HOW PROFESSIONAL ATHLETES USE CONTRACT NEGOTIATIONS AND COMPOUND INTEREST TO SUPERCHARGE WEALTH

The current moment is full of uncertainties, which we think offers a good opportunity to reflect on a principle that never changes: the relationship between time, compound interest, and wealth creation.

Every year on July 1, famed New York Mets outfielder Bobby Bonilla gets a check for $1.19 million. He hasn't put on a uniform in twenty years.

When Bonilla was cut from the team in the year 2000 after several seasons of middling performance, the Mets owed him $5.9 million. Instead of collecting his due all at once, however, Bonilla decided to delay receipt of his first payment until 2011, and then spread the payments out over 25 years at an 8% annualized interest rate. In the process, he managed to turn the $5.9 million left on his contract into a total payout of ***$29.8 million***. Bonilla was 37 at the time he restructured his contract, and he will be 72 when he gets his final $1.2 million check. Bobby Bonilla used his bat and his glove to earn money on the field, and his wit and his patience to build incredible wealth off the field.

The famous hockey player Mario Lemieux played his cards a bit differently, but with a similar mindset. When the Pittsburgh Penguins owners declared bankruptcy in 1998, the star center Lemieux was their largest creditor—he was owed $32.5 million. Lemieux formed an investment group with famed investor and businessman Ron Burkle, and decided to take $20 million of what was owed to him and convert it into team equity, adding an extra $5 million to make him the team's controlling owner. Lemieux's $25 million investment twenty-one years ago still makes him the Penguins owner today, a team that *Forbes* estimates is now worth over $600 million.

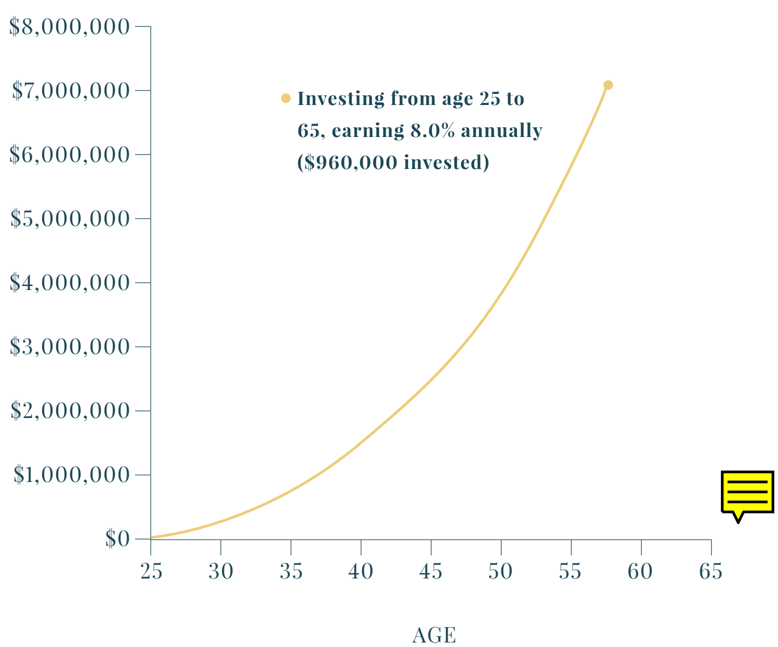
Back on the diamond, Ichiro Suzuki put together a hall of fame career and a similarly impressive retirement plan. Suzuki deferred 50%, or $7 million of his very first big league contract, which by itself demonstrates impressive restraint and long-term thinking. But he went even further and chose to defer $5 million each year from 2008 – 2012, for a total deferral of $32 million with interest. Though exact terms on the first deferral are not known, with a 5.5% interest rate and the final payment coming in 2032, we estimate that Ichiro will be paid more than $85 million on his deferral—making him the highest paid outfielder on the Mariners even though he retired last year.

Most people are not star athletes with multi-million dollar contracts and deferral offers of 8% annualized growth, guaranteed. But we all do have access to risk assets like stocks and real estate, where, generally speaking, long-term annualized growth rates also average 8% or more. Turning $1 million of savings into a $3.2 million estate requires just twenty years and 6% annualized growth.

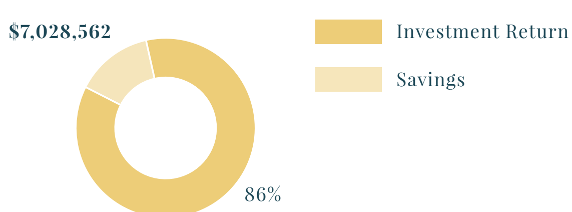
Twenty years may seem like a long stretch, but according to the Social Security Administration, a male turning 65 today can expect to live until age 84, while a woman turning 65 can expect to reach 86.5. For married couples, it is increasingly likely that one spouse will make it to 90. Many people also increasingly view wealth building as a multi-generational issue, with a goal of gifting money to charities, special causes, and heirs. In these cases, investment horizons are even longer and can span 50+ years.

One final example of the power of compounding interest, which you may find useful if you have kids or grandkids just getting started in the wealth building process. The graphic below offers a simple illustration of a person, starting with zero dollars, who invests $2,000 per month over 40 years and earns 8% annualized interest – a rate which represents a 20% discount to historical S&P 500 returns. At the end of the 40-year period, the person invested $960,000 but has a portfolio value of $7,028,562.

Account Growth of $2,000 Invested/Saved Monthly



ENDING PORTFOLIO



A majority of the portfolio's ending value is generated passively, driven by the combined powers of compound interest and time.

Source: J.P. Morgan

THE PANDEMIC IS NOT LIKELY TO CHANGE THE TRAJECTORY OF LONG-TERM RETURNS

For many, it may feel as though everything we once assumed to be true about life, work, and investing is set to change. In many ways, the pandemic is accelerating many changes that were already underway.

But we would stop short of thinking that the pandemic will stifle or even reverse the long-term trajectory of economic growth and asset returns. In fact, we might suggest just the opposite. When the bubonic plague struck Europe in the 14th century, many lives were lost but it also fundamentally changed the way people approached life, society, and systems in the Middle Ages. The next period in human history was the Renaissance.

The 1918-1919 Spanish flu pandemic infected around 500 million people worldwide ***(27% of the population)*** and reduced the population by 40 million people (including 675,000 in the US alone). World War I was happening simultaneously, making it one of the most uncertain and difficult periods in American history. What came next was the "Roaring Twenties."

All of these transitions in history have been messy and in some cases, brutal. But the thread that has never been broken over time is that of innovation, progress, and long-term growth. Capturing this growth over time is—and has always been—the key to wealth building and generational preservation.