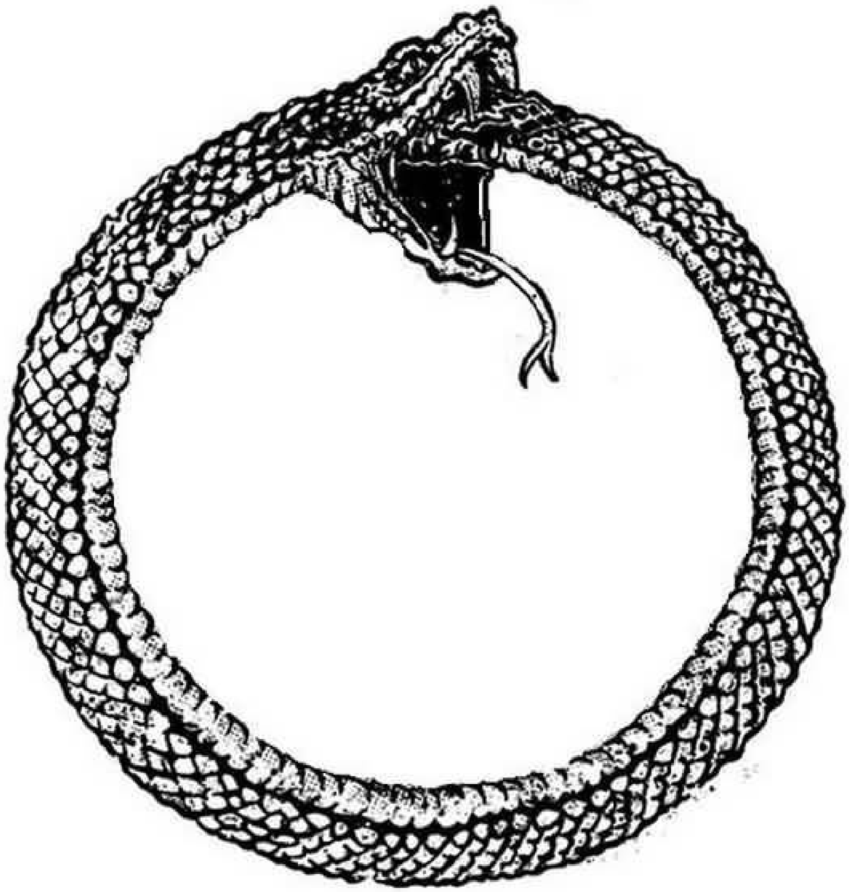

Nietzsche's Wheel, Draper's Carousel

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One of the most haunting concepts in philosophy is Nietzsche's eternal recurrence. Eternal recurrence is the idea that because time is infinite and the physical world is finite, the same events recur over and over—forever. But even Nietzsche never took this concept all the way to its haunting dead end. Recurrence means there's no escape from the past—because the future will be just like it. It also means we're not unique or special. Billions of other people have already thought our thoughts and dreamed our dreams. Meanwhile human life will never fundamentally change. Read people who lived hundreds of years before you. Marcus Aurelius. Montaigne. The answers they longed for, their everyday frustrations, are the same as ours. Now think about what that says. There's no hope of progress across the ages. Instead each generation is destined to repeat the struggles of the generations that came before it. And you can't escape. You can't be different—though you'll try. Everybody tries.

Markets captivate because they're where our dreams run 100 MPH into reality. Markets are the vapor barrier that ideas must cross in order to become real. Today our reality is that we're living in one of the biggest bubbles in history. Bonds trade at 1000-year highs. Equities are at one of the three highest valuations in modern history. Meanwhile towering valuations sit on top of towering leverage. Global debt is 300% of GDP, exceeding levels last seen during the Great Depression, the previous high water mark.

Bubbles, however, aren't just in our stars. They're in us. And the "everything bubble" is political. Personal. The culture war is so vicious because the stakes are so high. Each side is competing to have its myths enforced on the other, which is the closest those myths will ever come to being real. Meanwhile the more tolerant society becomes, the more its constituents seethe against one another. Interestingly periods of expanding social tolerance don't result in everyone just doing their thing. They result in everyone doing their thing and then resenting each other for it. Tyrannies often follow periods of personal freedom and relaxed values. Why? Because our fate truly is to endure an infinite return to the same things. And the more we try to escape to a higher state, the swifter we return to where we've already been.

You see this in how things have a way of leading to their opposite. Attempting to stamp out chaos only ignites different, often deadlier, forms of chaos. Making everything safe and "kind" imposes a boredom and dishonesty on life so suffocating that it becomes the violence it's attempting to stop. As a result, in trying to understand something, it's useful to know <u>what does it want to be, which is impossible for it to be</u>.

What characterizes our era is self-belief. That's what we want, which is impossible to have: for our self-belief to become real. Culturally there's been a power grab, an attempt to make subjective wellbeing lord over all, including objective fact. Economically, through money printing and artificially suppressing the cost of capital, global central banks have constructed a modern-day tower of Babel. In the origin myth, a civilization attempted to build a tower high enough to let them enter the realm of the gods. Today the world's advanced economies have attempted the same thing. They've risen up and tried to seize the forces they used to live in fear of. Now it's us who will tell the universe what our assets are worth, not the other way around.

What's so fascinating, though, is that this is exactly what every totalitarian ideology does. Totalitarians believe only their ideology can correct a fundamental flaw with the world. But in order for the ideology to work, people must believe in it totally. The ideology always fails, but faith in the ideology is never allowed to waiver. Thus all the totalitarians ever succeed in changing is what people are allowed to say and think. The result is closed loop with no touchpoint in reality.

Central bankers have constructed the same perpetual motion machine of subjectivity. Instead of creating actual wealth, they create an ideology that manipulates our beliefs about our level of wealth. Their target isn't the economy. It's the human mind. But the problem with closed loops is they delay contact, often fatally, with reality. The fact we've dead-ended here goes beyond bad policy, to something far larger and more frightening. The truth is, despite all our advancement, we can't help but commit the same errors that plagued those who came before us. Just as they did, we've taken every resource, every advantage, and exhausted them. And now we're at a crossroads.

Culturally and economically we've placed our wager—that we're unique, that the rules of the past no longer apply. But what's interesting is how many great investors made their careers betting <u>against</u> this exact belief. While others believed utterly in the present, most great investors believed as Nietzsche did in recurrence. In fact in few places does the idea of recurrence occur more frequently than in the stock market. Here's Jesse Livermore in *Reminiscences of a Stock Operator*, published in 1923:

> *When you read contemporary accounts of booms or panics, the one thing that strikes you most forcibly is how little*

> *either stock speculation or stock speculators today differ from yesterday. The game doesn't change and neither does human nature.*

Livermore later describes a trader of advanced age:

> *He had been on Wall Street for years, even back during the Civil War. People said he was a wise old codger who was always saying there was nothing new under the sun, least of all in the stock market.*

My favorite investing book is Ben Roth's little-known diary about the Great Depression. Roth records both the feel and the facts of the time. It's striking how many "unprecedented" things today were similar to the "unprecedented" issues they faced then.

Roth writes of the 1922-1929 period preceding the stock market crash:

- Morality was pushed to the background. People just wanted to have a good time and spend money.
- It felt like "a new era which was never going to end."
- Everyone was playing the market, often on margin.
- Stocks were selling at 20x, 30x, 40x earnings. People sneered at bonds yielding 4-5% as too low-return.

Eerily similar to today. Roth continues, writing that after the crash:

- Politics got radical. There was rampant socialism everywhere, particularly among ministers and college professors.
- Economists claimed the country's debt had to be canceled or inflated away.
- A popular theory at the time was that technology would replace many workers who'd never find work again.
- The government made cosmetic attempts to "do something." But its only real response was to print money. Money printing pumped up headline economic numbers and was nothing more than a hopeless bid to make perception become reality.
- Meanwhile the money either sat idle on the banks' balance sheets and did nothing, or it caused inflation, which rewarded favored constituencies by robbing others.

Once again all eerily similar. To gain context, Roth himself began searching the historical record to find a precedent for what was going on. He eventually came across the panic of 1873 and was shocked at how similar it was to his time. The panic of 1873 was preceded by prosperity, rising prices, speculation, corruption and then bank closings. Afterward there were wild schemes to inflate the currency. There was also a lot of radical talk about capitalism and socialism. Many people changed political parties. Like Livermore, Roth ultimately came to understand the "tragic" nature of the world—namely that booms and busts are an inevitable spoke on the wheel of history.

In a key moment, Roth realizes the answer to this tragic nature lies in one thing: survival. He meets a judge who lived through the 1873 panic. The judge tells him that everyone who went through that time always kept some money in government bonds. That way, they'd have income to survive on in a crisis and wouldn't have to fire-sale their nest egg.

How do we know Roth's judge's wisdom was always destined to be forgotten over and over—forever?

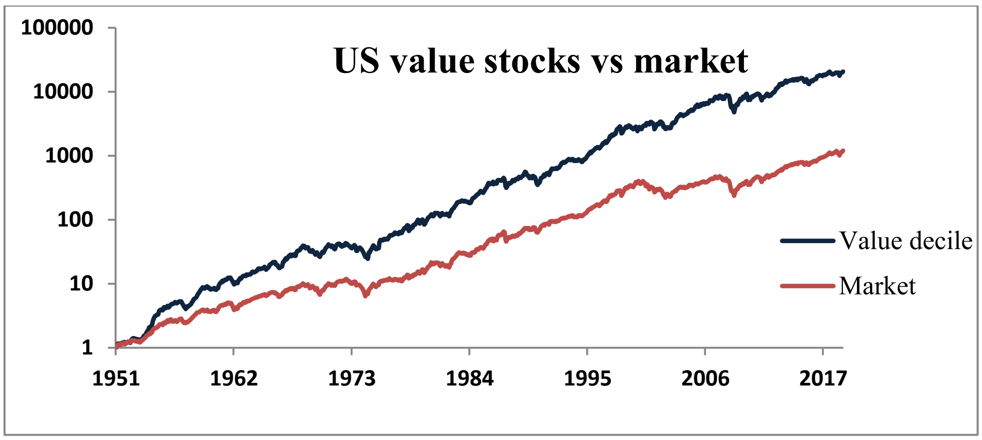
Because this is the exact survival mechanism that the Fed has ended. Its decade-long suppression of interest rates has not only punctured but banished the very idea of a financial life raft. In helping us transcend history, the Fed has created the conditions for our destruction. Incidentally, another conclusion of Roth's: every fifty years or so, there's a depression. 1873, 1929, 1975. That would make us due for one now.

My firm recently completed a study of the greatest investors in history (defined as those who outperformed by at least 2.5% a year over 20+ years). What we found was fascinating. 66% of these investors were looking for businesses that exhibited a high degree of sameness, i.e. persistence of historical character. They harnessed recurrence, didn't fight it. And they were betting on fixed, repeatable, enduring aspects of the world. What they weren't doing was chasing the ever-changing, the popular theories of the day, the bold market call or the notion that the times in which they lived were without precedent.

In other words, these investors' success stands for the opposite of the orthodoxy today. They believed in history. And they believed the past isn't dead. It's very much alive and with us at all times.

Also striking: the majority of great investors were value investors. There's no school of investing that bets more heavily on sameness and recurrence than value investing. That's what value investing is: the attempt to get big payoffs off of normalcy. Specifically it's buying at a discount to some fundamental—earnings, book value, whatever—and then waiting for the discount to close. But relying on those fundamentals is an inherent bet on sameness. If a company's character didn't persist, then buying at a discount to some fundamental would be meaningless because the fundamentals themselves would be random and meaningless.

Interestingly Nietzsche's idea of "infinite sameness" is echoed in the broader stock market itself. Ken French maintains a data library with stock market returns in 22 different countries. Spend a few hours sorting through this data, and something becomes clear. The largest and most enduring source of alpha in the world is in value stocks.



Source: Ken French data library.

The value decile is the cheapest 10% of the market in terms of P/E. Since 1951, the value decile in the US has returned 15.8% a year versus 12% for the market.

You see similar results not just in the US but everywhere. It's like gravity. Value stocks outperform in Germany and Hong Kong. They outperform in Brazil and the UK. What's so striking about markets isn't their uniqueness. It's their sameness. And this sameness extends not just vertically—across geographies—but horizontally—across time. In the US, value beat growth when John Dillinger was on the lam. Meanwhile in Germany, value beat growth when the Berlin wall came toppling down.

But why does value work with such ubiquity?

Growth is a bet on change. Value is a bet on sameness. Value trumps growth because life stays the same far more than it changes. But actually the underlying concept goes deeper than that—to another concept, believed in by Nietzsche but also by stoics and many religions. *Amor fati.* Love of fate.

Love of fate means accepting life on its terms, not on yours. It means finding meaning in the mundane truth instead of a pretty lie. And if you think all this is academic, look at the track record of things that don't confront life on its own terms. Look at the record of grand theories, grand plans, revolutions, anything remotely utopian. There's a reason why the American Revolution is one of the only successful revolutions in history. It wasn't a fight for change but for more of the same.

In a 1987 Berkshire letter, Warren Buffett noted that from 1997 to 1986 only 25 companies in the Russell 1000 consistently averaged over 20% returns on equity. Now the most interesting part: almost all of these businesses were in mundane, everyday industries. These companies weren't redefining our reality. They were harnessing life's sameness, not its variance. Value investors have an edge because other people frequently lose sight of the power of the mundane. But the more forgetful other people become, the greater the value investor's edge grows.

The principle underpinning value's success is so large that it bleeds over into seemingly unrelated arenas. Even Nassim Taleb is arguably a part of this tradition. It would appear that the father of the "black swan" is the opposite of a value investor. Instead of betting on sameness, he bets on explosive changes so large and forceful that no one can see them coming. But this doesn't capture what he was really doing. Phil Tetlock, in his famous study on expert predictions, noted that events which experts deem impossible occur a whopping 15% of the time. Having arrived at a similar conclusion himself, Taleb bet on "impossible" events that were priced as such. As a result, when they paid off, the payoffs were exponential, 10-40x, giving him the convexity he needed to compensate for the low hit rate of his strategy.

Essentially Taleb was value investing in randomness.

Like value investors, Taleb wasn't betting on some theoretical future. He was betting on a fixed feature of the world <u>as it exists today and as it has existed for a long, long time</u>. The difference between this approach and that of so many other investors couldn't be greater. Most investors obsess over ever-changing investment outlooks. The value investor obsesses over what doesn't change.

As markets enter seemingly uncharted territory, the lessons of the past recede farther and farther away. Everything is telling you to change. Adapt or die. There you have it. We face the same dilemma all the greats had to face: to which wagon do we hitch our star.

In the season 1 finale of *Mad Men*, Don Draper gives a presentation for a product called the Carousel. The Carousel is a circular slide projector, which Don has filled with photos of his family. As Don speaks, we see images of Don's smiling family, the wife and the children he's forsaken in his pursuit of booze and women. The slides go backward chronologically. And we watch their smiling faces get younger and younger, more and more innocent, as we return to a time before Don has wronged them.

At one point, the camera cuts to Don, and the look of awe on his face is unforgettable. This is a man glimpsing his entire life. And what I believe Don sees is what we all see eventually: that we're each all things. We're the fool whose blindness we can't stand. We're the hopeless, angry person we shake our heads at. We're the past we find so flawed and foreign. But we're also the things we love. We're the parent capable of bestowing great kindness and wisdom. We're the individual with quiet reservoirs of incredible strength, who no force in the world will ever own.

Draper's carousel is like Nietzsche's recurrence. It doesn't take us to new heights or to a different plane of existence. Instead it takes us, as it took Don, back to where we've already been. There's tremendous wisdom in accepting that, even liking it. Tremendous rewards too.