

I'm not a bot



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Dalio is a long-running New York Times bestselling author whose works include Principles: Life and Work, Principles for Dealing with the Changing World Order, Principles for Navigating Big Debt Crises, and How Countries Go Broke: The Big Cycle. He has been married to his wife, Barbara, for nearly 50 years and has three grown sons and seven grandchildren. Youtube TikTok Facebook X LinkedIn Instagram Threads BlueSky I have been a global macro investor for over 50 years, have bet on government debt markets for nearly as long, and have done very well doing that. While I previously kept to myself my understanding of the mechanics of how big debt crises transpire and the principles I use to navigate them, I'm now at the stage of life where I want to pass these understandings along to help people. This is especially true now as I see the US and other countries headed toward having the equivalent of economic heart attacks. That led me to write How Countries Go Broke: The Big Cycle, which comprehensively explains the mechanics and principles I use, as well as this very brief summary of the book. How the Mechanics Work The debt dynamics work the same for a central government as they do for a person or a company, except that a central government has a central bank that can print money (which devalues it) and it can take money away from people via taxes. For these reasons, if you can imagine how the debt dynamics would work for you or a business you run if you could print money or get money from people by taxing them, you can understand the dynamic. But keep in mind that your goal is to make the overall system run well, not just for yourself, but for all citizens. To me, the credit/market system is like the human circulatory system, bringing nutrients to all parts of the body that make up the markets and economy. If credit is used effectively, it creates productivity and income that can pay back the debt and interest on the debt, which is healthy. However, if it isn't used well so it doesn't produce enough income to pay back the debt and the interest on the debt, debt service will build up like plaque that squeezes out other spending. When debt service payments become very large, that creates a debt service problem and eventually a debt rollover problem as holders of the debt don't want to roll it over and want to sell it. Naturally, that creates a shortage of demand for debt instruments like bonds and the selling of them, and when there is a shortage of demand relative to supply that either leads to a) interest rates rising, which drives markets and the economy lower, or b) the central bank printing money and buying debt, which lowers the value of money, which raises inflation from what it would have been. Printing money also artificially lowers interest rates, which hurts the lenders' returns. Neither approach is good. When interest rates rise because the selling of debt becomes too large to curtail and the central bank has bought a lot of bonds, the central bank loses money, which hurts its cash flow. If this continues, it leads to the central bank having a negative net worth. When this becomes severe, both the central government and the central bank borrow to make debt service payments, the central bank prints money to provide the lending because the free-market demand is inadequate, and a self-reinforcing debt/money printing/inflation spiral ensues. In summary, the classic things to watch are as follows: The amount of government debt service there is relative to government revenue (which is like the amount of plaque in the circulatory system). The amount of selling of government debt there is relative to the amount of demand for government debt (which is like the plaque breaking off and causing a heart attack), and The amount of central bank printing of money to purchase government debt to make up the shortfall in demand for government debt relative to the supply of government debt that needs to be sold (which is like the central bank administering a heavy dose of liquidity/credit to ease the liquidity shortage, producing more debt, which the central bank has an exposure to). These all typically increase in a long-term, multidecade cycle of rising debt and debt service payments relative to incomes until that can't continue because 1) debt service expenses unacceptably crowd out other spending, 2) the supply of the debt that has to be bought is so large relative to the demand to buy that debt that interest rates have to rise substantially, which sends the markets and the economy down a lot, or 3) rather than allow interest rates to rise and the bad market/bad economy outcome to happen, the central bank prints a lot of money and buys a lot of government debt to make up for the demand shortfall, which sends the value of money down a lot. In any case, the bonds have a bad return until the money and the debt eventually become so cheap that they can attract demand and/or the debt can be cheaply bought back or restructured by the government. That is what the Big Debt Cycle looks like in a tiny nutshell. Because one can measure these things, one can monitor this debt dynamic happening, so it's easy to see problems approaching. I've used this diagnostic process in my investing and I've kept it to myself, but I'm now explaining it in detail in How Countries Go Broke: The Big Cycle because it is too important to keep to myself. To describe it more specifically, one can see debts and debt service payments rising relative to incomes, the supply of debt being larger than the demand for it, and central banks dealing with these things happening by being stimulative at first by cutting short-term interest rates and then by printing money and buying debt, and eventually the central bank losing money and then having a negative net worth, and both the central government taking on more debt to pay the debt service and the central bank monetizing the debt. All these things lead toward a government debt crisis, which produces the equivalent of an economic heart attack that comes when the constriction of debt-financed spending shuts down the normal flow of the economic circulatory system. Early in the final stage of the Big Debt Cycle, the market action reflects this dynamic via interest rates rising led by long-term rates, the currency declining especially relative to gold, and the central government's treasury department shortening the maturities of its debt offerings because of a shortage of the demand for long-term debt. Typically, late in the process when this dynamic is most severe, a number of other seemingly extreme measures are put into place, like establishing capital controls and exerting extraordinary pressures on creditors to buy and not sell debt. This dynamic is explained much more completely in my book, along with lots of charts and numbers to show it happening. The US Government's Situation in a Tiny Nutshell Now, imagine that you are running a big business called the US government. That will give you a perspective that will help you understand the US government's finances and its leadership's choices. The total revenue this year will be about \$5 trillion while the total expenses will be about \$7 trillion, so there will be a budget shortfall of about \$2 trillion. So, this year, your organization's spending will be about 40% more than it is taking in. And there is very little ability to cut expenses because almost all the expenses are previously committed to or are essential expenses. Because your organization borrowed a lot over a long time, it has accumulated a big debt approximately six times the amount that it is bringing in each year (about \$30 trillion), which equals about \$230,000 per household that you have to take care of. And the interest bill on the debt will be about \$1 trillion, which is about 20% of your enterprise's revenue and half this year's budget shortfall (deficit) that you will have to borrow to fund. But that \$1 trillion is not all that you have to give your creditors because, in addition to the interest you have to pay on your debt, you have to pay back the principal that is coming due, which is around \$9 trillion. You hope that your creditors will either relend or lend it to you. So, the debt service payments in other words, the paying back of principal and interest that you have to do to not default is about \$10 trillion, which is about 200% of the money coming in. That is the current situation. So, what is going to happen? Let's imagine it. You are going to borrow the money to fund the deficit, whatever that deficit is going to be. There is a lot of argument about what it's going to be. After taking the recently passed budget reconciliation bill into account, most of the independent assessors of the situation project that the debt in 10 years will be \$55-60 trillion (which will be 7-7.5 times revenue) because there will be \$25-30 trillion of additional borrowing. Of course, in 10 years, that will leave this organization with more debt service payments squeezing out spending and more risk that there won't be enough demand for the debt it has to sell without a plan to deal with this situation. My 3% 3-Part Solution I am confident that the government's financial condition is at an inflection point because, if this is not dealt with now, the debts will build up to levels where they can't be managed without great trauma, and it is especially important that this operation happens while the system is relatively strong rather than when it is weak. That is because when the economy is in a contraction, the government's borrowing needs increase a lot. From my analysis, I believe that this situation needs to be dealt with via what I call my 3% 3-part solution. That would be to get the budget deficit down to 3% of GDP in a way that balances the three ways of reducing the deficit, which are 1) cutting spending, 2) increasing tax revenue, and 3) lowering interest rates. All three need to happen concurrently so as to prevent any one from being too large because, if any one is too large, the adjustment will be traumatic. And these things need to come about through good fundamental adjustments rather than by force (e.g., it would be very bad if the Federal Reserve unnaturally forced interest rates down). Based on my projections, spending cuts and tax revenue increases by about 5% each relative to current planning and interest rates falling by about 1-1.5% in response would lead to interest payments that are lower by 1-2% of GDP over the next decade and would stimulate a rise in asset prices and economic activity that would bring in much more revenue. Some Commonly Asked Questions and My Answers to Them There's a lot more in the book than I have the space to get into here, including a description of the Overall Big Cycle (consisting of debt/credit/money cycles, internal political cycles, external geopolitical cycles, acts of nature, and advances in technology) that drives all the big changes in the world, my thoughts on what the future likely looks like, and some perspectives on investing during these changes. But for now, I'll answer some of the common questions I've gotten while talking about the book and invite you to check out the full book if you want to go deeper. Q1: Why do big government debt crises and Big Debt Cycles happen? Big government debt crises and Big Debt Cycles happen and can easily be measured by 1) the amount of government debt service there is relative to government revenue rising to the point that it unacceptably squeezes out essential government spending, 2) the amount of selling of government debt there is relative to the amount of demand for government debt becoming too large so interest rates rise causing markets and the economy to decline, and 3) the central bank responding to these conditions through lower interest rates, which reduces the demand for the bonds, which then leads the central bank to print money to purchase government debt, which devalues the money. These things typically increase in a long-term, multidecade cycle until they can't continue anymore because 1) debt service expenses unacceptably crowd out other spending, 2) the supply of the debt that has to be bought is so large relative to the demand to buy that debt that interest rates have to rise a lot, which sends the markets and the economy down a lot, or 3) the central bank prints a lot of money and buys a lot of government debt to make up for the demand shortfall, which sends the value of money down a lot. In any case, the bonds have a bad return until they become so cheap that they can attract demand and/or the debt can be restructured. One can easily measure these things and see them moving toward an impending debt crisis. That comes when the constriction of debt-financed spending happens, like a debt-induced economic heart attack. Throughout history these debt cycles have occurred in virtually every country, typically several times, so there are literally hundreds of historical cases to look at. They go back as far as there is recorded history. Said differently, all monetary orders have broken down and the debt cycle process I'm describing is behind these breakdowns. This is the process that led to the breakdowns of all reserve currencies, like the British pound and the Dutch guilder before the pound. In my book, I show the 35 most recent cases. Q2: If this process happens repeatedly, why are the dynamics behind it not well-understood? You're right that the process is not well-understood. Interestingly, I couldn't find any studies about how this happens. I theorize that it is not well-understood because the breakdown of monetary orders typically happens only about once a lifetime in reserve currency countries and when it happens in non-reserve currency countries this process is presumed to be a problem that reserve currency countries are immune to. The only reason I discovered this process is that I saw it happening in my sovereign bond market investing, which led me to study many cases of it happening throughout history so that I could navigate them well (such as navigating the 2008 global financial crisis and the subsequent European debt crisis. Q3: How worried should we really be about a heart attack debt crisis in the US when waiting for US debt issues to blow up? People have heard a lot about the pending debt crisis that never came. What makes this time different? I think we should be very worried because of the previously mentioned conditions. I think that those who worried about the debt crisis happening before, when conditions were less severe, were right to worry about it then because addressing it earlier could have prevented the conditions from getting so bad, like a doctor warning early against smoking and eating poorly. So, I theorize that the reason this issue isn't more widely worried about is both because it isn't well enough understood and because there is a lot of complacency that has developed as a result of the premature warnings. It's like someone with a lot of plaque in their arteries who is eating a lot of fatty food and not exercising saying to their doctor, "You've warned me that bad things would happen to me if I didn't change my ways, but I haven't had a heart attack yet. So, why should I believe you now?" Q4: What could be the catalyst for a US debt crisis today, when will it happen, and what would such a crisis look like? The catalysts will be a convergence of the previously mentioned influences. As for the timing, it can be hastened or postponed by policies and exogenous factors, like big political shifts and wars. For example, if the budget deficit is lowered to about 3% of GDP from what I and most others project to be about 7% of GDP, that would reduce the risks a lot. If there are big exogenous shocks, it will come earlier, and if there aren't, it will come later or not at all (if it is managed well). My guess, which I suppose will be a bad one, is that it will come in three years, give or take two, if the course we're on is not changed. Q5: Do you know of any analogous cases of the budget deficit being cut so much in the way you describe and good outcomes happening? Yes. I know of several. My plan would lead to a cut in the budget deficit of about 4% of GDP. The most analogous case of that happening with a good outcome was in the United States from 1991 to 1998 when the budget deficit was cut by 5% of GDP. In my book, I list several similar cases that happened in other countries. Q6: Some people have argued that the US is generally less vulnerable to debt-related problems/crises because of the dominant role of the dollar in the global economy. What do you believe those who make that argument are missing/underappreciating? If they believe this, they are missing an understanding of the mechanics and the lessons of history. More specifically, they should be examining history to understand why all prior reserve currencies stopped being reserve currencies. Stated very simply, currency and debt have to be effective storeholds of wealth or they will be devalued and abandoned. The dynamic I am describing explains how a reserve currency loses its effectiveness as a storehold of wealth. Q7: Japan whose 215% debt-to-GDP ratio is the highest of any advanced economy has often served as the poster child for the argument that a country can live with consistently high debt levels without experiencing a debt crisis. Why don't you take much comfort from Japan's experience? The Japanese case exemplifies and will continue to exemplify the problem I describe, and it demonstrates my theory in practice. More specifically, because of the high level of the Japanese government's overindebtedness, Japanese bonds and debt have been terrible investments. To make up for a shortage of demand for Japanese debt assets at low enough interest rates to be good for the country, the BoJ printed a lot of money and bought a lot of Japanese government debt, which has led to holders of Japanese bonds having losses of 45% relative to holding US dollar debt since 2013 and losses of 60% relative to holding gold since 2013. The typical wages of a Japanese worker have fallen 58% since 2013 in common currency terms relative to the wages of an American worker. I have a whole chapter on the Japanese case in my book that explains this in depth. Q8: Are there any other areas of the world that look particularly problematic from a fiscal standpoint that people may be underappreciating? Most economies have similar debt and deficit problems. The UK, the EU, China, and Japan all do. That is why I expect a similar debt and currency devaluation adjustment process in most economies, which is why I expect non-government-produced monies like gold and Bitcoin to do relatively well. Q9: How should investors navigate this risk/be positioned going forward? As general advice, I suggest diversifying well in asset classes and countries that have strong income statements and balance sheets and are not having great internal political and external geopolitical conflicts, underweighting debt assets like bonds, and overweighting gold and a bit of Bitcoin. Having a small percentage maybe 10-15% of one's money in gold can reduce a portfolio's risk, and I think it would also raise its return. This site is not viewable without JavaScript, and your browser currently has JavaScript disabled. Please enable JavaScript and refresh the page to properly view this site. Dreams + Reality + Determination = A Successful Life. Go to the pain rather than avoid it. Plan for the worst-case scenario to make it as good as possible. Manage yourself and orchestrate others to get what you want. Get over "blame" and "credit" and get on with "accurate" and "inaccurate." The same standards of behavior apply to everyone. Make sure that everyone has someone they report to. Be generous and expect generosity from others. Have people "complete their swings" before moving on to new roles. Remember who has what responsibilities. Watch out for "job slip." Don't let yourself get squeezed. Care about the people who work for you. Put things in perspective by going back before going forward. Understand the power of the "cleansing storm." Don't confuse checklists with personal responsibility. This site is not viewable without JavaScript, and your browser currently has JavaScript disabled. Please enable JavaScript and refresh the page to properly view this site.

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