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- » Walking through the steps of your first passive investment

# Chapter 1

# Passive Income 101

One of the hottest and fastest-growing financial topics in recent years has been *passive income*. When you think about it, you probably see passive income as part of the financial picture of the rich and affluent. Noted investor Warren Buffett famously said, “If you don’t find a way to make money while you sleep, you will work until you die.” Who wouldn’t want income flowing in without needing to work hard to get it? The great thing for you is, what’s growing just as fast (faster?) as the popularity of earning passive income are the choices and alternatives for earning it.

Many years ago, your choices for bringing in passive income were very limited: dividend stocks, interest-bearing accounts, annuities, and rental real estate. Perhaps I’ve missed an item or two here, but you get the picture. Fortunately, there’s been an explosion of various methods, strategies, and investment vehicles for gaining true passive income. The traditional ways still exist, but many new and improved strategies and methods have appeared on the scene in recent years.

The great news is, you have this book as a handy guide to help you understand all the ways to navigate this popular income-earning scene. Just be active (not passive!) with the information. This chapter gets you started on your passive income journey.

## Defining Passive Income

The purest form of passive income is a continuous stream of money that flows from a singular act or transaction requiring little or no maintenance on your part after the initial transaction. This book focuses on passive income from two different worlds: investing and business (see Chapter 3 for details on the differences between the two).



REMEMBER

You won't find any totally cost-free ways to generate passive income. You can come close, but some type of cost will exist. The cost will either be financial, or it will come in nonfinancial investments such as *sweat equity* (the initial setup work), or the learning curve of doing things to achieve the pending passive income.

The bottom line is, the passive income strategies I cover in this book don't require a lot of money to get started. Investing strategies will require some money, of course, but most investment vehicles and strategies can begin with as little as \$50 or \$100. Business strategies can be executed with no money at all. I discuss ways to find or make some money later in this chapter, so lack of money isn't an obstacle in the beginning.

For example, suppose you save up \$900; what can that cash produce for you via passive investing? Here are some possibilities:

- » You may buy some local public utility stock that earns a dividend yield of 6 percent. That's \$54 coming in per year. If you reinvest the dividend in the stock, you can grow your original \$900 into \$1,000, and then \$2,000, and on and on. If the stock increases its dividend, and you reinvest your earnings, your investment can grow to \$5,000, or \$10,000,

or more. By then, your annual dividend income can reach \$540 or more per year.

- » You may invest your cash in 100 shares of an optionable stock. You can then write a covered call option and easily earn a few hundred dollars (see Chapter 10). Say your investment earns \$200 in income. In that case, your \$900 has given you an effective dividend of 22 percent (\$200 divided by \$900). If you do that same covered call three times in a year, your \$900 will earn you \$600 in option income, which calculates to an effective dividend of 67 percent! And what if you reinvest that income? It can grow and grow . . .
- » You may use the \$900 to finance a business that gives you passive income from publishing, product sales, or affiliate marketing. Many businesses have generated a handsome income starting with much less. Eventually, you can sell the business, if it's generating income, for a large sum. Even if it generates income of only \$5,000 per year, on a price-to-earnings ratio of 15 (discussed in Chapter 5), that means your business may have a market worth of \$75,000!

These three scenarios aren't unreasonable. And I can go on and on. Rich people will be the first to tell you that small sums invested and reinvested over time become substantial wealth.

In my \$50 wealth-builder course — a class I've offered every year since 1983 — I tell folks what I'm telling you now: Building wealth, including wealth that yields significant passive income, isn't one big thing that you do. It's the hundred little things you do, day in and day out, over months and years, that give you the life-changing wealth you seek.

So, take to heart all the passive income strategies I share with you in this book, get really good at a few of them, make them grow, and you'll do very well.



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In this book I focus on passive income, of course, but some folks may be better off with *passive gains*. In other words, they'll make that initial singular transaction or effort but get their payoff in long-term appreciation (long-term capital gains) rather than income.

# Checking Out Categories of Passive Income

You don't have to be an expert in every kind of passive income strategy. Your greatest chance of success is to focus on one category or strategy. Get good at that, and do it over and over.

What's that, you say? You've had some success with recording an audiobook or selling artwork? Great! Just do it over and over, get excellent at it, and dominate your market. The passive income will build up, and the gains will come easier over time.



REMEMBER

Take a look at some of the different types of passive income categories:

- » **Investment:** This is the simplest one. You make an investment and get regular, predictable income through either dividends or interest. Examples include stocks, bonds, and the world of funds (exchange-traded funds, mutual funds, and so on). Investing is covered in greater detail in Chapters 4, 5, 6, 7, and 12.
- » **Real estate:** Although it can be lumped into the preceding category, real estate has enough variety and specialization to be its own category. Passive income opportunities range from hands-on real estate and limited partnerships, to real estate investment trusts and mortgages (covered in Chapter 9).
- » **Trading:** You can earn passive income by utilizing call and put options that complement your regular investment portfolio. Find out about call options in Chapter 10 and put options in Chapter 11.
- » **Traditional:** Social Security, pensions, and annuities are in this category. Annuities are covered in greater detail in Chapter 8.
- » **Business creative:** This involves creating something of value and putting or posting it in a suitable marketplace. Your creation can be an e-book, a course, artwork, and the

like. See Chapters 13, 14, and 15 for more on creating business income. Chapter 19 gives you 10 business ideas.

» **Business marketing:** This may include securing licenses and marketing arrangements to make money from what others create. Affiliate marketing, covered in Chapter 16, is an example of this.

## Finding Your Own Investable Cash

You may not be at the point where you have an investable million bucks on hand for your juicy passive income strategies to become 100 percent financially free . . . yet. But everyone has a starting point in their own personal situation. In the following sections, I provide some guidance on getting a hold of cash to invest.



TIP

You can find more income sources and ideas at [www.ravingcapitalist.com/PIFD](http://www.ravingcapitalist.com/PIFD).

### Selling your stuff

A few years ago, I sold a large batch of my childhood comics to a comic book dealer and got \$900. No, that's not a fortune, but it's always nice to free up a little money that can become productive and earn some passive income.



TIP

Perhaps you have some valuable items sitting around and gathering dust. Why not put those things to good use as you pursue passive income? Here are some examples of stuff you can convert into cash and where to go for more details on selling it:

» **Clothes and more:** Visit Poshmark ([www.poshmark.com](http://www.poshmark.com)), ThredUp ([www.thredup.com](http://www.thredup.com)), and Vinted ([www.vinted.com](http://www.vinted.com)).

- » **Designer handbags:** Check out Fashionphile ([www.fashionphile.com/pages/sell-with-us](http://www.fashionphile.com/pages/sell-with-us)).
- » **Furniture:** Try AptDeco ([www.aptdeco.com](http://www.aptdeco.com)).

## Trying fun activities

By “fun activities,” I mean income-producing activities that aren’t work at all if you think about it. Everyone generally does something day in and day out without viewing it as work or an activity that can generate income. Which of the following things are you doing just for fun . . . or just because you have some time on your hands? Here are some suggestions for turning those activities into money you can invest:

- » Do you like to shop? (That’s a dangerous question for some of my family members.) But if you like to shop, why not earn some money while you do it? Consider mystery shopping gigs with sites like Market Force ([www.marketforce.com](http://www.marketforce.com)), Secret Shopper ([www.secretshopper.com](http://www.secretshopper.com)), and BestMark ([www.bestmark.com](http://www.bestmark.com)).
- » Do you spend a lot of time surfing the internet on your laptop or smartphone? You can get paid while you do it. Check out paying gigs at Swagbucks ([www.swagbucks.com](http://www.swagbucks.com)) or InboxDollars ([www.inboxdollars.com](http://www.inboxdollars.com)).
- » Is driving fun for you? Look into getting some driving gigs with Uber ([www.uber.com](http://www.uber.com)) and Lyft ([www.lyft.com](http://www.lyft.com)).
- » Love going to restaurants? Hey, who doesn’t? You can make money while you enjoy your next meal at a restaurant. Check out Coyle Hospitality ([www.coylehospitality.com](http://www.coylehospitality.com)) and BestMark ([www.bestmark.com](http://www.bestmark.com)).
- » Enjoy giving your opinions? In my opinion, you can make money while sharing your opinion. Earn some bucks telling people what you think at Survey Junkie ([www.surveyjunkie.com](http://www.surveyjunkie.com)) and User Interviews ([www.userinterviews.com](http://www.userinterviews.com)).



TIP

If you make an additional \$1,000 per year from fun activities, set a goal of devoting \$250 or \$500 to dividend-paying stocks or exchange-traded funds (ETFs). How much would you have after five or ten years of doing something this simple?

## Building Your Passive Income Spreadsheet

Got some cash to start earning passive income? Great! Use your favorite spreadsheet program to track your passive income portfolio. The following sections can help you with the initial setup.

### Determining whether you can depend on your passive income

Just so you have an easier time tracking and predicting your passive income, figure out each type's pros and cons. Here are some questions to address in your passive income tracking sheet:

- » **Is the income predictable?** If so, is it paid monthly, quarterly, or on some other schedule? Dividend payments are predictable and usually occur quarterly (though some are monthly). Interest from bank accounts and brokerage accounts can be earned monthly. Meanwhile, interest from bonds tends to be semiannual.
- » **Is the payment fixed or variable?** For example, the type of payment you receive from an annuity depends on the type of annuity you have. The typical annuity has a fixed payment that arrives monthly, but some are different (see Chapter 8 for details).
- » **Is the income unpredictable?** If you get income from royalties and affiliate sales funnels, you may get great income for a given month . . . but little or nothing the following month. If you get money from the sale of subscriptions, the payment may be monthly and fixed but can end abruptly if anyone cancels their subscription.

Get familiar with how your preferred passive income methods work so you have a better handle on your current and future income.



TIP

If you're getting your passive income from unpredictable sources such as business projects, consider pledging to yourself that you'll take a chunk of that money and put it into investments to build your investment-related passive income. Make it a habit to regularly funnel money into that investment and keep building it. Try to do it monthly or quarterly if possible. At the very least pledge to invest whatever you can to keep building up your income-producing investments.

## Watching your income grow

Most folks track their wealth by regularly checking out their *net worth* — their total assets minus their total liabilities. They track their progress by making sure their net worth is rising, year in and year out. Some folks check monthly or quarterly. This is all good; everyone should be regularly tracking their net worth to ensure their financial progress and wealth-building continue for the foreseeable future.

But what does the passive income enthusiast track? Cash flows. You keep track of the passive money that's coming in (dividends, interest, annuity payments, and so on), and you watch for target amounts that become milestones as you head toward the ultimate goal of passive income: getting to the point that your passive income meets or exceeds the income levels you need to be financially free and stop working for someone else. (Find out more about planning for these milestones in Chapter 2.)

Given that goal, you can create a spreadsheet (or get software) to track your passive income. Table 1-1 provides an example.



REMEMBER

Some columns to consider for your spreadsheet are as follows:

- » **Investment type:** What kind of investment is it? Stocks, bonds, funds, or something else?

- » **Income type:** Is the income interest, dividends, or capital gains? This will be necessary to discern potential taxes (see Chapter 17).
- » **Annual yield:** What income is it generating: 4 percent, 6 percent, 10 percent, or another percentage? You want to know which investments are doing better than others.
- » **Annual income:** What total annual income is being generated? Are you doing better than the year before? How can you grow this total annual amount?

**TABLE 1-1**

### An Example of Tracking Passive Income

Investment Type	Income Type	Annual Yield	Annual Income
100 shares of Stock A	Qualified dividend	4%	\$400
50 shares of ETF B	Qualified dividend	5%	\$250
\$10,000 corporate bond	Taxable interest	3%	\$300
	Annual estimated income		\$950

Other helpful questions to ask yourself (and columns you may want to add to your spreadsheet) include the following:

- » **Last year's payout:** How does a particular investment perform this year versus how much you earned last year?
- » **Tax rate:** You should know to what extent taxes are affecting your return. Are your gains fully taxable, nontaxable, or subject to different tax rates? (See Chapter 17 for tax matters.)
- » **Cost basis:** If you bought a stock or ETF when it was \$50 per share and now it's \$98 per share, what's your actual yield given the stock's original cost?
- » **Your goal:** How much passive income do you want coming in annually? If you're seeking to be 100 percent financially independent with your passive income, you'll need to know what the shortfall is and how you're addressing it going forward.

# Starting with a Few Easy Steps

From the suggestions given earlier in this chapter (and some ideas you came up with on your own), scrounge up, say, \$50 or \$100 to start. Take this money and follow these steps to keep your first passive income strategy simple:

**1. Open a stock brokerage account and deposit the money you've saved.**

For starters, park your money in the broker's high-yield money market account.

**2. Buy a few shares of a nice dividend-paying ETF.**

Some pay quarterly; some pay monthly. Most will pay a yield of 4 percent or higher. See Chapter 7 for info on how to choose an ETF.

**3. Turn on the feature on your broker's website to designate the dividends for reinvestment.**

When you choose this option, you're ensuring that your initial investment continues to grow.

**4. As money comes in, keep adding to this position (investing in the income-producing ETF).**

Investment vehicles such as stocks or ETFs have the potential for good appreciation over time. One ETF I purchased years ago at about \$60 per share is now worth more than double that. Meanwhile, the dividends increased by nearly 300 percent over the same period of time.

**5. Now you have your first passive income investment!**

At this point, start to explore all the other strategies you can deploy to keep your passive income portfolio growing.



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