

CHAPTER 1

What Is the Permanent Portfolio? *Golden Beginnings*

The Permanent Portfolio is an investment strategy designed to grow and protect your life savings under any set of economic conditions. It will work during good and bad markets, and it will even work in markets experiencing extremely serious and unexpected events.

The idea for the portfolio was first proposed in the 1970s by the late Harry Browne, who had gained fame by betting against the dollar with his first book *How You Can Profit from the Coming Devaluation*. The premise of that book, published in 1970, was that the United States would soon break the last vestiges of the gold standard and the resulting inflation would be so bad that gold and certain other hard asset prices would skyrocket. Harry Browne therefore advised readers to purchase assets like gold and silver, and to invest in strong currencies like the Swiss franc as hedges against inflation.

As it turned out, in 1971 President Nixon in fact *did* break the gold standard and the results were spectacular. Starting from \$35 an ounce at the time of Nixon's announcement, gold ended the decade near \$850 an ounce (over \$2,200 in 2012's dollars). Assets like silver and the Swiss franc experienced very high returns as well.

That market call was quite good and there was now a real need to protect those profits once the bad inflation of the 1970s ended.

A Simple Idea

In response to the need to diversify their profits, Harry Browne and his team, which included Terry Coxon, John Chandler, and Charles Smith, began working out early versions of a new strategy. This strategy would allocate their money not just into assets like gold, but into stocks, bonds, natural

resources, and cash as well. Further, unlike Browne's prior bets on the market moving in a certain direction, the new strategy would avoid market timing entirely and be completely passive—something almost unheard of in the investing world at the time outside of a few lone voices.

Browne's new strategy would be called the Permanent Portfolio. The original strategy held the following:

- Stocks
- Bonds
- Cash
- Gold
- Silver
- Swiss francs
- Natural resources

This mix of assets was reached after extensive research into market history, economics, and the potential for a passive strategy to perform well under any environment. This research even included computer analysis, which at the time in the late 1970s wasn't yet in wide use due to the expense involved. Harry Browne, who was interested in the emerging personal computer technology, even did the programming necessary to conduct the research.¹

As the Permanent Portfolio idea began to take shape, readers of Harry Browne's newsletter—*Harry Browne's Special Reports*—were puzzled by his recommendation to consider owning stocks and bonds in a portfolio (which had done poorly in the 1970s inflation). Yet, Browne stuck to his advice that strong diversification would be a good long-term strategy.

Harry Browne and Terry Coxon then wrote a book in the early 1980s, *Inflation-Proofing Your Investments*, that (contrary to its title) presented a comprehensive review of this new way of thinking about investing that would do well when inflation came back under control. This is actually a pretty remarkable thing for an investment advisor to do. He built his career in the 1970s advocating hard asset investing (like gold) to fight inflation and all of the sudden he advises readers to sell a portion of their hard assets and buy something completely opposite like stocks or bonds? This was heresy!

Well, Browne turned out to be exactly right. In fact, gold soon did settle down by the early 1980s from the previous highs as inflation came under control and the stock market took off in response.

Over time, Browne simplified the Permanent Portfolio to make it easier to implement and more balanced. This effort culminated in Harry Browne's

¹ Personal interview with John Chandler, Harry Browne's former newsletter publisher and colleague.

1987 book *Why the Best Laid Investment Plans Usually Go Wrong*. This book, which is probably one of the best ever written on the flaws in many popular investment strategies, reduced the portfolio down to the core components that are still in use today.

A Simple Allocation

Now that the background of the strategy has been discussed, we can look more closely at the approach that evolved into the following deceptively simple asset allocation:

25 percent—Stocks
25 percent—Bonds
25 percent—Cash
25 percent—Gold

The allocation above is the strategy in its most basic conceptual form. Now, how you implement these 25 percent allocations is just as important as the allocation itself. This book will help you understand how to do that.

Simply Great Results

Don't let the apparent simplicity of the allocation fool you. Even though it appears simple, it is far from *simplistic*. The allocation actually reflects a sophisticated understanding of economics and financial history. It is this understanding of economics and financial history that allows it to perform so well under so many market conditions and provide strong diversification.

If you walk away from this book with anything, it should be the idea that you do not need a complicated investment strategy to do well in the markets. In fact, it's just the opposite. A simple strategy will often outperform complicated ones over time. It will do it with less risk, less management, lower costs, and more profits to compound. The Permanent Portfolio still remains not only one of the most simple asset allocations you are likely to encounter, but also one of the best in terms of risk versus return.

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