

AN EXCERPT FROM

MONEY RULES



CHAPTER 5

CHASING THE MARKETS & THE THREE POWERS

HARRY ABRAHAMSEN

Introduction

Money Rules is not your typical book about money. It is an overarching mindset written for people who want to maintain massive wealth. When you know the rules of how money really works and the ideas and strategies within Money Rules, you will be able to build and protect your money, not just have momentary fortune.

The philosophies and approaches in this chapter are presented to you by Harry J. Abrahamsen, and while you may be able to implement many of them right away, they are not to be mistaken for direct advice. Money Rules empowers you to be the master of your own wealth—your advisors are just one piece. At this point, you have been introduced to one aspect of the macro mindset. Make sure to read the rest of Money Rules to move into mastery.

Written for Influential Individuals, Entrepreneurs, Business Owners, and Families with Money. Though I dare anyone to pick it up and read it now.

There are many books written for individuals who are seeking to build wealth, but when you reach the point of impressive success and multiple commas to your name, you may be reliant on your inner circle with your decisions about money. You feel you have control, but you are just a few mistakes away from sacrificing everything.

This book is written for you, and in it you will find out the things you are missing, no matter how diversified your portfolio is or what you think you know about money. When you know the rules of how your wealth really works and the ideas and strategies within, you will be able to build and protect it, not just have success for a moment.

This book is not about what's right or what's wrong, it's about doing things the right way.

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**Risks do not
promise rewards.**

CHAPTER 5

Chasing the Markets & The Three Powers

If you're a *Billions* fan, Bobby Axelrod might have taught you what it means to be a master of timing markets, and maybe that inspiration is working for you. If you're bringing in an income, you might be prepared to withstand market volatility, especially if you have a few hundred million in the bank. Maybe you purchased Amazon or Microsoft at the time of the IPO's, and it made you confident. Your business is booming, your brand is strong, your assets are increasing, and you are winning in multiple markets. What's your next move? In the wisdom of Kenny Rogers: you've got to know when to hold 'em, and know when to fold 'em, and know when to walk away. Do you know when to hold? When do you take your gains and walk away? *Do you* walk away? No one wants to miss out on an investment opportunity or ignore a tip, but winning involves knowing when to stop.

Rates of return are not a plan, especially when they're the only thing at work.

When you are working and building wealth in the wealth accumulation phase, you are focused on how your portfolio is performing and getting your rates of return. But the moment you stop working and hit the

distribution phase, it's a different story. Portfolios are not a plan, and they won't maintain or protect your wealth. Portfolios risk money for a reward, and that's not a risk you want to take when you're no longer working and the money you have today is the only resource you've got to maintain your preferred way of life. You may think you can take risks because you feel you've got some room for mistakes and because that's what you have always done, but what will a mistake cost you? A few hundred thousand? A few million? Your ability to stop working at some point in time? Do you really want to jeopardize what your wealth will become, or destroy it?

When you stop being a person at work and your money is the only thing at work in the distribution phase, your money must be prepared to deliver your preferred way of life, to fuel your passions and invest in anything you want to pick up along the way, whenever you want it. This is when you start to discover the *withdrawal rate*, or the rate that you're able to pull out money to live your way of life after you've stopped working. What you will discover in this phase is that money behaves very differently when you are no longer earning an income, when you're no longer aggressively building your wealth and adding to your pile. This phase is the moment of truth for your strategies and the protections you have in play, and if you have problems with those, your rates of return are worthless. Do not be surprised if your advisors never mentioned this during the accumulation phase.

Imagine climbing a mountain with your buddy, who is a professional mountaineer. They're alongside you the whole way, helping you to make it up. (This ascent represents the time in which you're going for the rates of return and accumulating wealth.) But when you get to the summit they go their own way and leave you stranded. Now you must return by yourself. The descent is the hardest part of the journey—it's the stage many people never return from—but without your mountaineer friend you have nothing to bring you safely down it. If you aren't ready for the descent in the distribution phase of your wealth, it will devastate you.

Most people have an investment plan for the ascent, but they don't have an income plan to take them all the way.

What if you have tens of millions to invest? That just means you have tens of millions to make a mistake with, and hundreds of millions to miss out on in the future. Or what if you don't ever plan to stop working or have work-related income such as royalties or marketing revenue? You might push back and want to keep moving the most money you can towards a rate of return in the markets or private equity deals; you believe you'll be able to make up for a mistake. But what if you're wrong? What happens when people stop buying your book because the philosophy is outdated, or the studio cancels your show because the director did something unthinkable, or your business becomes irrelevant in the wake of a new technology, or your profession ages you out, or your partner makes a grave mistake with taxes? You stop being a person at work, but you didn't plan for it. What were you able to keep safe? Did you even imagine that would happen?

Many people think their impact or their success in business is infinite. But we all have pitfalls and are going to be shocked by something unexpected, and not even your psychic can predict the future well enough for you to stop planning for this. In 1998, the economist Paul Krugman said, "By 2005 or so, it will become clear that the internet's impact on the economy has been no greater than the fax machine's." Even financial experts get it wrong. Don't make the mistake of betting that the present is a mirror for the future. You will always need to think of more than just your returns.

The Myth of the Average Rate of Return

One of the biggest myths surrounding rates of return, particularly when you are withdrawing money, is the *average rate of return*, which I mentioned in the first chapter. Average rates of return are impossible to achieve in real life—if they were real, your wealth would build reliably,

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and it would be relatively easy to predict what you'd have in the future based on what's in front of you today. Institutions provide you with an average rate of return because it benefits them to offer you the assurance that things are looking up on your accounts. But you don't actually receive the amount of the average rate of return because averages are math, not money. On the money side of things, in every moment that you measure your actual rate of return it will be different because the market is volatile and it fluctuates. This means that some years you will receive less than the average rate of return your advisor has illustrated (maybe many years in a row). If you base your withdrawal strategy on the idea of some fixed number like the average rate of return, you eventually won't have enough money to maintain your preferred way of life, and you definitely won't be able to make passion purchases, because what if you don't make the same rate next year?

If we were to imagine that an average rate of return works in the real world, we'd review the history of the S&P 500 from 1970-1999 and add the rates of return, or yields, from each of the years, then divide them by the number of years we're reviewing. This chart shows you those numbers, and if we do the math, the average yield is 14.84%. But if this was a picture of your real finances, note that there is not a single year in which you actually would have earned 14.84%. What a devastating result there would be if you'd made a financial decision based on the hope that the rate of return would be 14.8% in 1973 when it was actually -14.73%.

Imagine, for the sake of simplicity, you have just \$1 million and decide to stop working; your income is then dependent on the potential of that \$1 million. Say you plan to take out money based on the average rate of return of 14.84%. You decide that you'll take 10% of the original amount out every year, so \$100,000 annually. You justify taking 10% because your account will be earning an average of 14.84% while you keep your original \$1 million intact and go about your desired way of life. If we calculate how much your account would grow with a 14.84% rate of return, it would be close to \$15 million after 30 years, as you see

BEGINNING RETIREMENT ASSET VALUE	10% OF BEGINNING VALUE	NUMBER OF YEARS	AVERAGE RETURN
\$1,000,000	\$100,000	30	14.84%
Year	Annual Return	Year	Annual Return
1970	3.99%	1985	31.65%
1971	14.33%	1986	18.60%
1972	18.94%	1987	5.17%
1973	-14.79%	1988	18.61%
1974	-26.54	1989	31.69
1975	37.25%	1990	-3.10%
1976	23.67%	1991	30.47%
1977	-7.39	1992	7.62%
1978	6.44%	1993	10.08%
1979	18.35%	1994	1.32%
1980	32.27%	1995	37.58%
1981	5.05%	1996	22.96%
1982	21.48%	1997	33.36%
1983	22.50%	1998	28.58%
1984	6.15%	1999	21.04%

in this chart below. But we know that you won't actually get a 14.84% yield every year, don't we? Because it isn't real.

Your rates of return would fluctuate year after year, so the outcome would be dramatically different, as you see in this next chart below. In this scenario, in years 14 and 15 your accounts are down to 0. There are a few issues with this: When you dip into the account for your 10% withdrawal, it drops the principal amount significantly—therefore making it a smaller number. By doing this, you've lowered the amount that would be the basis for the earning potential of your money. This means that next year, even if you have a high rate of return, you'd make less than if you didn't dip into that money.

What makes this situation even more difficult is the *break-even burden*. The break-even burden is the phenomenon where when you

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BEGINNING RETIREMENT ASSET VALUE	10% OF BEGINNING VALUE	NUMBER OF YEARS	AVERAGE RETURN
\$1,000,000	\$100,000	30	14.84%
Retirement Year	Annual Return	Annual Income	Annual Value
1	14.84%	-\$100,000	\$1,033,290
2	14.84%	-\$100,000	\$1,072,100
3	14.84%	-\$100,000	\$1,116,360
4	14.84%	-\$100,000	\$1,167,188
5	14.84%	-\$100,000	1,225,558
6	14.84%	-\$100,000	\$1,292,591
7	14.84%	-\$100,000	\$1,369,572
8	14.84%	-\$100,000	\$1,457,976
9	14.84%	-\$100,000	\$1,559,500
10	14.84%	-\$100,000	\$1,676,090
11	14.84%	-\$100,000	\$1,809,982
12	14.84%	-\$100,000	\$1,963,743
13	14.84%	-\$100,000	\$2,140,322
14	14.84%	-\$100,000	\$2,343,106
15	14.84%	-\$100,000	\$2,575,983
20	14.84%	-\$100,000	\$4,373,434
25	14.84%	-\$100,000	\$7,963,668
30	14.84%	-\$100,000	\$15,134,818

lose a certain amount of money, you need to earn even more than that amount just to become whole. For example, if you lose 30% from your account, you need to earn 42.9% to recover. The more you lose, the higher the rate of return will need to be. The reason for this, as you're aware, is that when you have less money in your account, the amount of money that the rate of return is applied to is lower, and therefore the growth is lower. This issue compounds over time, and the situation gets dire when you experience multiple losses in a row. People rarely factor this dynamic into their plan since they believe that money works like math.

Given all these variables, there's no way to really predict exactly what your account value would be in 30 years in this situation. What we

BEGINNING RETIREMENT ASSET VALUE	10% OF BEGINNING VALUE	NUMBER OF YEARS	AVERAGE RETURN
\$1,000,000	\$100,000	14	14.84%
Retirement Year	Annual Return	Annual Income	Account Value
1	3.99%	-\$100,000	\$935,910
2	14.33%	-\$100,000	\$955,696
3	18.94%	-\$100,000	\$1,017,765
4	-14.79%	-\$100,000	\$782,027
5	-26.54	-\$100,000	\$501,017
6	37.25%	-\$100,000	\$550,396
7	23.67%	-\$100,000	\$557,005
8	-7.39%	-\$100,000	\$423,232
9	6.44%	-\$100,000	\$344,048
10	18.35%	-\$100,000	\$288,831
11	32.27%	-\$100,000	\$249,767
12	-5.05	-\$100,000	\$142,204
13	21.48%	-\$100,000	\$51,269
14	22.50%	-\$51,269	\$0
15	6.15%	\$0	\$0

know for sure is that it won't be \$15 million. This is a miniscule amount of money for the sake of this illustration—if we used your real account values, the amounts would be much higher, but the problem is exactly the same.

If, then, you're not able to rely on an average rate of return to create income when you choose to stop working, the question becomes *how do you determine what to safely withdraw per year in order to maintain your way of life but never run out?* The industry has attempted to solve this dilemma with something called the *Monte Carlo Simulation*.

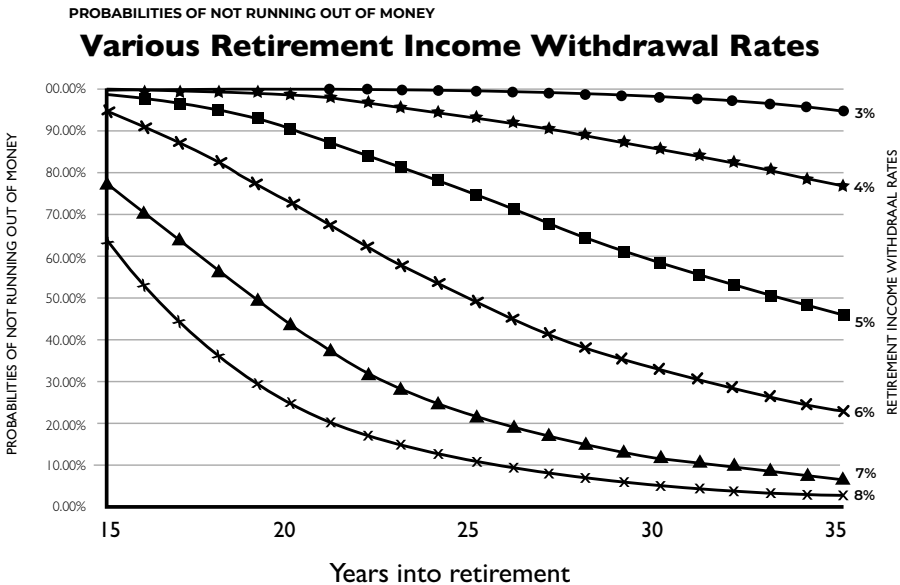
The Trouble with the Monte Carlo Simulation

Those who enjoy roulette are familiar with Monte Carlo, the illustrious gambling destination in Monaco, filled with roulette tables, dice, craps,

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and slot machines, as well as many wealthy individuals. The Monte Carlo simulation was developed by the mathematician Stanislaw Ulam, who worked on the United States' Manhattan Project nuclear initiative in World War II. Ulam became fixated on the game of solitaire while recovering from brain surgery and, obsessed with determining the probability of winning, he began applying mathematics to this simple game of cards. The simulation he developed became the basis for a software program: this software calculates the historic probabilities of running out of money in retirement based on historic rates of return over the period of 100+ years. This is calculated based on the *beginning asset value*, or the amount of money someone has when they choose to stop working—the program runs thousands of simulations for 15, 20, 25, 30, and 35-year periods, taking into account all kinds of market conditions and interest rate environments. The results are always the same, no matter what service runs the simulation.

Let's take a deep dive into this. We see the Monte Carlo Simulation in the graph below, which depicts the historic probabilities of not



running out of money during the distribution phase within 15 to 35-year timeframes. To be clear: what you are seeing in this graph are not rates of return, they're withdrawal rates. We must establish the income withdrawal rate before knowing the actual rate of returns.

If we look at the top curve: if you were to withdraw 3% per year in this scenario, there is a 90% chance that you would *not* run out of money in year 35—meaning that it's 10% likely you *would* run out of money. But if we review the bottom curve: if you were to withdraw 8% per year, there is a 5% chance that you would not run out of money in year 35, making it 95% likely that you would run out of money.

Imagine you're getting on a plane, and you have a personal flight attendant who gives you a hot towel and something to sip on the moment you sit down. The pilot comes over and greets you by name, then leans in and says, "Welcome to Retirement Airlines. It's 5% likely I will land this plane safely." You have about five seconds to get off the flight. What do you think you would do? Would you stay if it was 95% likely the plane would land? It doesn't take a rocket scientist to see that the lower the withdrawal rate, the safer you will be. But who wants to gamble even 5% when it comes to their way of life?

There are three substantial flaws with the Monte Carlo Simulation that make it a weak basis for financial planning. First, it is based on mathematics, and money is not math, and math is not money. Secondly, it doesn't take into account the fact that what you spend on your way of life each year is not a fixed amount of money and will change frequently over time. Finally, it doesn't account for black swans.

As I've mentioned before, a black swan is an unpredictable event with severe and potentially catastrophic results. A black swan event is impossible to simulate, but it may increase the likelihood of running out of money by an additional 20-40%. Soon I will share with you some strategies that use diversification to mitigate these disasters and withdraw safely despite the unknowns. Needless to say, the Monte

Carlo Simulation, particularly in the face of black swans—which are inevitable—does not give the full picture on how to withdraw money safely.

The other thing to remember is that markets aren't remotely reliable. They are known for behaving badly, particularly in the wake of black swans, and are unpredictable at random. You might be thinking: *Ok so I can't rely on mathematical simulations or the average rate of return to keep my wealth intact when I stop working. How do I withdraw my money safely and maintain my way of life?*

Introduction to The Three Powers

In sailing you have three sails—the mainsail, the jib, and the spinnaker. All three are required to reach the destination. When you tack into the wind, you use the mainsail and the jib; the spinnaker is designed for catching the wind that comes from behind. The spinnaker is the beautiful sail that you'd see billowing from the restaurant on the shore. It's what people most associate with the sailboat, but sailors know that special conditions are required for it to work. The mainsail and the jib are the active drivers of the boat. You do not use your spinnaker when the wind is in your face. Your three powers are like these sails. They must be played according to the conditions of the moment, and they must all be used, or you will never make it to your destination. I will teach you what they are and strategies to put them in play, and when you have them under your belt you will be able to move in any direction you want with your wealth.

There are three types of economic assets that comprise the structure of strategies for massive wealth—I term these the three powers.

Power 1. The power to not lose.

Power 2. The power to gain and not lose.

Power 3. The power to gain and lose.

Power one assets include financial products like whole life insurance. Power ones have very low rates of return but have zero market risk, meaning that your money is not affected by changes in the financial or real estate markets. When you stop putting money into a power one, it will continue to grow slowly. If you were to rely entirely on a power one, the money wouldn't grow fast enough to make up for the erosion factors that I discussed in previous chapters, and you wouldn't be protected from running out of money. Power ones are the foundation for wealth protection and efficiency and are significantly under-utilized by most people.

Power two assets include fixed index annuities and other products that have reasonable rates of return. These assets have zero market risk and a floor of zero—you will never lose a dollar from market risk. For instance, fixed index annuities grow based on underlying financial indexes. Every year your account is adjusted by the performance of this index, and you will participate in the growth. If the index is up, your account is credited with a gain, but if it goes down, you don't lose a penny from the market loss. It is like going to Vegas with \$100,000, gambling it all, and coming back home with at least \$100,000. Power twos are valuable for your wealth protection, for potential wealth accumulation, and for creating your preferred lifestyle, because you can withdraw money safely at a much higher rate from them than from your power three assets. They are also implemented the least often because most advisors focus on power threes alone due to their “higher” growth potential.

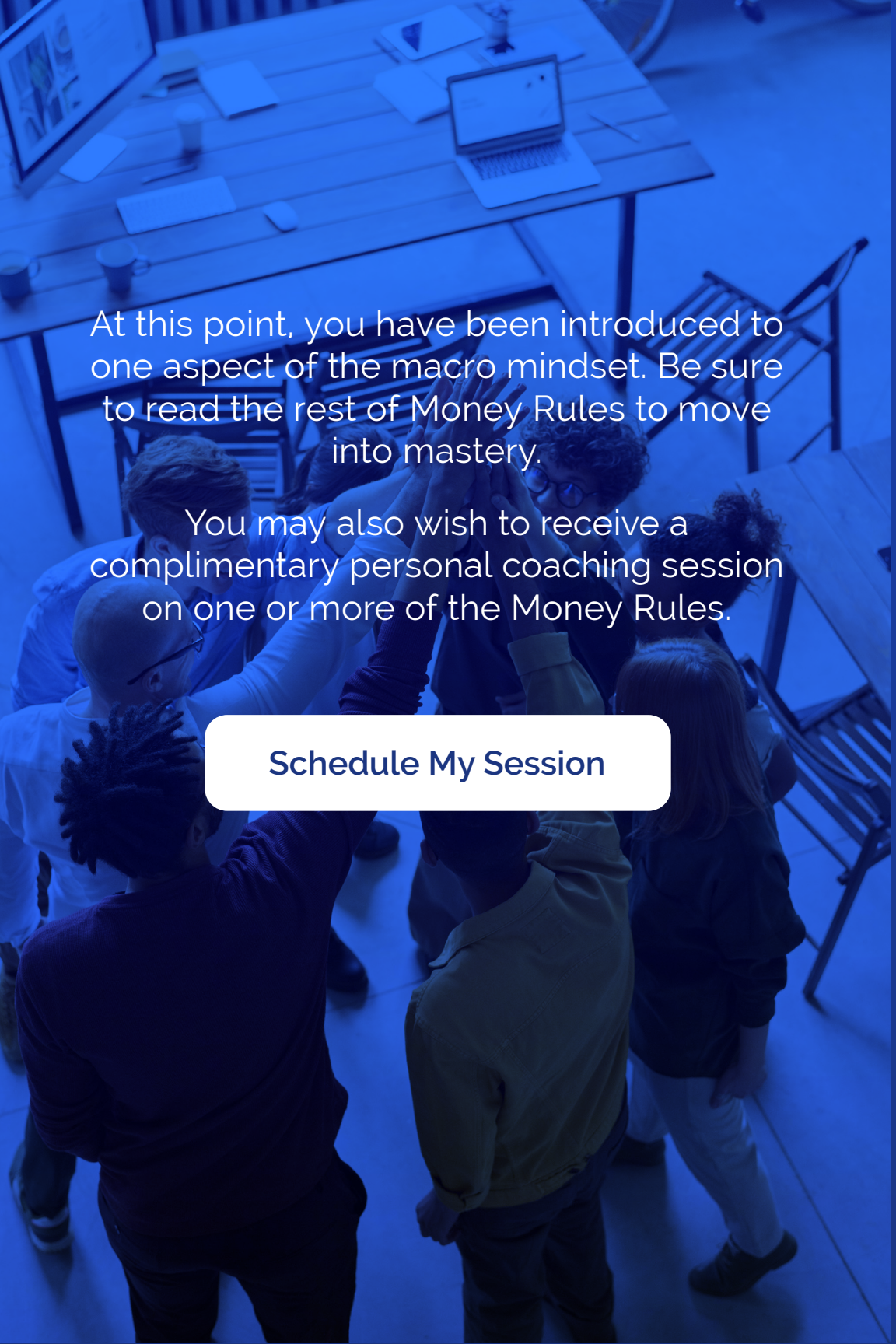
Power three assets are investments. These assets have the highest rates of return, and the highest risk. Your businesses, brokerage accounts, variable annuities, stocks, bonds, hedge funds, private equity, real estate, and crypto investments are all power threes. You need your power threes, but you have to think of them as wealth generators, not a whole strategy. The amount inside the account represents potential for wealth enhancement. It's not money in the bank—it's theoretical. The biggest mistake that people make is to bet solely on their power

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threes because they've become fixated on a rate of return. There are many people who put everything into their power threes and lost the entirety of their assets in a single black swan event. Relying solely on your power threes is like playing chess with no pawns. Sure, pawns have minimal movement, and they aren't as significant as the queen or king, but without them, you will never be able to win. There would be no game of chess if the pawns refused to play.

I'm not suggesting you stop playing Bobby Axelrod entirely, but I am asking you what you're doing to keep the gains. How much are you willing to gamble? Because losing might cost you your way of life. Most people don't think about taking chips off the table. They keep playing and playing until everything is gone. But by then it is too late.

You have someone to watch your home in Lake Tahoe when you're not there, someone to manage your social media accounts, someone to order your items and track down packages, maybe a bodyguard. You may think you have more money than you will ever know what to do with. You feel confident, invincible, and secure with your decisions because everything is working out. When is enough enough? If you are going to maintain all this, you have to know when to hold, fold, and walk away. Masters of their wealth do not chase the wind; they use it.



At this point, you have been introduced to one aspect of the macro mindset. Be sure to read the rest of Money Rules to move into mastery.

You may also wish to receive a complimentary personal coaching session on one or more of the Money Rules.

[Schedule My Session](#)

WRITTEN FOR INFLUENTIAL INDIVIDUALS, ENTREPRENEURS,
BUSINESS OWNERS, AND FAMILIES WITH MONEY

9 RULES TO MASSIVE WEALTH

MONEY RULES \$

Not your traditional book about money

HARRY ABRAHAMSEN