Key Takeaways

Theory isn't reality

"The challenge for us is that no amount of studying or open-mindedness can genuinely recreate the power of fear and uncertainty."

We are not spreadsheets. As much as reading can inform us about what has happened in the past, like stock market crashes or how stocks have trended up and to the right over time, learning about something in a book is very different from actually experiencing the event. So be careful. You may think that you can hold your stocks during a 30% market downturn because you know that only suckers sell at the bottom, but it's only when you experience that type of downturn that you'll learn what you'll do.

Luck and risk

It's easy to convince yourself that your financial outcomes are determined entirely by the quality of your decisions and actions, but that's not always the case. You can make good decisions that lead to poor financial outcomes. And you can make bad decisions that lead to good financial outcomes. You have to account for the role of luck and risk.

To mitigate the risk of overweighting the role of individual effort in determining outcomes:

1. Be cautious about the people who you admire and look down upon. Those at the top may have been the benefactors of luck while those at the bottom may have been the victims of risk.
2. Focus less on individuals, and turn your mind to broader patterns. It's difficult to replicate the outcomes of successful individuals, but you may be able to participate in broader patterns.

"But more important is that as much as we recognize the role of luck in success, the role of risk means we should forgive ourselves and leave room for understanding when judging failures."

Be kind to yourself when you make a mistake or end up on the wrong side of risk. The world is uncertain, and it may not be your fault if something goes wrong.

Lessons from Buffet

"There is no reason to risk what you have and need for what you don't have and don't need. – Warren Buffet

It’s easy to have a goalpost that keeps moving. Once you achieve your goals, you look toward the next goal. And the cycle never ends. This is often driven by comparing yourself to others, and you’re often comparing yourself to someone who is above you in the ladder that you benchmark yourself against.

When it comes to money, someone will always have more of it than you. That’s okay. It’s fine to pursue more money, but don’t start making risky bets that put what you have at risk for something that you don’t need.

“As I write this Warren Buffet’s net worth is $84.5 billion. Of that, $84.2 billion was accumulated after his 50th birthday. $81.5 billion came after he qualified for Social Security, in his mid-60s.”

Compounding is deceptively powerful.

Getting money vs. keeping money

“Getting money requires taking risks, being optimistic, and putting yourself out there. But keeping money requires the opposite of taking risk. It requires humility, and fear that what you’ve made can be taken away from you just as fast. It requires frugality and an acceptance that at least some of what you’ve made is attributable to luck, so past success can’t be relied upon to repeat indefinitely.”

Getting money and keeping money are two distinct skills. While getting money necessitates risk taking, hard word, and an optimistic disposition, keeping money is a different skill. It requires you to mitigate risk, avoid getting greedy, and to remember that things can be taken from you at any moment.

Cash is not the enemy

“A plan is only useful if it can survive reality. And a future filled with unknowns is everyone’s reality”

If you’re relatively young and earn more than you spend, the best way to optimize your long-term investment returns is to invest the majority of your money into a diversified portfolio of low-cost index funds. Holding more than a few percentage points of your net worth in cash is silly because the value of cash erodes with inflation, and that cash can otherwise be put into assets like stocks that historically have compounded at a rate of 6-7%.

While it’s an alluring prospect to invest in ways that maximize your returns, these theories often don’t account for you psychology. Imagine you’re 95% invested in stocks and have 5% in cash. The market declines 20-25%. Depending on how that crash affects your psychology, having such a small percentage in cash may make you more likely to panic sell some of your stocks during that downturn. And that

panic sell may lead to you missing out on far more returns than if you had held a larger percentage of your portfolio in cash and didn't sell because you felt more secure.
This actually happened to me during the March 2020 downturn. Being too invested with low cash reserves led me to panic sell some of my portfolio, and it was a financially and psychologically costly mistake as we saw one of the fastest market reversals in history. Humans are not spreadsheets!0 So even if the models say that you maximize returns by being only 1-5% in cash, you might actually hold 10-20% in cash to protect yourself from your psychology when things go poorly. And if this larger cash reserve saves you from one making one big financial mistake, it might be the best move for your portfolio.

Long tails

"Long tails – the farthest ends of a distribution of outcomes – have tremendous influence in finance, where a small number of events can account for the majority of outcomes."
The investment decisions you make on 99% of days don't matter. It's the decisions you make on a small number of days when something big is happening – a massive downturn, a frothy market, a speculative bubble, etc. – that make all the difference. Warren Buffet has owned 400 to 500 stocks during his life. He's made the majority of his money on 10 of them.

Highest form of wealth

"The ability to do what you want, when you want, with who you want, for as long as you want, is priceless. It is the highest dividend money pays."
Having more flexibility and control over your time is far more valuable than getting another 2% on your returns by working all-nighters or making speculative bets that impact your sleep.

Ferraris don't generate respect

People buy mansions and fancy cars because they want respect and admiration from others. What they don't realize is that people don't admire the person with the fancy house or car; they admire the object and think of themselves having that object. So buying impressive items to gain admiration and respect from others is a fool's pursuit – these things can not be bought.

Being rich vs. wealthy

If you're rich, you have a high current income. But being wealthy is something different – wealth is not visible. It's the money that you have that's not spent. It's the optionality to buy or do something at a future time.

Being rich offers you opportunities in the short-term, but being wealthy provides you the flexibility of having more of the items you want – freedom, time, possessions – in the future.

What's the optimal portfolio?

The optimal portfolio is one that allows you to sleep at night. It allows you to generate reasonable returns, while also maximizing your quality of life and control over your life. It will stand the test of tough recessions and other blips in the road. Most academic understandings of the ideal portfolio ignore the very real human factors that come into play and that may cause you to deviate from the strategy.

Leave room for error

If you want to be in the game for the long run, you need to leave room for error. *"Room for error lets you endure a range of potential outcomes, and endurance lets you stick around long enough to let the odds of benefiting from a low-probability outcome fall in your favor."*

A big gap in most people's understanding of room for error is accepting that there is a difference between what you can technically endure vs. what you can emotionally endure.

For example, maybe you have enough money saved up to last you two years. So maybe you quit your job to pursue your dreams, assuming that you can always get a job when you get closer to $0 in savings. Technically, you can do this, and you won't even be in debt. But perhaps emotionally, you start getting nervous after you've burned 30% of your savings, and all of a sudden you're depleted psychologically. If that's the case, you may ditch your dreams and go back to a day job even if you had another year+ in financial runway.

So if you don't account for your emotions in your models, you may end up in suboptimal situations.

The difficulty of long-term financial planning

As humans, we tend to underestimate how much our personality and goals will change with time. This makes long-term financial planning hard. We may think

we'll never have kids or a big house when we're young, so we plan as if that's the case, but then we find ourselves with a house and kids that the plan didn't account for. So when thinking about your investment strategy, try to account for the unknown.

The price of investing

"Like everything else worthwhile, successful investing demands a price. But its currency is not dollars and cents. It's volatility, fear, doubt, uncertainty, and regret – all of which are easy to overlook until you're dealing with them in real time."

If you choose to invest and try to compound your wealth, there is a price. And that price is often hidden – it's the ups and downs of Mr. Market that take you on a ride. It's the uncertainty and fear that pop into your mind from time to time, as market conditions and your personal conditions change. You have to be willing to pay that price if you want to invest, especially if you're very active with your strategy.

The only way to deal with this market fee is to accept that it exists and to be willing to pay the price. You need to be prepared to deal with the volatility and uncertainty. It's a part of the game you're playing.

What game are you playing?

"Few things matter more with money than understanding your own time horizon and not being persuaded by the actions and behaviors of people playing different games than you are."

If you have a buddy who's making lots of money trading short-term options and you start getting FOMO and want to play that game, you really need to consider if that aligns with your goals. If you have a 20-year time horizon and like the simple nature of passive investing, it would be stupid for you to start playing your buddy's game. You may be able to profit, but at what cost? Know the game you're playing, and know the game others around you are playing as they tell you about their latest tactics.

Pessimism is persuasive

Pessimism often sounds smarter and more persuasive than optimism. If something is not going well, it's easy to think that it will continue not going well. And that sounds very plausible. But what this line of thinking misses is that problems often create demand for change and solutions. And this leads to ingenuity that creates changes that only the optimist might believe in.

The problem with hindsight

When we look back at the past, we create stories about why certain things happened. And those stories make us think that the world is understandable and makes sense in some way.

The problem is that these stories may be complete nonsense. What happened may have been completely random, yet our stories delude us into thinking that there is some lesson we can learn to better predict the future.

Avoid the illusion that you have full control in the uncertain world in which we live.

Investment results

- If you evaluate how well you've done by focusing on your individual investments, versus your entire portfolio, you'll overestimate the brilliance of your winners and feel too much regret about your losers.
- Good decisions are not always rational. Sometimes, you have to consider that you're an emotional creature that may have different needs than an ROI-optimizing model may suggest.
- If you can do everything you want without trying to outperform the market, then why try to outperform the market and endure the price tag that this pursuit requires?