

# Billionaire Hedge Fund Manager Ray Dalio's 6-Step Success Formula

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*Photo Credit: World Economic Forum/Moritz Hager*

*Please excuse typos. This report is an informal summary of Dalio's seminal ebook, [Principles](#)*

# Overview

Beating the market consistently for years is rare. Beating it over decades is almost unheard of outside of a few of the world's top investors.

Ray Dalio is one of those. Over the last 20 years, its average return has been [14.7%](#), resulting in a total of \$50 billion capital gains for its investors. Dalio's net worth is estimated to be \$15.2B as of August 7, 2015 [by Forbes](#), making him #30 on the Forbes 400 list of the richest people in America.

Investors take limited resources and invest them for gain. Entrepreneurs and business leaders do the same thing. Except, instead of investing our money in stocks, bonds, and commodities, we invest our time, our people's time, and our money into the process of producing and selling products and services. Many of the core principles of financial investing are true in the world of entrepreneurial investing.

Dalio has created a systematic life and business philosophy, which he lays out in [Principles](#). This document condenses the 117-page manifesto into a step-by-step process.

Here's how you can be like Dalio and come up with independent opinions that go against conventional wisdom and create immense gains for yourself:

## Step #1: Create Your Own Goals

First, Dalio sees independent opinions within the framework of choosing your own goals rather than having them passively chosen for you:

"While most others seem to believe that learning what we are taught is the path to success, I believe that figuring out for yourself what you want and how to get it is a better path...after all, isn't the point of learning to help you get what you want? So don't you have to start with what you want and figure out what you have to learn in order to get it?"

### Goal Setting Questions

Ray recommends you ask yourself the follow questions when setting your goals...

**How well do you know what you want most out of life?**

*What are your most important goals?*

*Are you good at setting your goals?*

*How confident are you that your assessment of your ability to set goals is right?*

*If you are confident of your self-assessment, why should you be confident (e.g. because you have a demonstrated track-record, because many believable people have told you, etc)?*

## **Ray Goal Setting Truisms**

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**You can have virtually anything you want, but you can't have everything you want.**

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**To achieve your goals you have to prioritize, and that includes rejecting good alternatives. (so that you have the time and resources to pursue even better ones—time being probably your greatest limiting factor, though, through leverage, you can substantially reduce time's constraints).**

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**In order to get what you want, the first step is to really know what you want, without confusing goals with desires, and without limiting yourself because of some imagined impediments that you haven't thoroughly analyzed.**

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**Achieving your goals isn't just about moving forward.**

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**I believe that it is nothing more than getting what you want—and that it is up to you to decide what that is for you. I don't care whether it's being a master of the universe, a couch potato, or anything else—I really don't. What is essential is that you are clear about what you want and that you figure out how to get it.**

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**Also, for most people happiness is much more determined by how things turn out relative to their expectations rather than the absolute level of their conditions. For example, if a billionaire loses \$200 million he will probably be unhappy, while if someone who is worth \$10 thousand unexpectedly gets another \$2 thousand, he will probably be happy. This basic principle suggests that you can follow one of two paths to happiness: 1) have high expectations and strive to exceed them, or 2) lower your expectations so that they are at or below your conditions. Most of us choose the first path, which means that to be happy we have to keep evolving.**

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**Another principle to keep in mind is that people need meaningful work and meaningful relationships in order to be fulfilled. I have observed this to be true for virtually everyone, and I know that it's true for me.**

## **Step #2: Come Up With Independent Opinions On How To Achieve Them**

Core to Dalio's philosophy is [becoming an independent thinker](#) rather than focusing on what you are taught by others:

You have to be an independent thinker because you can't make money agreeing with the consensus view, which is already embedded in the price. Yet whenever you're betting against the consensus there's a significant probability you're going to be wrong, so you have to be humble.

In other words, according to Dalio, the key to being a successful investor is finding when the consensus is wrong and having an independent opinion that is right.

	RIGHT	WRONG
CONSENSUS	Average Results	Poor Results
INDEPENDENT	Extraordinary Results	Poor Results

In order to come up with independent opinions that are right, Dalio goes really deep and wide.

When most people analyze situations, they use the experiences of their life as the main data source. [Early in his career](#), Dalio widened his lens to human history; making it easy to notice cycles of different lengths that keep on repeating themselves. Previously, he he had been surprised when once-in-a-lifetime events happened. Now he saw the same events as parts of cycles that keep repeating throughout history.

[The Economist goes deeper](#) into his process, "[he] has conducted in-depth analysis of past periods of economic upheaval, such as the Depression in America, post-war Britain and the hyperinflation of the Weimar Republic. He has even simulated being an investor in markets in those periods by reading daily papers from these eras, receiving data and "trading" as if in real time."

A [2011 New Yorker profile](#) peels back the curtain even more and explains how their weekly 50-person "What's going on in the world?" meeting works and helps Dalio pull from lots of different perspectives and get to the truth:

A colleague began describing how the European Central Bank had just bought some Greek bonds from investors at a discount to their face value—a move that the speaker described as a possible precursor to an over-all restructuring of Greece's vast debts. Dalio interrupted him. He said, "Here's where you are being imprecise," and then explained at length what a proper debt restructuring would entail, dismissing the E.C.B.'s move as an exercise in "kicking it down the road."

[...]

The discussion in the conference room moved on to Spain, the United Kingdom, and China, where, during the previous week, the central bank had raised interest rates in an attempt to slow inflation. Dalio said that the Chinese economy was in danger of overheating, and somebody asked how a Chinese slowdown would affect the price of oil and other commodities. Greg Jensen, Bridgewater's co-chief executive and co-chief investment officer, who is thirty-six, said he thought that even a stuttering China would still grow fast enough to push world commodity prices upward.

[...]

Many hedge-fund managers stay pinned to their computer screens day and night monitoring movements in the markets. Dalio is different. He spends most of his time trying to figure out how economic and financial events fit together in a coherent framework. "Almost everything is like a machine," he told me one day when he was rambling on, as he often does. "Nature is a machine. The family is a machine. The life cycle is like a machine." His constant goal, he said, was to understand how the economic machine works. "And then everything else I basically view as just a case at hand. So how does the machine work that you have a financial crisis? How does deleveraging work—what is the nature of that machine? And what is human nature, and how do you raise a community of people to run a business?"

In its essence, Dalio's philosophy is that, "There are an infinite number of laws of the universe and that all progress or dreams achieved come from operating in a way that's consistent with them. These laws and the principles of how to operate in harmony with them have always existed."

## **Step #3: Stress Test Those Opinions**

From Dalio's perspective, "...one of the greatest sources of problems in our society arises from people having loads of wrong theories in their heads." Later on, he adds, "The biggest mistake most people make is to not see themselves and others objectively. If they could just get around this, they could live up to their potentials."

To make sure he isn't one of those people, he takes the following precautions.

- **Instills a culture of radical transparency at his company.** [All meetings at Bridgewater are tape-recorded](#). The goal of this is to have people say their opinions directly to people rather than hide them or talk behind someone else's back. This culture makes sure that people are constantly receiving feedback from others that they'd normally never receive in other environments and then learning how to bypass their own defense mechanisms and really understand the feedback.
- **Shares his theories with others.** "I stress-tested my opinions by having the smartest people I could find challenge them so I could find out where I was wrong about which companies were exciting." When Dalio tested his opinions, he wasn't interested in their reaction. He was more interested in listening calmly to the logic people used to come up with their opinion. Then, he explains why and how he didn't come to the same conclusion. He calls it being "[open-minded and assertive at the same time](#)."
- **Be skeptical of his own ideas.** One of history's greatest investors, Paul Tudor Jones, famously said, "Every day I assume every position I have is wrong." Dalio follows a similar philosophy, and it helps him avoid confirmation bias, the bias to rationalize our own opinions instead of challenging them. This bias is one of the most pervasive cognitive biases [as noted by Charlie Munger, Warren Buffett's business partner](#).

"I remained wary about being overconfident, and I figured out how to effectively deal with my not knowing. I dealt with my not knowing by either continuing to gather information until I reached the point that I could be confident or by eliminating my exposure to the risks of not knowing. I never cared much about others' conclusions—only for the reasoning that led to these conclusions. That reasoning had to make sense to me. Through this process, I improved my chances of being right, and I learned a lot from a lot of great people."

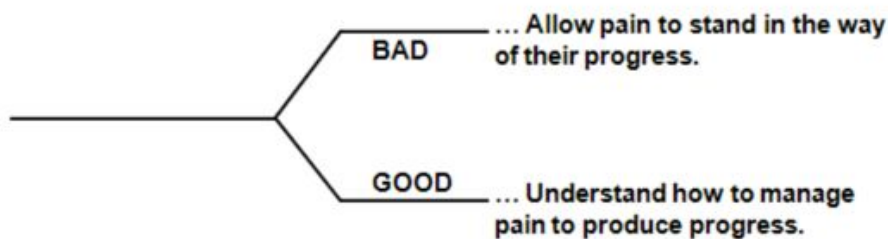
## Step #4: Reflect On Your Psychological Pains And How To Overcome Them

Dalio stresses that having independent opinions is not enough - one must also reflect to learn from the current situation and improve next time around. In his own words: "I wrestled with my realities, reflected on the consequences of my decisions, and learned and improved from this process."

More importantly, Dalio acknowledges the importance of acknowledging and overcoming the emotional pain often associated with the reflection process.

“It is a fundamental law of nature that to evolve one has to push one’s limits, which is painful, in order to gain strength—whether it’s in the form of lifting weights, facing problems head-on, or in any other way.”

This idea is so important to Dalio that he discusses 5 critical decisions that we’re constantly faced with throughout life, and the decision of how we react to pain is one of them.



He adds:

Most people react to pain badly. They have “fight or flight” reactions to it: they either strike out at whatever brought them the pain or they try to run away from it. As a result, they don’t learn to find ways around their barriers, so they encounter them over and over again and make little or no progress toward what they want.

Those who react well to pain that stands in the way of getting to their goals—those who understand what is causing it and how to deal with it so that it can be disposed of as a barrier—gain strength and satisfaction. This is because most learning comes from making mistakes, reflecting on the causes of the mistakes, and learning what to do differently in the future. Believe it or not, you are lucky to feel the pain if you approach it correctly, because it will signal that you need to find solutions and to progress. Since the only way you are going to find solutions to painful problems is by thinking deeply about them—i.e., reflecting 30—if you can develop a knee-jerk reaction to pain that is to reflect rather than to fight or flee, it will lead to your rapid learning/evolving.

He then asks the reader: “How big of an impediment is psychological pain to your progress?” To better manage negative emotions in coming up with independent opinions that often don’t fit well with the mainstream viewpoint, Dalio practices meditation, especially when he’s stressed.

[Dalio himself said](#): “Meditation, more than any other factor, has been the reason for what success I’ve had.”





## **Ray Reflection Truisms**

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**You will be much more effective if you focus on diagnosis and design rather than jumping to solutions.**

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**Root causes, like principles, are things that manifest themselves over and over again as the deep-seated reasons behind the actions that cause problems. So you will get many everlasting dividends if you can find them and properly deal with them.**

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**There is nothing to fear from truth.**

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**I learned that finding out what is true, regardless of what that is, including all the stuff most people think is bad—like mistakes and personal weaknesses—is good because I can then deal with these things so that they don't stand in my way.**

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**Pain + Reflection = Progress**

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**The most important qualities for successfully diagnosing problems are logic, the ability to see multiple possibilities, and the willingness to touch people's nerves to overcome the ego barriers that stand in the way of truth.**

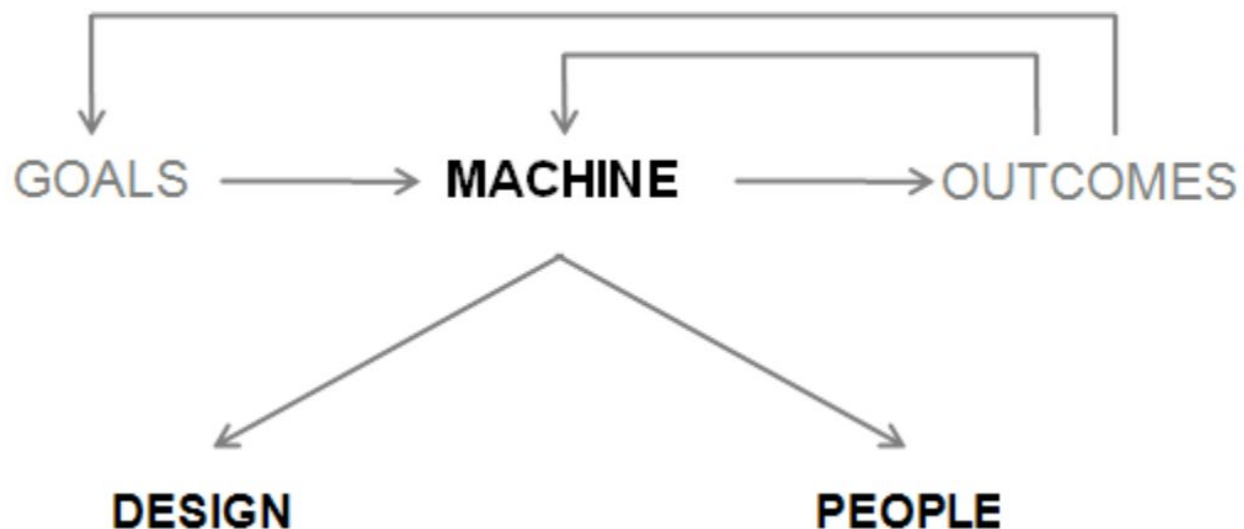
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**Tolerating problems has the same result as not identifying them (i.e., both stand in the way of getting past the problem),**

## Step #5: Turn Your Proven, Independent Opinions Into A Machine

Dalio uses the metaphor of a machine to represent systems you can create in your life that produce consistent, predictable results.

In his words, “Those who are most successful are capable of “higher level thinking” —i.e., they are able to step back and design a “machine” consisting of the right people doing the right things to get what they want. They are able to assess and improve how their “machine” works by comparing the outcomes that the machine is producing with the goals. Schematically, the process is as shown in the diagram below. It is a feedback loop:



A [2011 New Yorker profile](#) on Dalio gives some insight on how he turns his lessons learned into a machine

To guide its investments, Bridgewater has put together hundreds of “decision rules.” These are the financial analogue of Dalio’s Principles. He used to write them down and keep them in a ring binder. Today, they are encoded in Bridgewater’s computers. Some of these indicators are very general. One of them says that if inflation-adjusted interest rates decline in a given country, its currency is likely to decline. Others are more specific. One says that, over the long run, the price of gold approximates the total amount of money in circulation divided by the size of the gold stock. If the market price of gold moves a long way from this level, it may indicate a buying or selling opportunity.

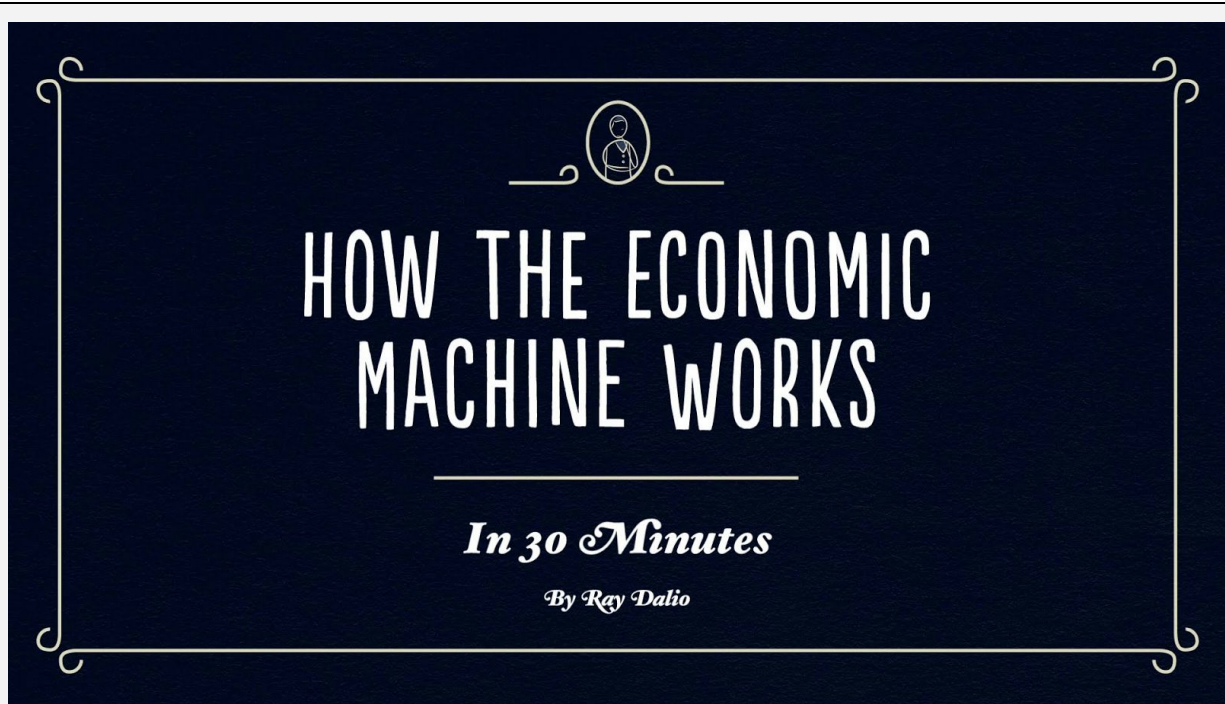
In any given market, Bridgewater may have a dozen or more different indicators. However, even when most or all of the indicators are pointing in a certain direction, Dalio doesn't rely solely on software. Unless he and Jensen and Prince agree that a certain trade makes sense, the firm doesn't make it. While this inevitably introduces an element of human judgment to the investment process, Dalio insists it is still driven by the rules-based framework he has built up over thirty years. "When I'm thinking, 'What is going on today?,' I also need to make the connection to 'How does what is happening today fit into our framework for making this decision?' " he said. Ultimately, he says, it is the commitment to systematic analysis and systematic investment that distinguishes Bridgewater from other hedge funds. "I hear a lot of people describing what's happening today without the proper historical context and without the framework of how the machine works," he says.

When designing the machine, Dalio recommends dividing yourself into two people:

- Observer who creates the machine and monitors its performance.
- Participant who makes the machine work.

He emphasizes the importance of being objective about yourself as a participant and putting yourself in a position to win based on your unique strengths, "Let's imagine that your goal is to have a winning basketball team. Wouldn't it be silly to put yourself in a position that you don't play well? If you did, you wouldn't get what you want. "

## Resource



### [How The Economic Machine Works \[Video\]](#) (2M+ views)

This simple but not simplistic and easy-to-follow 30 minute, animated video answers the question, "How does the economy really work?" Based on Dalio's practical template for understanding the economy, which he developed over the course of his career, the video breaks down economic concepts like credit, deficits and interest rates, allowing viewers to learn the basic driving forces behind the economy, how economic policies work and why economic cycles occur.

For a summary of the video, read [Billionaire hedge fund manager Ray Dalio explains how capitalism works](#).

## Ray Machine Truisms

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**Creating a design is like writing a movie script in that you visualize who will do what through time in order to achieve the goal.**

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**Your most important role is to step back and design, operate and improve your “machine” to get what you want.**

## **Step #6: Turn The Machine On**

### **Ray Take Action Truisms**

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**I believe the importance of good work habits is vastly underrated.**

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**It is critical to know each day what you need to do and have the discipline to do it**

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**People who are good at this stage can reliably execute a plan. They tend to be self-disciplined and proactive rather than reactive to the blizzard of daily tasks that can divert them from execution. They are results-oriented: they love to push themselves over the finish line to achieve the goal.**