The Psychology of Money – Morgan Housel

Notes and Takeaways

In the world of investing, No One is Crazy, but they may behave that way - just doing what makes sense to them at the time. Because everyone grew up in different circumstances, they react differently to risk and reward in the markets.

One's own experience in the markets represents 1/400M of total market experiences but = 80% of the way they think that the market works.

One's experiences are anchored to market experiences in the 20-30s. Inflation means something completely different to someone who was a teenager from 1970-1980 or 2000-2020.

Luck and risk are interchangeable as determinants of success/failure and since it is often impossible to figure out what % is attributable to each, it is best to stay humble, especially when things are going well.

Excessive leverage often present in a high % of failures, pay attention to patterns of success rather than individual examples of success which might have been attributable to luck: Bill Gates had a 1/1M chance of going to a high school with a computer back in late 1960s, yet he did attend Lakeside school just outside Seattle which was one of 3 USA high schools that had access to a computer.

A concept of more is "never enough" gets people in trouble as they stretch and strive for ever more stuff. Must get the goalposts to stop moving in your life, being content with what you have allows for happiness and takes the pressure off. Warren Buffett on the failure of Long Term Capital Management in late 90s:

- "To make money they didn't have and didn't need, they risked what they did have and did need and that is just foolish."

Enough is NOT TOO LITTLE because an insatiable appetite for more will always push you to the point of regret usually around too much leverage.

What is never worth the risk? Reputation, freedom and independence.

Good investing is not earning the highest returns which tend to be one-hit wonders and impossible to repeat, it is earning pretty good returns consistently that you can stick with and can be repeated.

Good investing is not necessarily about making good decisions, it's about consistently NOT screwing up, recognizing it takes years and years to get wealthy and just accepting that fact. There was a third investor in Berkshire Hathaway besides Charlie Munger and Warren Buffett, Rick Guerin – he was in a hurry to get rich and lost it all due to excessive leverage in the 70s. Warren bought his Berkshire stock back for $40, 47 years later that same stock is worth $402,600 each or 10,000 X more.

More than big returns, seek to be financially "unbreakable" because this allows the power of time and compounding to work to your benefit.

The key to successful financial planning is to plan on the plan not going according to plan and being flexible enough to pivot when it does. A barbell strategy makes sense, otherwise known as optimistic about the future and paranoid about what will prevent it:

- One part terrified of risk, so zero risk $ in cash and treasury bills
- One part stock portfolio to grow over time and gain value for the future
- Place the amount of cash into each that allows you to sleep well at night.

People continuously underestimate what kind of person they will be in the future, people do not see what their future self at +20 years from now will need or want, therefore best to be flexible.

Moderation is the key: moderate saving, moderate work/life balance, moderate commute, moderate time with your family increases the likelihood of sticking with your plan.

Compounding often shows up in huge returns to a very small % of portfolio. Buffett has owned 500 stocks in his investing portfolio and the vast majority of his return is the result of 10 companies, 2% of them to create most of $82.5B net worth.

The best return on investment portfolio - controlling when and for how long you work, with whom you work, what you do with your time - this leads to a happier person both while working and in retirement.

Retirement $ = freedom to do whatever you want

Enough retirement $ = freedom to do whatever you want WITHOUT WORRY

Difference between being

A. Rich: high income, no faster way to feel rich than to spend money on luxury things

And

B. Wealthy: you don't spend money you don't have and you don't spend the money that you do have, wealth is often hidden, people don't "look wealthy", they want what they have and take what they are given with grace.

Saving money should become second nature because life can throw you lots of financial "curve balls". Building wealth has little to do with income or investment returns over 60 years but spending only money that you have and saving the rest. Your savings rate is a much higher predictor of success than income or returns and this is in everyone's control - income and investment returns are not controllable.

Do not expect rational behavior in the market activity or even from yourself, reasonable behavior is as good as it gets. Trading trends belie the fact that the future often really surprises us -Covid 19 and 9/11- and you will never see them coming because they are outliers and never even contemplated.

So, leave room for error:

Love risk taking but be completely averse to ruin.

Taking on a risk that can wipe you out is never worth taking.

Nothing in life is free – financial freedom comes with paying a fee = emotional discomfort during down markets, MUST BE PREPARED TO SUFFER AND PAY THE PSYCHOLOGICAL FEE to be wealthy in the long run. Note that you are paying a psychological fee, not a set $ fine to participate in the markets, a very important distinction.

Some people try to avoid paying the price - they invest in high risk investments, try to shorten the timeline to wealth - it often ends badly and they end up paying double the price.

Recognize the game that you are playing and the game that others are playing and choose NOT to play their game. Day traders may set the daily market price of your investments but that is NOT the game you are playing, biggest dividend to investors that COMPLETELY ignore the other games being played.

Why is pessimism so seductive? Due to asymmetrical aversion to loss – it hurts more to lose money than the pleasure of making money. Money is everywhere so when bad things happen to money (markets go down) it affects everyone and captures everyone's attention. Bad events grab headlines, pessimists extrapolate the bad things continuing and people willingly believe and listen because it sounds so credible where an optimistic view is seen as naïve and counterproductive. Sneaky thing about markets and progress = a relentless drive to improve and finding ingenious ways to do so is SLOW and hard to spot going on, yet it is perpetually there. This is why markets always rebound often at just the point where pessimists have everyone completely despondent.

Final takeaways:

Stay humble when things are going well and have forgiveness/compassion when they go wrong.

Less ego = more wealth.

Manage money in a way that lets you sleep well at night.

Become OK with lots of things going wrong, this is just life.

Use money to gain control of your time.

Save for savings sake – comes in handy when life surprises you.

Define financial success and be ready to pay for it when things don't go your way, stay the course during bear markets. The psychological fee that you are paying is a price to be wealthy.

Room for error is: the gap between what could happen and what you need to happen to do well. Worship that room for error and make sure your cash account is sizeable enough to be that gap protector.

Avoid the extreme ends of financial planning, your future self will thank you for it.

Embrace risk, fear and be paranoid about ruin.

Define the game that you are playing, learn to play it well, forget/ignore those other people playing a different game.

Respect the mess, No One is Crazy.