Introduction: The Greatest Show on Earth

- Success with money relies more on Psychology than Finance
- The premise of this book is that doing well with money has little to do with how smart you are and a lot to do with how you behave. And behavior is hard to teach, even to really smart people
- Remember the story of the following two characters: Ronald Read was patient while Richard Fuscone was greedy
- Financial success is not a hard science. It is a soft skill, where how you behave is more important than what you know

Chapter 1: No One's Crazy

Your personal experiences with money make up maybe 0.00000001% of what has happened in the world, but maybe 80% of how you think the world works

- People do crazy things with money. But no one is crazy because the way we see the world is also different
    - We see the world through a different lens
- The challenge for us is that no amount of studying or open-mindedness can genuinely recreate the power of fear and uncertainty
- Economists have found that people's lifetime investment decisions are heavily anchored to the experience those investors had in their own generation – especially experiences early in their adult life
- Economists have written: "Our findings support that individual investor's willingness to bear risk depends on personal history"
    - Just dumb luck on when and where you were born
- It was not until the 1980s that the idea that everyone deserves and should have a dignified retirement took hold
    - And the way to get that dignified retirement ever since has been an expectation that everyone will save and invest their own money
    - It should surprise no one that many of us are bad at saving and investing for retirement

Chapter 2: Luck & Risk

Nothing is as good or as bad as it seems

- One in a million high-school-age students attended the high school that had the combination of cash and foresight to buy a computer. Bill Gates happened to be one of them
- Bill Gates experienced one-in-a-million luck by ending up at Lakeside High School
    - Kent Evans experienced one in a million risk by never getting to finish what he and Gates set out to achieve
- Luck and risk are both the reality that every outcome in life is guided by forces other than individual effort

  - They both happen because the world is too complex to allow 100% of your actions to dictate 100% of your outcomes
- They are driven by the same thing: You are one person in a game with seven billion other people and infinite moving parts.
  - The accidental impact of actions outside of your control can be more consequential than the ones you consciously take
- For every Bill Gates there is a Kent Evans who was just as skilled and driven but ended up on the other side of life roulette
- If you give luck and risk their proper respect, you realize that when judging people's financial success – both your own and others – it is never as good or as bad as it seems
- The line between bold and reckless can be thin
  - When we do not give risk and luck their proper billing it is often invisible
- What is the lesson for entrepreneurs here? I have no idea because risk and luck are so hard to pin down
- Risk and luck are doppelgangers
- Two things to point you in the right direction
  1. Be careful who you praise and admire
  2. Be careful who you look down upon and wish to avoid becoming
     - Just be careful when assuming that 100% of outcomes can be attributed to effort and decisions
- Answer: Therefore, focus less on specific individuals and case studies and more on broad patterns
- The more extreme the outcome, the less likely you can apply its lessons to your own life, because the more likely the outcome was influenced by extreme ends of luck and risk

Chapter 3: Never Enough

When rich people do crazy things

- "There is no reason to risk what you have and need for what you don't have and don't need."
  1. The hardest financial skill is getting the goalpost to stop moving
  2. Social comparison is the problem here
  3. "Enough" is not too little
  4. There are many things never worth risking, no matter the potential gain
- It gets dangerous when the taste of having more: more money, more power, more prestige – increases ambition faster than satisfaction
- **Modern capitalism is a pro at two things: generating wealth and generating envy**
- The general goal: the trick when dealing with failure is to arrange your financial life in a way that a bad investment here and a missed financial goal there will not wipe you out so you can keep playing until the odds fall in your favor
- The point is that the ceiling of social comparison is so high that virtually no one will ever hit it
  - **Accept that you might have enough, even if it is less than those around you**

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- Reputation is invaluable
- Freedom and independence are invaluable
- Family and friends are invaluable
- Being loved by those who you want to love you is invaluable
- Happiness is invaluable
- Your best shot at keeping these things is knowing when it is time to stop taking risk that might harm them. Know when you have enough
- Happiness = Results – Expectations

Chapter 4: Confounding Compounding

$81.5 billion of Warren Buffett's $84.4 billion net worth came after his 65th birthday. Our minds are not built to handle such absurdities

- If something compounds – if a little growth serves as the fuel for future growth – a small starting base can lead to results so extraordinary they seem to defy logic
- Buffet's fortune is not due to just being a good investor, but being a good investor since he was literally a child
  - The real key to his success is that he has been a phenomenal investor for three-quarters of a century
- Effectively all of Warren Buffet's financial success can be tied to the financial base he built in his pubescent years and the longevity he maintained in his geriatric years
- His skill is investing, but his secret is time → that is how compounding works
- **Compounding is counterintuitive because we are wired for linear thinking**

Chapter 5: Getting Wealthy vs. Staying Wealthy

Good investing is not necessarily about making good decisions. It is about consistently not screwing up

- There is only one way to stay wealthy: some combination of frugality and paranoia
- Getting money is one thing. Keeping it is another as they are two different skills
- Getting money requires taking risks, being optimistic, and putting yourself out there
- Applying the survival mindset to the real world comes down to appreciating 3 things:
  1. More than I want big returns, I want to be financially unbreakable. If I am unbreakable, I will get the biggest returns because I will be able to stick around long enough for compounding to work wonders
  2. Plan on your plan not going according to plan
  3. A barbell personality – optimistic about the future, but paranoid about what will prevent you from getting to that future – is vital
- As mindset that can be paranoid and optimistic at the same time is hard to maintain, because seeing this as black and white takes less effort than accepting nuance
- You need short-term paranoia to keep you alive long enough to exploit long-term optimism

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Chapter 6: Tails, You Win

You can be wrong half the time and still make a fortune

- The great art dealers operated like index funds
  - They bought everything they could
  - And they bought portfolios of art, not individual pieces they happened to like
  - Then they sat and waited for a few winners to emerge
- Anything that is huge, profitable, famous, or influential is the result of a tail event – an outlying one-in-thousand or million event
- **Remember, tails drive everything**
- 40% of companies in the Russell 300 failed
  - But since 1980 the index has increased 73x. How?
  - Because 7% of the companies in the index performed tremendously well
- Your success as an investor will be determined by how you respond to punctuated moments of terror, not the years spent on cruise control
- Something I have learned from both investors and entrepreneurs is that no one makes good decisions all the time
  - The most impressive people are packed full of horrendous ideas that are acted upon
- When we pay special attention to a role model's success, we overlook that their gains came from a small % of their actions

Chapter 7: Freedom

Controlling your time is the highest dividend money pays

- Money's greatest intrinsic value is its ability to give you control over time
- **The United States is the richest nation in the history of the world**
  - **We have used this wealth to buy a lot of things but we have simultaneously given up more control over our time**
- Compared to generations prior, control over your time has diminished
- Controlling your time is the highest dividend money pays
- "Wise old owl lived in an oak, The more he saw the less he spoke, the less he spoke, the more he heard, why aren't we all like that wise old bird?"

Chapter 8: Man in the Car Paradox

No one is impressed with your possessions as much as you are

- If respect and admiration are your goal, be careful how you seek it.
  - Humility, kindness, and empathy will bring you more respect than horsepower ever will

Chapter 9: Wealth is What You Do Not See

Spending money to show people how much money you have is the fastest way to have less money

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- We tend to judge wealth by what we see, because that is the information, we have in front of us
- Wealth is the nice cars not purchased
- Wealth is financial assets that have not yet been converted into stuff you see
- The only way to be wealthy is to not spend the money that you do have
- Rich is current income while wealth is income not spent
- Exercise is like being rich.
    - You think "I did the workout and I now deserve to treat myself to a big meal."
    - Wealth is turning down that treat meal and actually burning net calories
    - It is hard and requires self-control
- Financial assets not yet spent gives you freedom and flexibility

Chapter 10: Save Money

The only factor you can control generates one of the only things that matters. How wonderful

- The first idea – simple, but easy to overlook – is that building wealth has little to do with your income or investment returns, and lots to do with your savings rate
- The world grew its "energy wealth" not by increasing the energy it had, but by decreasing the energy it needed
- Investment returns can make you rich, but remember that investment results are shrouded in uncertainty
    - Thus, personal savings and frugality – finance's conservation and efficiency – are parts of the money equation that are more in your control
- Building wealth is powered by your own frugality and efficiency rather than by requiring more money or big investment returns
- Wealth is just the accumulated leftovers after you spend what you take in
- More importantly, the value of wealth is relative to what you need
- Goal: learn to be happy with less money because it creates a gap between what you have and what you want
- Past a certain level of income, what you need is just what sits below your ego
- Everyone needs the basics. Once they are covered there is another level of comfortable basics, and past that there's basics that are both comfortable, entertaining, and enlightening →Maslow's Hierarchy of Needs
- Think of it like this, and one of the most powerful ways to increase your savings is not to raise your income. It is to raise your humility and reduce your spending
- Define savings as the gap between your ego and your income
- People's ability to save is more in control than they might think because savings can be created by spending less
- You do not need a specific reason to save … Saving is a hedge against life's inevitable ability to surprise the hell our of you at the worst possible moment
- **Every bit of savings is like taking a point in the future that would have been owned by someone else and giving it back to yourself**

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- That flexibility and control over your time is an unseen return on wealth
    - What is the return on cash in the bank that gives you the option of changing careers, or retiring early, or freedom from worry?
- When you do not have control over your time, you are forced to accept whatever bad luck is thrown your way
- Savings in the bank that earn 0% interest might actually generate an extraordinary return if they give you the flexibility to take a job with a lower salary but more purpose or wait for investment opportunities that come when those without flexibility turn desperate. And that hidden return is becoming more important.
- In a world where intelligence is hyper-competitive and many previous technical skills have become automated, competitive advantages tilt toward nuanced and soft skills – like communication, empathy, and perhaps most of all, flexibility

Chapter 11: Reasonable > Rational

Aiming to be mostly reasonable works better than trying to be coldly rational

- **You are not a spreadsheet. You are a person. A screwed-up, emotional person**
- It may be rational to want a fever if you have an infection, but it is not reasonable
- When making decisions with our money we should aim to be reasonable instead of rational
- A rational investor makes decisions based on numeric facts
- A reasonable investor makes them in a conference room surrounded by co-workers who you want to think highly of you
- Day-trading and picking individual stocks is not rational for most investors – the odds are heavily against your success

Chapter 12: Surprise!

History is the study of change, ironically used as a map of the future

- Things that have never happened before happen all the time
- History is mostly the study of surprising events. But it is often used by investors and economists as an unassailable guide to the future
- Investing is not a hard science. It is a massive group of people making imperfect decisions with limited information
- Two dangerous things happen when you rely too heavily on investment history as a guide to what is going to happen next:
    1. You will likely miss the outlier events that move the needle the most
    2. History can be misleading guide to the future of the economy and stock market because it does not account for structural changes that are relevant to today's world
- Ben Graham:
    - In general no I am no longer an advocate of elaborate techniques of security analysis in order to find superior value opportunities.

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  - This was a rewarding activity say 40 years ago when our textbook was first published
  - But the situation has changed a great deal since then
- The thing that makes tail events easy to underappreciate is how easy it is to underestimate how things compound
  - 9/11 → Fed cut interest rates → housing bubble → financial crisis → poor jobs market → more go to college → $1.6 trillion student debt
- The most common plot of economic history is the role of surprises. This is not a failure of analysis. It is a failure of imagination

Chapter 13: Room for Error

The most important part of every plan is planning on your plan not going according to plan

- The purpose of the margin of safety is to render the forecast unnecessary
- Margin of safety is the only effective way to safely navigate a world that is governed by odds, not certainties
- Forecasting with precision is hard
- The two biggest gains occur infrequently, either because they do not happen often, or because they take time to compound
- So, the person with enough room for error in part of their strategy (cash) to let them endure hardships in another (stocks) has an edge over the person who gets wiped out, game over, insert more tokens, when they are wrong
- Use room for error when estimating your future returns and simply save more and more and more
- No risk that could wipe you out is ever worth taking → think Russian Roulette
  - The odds are in your favor, but the downside is not worth the potential upside
  - There is no margin of safety that can compensate for the risk of death
- If the cost of the downside is ruin, the upside likely is not worth the risk, no matter how appealing it looks
- **The ability to do what you want, when you want, for as long as you want, has an infinite ROI**
- The biggest single point of failure with money is a sole reliance on a paycheck to fund short-term spending needs, with no savings to create a gap between what you think your expenses are and what they might be in the future

Chapter 14: You will Change

Long-term planning is harder than it seems because people's goals and desires change over time

- We should avoid the extreme ends of financial planning
- Compounding works best when you give a plan years or decades to grow.
- This is true for not only savings but careers and relationships. Endurance is key
- We should also come to accept the reality of changing our minds

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Chapter 15: Nothing's Free

Everything has a price, but not all prices appear on the label

- Every job looks easy when you are not the one doing it
- Most things are harder in practice than they are in theory
- We are often not good at identifying what the price of success is, which prevents us from being able to pay it
- Successful investing demands a price: volatility, fear, doubt, uncertainty, and regret
- The price for market returns long-term is underperformance most of the time
- A penny gained a dime lost
- It sounds trivial, but thinking of market volatility as a fee rather than a fine is an important part of developing the kind of mindset that lets you stick around long enough for investing gains to work in your favor

Chapter 16: You & Me

Beware of taking financial cues from people playing a different game than you are

- Investors often innocently take cues from other investors who are playing a different game than they are
- An idea exists in finance that seems innocent but has done incalculable damage: it is the notion that assets have one rational price in a world where investors have different goals and time horizons
- When investors have different goals and time horizons and they do in every asset class – prices that look ridiculous to one person can make sense to another because the factors those investors pay attention to are different
- An iron rule of finance is that money chases return to the greatest extent that it can
    - Momentum attracts short-term traders in a reasonable way
- Bubbles form when the momentum of short-term returns attracts enough money that the makeup of investors shifts from mostly long-term to mostly short-term
    - Before long – and it often does not take long – the dominant market price setters with the most authority is those with shorter time horizons
- Bubbles are not so much about valuations rising.
    - That is just a symptom of something else: time horizons shrinking as more short-term traders enter the playing field
- Short-term traders operate in an area where the rules governing long-term investing – particularly around valuation – are ignored because they are irrelevant to the game being played
- Bubbles do their damage when long-term investors playing one game start taking their cue from those short-term traders playing another game
- So much consumer spending, particularly in developed countries is socially driven
    - Subtly influenced by people you admire, and done because you subtly want people to admire you

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- **A takeaway here is that few things matter more with money than understanding your own time horizon and not being persuaded by the actions and behaviors of people playing a different game than you are**

Chapter 17: The Seduction of Pessimism

Optimism sounds like a sales pitch. Pessimism sounds like someone trying to help you

- Optimism is actually the best bet for most people because the world tends to get better for most people most of the time
- Real optimism is a belief that the odds of a good outcome one in your favor over time, even when there will be setbacks along the way
- Pessimism just sounds smarter and more plausible than optimism
- There is an iron law in economics: extremely good and extremely bad circumstances rarely stay that way for long because supply and demand adapt in hard-to-predict ways
- Progress happens too slowly to notice, but setbacks happen to quickly to ignore
- Growth is driven by compounding, which always takes time
- Destruction is driven by single points of failure, which can happen in seconds, and loss of confidence, which can happen in an instant
- **In investing, you must identify the price of success – volatility, and loss amid the long backdrop of growth – and be willing to pay it**

Chapter 18: When You Will Believe Anything

Appealing fictions, and why stories are more powerful than statistics

- The more you want something to be true, the more likely you are to believe a story that overestimates the odds of it being true
- Everyone has an incomplete view of the world, but we for a complete narrative to fill in the gaps
- There are many things in life that we think are true because we desperately want them to be true
- Take Bernie Madoff for example: In hindsight he told a good story and people wanted to believe it
- Daniel Kahneman:
    - **“Hindsight, the ability to explain the past, gives us the illusion that the world is understandable. It gives us the illusion that the world makes sense, even when it does not make sense. That is a big deal in producing mistakes in many fields**
    -
- The illusion of control is more persuasive than the reality of uncertainty
- Wanting to believe we are in control is an emotional itch that needs to be scratched, rather than an analytical problem to be calculated and solved

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Chapter 19: All Together Now

What we have learned about the psychology of your own money

- Go out of your way to find humility when things are going right and forgiveness/compassion when they go wrong
- Less ego, more wealth
- Manage your money in a way that helps you sleep at night
- If you want to do better as an investor, the single most powerful thing you can do is increase your time horizon
- Become OK with a lot of things going wrong. You can be wrong half the time and still make a fortune
- Use money to gain control over your time
- Be nicer and less flashy
- Save. Just save. You do not need a specific reason to save
- Define the cost of success and be ready to pay it
- Worship room for error
- Avoid the extreme ends of financial decisions
- You should like risk because it pays off over time
- Define the game you are playing
- Respect the mess

Chapter 20: Confessions

The psychology of my own money

- Independence, to me, does not mean you will stop working. It means you only do the work you like with people you like at the times you want for as long as you want
- True success is exiting some rat race to modulate one's activities for peace of mind
- Cash is the oxygen of independence
- I think some people can outperform the market averages… it is just hard to do… Really hard
- **Dollar-cost averaging into low-cost index funds will provide the highest odds of long-term success**
- Beating the market should be hard. The odds of success should be low
- There is little correlation between investment effort and investment results. The reason is because the world is driven by tails – a few variables account for the majority of the returns
- Gaining Independence of Time:
    - Relies on a high savings rate
    - Relies on patience and optimism that the global economy will create value over the next several decades

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Postscript: A Brief History of Why the U.S. Consumer Thinks the Way They Do

1. August 1945 World War II ends
2. Low interest rates, and the intentional birth of the American consumer
3. Pent-up demand for stuff fed by a credit boom and a hidden 1930s productivity boom led to an economic boom
4. Gains are shared more equally than ever before
5. Debt rose tremendously. But so did incomes. So, the impact was not a big deal
6. Things start cracking
7. The boom resumes, but it is different than before
8. The big stretch: consumption became an explicit economic strategy in the years after WW2
9. Once a paradigm is in place it is very hard to turn it around
   - Everything in finance is data within the context of expectations
   - The biggest difference between the economy of the 1945-1973 period and that of the 1982-2000 period was the same amount of growth found its way into totally different pockets
   - The lifestyles of a small portion of legitimately rich Americans inflated the aspirations of the majority of Americans, whose incomes were not rising
   - We have spent 75 years since the end of the war fostering a cultural acceptance of household debt
   - Since the early 1980s the economy works better for some people than for others
10. The Tea Party, Occupy Wall Street, Brexit, and Donald Trump each represent groups shouting, Stop the ride, I want off!

- Expectations move slower than reality on the ground

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