PERMANENT
WEALTH PARTNERS

THE RULES OF WEALTH:

10 PROVEN STEPS TO TRUE FINANCIAL FREEDOM

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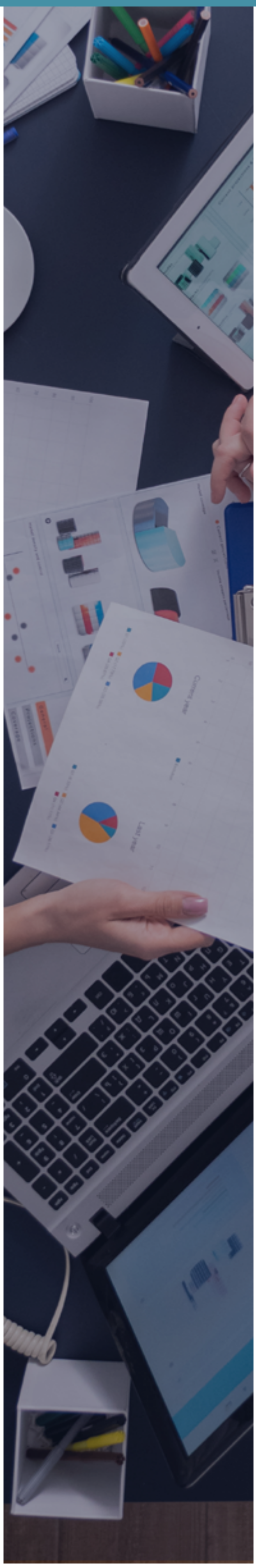


Introduction

This book has been over 20+ years in the making. It feels like I have spent my life actively researching, investing and thinking about building wealth and I now am lucky enough to get to do this every day for my clients. The book is not meant to be a get-rich-quick guide. In fact, it is the exact opposite. It is more of a build-wealth-slowly template after distilling down what I believe to the most important 10 rules of wealth. I wish you luck on your wealth journey and urge you to stay the course. If you do, you will get there.

Adam Walkom

RULES OF WEALTH No. 10

The ultimate wealth-builder is to structure your wealth so you never have to touch your investment portfolio. This compounds in two ways - you live within your means (and savings) and you let the investments compound over many, many years.

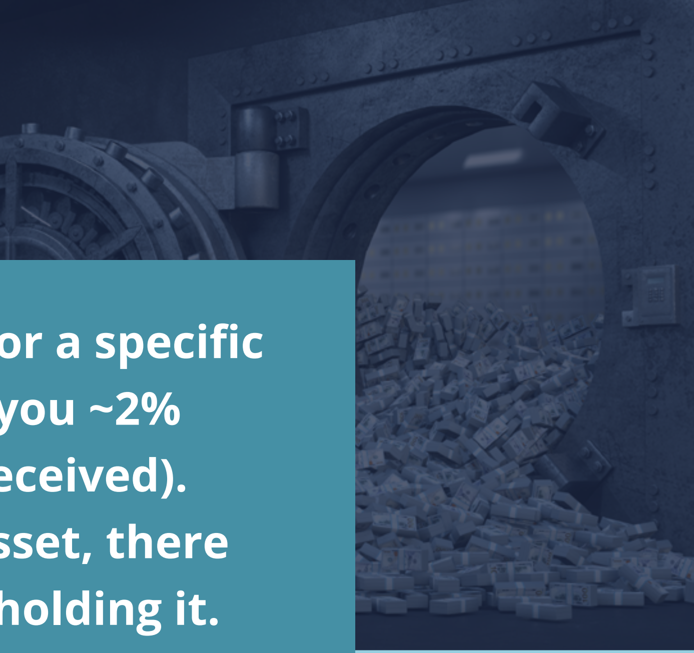
Can I sum up both of these in one word – yes. **DISCIPLINE.** Discipline to say no to unnecessary spending and discipline to leave your investments alone and let them compound over time. As my great hero Jocko Wilink says: "Discipline equals freedom" and it is true freedom that wealth brings. Let's dive into each side a little deeper.

> **"Discipline equals freedom"**
>
> Jocko Wilink

So much of our spending can be split between "needs" and "wants". Do you need to pay the electricity bill? Yes. Do you need a new Garmin fitness watch or that Balenciaga handbag? Probably not. That doesn't mean you should necessarily not buy it. It just means you want it, not need it. Some of life's great pleasures are from indiscriminate purchases that we hold dear and value because they did cost a lot of money. However, I find it helpful to stop for a brief moment and just consider for each purchase – is this a "need" or "want"? This short pause also allows our brain to catch up and do a quick calculation in terms of the source of funds. Do I/we have enough this month that will allow this purchase? If no, then no. If yes, then great, but can that money be used for something else? Like investing or paying off more of the mortgage. I don't want to sound like the fun police, I just want to help you pause, think and create a little discipline around it.

The other side of this discipline is the upside. The freedom. More money invested today = multiple times more money in the future. It is as simple as that. I could talk about the benefits of time in the market and the added financial gains of being in the market on the best performing days, but that is just too technical. The simplest thought is to get as much of your money as you can working hard for you, and then just leave it there. Do everything you physically can to not touch it. After a few years, you will be happy with the results. After many more years, you will be absolutely amazed.

RULES OF WEALTH No. 9



Holding cash is fine as long as it is for a specific reason. Remember, cash is costing you ~2% per year (inflation minus interest received). If you're losing 2% per year on an asset, there needs to be a very good reason for holding it.

To my mind, cash is potential energy in the pure physics definition. Cash in itself is nothing; what makes it matter is the opportunity to use it to do something useful – to buy a new boiler, upgrade a flight or even buy a house. With interest and savings rates where they currently are, cash by itself sitting in a savings account does nothing. However, what it **CAN** do is the most important part and that is why having an amount of cash stashed away is vitally important. Cash is potential. Cash is flexibility. Cash is the option to make your own decisions at your timing and not somebody else's.

However, this can go too far.

Leaving cash in an account for a long period of time is not only pointless, it is destructive. Compound interest is what makes value rise. It also works in the opposite direction.

Imagine you have cash sitting in a standard savings account and you are getting 0.5% interest. Now, typically inflation runs along at ~2.5% per year, but it's amazing how much higher than that it goes for all the important and/or fun things. Think about school fees, concert tickets or Sky subscriptions. They all definitely go up by more than 2.5% per year, but for the sake of this exercise let's generalise to say everything goes up by 2.5% per year.

So, in reality you are **LOSING** 2% per year in value on your cash – the cost of everything is going up by 2.5% yet you're only receiving 0.5%. If you do nothing with your cash, after 5 years you have lost over 10%. After 10 years you are down nearly 22% in real value of that cash.

So cash can also be lazy and destructive to your real wealth.

Do I seem to be giving conflicting messages? I'm not really. What I'm asking you to do is to think about the cash you hold in relation to the cash you need.

RULES OF WEALTH No. 8

What's the single best investment you can ever make? Pay off that credit card debt.

If I was to offer you an investment that paid a guaranteed 19% return, that sounds pretty good right? Well that's what paying off your credit card is. Depending on the card it could be even more than that – I've seen some rates that are up to 49%.

Remember we are in a very low interest rate environment with the base rate at the Bank of England at almost 0%. Credit cards are insanely profitable for banks because they get to borrow at this almost 0% and charge the poor credit card holder 19% or more. Think about it. Who uses credit cards? People who don't have the money to hand – people who can't necessarily control their spending. People who aren't wealthy. It's no secret banks specifically target these people and we've all heard the stories of people stuck in horrible credit card debt cycles where they can afford to pay just the exorbitant interest each month and never even reduce the debt – it can happen.

And please don't give me this rubbish that you keep switching cards for the 0% rate period. Because:

IT DOESN'T ALWAYS WORK

You will forget once or twice and get charged.

IT'S A HASSLE

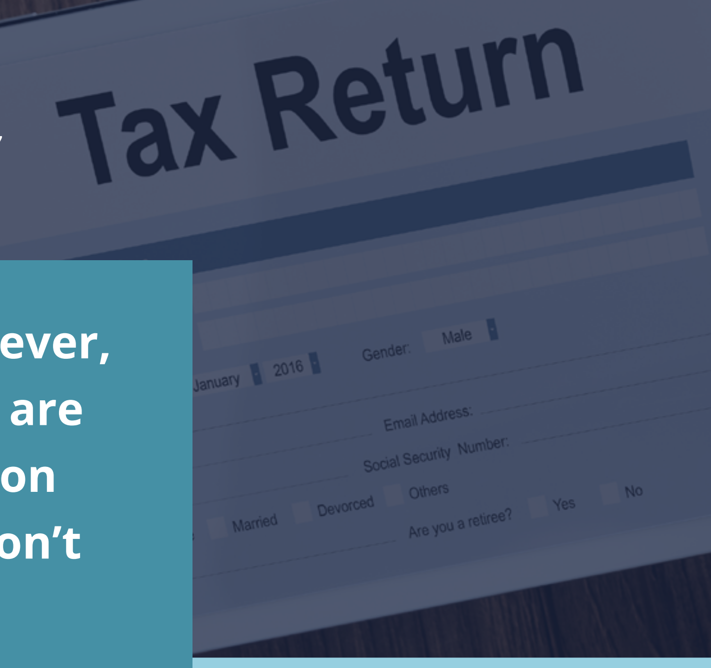
Who wants to deal with banks or credit card companies more than they need to.

WEALTHY PEOPLE DON'T DO IT

That's right. This is the Rules of Wealth remember, and wealthy people are busy building their wealth (either actively or passively) and not messing around with switching credit cards – there's much more to life than that.

Pay it off in full, then cut it up – now you're on your way.

RULES OF WEALTH No. 7



Tax is law. You have to pay it. However, getting tax relief is also law. There are many different ways to gain relief on taxes that people simply miss or don't use. What do you do?

Do you know one thing that winds me up? Certain parts the political and media establishment coming out and saying we have a moral duty to pay tax. No we don't. We have a legal duty to pay tax. If you don't pay the tax you owe, you should go to jail. It's that simple. But we also have the opportunity to structure our financial affairs, in 100% legal ways, which minimise the legal amount of tax we have to pay. If Governments want us to pay more tax, they should change the law, not try to persuade us with a moral obligation.

There are many different investment vehicles that offer tax relief – the obvious ones most people are aware of such as ISAs and Pensions. There are also the more specialised vehicles like VCTs, EIS and BPR (for inheritance tax relief). Most of the tax relief has been defined by HMRC to encourage good behaviour for society, as getting people to save more for the long-term has huge societal benefits (reduced poverty, reduced health complications, reduced crime), so it makes sense for Governments to encourage it.

Here's a fun trick. Next time anyone tries to have a discussion with you around the moral obligation of paying tax, ask them if they've ever bought anything duty-free? Buying products duty free is a legal way of not paying tax. See how that fits in with their moral obligation.

RULES OF WEALTH No. 6

Set-up your personal finances like a call option or a real option. Limit the downside and have unlimited upside.

LIMITING DOWNSIDE	=	INSURANCE AND HOLDING CASH RESERVES		UNLIMITED UPSIDE	=	LONG-TERM EQUITY INVESTMENT IN EITHER LISTED OR UNLISTED BUSINESSES

Then see rule no. 4 (Volatility) & no. 5 (Time) and wealth will come.

I have already mentioned the importance of flexibility in your financial plan, but now I want to expand on that discussion and bring in the idea of creating real options for yourself. You don't hear much from the investment industry about time and flexibility because they have not found a way to turn them into products. If they can't make products, they have nothing to sell, and if they have nothing to sell, then funnily enough they tend not to talk about them. But this is where you, as an individual investor, have an advantage. You can make the decisions that are best for you based on all the different factors that we discuss in this book. With a little knowledge and perhaps help from me, you are unstoppable and all the financial dreams we've discussed are yours for the taking. But you do need a bit of flexibility in your plans.

We all know – or we do if we give it a moment's thought – that life is not linear. In his book "Antifragile", Nassim Taleb talks a lot about volatility and how the more intelligent someone is, the more likely they are to fall into the trap of thinking that volatility in everything can be removed or "managed away." The usual reason for believing this is that they have studied or committed to a theory (usually promoted by highly paid management consultants) which they apply to real-world situations. The further down the path people take this, the more trouble they tend to find themselves in when the inevitable happens and a totally unexpected event blows the theory out of the water taking the business/people/idea with it.

Harold Macmillan, former UK Prime Minister, when asked what had blown his government off course, famously replied,

'Events, dear boy. Events.'

It's the same for all of us. We don't know what the events will be, but we know they're going to happen.

So how can we prepare for the unexpected when we have no idea what it will be? By building flexibility into our plans. By not stretching or over-extending ourselves in any particular direction and keeping that buffer of cash secure and handy. By giving ourselves real options.

And this is not just talking about the boiler blowing up or needing to travel internationally at very short notice. This is giving yourself the option to buy a bigger house in a few years' time because you've been disciplined about paying down the mortgage. This is not over-committing into your pension scheme or children's Junior ISAs, because that money is not accessible if you ever need it. This is deciding to stop work or start a passion project at age 55 because you have the money in the bank and have done the forecasting to ensure that you will never run out of money in your lifetime. All of these are real options and all are available to you, depending on what you decide, because you built flexibility into your plans.

The best example of looking at the misunderstood value of having real options was provided by Michael Maboussin, an acclaimed research analyst and author when he was at Credit Suisse First Boston back in 1999. Maboussin wrote an investment report on real options and highlighted a number of companies who were very good at it. There was, however, one company he highlighted as standing out way above the rest in 1999.

"Nowhere does a real options approach apply more than at a company like Amazon. In fact, options thinking is built into the culture, which stresses flexibility and adaptation."

At the point of publication of that report on June 23rd 1999, Amazon's share price closed at $58.90. As I write this today its $3,165. (Maboussin, Michael, Get Real – Using Real Options in Security Analysis). That's a significant rise in value for understanding and using real options.

Having flexibility and options built into your own planning can, like Amazon, also create enormous value for you in your own life. Flexibility is an essential tool in tackling the old enemy – time.

RULES OF WEALTH No. 5

Time is your best friend in the market. Only when you try to rush performance does it come back to bite you. The equity market always goes up.. you just need to leave it long enough for this to be true.

The world of finance is very good at creating theories and over-complicating what should be relatively simple.

Valuation analysis, portfolio theory and efficient market hypothesis are 3 core finance and market theories that are in essence mathematical concepts that have filtered their way into the core syllabus of most finance courses. *"Look, we can now calculate the exact valuation of what a company should be, or the exact portfolio you should own so you never lose!",* but in essence what they have done is now determined a way to be precisely wrong instead of somewhat correct.

One of the simplest, yet often most overlooked factor in choosing any investment is time. Time changes the way portfolios should be set-up to drive to a certain result and most of important of all, those portfolios should be constructed very differently if the time horizon is short, medium or long.

Too many times I see advisers classify someone as a "Balanced" investor and lazily recommend all their funds into some sort of "Balanced" or 60:40 Equities to Bonds fund. This path has no consideration of the person's underlying circumstances, needs, wants or anything else. It's lazy and it's wrong and ultimately the client pays the price by losing out on potential long-term growth.

> **"Time brings all this to pass"**
>
> Aeschylus

Splitting your investment portfolios into time-based portfolios and linking those to particular goals in your life not only makes sense from a personal point of view – it's your money so your plan should be designed for you – but also from a total return point of view.

Consider this: you have 2 different portfolios – a "low-risk" (I hate that label as it misuses the definition of risk) portfolio which has a long-term average return of ~4.5% but also has potentially extreme moves to +/- 15% in any one year. You also have a "higher-risk" (again not the correct label, but its industry definition) with a long-term average return of ~7% and can have extremes of +/- 40% in any one year.

Having the higher returns sounds great, but not if you have a short timeframe. You may end up suffering one of the extreme -40% years and then if you need to withdraw your funds at that point, then you really have lost. However, if you use the lower-risk portfolio for that short period, you still may end up losing slightly, but it certainly won't be anywhere near as much.

The same goes for the other way around. If you don't need to access these funds for 25-30 years, the overall "loss" of staying safe is potentially very large.

If you invest £10,000 for 25 years at an average return of 4.5% annually there you will end up with just over **£30,000** – not bad.

However, if your return averages at 7% per year, then the figure if just over **£54,000** – much better.

For the long-term returns, it doesn't matter if you have any extreme down years. As its long-term money it can and will always recover as long as you're invested in funds that are still in existence (not like Mr Woodford), plus you will sometimes also get the extreme up years as well. This is another reason why we like passive index funds for long-term investing like this. You get the benefit of lower costs, plus the index will continue to rebalance and throw out the worst performers whilst adding in the faster growing companies – all without you needing to do a thing.

LOWER-RISK	HIGHER-RISK
long-term average return of ~4.5%	**long-term average return of ~7%**
extremes of +/- 15%	**extremes of +/- 40%**

Having your investments designed to match different time horizons requires deep thought and planning. **Do you have time to do it?**

RULES OF WEALTH No. 4

For long-term wealth, volatility is your friend. Once you accept and embrace volatility, not only do you remove worry, you also grow a lot more.

On October 19th 1987, stock markets globally crashed. Black Monday saw the collapse of every major stock exchange across the world. This had happened before. Is there no way to know when it will happen again? Unfortunately, there isn't. What experience teaches us is how to deal with a catastrophe like the last one. And the only thing I can promise you about the next catastrophe is that it won't be like anything we've already had. We haven't a clue what will cause the next market crash. All experience teaches us is that there will be one. Since Black Monday, there have been four more international disasters:

2000
Dot-com bust

2001
9/11 Twin towers

2008
Lehman Brothers bankruptcy

2020
COVID-19

Do you know anyone who forecast them? Neither do I. Oh sure, there were reasons behind the dot-com bust that should and did make some people think (and say), *'It can't go on like this. This is a bubble, it's out of control and it will burst.'* But America's allies the Saudis organising jihadists to fly into the World Trade Center? The global financial system nearly imploding because a few Americans didn't pay off their mortgage and nobody knew how much the risk was spread around. And as for the virus – it's not inconceivable that some scientists in China could have told us what was coming, but chose not to in order not to be disappeared by their own government, but there was no way for any Western investor to foresee it. And while it hammered businesses and stock indices when it struck, to slightly misquote Stephen Sondheim, we've been through all this and we're still here. Before the virus struck, investors worried about all sorts of things. As it turned out, the things they were worrying about really didn't matter. It was something they had never thought of that was about to devastate the market. And that, I submit, is always the case. Yes, investors need to be aware of what is going on – but worrying is pointless because you almost invariably worry about the wrong thing.

Having these concerns around tends to keep investors less than fully invested. This means there is more potential cash to put to work as these worries gradually disappear, which is the reason for the phrase "markets climb a wall of worry." This is the secret. This is what I would like you to understand. It is because there are these concerns out there that financial markets go higher.

There will be a crash again at some point in the future, we all know that, but we will never know what the cause is until it's too late.

Nor does it always take something catastrophic like 9/11 or Covid-19. Markets rise and markets crash – that's just what they do. They have always done it and will always do it because markets are simply extensions of our own human emotions – specifically fear and greed.

There are a number of technical factors that push markets around such as liquidity and positioning which I could bore you with for hours, but the simple fact is this: markets keep going up until they don't. Then they drop. And they normally drop much faster than they go up. Once the drop has finished, they start going up again. And repeat. There is always a reason and there is never a reason. Humans sometimes try to provide too many answers and find it difficult just to accept the present state as it is. The quicker you can come round to this, the more successful investor I promise you will be over the long-term.

So we shouldn't worry? I didn't say that. But what is more important is **to have in place a financial plan to protect and prepare you for whatever happens. And that plan should take account of risk in its general form.**

RULES OF WEALTH No. 3

The only way to make serious wealth is through owning equity. That could range from your own business (100% equity) to a share of Amazon (~0.000001% equity). Just selling your time will not cut it.

Without getting too philosophical, let's think about one of the main differences between communism/socialism and capitalism as economic systems– for simplicity lets call them the left and the right.

On the left, business is seen as 1+1=2.

I.e. an extra pound or dollar of profit, is a pound or dollar, taken away from the worker and/or consumer. They generally see life as a zero-sum game, which is also the nature of taxation. If you take something away it will have equal value elsewhere.

On the right, things are a bit more optimistic. 1+1=3 or even more.

An extra pound or dollar, used wisely, can create value more than the sum of the original parts. This resource can generate profit, which can in turn be re-distributed to shareholders, workers or invested back into the business to generate more profit.

Not wanting to get political, but I'll leave it to you to determine which economic system has been most successful over the last 200 years.

The point is we live in a capitalist society which has significant benefits as an investor. The main being, we can lend our resources to another business, who can use those to generate value, then pay us back more than we lent to them either in income or capital. We don't need to do it all ourselves. Let someone else work your money hard for you.

It's almost impossible to create serious wealth through just work. Yes, you can get paid well for your job like a Doctor or a Lawyer, but it is unlikely you will ever achieve total financial freedom. Why? Because you are being paid by the hour and you can only physically work so many hours in the day, regardless of the rate you're paid. Remember above 1+1 = 2.

So what do Doctors do? They own the medical practice. What do Lawyers do? They create partnerships and own the firm. They create a business and own equity and hire people. **1+1=3 or more.**

The modern advantage of global stock markets that are accessible to virtually everyone means we don't even necessarily need to start our own business. We can become owners of the best businesses in the world just through a few taps on the keyboard. And if you want to diversify some of that risk even more, you can buy an index fund, which means you are just investing in human ingenuity and economic progress in general. Given the record of humanity over millions of years, that's a pretty sure bet.

RULES OF WEALTH No. 2

Your current employer pension is probably going to be the 2nd largest asset you ever own. Wouldn't it make sense to take a little bit of time to understand what it's doing?

Imagine this scenario. A long-lost aunt dies and leaves you a house. It's not worth as much as your current house, but it's a nice enough house in a nice location and totally mortgage free. And the only restriction with the house is that you need to keep it until you're 55 (if you're currently younger than that), after which you're free to do whatever you like with it.

So what do you do? Well if you're like most people, you start by feeling slightly guilty that you never really made much effort with that aunt. But very quickly you get over that and think about what's the best thing to do with the house. Does it need any work? How can you tidy it up? What's the best way to maximise the potential growth and/or income (i.e rent) from the house. The most important thing is you actually think about it.

Why don't people do that with their pensions?

Well if you're a client of mine, then you already have and that's great. However most people don't and when they eventually do, it's too late. The typical response to getting your annual pension statement is to try to read it, have no comprehension of what you're looking at, so ignore it and file it away in the bottom drawer.

12 months go by and you repeat the exact process. Let me remind you, this piece of paper that is being ignored is your financial livelihood from age 55 onwards. It's your bread & butter, gas bills, holidays and petrol. And you're just throwing it in the bottom drawer without a second thought.

I want to start a pension crusade. Pensions offer everyone an enormous opportunity to significantly increase their lifetime wealth, yet nobody thinks about them this way. I want people to start thinking about their pensions before it's too late. Do you know what charges you're paying? Do you know how your funds have performed? Do you even know where they are?

And then there is a little secret. Remember how pensions are long-term investments. Remember how nobody can access their pension before the age of 55. Remember rules 4 on Volatility and rule 5 on Time. The secret it as the money is long-term and not accessible it allows you to take on more risk and accept higher volatility. Why? Because you are a forced holder. Even if the market drops significantly, you cannot touch the funds anyway. So why not take on more risk? And from our previous rules, put this altogether and what does it add up to? Higher long-term returns. Which also happen to be tax-efficient because they are in your pension.

See what I mean about an opportunity? As my title suggests, your pension is potentially the second largest asset you will ever own. It deserves better. **You deserve better.**

RULES OF WEALTH No. 1

Growing your wealth and staying wealthy are two very different and sometimes contradictory skills.

GROWING WEALTH REQUIRES	VS	KEEPING WEALTH REQUIRES
Risk-seeking behaviour		Risk-reducing behaviour
Seeking volatility		Reducing volatility
Focus on accumulation only		Focus on income and accumulation
Concentrated investments		Diversified investments

You cannot make serious money without taking some sort of risk. However, you can KEEP serious money with much less risk.

How many times have you heard the stories of the gambler who strikes it rich, but then loses it all again because he can't resist going back to the well one more time. Don't be that guy.

So much of serious wealth can be built over time, simply just by not messing up. We call it the **"four-eyes" approach**. Having a second set of eyes looking over something can takeaway an enormous amount of risk of doing something exceedingly stupid.

If it's just you and you lose it, then yes I'm sure you will be fine and you can make it back again. But will it just impact you? What about your family, spouse, children etc? What would keeping these funds safe do for their lives? How would they feel if all the money went away?

However, there is one simple act that can mitigate all this risk – have a plan in place.

Most people don't recognise that there are different skills required between growing and keeping wealth.

A plan, built by someone professional, allows you the freedom to continue to grow, take financial risks and enjoy your life. However, it also will play the much more important role of keeping your - and remember your family's - wealth safe.

This book is a collection of edited blog posts from Adam Walkom, founder of Permanent Wealth Partners. Permanent Wealth Partners help professionals achieve profound financial peace with their family's financial situation.

About Adam

Adam Walkom has worked in financial markets his whole career. Starting on the trading floors of BNP Paribas and UBS, he had a brief time as a Consultant with McKinsey & Company before becoming a qualified financial planner in 2014 and now is a Partner at Permanent Wealth Partners.

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