

The Singapore Permanent Portfolio

**Grow Your Wealth through Good and Bad
Times with Lower Risk and Less Effort**

ALVIN CHOW

Aktive Learning
c/o Aktive Group Pte. Ltd.
10 Anson Road #10-11
International Plaza
Singapore 079903

E-mail: publisher@aktive.com.sg
Web site: <http://www.aktive.com.sg>

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FOREWORD

I have known people that have lost much of their life savings over a matter of days. Years of work vanished and the anguish of an uncertain future for them and their family followed. It taught me that a lifetime of savings could be ruined in an instant if you aren't careful, no matter how smart you think you are. Overconfidence, greed, and a belief that an investor can beat the market, are good indicators that a big loss is going to happen to them eventually.

Watching investors take large losses (and a few of my own!) led me to the Permanent Portfolio concept years ago. It is a strategy that can both grow and protect your money against a wide range of threats. It does so with safety, simplicity, and stability – three things that are critical for investor sanity.

When I first spoke with Alvin he was interested in letting his fellow Singaporeans know about the simple, safe and effective Permanent Portfolio. He recognized the nature of the markets and the risks that it presents. We had a good discussion about the importance of being diversified, not trying to predict the future, and how the Permanent Portfolio concept can apply to investors in Asia and the booming Singapore economy.

Specifically, my 25 years of investing and business experience has given me a simple recipe for success:

1. Live below your means.
2. Keep investing simple.
3. Keep costs low.
4. Invest passively.
5. Stay widely diversified at all times.

The Permanent Portfolio is a strategy that incorporates these five basic principles, and more, into one coherent way to manage your wealth. The ideas are encapsulated very simply:

- Don't assume you can replace your wealth if you waste it.
- Complex investments hide a lot of dangers that even the smartest person in the world can't predict.
- High cost investing strategies eat away your returns, which compound against you over time.
- Actively trading the market runs up your costs, increases your risks of loss, and adds a lot of stress to your life.
- A great investment (or economy) can go bad quickly. Undiversified investments put you at risk of taking a huge loss if they go bad. You must diversify.

With the rise of Singapore as an economic hub, it's more important than ever for investors not to get overconfident when they see their economies boom. In fact, investors (no matter where they live) should protect their hard earned money with a sensible and safe investment approach at all times. This book will allow you to do that.

This is the guide a Singapore investor needs to protect and grow what they've worked hard to earn. With this information, a Singapore investor can have a core strategy to diversify and protect their savings no matter what happens in the future. I hope you enjoy reading this book as much as I did.

Craig Rowland

Author, *The Permanent Portfolio: Harry Browne's*

Long-Term Investment Strategy

South Island, New Zealand

PREFACE

I was first introduced to the Permanent Portfolio through Harry Browne's book, *Fail-Safe Investing*. I did not pay much attention to it as I could not appreciate the beauty of the Portfolio and what it serves to do. This is not surprising as I was a beginner in the investment world. I felt that it was too boring for me, and that there were better strategies. I even sold the book off as I deemed it useless to me!

It was not until I suffered many hard knocks in the stock market that I realised it wasn't easy at all. In fact, my dollar cost averaging investment plan in the STI ETF was my most profitable investment in the early part of my investment journey! Instead of looking at individual stocks, I went on to study portfolio structuring – as the academics always emphasise, returns come from asset allocation rather than market timing or security selection. I do not really agree with that, though.

Nonetheless, asset allocation is still important in managing investment risks, and indeed, portfolio returns are much more important than returns from individual securities. David Swensen's success in managing the Yale Endowment Fund was an inspiration. I learned about the different ways of structuring portfolios with various asset classes, and understood how each asset class would perform in different economic scenarios. This naturally led me to revisit the Permanent Portfolio.

While researching on the internet, I found a wonderful resource on the Permanent Portfolio on Craig Rowland's website. He back-tested the Permanent Portfolio for a period of 40 years and, excited as I was, I approached Craig for a Skype interview. The interview gave me the opportunity to pick his brains about the Permanent Portfolio and he was generous with his sharing – you can see that it is still the longest interview conducted on BigFatPurse.com.

Craig and J.M. Lawson co-wrote *The Permanent Portfolio*, which was published shortly after the interview. I believe I was one of the first few to grab a copy in Asia. The book was detailed and filled the vast gap in *Fail-Safe Investing*. You can regard Craig and Lawson's book as the Bible of the Permanent Portfolio. I am not going to emulate their book as it would be too audacious to do so.

The Singapore Permanent Portfolio aims to tackle the tactical aspects of the Portfolio, such as the buying and selling of certain products as well as the rebalancing process. I want to make it as simple as possible so that readers can understand how to implement the Portfolio for themselves. This is my book's value proposition.

I have implemented the Singapore version of the Permanent Portfolio for a period of time. It is important to clarify that I do not have a Permanent Portfolio at the time of writing. It isn't because I do not believe in the strategy. In fact, I believe in this strategy even more than before with the amount of uncertainties and risk-taking I have observed in the financial markets. Rather, I liquidated the Portfolio because I needed funds to test other strategies that match my risk profile and objective. I will undoubtedly implement the Permanent Portfolio in the future for my retirement planning.

After appreciating the beauty of the Permanent Portfolio, I began a personal expedition to help others see the beauty of it too. I have a natural tendency to share things that I know. I wrote about it on BigFatPurse.com and built a model to forward-test the Singapore Permanent Portfolio.

Lek Yew Meng was instrumental in providing a speaking platform for me to reach out to retail investors. I was invited to talk about the Permanent Portfolio for countless sessions and I estimated that close to a thousand people were engaged. Every session was enjoyable and satisfying. The only regret I had was that there wasn't a guidebook for them to take away after the session. Even though the Portfolio is relatively simple to implement compared to other strategies, most retail investors find it challenging to buy ETFs and Bonds, or to calculate the re-balancing amounts. Hence, I have decided to write this book.

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Are We Rational?

Economic theory was grounded in the principle that market participants always act rationally, and in their own best interests. This idealistic thinking remains today, although it is changing with the developments in behavioural finance.

It is always easier to decide on something that makes us *feel* comfortable, rather than what is right. For example, we all want a healthy body and we also know that we need to eat healthily and exercise more. However, we tend to do the opposite in reality – we eat delicious but unhealthy food, and procrastinate when it comes to exercising. We choose certain foods for lunch because we *feel* like eating that. We buy certain clothes of a certain design and colour because we *feel* they are nice. We *like* to do certain things because we *feel* happy doing them. We are not as rational as we think we are. Think about the other facets of life, and soon you will be aware of how irrational you can be.

I, too, began with the mindset that I was a rational person, and even believed I was more so than others. But I did not realise that I was making many decisions based on my feelings, including buying and selling decisions in the stock market. I also suffered my greatest lesson in the options market.

Emotions make us very poor investors because greed forces us to buy when prices are high and fear forces us to sell at the low. Hence, the profitable way of buying low and selling high is very difficult to execute. Very few people are interested in the stock market or property market when prices are low. Most people would rather go shopping, watch movies or enjoy their hobbies, instead of looking at the markets. However, they soon become interested when they hear about property or stock prices breaking record highs and people are making tons of money.

However, we do not consider ourselves people who come to the party late. If we plot our past investment transactions, we may get the shock of our lives – we bought high and sold low. And we still wonder where all our investment profits have gone all these years. Figure 1.1 illustrates the dissonance between our perceived and actual stage in the market at which we buy and sell our investments.



Let us rewind back the clock for a bit. The Singapore property market was in a slump from 2002 to 2005 and not many people were interested in getting properties. As prices increased in 2007 and even more so in 2012, investors started to pour their money into properties. The craze was apparent in the full showrooms, over-subscribed HDB flats, record-breaking land prices and newspapers filled with property advertisements. This doesn't look like buying low to me at all. However,

this is entirely rational to the investors and they had these reasons for buying properties:

1. Property prices in Singapore are always increasing.
2. Singapore is a tiny country with limited land.
3. The government has indicated to grow our population with immigrants.
4. High spending power of Chinese immigrants and massive liquidity from U.S. are going to push up asset prices.
5. I am buying property for my children, as they will not be able to afford a house in the future.

Behavioural studies have shown that humans make decisions first and find reasons for their decisions later. The decision was initially made based on feelings, even though investors may not realise it. The real reason for buying was thus emotional in nature, involving greed and fear. Greed featured because they wanted to make quick money by buying high and selling even higher. Fear arose because they were afraid of losing out to others and turning out poorer than those with properties. The reasons they gave were merely a logical framework which they could hold onto after making an emotional decision.

Property prices in Singapore crashed by about 44 percent in 1997, taking 12 years to eventually recover (see Figure 1.2). In fact, Property Soul shared a real story about a property investor who had to wait for twenty years for the breakeven point, after he purchased the property in the mid-90s.¹ I am not sure if most exuberant property investors remember those times. Some of them may believe that “this time is different”, but Sir John Templeton has advised that those are the four most expensive words in the English language. I believe markets have cycles. Good times do not last forever. Boom and bust in the financial markets happen repeatedly due to the greed and fear in market participants.

¹ “The resurrection of property prices,” last modified April 22, 2014, <http://propertysoul.com/2014/04/22/the-resurrection-of-property-prices/>

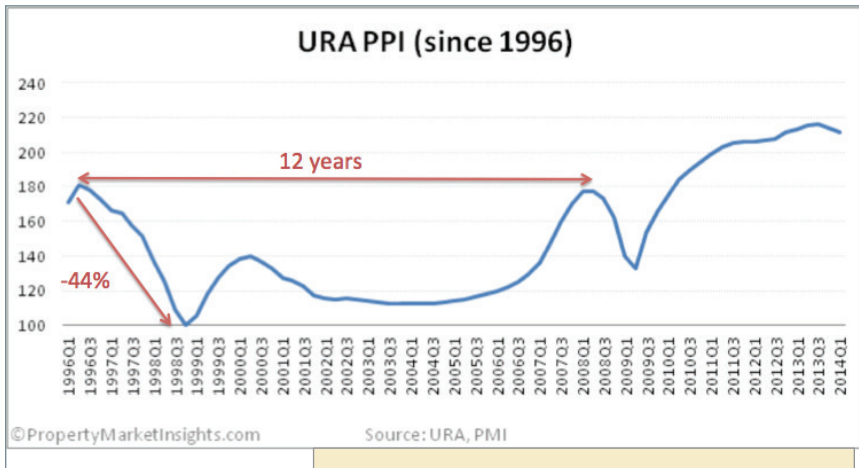


Figure 1.2 – Singapore Property Price Chart – 12 years taken for prices to recover from the 1996 peak (Image reproduced with permission, courtesy of PropertyMarketInsights.com)

I saw the same exuberance in the 2007 stock market. The financial crisis unfolded in 2008 and the stock market crashed by about 50 percent from its peak (see figure 1.3). Those who lost the most money were those who bought stocks close to the market peak. They were most likely enticed by the thought of making fast money yet lacked well-grounded reasons to invest, therefore easily succumbing to fear and dumping the stocks at low prices.



Figure 1.3 – Buying High in 2007 and Selling Low in 2008 (Image reproduced with permission, courtesy of Shareinvestor)

We flock together because it is comfortable. If everyone is doing it, we assume it isn't wrong to follow suit. When we flock together to buy into an investment, it is rarely cheap. The demand would have pushed up the price. The contrary is also true. When we converge to sell an investment, it is rarely profitable. The supply would have driven the price down.

Hence, it always pays to be a contrarian in the financial markets. We all know this as generations of gurus have taught us that. But being a contrarian is very uncomfortable and we prefer to avoid the emotional pain, instead seeking comfort in the crowd. This results in buying high and selling low. Bubbles and crashes in financial markets are bred by our irrationality, and they will continue to happen unless collective investor behaviour changes. Do you think this change is possible? I do not think so, and that is why wise investors are able to capitalise on this weakness of humans, by being contrarians.

Do We Overestimate Our Holding Power?

Most people invest by looking at the potential returns. However, this is how investment scams work – promise easy money in a short period of time to entice people to part with their money. Once they are blinded by greed, they will seek information to support their decision to invest, while ignoring the risks of such speculations.

Time and time again, I have realised that holding power is one of the keys to investment success. It does not matter how high the returns are, the question is whether you can hold on till you achieve that return. It requires emotional wisdom. Investing is a path-dependent process, and it requires you to walk through the rite of passage, experiencing the ups and downs in your emotions, before getting to the pot of gold at the end of the rainbow.

Hence, it is wise to figure out our actual level of tolerance way before we invest our money. We should think about the amount of money we can afford to lose and use this as a main criterion to structure our investment portfolio. As the saying goes, focus on the downside and the upside will take care of itself.

Do We Overestimate Our Chances?

Psychologists have proven human beings have an overconfidence bias via various experiments. Most, if not all, investors think that they are above average investors. However, if everyone is above average, who is average? This overconfidence bias has encouraged investors to take on more risk than they should. They believe that they can beat the stock index returns, doing better than most investors by either picking stocks or timing the market. The reality is disappointing; most investors do worse than index returns.

One of the problems is the focus on predicting market direction, hoping to invest in an asset before its price increases. It is a display of overconfidence to expect to be able to predict the future accurately. The future is full of uncertainty and investors have to accept that. The more appropriate approach is to take a position that would be resilient in as many economic scenarios as possible.

How Do We Want to Spend Our Time?

We are busy individuals. Not everyone has the time, energy or interest to be a stock picker or a trader. We need something that can take care of our wealth, allowing us to do our best in the other things that matter in life.

There are about 800 stocks listed on the Singapore Stock Exchange. If you take 1 hour to analyse each stock, that will be 8,000 hours or 333 days. It is impossible to do it within one year because this means you will only have about 2 hours of sleeping time per day. Most of us are less hard-working; we search for short cuts. It is possible to use a stock screener to narrow down the number of companies to research on. However, our idea of shortcut is to be spoon-fed by analysts, experts, friends and family, i.e. to get stock tips. We are awed by the stories they tell us and we want to believe in them, so that we have the courage to buy the stocks they recommend. However, stock tips rarely make us money.

Since reading annual reports and analysing companies' fundamentals are tough and time-consuming, some people prefer to time the

market by getting in and out of it. However, it still requires time, effort and passion for the market. I have seen many new traders enthusiastic at the beginning, but eventually quitting the market after a few months. They did not have genuine interest in trading and were only willing to do it for perceived quick profits. Without the passion for trading, they gave up easily after realising that hours spent analysing price charts have not translated into significant returns from trading activities.

Don't get me wrong. It is possible to beat the market, but it takes hard work and overcoming failures, coupled with only a very slim chance of success. Do you want to make investing activity a key part of your life or are there more important things you want to do and achieve in this lifetime? If you ask me, everyone is good at something and it is a matter of discovering that talent of yours. It would be a blessing if you can put that talent to good use. The society will benefit and you will be rewarded more than fairly when you have provided great value to others.

We need to understand the reality of our state of investment before we can find the right solution. I believe you can identify and relate to some of the investment woes mentioned in this chapter. In the next chapter, I will go through the concept of the Permanent Portfolio – you will be able to understand why it could be a suitable investment solution for you.