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Five Lessons Investors Can Learn From Lottery Winners

Winning the lottery sounds like a dream. Overnight, it is possible (despite nearly impossible odds) to materially change your wealth and live a carefree, secure life. However, all too often, lottery winners find that dream to actually be a nightmare and end up losing everything within a matter of years!

How can this be?

This past month, the Powerball jackpot paid out the largest single jackpot in North American history – a whopping $758.7 million! We thought it a perfect time to look at five reasons why lottery winners squander their earnings, and point out lessons that can be learned for the non-lottery-winning investor.

1. Paying Taxes

Whether you are earning money, inheriting money, or winning the lottery, the government will want its share. In the case of the lottery winner who took home $758.7 million, that winner chose to take the lump-sum payment of $480 million – still not a modest amount! The State and Federal government ended up taking $144 million in taxes, leaving the winner with $336 million. Of course, this is still an absurdly large amount of money. However, it is a stark difference – less than half – than what is reported and what the winner perhaps thought she was taking home.

The same lessons can be applied to investors. If, for example, you have an IRA account, and you are counting on using that money to support your retirement, it is important to remember that the government will tax your distributions at your ordinary income rates. While you may be planning on taking distributions of $100,000, the government would tax you $20,000 or more (depending on your ordinary income rates at the time of the distribution). Especially over time, this may leave substantially less than what you planned.

The main lesson: when planning for retirement and forecasting distributions, make sure to remember to incorporate taxes in the calculation.

Taxes also play an important role in investing before retirement, as well, because they can deplete your earnings quickly. When investing, as we have written before, employing a tax-efficient strategy can often times leave more money in your pocket compared to a short-term strategy that buys and sells securities on a more frequent basis.

2. Wanting to Help Loved Ones

All of us want to help loved ones when possible. After winning the lottery, there have been several cases where winners simply could not say "no." This is somewhat understandable – it is human nature to feel guilty or selfish if you have the means to help family and friends without hesitation when it appears you have enough wealth to do so.

Still, this type of behavior can quickly lead to a depletion of wealth, especially when those "yes" answers are becoming more and more frequent. Whether you win the lottery or are investing a more modest amount, it is essential to "put yourself first" to some degree. This is not to say that you should avoid gifting altogether – that certainly is not the case. Instead, it is only to point out that you should begin developing a plan to incorporate your gifts, and stick to that plan as much as possible. In addition, you can use effective Estate Planning strategies to also help friends and family, or gift to charities. When executed properly and timely, these strategies can also help reduce your tax bill, allowing you to keep more of your well-earned money.

3. Managing Emotions

The third roadblock that lottery winners sometimes run into is a failure to properly manage emotions.

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One day, these winners may have been living paycheck to paycheck, and then the next morning, they won millions of dollars. Emotionally, these individuals go from one extreme to the other, which can often times cloud judgment.

You don't need to win the lottery to fall into this trap. For example, investors may get too high or too low when the market goes up and down, selling a business or inheriting wealth. As a result of these emotions, they may deviate from a well-planned investment strategy and miss out on earning large amounts of money in the long-term. Managing emotions can also be important when going through the Estate Planning process, whether for yourself or a closed loved one.

Managing emotions can be difficult, but the good news is that it is controllable. By sticking to a plan that is coherent and well thought-out, and focusing on long-term goals, investors can reduce their stress levels on a day-to-day basis and better control emotions.

4. Investing in Assets that Appreciate

A major culprit to depleting lottery winnings is spending more than you make. This seems obvious, and very difficult to accomplish given the large amount of winnings these individuals have to spend. However, it can be done, regardless of the money you are making, inheriting, or winning in a lottery.

We have written about the need to carefully examine one's spending habits before, and won't dwell too much on the point here. When you spend money on assets that appreciate, you greatly increase your chances of increasing your wealth. Spending large amounts of money on a large yacht or fancy car may feel good in the short-term, but has the potential to stall and deplete your accounts because these items require large amounts of money to maintain and depreciate fast not to mention the ongoing upkeep of these purchases.

Instead, it is critical to invest in assets that are appreciating and generating money to sustain your lifestyle. This is why it is prudent to invest in high-quality securities geared towards long-term growth – they have the highest likelihood to appreciate and grow your wealth over time.

5. Surround Yourself With the Right People

Last, but certainly not least, lottery winners often fail to surround themselves with the right people. Friends and families (as discussed above) may come forward with investment opportunities or a need for help. Strangers may even approach these winners promising to act in their best interest, only to be interested in making a quick buck for themselves.

The same is true for non-lottery winners, but maybe to a lesser extent. We always recommend working with an experienced attorney, accountant and, of course, a Registered Investment Advisor that will act as a fiduciary, like Investment Counsel. Surprisingly, not all investment professionals are required to do so, and it is important to know the distinction.

Conclusion

A disturbing amount of lottery winners have lost a majority, if not all, of their winnings. There have also been success stories. These individuals, despite each living somewhat different lives, generally acknowledged and incorporated the above five points into their long-term plan.

Though we would love for any of our clients to win the lottery, the unfortunate truth is that the chances are slim to none – there is a better chance of being struck by lighting twice in the same day according to the mathematical odds! Regardless of whether you win the lottery, these five lessons can be widely applied to investing to help create the best possible chances of growing wealth long-term. ■

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