Investment Secrets of the Wealthy

Decoding the Habits that Can Put You in the Top 1% of Investors

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Often times we get told there are no secrets to getting wealthy. Getting wealthy is just a matter of hard work, determination, and a little luck. Yet, all around us we see wealthy families getting wealthier and wealthier. So what do these individuals all have if they don't have secrets?

Ask a financial pundit and they will might tell you, "Well, it takes money to make money". Take a second to think about that statement though. Not everyone who is wealthy inherited it from their family. Not everyone who is wealthy started by winning the lottery and therefore started out with more money than you or I. No, wealthy individuals have created wealth through a process. And that process is repeatable.

Call them secrets, habits, or common traits. It doesn't matter what you call them. What matters is the process and how you can use it to benefit you and your future. And then, on top of that process, it still takes hard work, determination, and discipline.

Most people mistake themselves by looking at someone wealthy and say, "There is no way I could ever get to that point. That wealthy person owns their own business (or insert high-income profession here). I am not in a position like that." We are not going to lie to you, your career plays a role but it is smaller role than you think. There is a great equalizer at work here. One that "levels the playing field" for almost everyone. And that one thing, is investing.

Part of the reason a wealthy person is wealthy is because they know how to take the money they've earned from their job, and grow that money into more money. They are world class in investing. Think about your finances and ask yourself one simple question,

Do I think the wealthy are implementing a better investment plan than I am right now?

If the answer is no, then we have good news for you. You can put this down this special report and save yourself the next ten minutes of reading this. This report is simply review and you have obviously already reached all of your financial goals.

If, however, the answer is yes, then the rest of this report might be one of the most important things you read. This isn't hyperbole. This is a no BS report on the strategies of America's wealthiest investors and how you can adopt these strategies to improve your finances. So sit back, relax, and learn the best investing habits of the wealthy.

They Don't Give a **Sh*t About the Crowd**

Humans are pack animals, plain and simple. It is built into our DNA. We like to be around other people and we feel more comfortable if we're doing what everyone else is doing. This made a lot of sense throughout our history.

Think back to our primitive beginnings. Back to the plains of Africa when we were all hunters and gathers. If we were out on a hunting mission and we saw members of our tribe screaming and hollering and running away, it usually meant that there was imminent danger. This triggered a reaction in us to also run away to avoid danger. Unfortunately, our natural tendencies have not progressed with the times.

Although humans don't have to run away from any lions or tigers anymore, our pack-like tendencies have crossed over into our more developed world. In the investing world, this often works against us. Most of us have a habit of following what everyone else is doing. We watch shows like CNBC or Fox Business to see what's "hot" and what's not. Investors read the Wall Street Journal or the New York Times to see how the markets are doing and where we should be putting our hard earned money. The problem with all of these things is that none of it correlates to wealth.

Take a look at the news roll for CNBC. Look at the top 20 headlines. No matter what the daily, weekly, or monthly performance was, there will be a number of different headlines with conflicting opinions. One expert will say something like, "The stock market is poised for the biggest bull market ever!" The next will say, "This market is certainly going to encounter a bear market in the next year…" So which one is right? It doesn't matter. Both pundits are throwing hail mary's in the dark hoping to connect so in a year they can say, "I told you so".

In addition, following the crowd typically results in mediocre performance. By definition, to be wealthy, you cannot be mediocre. For a small case study, let's examine how good the "crowd" is at managing their investments. We will look to the last stock market crash for indication and assess mutual fund money flows. Mutual fund money flow is term used to describe how much money is moving in and out of mutual funds. Theoretically, the more money moving into mutual funds means that people are bullish on the investment market and think it will go up. A negative money flow means investors are fearful of the future.

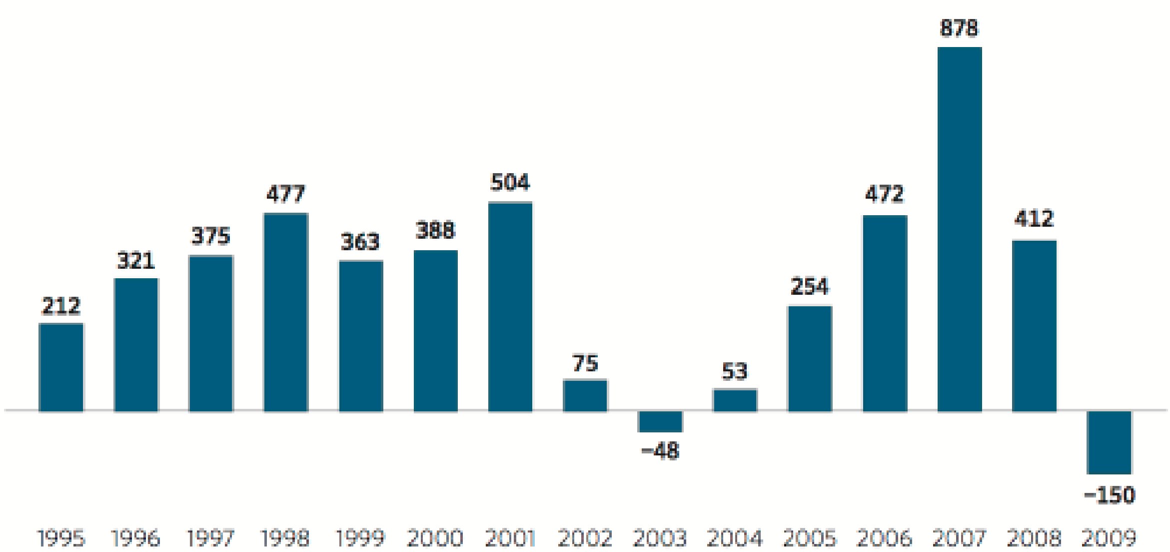
Generally speaking, the crowd has been poor at timing opportunities. Below is a chart of money flows from 1995 to 2009. As a general reminder, the two bear market of the last 15 years happened in 2000-2003 and 2008. Interestingly enough, those dates also correspond with the largest net outflows out of investment funds. Conversely, the largest net inflows are happening right before these crashes . **This means the majority of investors are getting into the market at market tops and then are selling their assets when the market is at its greatest discount.**

The wealthy are able to completely unhinge themselves from crowd behavior and invest differently. This is one of the hardest things to do because it requires that you leave emotion out of the investment plan. You no longer are able to invest based upon market news or "hot" stock tips. You must form a plan and stick to that plan.

FIGURE 2.3

Net Flows to Mutual Funds

Billions of dollars, 1995-2009



Wealthy Investors **are Active Investors**

Many investors have heard the statistic, 80% of active fund managers fail to beat their benchmark each year. Yet, we still see that an overwhelming amount of wealthy investors invest in an active way. Haven't wealthy investors ever heard this stat? Do they just believe they will be in the top 20% that will beat the benchmark? Well, there are basically two parts to this answer.

First, the statistic listed above is a bit misleading. The actual stat is 80% of active mutual fund managers fail to beat their benchmark each year. The study is performed by the Standard and Poor's and it's a report called the SPIVA report . Where the typical investor is deceived is that the report is limited to just mutual funds. Mutual funds, by law, are handicapped by a set of rules called a prospectus. It is a document that details how they will invest, what they will invest in, and how often they will trade. It is meant to allow investors to how the fund is investing but ends up hand cuffing the fund manager.

It's the equivalent of putting your family in a car, telling them to meet you at a spot across town, pointing them in the right direction, and then taking away the steering wheel. They might start out on the right path but, without the steering wheel, they will get led off course.

So is it really a surprise that most mutual fund managers underperform their benchmark? We are actually surprised that all fund managers don't underperform that benchmark.

For instance, let's take a look at a very popular mutual fund, the Growth Fund of America by American Funds. The fund has three extremely restrictive rules.

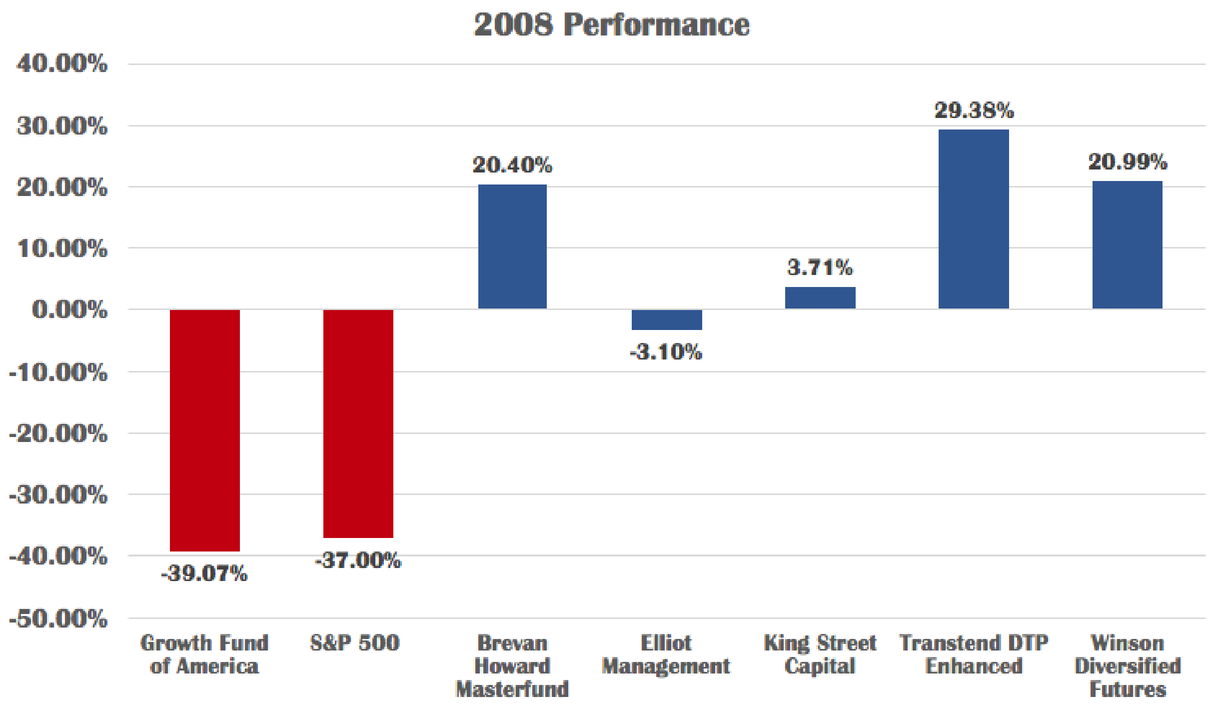
1. Fund must stay at least 65% invested in common stock
2. Fund may only invest up to 10% in nonconvertible debt
3. Fund may only invest up to 25% of assets in stock outside of the U.S.

Based upon the name, Growth Fund of America, one would assume that this fund could invest in anything that's growing and get out of investments that are losing. However, its rules say otherwise. What happens when common stock is in a bear market like 2008? The stock market lost over -55% of its value at one point. Even if there was zero growth in the stock market, the Growth Fund of America had to stay at least 65% invested in stocks.

Aside from mutual funds, wealthy investors actually have another whole type of fund they can invest in called a hedge fund. For many investors, the word hedge fund can be a scary word. It incites thoughts of The Wolf of Wall Street or of Gordon Gecko on the movie Wall Street. A hedge fund, however, is just a fancy term for a mutual fund that has less constraints. Basically they can invest without an investment mandate.

Well that sounds like a more appealing option than having a fund manager that has tight constraints, right? But wait, there is a kicker. To invest in a hedge fund, you need to be considered an accredited investor which means you make over $200,000 as an individual or have a net worth over $1 million . Unfortunately, most people don't qualify.

A key reason why wealthy investors trust their money with a hedge fund is because the fund is actively managed. Meaning the fund manager can adjust based upon the market conditions. If the market is experiencing a global recession like 2008, they can go to cash or even short the market.



Note: Shorting is a concept where an investor can actually take the inverse position on the market. This means that as the market falls, the investor would make money. However, this also means that if the market rises, they would lose money.

On the previous page is a chart showing performance of in 2008. On the left side is the S&P 500 and the Growth Fund of America. On the right side are the five biggest hedge funds and their performance. Now remember, this isn't the five best performing funds, just the five biggest.

As you can see, the hedge funds had the ability to make active investment decisions and avoid losses and even profit in a significant down year. Let me be clear on one thing, this does not mean all hedge funds are good and this does not mean that active managers always perform better. This is simply used as an illustration to show the average investor what is possible.

So you may be sitting there thinking, "Great, so wealthy investors have access to better investments than everyone else. How does that help me?" Although many of us still cannot gain access to hedge funds, there are other alternatives. There is a middle ground between mutual funds and hedge funds and they are called Registered Investment Advisors (RIAs). RIAs have the benefit of having few investing constraints (like hedge funds) but are also available to the average investor (like mutual funds). This creates the capability of combining the best of both worlds.

They Use Strategic **Diversification**

Traditionally, many of us have been taught that to minimize our risk, we should diversify. We get told idioms such as, "Don't put all your eggs in one basket because if that basket breaks, so will all of your eggs." Many of us get taught that, in investing, this expression means not investing in one single company or one single investment. Rather we should build a portfolio of multiple strong companies and multiple investments. Although this is just one part of diversification, it does a poor job minimizing risk for investors on its own.

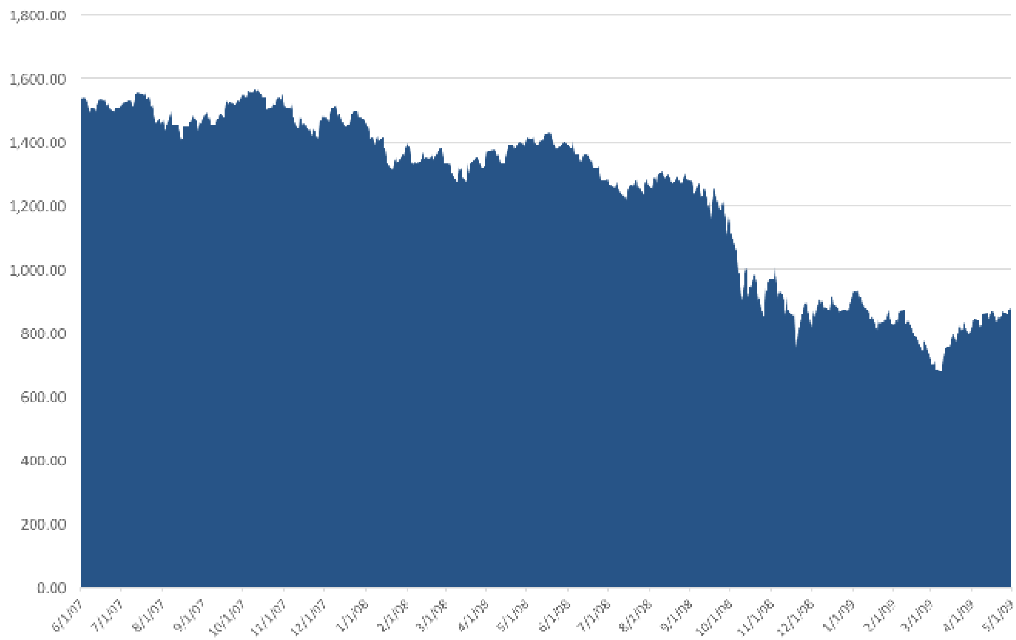
Traditional diversification does have a place in investing. It can be a cure for some serious investing mistakes. Images of companies like Enron and Worldcom flash before our eyes. These single companies, worth $60 billion and $186 billion respectively at their peaks, ended up bankrupt. Owning these stocks on their own would have meant that you would have lost your entire retirement portfolio. However, every stock that is added to your portfolio would help decrease the losses suffered. This is the idea of traditional diversification.

Traditional diversification on its own isn't enough, however. Below are three charts showing three bear markets of the last 100 years. The charts are of an index called the S&P 500. This index contains the 500 biggest companies in the U.S. By traditional

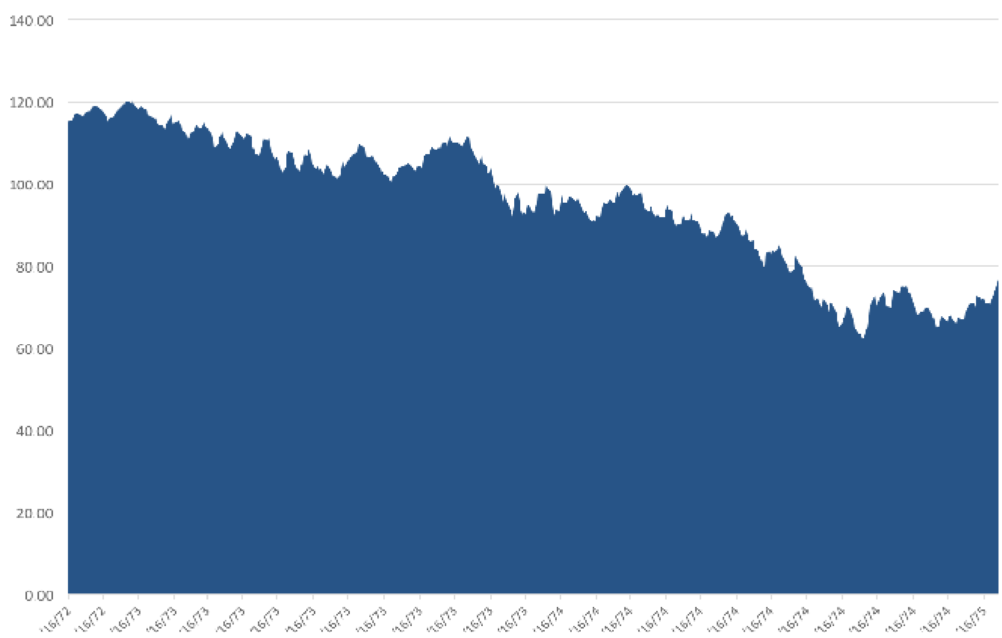
Since 1900 there have been 13 times when the stock market lost -20% or more. That means there is only 6.65 years between every bear market. The average decline of these downturns is 39%.

Many investors misinterpret years like 2008 and think that these are once in a lifetime type events. They are actually must more common than the average investor thinks.

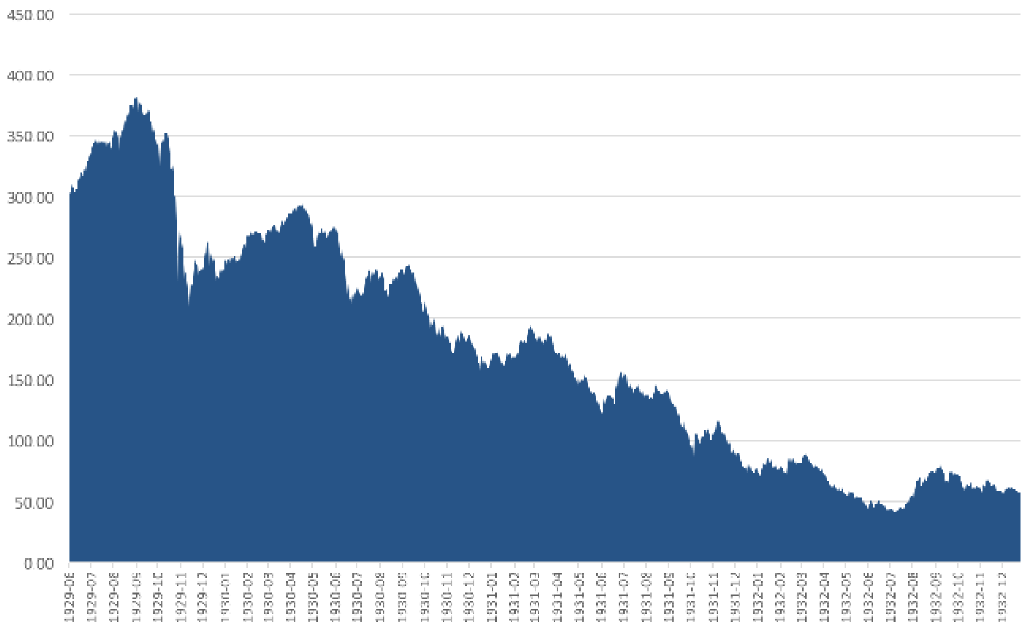
diversification standards, investing in America’s 500 biggest companies would be considered highly diversified. This wouldn’t have prevented investors from losing:



over -55% of their money in 9 short months in 2008,



or another 48% of its value in 1973,



or over 85% of its value during the Great Depression.

So if traditional diversification doesn't work, how are investors supposed to minimize risk? Many wealthy investors do so through strategic diversification. Strategic diversification is an expanded version of managing and mitigating risk.

Traditional diversification looks at the risk management process from a very narrow viewpoint. Everything is focused on mitigation on the single company and stock level. However, there are a many other ways to diversify. The list below expands on more diversification techniques

1. Asset Class

Think to your personal investment or retirement portfolio. If we took a poll of everyone reading this report, we would likely find that investors are invested in American stocks and American bonds. Would you fit this mold?

This is due to a bias called the home-country bias. Investors like to invest where they live. For Americans, you feel much more comfortable investing in a company like McDonald's, which you pass 4 times a day on your way to work, than you do investing in a Russian oil company. However, only investing in American companies because you are familiar with them creates a vulnerable situation.

This home-country bias causes investors to forget about other asset classes. American stock and American bonds are just two classes in a sea of many. There are commodities, currencies, developed international holdings, emerging international holdings, options, private equity, and the list goes on and on. Each of these asset classes behaves slightly differently as the others. For instance, in 2008, world stock markets were down significantly. In comparison, gold and international bonds both posted positive returns. Having a portfolio that included a variety of asset classes in 2008 could have greatly reduced the impact of the Great Recession.

2. Strategies

The typical investor is what we would call an "all-in" investor. They tend to lock on to one type of investing strategy and then they go all-in on that strategy. This creates a vulnerable point in an investment plan.

A buy and hold strategy will perform very differently from a momentum, merger arbitrage, trend following, managed future, long-short, etc. strategy. Like asset classes, there are more than just a few types of strategies and they all perform well in different market environments. By combining multiple strategies in a portfolio you may actually be able to increase the overall return while decreasing risk.

3. Managers

Diversifying amongst managers is very similar to diversifying amongst strategies. Do you feel more comfortable putting your future on the shoulders of one person? That person may be extremely capable and therefore deserves that trust but most wealthy people feel much more comfortable putting their future on the shoulders of multiple capable people.

4. Direction

This may be the more powerful and yet most underutilized diversification strategy. It is a fundamental truth that the market can go one of three ways; it can go up, down, or sideways. And yet, almost all investor's plans perform well in only one type of market, the up market. However, this is completely disregarding the other two directions.

What happens to your investments when the market goes down? What happens when the market goes sideways? Your investment plan likely becomes ineffective. True strategic diversification means that your investment plan rarely if ever becomes ineffective. The hedge funds shown earlier masterfully diversified amongst direction and therefore were able to profit in a year where almost all world markets were down

The Wealthy Think **About Risk Differently**

An entire book could be written on the idea of risk but there are two key areas where the wealthiest of investors differentiates themselves. The first is in the idea of risk and return. If we were in an academic setting, we would be taught that risk and return hold a close, linear relationship. Meaning that risk and return are always a tradeoff. If you want a higher return, you must take higher risk.

Wealthy investors completely disregard this notion. Instead, they focus on what is called asymmetric risk-return. It's the idea that risk and return are two independent variables rather than two correlated variables.

The famous investor, Warren Buffett, proved this time and time again when he was investing. Buffett would always make sure each of his investments had a margin of safety built in. A margin of safety is the margin that Warren could be wrong and still make money. This, by definition, meant that many of his investments were asymmetric.

The second part of risk is how they view it. If we asked you, how risky are your investments, what would you say? How would you even start to judge the riskiness of your investment portfolio? Many investors wouldn't even know where to begin. In our practice, we often ask clients, "What is the most that you would be able to lose before you started panicking?" The typical client will say anywhere from -20% to -30%. Yet when we peel back the layers of their investment portfolio, we see that historically, what they are investing in has had periods where it lost much more than -20% to -30%. So what gives with the discrepancy?

Many investors don't know how to adequately measure risk. In 2016, our company's Chief Investment Officer published an article called The Exploration of Risk: Measuring Risk for the Individual Investor. In this article he introduced a new way to measure risk (called the True Risk Formula) that includes every pertinent variable to the individual investor. One of those variables is max drawdown. Max drawdown is worst-case scenario metric that measures the most an investor could have lost historically. Most investors list their max drawdown tolerance was -20% to -30%. Yet, the American stock market has lost upwards of -50% twice in the last two decades. If we go back to the last century, the American stock market has lost over -85% of its value at one point. This is way beyond the typical investor's tolerance.

How successful do you think an investor will be if he/she can't handle the risks that come with their investment plan? I think we both know the answer to that. The True Risk Formula dives much deeper into the risk equation but the overarching message is that an investor can't be successful without first understanding risk. **To wealthy investors, risk is the most important piece of the risk-return discussion. The return of principal is more important than the return on principal.**

Fees Don't Matter **Value Does**

Value, in our world, is defined as the benefit you receive minus costs and fees. It is the benefit after fees are taken out. Let's imagine that there are two investments. Investment A averages a return of 25% per year (after fees) but costs investors 5% per year in fees. Investment B averages 5% per year in returns (after fees) but only costs investors 0.50% in fees. Which investment would you choose? The savvy investor would choose Investment A every day of the week and twice on Sunday . All fees are already taken out of the return information. Therefore, the fee does not matter. The value of Investment A was greater.

To further explain to our clients this concept, we usually tell the story of Jim Simons, famous founder and manager of Renaissance Technologies, a hedge fund based in New York. Jim Simons also happens to be one of America's greatest mathematical minds. Renaissance's flagship fund, The Medallion Fund, from 1988-2000 averaged returns 35.6% annually after fees. That is almost double what the S&P 500 did. They also did all of this with only posting one losing year.

The kicker with The Medallion Fund is its fees. Simon's firm takes a 5% per year management fee (regardless of performance) plus a 44% performance fee. **Even with charging this astronomically high fee, they still had one of the best track records of any fund companies ever. So do fees matter? Of course, but value matters infinitely more.**

In an ideal world we would all get access to the Medallion fund at no cost, however, we don't live in an ideal world. As investors, our pursuit should always lead to get the most value at the lowest cost but the fee only becomes part of the discussion after talking about value. This is where most investor's fail.

They Know the Value **of Investment Advice**

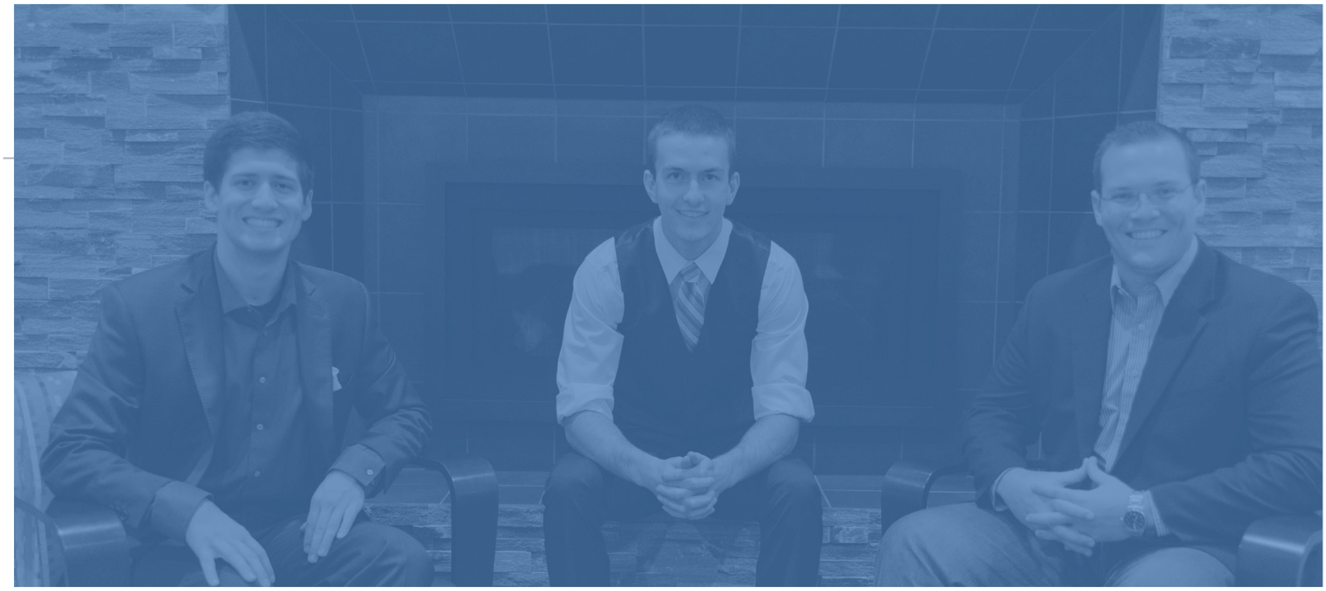
The wealthy know what they know, they know what they don't know, and they are willing to find help on the things they don't know. Typically, the wealthiest of individuals get to be where they are through specialization. Maybe that means being a doctor, a small business owner, or some other profession. Because they are completely specialized in their craft and understand the value of expertise, they are willing to delegate to those who are specialists in a different craft.

If you're reading this, it is mostly likely because your specialization and craft is not investing. And it doesn't have to be. When you're sick, do you hire a doctor or nutritionist to help cure you or do you try to learn everything about medicine and nutrition? You pay someone else. Why is investing any different? If it isn't their craft, the wealthiest investors employ the power of delegation.

We actually see that most investors agree with this premise. The key is finding the right team to delegate to. One that can build you a comprehensive investment plan that you can be confident in. So what does a team like that look like? Included in this special report is a investment plan checklist. If you can check off every item on this checklist, it means that you have an investment plan that is of wealthy investor quality.

If you found this guide valuable and would like to learn more about how you can protect your retirement from bear markets, optimize your retirement, and check off every box on the investment checklist, you can find additional resources through the Fox River Capital Knowledge Center on FoxRiverCapital.com.

Meet Our **Team**



Our company was founded by asking one question, “What if everyday people could have access to the best advice and tools on the planet”. It was out of this question that Fox River Capital was born.

Fox River Capital’s team was built to help you navigate the retirement maze.

No flash, no fluff, just the real, “nuts-and-bolts” tactics that can get you where you need to go. We understand you’ve fought hard to build what you have.

We’re here to help make sure you’re able to enjoy it.

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