Foreword

I have a great job. I travel the world, give speeches, advise corporations, nurture companies, write about investing, and talk about investing on television. It's the kind of job that has its share of perks, one of which is that I get to meet smart people who truly grasp the ins and outs of investing in stocks and bonds. A vast amount of investment advice is available today, and much of it is garbage. But among the smart advisors—the accurate ones—are those who understand that investments behave in certain ways for a certain set of economic reasons, and that there's a right and wrong way to invest during each and every economic moment. Right now is an economic moment. Is your money invested according to the distinct set of economic circumstances that define it? Is your money where it should be?

I count Victor Canto among today's best and smartest advisors—a select group, to be sure—and for very good reason. When it comes to economics and investing, and the permanent marriage of the two, Victor knows what he is talking about and has proven it over the decades. He has made money in both good times and bad, for many a satisfied client. This is an important detail: Victor never *wills* his investment advice. For Victor and today's sharpest financial advisors, things are what they are. Sometimes the stock market is trending up, other times down. Still other times it's as flat as a pancake. But the good ones know how to invest in each circumstance. Simply, they know where the money should be at all times if it is to have the best chance of turning into more money.

I am happy to say that Victor has now done all investors, including myself, an important service: He has written a widely accessible book about the marriage of economics and investing, and the crucial ties that bind the two. If I had to sum up Victor's book in a few words, I'd say it's the story of how big ideas make the investment world go 'round.

Big ideas matter. And they should matter *a lot* to investors who want to make meaningful money in the stock and bond markets.

For instance, technology is a big idea—and a personal favorite of mine. I've had my eyes on technology since my earliest days as an

investor. You've probably noticed it, too. Technology has dramatically changed our lives in a historically short period of time. One day not so long ago, we thought the fax machine was the most amazing piece of office equipment ever conceived. Who faxes now? Hardly anyone: We e-mail important documents to whomever we want. Pay phones once were standard technology. But with the glacial advance of the cell phone, they're dropping like dinosaurs. This is how most of us think of technology—in terms of how it affects our everyday lives. This is micro stuff and important stuff. But how about looking at technology from a macro perspective, as a big idea?

The technology revolution has led to higher economic growth, more productivity, lower inflation, and, correspondingly, lower interest rates. The rationale goes like this: Because the Internet has made everything in the office go faster, it has reduced the amount of time it takes to do a dollar's worth of business. That has both enhanced productivity and resulted in faster growth, which shows up in higher gross domestic product. Because more is being produced with less effort, this process brings about lower prices and, hence, lower inflation. And when inflation is low, there's every reason why interest rates also can be low.

This progression deserves a "wow." One big idea—technology—has influenced so many other big ideas, each critically important to the direction of the economy and the stock and bond markets that reflect that economy.

Consider inflation. Higher inflation reduces the value of all income streams, whereas falling inflation does the opposite. Obviously, this is a powerful animal, one that is best contained in a manageable range. And that's where the Federal Reserve comes in, a big idea in its own right.

When the Fed perceives potentially higher inflation, it tightens, or extracts money from, the economy. It does so by raising interest rates. For a time, higher interest rates can partner with a vibrant economy. Traditionally, this is a stock moment rather than a bond moment. But what happens when the Fed keeps raising rates to crush inflationary pressures? Well, it just might put the brakes on the economy. And when those brakes slam too hard, the economy might well fall into recession, perhaps one marked by deflation. What then? Well, for one, the bond markets will cheer. Bond traders love bad news, particularly the recessions and deflations that make the bonds they sell more valuable.

Here, one big idea (the Fed) can turn a couple of other big ideas (inflation and interest rates) on their heads, the result being the collapse of a monstrously big idea (economic growth) and the wholesale transfer of investor money from one big idea (stocks) to another (bonds).

Whew.

Here's another big idea: taxes. The economy's potential to grow and the likelihood that stocks will climb disproportionately relative to bonds each are enhanced when tax rates are lowered, particularly taxes on capital and investment. Write that down, memorize it, and believe it. It's a favorite big idea that I share with investors who know how to make money.

Regulations matter, too. Do governments need to set the rules for the businesses that operate within their economic boundaries? Well, if societies are to have order, they must. But it's all a matter of degree. High regulations—lots of rules—depress the ability of businesses to be profitable. Low regulations, on the other hand, unleash the profit-making prowess of businesses. Write those down, too.

Capital is a big idea, big and beefy. *Capital* is another word for *money* or *wealth,* and it moves to where it is most welcome. And where it ends up is often an excellent place for *you* to put *your* money. What makes capital most welcome? Two familiar big ideas: low taxes and low regulations. Just look at Ireland. For decades, this island was pretty low on the list of capital-friendly international locales. But a lot changed toward the end of the twentieth century. First, it got a lot quieter in the north: The desire for peace and prosperity at last trumped the decades-long spiral of guns, conflict, and killing. Foreign businesses and investors began to take notice. But what really attracted the world's capital was the island's shift to lower taxes and regulations. The guns silenced and the government-induced barriers to investment lowered. As a result, Ireland today is blanketed in green, and I don't mean the kind the cows eat.

Do the small things matter? Sure. I have written that the more time company managers spend thinking about customers and products, and the less about financial indicators—many of which relate to those big ideas I'm talking about—the better our companies will perform. Same for stock pickers. If stock picking is to be done with good results, it should be left to those who can properly scrutinize the

products, management, customers, and profitability of our public companies. Thinking small, or in a very precise and targeted way, can lead to big corporate profits and, likewise, big investor gains.

But a word to the wise: Most investors don't have the time or skill to be successful stock pickers, to play investing small ball day after day. All investors, however, can play investing big ball with excellent results, while saving themselves a lot of sweat and heartache.

When I say "big ball" here, I'm talking about asset allocation, the big idea that goes like this: Basically, no single investment is a loner in an asset-allocation world. It is a security that falls into one of a few asset categories. Let's call these categories A, B, C, and D. Each moves above and below the water line of average returns at different times and to differing degrees. Sometimes it is an A and B moment; other times, allocating to C and D might make you the most money. So how to pick the winners? Well, *critically and fundamentally,* changes in government policies related to taxation, regulation, the value of currencies, interest rates, and inflation go a long way toward determining these movements. In other words, asset allocation is the big idea of big ideas in the investing world; it is the crossroad where economics and investing meet.

Naturally, when you arrive at any crossroad, you are faced with the same question: Which way to turn? Just as naturally, you answer that question based on the information you're carrying around.

Information will forever be a huge big idea, both the good *and* the bad kind. Good information produces winners with regularity, whereas bad information usually corresponds with the losers. Of course, if you keep acting on bad information, the poor results you produce are yours and yours alone. You've earned them. But I've long held that losing is an important big idea if it becomes an opportunity to learn. When you get on a horse, sometimes you'll get thrown. *Riding itself is chancy.* But you become a better rider by getting tossed, standing up again, and mounting once more. Indeed, if you take your lumps and *learn from them,* you'll pretty soon notice that you are riding farther, longer, and faster.

In this same vein, I have said before that bruises, not books, are life's best teachers. But here I stress that I'm an avid reader of books—good books, that is—who understands the value of the information they provide.

And now to the biggest idea at hand: Victor Canto has written a book that not only will lessen the incidence and magnitude of your investment bruises, but also will teach you about all the big ideas that have so very much to do with making *significant* gains in the stock and bond markets.

Listen to Victor, *think big,* invest appropriately for each economic moment, and prosper.

—*John Rutledge*