



FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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The Zurich Axioms

Oftentimes I'll read a book that I wish I had read at the beginning of my career. [The Zurich Axioms: The Rules of Risk and Reward Used by Generations of Swiss Bankers](#) (4.5 stars) by Max Gunther—a little-known classic—is one of those books.

The first major axiom is somewhat counterintuitive: "If you are not worried, you are not risking enough....if your main goal in life is to escape worry, you are going to stay poor.... Adventure is what makes life worth living, and the way to have an adventure is to expose yourself to risk."

The second major axiom is "Always take your profit too soon....by reducing your greed, you improve your chances of getting rich....There are many kinds of human endeavors in which starting and ending positions are clearly seen, felt, and understood....Few such clear break points exist in the world of...speculation....Such a race is open-ended. No arbitrarily chosen measure of time or distance, no judge or referee will tell you when you can stop striving....You are required to do that yourself....*The race ends when you say it ends.*"

"Minor Axiom III tells you how to arrive at this ending. Decide where the finish line is before you start the race." This is why I have a target sell price for a stock before I even buy it.

Personal effectiveness guru Michael Hyatt says you should celebrate your wins. Similarly, Max quotes Gerald Loeb, “Why do you go to all the trouble of making this money? What's it there for? To look at?” Loeb recommended that investors spend some of their winnings, which seems like would provide some positive psychological reinforcement.

The third major axiom is “When the ship starts to sink, don't pray. Jump....Knowing how to get out of a bad situation may be the rarest of all speculative gifts....It takes courage and a kind of honesty with a cutting edge....Some say it is the most important of all the tools in a...speculator's kit....An amateur gambler hopes or prays the cards will fall his way, but a professional studies how he will save himself when they fall against him....The inability to jump quickly off a sinking ship has probably cost more speculators more money than any other failing, and has undoubtedly led to the spilling of more gallons of tears than any other kind of financial misfortune.”

I have a rule that when a stock I own cuts its dividend, I sell it immediately, because things are probably never going to get better. Other signs of a sinking ship that will prompt me to look for the nearest exit include a Beneish M-score higher than -1.78 (which indicates that the company is likely manipulating its reported earnings), high short interest, a large volume of insider sales, or the dividend becomes unsafe.

The fourth major axiom is “Human behavior cannot be predicted. Distrust anyone who claims to know the future, however dimly....Every prophet is right sometimes and wrong sometimes—more often the latter, but you can't tell in advance which it is going to be. To be in a position to tell, you would have to make predictions about the prophet's predictions. If you were that good at predicting, you wouldn't need the prophet. Since you aren't that good at it, you can't count on anything the seer says....Human events absolutely cannot be predicted, by any method, by anybody.”

Max continues, “One of the traps money-world prophets fall into is that they forget they are dealing with human behavior....The stock market...is a colossal engine of human emotion. Prices of stocks rise and fall because of what men and women are doing, thinking, and feeling. The price of a given company's shares doesn't rise because of abstract figures in an accounting ledger, nor even because the company's future prospects are objectively good, but because people think the prospects are good.” The market slumps “because people are worried, or discouraged, or afraid.”

Similarly, all economic statistics are the result of human interaction. “And as such, all are entirely unpredictable. There are simply too many unknowable variables involved to allow for trustworthy forecasts [of a statistic that] is caused by millions of people making billions of decisions....” Max cautions, “Never lose sight of the possibility that you have made a bad bet.” Yes. An investor needs to cultivate humility, because confidence is very dangerous.

The fifth major axiom is “Chaos is not dangerous until it begins to look orderly....The minute you think you see an orderly design in the affairs of men...you are in peril.... Everybody is looking for [a formula that will consistently result in riches]....the world of money is a world of patternless disorder, utter chaos. Patterns...are ephemeral [and]

alluring....[This axiom] may be the most important Axiom of them all. It is the Emperor Axiom.”

Minor axiom VII is “Beware the correlation and causality delusions....The human mind is an order-seeking organ. It is uncomfortable with chaos and will retreat from reality into fantasy if that is the only way it can sort things out to its satisfaction. Thus, when two or more events occur in close proximity, we insist on constructing elaborate causal links between them because that makes us comfortable.”

The seventh major axiom is “A hunch can be trusted if it can be explained....When you are hit with a strong hunch...the possibility is that this conclusion is based on actual, solid information that is stored somewhere in your mind. What makes it perplexing is that *it is information you don't know you possess....it is a common human experience to know something without knowing how you know it....you take in colossal amounts of data every day—vastly more than you can store in your conscious mind and recall....Most of it is stored in some other reservoir just below...the conscious level.*”

The ninth major axiom is “Optimism means expecting the best, but confidence means knowing how you will handle the worst....One reason why optimism is so treacherous is that it feels good....It has a hypnotic allure. It is like the Sirens of ancient Greek legend, whose sweet singing lured sailors to death on the rocks. Any venture...has a limitless number of possible futures, some good and some bad.”



This painting is in my office.

Max writes that optimism “can lead to financial doom if allowed to get out of control.... [It's] a leading cause of pervasively flawed judgment....We are drawn to optimism and

optimists....There are optimists all around you, and there is undoubtedly a very insistent one inside your head. Watch out for them all. They can befuddle your good judgment to an alarming degree....No defense is effective against the song of the optimist....[But you can] stay aware of the optimistic bias in your internal compass and stay alert to its dangers.”

The tenth major axiom is “Disregard the majority opinion. It is probably wrong....as [René] Descartes said, it is more likely that the truth has been found by few than by many.” Yes. Just look at how the few skeptics of the government's response to COVID-19 have been vindicated.

The twelfth major axiom is “Long-range plans engender the dangerous belief that the future is under control. It is important never to take your own long-range plans, or other people's, seriously. This is a hair-raisingly dangerous belief.” This is why as a financial planner, many years ago I stopped projecting my clients' cash flows over their remaining life expectancy. It merely provided a comforting illusion that the future was under control. But those numbers depend on financial markets, politics, war and a number of other domains that are in Extremistan and thus spawn Black Swan events that can't be projected.

As Max writes, in the future, “You cannot even know if there will be a money world at all, or a dollar, or anything to spend the dollar on.” Instead, you should “stay light on your feet [and] react to events as they unfold in the present....The only long-range plan you need...is an intention to get rich. Exactly how you will accomplish that...is something you cannot know....The only kind of preparation I can make...is to continue studying the market, to go on learning and improving.”

Finally, Max advises to not get rooted in an investment: “Every investment should be, at the very least, re-evaluated and made to justify itself afresh every three months or so.”

Max wrote several other books, some of which I put on my To Read list.

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