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Notes on *Fail-Safe Investing* by Harry Browne

"Rule #1: never lose money. Rule #2: never forget Rule #1."

Warren Buffett, renowned investor

For many (if not most) of us, business is attractive because it's a way to make money: to support ourselves and our loved ones, and to get more of what we want out of life. It's ironic that one of the biggest threats to our long-term financial success is our personal investment strategy. With plenty of market volatility to go around these days, it pays to consciously adopt a sane, secure long-term investing strategy.

That's where Harry Browne's *Fail-Safe Investing* comes in.

Here are 10 big ideas from *Fail-Safe Investing*.

1. No one can predict the future. Period.

No one has the foggiest idea what's going to happen next week, let alone next year. The future is an inherently uncertain place that changes all the time. No one - absolutely no one - is omniscient.

That includes YOU. Beware Excessive Self-Regard Tendency. It's tempting to believe that you have insights that others don't have, and see things others can't (or don't) see. It's also tempting to believe other people, like advisors or fund managers, have this capability. They don't.

Embracing the uncertainty and change that exists in the world is the first step toward becoming a sane investor. Once you truly grok the truth that the future is essentially unpredictable, you stop trying - and you stop making stupid mistakes that lose money, which helps you get better results.

2. Your career is your #1 source of wealth: don't assume your monetary wealth is quickly replaceable.

When it comes to investing, it pays to err on the side of safety. Your career is (and will continue to be) your #1 source of material wealth. Most of the money you'll make in your life will come from your career. The money you have to invest as capital will come from your career.

You work hard for your money, so don't part with it quickly for a promise of huge speculative returns. If you experience losses, you may very well not be able to get that money back.

On the flip side, investing in your own personal knowledge and capabilities always provides the best returns. Too many people spend time and energy trying to perfect their investment approach, at the expense of developing their career. That's a mistake.

By investing your money in books and courses that improve your skills and capabilities, you can use what you learn to build businesses that bring in tens of thousands (or millions) of dollars every year. You'll never find a better return on investment anywhere.

I recommend setting aside a certain sum of money every month in a "Personal R&D" account earmarked for personal investment. Investing in yourself will pay dividends for rest of your life.

3. There's a huge difference between investment and speculation.

Investment is using your capital to purchase assets you believe will appreciate in value. Most people think of investing as purchasing things like common stock in a company, but there are many potential types of investments.

It's impossible to tell in advance how a particular investment will work out. Even with the best research, it's very likely one or more of your investments won't work out: that's risk.

Since no one can predict the future, markets fluctuate in an effort to establish prices for goods and services - an outcome of the Pricing Uncertainty Principle. In general, you should expect the same return that the "market" in the overall economy or industry is providing - the price the market has temporarily settled on in the face of uncertainty and change.

Speculation is prediction about how the world is going to turn out in some way, at some point. When you go to Las Vegas and play roulette, you're speculating. When you purchase stock in an individual company with the expectation that the company will beat the market, you're speculating.

4. Foolproof speculative systems don't exist. Period.

If someone tries to sell you a method to grow your money through speculation, it's a scam. If such a system existed, (1) the seller would have to possess some means of predicting the future, and (2) they'd be making so much money that they'd have absolutely no need to sell it to you.

Your long-term investment portfolio should, first and foremost, be structured in a way to minimize your risk of loss. Never speculate with funds you need to pay your day-to-day expenses or handle emergencies.

5. Speculate only with money you can afford to lose.

Speculating can certainly be fun. Without a huge element of luck, however, it's a recipe for poor returns. For example, if you go to Las Vegas and place a huge bet on a single number on the roulette wheel, you can certainly make a lot of money fast. You can also lose that money incredibly fast - and the odds are in favor of your loss, not your gain.

The same thing goes for investing in individual companies. It's one thing to invest your time, energy, and funds into building your own company: you have a large amount of control, and can personally make decisions to ensure the safety and growth of your capital.

That's not true for purchasing stocks in individual companies: you have no control over their operations, the decisions of management, regulatory issues, etc. unless you're purchasing a Warren Buffett-size stake in the company. Speculation opens you up to massive losses: losses that you may not be able to afford.

If you choose to speculate, do so consciously. Don't rob your "permanent" investment funds to fuel your speculation.

6. Make your own decisions - never give anyone else direct control over your money.

No one cares as much about your financial situation as you do. That includes brokers, mutual and hedge fund managers, "wealth management" advisors, etc.

Remember, foolproof speculative systems don't exist. Brokers, fund managers, and advisors are more than happy to speculate with your money, regardless of your real returns, because you're paying them to do it.

Remember: people become wealthy by selling things, not by buying them. You're certainly free to give a manager 2% of your savings every year to underperform the market, or pay a broker thousands of dollars in unnecessary transaction fees every year... but I don't advise it if you want good investment returns.

Every dollar you pay someone else to manage your money is a dollar that's not working for you. Once you account for all cases of luck, there's no such thing as a "winning" fund manager or advisor.

7. The best approach to investing is to put your money into a “Permanent Portfolio” and keep it there.

If no one can predict the future, it pays to build your investment approach around that fact. Instead of assuming the stock market will always go up, or that a particular investment will do well over time, it pays to construct your investment portfolio so that it does as well as possible regardless of what happens in the world.

Browne’s “Permanent Portfolio” is build for resilience: it’ll preserve your capital even in the worst economic conditions, and perform as well (or better) than a 100% total stock market portfolio over the long term.

To understand how Browne’s portfolio is constructed, it helps to know a little bit of economics.

8. There are four broad economic forces: prosperity, recession, inflation, and deflation.

According to Browne, there are four major basic forces in every economy:

Prosperity is a period in which businesses are growing, customers are spending, and unemployment is falling.

Recession is a period in which businesses are shrinking, customers aren’t spending, and unemployment is rising.

Inflation is a period in which prices are rising as the purchasing power of a currency shrinks due to increased supply. (This is good for people who own real assets, but bad for people who hold cash.)

Deflation is a period in which prices decline as the purchasing power of a currency increase due to a contraction in monetary supply. (This is good for people who hold cash, but bad for people in debt.)

So, to summarize:

- Businesses will either become more successful… or they'll become less successful.
- A currency will either become more valuable… or it'll become less valuable.

Certainly not rocket science, right?

Remember: we can't predict the future. We don't know exactly what will happen, but we do know that some combination of these definitely will happen.

The Permanent Portfolio is constructed with uncertainty and change in mind. The portfolio is essentially a system of counterbalances: if businesses are doing poorly for a while, you want another asset that will do well during that time, and vice versa. If your currency is becoming less valuable over time, you'll want an asset that becomes more valuable during that time, and vice versa.

Here's Browne's recommended "Permanent Portfolio" asset allocation:

- 25% Total Stock Market Index - does well in prosperity, not well in recession, inflation, and deflation
- 25% Cash - does well in deflation, preserves value in recession (for rebalancing), not well in prosperity inflation

- 25% Gold - does well during inflation, poorly during deflation
- 25% Long-Term Government Bonds - does well during deflation and prosperity, poorly during inflation and recession, with the lowest possible credit risk.

The beauty of this system is in its simplicity. These four asset classes aren't highly correlated to each other: they move largely independently, and opposite to each other. When the stock market goes down, gold and bonds tend to go up. When gold or bonds go down, the total stock market is probably rising.

The other beautiful aspect of this system is how it avoids Loss Aversion. Humans universally hate to lose - they even hate the potential or perception of loss, however transitory that loss actually is.

Alternatively, you can think of the Permanent Portfolio as being the four major asset classes that people flee toward when things get scary. When business is good, everyone is interested in stocks. When inflation, deflation, or recession are looming, investors flee stocks into Bonds, Gold, or Cash. By owning all four asset classes, you're covered, regardless of the whims of the market.

The Permanent Portfolio's system of asset counterbalances is an enormous psychological help: it smooths what would typically be a jumpy 100% stock portfolio into a very manageable (dare I say boring?) steady upward climb. When most investors are up at night worrying about the stock market, Permanent Portfolio investors don't even notice.

So how does it perform?

The largest single yearly loss the Permanent Portfolio has experienced was (~~3.9%) in 198## 1. The compound annual growth rate from 1972-2009 was +9.7%.

When most 100% stock investors experienced a loss of in 2008, the Permanent Portfolio gained +1.8%. The portfolio returned *7.8% in 2009“:http://crawlingroad.com/blog/2010/01/01/permanent-portfolio-results-2009-a-thrilling-ride/, and”*14.5% in 2010.

Those are very good numbers for an entirely passive, decision-free, low-cost investment strategy. That’s why I personally use a Permanent Portfolio allocation for 100% of my long-term investment funds.

9. Personal debt and leverage are extremely dangerous: tread cautiously.

Leverage is like rocket fuel - it can propel you to amazing heights, or explode disastrously. Leverage works both ways: it multiplies your potential for losses, as well as potential gains. When someone goes bankrupt, it’s usually because they tried to grow their net worth via leverage: borrowing money in an attempt to magnify returns.

Avoid the temptation to borrow money. Whether it’s to purchase a big house, buy new toys, or magnify your investing, borrowed money can get you into trouble, particularly if you find yourself in a cash crunch.

The best thing you can do to improve your personal financial stability is to create an emergency fund 2-12 months of living expenses, which can help you weather personal crises or take advantage of unexpected opportunities.

10. When in doubt, err on the side of caution to prevent costly mistakes.

It’s easy to make poor investment decisions if you don’t understand what you’re doing. When in doubt, it pays to wait, do your research, consult an advisor, etc.

Avoiding preventable mistakes is one of the best ways to ensure your long-term financial success. I can’t count the number of times I’ve avoided disaster by listening to my gut, and choosing not to move forward with a decision that didn’t feel right for me.

If you're still not sure of what's going on, or don't feel right about the choice you're making: don't do it.

To supplement these notes, I've put together a detailed summary of how I personally invest using the Permanent Portfolio. I hope you find it useful.