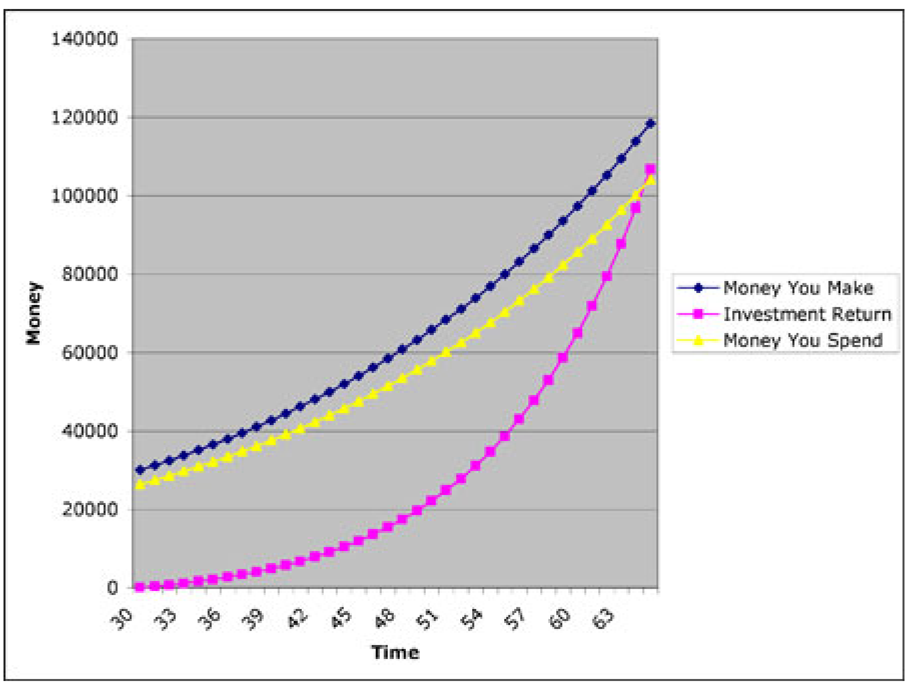
When Your Income From Investments Covers Your Living Expenses: The "Crossover Point"

By **Trent** January 12, 2007

About a month and a half ago, I read *Your Money or Your Life* and found it to be a revelatory experience (check out my review of the book). One particularly interesting part was a discussion of a concept that the authors referred to as the "crossover point." Since then, I've seen reference to this concept in other places under other names, but I'll continue to use the same name here.

What is the "crossover point"? The crossover point is the point at which your investments begin to earn more money than the cost of your living expenses. The crossover point is usually reached by keeping your living expenses lower than your income and investing that amount for the long term.

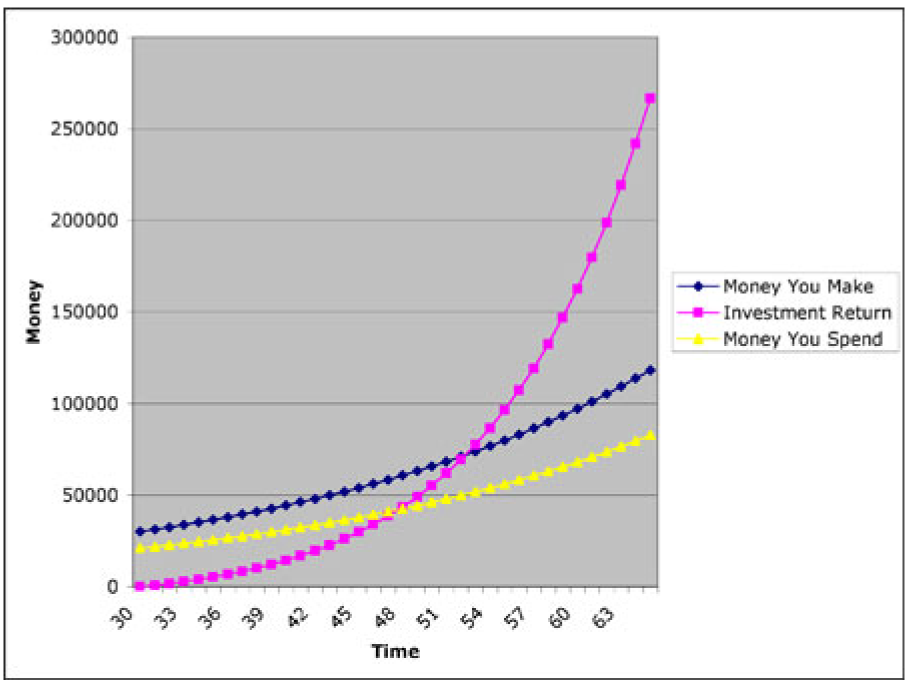
Let's use Joe as an example. Joe is 30 years old and has a steady job where he makes $30,000 a year with a 4% annual raise. He commits himself to spending only 88% of his income each year and investing the other 12%. He puts that investment in a balanced portfolio which earns an average of 9% a year. Let's see how this works for him:



As you can see, each year Joe earns an amount equal to the point represented in dark blue, but spends only an amount equal to the point colored in yellow. He invests the difference between the two. For the first several years, it doesn't seem to be doing him a whole lot of good: the pink dot represents the return on his total investment for the year (which Joe keeps rolling over into future investments). However, around age 50, this return on investment really starts taking off and, even though he's spending more money than he was before, he's still sticking to a 12% annual investment. At age 65, it finally happens: his investments return an amount greater than his living expenses for the year. He can continue with basically the same "salary" in perpetuity and never work again.

For many people, the "crossover point" is a major goal. It's the point at which your gainful employment has absolutely no impact on your ability to live your life; you can simply walk away and do whatever you want. For some, this literally becomes their life goal; although I haven't directly discussed it with him, I would speculate that my best friend is making lifestyle and investment choices so that he can reach his crossover point in his early 50s (according to my estimate).

Let's look at another example, that of Fran. Fran has the same job as Joe, but is a very frugal lady: she's committed to only spending 70% of her take home pay each year. Let's see how she does:



Fran reaches her crossover point at age 48, but chooses to keep on working. She has a second crossover at age 53 where her investment income exceeds her salary, but she keeps working. By age 65, her annual investment return is more than double her salary; she could quit, live off of even 70% of this, and more than double her living expenditures.

Awesome! I want in! There are two major challenges to achieving a crossover point that render it highly difficult in the modern world. First, it assumes a reasonably steady employment without any major crises, a giant assumption in the modern era. Second, it assumes that an individual is willing to *constantly* live below his or her means; in our consumerist world, very few people are willing to do this. Adding the two together makes for a nearly impossible task.

Of course, if you're really willing to focus on overcoming these two obstacles over a long period of time, the crossover point can come earlier than you think.

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