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Making the Most of Your Money

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Dave Ramsey's 12% Solution

By ANN CARRNS

Associated PressThe financial guru Dave Ramsey in his broadcasting studio in Brentwood, Tenn., in 2009. Thousands of people swear by the philosophy of Dave Ramsey, an up-by-the-bootstraps kind of guy who doles out tough financial advice about getting out of debt and living within your means. His legions of fans call his nationally syndicated radio show to seek his advice, attend his self-help seminars in both big arenas and small church classrooms and buy his best-selling books and DVDs. He's part entertainer, part financial coach.

Mr. Ramsey has become immensely popular by giving out advice that includes "baby steps" to financial freedom, like saving \$1,000 in an emergency fund and getting rid of credit card debt. His Web site says his company, the Lampo Group, provides "biblically based, common-sense education and empowerment" which gives HOPE to everyone from the financially secure to the financially distressed."

Even his critics give Mr. Ramsey credit for helping thousands of people shed debt and build savings. But when it comes to his investment advice, financial advisers say he is wildly optimistic.

Particularly troubling, they say, are his statements about the potential returns to be had by investing in the stock market, and his recommendations on how much retirees can safely withdraw from their nest eggs each year. A sort of cottage industry has arisen of advisers who refute Mr. Ramsey's claims.

Mr. Ramsey often says, for example, that mutual fund investors can expect "average annual" returns of 12 percent, based on the long-term performance of the S&P 500. From 1926 through 2010, his Web site says, the index's average annual return is 11.84 percent. "When Dave says you can expect to make 12 percent on your investments," his site says, "he's using a real number that's based on the historical average annual return of the S&P 500."

The problem, financial advisers say, is that not all investments track the S&P 500, and using average annual returns is misleading. Thomas De Jong, a financial planner in Sioux Center, Iowa, who is affiliated with Money Concepts International, explains why, in a simplified example in a report he wrote about Mr. Ramsey's claims. (Mr. De Jong noted in a telephone interview that he was initially inspired to become a financial adviser after reading one of Mr. Ramsey's books.)

Here's a synopsis of Mr. De Jong's case: Say you invest \$10,000, and you double your money in the first year. You now have \$20,000, or a 100 percent return. But in year two, you lose 50 percent. Your balance is back at \$10,000. The "average annual return" on your investment is 25 percent (100 percent minus 50 percent divided by two years = 25 percent), but you have earned nothing.

"What is your true rate of return?" Mr. De Jong wrote in his report. "The answer, of course, is zero."

That's why knowledgeable investment advisers use "annualized" returns, also called the compound annual growth rate, to measure investments. That formula smooths out the swings in the market and shows what you've actually earned on your investment.

On a compounded basis, the S&P 500's return from 1926 through 2010 is just under 10 percent, about 2 percentage points less than the figure Mr. Ramsey points to. That might not sound like a lot, but over time the impact on your investment is enormous. Mr. De Jong gives a comparison and invites followers to check the numbers on this [financial calculator](#). (We updated Mr. De Jong's example using 2010 numbers):

- Say you start with \$100,000 in your investment account. After 30 years, at 12 percent annually (per Dave Ramsey's advice), you'd have **\$2,995,992**.
- At 9.89 percent annually — the S&P 500's true return from 1926 through 2010 — you'd have **\$1,693,344**.
- At 6.7 percent annually — the true S&P 500 rate, after adjusting for inflation — you'd have \$699,733. That's roughly a fourth of what Mr. Ramsey leads his devotees to expect.

The danger, advisers say, is that unsophisticated investors will be lulled into thinking that **they will have much more in retirement savings than they actually will. To make things worse, Mr. Ramsey also says retirees can withdraw as much as 8 percent of their nest egg each year for living expenses. Most advisers recommend no more than 4 to 4.5 percent, to avoid depleting their retirement funds too soon.**

So why does Mr. Ramsey use such high figures? He did not make himself available to explain. "Dave is currently working on the completion of his new book and unfortunately is not able to add anything to his schedule, at this time," a Lampo Group public relations assistant said in an e-mail. "He would like to apologize and thank you for requesting an interview."

While Mr. Ramsey doesn't have time to explain his investment philosophy, his staff has made time to talk to advisers who publicly disagree with his statements.

Rick Kahler, a financial planner in Rapid City, S.D., wrote a column in 2007 called "Dave Ramsey, How Could You?" and posted a video version on YouTube, taking issue with Mr. Ramsey's investment advice. (Mr. Kahler had heard Mr. Ramsey dismissing REIT funds on his radio show, in favor of growth mutual funds.)

Subsequently, a notice from Lampo Group was posted to YouTube, ordering Mr. Kahler to “cease and desist” using Mr. Ramsey’s name in the title of the video and in its “tags,” which are identifiers that allow Internet postings to show up in online searches.

Here’s the text of the message, which Mr. Kahler provided in an e-mail (it also links to the video):

“Dave Ramsey’s name and image, along with other properties of The Lampo Group, Inc. are legally trademarked. Any opportunistic use (including for-fee and nonprofit services/products) of these items without written consent of The Lampo Group, Inc. is strictly prohibited.

In order to protect the Dave Ramsey brand, The Lampo Group, Inc., customers, clients, and other third parties who are in agreement with Dave Ramsey, legal action will be pursued for trademark violations and copyright infringements with anyone who knowingly violates these rules.

We have found violations in your use of “Dave Ramsey” either in the title, keywords, or tags for the [YouTube videos](#) below.

Action Required: Cease and Desist using Dave Ramsey or related terms in the title, keywords, or tags of the video above and any other existing and future videos.

We expect compliance with the requested actions by 3/17/2008. Please also notify us when you have been able to comply with the things outlined in this email.”

Mr. Kahler said the issue eventually fizzled after he contacted Mr. Ramsey’s office. His Web site says he is a fan of Mr. Ramsey’s debt-free living advice, although he continues to be [publicly critical of his investment opinions](#).

Have you considered Mr. Ramsey’s investment advice? Are you confident in his understanding of how returns are measured?