portfolio of stocks that complement each other, are resilient to market conditions and achieve our overall goals.

No investment is safe and a higher potential payoff usually carries a higher risk. That's why so called "junk bonds" pay much higher interest than long term government issued bonds, the chance that they go worthless is simply significantly higher (not that government bonds are safe either). One of the easiest ways to mitigate this risk is to diversify investments to cover different types of investments, markets, sectors and companies. For our stock portfolio we need to make sure it covers different sectors and global markets, and once we've reached our passive income goal a part of the income can be used to diversify to other types of investments - even if they're not as efficient or has the low threshold to investing that stocks do there are some good reasons for diversifying outside the stock market as well.

The easiest way to diversify stocks is to invest in a mutual fund covering a broad index such as the S&P 500 Dividend Aristocrats. Even though the financial sector is slightly overweight in this index - due to a proportionally large amount of financial companies with an established dividend growth strategy - this will spread the investment across companies, sectors and worldwide markets through the global operations of many of these companies. This will take all the work out of weighting and balancing the portfolio and managing the more than one hundred stock positions in the case of the Dividend Aristocrats index in 2016.

"following a broad index doesn't provide the opportunity to beat it"

What following a broad index doesn't provide is the opportunity to beat it. Such indices are "dumb" in that they also include bad companies with bleak outlooks or companies with low dividend yields. By picking stocks individually - using the Dividend Aristocrats index or a collection of dividend growth stocks such as David Fish's *Dividend Challengers, Contenders and Champions*[10] as a first screener - we can choose which stocks to invest in to beat the index handsomely while providing most of the resilience through stock diversification.

Benjamin Graham wrote in *The Intelligent Investor* that a stock portfolio can be adequately diversified with 10-30 different companies with the implication that more stocks than this doesn't reduce the risk in a linear way. Most research that has been made on diversification concerns the value of the portfolio but concludes that most of the risk can be mitigated

[10] David Fish's Dividend Challengers, Contenders and Champions universe: http://www.dripinvesting.org/tools/tools.asp

through a small subset of stocks.[11] There's even a term coined by Peter Lynch in his excellent book *One Up on Wall Street*, "diworsification", that implies that a company that diversifies too broadly will be spread too thin, loose focus and not be able to give sufficient attention to each area. The same is true for a stock portfolio, there's no use buying stocks in a worse but otherwise comparable company that one that you already own.

If one of 20 companies in a dividend stock portfolio eliminates their dividend the result is a five percent reduction of overall yield, certainly not good but not a catastrophe either. Making sure that no single type of company or sector is overexposed - both in value as well as generated dividend - and that the companies have a sufficiently global customer base in aggregate is the key for a resilient passive cash flow from dividend stocks.

"performance goals and some basic risk criteria must be set"

Before suitable stocks for the portfolio can be found the performance goals and some basic risk criteria must be set. This includes the expected dividend and dividend growth, which was used when finding out how much to save each month, and how many years of dividend increases a company has to have before qualifying. These need to be realistic, setting the limit at two versus three percent in yield opens up to investing in many more quality companies, but has a significant impact on when The Flip and financial independence is reached.

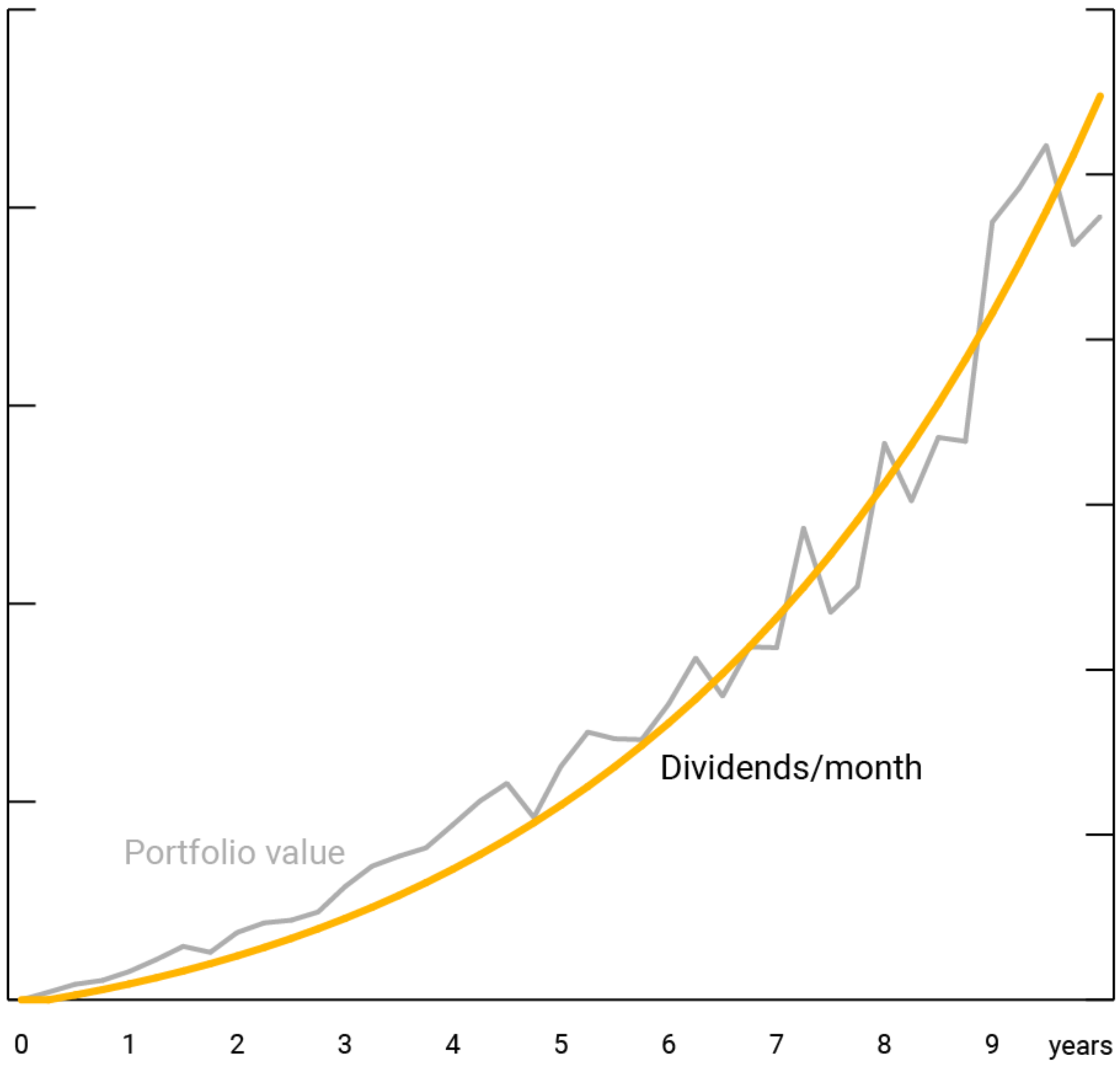
The Flip way of finding out which company to invest in, usually once per month, is to analyze and score stocks in the three dimensions presented in the *Dividend growth stock investing* chapter to get a top list[12]. Then qualitative analysis - reading up on the company, their market and how well we think they'll do in the future - is used to pick the winner. This can very well be a new position in a company we already own or a new initiation, keeping in mind to diversify sufficiently.

Key takeaways

- **Build a diversified stock portfolio with at 10-30 companies**, making sure that no sector is over exposed.
- **Set the overall performance goals** and use these as an input when **screening and choosing stocks** to invest in.
- **Choose stocks** based on their **fundamentals**, the **value they provide** in the form of dividends and the current **price compared to fair value**.

[11] Investopedia, The Illusion of diversification: http://www.investopedia.com/articles/stocks/11/illusion-of-diversification.asp
[12] The *Blueprint to creating the passive income machine* chapter goes through this step by step.

No need to stress is portfolio value fluctuates since it's not directly proportional to dividend income



The total value of your stock portfolio is irrelevant

... and why you shouldn't stress out if it drops

As an investor we like to check how our portfolio is doing, either by just looking at the value progress or by comparing the it to some index. We smile when our rate of return is double that of the S&P 500 index, and our mood is soured for the day when a month's salary is "lost" on a bad day at the markets. This is counterproductive and will only lead to bad investment choices and a stressed stomach.

We invest to get passive income, not a bunch of numbers that look cool on a bank statement. It's the actual, generated cash that'll provide a base for further investments or an income that can replace a day job, not the momentary value of the assets.

When buying dividend growth stocks you get two things, a stock with some value and a commitment from the company to pay you, an owner of the company, a dividend. When buying the stock the price and dividend is linked in the form of the yield. But, as soon as you've bought the stock the price becomes irrelevant. The stock is now doing what you bought it for, generating cash dividends, and the price is only relevant if you're going to sell the stock. Which you probably aren't, because why did you buy it in the first place if that's the case?

> *“the stock will rise and fall in value, but this has exactly nothing to do with how much dividends you're receiving”*

Over time the stock will rise and fall in value, but this has exactly nothing to do with the amount of dividends you're receiving. The company will probably raise the dividend over time which means that the value given to you as an owner - the dividends - will only further deviate from the yield you got when you bought the stock and the yield new owners will get from buying the stock.

Sometimes the price of the stock drops and then it's a mental challenge to see the value of that investment drop. But you need to understand that when you bought the stock it was the right decision. The only time you are allowed to regret a buy, and when you also must do something about it, is when you didn't do your due diligence and bought a company with bad fundamentals that's going to cut its dividend.

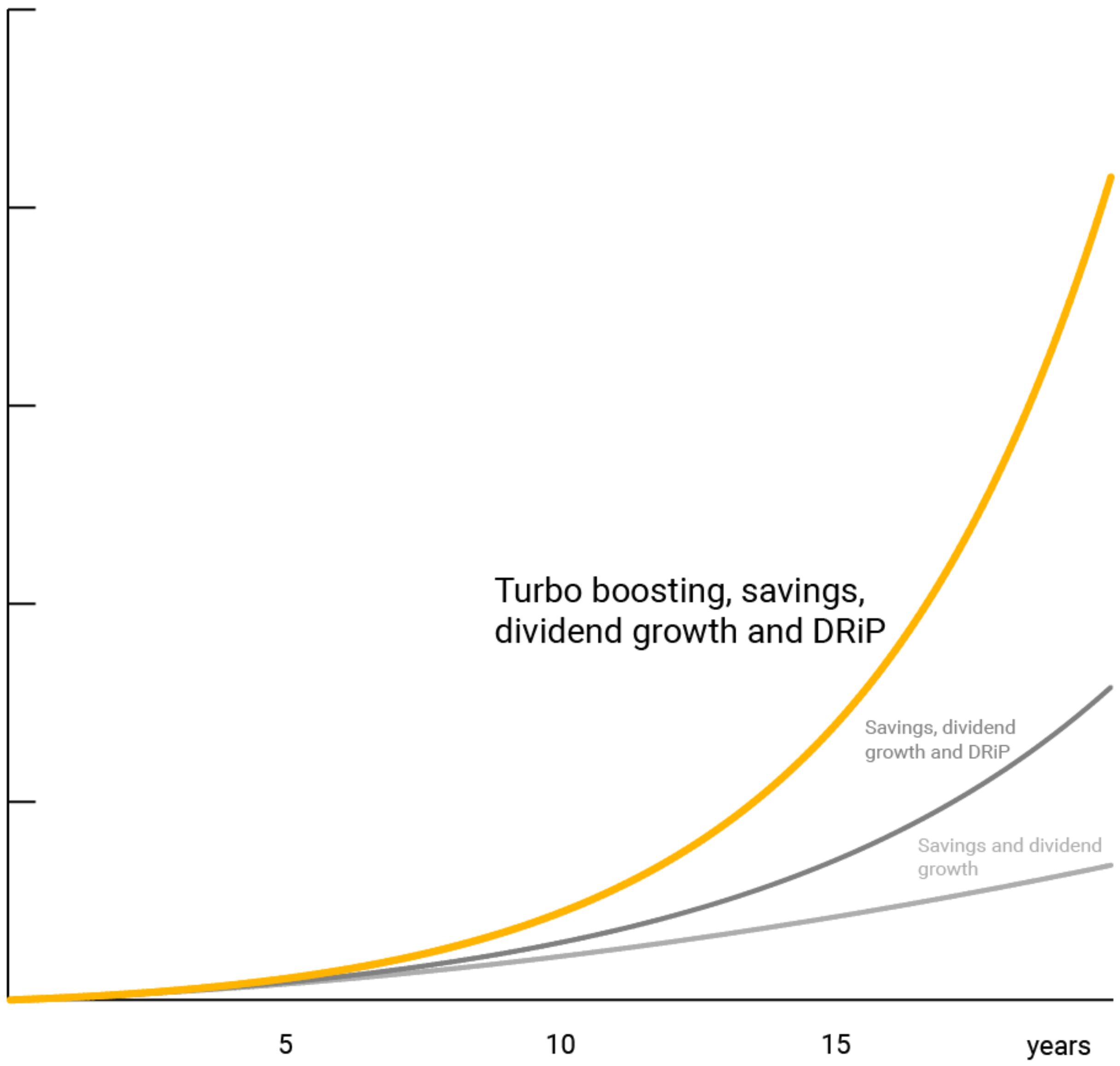
Any other time the share price falls gives you another opportunity to invest and get even better value as an owner. The beauty of dividend reinvestment (and continuous savings) is that you regularly get new funds for additional stock investments. Buying quality companies that are out of favor is what gives the best value for you as an investor. Buying when the price is low and continue to fall will lead to some stocks falling further in price after you bought them, but this is something good that will let you make the very best investments. When the opposite happens, a stock quickly rises in price after you've bought it, you have two options. Just sit back and let it do what it's supposed to do. Or, if it rises very fast in value and becomes overvalued, you can sell it and use the profit to turbo-boost your reinvestment strategy. This is explained more in the next chapter on compounding interest.

The point is that as long as the fundamentals of a company is good and it continues to distribute continuously increasing dividends it's doing exactly what you bought it for, no matter which price the market is willing to pay at a given time. Realize that the dividend rate over time is the important metric, not the paper-value of your investment portfolio, and you will sleep a lot better at night and make the right investment decisions.

Key takeaways

- The **total value** of a passive income stock portfolio **has nothing to do** with the actual **value generated** for the owner.
- **Price** is important **when buying** a stock, but **not when owning** it.
- **Peace of mind** is generated by knowing that the **stock portfolio is doing what it's supposed to do** - generating dividends - not by checking its value.

Multiple sources of dividend growth generates exponential returns through compounding interest



Compounding interest and exponential returns

Exponential returns are sweet. Having just increasing returns is good, as long as they're bigger than inflation we'll stay ahead of the curve and keep or slightly increase our relative purchasing power. But once we can find a way to get exponential returns it's possible to transform relatively modest investments into huge returns with the help of consistency and time.

In our strategy we're mainly interested in getting as much dividend cash flow as possible. Even after The Flip, when cash flow from the dividend stocks are redirected from reinvestments, we'll still see exponential growth to the dividends which will continue to increase available cash flow - just not at the same rate as when everything was reinvested.

Any time a consistent, fixed percentage increase of the underlying value is realized over time we get an exponential increase. It might be so small it looks like a straight line, but with enough time it will show its characteristic increasing slope. For example, the normal inflation rate has been between 1.0-4.0% on a yearly basis for most of the history since the middle ages. Nowadays many national banks have a target inflation rate around 2.0%. This is almost imperceptible on a yearly basis, but over time has led to big changes in the value of money.

> *"a collection of stocks giving a 12% dividend growth year after year will double the dividend every five years"*

As in investor, we need to make sure that we stay ahead of the expected future inflation, otherwise we'll lose relative purchasing power. Better yet is to make sure that we beat it and the easiest way to do this is to invest in companies with good future prospects that can grow faster than the economy in large.

For a collection of stocks giving a 12% dividend growth year after year - something usually not impossible to find - the total dividend will double every five years, giving an increase in cash flow that not only beats the inflation by a healthy amount but also the salary development of most careers. Many utilities and other companies in non-growth sectors have long streaks of dividend growth, but with increases around 4-6% they will not give the same kind of increases that faster growing companies can give. Finding stocks that can give this is the first step to getting an exponential increase in cash flow over time.

To take our exponential returns to the next level we use something called compounding interest. By reinvesting the dividends we receive we not only get the dividend growth on the originally invested capital but also dividends and dividend growth on the dividends themselves. Getting this additional boost will add to the exponential factor. Since we're initially looking at small returns relative to the amounts invested, usually 2-5% per year for a dividend growth stock, the impact will not be that evident right away. But over time this will provide a significant contribution to the overall returns and size of the cash flow.

Some companies offer their owners to receive additional stock instead of cash payouts during the dividend payouts. This is usually called a Dividend Reinvestment Plan (DRiP) but the meaning of the term has widened to refer to any investor reinvesting their dividends as a DRIP investor. If you have the choice, always receive cash distributions since these can be used directly as income or to buy the most suitable stock at the moment, which doesn't have to be the distributing stock. This is also a crucial contributor for exponential returns over time.

"turbo-boost the capital base of our portfolio by buying stocks that are cheap"

There's one additional way to increase the dividend returns even more aggressively. We can use the technique of buying undervalued stocks and then selling them once they've re-aligned to their fair value, as described in the section on *The fair value* in the *Dividend growth stock investing* chapter. This will increase the amount of capital we have available to buy dividend generating stocks. A stock that rises 10% in value in a six week period is roughly equal to three years' worth of dividends from a stock that gives 3% in yield. By selling this stock and reinvesting all proceeds in another dividend growth we have effectively gotten three years of compounding returns from dividend reinvestment in six weeks. If there are stock positions which appreciate at a pace of 60% or more on a yearly basis, they have increased more than 10% in value and there are other equally good dividend growth stock investment opportunities, then this is a good tactic to use.

But, this is something that should be used with caution. It can lead to a search for quick profits rather than the focus on the ultimate goal of dividend returns that cover our living expenses. If a dividend stock is sold and a no other stock can be found, or a lesser stock with lower combined yield and expected dividend growth is bought instead, we're missing out on compounding interest which negates this move in the first place. Important to understand is that as long we've bought a stock and it continue to give us growing dividends it's doing exactly what we bought it for.

Key takeaways

- Setting up an investment strategy for **exponential growth is a very powerful tool** to increase future returns.
- **Compounding interest** through **reinvesting** the received dividends and the **dividend growth** of the stocks provide the base for **exponential dividend returns**, together with the amount invested every month.
- **Quickly appreciating investments** can also be sold to increase the overall dividend payout by **turbo-boosting the total investment capital**.

Being a passive-active investor

The best things for us would be to simply buy some stocks and then forget about them, letting them provide us with dividends in perpetuity and simply add new stock purchases on a regular basis. Unfortunately, things don't always go smooth and we need to be active enough to realize if one of our holdings is starting to deteriorate.

Even companies with decades of solid dividends can experience hard times or changing markets that challenge the very existence of the company. GM and Kodak were two examples in the early 2000's[13], companies that failed to change with their markets and subsequently collapsed and became bankrupt. Needless to say, they also cut their dividend during the turbulent times.

"read through the quarterly earnings call transcripts"

To avoid situations like this it's important to continue to monitor a company after buying shares in it. A good opportunity is to read through the quarterly earnings call transcripts as well as some stock analysts reports while other stocks are being considered for buying. The default action should be to just let the stocks do what they were bought to do, being a passive investor, but if there's some real trouble in the company it's better to take decisive action and cut losses early than hoping that everything will be fine.

Create a routine of doing this regularly. If you invest money every month it can be a good preparation to the investment decision, perhaps as preparation to a monthly household review where both the economy as well as other routines are gone through and next month is planned. Try to avoid checking the value of your investment when you're outside of these reviews, it'll only make you stress about different aspects of your investments or lead you to take rash decisions.

"rules will make it clear when it's needed to take action"

It's good to define some rules, for example that once a stock has cut its dividend or it has a negative expected five year growth it's time to sell it and use the funds to buy some other stocks with better future prospects. These rules will make it clear when it's needed to take action. This is why it's important to care about the companies we invest in, we need the interest to keep up to date with what they're doing.

[13] Dividend.com, The Biggest Dividend Stock Collapses of All Time: http://www.dividend.com/dividend-education/the-biggest-dividend-stock-disasters-of-all-time/

Once you've reached your passive income goal it's time to start reaping the benefits of this money making machine. Through the dividend growth the passive income will still increase on a yearly basis, but it's also a good practice to leave some of the dividend for further reinvestments and to provide a safety buffer in case there's an increase in living expenses or a company cuts their dividend. Continue to monitor the portfolio as before and sell positions that have appreciated quickly to reinvest in a stock that gives even better returns.

Key takeaways

- **Follow the companies** you've invested in and **not the investment itself**.
- Create a **regular routine** for keeping yourself **updated on your investments**, choose **new investments** and take any **actions on your investments**.
- **Create a set of rules** for when to **exit an investment**, either for good behavior (appreciating stock price) or bad behavior (reduced dividends, negative future outlook, etc.).

Blueprint to creating the passive income machine

Consistency and a clear strategy is the key to successful investing for building the passive income machine. To ensure success and that we keep to our chosen path for financial independence we'll form a habit to invest and review the stock portfolio once per month. This is triggered by the arrival of new funds in the investment account. Already waiting in the investment account will be dividends paid since last month's investment cycle, these will also be used.

Dividend growth stocks is the preferred investment type since we can exploit the markets tendencies to price things wrong and tailor the stock purchases to our portfolio needs. But, if it seems too cumbersome to search, screen and pick stocks it's also possible to use any other type of investment that can provide the same kind of returns; it could be real estate, land or broader exchange traded funds (ETF) following one of the dividend growth indices. The ETF's usually won't give the same level of yield and dividend growth, but they are very well diversified[14]. Of course, just like any investment the index, the company providing the ETF and the fund itself needs to be scrutinized before investing.

Once you've reached your desired expense level in passive income you have Flipped and are financially independent. From now on you can quit your job, if that's what you want, and spend your time doing what you'd like to do rather than what you have to do. With the dividend growth and possible dividend gains from quickly appreciating stocks you'll most likely have a passive income growth every year that's multiples greater than the inflation. Set aside some of the dividend income to further boost future passive income and to provide a cash flow buffer, for example in case one or more companies lower their dividends.

Step 0: Create the habit

Define how and when you want to review your stock portfolio and take investment decisions. After figuring out how much you need to invest to reach your financial goals set up an automatic transfer to the investment account at a specific date each month - at the end of the month is usually a good time. Around this date it's time to sit down and work through the routine. Once it's finished, treat yourself with something you appreciate - it doesn't have to cost anything but should be a nice reward for a job well done.

> *We have written down a number of habits in a shared document. They are all designed to keep us in the lifestyle we want or bring us closer to either our own or our family goals. Our monthly family board meeting basically looks like this:*

[14] A couple of examples are the SPDR S&P Dividend ETF (ticker SDY) which is based on the S&P High Yield Dividend Aristocrats, the ProShares S&P 500 Aristocrats ETF (ticker NOBL) based on the S&P 500 Dividend Aristocrats index and the Vanguard Dividend Appreciation ETF (ticker VIG) which is based on the NASDAQ US Dividend Achievers Select Index with more than ten years of dividend increases. For even more global exposure, the SPDR S&P Global Dividend ETF (ticker WDIV) follows the S&P Global Dividend Aristocrats Index.

Cue: Last Saturday afternoon/evening of every month (Sunday as backup)
Routine:

- *Review and adjustment of weekly operational routines*
- *Review progress to life goals*
- *Walkthrough of actual expenses mapped to budget*
- *Adjustments to family budget*
- *Investment portfolio review*
- *Monthly investment decisions (ideas will be communicated beforehand so that they can be investigated separately and a conclusion reached during the meeting)*
- *Document monthly investment status in excel-sheet*
- *Travel, activities and home improvement planning for the month*

Reward: A really nice bottle of wine with a suitable dinner

We also have other weekly, operational routines designed for the things we want to make sure we actually do, such as working out, keeping our home tidy and other activities.

Step 1: Review the portfolio

The first step of the monthly investment routine is to find out the total value and dividends per stock in the portfolio. Has anything happened that makes a particular stock or sector overrepresented? While building a portfolio it's not uncommon to have single stocks represent a bigger share than ideal, but once there are more than ten stocks in the portfolio no single one should represent more than 15% of the value or the dividends to limit exposure in case something unexpected happens. Ideally, no single stock should constitute more than 7.5% of the total portfolio and a sector no more than 25%.

Through our entry criteria no type of stock should ever become overweight, but if it happens a plan should be devised for how to rectify this over the coming months. Selling something solely for the purpose of rebalancing should only be a last resort.

Find out if there are any new quarterly earnings calls from the companies in the portfolio[15] and read through these. Keeping up to date with the companies and how they're doing is essential. Look for signs that a stock is about to cut its dividend. A Dividend Aristocrat cutting its dividend is a major sign for trouble and will usually lead to all sorts of panic for the stock, so it's better to be slightly defensive than waiting until the dividend cut is a fact.

Are there any stocks that have appreciated quickly? A stock position that has appreciated at least 10% with over a 60% yearly rate is a candidate to sell for a turbo-boost to the portfolio, if there are any suitable stock with equal or better dividend prospects to choose instead.

Keep track of each trade as its own "stock position", the circumstances such as price and yield as well as point in time it was bought is just as important as to which stock it is. The decisions we do are not averages, as a result it's only possible to learn from previous investments by looking at the specifics of those decisions, not the average acquisition price or other statistics. Selling a position of 100 stocks that has risen 12% in one month can be a very good trade for turbo-boosting the portfolio, but for 200 shares where we have owned

[15] A good resource for earnings call transcripts (and other news and analysis from various sources) is the website Seeking Alpha: http://seekingalpha.com/

100 for one month and 100 for two years is not the same thing. Tracking each stock position as its own entity lets us distinguish this.

> *As part of our monthly routine, I go through our list of investments (the "2. Investment Portfolio" tab of the Investing.xlsx tool). For each company, I use Seeking Alpha, Google Finance and David Fish's list of dividend achievers to find recent news, upcoming events and dividend status updates. If there's been a recent quarterly earnings call, I read through the transcript to get the state of the business and hear the leadership's response to challenges in the market. If the long term earnings growth seems limited or negative it can be a signal that it's time to exit the company in a controlled fashion even if the dividend is being paid out for the time being.*
>
> *The dividend is also usually released together with the quarterly earnings. I find out when the last dividend increase was and whether they are due for a raise or not. If they freeze the dividend when it's due for an increase or reduce it it's a clear warning sign for the stock which could quickly lead to further dividend reductions as well as a price collapse, so when that happens I usually move quite quickly to reduce our exposure to that stock to limit any losses.*
>
> *Based on the sectors for the different investments, I make sure that no sector or stock is overrepresented in dividend and total value. If they are I make a plan for how to eventually get the portfolio into balance without having to sell anything just for this purpose.*
>
> *I finish by screening for stocks to sell for the turbo-boost effect. The turbo-boost effect is one of the most powerful to make the dividend machine grow quicker than the market as a whole, but trading to much leads puts a lot of focus on money and the investments when that is exactly what we try to avoid. One of the hardest things to do is to know when to actually sell stocks which have appreciated quickly.*
>
> *The way I usually do it is to set an absolute level that the stock position has to increase in value together with a relative value on a yearly basis. Then I make sure that the price is approaching fair value and that there are other, good investment candidates available. For example, the stock position could have had to appreciate by at least 10% on a 60% yearly basis (that's two months) with a fair value above 90%. Also, it there has to be other stock available with a higher yield on cost and/or higher expected future dividend with a similar risk profile so that the net effect is an actual increase in dividend - so unless there are "better" stocks worth buying it's not a good idea to sell.*
>
> *I keep a log of all my trades (they are moved from "2. Investment Portfolio" to "3. Closed Trades" when they are closed) and I regularly go through them, especially once I close a position, to evaluate and refine my strategies and improve upon them.*

Step 2: Screen for stocks

The activity that usually takes the longest is to find and evaluate stock candidates for investment[16]. First, a set of criteria to screen and find stocks that you find worth investing in is needed. We need to assess three dimensions of a stock - the fundamentals, the value from owning it and the price - and find characteristics that allows us to objectively evaluate these. How many years of dividend increases is one such characteristic that needs to be

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[16] With a background as a programmer I've created my own automated tool to screen and evaluate stocks, based on the criteria presented here, which I then manually go through and investigate further. Find out how you can do this as efficiently as possible with the tools you're comfortable with.

decided, for a defensive portfolio a line could be drawn at 25 years but for someone else 10 years might be enough to be evaluated.

Based on the characteristics we delved into in the *Dividend growth stock investing* chapter the following thresholds are starting points that can be adjusted further to suit risk and return profile of your stock portfolio:

Fundamentals:

- Years of dividend increases > 10 years
- Payout ratio < 80%
- Estimated five year earnings growth > 5%
- Market cap > $5 billion

Dividend returns:

- Yield > 2.5%
- Last five year average dividend increase > 6%

Fair value:

- Price < fair value

Free cash flow, debt ratio and average trading volume are some other fundamental characteristics worth looking into.

A good start for stocks to screen are the *S&P 500 Dividend Aristocrats* or *S&P High Yield Dividend Aristocrats* indices. Another option is the *Dividend Champions, Contenders and Challengers*[17] universe maintained and provided by David Fish. This list is provided as an Excel-file with lots of additional information making further sorting and evaluation possible. In this list the stocks are grouped based on the number of years of dividend increases, with Challengers having more than five years on uninterrupted increases, Contenders having more than ten years and Champions having more than 25.

Using the above criteria to filter a list of dividend growth stocks usually leaves some ten to 20 stocks. Leave the calculation of fair value until the end when most have been filtered away. Eliminate the ones you don't want anything to do with[18] and the ones you clearly don't see any future for. For the ones still on the list, do some research on their business, read other people's analysis and find some recent earnings call transcripts to make up your own mind about their future prospects.

> *My personal set of criteria is a reasonably aggressive one, since I'm not solely dependent on this income stream and would like it grow fast. I've done lots of simulations and dry runs using different values in "1. The Flip Progress" to find out what the average profile of my stocks needs to be in order meet my goals with the amount of funds set aside.*

[17] David Fish's Dividend Champions, Contenders and Challengers: http://www.dripinvesting.org/tools/tools.asp

[18] Even though the big tobacco companies often have an overall profile suited for dividend growth investing I have a hard limit on these and refuse to sponsor or profit from anything that has to do with smoking.

The easiest way to start screening dividend is to use [David Fish's U.S. Dividend Champions list](), first filtering on years of dividend growth and then adding on further criteria like current dividend and past five years average dividend growth until a manageable number of stocks are left. There are other sources available as well that might be worth pursuing for stocks or funds that are not part of the dividend achievers universe, but the basic principle remain the same.

Step 3: Evaluate and rank stocks

Now comes the fun part, clearly we need some way to distinguish which stocks are better than other at any given time. Even though we have used some characteristics to screen stocks we haven't put any value on stocks with a longer history of dividend increases or a lower payout ratio.

We'll do this by devising a points system for the three dimensions of the stocks under evaluation (fundamentals, dividend returns and fair value). For example, give each a score from zero to ten and then add them together to find the total score for the stock. The one with the highest total score is at that moment in time the strongest company with a stock that has best price and gives its owners the most value, assuming the data used is good. If the future outlook for the company looks sustainable and the type of company and sector matches the diversification goals of the portfolio, it's a buy. If one of these are not optimal, look further down the list. There might be other stocks that make more sense at the moment, even though their score is lower.

To assign points along each dimension of the stock, decide if each screening criteria is a "pass or fail" or something that actually gives value for the owner. If it gives value, assign points linearly based on a minimum (the screening value) and a realistic upper limit. For dividend returns we can choose to premier yields from 2.5-7% and dividend growth from 6-20%. A yield over 7% is often a sign that the price is pushed down due to future trouble and growth rates over 20% is simply not sustainable for companies with long dividend streaks. Give 0-10 points along this scale and then take an average of both, getting an overall score of zero to ten for dividend returns. A stock with a yield of 4.75% and 13% dividend growth would get 5 points overall in dividend returns since it's right in the middle of both ranges, for example.

In "4. Stock Screener" I enter the characteristics of the top screened stocks. For each of my screening criteria I've set a range, 2.5-7% in the example above, and provide proportional points along this scale, divided among the number of criteria for that category. So, for Dividend Returns, I give half of the points for current yield and half for five year average dividend growth.

*Using the ranges above the stock with a 4.75% yield and a 13% dividend growth gets (5+5)/2=5 points for Dividend Returns. It gets 5 points for each characteristic since the midpoint of 2.5% to 7% is 4.75% just as 13% is the midpoint of 6% to 26%. For a stock with 2.7% yield and 15% dividend growth using the same point range scale we have to calculate a little bit more, (2.7-2.5)/(7-2.5)*5=0.18 points for yield and (15-6)/(20-6)*5=3.21 points for a total of 3.39 out of 10.*

This can be done more or less strict, but using numbers gives an objective picture. It can be compared to scoring a wine or reviewing a restaurant, with enough experience it's possible to give a consistent, objective score on a subjective experience. A company very likely to increase its dividend on an even faster rate in the future could get a higher score in for dividend growth, for example.

Once this is done for all investment candidates we have a total score where the highest scoring stock is the objective winner, but it doesn't necessarily have to be the one chosen for investment that month. There might be different reasons for picking a stock which we discuss during the board meeting. One stock could have worse fundamentals but higher dividend returns than another one, another could be disqualified for being in an overrepresented sector or there might be some other reason for avoiding a stock (like being a tobacco company or belonging to a doomed market). This is where the review and future plan of our portfolio comes into play and we together decide on the best investment choice according to our goals and the current choices.

Step 4: Invest and reward yourself

After picking a winner, invest this month's investment funds - new savings, dividends and proceeds from sold stocks - and thank yourself for still being on track to financial independence. See how much dividends you've made so far this year and how much more it is than last year.

Pick a reward for yourself; a nice cup of coffee, a magazine, watch a movie or something else that you truly enjoy. A reward establishes it as a habit and makes it something you look forward to. If this routine is done together with the household budget review or board meeting, make sure that all participants gets a reward to establish this good habit.

The actual trades needs to be done on a weekday when the markets are open, but the reward for doing the routine should be immediate. We enjoy treating ourselves with a really nice bottle of wine with matching home cooked food for our board meeting days since the entire routine is a family effort and this is something we truly enjoy.

After the trades using all available funds are done I update the logs (tab "2. Investment Portfolio" and "3. Closed Trades") while "1. The Flip Progress" is updated during our routine to keep both of us in the loop - and it gives us something to celebrate at the end of each and every month as we see the passive income grow and grow.

Summary

0. **Create the habit** of reviewing the portfolio and investing new funds once every month, by defining a trigger and deciding on a reward.
1. **Review the portfolio**
    a. Is the portfolio diversified enough? Total value and dividends per stock and sector?
    b. How are the companies doing? Any stocks that needs to be cut from the portfolio?
    c. Identify quickly appreciating stocks - are there any candidates for turbo-boosting the portfolio?
2. **Screen for stocks**
    a. Define or revisit your criteria for evaluation.
    b. Use indexes or other sources to find a base selection.
    c. Evaluate prospects and eliminate candidates not worth pursuing.
    d. Find payout ratio, earnings per share, EPS growth, market cap, fair value for candidates.
3. **Evaluate and rank stocks**
    a. Assign scores for fundamentals, dividend returns and fair value.
    b. Rank stocks, taking sector and market into account, and pick a winner.
4. **Reward yourself** for still being on the track for financial independence and enjoy the progress you've made since last month.


“Almost any dream is possible to bring to life with knowledge, a plan and time”

Understanding The Flip method

What's the difference between a dream and a goal? Both are things you want, but for a dream to become a goal you need to have it clearly defined and a road to get there. Where I differ from most people is that I hardly see any dream as unattainable and not worth pursuing just because it seems out of reach at first glance.

A dream can only be discarded once all paths to get there has been evaluated, tried and deemed as unviable. Many people have the dream of being rich, but judging from the vast amounts of money wagered on Powerball lotteries and other forms of gambling with infinitesimal chances of winning and a negative expected value it's clear that they have every intent on keeping it a dream. From reading the first two sections of this book you've probably realized that almost any dream is possible to bring to life with knowledge, a plan and time.

In this section I want to share some of the tools, practices and experiences used to create The Flip method. We'll see how these can be used to create a goal from a dream and what tools are used to define the way and making sure that we keep on track. In the process of doing so, I hope you'll see how these can be applied to other dreams as well.

Purpose-driven frameworks

Most products and services are designed fulfill a purpose; the reason for why it exists is to provide a function. It can solve its purpose in a good way, in which case it's well designed, or in a less than optimal way. But, it's when well designed products are filled with meaning and substance that they become iconic; a building that functions thousands of years later, a consumer product being displayed in museums or a dish served at a restaurant that makes you laugh with joy.[19]

With humans it's different. Every person has their own thoughts, ideas and opinions. We are created and filled with meaning and substance from the start, and then we have to find our own purpose to give direction to those thoughts and our values. Our brains evolve over time, they build new pathways based on inputs and experiences. When we're young it's called growing up, when we're older it's called finding yourself. This means that your goals, dreams and purpose can change or grow stronger over time and that's just the way we're built. What's important is that we can control this and by doing so we take coherent decisions while still being multi-dimensional.

Purpose

People with a purpose in life live longer and happier lives than those who don't.[20] It's not the ambition that's driving the improvement, just having a reason to go up every day has a significant impact in making people live longer. Starting to dig into this purpose and finding out what motivates and drives you is the start of the process to defining goals and the path to them.

There's a difference between having a purpose and pursuing goals. Goals help you fulfill your purpose, but you are never done with your purpose. Achieving a goal can be unfulfilling, it's not uncommon for people who retire early to feel empty once they stop working. That infinite vacation was simply not what they expected it to be, they don't longer feel valuable and miss being able to contribute. In short, they lack a purpose. Financial independence, which retirement is a subset of, is not a purpose in itself, it's an enabler that free time for other activities - those that give you purpose. As I wrote right in the introduction of The Flip, "What does financial independence mean to you?" Answering this question is what counts, "not having to work" is not an accepted answer but what you choose to replace work with, if you want to quit your job at all.

[19] A well executed product with meaning and substance but without purpose is what I define as art, and that also has it's place. When a purposeful, well designed product triggers the same emotional response as great art, it has become functional art - and that's something amazing to experience.
[20] At least according to a study by Ph. D. Patricia Boyle at the Rush Alzheimer's Disease Center who conducted a study of elderly people in 2009:
https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3389510/

Having a purpose and knowing where you want to be puts you in the driver's seat of your life, enabling your dreams and wishes. When you realize this you also know, even if it's just a hunch at this stage, whether your actions takes you in the direction of your dreams or further away from them. Accepting your current place in the universe as a constant, and participating in the Powerball lottery, is giving up way too easy.

The act of *delayed gratification*, to forego an immediate reward for a bigger one later, has been shown to be a significant indicator in all kinds of success factors.[21] This single behavior, doing the right thing in the heat of the moment, is the most important enabler of your dreams. But if you don't know what the right action is then all the self-control in the world it isn't of much use. That's why most of the tools we use in The Flip either help us to identify what we need to do or make the right choice inevitable - either through restrictions on our behavior, like setting up a restriction to only make it possible to spend a set amount every month, or by reprogramming our behavior through habits designed to accomplish our goals. We'll come back to those tools later.

But first, we need to find our direction and identify goals that helps us fulfill our purpose. At one of the companies I've worked for every employee was boxed into a role based on a career track and level. This role description contained lots of information about the types of skills you were supposed to have and the amount of responsibility expected on project roles. Looking further up the career ladder made it easy to set the goals needed for promotions.[22]

Having this clear progression path made it easy to identify the skills and experiences needed to be ready for the next level. There was a yearly process in place to identify goals and review the outcome. No one could dodge around this, although the level of engagement varied quite a lot. With this system in place professional growth along with company needs becomes automatic, at the same time as the individual gets continuous training in identifying goals and the path to realizing them.

The problem with having your goals served to you is that you might not buy into them, in which case the willpower to work towards them will fall drastically and with that the chance for success. That's why finding your own goals and making sure that they support your purpose is so important.

What do you see when you envision your ideal life and ideal self? What brings you joy? What gives you a sense of achievement? Are you already there? If not, is it a slightly improved version of yourself along the current path? Is it something completely different?

[21] There are many articles and studies on delayed gratification, most famously the "Marshmallow experiment" by Walter Mischel in the 60's, but many more studies have followed up and expanded on the findings in that one. For a summary, James Clear has a good overview: http://jamesclear.com/delayed-gratification

[22] Whether you got a promotion or not was another question, it had more to do with the number of slots available and your relative performance than if you met the criteria.

Finding and defining goals

If you're not sure, an ideation and refinement exercise can help along the way. Start by just writing down a list of things you want to achieve, become, do, learn or have. Be specific, "rich" or "successful" doesn't really provide much information but "financially independent", "have a supercar", "be the world's best parent" or "work as a C-level executive" provides some clues where we're heading. At this stage quantity is the primary objective, but use a time limit to keep the focus up. If needed, take multiple five minute sessions where you can build on your previous ideas. Group similar items that can be combined into a single goal visualization. Close your eyes and experience how it would feel to live that scenario.

Prioritize three to seven of them and put the rest in an idea bank for later use. Try how the different goal visualizations play out against each other, if some are contradictory they might need to be modified or moved out of the prioritized list. This list can be seen as a career track that can be used to set tangible goals. S.M.A.R.T. (specific, measurable, agreed upon, realistic and time-based) goals are often used in the professional world and defining goals in this way helps to break them down into a set of clear targets. What does being a perfect parent mean? How can that be measured?

Once the overall goal is known we can start the process of getting there. When developing large scale software systems, or buildings in the real world, the architecture is the overall framework that will provide guidance to how every small building block should look and where to place it - the blocks that actually constitute the solution or building. The equivalent in the business world is strategy. Without this we usually end up taking sub-optimal decisions based on a very narrow context. Eating one glazed carrot cake muffin with the afternoon coffee one time can be very good for the mind and have no lasting, measurable effect on weight or any other health metric. But falling to temptation and eating one of those muffins every day will quickly lead to issues. We have created a bad routine.

What we want to do is the reverse, by creating a framework that guides our actions and decisions we make it inevitable to reach our goals. Some of the building blocks are suited to address with habits, other through conscious decisions that have been analyzed in advance. Creating this toolkit and how to use it is our framework to reach our goals. One example is if you want to project a certain appearance. Taking the time to think about the how to dress is the first step. Next, have a wardrobe that only contains clothes that work towards this goal. Now, every morning the process of making the right choice to support your appearance goal becomes automatic.[23]

The great Swedish alpine skier Ingemar Stenmark, widely regarded as the greatest slalom and giant slalom specialist of all time, once said:

> *I don't know anything about luck, but that the harder I train, the luckier I get.*

[23] If your desired style is more complex than simple mix and match, you can always create index cards with complete outfits in advance. If you encounter a process that doesn't quite suit you, figure out how to adapt it to do so.

Professional athletes are the ones who's really taken goal setting and progression to the next level. The feats they do now could not even be imagined a few decades ago. One answer lies in the bigger pool of talent, technology improvements and the ability for more people to be professionals and dedicate more time to training, but the major factor is simply the science of training.

For the marathon event at the first modern Olympics in Athens in 1896, Spyridon Louis crossed the line in two hours 58 minutes and 50 seconds. To even be allowed to participate in the Boston Marathon, the world's best known and oldest annual marathon with 30,251 entrants in 2015, a contestant needs to post a three hour and five minute time during a sanctioned race. That would've been enough for second place during the 1896 Olympics. What about shoes and other technology that usually account for significant progress? In 1960 Abebe Bikila won the Rome Olympics with the new record time of two hours 15 minutes and 16 seconds - running barefoot with the rest of the field taking advantage of 40 years of running shoe development.

A training program is just like a blueprint for a building, it's an instruction set for bringing the goal to reality. Programs for how to reach to Boston Marathon qualifying goal is only an internet search away. Most are based on running multiple days of the week, and this was also known also in the 1800's, but it's knowing how to combine specific sessions and how they work together that really counts. It's the same with saving money, only knowing that you should save some every month will only get you so far. It's knowing how much and what to do with it that really sets you up for success in the form of financial independence, as we do in The Flip.

Some popular goals have ready-made training programs available which can easily be found. Other requires a bit more work to arrive to. *Design thinking*, as popularized by IDEO, is an extraordinary method to find answers to complex problems.[24] I first encountered the term during a course on industrial design during my final year at the University where we watched a segment from ABC Nightline where IDEO took on themselves to totally redesign the shopping cart concept in four days. The end result is nothing like you'd expect but really nails everything we want from a shopping cart in a grocery store.

A couple of years later I worked on a project where IDEO had created a vision for the future of the customer experience to the company. We were a small team tasked with exploring one part of this future with technology that was just about to go mainstream. Not having the answers of what could be done or how it could be used made it necessary for us continue the exploratory process initiated in the vision. We used design thinking to come up with ideas for a completely novel online shopping experience that we took to a working demo years before similar solutions came out on the market. It's still one of the most exciting projects that I've worked on.

[24] For more on design thinking, Tim Brown of IDEO has written the excellent book *Change by Design*.

In situations like this, the primary target is to explore options so that we can figure out what might work or not. Divergent thinking is used to generate ideas which are then narrowed down to a solution. The opposite is analytical problem solving where we strive to come up with one, correct solution from the start. There's room for that as well, but the objective here is figuring out if there is any solution at all or in what direction the solution might be. It doesn't really help if we have the world's best software developer on the team when we need a fashion designer to develop the idea.

A version of the design process we used in the practical guide to create our personal finance system is often used in design thinking. There's an added emphasis on the ideation and divergent thinking phase and the use of prototypes to quickly test and gather feedback on ideas before converging on a holistic solution. The complete process then reads as *define, research, ideate, prototype, choose, implement, and learn*.[25]

Prototyping and experimentation is a key activity that should use the least amount of effort possible to test if an idea is worth pursuing further. In the software world we often make interface or function prototypes from paper notes, simple sketches in a presentation deck or pure text based functions without a graphical user interface. In architecture and product design foam and cardboard is used to create models that make fast iterations possible.[26] In The Flip, we use a simple spreadsheet model to get feedback on future returns based on anticipated stock portfolio performance. This lets us explore if the journey we embark on is realistic and worth pursuing, and more importantly what we need to fill our overall framework with to transform it into a blueprint that takes us to our goal.

You can also create prototype experiences from your life goals to see if they're actually worth pursuing - and if they are, create vivid memories that can be used for goal visualization. If you want to live in a metropolitan penthouse, create a prototype by renting a suite at an upscale hotel that matches your vision. If you want to dedicate your life to charity work, try a volunteer vacation. The trick is to not only enjoy these experiences, but to really feel how it would be to live this every day. This also minimizes the chance that you one day reach your goal only to realize that it wasn't what you really wanted.

Finding and exploring our purpose and life goals provides an overall direction that will help us steer towards them in everyday decisions, but it's breaking these down into actionable components that is the foundation of creating a blueprint or a training program to bring these to reality.

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[25] It's the *generate and analyze ideas* step that's been broken out into *ideate* and *prototype* with *implement* into *choose* and then *implement* before arriving at *learn*.
[26] The work of Bjarke Ingels and his architecture firm (BIG) is very indicative of this, Bjarke has made a TED talk called *3 warp speed architecture tales* that really showcases the power of prototyping and iterating to find the final solution:
https://www.ted.com/talks/bjarke_ingels_3_warp_speed_architecture_tales

Filling in the framework

Having a direction and overall framework for where we want to go is the foundation for progress towards a goal, but being able to break it down into actionable chunks and fill them with the very actions that will take us to the goal is a requisite for completing the goal. Doing this usually requires prior experience or access to someone who has the experience, but it's possible to figure out what's necessary and find out how to split up the work on your own as well. That's what we'll focus on now.

An iterative approach

When computer software was distributed on diskettes and compact disks it had to be complete when it shipped. If it was buggy or one module didn't work the cost and time to fix that was very high. This led it to be developed with a fixed scope according to a set plan as an appliance or any other mechanical product simply because that was basically what it was, even though the usable part of the product was intangible (it is called software for a reason).

The internet changed all that, at first simply as a delivery platform instead of physical media but with time more complex solutions are been offered as web based services. Both the ability to fix mistakes, patch issues that arise over time and the competitive need to get changes in software out to the end user faster has led a shift from a ship-once philosophy to getting the changes out as soon as they're ready. To support this the development model has also had to change.

One of the most popular alternatives to the fixed scope waterfall-based development models is agile software development. At its core these models can be described as incremental and iterative, meaning that instead of shipping the product only after every single feature is implemented it is built and delivered in stages, usually called sprints. Scrum, the framework that set off the agile revolution, is described by the Scrum Alliance as:[27]

- *A product owner creates a prioritized wish list called a product backlog.*
- *During sprint planning, the team pulls a small chunk from the top of that wish list, a sprint backlog, and decides how to implement those pieces.*
- *The team has a certain amount of time — a sprint (usually two to four weeks) — to complete its work, but it meets each day to assess its progress (daily Scrum).*
- *Along the way, the ScrumMaster keeps the team focused on its goal.*
- *At the end of the sprint, the work should be potentially shippable: ready to hand to a customer, put on a store shelf, or show to a stakeholder.*
- *The sprint ends with a sprint review and retrospective.*
- *As the next sprint begins, the team chooses another chunk of the product backlog and begins working again.*

[27] For the Scrum Alliance's Scrum Guide: https://www.scrumalliance.org/why-scrum/scrum-guide

Doing it this way reduces risk and increases velocity. Just like using prototyping in the design thinking methodology to try ideas early, features and technology can quickly be tested and discarded if they don't work. These quick feedback loops can be used to test things internally as well as externally, trigger discussion and explore new ways. It's much better to find out that a certain path is a dead end after a couple of weeks rather than months or years later, but also to find out that a small hidden feature was a major asset that can be explored further.

In addition it's much easier both technically as well as mentally to take baby steps instead of giant leaps. The Product Owner is in charge of the overall roadmap and makes sure that those baby steps leads to the ultimate goal, the purpose of the project. The beauty is that it's possible to change the direction or devote more resources to a particular area, as needed. Having this flexibility is a key component to ensure success with a plan.

Scrum also emphasizes the importance of communication and alignment. Hidden in the point *Along the way, the ScrumMaster keeps the team focused on its goal* is a couple of practices that makes sure that the entire team is on the same page. Among these is the *daily scrum*, where all team members meets and share what they are working on and if they have trouble finishing something. The objective is to raise issues early by forcing everyone on the team to communicate openly and directly without putting blame on anyone.

At the end of the sprint the review and retrospective is familiar from the design process. This enforces continuous learning and makes sure the team never stagnates. Usually different types of exercises are used to figure out various issues within the team, whether it is teamwork, direction, competency gaps, communication, tools or whatever else it is that holds the team back at that moment in time. Having a structured way of bringing this to the surface is extremely effective to keep the team grow more efficient and produce higher quality work over time.

All of the mentioned practices are used in The Flip. We base our overall plan on monthly sprints, break down the overall goal into small pieces, have a team review and revisit the overall direction from time to time to see if it needs adjustment.

The incremental, iterative approach increases the chance for completing big undertakings considerably by completing small, easy goals which all lead to the final target. Saving and investing a small amount every month in order to reach a big investment goal years later is one such example. But you need to know what you aim for, and for that you have to be more specific than "to be financially independent" or "in shape". In *A budget is a plan for your future* we looked at what financial independence really means for you before we started figuring out a plan to get there. Most people knows that it's good to be in shape but the training looks very different depending on if your goal is to get a better immune system, increase aerobic capacity for a marathon, gain muscle endurance for climbing or develop the ultimate beach body.

Seeing the big picture while focusing on the details

Breaking down our overall plan into small chunks which builds towards the ultimate goal forces us to keep evolving. *Periodization*[28] of training has been around in sports since the 1950's when it was developed in the Soviet Union to increase the results of the athletes. It does this by keeping the athletes body in a state of continuous growth by changing the type of training used so that the body always needs adapts to something new. Without switching exercises, weights, number of repetitions, sets, tempo and so on the progress would stagnate and little or no further improvement would occur even with a very demanding training regime.

This is equally true for the brain and other types of skills. To avoid reaching a plateau, as it's known, one must continue to be challenged. The periodization idea can be used in two ways to ensure everlasting progress:

- Breaking down a long term plan into macrocycles (annual) and mesocycles (2-6 weeks typically) with different, complementary activities for each cycle
- Reviewing performance after a mesocycle and define actions and training activities to address identified shortcomings

Some people think it's stressful to always have to change how things are done once they start to feel comfortable and to have to look for issues that needs fixing. It's a way for progress, nothing more and nothing less. Change is a constant in our society, so learning to live with it is a prerequisite. Embracing it is a way to continue to be relevant and maximizing one's potential. Using reviews to identify gaps in ability and then devise a training program for eliminating these is one of the easiest ways to increase the skill level. One of the defining traits of a professional poker player is to review hands and overall game play to learn from mistakes, analyze tricky decisions and enforce correct game plays. The exact same methods can be used in investing to analyze investment decisions in retrospect but also for any other type of situation where a competitive advantage is desired, such as sports.

Where it gets a little more complicated is knowing exactly how to analyze a given activity and to implement each of the small pieces in our plans. Evaluating stocks is a science in itself, as is running and cooking, and to figure out what to do requires some interest and nerding out a little bit. Fortunately more and more people bring new levels of dedication to get to the bottom of their area of interest and then share their knowledge with the rest of us. *Franklin Barbecue* by Aaron Franklin and *Coffee* by Tim Wendelboe are two books that goes in-depth of how to produce world class[29] barbecue and coffee, explaining every single

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[28] *Serious Strength Training* by Tudor M. Bompa is one of the classic volumes on body building which has shaped much of modern training science through its introduction of periodization training. Bompa developed the original east bloc ideas further and presented a complete system for the first time, which also included nutrition.

[29] Franklin Barbecue in Austin, Texas has been widely regarded as the best barbecue restaurant in the world since it was opened in 2011. Tim Wendelboe won the World Barista Championship in 2004 and has a coffee house in Oslo, Norway. What they share is the extreme focus and dedication to serving a pure and perfected experience and the passion to share this.

component and step of the way to reproduce this in a home setting. A surprising amount of practices are similar, with an in-depth evaluation of every component that contributes to the end result, trying to figure out the desired contribution and then how to maximize the result with a focus on repeatability. No stone is left unturned, but the hunt for perfection also never loses sight of the overall picture and what makes the end result balanced, enjoyable and filled with meaning.

Breaking something down into components makes it easier to identify what we really want to figure out, find out what gives the most efficient results and also how the components interact to create a final piece that's order of magnitudes better or more efficient than the individual pieces. Using synergies to be more efficient, so that we have more time and energy left over once all necessities are done, or to get exponential results is a powerful tool. Investing cash in dividend stocks, dividend growth, trading wins and dividend reinvestments all work together to get exponential returns in our passive income machine, just like a nutrition plan that feeds the body what it needs when we follow a physical training plan ensures that we can benefit from all the training we put in.

A dish is composed of its idea, the ingredients, the cooking, the components and how it's served. Knowing that these are the main dimensions we need to look into when cooking makes it much easier than to do everything at once. When I realized that I could break down a stock into how much value it gives its owners, if it's fairly valued and how the fundamental financials of the company it made it much easier to evaluate, compare and rate stocks. The evaluation of each of these characteristics can also continue to be refined with time as we find better data, develop our tools or learn new more.

Knowing where to find this information relevant for your goals is the key. For much of the basics when it comes to investing *The Intelligent Investor* is still the book to read decades after it was published. For some areas there's no precedent though, and then we have to find the answer ourselves. Through controlled experiments, for example using prototypes, it's possible to find out what you need to know once you have some idea of what you're searching after. For web based system it's common to use A/B-testing to measure which of two different versions of the same functionality is the most effective. It could be simple things such as ad text or more complicated user flows, and the exact same idea can be used on everything from investment decisions to getting to work in the best and most efficient way possible.

Taking an innovative approach and attention to detail to the next level is Heston Blumenthal, whose restaurant *The Fat Duck* has won more awards than possible to list.[30] In his book *The Fat Duck Cookbook* Heston describes the entire process of how a series of his most iconic were created. His dishes usually starts with a seed, something that will provoke a memory or a feeling that in turn will provide an emotional response. This seed usually dictates some main ingredients and whether it's sweet or savory or in between. The first steps is quite like a design thinking process where he lets the ideas go where they want to go rather than trying to reel them in into established conventions. After this an experimental, iterative process

[30] Among them first place on The World's 50 Best Restaurants in 2009 and the fastest to go from one to three Michelin stars in Great Britain (1999-2004).

begins, divergent at first and then convergent, to figure out the actual components and to refine them until perfection. He uses taste science to figure out which flavors that goes well which other and food science to reach the textures and transformations of ingredients he envisions. In every step of the process the importance of precision is emphasized for the ability to repeat the desired outcome. The end result is new and exciting dishes that touches the diner on a deeper level, where things are not different for the sake of it but because that's the logical extension of the base concept, and once the dish is complete you couldn't imagine it any other way.

Another person that takes a similar approach is Tony Conigliaro, but his chosen field is cocktails instead of food. His approach is familiar in that it's based on experimentation with the same focus on precision and repeatability as Heston, Tim and Aaron for the ability to serve a consistent product. In addition, in *Drinks* he also shows a fantastic way of visualizing the sensations of the different components of his drinks, showing how they complement each other and build to a complete, finished product. Thinking of how to separate and evaluate components that together are part of something greater can be extremely valuable. The three dimensions that a stock is evaluated by in The Flip is basically the same concept as a pre-dinner cocktail or a dish, we have an idea and concept of what we want to achieve and then find out how to break it down into components - and study and iterate to perfect each of these components.

Sticking to the plan

The brain is plastic. It can be trained to become more proficient at things, just like the rest of the body, but it can also be programmed. By experiencing new things, or forcing yourself to take a different stance compared to what you usually do, it activates other neural pathways than what it's used to use. With enough repetition these becomes stronger than the old paths and the new natural way of doing things.

This is what happens when a child learns to eat and enjoy vegetables or fish, but it's not limited to children. It's the same with boys growing up and telling themselves to enjoy beer or someone who becomes a manager at a company and all of a sudden has to stand behind and live by the company's values. Almost anyone can learn to appreciate almost anything, as long as the will or right incentive is there. At first it's a forced experience and you have to tell yourself it's something you're supposed to do, but when the brain has adapted it's as real as any other part of your personality - because you have evolved.

Food is the easiest example of how we adapt the brain by first accepting and then start enjoying something only through being exposed for enough repetitions. No more skill or effort than having an open mind and taking a chance that presents itself is required. A more advanced technique to program the brain is visualization. This can be used both for short term or long term goals.

When an alpine skier waits at the top of the hill for their starting slot you can often see them with their eyes closed doing run after run of the course in their heads. By doing this enough times the actual course becomes second nature and little brain effort has to be used to find the way or figure out the optimal path down the slope. Almost all mental capacity can be used to perform each turn as perfectly as possible and for reacting to unexpected events during the run. When you manage to dry-run the mechanics of a specific task, whether physical or mental, and can perform it with full focus on the actual performance, it's a great feeling. With enough skill and preparation you can get the world around you to seemingly move slower than you can think, as if it's in slow motion, when you process all inputs and adapt faster than what's possible physically, and that's truly mind blowing.

The other form of visualization is *outcome visualization* where you envision a big, long term goal and by doing so start reprogram the brain to lead to it.[31] By experiencing how it would feel to accomplish or live that goal, whether to cross the finish line of a marathon or living in a penthouse on Fifth Avenue in New York City, the neural pathways start to adapt and crave that goal. Some people call this dreaming, the difference is that goals are something you actively work to achieve while dreams are destined to forever remain just that. When starting out with the journey towards financial independence it's important to visualize the end result and what financial independence means for you, that will make the financial sacrifices made

[31] I first encountered outcome visualization in the *Positivity* audio programme by hypnotist Paul McKenna, which really got me thinking about how I looked at my future.

along the way not only acceptable but enjoyable since they remind of the progress towards the ultimate goal. The more specific and detailed you can make these visualizations, and the more powerful the rewards are along the way, the greater effect they have.

Habits and behaviors

Modifying behaviors by experience, i.e. repeating an action until it has become second nature, is called *programming*. This can be done by other people, like your parents or other authoritative people, through subconscious emulation of the behavior of role models or by actively taking action to imprint a behavior or response. You can program yourself anything from learning to like new types of food, telling yourself that “I love fish” while trying new dishes, or modifying the response to certain types of tasks or stimuli (“I really enjoy sending in my time report”). Programming the mind is not easy, it requires a clear vision of what to achieve, a plan to perform the necessary repetitions and the willpower to carry through.

An easier way is to use a set of rewards to trigger a behavior on a designated queue or strengthen a desired response. This is called *conditioning* and the most classic example is Pavlov’s Dogs, the experiment set up by Ivan Pavlov and presented in 1901 in which he showed that by sounding a bell before serving food to dogs, the dogs developed a behavioral reflex - salivating, for example - as if the food was served already when the bell was sounded. A neutral stimulus is conditioned to elicit the response of a potent stimuli. This is called *classical conditioning*, when behaviors are strengthened or weakened through rewards or punishments it’s called *operant conditioning*.

A more recent variation on this is called *temptation bundling*[32], where you pair something you need to do with something you want to do to make sure that you actually carry through. It could be that you listen to a favorite podcast or audiobook while working out or buy a nice cup of coffee with something sweet to eat after planning next week's activities. The trick is that the treat has to be something you really want and exclusive to the activity. In today’s society almost everything is available at any time of the day, so refraining from indulging in your temptations until you have actually deserved them is the key. This is delayed gratification at work, and in this case used for almost immediate rewards. Once you see that it works on a short time-scale you learn to trust that it’ll also work for bigger goals, especially once you’ve set up a plan and start to see the progress towards your life goals.

Behaviors can also be seen as part of a habit. In *The Power of Habit* Charles Duhigg breaks down habits into a trigger, a routine (or behavior) and a reward. As most of the armed forces of the world have learned habits are incredibly powerful and can be used to both instill a set of common routines, such as always packing the gear a certain way, or to set common values through the common way things are done. At first the reward (or lack of punishment) is the main driver but with time the actual routines becomes so self-fulfilling that you don’t want to be without them. Something just feels wrong if you don’t get to complete your routine.

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[32] *The Freakonomics Podcast* has a great episode called *When willpower isn’t enough* where they talk to Katherine Milkman about the willpower to actually do what you want to do: http://freakonomics.com/podcast/when-willpower-isnt-enough-a-new-freakonomics-radio-podcast/

As anyone with a bad habit knows it can also be very hard to change a habit once it's established - or way too easy to let go of a good habit if you lose the rhythm of it. This shows the strength of habits and by taking control over them you gain access to this potent tool. Identify the components that make up a habit to design them to lead to your goals, or remove the influence of bad habits by modifying parts of them. If you remove the trigger for a habit you won't fall into that routine, for example.

By using triggers and rewards for the core activities that is at the heart of The Flip we condition ourselves to follow through with the plan that will takes us where we want to go. We program our brain and create new habits that become part of our personality. This is not limited to The Flip, the same strategy can be used to design a path to all sorts of goals, from cleaning the house every week to running a marathon. To get a household to pull in the same direction it's necessary to have a way of taking common decisions, having transparency for any shared economy and lift up issues in a controlled setting. One designed habit that serves the same basic purpose as the SCRUM sprint retrospective could look like this:

Cue: Last Saturday afternoon/evening of every month (Sunday as backup)
Routine:
- *Review and adjustment of operational routines and personal habits*
- *Walkthrough of actual expenses mapped to budget*
- *Adjustments to family budget*
- *Monthly investment decisions (some ideas will be communicated beforehand so that they can be investigated separately and a conclusion reached during the meeting)*
- *Travel and home planning for the month*

Reward: A really nice bottle of wine with a matching dinner

Another example to keep the home looking tidy (one of the operational routines):

Cue: Every night before bedtime
Routine:
- *Do all dishes, empty sink and wipe counter tops*
- *Put away all stuff from open surfaces*
- *Fluff pillows and put away blankets*
- *Take care of any dry laundry*

Reward: Waking up to a beautiful home

Making routines this explicit sets the expectation with all parties. If someone disagrees, passively by not complying with the routine or more direct, this needs to be addressed during one of the monthly reviews. Either the routine needs to be changed or the different expectations has to be resolved. Having this structure in place will bring differing points of view to the surface and create conflict. This might be uncomfortable but it's much better to have a framework and get it out in the open, actively working to resolve it than to build up lots of internal frustration by not having aligned expectations.

Morning routines and starting with a clean slate

Sometimes it’s hard to do something even with a habit and a reward in place. Other things get in the way that seem more important at the time, even if they detract from the overall goal and postpone results further or increase your stress level by not doing the things that needs to be done.

Getting a good start each and every day by getting the things that you prioritize as the most important out of the way leave you open for tackling the rest of the day as it comes. If you get distracted or lose your energy it’s ok, because what’s most important has already been achieved. Establishing a morning routine routine is key to this.

The morning actually starts the night before. The night-time routine mentioned above, or variations of it, is actually a prerequisite to starting the day with a clean slate. By emptying all of the things that you have to do and take care of, you can go to bed with a clear head that doesn’t think about e-mails you need to answer, dishes that need to be put in cupboards or everything else you have to take care of. You’ll sleep better and can start your day with the things that are most important to you instead of wasting your best time of the day of taking care of the things you are already behind with.

Right out of bed most people are not at their best. Quite frankly, we need some time to wake up regardless if we’re early risers or not. As a result, having a morning that doesn't require any decisions is a good place to start. It will be more efficient and prime you for the most productive time of the day, when you have the most energy, focus and least amount of distractions. To really set yourself up for maximizing this time, also do something to empty your head while energizing your body. It could be working out, taking the bike to work, performing a mindfulness exercise or something else. It gives you time to wake up while leaving you hungry for completing your highest prioritized tasks.

Having completed these tasks, or made some significant progress on more long term projects, you can continue with the rest of your day, energized and satisfied that what’s most important has been done and that you can adapt as needed when things pop up that needs your attention. Continue with the rest of your day, energized and satisfied that your most important tasks have been done and that you can adapt as needed.

To summarize:

1. Start with a clean slate, empty your inbox before leaving work and reset your home before going to bed.
2. Establish a morning habit where you don’t have to take any decisions, decide on the breakfast you’ll eat, how to choose clothes, etc. once and not every morning.
3. Empty your mind by taking a walk, working out, meditate, do mindfulness, etc.
4. Start your day with a period of productive time, in an office environment make sure to get there early or block out your calendar. Perform your highest prioritized tasks for the day.

Continuous learning

During my university studies I played poker rather seriously and learned that there are two main differentiators between professional poker players in it for the long run and merely good players: bankroll management and to continuously review your game.

For me it came really natural to adjust the stakes to how much I had in the bankroll, even though you'd be surprised to know how many players either don't grasp the concept of bankroll management or are incapable of sticking to it.[33] Having a solid bankroll for the stakes played and playing within the rules you set is a great tool for being able to tackle variance without getting depressed or getting in a bad mood from losing money. The same is equally true in investments, only risk what you can afford to lose and don't let short term variance affect your decisions or your mood.

But where I got the big "a-ha" moment was how the good players used tools to review their game. Playing online has the big benefit of generating detailed statistics on all aspects of the game. The really structured players review this data after every session, trying to find leaks that needs to be adjusted or situations where they are too predictable. Once an issue, or an opportunity that isn't used enough, has been found the player tries to come up with how to address this and then makes a conscious effort to incorporate it into his game. During the next session review the player can see if he managed to incorporate the changes to the game and if these were beneficial or not, creating a fast feedback loop for *continuous learning*.

One of the key elements in this loop is *deliberate practice*[34], which breaks down how to excel at a given task by not merely practicing - this we all need to do - but finding out what you need to practice on and then tailoring your training plan according to this. A coach with previous experience can be of big help but sometimes there's no one available, they are too expensive or it's just not possible to use an external teacher. In poker, the right decision in a given situation can sometimes be found by running simulations on the probability for a certain board to show up. With a range of hands for you opponent it's possible to see your chance of winning the hand. By doing this during the reviews you build a mental library of scenarios that can then be used. The same technique is used in The Flip to find targets for financial independence based on experiments with how much to save and how aggressive investments to use.

When I started working with software development projects using the Scrum methodology I encountered the same basic principle. One of the main pillars of Scrum is breaking down development work into 2-4 week sprints and if you remember from the overall description of Scrum part of the closing routine of the sprint described as *The sprint ends with a sprint*

[33] For small to medium stakes no-limit Texas hold'em, which during the online poker boom of 2003-2006 was buy-ins of $25 to $200 for $0.1/$0.25 to $1/$2 blinds, the established best practice was to keep at least 25 buy-ins in the bankroll to account for daily swings.
[34] Another *Freakonomics Podcast* episode, called *How to be great at anything*, details the work of Anders Ericsson who has studied the science of expertise and how to excell at a given task: http://freakonomics.com/podcast/peak/

review and retrospective. With the retrospective we're actually creating a habit of continuous learning on a team level using the end of the sprint as a trigger. The sprint review is usually part of the reward, where you get to sit down and see what your and other teams working have accomplished over the last sprint. In some of the most successful projects I've been working in the end of the sprint have really been celebrated with one of the teams in charge of setting up a fun event for the rest of the organization and a strong reward.

Doing this keeps all teams evolving, gaining effectiveness and efficiency while reducing internal and external friction. Skill gaps, interpersonal conflicts and recurring impediments are identified and then solutions are developed through various exercises. These are followed up daily during the daily Scrum and on the next sprint retrospective, making sure the team has a structured way for continuous learning and improvement. In a professional setting one person is usually appointed as a Scrum master and team lead and is responsible for making sure that the team follows these routines. This person is usually chosen for the ability to be structured, balanced and making sure the entire team follow through with the activities decided internally during retrospectives while following the external frameworks set up.[35] Having a person like this, whose job it is to make sure the team keeps on track and does what it has decided is best for it, is a luxury not many individuals or households have, so designing habits that are so strong they can't be resisted is a very important skill.

Understanding how to create a habit of continuous learning using deliberate practice for self-improvement is perhaps the key element to excel at any given task. For example, after setting a goal a training program can be designed based on a periodization plan for the main areas of improvement and milestones with the specific training activities defined as part of a fixed review and retrospective cycle. Form a macro-scale habit for reviewing and updating the overall plan and a daily habit out of performing the necessary practice to reach the milestones. Doing this will make it hard not to reach the goal.

Keeping focus

Going into the daily grind there's sometimes hard to keep focus. In the moment, it might seem more important to just finish this email, treat yourself just this time or sleep in that morning and catch up with training in the afternoon instead. Once you do this and break the triggers and rewards you've so carefully designed to be part of your habits leading you to your goals, it's all too easy fall out of the rhythm. As long as you keep some kind of retrospective sessions where you can realize this and adjust all is not lost, but it's being able to do what's right in the moment that will bring you towards your goals, one small step at a time.

In *mindfulness* the main objective is to be conscious and aware in the present. If you're in a conversation this means to fully focus on the other person and in a meeting not to let your

[35] In pure Scrum, the team is supposed to be self-organizing, meaning that the team figures out who should lead it, if they choose to have a leader at all. There are some big companies working like this across the entire organization, but my experience is that not all strong leaders see the whole picture when it comes to why certain routines are prescribed or can properly lead team members on an individual basis, leading to less than optimal results in the best case and disastrous results with people quitting and finding other places to work in the worst case.

thoughts drift away. With all inputs around us it's way too easy to do this - and also too easy to get away with it. By being present and recognizing when it's time to pause and reflect you're able to make active choices. Instead of letting your mind go on autopilot, you can weigh your alternatives and decide what's best for you even in the heat of the moment. You'll make better choices and the people around you will feel like you truly see them.

Learning to be proactive, instead of reactive, is one of the most productive and liberating things you can do. When you react, either to a request or a comment, you're almost always bound to go into a defensive mindset while at the same time being dragged out of the productive work you're doing. By being in the proactive zone and doing the tasks you've planned to do, either at work or at home, your productivity is on an order of magnitude greater than if you were to do things reactively.

The easiest way to be proactive is to do the tasks most important to you first thing in the morning.[36] Inevitably things show up and requests gets made, but having been able to go through the things that must be done takes away much of the pressure. Some people feel valued and recognized when they get requests and for this reason see no point in avoiding notifications and switching between tasks. But this is highly inefficient on a productivity basis and also detrimental to doing what's good in the long run. Each person has a limit for how much they can do before becoming exhausted, mentally or physically, and only being able to do the bare minimum after that. If all energy is spent doing reactive work there's nothing left to use for working towards goals and spontaneous activities, meaning you'll see little growth and positive energy compared to if you could follow your plans.

Your set of goals and habits - and other things you want to do - will result in a number of activities every week. By planning these beforehand you'll increase your chances of completing them by orders of magnitude. For example, having a goal of working out three times per week will be hard when you get to Thursday and still haven't gotten around to the first workout. By planning the workouts for Monday, Wednesday and Friday morning before work and then actively avoiding having meetings at work early those days will make following the plan easy. Every year, every month, every week and every day is a chance to start fresh, so even if something slipped the day before it's possible to reflect on why and make changes for the next day.

With all this focus on taking active decisions and being in the moment your energy will deplete. Sometimes autopilot is good and it's ok to zone out, it's what we need. When doing the dishes the only focus needed is to get them clean and not break anything. But there can also be other solutions that will even preserve that energy. A dishwasher will automate the

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[36] The *7 Habits of highly effective people* by Stephen R. Covey was a game changer for me during a time when work was all-consuming and I was bombarded with high priority, urgent request from multiple time zones. It contains a model for how to take the control back in those kinds of situations, including a number of tools and activities expressed in the "7 habits", among them habit number one: "Be proactive" , habit number two: "Put first things first" and habit number seven: "Sharpen the saw" which is basically continuous learning and improvement.

task almost completely. Technology, and services to some degree, can automate many tasks and ensure that they get completed with very little energy and time needed. There's no need to manually transfer funds to different accounts every month. Actively seek out what's possible to do more efficiently or even automate and use the energy saved for something more productive.

By saving your energy for the most important tasks on your agenda, and being the boss of your agenda, you'll find that you can do the things you actually want to do, more efficiently and with more focus. Allow yourself to be bored while still being energized and you'll find it impossible not to be filled with inspiration and great ideas just bursting to get out.

Blueprint to accomplishing any goal

It might sound farfetched that you can accomplish any goal you can think of, and very true, some will be out of reach. For certain jobs, roles or accomplishments you not only need a set of skills that are next to unique, but also pure luck to be at the right place at the right time. All the money in the world is not enough to buy the Mona Lisa, but having the resources available when something like it do show up at an auction is a prerequisite for being able to take advantage of the opportunity. Try breaking goals down and figure out on a conceptual level what it takes to get there. You'll see that very few things are out of reach, even though some might take a commitment that span decades.

Remember that goals in themselves don't bring happiness or fulfillment. Only goals that fulfill a purpose does that, but even if achieving the goal wasn't what you thought it would be you still have the experiences, skills and the actual result of the goal that you can take with you. So make sure that the journey is rewarding in itself, as it so often is.

To succeed with any goal, a plan and a way of sticking to the plan is all that's necessary. Of course, the knowledge of how to set goals, develop the steps that lead there and actually create the plan that binds it all together is needed - and that's something you need to research for each of your goals. This is the general formula that can be used for almost any goal, and you should recognize most of the activities from the previous blueprints.

Step 1: Define goals

The difference between a dream and a goal is that a goal is something clearly defined and attainable. Even with a goal that borders on being a dream due to external dependencies it's possible to set yourself up for success by having all basic requisites in place when the opportunity arises.

Make sure that your goals are based in your values and that you have ownership over the goal. Even if the origin comes from somewhere else, for example something you have to do to get a promotion at work, you need to make it your own. If it goes against your own values, maybe you work at the wrong place.

Be specific and break it down into the smallest actions or constituents that enables the overall goal, really trying to identify every last component that contributes to the overall result and understand how it contributes.

Step 2: Create a plan

Find the areas where you need to improve and define how to to measure progress and success. Identify the skills needed for completing or improving each component of the overall goal. For many goals a basic set of skills are needed which is then used for continuous progress towards the goal, the skills provide the foundation for progress but the actual work towards the goal is down to everyday choices and routines.

Figure out which components that gives the most results for the time and energy used. Start with these and then explore synergies between the actions needed to do them more efficiently or to get exponential results. Develop a progressive plan where you focus first on whatever gives the most results for the least invested time and effort. When starting to work on something more consciously there's usually some area that's been left behind even if you're a seasoned practitioner, improving in these will quickly lead to big improvements towards the goal.

Map out a high level plan to achieve the goal - spanning years or even decades if needed - making sure that there are partial goals to connect an overall arc leading to the final goal and that the goal is in line with your purpose.

Set up checkpoints for deciding on exact progress for the next phase, using an iterative approach to change direction when needed and having a method for continuous learning and improvement. Use periodization, when relevant, to avoid stagnating your development.

Step 3: Execute the plan

Follow the plan you've set out. Make sure to perform each activity and repetition with purpose as a chance to learn something new. Make notes and review what you could've done better, focusing on this or adapting the plan if needed. Trust your plan in taking you to your goal. If progress doesn't match the plan, adjust the method during the next checkpoint and evaluate if the overall plan is realistic. Perhaps another skillset or new knowledge is needed to design the plan, seek out expertise or learn more if that's the case.

Design habits and rewards for sticking to the actions in the plan, programming your brain to accept these routines as the new normal. Be proactive and prioritize tasks according to your agenda, making sure to be the master of your time and energy. Plan all major activities, those leading to your goals as well as other commitments, for each week in advance and start the day with what's most important to make sure it actually gets done. Set up reviews, preferably monthly, to evaluate the success rate of your plan, habits and routines and adapt if needed.

Summary

1. **Define goals**
    a. Map to your values and take ownership.
    b. Be specific with formulating goals.
    c. Break down goals into every last component.
2. **Create a plan**
    a. Identify what you need to learn.
    b. Use synergies for exponential results.
    c. Focus on the skills or activities that gives the most results first.
    d. Iterative approach with partial targets.
    e. Continuous learning.
3. **Execute the plan**
    a. Follow the plan and perform each activity and repetition consciously and with purpose.
    b. Use habits and rewards to reprogram your brain.
    c. Be efficient and preserve your energy for what’s important.
    d. Evaluate the day to day activities and adapt if necessary during reviews.

Final Words

I hope that this book has inspired you to not only take action to shape your economy to suit your lifestyle and financial goals, but also for you to bring out a pen and paper to design other aspects of your life and finding ways to use everyday habits to complete them.

There are techniques and insights everywhere, learn to spot the methods used and understand the reasoning behind them. Figure out if they can be adapted to your needs, if not you've gained one more repetition in the skill of continuous learning so the effort isn't wasted anyway.

My biggest reward for sharing this knowledge is to eventually find about your story and what The Flip enables you to do, what you are able to create and devote your time to once you have the freedom to do what you want. I'm also eager to learn what has worked for you and how you've improved on the methods.

Good luck, even though luck has nothing to do with it.