# JUGGLING DYNAMITE

# Juggling Dynamite

An insider's wisdom about money management, markets, and wealth that lasts

Danielle Park

INSOMNIAC PRESS

**Library and Archives Canada Cataloguing in Publication**

Park, Danielle, 1965- Juggling dynamite : an insider's wisdom about money management, markets, and wealth that lasts / Danielle Park.

Includes index. ISBN 978-1-897178-34-8

1. Finance, Personal. 2. Investments. I. Title.
HG179.P39 2007 332.024'01 C2007-901107-1

The publisher gratefully acknowledges the support of the Department of Canadian Heritage through the Book Publishing Industry Development Program.

Printed and bound in Canada

Insomniac Press, 192 Spadina Avenue, Suite 403
Toronto, Ontario, Canada, M5T 2C2
www.insomniacpress.com

Canada

*For Quinn and Spencer:*
*What we've learned so far…*
*Love Mom*

# Acknowledgements

This book had been in my plans for a long time. I am glad to have it finally out of my head. Acknowledging all those who have helped me complete this task could be lengthy; I will be succinct.

This book captures a lifetime of mentors and inverse mentors who have brought me a rich breadth of experience. First, I wish to acknowledge Irene, Gilbert, and Mary, three of the best grandparents a kid could ever have the privilege of growing up around. Their gifts of wisdom, experience, and time generously invested in me are forever helpful. I am also indebted to my parents, Tom and Norinne, for their example of non-conventional thinking and passionate living that conditioned me from an early age to measure success more in quality of life than quantity of goods.

I am indebted to some truly great teachers in my life who encouraged and inspired me to write and think critically from an early age, most notably my mom, Beverly Rumble, and Rosemary Sullivan.

Thank you to my assistant Colleen for her excellent support over the past many years, which has helped me to carve out time for writing and teaching on top of a busy practice. Thank you to Ann for her five years as our loving nanny who helped us raise a young family and continue a career.

I am grateful for my publisher, Mike O'Connor, at Insomniac Press for taking a leap of faith with me. And to my editor, Dan Varrette, for his diligent and patient work in knocking my rambling thoughts into shape on the page.

I am very thankful for the time and feedback of a few key people who have encouraged me to complete this book and who served as the first trusted eyes to review early drafts. In particular, Lisa Walters, Howard Gwin, Isabelle Gagnon, and George Taylor. I will always remember your kind support.

In my own education about money, I am humbly indebted to some sage voices who have gone before me: John Kenneth Galbraith, Peter L. Bernstein, Benjamin Graham, Warren Buffett, and John Templeton, to name a few. I offer these mentors much credit for that which may be worthy in this book. Any errors or misstatements are mine alone. I am also indebted to many clients, colleagues, and students over the years who have helped me learn important lessons about all of us.

Finally, I am indebted to my partner in life and in work, Cory Venable, a gifted market analyst and fiercely independent thinker who has been my constant sounding board through the failures, revelations, and triumphs of the past twenty years. Our joint evolution has been so collaborative it is in many ways our collective thoughts and experience that form this book. Your faithful friendship remains my greatest reward.

# Table of Contents

# Preface

As a money manager, I am focused first on protecting capital from blowing up. Investing requires a lot of measuring and estimating, a process highly charged with the emotions of the investment creators, marketers, and holders. For this reason, investments can be like lit dynamite: remarkably volatile and full of risk. Once destroyed, invested capital and precious time are lost forever. In this sense, a money manager's role can be likened to that of a professional dynamite juggler. Many investors cannot see the risks involved until a pick ends badly. Many do not even realize the fuses are lit until an explosion goes off, and when it does, most are surprised by the extent of the damage caused.

It was an interest in connecting key themes noted throughout my professional career over the past twenty years that brought this collection of thoughts to paper. This is not a financial planning book or a finance text. The purpose is to highlight some of the pitfalls in our human behaviour around money so that we may see truth and gain insight, waste less and benefit more. Furthermore, it is my purpose to confront the self-serving rhetoric of investment sales and demonstrate why objective discipline and market cycle timing are critical to lasting success for real-life investors.

We live in a time when we have access to more information than ever before, and yet its true utility often remains unclear. People today are perhaps more informed but generally, it seems, not very enlightened. It is my hope that this book will be useful to readers seeking clarity.

I have included a bibliography of key books that I believe all investors should read. I have compiled this list as I have discovered them one by one over the years. With much sales puff in the field of investing, finding the truly useful books can be challenging and yet critical, in my view, to lasting success.

# Section I

# The Fuse:
## People and Their Markets

# Chapter 1

## The Truth about Human Nature

*It is human nature to think wisely and act foolishly.*
—Anatole France

Many of us are not ready to hear the truth. We would rather continue living in a bubble. But if the bubble were to burst, our worldview would be forever altered. As in all things, our understanding of money must start at the beginning. Although some people do win the lottery, for most of us, the key to lasting financial success is constant, conservative, diligent discipline and self-restraint. And if this last point doesn't cause you to close this book and toss it in the bin, there is hope. You can learn this stuff, and you don't need a graduate degree in finance to be wise about money.

Throughout my life, I have noticed that people generally fall into one of two camps. One is the "I know nothing about money" camp. These people believe that finance and investing are very complicated and that they know nothing about them. This is partly what the financial industry likes us to believe, because it serves their purpose in two ways: first, if it is all very complicated, then we need "an expert" to show us the way. Second, if everything is so complicated, then we are less able to follow the pea under the shell as it is shuffled around in front of our eyes. Believing we know nothing about money and investing is actually a dangerous cop out. If we are going to have some money and live in our modern world, we need to stop throwing our hands up and start doing some real work listening, reading, and learning. A fool and his money are soon parted, so we need to get a grip—and the sooner, the better.

As a money manager, when clients tell me they understand nothing about money, up raises a red flag of caution. They often say that they don't need to understand since they have hired me to do it for them. This tends to cause everyone great unhappiness. First, if a person has no understanding, then they also will lack the self-discipline that flows from understanding. A client must be aware of the dangers to know why their leader is taking them around a longer route. If not, they may follow for a short while, but ultimately they will grow impatient and begin to complain that their leader is wasting their time. Clients can be attracted to those who offer them shortcuts, not realizing that they must blindly wade through landmines along those routes. At the peak of each financial bubble, it happens repeatedly that the wisest, most prudent managers are fired for being too conservative and risk-averse. Victims don't often see the importance of alarm bells and a breaker system until after disaster has struck.

Over the years, I have met people who have explained they don't need to know about money because they can rely on their parents, spouse, or partner who have it all worked out. Others will explain that they don't need to know about money because they are rich and money is not a worry. These are famous last words! If we rely on friends and family to look after all our money decisions, we may be placing ourselves in peril. People die, spouses leave, and fortunes are lost. No one should be without good knowledge and skill in financial matters. Financial ignorance can be very expensive. Consider how many of the *Forbes* richest people in the world fall off the annual list within twenty years. The answer is 87%.

The second camp, of which there are fewer but still significant numbers, is the "I am very smart and educated about other things and so I am sophisticated and naturally know a lot about investing." This group tends to be very hazardous to its own financial health and sometimes to the financial health of others around it. These people have generally had some success either in another profession or in business. They are undoubtedly experts in their own area, but they make the catastrophic assumption that being able to make money in business makes one brilliant in general. "Financial genius is before the fall," economist John Kenneth Galbraith warns us in his book *A Short History of Financial Euphoria*. The ancient Greek term for this is *hubris*: the tragic flaw of the heroes who fall in love with their own intelligence or ideas.

In our financial affairs, it is important to our success that we face the facts. The first thing someone looking for "the truth" should do is read Galbraith's book. It's a quick read, but it's an excellent starting place in the journey to financial enlightenment. Beware, however: Galbraith does not pull any punches. He ominously warns us about one of our greatest human flaws: our "specious association of money and intelligence":

> In all free-enterprise (once called capitalist) attitudes there is a strong tendency to believe that the more money, either as income or assets, of which an individual is possessed or with which he is associated, the deeper and more compelling his economic and social perception, the more astute and penetrating his mental processes … this is readily transmuted by

> the recipient into an assurance of personal mental superiority. Treated that way, I must be wise. In consequence, self-scrutiny—the greatest support to minimal good sense—is at risk.[1]

We should print off these words and post them somewhere so that we can see them every day as we journey through life. The daily discipline of keeping our ego in check is a key to long-lasting success. As a famous economist, Galbraith spent a prolific career in counsel with political and business leaders and scholars. And yet, throughout, he maintained the pragmatic core of the Ontario farm boy he had been. He saw that a material society too easily equates assets and income with wisdom and intelligence, often granting credit where little or none is due.

There are many reasons why people seem to have money and these may be quite unrelated to their intelligence or personal acumen. Money can be won, inherited, and even stolen. The point is that we are foolish if we assume that just because someone has it, or appears to have it, they must be smart, good, or worthy of trust.

I recall my first glimpses of these notions when I was a young lawyer working as a junior on a number of high-society divorce files. At the time, I was earning $23,000 a year and was up to my neck in student loans. One of our clients owned a number of walk-in dental clinics and was obviously loaded. He drove a fleet of exotic cars, wore designer clothing, lived in what seemed to me a palace, and generally had the "I am very smart and successful" air to go with it all. I was certainly quite impressed, I can tell you. It was my job to have him prepare financial statements for the court proceeding. He gave me his very impressive income figures—he made $1 million a year (a daunting figure to me then). He had a long list of boats and cars and every possible toy, and he had a negative net worth! I could not believe my eyes when I calculated the columns on his debts versus assets. How could this guy who had been making a million bucks a year for a few years have had a negative net worth? My mind was boggled.

What many people don't get is that making money is quite different from *having* money, and having money is not necessarily a static condition—it means that you must *keep* it once obtained. Keeping it means you have to be careful, frugal, and generally respectful of your money. The concentrated risks that one may take to make money in the first place, either through occupation or business, are quite often the things one must avoid exposing that money to again if it is to be protected and endure. No matter how wealthy we may be, we can never afford to become cocky or blasé. Witness Conrad Black in the news of late. Lord Black is one of the wealthiest guys in Canada (or at least used to be). Incredible fortunes have a nasty habit of reversing once common sense, humility, and self-scrutiny are lost.

People who are easily distracted from the donut often end up with only the hole. To give wealth and income earned some context, consider this: in order for a forty-year-old to collect an after-tax income of $1 million a year for the rest of their life, they would need to have in excess of $50 million carefully and conservatively invested.[2] Less than 85,000 people in the world have that much money. Less than nine million people in the world have more than a million dollars outside of their own home and contents. That is less than 0.14% of the world population, or just 1,300 people in a million worldwide.[3] And yet, besieged by the marketing machine of popular culture, many in our society believe that most people have more money than they actually do.

## World Wealth in Perspective

| | Population | % of World Population* |
|---|---|---|
| High Net Worth Individuals (Those with net financial assets greater than US$1 million) | 8.7 million | 0.137 |
| Ultra-High Net Worth Individuals (Those with net financial assets greater than US$30 million) | 85,400 | 0.00137 |
| Billionaires | 793 | 0.000012 |

***World population 6,551,205,725***

***Source: World Wealth Report 2006, www.capgemini.com***

We compare our lifestyle to the pictures in celebrity and fashion magazines and deem that we fall far short. We feel like underachievers in comparison to the wealth we perceive in others. Once we see the world this way, we think there must be some trick or shortcut to getting into a more elite club. Whether we acknowledge it or not, many of us make the pursuit of this perceived wealth the main focus of living. There is always hope for the great easy: a way to get rich without real work. This is the underlying promise of the marketing machine that surrounds investment sales. It is the real reason otherwise sane people agree to hold dynamite in the first place.

Properly invested to preserve the capital, $1 million will produce a maximum pre-tax income of about $50,000 per year. In this sense, people earning annual salaries of $50,000 are already living on an income as though they were millionaires. Few of them would think of their financial status in such favourable terms. When people have the good fortune of winning or inheriting $1 million, it is often blown quickly, as recipients erroneously believe such a stipend can afford them lavish things. Ignorance and unreasonable expectations around money are a common plight.

So the first thing we have to do is get realistic and stop thinking apparent wealth is true wealth, or that earning a big income solves all the problems, or that people who seem to have money must also have all the answers. There is a lot more to this.

The most constant impediment to our financial success is human nature. We are impulsive animals by origin and nature. We can be enormously influenced by emotional swings and faulty logic. It is difficult to maintain an objective self-view, and this is especially true when it comes to our money. We hope for many things, but we must be very careful that our hope is not the only thing driving our money decisions. We may hope to win the lottery or strike it rich overnight, but we must plan our actions for the likelihood of these things not being our fate. Harvard Ph.D. Terry Burnham calls the impulsive side of our decision-making our "lizard brain." He points out that the animal skills that evolved to help us forage for food and find shelter tend to be exactly out of synch with financial opportunity.

> …our brains, like our bodies, reflect the world of our ancestors. In particular, our lizard brains are pattern-seeking, backward-looking systems that allowed us to forage for food, and repeat successful behaviours. This system helped our ancestors survive and reproduce, but financial markets punish such backward-looking decisions. Consequently, our lizard brains tend to make us buy at market tops and sell at market bottoms.[4]

We have a tendency to be aggressive when we should be careful and afraid when we should be confident. In money matters, these traits become the mirror peaks of fear and greed that continually threaten sound financial decisions.

Another theory that informs this area of human behaviour is something called "EQ," or "emotional quotient." Psychologists John D. Mayer and Peter Salovey wrote a series of papers on this topic in the early '90s, and Daniel Goleman further developed the concept in a 1995 book entitled *Emotional Intelligence.*

Their collective theory was developed out of combined research in neurophysiology, psychology, and cognitive science. In the end, they conclude that EQ, the ability to perceive and understand one's emotional responses, can be more important than IQ in determining how a person perceives and responds to the world. In the area of money and investing, I believe that their research is highly relevant.

I have noted this phenomenon many times over the years, where people who were undoubtedly intelligent and well educated repeatedly made poor decisions when it came to their money and investing. As a naive undergraduate student, I believed that the people with MBAs, CFAs, and Ph.D.s in finance were the best equipped to advise on investing. I have since seen how little academic learning can guarantee one's success with money. Many of my professors who held multiple degrees in finance and business often admitted that they had repeatedly suffered painful losses to their own capital. I have come to understand what economist and teacher Benjamin Graham meant when he wrote that successful investing is more a trait of the character than of the intellect. John Kenneth Galbraith said, "One of the greatest pieces of economic wisdom is to know what you do not know." So, humility is important, and the dangerous challenge to humility is hubris.

I once met with a fortysomething dot-com guy who had been referred to our firm for investment counselling. He had cashed out his shares on an IPO at the peak of the tech market bubble in the late '90s and went from earning a good salary to having $50 million in the bank at one fell swoop. Unfortunately, dot-com guy didn't realize he had won the lottery. He seemed to believe that his newfound wealth was the natural product of his superior vision and intelligence. We call this "losing your nut" in my house. He took the hour of our interview to lecture me on why he was not in favour of diversification or bonds or capital preservation as a main focus of an investment policy. He was interested in high-risk investing and spoke of the "obvious" fact that high risk means high reward. I will make a prediction: the dot-com guy and his money have a high probability of being parted. It may take some time, and yes, he could win the lottery another couple of times, but the law of averages will prevail. There is a reason Las Vegas is very rich: high-risk rollers will eventually lose large amounts of money. Having $50 million deposited into a bank account does not mean that wisdom is deposited with it.

Wisdom is found through real-life experience and humility, and for many people, painful losses are required before the penny will drop. I have learned by observing human behaviour that the money-wise tend to be those who have suffered losses and have resolved to learn from past weaknesses. That said, there is still hope that if people can appreciate their own fallible nature in advance and set up guardrails to guide their path, great loss can be avoided or at least experienced with much less frequency.

There are a lot of harmful ideas about money that permeate our culture. There is the school of thought, widely held, that believes when you have lots of money, you can afford to waste it. "If you have to ask the price, you can't afford it." What utter rubbish. Some of the wisest wealthiest people I know are also the most careful with how they spend money. They know that money is a scarce commodity and that no matter how big your pile may be, it is, after all, a finite pile. If you spend or lose too much of it, it will disappear. And in a world where there is great need, wise people understand that money is a resource not to be squandered. Cost should always matter. Contrary to popular advertising, very few wealthy people actually hire private jets to tour the world on their own tab. It is much more common that such excesses are indulged in when a public corporation is paying for the extravagance.

It's easier to spend other people's money than it is to spend one's own. I will always remember the story of a former politician who used a fleet of jets to fly a fleet of black Mercedes cars to whichever country he was visiting. He did this to ensure that his entourage left the airport in a manner befitting his stature. The politician was not spending his own cash to support such a demonstration; the poor taxpayers were the unsuspecting patrons. Meanwhile, the rest of us who feel like paupers tend to marvel at such displays: "When you have that much money, you are in a different league, I guess!" No, when you spend money that frivolously, it is still a great waste. It does not make us common to ask the price of something to assess its value for its price.

While I was waitressing my way through university, I had the good fortune of serving many people from all walks of life. Much can be observed about human nature from the vantage point of a server. The owner of one of the restaurants I worked in was a self-made millionaire who had founded a chain of stores and later sold them to a larger chain. His new second wife at twentysomething was some thirty years his junior. Sadly, the millionaire had a massive heart attack one day and died in his office. The young widow spent the next few years embroiled in some nasty litigation with the millionaire's former wife and children. Word was that the estate topped many millions, so in the end, even after considerable litigation, the estate was divided and all were well-to-do.

The young widow then became famous in town as the prize catch, being both attractive and young in addition to being loaded. Unfortunately, wisdom was not as much in supply. A decade later, she had married a fast-talking man who acted with great confidence and importance in all of his affairs. He and the now thirtysomething wife were the toast of the town and invited to all of the most important social events. When others spoke of the couple, it was generally with awe as people clamoured to say that they had dined with them last week or golfed with them yesterday.

No one seemed to know quite what the husband did for money, but presuming that he had access to the wife's enormous stash, he naturally was invited to partner in various ventures with other local investors. The husband even set up his own business office with the outrageous title "financial advisor" posted on the door. With one failed venture after another, five years later, the fast-talker had fled town and the wife was left, now fortysomething, hiding from creditors she could not pay. The endless supply of money had been spent. In less than fifteen years, the famous "richest woman in town" was declaring personal bankruptcy.

Despite such stories being fairly common, the disastrous ending seems to take many by surprise. There is a seductive pull to the apparently rich. Simply the appearance of having money grants them certain fame. Too often, those around them see what they want to see and hear what they hope for. Many believe that wealth and good fortune may somehow rub off and that people with money can teach us the trick. People easily put themselves in harm's way, searching for the trick or the shortcut to wealth. This makes them highly susceptible to false messengers who pump the sunshine and tell us what we would like to hear. As an investment counsellor, I frequently meet people with low risk-tolerance looking for double-digit annual returns on their portfolios. When I tell them why they are expecting too much and should save more and spend less in order to grow their money, they are sceptical. They tell me that a financial planner or stockbroker has assured them that they can earn 12% per year and withdraw 10% per year in income throughout retirement. "Well, that's not a sustainable plan," I tell them. "It is all but certain to fail." At least half will thank me for my time and never darken my door again.

To put things into perspective, consider that given long-term investment returns in financial markets, $5 million in an investment account will produce an income net of tax of about $175,000 per year.[5] This amount of income may be considered comfortable for some, but is it rich? It is certainly not rich enough to live the lifestyles that upscale commercials and magazines urge us to pursue. The reality is that most people today who aspire to a life of material affluence are supporting their habits through escalating amounts of borrowed money. Spending money we don't have is a bad plan. Past generations worked to pay off their homes as quickly as possible. Today's masses have been repeatedly refinancing their homes to live.

Wise wealthy people shop for bargains and have to spend less than they make or they will erode their capital. One useful way to think about money is simply as a way to exchange energy. When we work for money, we invest our physical and mental energies and the resources of the planet in providing products or services for others. We then use the money received—now a token of expended energy—to exchange it for the products and services of others. Each time we are deciding to give money for something, we should consider whether it is likely to be a worthy exchange of energy.

The bottom line is that price should always matter. Price is the most important determinant of whether an investment is likely to be rewarding. If you pay too high a price, the odds of being rewarded drop significantly, but, again, this is the exact opposite to the way most people respond. Humans like to move in packs; they generally like to buy what they think everyone else is buying, so they pay premiums for name brands even where lesser-known brands are as good or better. When it comes to investing, people can be afraid of missing out, so when they see a particular asset has experienced large gains, they are attracted to it like bugs to a light. People want to buy more of what was a big gainer last year. The higher the price rises, the more they want in. The problem is, this impulsive tendency is exactly the wrong way to choose investments. Buying when prices are lower is the key to financial success. When prices are lower, there is a higher probability of the price going up from our entry point. Also, when we pay attention to price, we can develop rules about when to go against the pack and take our profits. In order to make money, we need to buy and then sell an investment, and using our gut to pick entry and exit points is a path to certain disaster.

Here is the trick to staying fit and healthy: eat less and exercise more. Here is the trick to retiring with money: spend less, save more. Both require living with self-discipline.

The truth about human nature is that it must be constrained in order to be wise. Even those of us who are educated and trained in managing money must guard against our human susceptibility to fear and greed. Unbridled optimism and rampant risk-seeking are well-worn paths to ruin when it comes to money. We have to set up objective rules to control our tendency to hubris, and we must act like grown-ups in taking responsibility for our money decisions. It is not easy to do, and it requires constant effort to maintain the discipline to protect us from ourselves and from the bad advice of others. But the truth can set us free.