Bobby Bonilla and Compound Interest - Transcript

Tom Mullooly: In episode 147, we're going to talk about the magic of compounding, just not how you might expect it. I'll give you a hint. Let's go, Mets! Stick around.

Welcome to the Mullooly asset show. I'm your host, Tom Mullooly, and this is episode number 147. Thanks for tuning in.

You see a lot and read a lot about compounding, especially from our industry. I'm going to show you an example in living color of how compounding can work.

The New York Mets, my favorite whipping boy, wanted to release Bobby Bonilla back in 2000, so this is almost 20 years ago, but there was a problem. They owed him money on his contract. They owed him $5.9 million. Remember that number. $5.9 million. The Mets cut a deal with Bobby Bo, and what they wanted him to do was basically walk away, but instead of getting a check or paychecks the rest of that year, these geniuses at the Mets in Queens gave out the following terms.

What they said was, "Hey, we'll defer the payments from 2000, where they were now, till 2011, so 11 years of compounding. Then, we're going to pay the money out over 24 more years, starting in 2011, so it's going to go through 2035." We're recording this in 2019. Bobby Bo is still going to get 16 more checks from the New York Mets. Unbelievable. At the end of the deal, Bobby Bonilla will have been paid $29.8 million from, remember the number, 5.8 so ... I'm sorry, 5.9. 5.9 grew to $29.8 million.

And every year, on July 1st, the Mets send Bobby Bonilla a check for $1,190,000. Pretty good gig. Bonilla actually had an earlier contract that was split between the Mets and the Orioles, because there was a trade involved where he was collecting about $15 million. So, say what you want about Bobby Bonilla, he and his agent are pretty good at math, and they understand compounding, and it's pretty clear that the Mets don't know two things. They don't know how to build a bullpen, and they don't know much about math.

See, at the time, in 1999 and 2000, the Mets were totally wrapped up with Bernie Madoff, who was telling them, "I guarantee you you're going to make 10% a year." So, they turned around and guaranteed Bobby Bonilla that he was going to make 8% a year. So, they compounded his money for 35 years at 8% because the Mets thought they were going to make money on this guy. Well, we'll make 10 but we'll pay him eight. We'll make money on his money.

So, let me ask you a question. Have you put money into a retirement account? You know, an account that you're not supposed to touch. I know a lot of people go in, they take loans from their retirement account or they'll just close out their account when they leave a job or they'll just stop contributing to it. Then you understand how compounding can work, but the problem is it won't work, compounding won't work if you keep tearing up the game plan and keep changing the investment.

Likewise, you hear all these stories about people with $200,000 in student loans, but they didn't go to medical school and they didn't go to law school. Many times when you read these stories, you find out that these people stopped paying their student loans, and the interest just continues to pile up every day. So compounding can work for you or compounding can work against you. It's important to know which side you're on.

For example, if you buy a house for 400 grand and you put 20% down, or $80,000, you're borrowing $320,000. Think about that. You're borrowing $320,000. Let's just do a simple math illustration. You take out a mortgage for 30 years, you pay 5% interest. Over 30 years, that $400,000 home is going to cost you $720,000 in payments, including 300 grand in interest.

Compounding can work for you; compounding can work against you. That's the lesson behind Bobby Bo and episode 147.

Thanks for tuning in.