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PROSPER!

How to Prepare for the Future and Create a World Worth Inheriting

FREE CHAPTER PREVIEW

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FOREWORD BY ROBERT KIYOSAKI,
AUTHOR OF THE INTERNATIONAL BEST-SELLER *RICH DAD POOR DAD*

CHAPTER 6

Financial Capital

When we speak publicly about the Three E trends, most people who come up to us afterwards ask: *What should I do?* What we've learned is that most of them are really asking: *What should I do with my money???*

We get it. Most of us spend the majority of our waking hours at work, earning money that we hope will provide a secure future for ourselves and those we care about. The idea of losing our hard-won financial savings suddenly during another economic crisis, through job loss or a market crash, is a near-universal fear.

Given this sensitivity and the related urgency many have around it, we'll begin our journey in resilience-building by focusing on developing Financial Capital.

So how can we protect our money and its purchasing power? And how may we be able to use our insights of future trends to make more of it?

Money ≠ Resilience

But first, let's get some perspective. It's very important to note that even though we're starting with Financial Capital, that does not mean it's more important to developing resilience than any of the seven other forms. It's not.

And let's be really clear about this. If all you have is Financial Capital, even if you have millions to your name, you are NOT resilient.

We'll explain why more fully as we dial through the other forms of capital in future chapters, but for now, suffice it to say that some of the least resilient people we encounter in our consulting work have 8-figure bank accounts or higher. This is due in part to how completely these folks have let their identity become defined by the size of their savings account. They live in fear of their money disappearing; afraid they'll have no purpose or worth in the world without it.

Don't get us wrong, though. Financial Capital is important: *it is often the easiest means by which you can acquire other forms of capital.*

Think about it. You don't use your dollars (or Euros, or Pounds, or Yen, etc) for a physical purpose. You don't build a house out of them. Eating them doesn't nourish you. Instead, you exchange them for goods and services that can.

SOME PEOPLE ARE SO POOR, ALL THEY HAVE IS MONEY

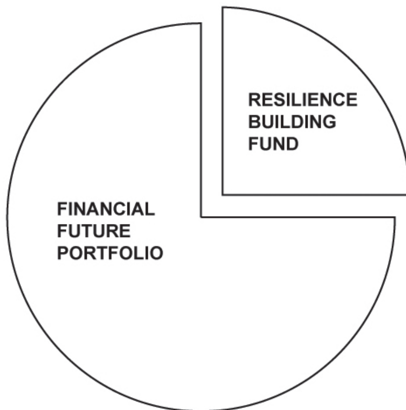
And this exchange not only leaves you with a desired asset. It can also leave you with a tremendous surplus of *Time* (one of the other forms of capital), as you didn't have to invest the labor to produce the acquired asset. Anyone who's ever built a house, grown a crop, or gone through medical school themselves has a real appreciation for the true time savings that exchanging money for goods and services offers.

Which is why we encourage you to start thinking more broadly about what "wealth" is. Yes, money is a very real part of wealth, but only a part. In addition to the cash to your name, are you healthy? Happy? Safe? Wise? Valued by others? Self-sufficient? Those are the real "assets" you truly want to end up with in life. Money is simply one of the means of acquiring things in life that we need or value.

If there's one light bulb we're trying to turn on in your head in this chapter, it's this: Think about your financial holdings as divided into two buckets.

The first bucket is your **Resilience-Building Fund**. This is the allotment you plan to exchange for other forms of capital in the near term.

The second is your **Financial Future Portfolio**. This is the money you will save and invest today, with the intent to exchange it for other forms of capital at a later time (i.e. years) in the future.



How much of your holdings should go into the seed fund? And what should you do with the money left in your financial portfolio?

We'll go into answering these questions in detail in this chapter. But first, it helps to start this journey with a clear picture of your current financial situation. After all, you can't make good decisions without good data.

THE FUNDAMENTALS OF YOUR MONEY

Given the enormous range of bright and well-educated people we interact with each month at PeakProsperity.com, we're constantly surprised by the education gap many of them live with in regards to their personal finances.

Money is a topic often burdened by a lot of emotion for many people. As behavioral economist Dan Ariely has empirically cataloged in his book, *Predictably Irrational*, we humans frequently make inefficient, even nonsensical decisions around money – despite it being extremely quantifiable and trackable. For a number of fascinating cognitive reasons, bias, avarice and fear color our judgment in many ways of which we are usually unaware. The result? We often avoid the topic completely, or make hasty reactions to short-term issues—both of which undermine good decision-making.

Which is why your first steps towards Financial Resiliency start with taking a hard, honest look at your current situation. How much in savings do you have, after subtracting any debts you owe? Are you living within your means when it comes to your monthly income and expenses?

If you don't have the data readily at hand to answer these questions, don't worry. In the *What Should I Do?* workbook that accompanies this book, we have helpful templates and step-by-step guidance that makes the process of putting together your personal financial picture easy.

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While everyone's financial situation is unique, having this insight allows you to start crafting informed responses to important questions like:

- Do I have enough net wealth to fund my life's goals? If not, how much more do I need?
- Am I too indebted for comfort?
- Should I prioritize increasing my assets, or paying down my debts?
- Are my financial assets well-diversified?

- Are there any assets I'd prefer to sell now versus holding longer?
- Which debts should I pay off first?

Dividing Your Buckets

Armed with this new-found clarity into your finances, it's now time to make an important decision: *How much money are you going to allocate to your Resilience-Building Fund?*

Don't worry about being "exactly right" at this moment. You'll refine your answer as you go through the rest of this book and the exercises in the accompanying workbook. But it's important at this time to make a ballpark commitment of how much of your Financial Capital you're willing and able to start exchanging in return for other forms of capital that you may be currently deficient in.

Why now?

Well, first, this is your initial step towards making the mind-shift away from thinking about 'wealth' strictly in financial terms. And, secondly, the money that remains comprises your Financial Future Portfolio. The rest of this chapter will focus on how to increase both the size of your Financial Future Portfolio as well as its ability to weather unexpected shocks.

As with all things financial, how much you decide to devote at this point to your Resilience-Building Fund is a personal decision unique to your own situation and goals. But as a general benchmark, we recommend a starting range of between 10-15%. We'll give plenty of guidance on how to consider best allocating this in the upcoming chapters.

And for the money that remains in your Financial Future Portfolio, you must take care to ensure it's managed well. The many worrisome trends summarized in Chapter 2 and by *The Crash Course* practically guarantee that the future will see a higher degree of price volatility in the financial markets, economic crises, currency devaluations, relapses into recession, tax increases, and job market weakness. An investment portfolio managed in the old paradigm of buy-and-hold, "set-it-and-forget-it" has a dangerously elevated risk of being ravaged in this new environment.

Start by Safeguarding

"*Primum non nocere*" ("First, do no harm") is a founding principle of bioethics that all healthcare students are taught. When it comes to managing

your Future Financial Portfolio, we feel a similar commitment to safety and loss-avoidance is wise to adopt.

For this reason, we recommend that you strongly consider working under the guidance of a seasoned financial adviser, one who understands and appreciates the outlook and risks presented in *The Crash Course*, and who excels at risk-management. On our own, most of us lack the knowledge and the ability to hedge our investment positions effectively and affordably. And with busy lives, nearly all of us lack the time that active portfolio management will require in the high-volatility era we're entering. A responsible, prudent, experienced financial adviser can provide valuable stewardship here—though you do need to do your due diligence to find one of quality.

First and foremost, only consider advisers who convince you they truly understand your unique situation, goals and needs—and are willing to build a personalized investment strategy around them. A good sign you're dealing with the right kind of adviser is if they demonstrate a high listening-to-speaking ratio and take the time to ask clarifying questions.

There are far too many wealth management 'professionals' out there who only care about getting their hands on your hard-earned savings, which they will then toss into a one-size-fits-all portfolio that maximizes their earned fees and minimizes the time they need to spend managing it. We've been shocked by the many stories folks have shared with us about abysmal neglect their portfolios have suffered under such advisers; and a good number of these accounts had balances in the millions, leading us to wonder: *How huge does an account need to be to qualify for active oversight?*

As mentioned earlier, we strongly urge you to select an advisor with demonstrated years of risk-management experience. By this, we mean using investment allocations and instruments that provide downside protection to your portfolio, in case the market moves against you—a practice frequently referred to as 'hedging.' Hedging can be as simple as holding a higher percentage of your portfolio in cash when markets seem dangerously 'frothy,' but it can get quite complex

READ:

How to Hedge Against a Market Correction

TOPIC:
Common Hedging Techniques

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quite quickly through the use of stops, limit orders, short positions, inverse and leveraged positions, options and future. A good risk manager knows how (and when, very importantly) to use these instruments with confidence and prudence to avoid damaging losses.

Here's a checklist to use in your search for a good adviser:

- They place the focus on you and your goals, not how much money you're giving them.
- They patiently offer full and clear explanations to your questions, no matter how small or 'naïve'.
- They have thoughtful, intelligent responses if you bring up the themes discussed in *The Crash Course*. For example if you have concerns about the standard "buy and hold" meme, want to know if they take Peak Cheap Oil into account in their investment strategy, or want to consider allocating some of your portfolio into gold and silver, they don't dismiss or otherwise condescend to you (We find this is a pretty effective litmus test. PeakProsperity.com readers tend to find themselves quickly unhappy with advisers unwilling to discuss these themes seriously.)
- They're independently owned and operated. (Brokers at large firms are often pressured to place client funds into securities from which the parent firm makes more money.)
- They provide anytime access to your portfolio and its performance
- They have a track record of satisfactory returns over periods where the market is up, and excellent relative outperformance over periods where the market drops.
- They are in good regulatory standing and have no history of valid disclosures filed against them (complaints, arbitrations, regulatory actions, etc.). FINRA, the Financial Industry Regulatory Authority, offers a webtool that makes it simple to run a quick background check on any broker or firm at http://brokercheck.finra.org/
- Most important: they give you quality service and inspire your trust.

If you already have a trusted advisor in place, *Congratulations!* If not, time to get started finding one to partner with.

And if you find you have trouble locating one you feel comfortable with, we can help. We endorse a (very) short list of financial advisers with whom we have worked closely over the years and referred a number of Peak Prosperity readers to. We selected them for this very reason: many people

were contacting us, hoping we could help connect them with professionals who look through a similar lens as we do. Apparently, there's a real dearth out there of advisers who share our concerns about the economy's blind assumption that economic growth will continue forever.

You can learn more about those advisers and request an initial, free consultation with them at www.greylockpeak.com.

Once you've recruited professional help on to your team, it's now time to get your perspective in the right place.

YOU MUST BE PREPARED TO LOSE MONEY

We're sorry to bear the news that Financial Repression is only one of a number of fronts on which your money is under siege.

Higher Taxes

As resource constraints increasingly restrict world economic growth, the interest demanded by our exponentially-expanding debts will start squeezing budgets ever-harder at both the Federal and municipal levels. And the response to this is incredibly easy to predict:

More taxes.

Like a drowning man, a fiscally-challenged government will grasp at anything—any revenue source it can lay it hands on—to avoid having to make itself smaller. And taxation is its easiest method of doing so.

Right now, income tax rates in the United States are near 80-year lows. The same is true of taxes on capital gains. So there's lots of room for scared politicians to raise both from here "in the national interest."

Expect to experience more taxation in the coming years, both through direct rate hikes as well as through "stealth" taxes like monetary inflation (which reduces the real cost to the government of making its debt interest and entitlement payments) or legislation like the Affordable Care Act (which has led to higher average health care premiums).

When it comes to stewarding your financial capital, working with a professional accountant (one with a CPA license) is strongly recommended. Employing legal ways to minimize your exposure to taxation is going to be a key pillar of building and retaining financial wealth over the next several decades. A good accountant will also work hand-in-hand with your financial adviser to develop and deploy a tax-advantaged investment strategy for you.

Lower Pensions

In addition to taxing more, as governments become more pinched for funds, they are also going to be forced to start spending less.

Right now, U.S. state public pensions are collectively underfunded by more than $1 trillion. And private sector pensions are underfunded by an even greater amount.

At the Federal level, the situation is even more dire than *that*. Estimates of the funding shortfall of entitlement programs like Social Security, Medicare and Medicaid range from—$60 trillion U.S. dollars to more than $200 hundred trillion.

These underfunded programs simply can't meet everything that's been promised. As budgets get tighter, funding for retirees and the unemployed will increasingly compete with infrastructure and commerce investment. When dollars are tight, will politicians spend what remains to create jobs, or pay people who aren't working? They will, predictably, go with the votes. This means that at first paying retirees will win out, but then later, the desire to create jobs will be stronger. That is, both groups will lose in the end by amounts equal to today's shortfalls which are, to be blunt, staggering.

The bottom line here is that if you are expecting to receive some sort of guaranteed payment from the government or employer when you retire, you'd better develop a contingency plan that assumes a good portion of it never arrives.

The Coming Bubble 'Pop!'

As we've mentioned, prices indicate that bubbles have re-emerged in the stock, bond and real estate markets, as well as many other investment classes from fine art to MLB season tickets. All courtesy of our friendly central bankers and their easy money.

And what do we know about bubbles? *They pop*. Remember what happened to investment portfolios and your house values between 2007-2009? It wasn't pretty.

None of the foundational culprits of the 2007/2008 crash have been effectively addressed and made safer. Indeed, nearly all have gotten worse. Compared to before the last crash: world debt is $57 trillion higher, world GDP growth is anemic, the "too big to fail" institutions that created the mess have only increased in size, and the crony relationship between our politicians and banking system has only become more entwined.

For the reasons we write about daily at PeakProsperity.com, many of which we've mentioned in this book, we are highly confident that a major crash—one that could cut prices in half or more—is in our near-term future

(near-term defined as within the next five years). We realize that this may well be unpopular news. Many of us still feel like we've just picked ourselves off the floor after the knock-down blow the Great Recession dealt us, and we hate to be bearers of an unwelcome prediction like this. But we value realism, and sense you do, too, if you bought this book.

Which leads us to the title of this section: *Be Prepared To Lose Money.* Whether it's a market crash, a loss of income during the next recession, or just the slow erosion of wealth from financial repression and parasites like the high frequency trading computer robots that never fail to skim money from the markets for their owners, you have to get comfortable with the likely reality that events will conspire to make you lose money at times as we enter this turbulent future.

The trick to financial prosperity? *When those hard times arrive, make sure you lose* ***less*** *than everybody else.*

Our strongest advice is to then invest the money you've saved while prices are depressed and value can be bought on the cheap.

In order to be able to do this, it's critical for you to develop the emotional readiness now, in advance, to be able to buy "when there is blood in the streets" and not be paralyzed by the paper losses you will be sure to have taken when that moment arrives. Accepting these losses now, before they have happened, will prevent you from being overwhelmed or panicking when they actually occur, as well as give you the clarity of purpose to act when most others are too stunned or too fearful to do so.

Yes, it sounds strange. But for this reason, we firmly believe that making peace with losing money is an essential step towards ultimately accumulating a lot more of it.

First Deflation, then Inflation

This emotional readiness is going to serve you well as the approaching set of crises discussed in Chapter 2 fully get underway. Things are going to get very rocky, and very confusing. Most people will simply hunker down during this time, and not realize what's happened to them and their wealth until the transfer is completed.

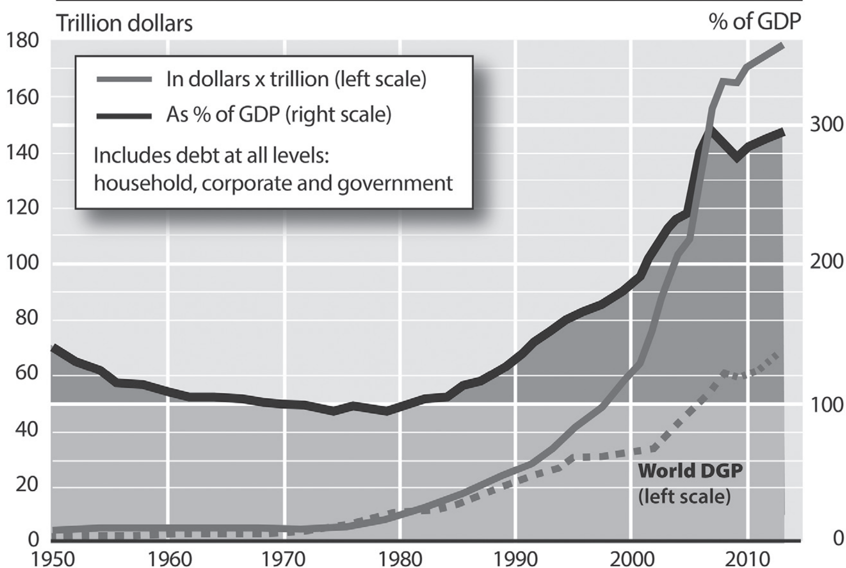
So understanding the likely course of coming events is hugely important, and can give you a tremendous advantage. Because you'll know what signs to look for and what to do when you see them.

The Ka-POOM! Theory

What the 2008 financial crisis made clear is that when natural market forces want to purge the oversupply of poor-quality debt from the system they do exactly that. The bad mortgages (think subprime), the bad sovereign debts (think Greece), and the loan portfolios of over-extended financial institutions (think Citibank) represented "poor quality debt." When the market (finally) figured out that those debts would never be repaid at face value, or perhaps at all, turmoil erupted.

During times like these, the market demands higher interest rates for the increased risks it sees. But this makes debts harder to service, ultimately triggering defaults, which only compounds the difficulties of the issuers of low quality debt, as interest costs and defaults spiral ever upwards until the system is purged. Think of it as nature's way of removing bad credit from the world, the way a lion chases the lamest antelope first.

Because in our fiat currency system "all money is loaned into existence" (see chapters 7 and 8 of *The Crash Course* on-line video series), during periods of high debt default, the money supply shrinks. This is the textbook definition of deflation—a common symptom of which is falling prices—meaning there is less money (and/or credit) available to chase goods and services.



This is what we saw of course, as the last financial crisis struck in 2008: Prices fell hard across stocks, bonds, real estate, and a wide number of other asset classes.

The "recovery" we've experienced since then is primarily due to the world's central banks acting in unison, printing over $10 trillion to buy up huge tranches of this lame, limping debt and holding it so that it can't be declared in default—essentially preventing nature from having its due (for the time being).

This thwarting of the natural order can't last forever for a number of reasons, a big one being that the system went right back to its reckless ways, unsurprisingly, after the central banks rode to its rescue. In the years since the excessive highs of 2008, global credit-market debt has increased by another $57 trillion, on track to soon top $200 trillion in total.

The year 2008 was a wake-up call to change our ways, but as a society we didn't listen at all. Instead, we've responded by doing more of the same behavior that created the crisis in the first place. That's a sure-fire recipe for repeating the same downfall, just from a higher elevation next time.

This is a main reason why we have great confidence that deflation will once again gain the upper hand in the future. Nature can only be denied for so long.

This is why we subscribe to the *Ka-POOM!* theory, originally coined by economist Eric Janszen in1998 (who later re-named it The Janszen Scenario). Its name is inspired by the dual nature of most explosions: first a detonation creates a shock wave (the *Ka!*) inside the financial matrix which first compresses it initiating a chain reaction, and then quickly morphs into a massive pressure build-up that explodes in a shock wave that spreads outwards in all directions at hypersonic speeds (the *POOM!*).

Janzen's theory forecasts that our twin burden of too much debt combined with overinflated asset prices will reach a tipping point, where buyers of both debt and equity go on strike. A deflationary crunch (the *Ka!*) is the first of this two-act play, creating a vicious cycle of defaults, corporate layoffs and portfolio losses, which only make buyers retrench even further. The mal-investments are hunted down and eaten by financial predators.

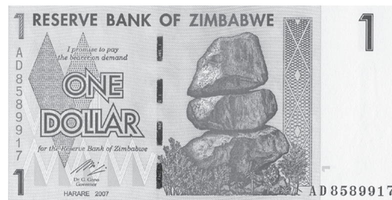
This period will be experienced by most as a brutal time, and will look and feel similar to the last financial crisis, only worse. It's important to remember that within just five short months after the crisis hit in October 2008, the Dow Jones index had dropped by over 50% and the labor market had shed over 4 million jobs. Again, given that conditions today are even more overextended on many fronts, the carnage wreaked by this coming deflation will likely be worse.

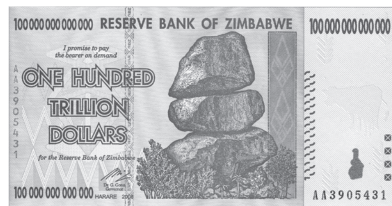
Of course this will send our central leaders and policymakers into panic. Shouts of *"Do something, anything!"* will come from politicians and voters alike. All eyes will look to the central bankers to *"Do whatever it takes"* to make the collapse stop. And they will respond using the only weapon they have: the printing press.

Concluding that their previous quantitative easing (QE) programs were effective but simply not large enough, they will turn the presses on overdrive in order to prop up prices and end the defaults. Former Federal Reserve Chairman Ben Bernanke once quasi-joked of dropping money from helicopters to combat deflation—the *Ka-POOM!* scenario is the sort of one he was referring to. The Fed would become the buyer of last resort, purchasing huge percentages of the bond market, the stock market, and home mortgages. In addition to supporting the banks, it would probably send stimulus directly to citizens, either as checks or in the form of future income tax forgiveness and/or prior year rebates. That is, they would try and print their way out of trouble.

This explosion of new "thin-air" money (the *POOM!* part of the cycle) will be highly inflationary and if large enough will temporarily stop and reverse the fall in asset prices. But in so doing, the purchasing power of the currency will be viciously and rapidly diminished. So we expect the central banks to "win the battle" for a while, but ultimately lose the war.

Savers will be destroyed. Prices will skyrocket—this will actually not be the result of things becoming more expensive, but of people's faith in money eroding. Fear of holding currency will grow, as citizens rightly worry that its rapid depreciation will continue. The velocity of money will skyrocket and just as happened in Weimer Germany in the 1920s, Yugoslavia in the early 1990s, Zimbabwe in the 2000s, and as is happening now in countries like Argentina and Venezuela, the populace will lose confidence in the value of its currency. Once that happens hyperinflation results, exposing the fact that the majority of paper money's value comes from confidence and nothing more.





In hyperinflation, a currency becomes essentially worthless; so much of it has been printed that no one wants it, and therefore it fails to be either a means of exchange or a store of value—the two basic functions money must perform.

Transition into Tangible Assets

This likely progression into currency collapse is critical to understand, as several key conclusions can be drawn from it. The most important being: move your financial assets from paper investments into real things before the trouble begins!

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> *TOPIC:*
> *Hyperinflation in Zimbabwe*
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> *URL and LINK:*
> *See page 205*

Tangible assets, often referred to as "hard assets," are things like land, commodities, finished goods, and productive enterprises. These things cannot be magically increased at will, as can currency with a printing press and so they preserve actual wealth. This has always proven to be true throughout history.

As prices become more and more distorted by central bank policies, the true value of tangible assets remains constant. A stand of timber has an intrinsic value, no matter how much or how little the *price* of lumber is. It is because of this feature that tangible assets serve as a good store of value in the way that money should (but routinely does not).

This means that in times when our currency is failing us (but really it's our leadership failing us), the desire to hold tangible assets grows. Those holding hard assets not only protect their purchasing power, but are often offered attractive premiums by potential buyers at key moments who are increasingly desperate to own some hard assets of their own.

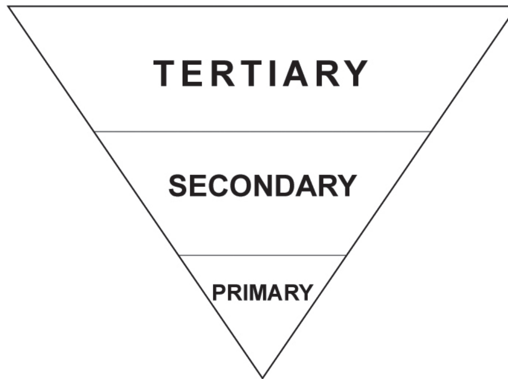
Move to Own Primary and Secondary Assets

We expect that there's going to be a massive shift in the concentration of financial wealth back into more tangible forms of wealth.

We'll talk in more detail about this in the chapter on Living Capital, but we agree with E.F. Schumacher who viewed financial wealth as being divided into three principal forms: primary, secondary and tertiary.

Primary wealth consists of raw natural resources: timber, farmland, fisheries, mineral ores, etc.

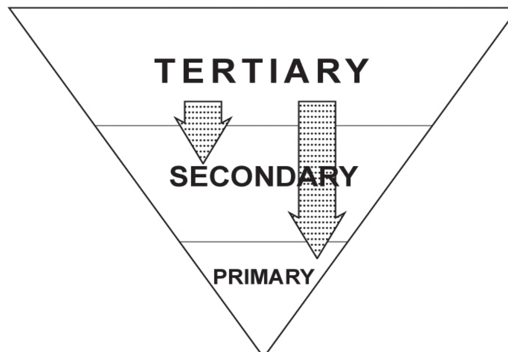
Secondary wealth is comprised of the goods and services that result through the transformation of primary wealth: lumber, food, steel, productive businesses, etc.



Tertiary assets like stocks and bonds, however, are simply paper *claims* on secondary and primary forms of wealth. Without those more fundamentals assets, tertiary wealth would have no meaning, no value, and would not exist. And if we look at the number of those tertiary paper claims, and the ways in which these claims have been greatly multiplied through the use of leverage and derivatives (American banks alone have over $280 trillion in derivatives on their books) we quickly compute that the vast majority of tertiary assets are unsecured "phantom wealth." *There are simply way more claims on "real stuff" than there is "real stuff."*

So in essence, tertiary wealth is only worth what people are willing to accept for the paper currency it's denominated in. But, at the end of the day, what people actually want is to be able to exchange their claims for 'stuff.' What will happen when people's preferences shift from wanting to hold paper claims to wanting to hold real things? The perceived worth of tertiary assets will evaporate. No one will want to hold stock or bonds or derivatives or even currency itself if things get bad enough.

This is why we predict the eventual shift of financial capital from paper into things.



In fact, it's already happening if you know where to look. The top 1% are quite busy exchanging their tertiary wealth for land, for fine art, for trophy properties and other assets that are finite, desirable and discrete. For example, at the end of 2014, it was revealed that Microsoft billionaire Bill Gates has quietly amassed one of the largest portfolios of farmland in the U.S. Southeast. And it's not just rich individuals; a number of hedge funds and indeed nations, via their sovereign wealth funds, are following suit.

So, how does the average individual start moving a portion of their financial wealth out of tertiary capital and into tangible assets?

Sell Claims and Build Cash

The first step is easy. Sell some of your stock and bond positions. Determine a starting percentage—5%, 10%—and hit the sell button (deciding how much to liquidate and which positions to sell is, of course, best determined with the guidance of your professional adviser).

It is worth talking for a moment about the wisdom of holding cash in this environment, despite our near-term concerns about financial repression and our long-term ones that the currency is likely to get debased.

First, we have yet to enter the *Ka-POOM!* phase. All of that likely madness is still ahead of us. In the here and now, as discussed, we are increasingly seeing bubble pricing in markets. And what happens with bubbles? They pop. When they do, prices drop and cash then buys a lot more than it did before the bursting. Unless you have a gambler's mindset with your savings, having a substantial portion of your financial portfolio in cash right now seems quite prudent to us.

Second, once we do enter the *Ka!* Phase—which may come with the popping of these latest bubbles, or not (no one can predict with certainty)—the deflationary price downdraft will be vicious. All asset prices, tangible assets, too, will suffer. This is the "blood in the streets" moment you've heard about. At this time, cash will be of paramount importance. Both as a store of value, and as 'dry powder' to deploy in purchasing excellent primary and secondary assets on the cheap.

So, specifically, we recommend the following with cash:

- **Step1: Build an emergency stash** – this should be in physical bills, kept outside of the banking system (home safe, etc). This is money for a true emergency, like a surprise shut-down of the electrical grid or banking system. It's for you to trade for supplies or pay transport costs if you need to get to a safer location. Our recommendation is to ultimately have $2,000 per family member.

- **Step 2: Keep a reserve for hard times** – this is your savings to help cushion against a surprise loss of income (job loss, etc.). We recommend working to save up three to six months worth of your current income in cash, out of the banking system.
- **Step 3**: **Build your dry powder** – this is the capital you will use for purchasing tangible assets at attractive prices. Which assets and at what prices is, again, best arrived at in partnership with a good adviser. We recommend taking a measured approach here. Don't rush to deploy this cash unless certain conditions (which we'll mention soon) occur.
- **Step 4**: **Diversify your other holdings** – No one knows for certain what the future will bring. Holding a core position (say 10% of your financial wealth) in cash gives you a safety margin, some portfolio diversification, and preserves some options for you if the future ends up surprising us all. Your diversified positions can be, and if large enough *should* be, diversified into multiple currencies and cash equivalents (e.g., Treasury bills) for further safety.

There are a few notable risks with cash to be aware of.

One is the risk of a **bank bail-in** when the next financial crisis arrives. A "bail-in" occurs when the government determines a failing bank can only meet its obligations to various creditors by deploying depositors' funds. In a bail-in, your savings are essentially used to pay for the banks misdeeds and bad decisions. This type of bank rescue occurred in Cyprus in 2013, and many think this was a test-run for future such situations elsewhere in the West. Indeed, the G20 decided in November 2014 that any deposits above the federally-insured limit will be subordinate to most creditor claims of a failing bank including, remarkably, any losing derivative bets your bank may have made

Yes, even though it's *your* money, the rules have been changed to give others senior rights to it during times of trouble. Not so coincidentally, every single one of the recent rule changes have been made *against* you and *for* the banks and their betting partners.

So, if your cash balances are large enough, we recommend you spread them out across several banks, always keeping the balance in each account under the federally insured level ($250,000 per individual account in the United States, but $100,000 would be safer as that's the old limit).

Fortunately, the trouble that hit the banking system in Cyprus and other hard-hit nations, like Greece, did not happen overnight. We believe we'll be able to observe warning signs in advance, and if we do, we will issue an alert through PeakProsperity.com if we become concerned enough about

the stability of the major United States and European banking systems that considering taking your actual cash notes out of the bank is warranted.

The other big risk with cash will arrive with the *POOM!* phase discussed earlier. Once the deflationary tide has been reversed, the ensuing hyperinflationary flood will destroy cash's purchasing power. This is another scenario in which we will issue a PeakProsperity.com alert to *run*, not walk, to exchange all of your cash for tangible assets. Again, it's highly unlikely this will be an overnight development; and we'll have the proceeding *Ka!* phase as our wake-up call. But it's an eventuality we all must remain vigilant for.

Own Precious Metals

With such dire talk of inflation, deflation and currency crisis, it should come as little surprise that we are big advocates of owning precious metals.

Our rationale why could fill an entire book in itself. Indeed, we've written extensively on the topic at PeakProsperity.com for many years. But simply put, we are keen on owning precious metals—gold and silver, primarily—for two principle reasons.

The first is they are among the easiest tangible assets to own. Buying real estate, a business, or collectibles like fine art requires a substantial investment of time and due diligence; whereas gold and silver bullion can be purchased within minutes from a reliable vendor. They require no management, are easy and inexpensive to store, and do not spoil. They are the "gateway drug" into tangible asset investing.

The second is that gold and silver have served successfully and effectively as money since the dawn of human history. This thousands-year-old streak is not likely to end anytime soon, despite our historically recent experiment with un-backed (also known as "fiat") paper currency.

As hard assets, precious metals promise to hold their value well during times of economic turmoil (in fact, during these times they often enjoy a 'safety' premium). On top of this, they also have potential to be one day re-monetized: to be used as backing for one or more major world currencies. Should one or more of the major fiat currencies fail, it would not be unlikely at all for a return to some form of gold standard to be called for. It's pretty much the only historically-stable alternative the world knows of. Were this to happen, the perceived value of gold would likely rise much, much higher from where it is today given the relatively small volume of gold above the ground compared to today's world money supplies.

For these principle reasons, we recommend that everyone strongly consider:

- **Establishing a foundational position in gold and silver**. This is your Armageddon insurance against a currency crisis and general meltdown of the financial system. If you're new to precious metals investing, this should be a minimum of 5% of your financial portfolio, though 10% or more is reasonable given where we are in this particular story of monetary madness.
- **Buying physical bullion**, not "paper gold" like ETFs or mining stocks. Take delivery of the metal yourself or have it stored somewhere you have confidence is secure. If stored remotely, make sure the metal is owned outright in your name (referred to as "allocated" storage), as opposed to having a claim on bullion that is pooled together ("unallocated" storage).
- **Increasing your exposure over time**. There are many ways above owning physical bullion to invest in precious metals. For those with their foundational position already in place, expanding into these other forms of ownership offers access to greater wealth creation when capital starts fleeing the tertiary levels of wealth looking for safety. As an unadulterated form of primary wealth with universal acceptability, durability, portability and divisibility, the precious metals are the ultimate crisis safe haven for financial capital.

As mentioned, precious metals are a large focus area of our work at PeakProsperity.com. We've created several helpful resources there for you to learn more:

- Guide on which forms of precious metals to buy
  http://www.peakprosperity.com/buying_gold
- Reputable places to buy precious metals
  http://www.peakprosperity.com/where-to-buy-gold-and-silver
- Gold & Silver discussion group
  http://www.peakprosperity.com/group/gold-silver

Invest in Sustainable Ventures

With the financial capital you have remaining, we strongly consider investing it in businesses that own, produce and manage primary or secondary forms of wealth. Again, here's where a good financial adviser who understands the Three Es will play an invaluable role in providing guidance.

Sectors we think worthy of consideration include:

- Real estate (especially farmland and timberland)

- Oil and gas exploration and production
- Resource mining companies
- Water infrastructure and utilities
- Smart grid/electrical power transmission
- Small to mid-size local businesses providing essential services

Your financial adviser should be able to find plenty of publicly-traded candidates in these sectors with strong balance sheets for you consider.

In addition, for accredited investors (as defined by the SEC), there are an increasing number of opportunities emerging for investing privately in these sectors. A few that have caught our attention over the years are:

- **Farmland LP**: a fund that upgrades conventionally-farmed fields to organic status, managing them thereafter using sustainable practices
- **Slow Money**: invests private capital in local food systems across the United States
- **CircleUp.com**: invests private capital in early-stage innovative consumer product and retail companies

LISTEN:

Woody Tasch Podcast

TOPIC: The Slow Money Movement

URL and LINK: *See page 205*

LISTEN:

Farmland LP Podcast

TOPIC: Investing in Farmland, Sustainably

URL and LINK: *See page 206*

Invest Locally

For many reading this, some of your best options for moving capital into secondary or primary forms of wealth will be within a 10-mile radius of where you live.

Buying into local businesses or property holds much potential for those looking to diversify out of traditional stocks and bonds. First off, it keeps your money out of the Wall Street casino, offering you greater visibility and control as to how your investment capital is put to work. Imagine: if enough of us eventually do this, our collective starvation of that beast might just sufficiently de-fang it and free our society from its jaws.

In addition to attractive profits, investing in local businesses yields additional returns Wall Street cannot offer. Keeping your capital local allows entrepreneurs in your area to create value, value that benefits your community, increasing its overall state of resilience. A regression analysis published in the *Harvard Business Review* (2010) calculated that communities with the highest local businesses per capita enjoyed the highest probability of per capita job growth.

Even the Federal Reserve agrees. In September 2013, the Atlanta Fed released a study of all U.S. counties, concluding that those with the highest concentration of local businesses had the highest per capita income and the highest probability of eradicating poverty. When the next economic downturn hits, the presence and use of local capital is going to be a principal determinant of how your city fares.

Investing your capital locally also increases your perceived value within your community. Your visibility as a supporter of the local economy is appreciated by entrepreneurs and customers alike. It's a distinction that increases your social value: when tough times hit, you've demonstrated that you're the kind of person the community is better off with than without.

So, lots of good reasons exist to direct a portion of your Financial Future Portfolio into investments in your local area. But how, exactly to do it?

Being honest, it's substantially harder today to invest locally than it is on Wall Street. That's just the reality of where we are in this story. You can buy a publicly traded stock or bond with the click of a mouse. Identifying local investments, doing your due diligence, and arranging terms with your potential new partners, however, takes time and effort. Often a lot of it. And while there are start-ups working hard to create exchanges to bring local capital together with local businesses, the experience will likely never be as immediate and effortless as buying a stock on the NYSE.

But perhaps that's a good thing. We've all been sold on the narrative that investing is easy: All you do is press the buy button, then hold for the long run (and along the way: Buy the dips!) and everything will turn out just fine. Well, in reality, investing is much more complicated than that, or otherwise everyone would already be rich.

Given the more turbulent future we predict is ahead of us, perhaps *all* investments should be preceded with a fundamental examination of the strategy, plan and talent behind them. The local investing model may just have a lot to teach the financial community.

If you don't have relationships with many local businesses, your city's Chamber of Commerce is a good place to start for a directory of those in your area. These Chambers often arrange regular meetings of their members, which you can either attend or ask if your name would be circulated as someone interested in contributing capital to a local venture. Bank loan officers are also good contacts to make, as they have good visibility into which nearby companies are raising funds.

Here are several good books containing *How To?* specifics on investing locally:

- *Local Dollars, Local Sense: How To Shift Your Money From Wall Street To Main Street and Achieve Real Prosperity*, Michael Shuman (2012)
- *Locavesting: The Revolution In Local Investing And How To Profit From It* Amy Cortese (2011)

Resilience Investing

And don't forget about your Resilience Fund! That's the money you've left aside to exchange for other forms of capital that will increase your overall resilience.

In addition to enhancing your ability to weather future surprises, many of these other types of capital yield excellent financial returns. For example, energy production or efficiency systems often yield tremendous cost savings over their lifetimes. A solar hot water heater can often have a financial ROI well over 100%. Similarly, investing in your health, wellness and fitness (such as a nutritionist consultation, therapist, CrossFit membership, etc) can save you thousands of dollars and perhaps add years to your lifespan.

We'll have more specifics about how to best deploy your Resilience Funds over the other 8 Forms in the chapters that follow.

Prioritize Cash Flow

We're big fans of investing your capital, locally or otherwise, in opportunities that produce positive cash flows.

We've spent time with a number of successful investors and entrepreneurs, and this preference for cash flow is a common trait they all clearly share. Investment author Robert Kiyosaki believes so strongly that good cash

flows are the key to financial wealth that he gambled everything at the start of his career on a game, *CASHFLOW*, he and his wife Kim created to teach people about them. His best-selling book *Rich Dad Poor Dad* is basically a beefed-up version of the game's instruction manual (one that has sold over 35 million copies!).

Invest in Assets with Positive Cash Flows

As you deploy your capital, locally or otherwise, we encourage you to place a higher preference on opportunities that generate positive cash flows versus those that merely "promise" future price appreciation.

During the deflationary phase predicted by the *Ka-POOM!* theory, prices of nearly all assets should be pushed downwards. That will be much less of a problem if the asset is producing a positive cash flow. While, yes, the price of your investment may have lost money on paper, that only matters if you sell it. If instead you can hold onto it and use the cash flow you receive to weather this lean time, when the inflationary *POOM!* phase hits later on, you'll likely have the chance to sell the asset (only if you want to, of course) at a higher price down the road.

But if the asset doesn't produce cash for you, like most of today's high P/E tech stock darlings, things can be much more dire.

First, during a deflationary rout, all prices fall. But the prices of unprofitable assets fall most. Nobody wants to hold a money pit when money is scarce.

And second, you may be forced to sell the asset during this rocky time. Maybe you fear the asset is on its way to becoming worthless, and you want to get at least some of your capital back. Or you lose your job, have unexpected expenses to pay or, God-forbid, have margin calls to meet. Without positive cash flows to sustain you during this period, you have few options but selling if you need the money. And when you liquidate the asset, you lock in the loss. At that point, the money you've lost is gone for good.

Develop Multiple Streams of Income

Most people have all of their eggs in one basket when it comes to income. If the family bread-winner loses their job, most if not all income to the household stops.

Sadly, expenses do not. And without income, expenses start chewing through savings very quickly.

Remember the personal Income Statement and Balance Sheet we created at the beginning of this chapter? Given yours, how long could you sustain

your household if your main source of income suddenly disappeared? Three months? Six months? More? Less?

Your best defense against sudden income loss—due to recession, layoff, firing, injury, whatever—is having multiple income streams in place. Earlier we talked about *redundancy* as an important component of resilience, such like that seen in animals that give birth to large litters. This is the same concept.

With multiple income streams, if you lose one, you still have the others to sustain you.

And even if the source of the majority of your income disappears, having 20-30% of your prior income level is vastly better than having 0% of it. Having *some* income allows you to pare your expenses down to the bare essentials and perhaps still be solvent and self-supporting. Having *none* precludes those options.

So how does one create an additional stream of income? There's no one-size-fits-all answer to this question. It depends on your skills, interests, strengths, resources and appetite for risk.

But there are methodologies you can follow to identify opportunities that will be a good fit. Working with a mentor or a professional adviser, like a qualified career or life coach, who can walk you through the structured exploration, is recommended. As is reading a few of the many, many books available on the topic, if for no other reason than getting additional exposure to potential income-generating ideas to consider.

New income streams can be any size and require anywhere from 0 to 20+ hours per week. You can earn them with your labor and expertise (such as starting a weekend lawn care service), or purchase them with your investment capital (like buying a rental property). Again, your personal circumstances will determine what's best for you to pursue.

But our advice is to leverage your strengths and diversify. If you've developed mastery of a skill (Sales, for example) that one employer is already paying you for, then others are likely to pay you for it, too. If all of your income streams have the same risk exposure, the likelihood they could all get compromised at the same time increases.

This isn't empty guidance. Both Chris and Adam have worked to create income streams of varying sizes across different lines of business to supplement their base earnings from running Peak Prosperity. While their 'day job' provides each with their largest income stream, should it go away for some (hopefully incredibly low probability) reason, these other cash flows should keep them afloat while they determine what to do next.

Your next supplemental income source should fit in the overlap of what you *want to* do, what you *can* do, what you have *time* to do, and what you can *afford* to do. Once you've identified the opportunity, pilot the idea with a few potential employers/customers and then iterate from there based on the feedback you receive.

Amass Passive Income

Active income is earned based on the sweat of your brow. Most salaried jobs fit in this category. If you don't go into work, you don't get paid.

Passive income is earned by your financial capital. Essentially, this is your money working for you, while you sleep in or attend to other things in life.

The financially wealthy primarily make their cash flow from passive income, from the earnings produced by their investment portfolios. Indeed, a common measure of becoming "rich" or "financially free" is reaching the milestone where your annual passive income exceeds your annual living expenses. At this point, you're free to spend your time however you like, without the worry of unpaid bills.

This is a good goal to strive for with your financial capital. Even if you never attain "financial freedom," having more and more of your expenses offset by passive investments with positive cash flows will make your financial life easier and easier over time. The difference in effort and stress between having to actively work to fund 100% of your expenses versus 25% of them is very large.

The most common sources of passive cash flows are from investments in blue-chip stocks (dividends), bonds (coupon payments), business ownership, rental real estate properties, franchises, and royalties/licensing (from books, music, product patents, etc.).

A good financial adviser can help guide you in how to find and evaluate opportunities in many of these categories to determine if they may be right for you. Successful investing in this space takes capital and expertise. Pursue opportunities over time with a "slow and steady" approach and an eye to risk-minimization. Smaller, safer investments will accrete over time to create a sizable passive income stream—without the risk involved in big "swing for the fences" bets.

Manage Debt Very Carefully

Be very, very careful with debt in the coming years.

During deflation, the real cost of debt increases. If you lose your income during this time and can't service your interest payments, debt then becomes a stone-cold killer.

In general, we recommend living a debt-free lifestyle whenever possible.

We can say with certainty that "unproductive" debt should be avoided whenever possible. This is debt that doesn't increase your odds of earning more income in the future. It's usually consumptive in nature, like charging your vacation expenses on your credit card. We pretty much don't like any kind of credit card or auto loans, and we generally advise people to pay down their mortgages whenever able to.

Increasingly, we also see most student debt as detrimental. Tuition costs have far outpaced the value that today's university degrees are worth, creating a generation of debt serfs. Unless you have high confidence you know you will be earning enough out of school to afford the cost of the degree, taking out large student loans is a bad idea. There are an increasing number of innovative ways to educate yourself at affordable cost, albeit unconventionally.

We're less allergic to "productive" debt, as long as it has a high probability of enabling you ultimately to earn more than you borrowed. An example of productive debt is a mortgage taken out to purchase real estate you plan to lease. If you can lease it out for more than your monthly mortgage payment, thereby letting the renter pay your mortgage off for you over time, that's worth seriously considering. Just run the numbers to calculate that if prices crash and you're forced to sell at a loss, it won't be one large enough to ruin you.

People ask us frequently that if high inflation wins out eventually, won't debt burdens be inflated away? The short answer is "yes," but a very cautious one. We're not advising folks to leverage themselves to the hilt, counting on high inflation to save them. As we emphasize, no one knows the exact path things will take, and you don't want to be caught with a lot of debt at the wrong time. That way lies ruin.

Though, there may come a time, at the turn from the *Ka!* phase into the *POOM!,* when it will make sense to take out low-cost debt and buy productive, tangible assets with it. The burst of inflation should make the cost of servicing your debt much lower as time goes on, while the prices of your assets rise.

We will be keeping our eyes out closely for that, and if/when the time does occur, we'll issue an alert to our subscribers on PeakProsperity.com.

Live Below Your Means and Invest the Difference

At the end of the day, the less we want, the less we need. As Ralph Waldo Emerson eloquently praised Henry David Thoreau back in 1862:

"He chose to be rich by making his wants few, and supplying them himself."

We should all aspire to such an approach to wealth. Happiness is not how many dollars you have to your name. Rather it's about your ability to satisfy your wants dependably.

As we close this long chapter (don't worry, the rest are a lot shorter), we should remember that Financial Capital is only money.

And Money ≠ Resilience.

Instead, resilience results from wealth across all 8 Forms of Capital. With Financial Capital now taken care of, let's start developing the remaining seven.

If you enjoyed this free chapter of our new book *Prosper!: How to Prepare for the Future and Create a World Worth Inheriting,* we invite you to purchase the full book,

www.peakprosperity.com/prosper

Print, e-book & audio versions available

Thanks,

Chris Martenson & Adam Taggart