JOIM
www.joim.com

JOURNAL OF INVESTMENT MANAGEMENT, Vol. 21, No. 4, (2023), pp. 86–87

BOOK REVIEW

Mark Kritzman, Senior Editor

PRINCIPLES FOR DEALING WITH THE CHANGING WORLD ORDER: *WHY NATIONS SUCCEED AND FAIL BY RAY DALIO*

(*Review by Fangzhong Liu*)

Warren Buffett has a well-known stance on macro forecasting: He and Charlie Munger have never made any investment decisions based on "macro factors" because he believes that predicting the macro environment is impossible given that "something different happens all the time and there could be anything such as political developments or 400 other variables when you get into economics." Ray Dalio, to the contrary, built the world's largest hedge fund by studying and betting on how the world's markets and economies work. Based on the essence of his recent book—*Principles for Dealing with the Changing World Order: Why Nations Succeed and Fail,* the following could be Ray's potential response to Buffett: (1) Yes, there will be surprises in the future, but there are also long-lasting cause/effects relationships that shape repeating big-picture patterns and cycles, and (2) Indeed many factors play into anticipating economics, and it's impossible to capture everything, but in the case of forecasting the performance of a country, there are 18 most important determinants and here is how it works. . .

To what investors would be interested in the most, this book sheds light on how Bridgewater conducts research. The author lays out a quantitative framework that he uses to evaluate different countries throughout history. This scoring system calculates an "empire score" of a nation as a weighted average of 18 determinants, with the most important of which are economic/financial position, internal conflict gauge, external conflict gauge, innovation & technology and acts of nature. Each determinant is a further combination of different variables. Based on backtesting, the author stated that "these estimates would have predicted a country's average growth rate over the next decade within 1 percent of the actual growth 59 percent of the time, and within 2 percent about 90 percent of the time, with a correlation to subsequent growth of 81 percent."

This book is also an interesting read where the author rewinds time to the 1500s and walks through the rise and fall of the greatest empires including the Netherlands, the United Kingdom, the United States, and (potentially) China. The holistic and succinct description of the last 500 years paints a picture of repeating big cycles of three (the money/debt/economic activity cycle, the internal conflict cycle and the external conflict cycle). It shows how innovations in the political system, finance, and technology propel productivity and economic growth, and how excesses of money and debt, increasing wealth gap and loss of competitiveness lead to decline in many nations throughout time. From a finance perspective, the book also depicts how it interacts with the real economy, and how governments, through fiscal and monetary policies affect the purchases and sales of goods, services and financial assets at different stages of the cycle.

The author also includes his broad observations on different areas including human psychology, culture differences (U.S. vs China), optimal institution design (to increase the size of the pie, and at the same time best divide the pie), which I find intriguing and insightful. The rise and fall of nations offers important lessons, not just for investment professionals, but for anyone looking to savor the wisdom of history.