Vitaly's

ARTICLE ALMANAC

2022

Contents

From Vitaliy

Last year, the IMA team started a new tradition of creating an almanac of articles I wrote in the departing year. You can read the 2021 almanac here.

This year's almanac is divided into four sections – I'll touch on each section below.

Russia's Invasion of Ukraine

As I reflect on 2022, the most important event of the year, at least for me, is Russia's barbaric invasion of Ukraine. In the past, when people sensing my accent asked me where I was from, I unhesitantly answered, from Russia. Today, I am overwhelmed with embarrassment for the country I left 31 years ago, and thus I answer that I am from the USSR. This is factually correct: Russia as a country did not exist when on December 1, 1991, my family boarded a Pan Am flight from Moscow to NYC.

Today's Russia has no qualms behaving like the Nazi Germany I was taught to hate in Russian schools even before I could read. I wrote a series of essays about this war that you'll find in the "Russia's Invasion of Ukraine" section.

Investing

The stock market bubble that I've been writing about for the last few years is finally bursting. For the first time in almost a decade, it feels like common sense has stopped being a painful headwind and is turning into a tailwind.

Paying any price for the stocks of companies that were growing revenues but had no hint of profitability and were diluting shareholders by giving away 10% of shares in stock-based compensation every year is an approach that has stopped working.

Investors are discovering that the price you pay matters, eventually. Many of these companies are down 70-80% from their highs and are still expensive.

Rising interest rates are making value investing great again!

In the “Investing” section, I discuss the economy, inflation, deflation, individual stocks, the housing market, and a lot more.

Life & Philosophy

I was going to create a separate “Philosophy” section in the almanac. Then I realized that it’s often difficult to find the line where life ends and philosophy begins. Philosophy doesn’t exist in an esoteric bubble, it is inseparable from life. The word philosophy is unnecessarily intimidating – it should not be. After all, it translates from Greek as love of wisdom.

In 2022 I published *Soul in the Game: The Art of a Meaningful Life* (Harriman House). Writing a book is like having a child, and just like having children, writing this book changed me. I realized that in my actions I now have to answer to a higher authority – the better version of me that appears in the pages of the book.

So far the reader feedback I have received has been overwhelmingly positive. *Soul in the Game* is achieving what I hoped it would do – have a positive impact on readers’ lives.

The most frequent response I get from readers is “I wish I’d read it years ago.”

That is exactly what John Mauldin said at a recent CFA Colorado event where we shared the stage. John is a friend and the gifted writer of one of the most-read newsletters on economics in the country. At the event he said that he was buying a copy of *Soul in the Game* for each of his ten kids for Christmas. He really wants them to read it, and thus he’ll pay his kids if they read it and can have a 15-minute conversation with him about the book.

I don’t know if I’ll write another book, but I keep on writing this one. I’ve already written six new chapters that I’ll be sharing with folks who bought *Soul in the Game* and registered their purchase by emailing bonus@soulinthegame.net (you can email your receipt or just a picture of you holding the book). I’ll be releasing new chapters to “unregistered” readers at a later date. We also added a bonus section, where you can read several chapters excerpted from *Soul in the Game*.

Music

I wrote a lot less about classical music this year than I normally do. The book launch and writing about the war in Ukraine consumed a lot of my writing time. I intend to rectify the situation in 2023.

My team puts a lot of effort into creating a marvelous almanac. As with everything we do at IMA, they had soul in the game while creating it. If you like how it looks, thank the IMA team (you can email them here: contact@imausa.com) . My contribution to it is just limited to the articles and the introduction you just have read.

Feel free to share this almanac with your friends, enemies, random strangers and of course, your kids.

I hope you enjoy the almanac and prosper.

Vitaliy

Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

WAR IN UKRAINE

WAR IN UKRAINE

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War in Ukraine: Why I Was Blindsided, Part 1

Click to listen to a narration of this article

3/1/2022

On February 24th the world changed. What I thought could never happen has happened. Russia declared war on Ukraine.

I have not felt this level of sadness in years. I feel like someone close to me died. But I am sitting in my comfortable armchair, with my headphones on, drinking coffee as I write, while somewhere in Ukraine, people just like me are being bombed by Russian artillery. They went from going to Starbucks, shopping, and sharing carefree meals with their families to hiding in subway stations at the first sound of the siren. Hundreds of thousands have been forced to flee to other parts of the country or to Poland.

> Eight days before Russia invaded Ukraine, I wrote an article saying there would be no war. I was certain of it. I was wrong. Why was I blindsided? The more you knew about the situation, the more likely you were to get it wrong.

I have to confess, Ukraine is all I can think about. I don't want to write about investing. For the last few days, I've been writing four, five hours a day. This is my way of dealing with this tragedy and stress. Some people drink, some take up smoking, I write.

I have written quite a lot, and I keep writing. This is how I bleed, one word at a time. I am going to break it up into smaller, more readable chunks. I'll send them out as soon as I finish writing them. You'll be getting a lot more emails from me than usual. I hope this war ends soon so I can go back to writing on more trivial topics.

By the way, I share my more real-time, unpolished thoughts on Twitter – you can follow me here.

One last thing. If you know any charities that help folks in Ukraine, please send the info to me. I'll be delighted to donate and will start accumulating a list at the bottom of each email.

Why Was I Blindsided by the War?

Eight days before Russia invaded Ukraine, I wrote an article saying there would be no war. I was certain of it. I was wrong. How could I get it so wrong? The more you knew about the situation, the more likely you were to get it wrong.

Let me take you back to my childhood in Russia. I and everyone around me hated the Nazis with every ounce of our souls. Every other movie made in the Soviet Union was about WWII. A lot of those movies were in black and white. I am not referring just to the color of the film but to the lack of ambiguity of the message: Without provocation, the Nazis invaded the Soviet Union. Russians were good, courageous, honest, peaceful people. Germans were heartless, evil, soulless invaders that slaughtered innocent Russians. Russians were good. Germans were bad.

Reminders about WWII were not just in the movies. We studied the horrors of WWII in school, and then there was the May 9th celebration of Victory Day, when Germany surrendered, on May 9, 1945. Unlike Independence Day in the US, which is just an excuse for BBQ and to sell couches at a 30% discount, May 9th was a day that was truly dear to everyone. We all went out onto the streets to celebrate it. We all knew someone who had fought or died in WWII, and most of our parents had lived through its horrors. WWII is not just an entry in a history book for Russians; its memories and lessons are deeply embedded in Russian culture.

This is the first reason why war with democratic Ukraine seemed unfathomable. Even after it happened, my mind still didn't want to recognize that at 4 AM – the same hour that Germany attacked the Soviet Union in June, 1941 – Russia invaded and started to bomb Ukraine. This makes Russia just like Nazi Germany – behavior that we despised all our lives.

The Soviet Union was a melting pot. Take my family for example. Three quarters of my ancestors, including my mother, were born in Vitebsk, a small town in Belarus. My father's father was born in Pavlograd, a city in Ukraine – he was a lieutenant colonel who fought in WWII in the Soviet army. My father was born in Moscow. I was born in Saratov, a city on the Volga River to which my mother's family evacuated during WWII. From the time I was three months old until I was 18, we lived in Murmansk, in far northwestern Russia. Was I Russian, Ukrainian or Belarusian? Add the fact that I am Jewish to the mix to confuse things a bit more. (I posed this question in the past and tried to answer it here). Most importantly, I am not an exception, but the rule (except for the being Jewish part).

To this day when I say Russia, I catch myself referring to more than just the geographical territory of Russia but not to the whole Soviet Union, either. I am referring to all the Slavic countries, including Russia, Ukraine and Belarus. These countries share a common culture. We watched the same movies, sang the same songs, laughed at the same jokes, and we even spoke the same language. We considered anyone from these republics to be "Russians plus." The plus being that they had their own cultures and languages, but the Russian language and culture was a common denominator. This was and remains the perspective of my and the older generations that grew up in Soviet Russia. I am sure that today it is not shared by the citizens of the other Slavic countries I mentioned above.

Slavs also look the same. You wouldn't be able to tell any physical difference between Ukrainians, Byelorussians, and Russians. This point is very important.

I remember visiting the Holocaust Museum in Jerusalem and hearing a story about a group of Jewish refugees from the Soviet Union finding their way to Japan during WWII. Japan and Germany fought on the same side, but Japan did not embrace the German Aryan ideology that wished to purge the human race of Jews.

Germany demanded that the Japanese send these Jewish refugees to Germany. The Japanese were somewhat bewildered by this request. They asked the Jews, “Why do Germans hate you so much?” To answer this question fell on a Rabbi, the head of the group. Just imagine you are this Rabbi, the heaviness of this question. Your answer will decide the fate of hundreds of people, many of them your relatives. The Rabbi thought about it for a few minutes and answered, “They hate us because we look like you.” This brilliant answer saved the lives of these people; they were not shipped to Germany.

It is in our genetic programming that it is easier for us to kill (yes, that is what war is) people that are not like us (from a different tribe). We are more sympathetic to people like us, just as we prioritize our family over strangers. This horrible invasion of Ukraine by Russia is as close as you will come to a civil war between countries that are blood brothers.

Now, combine a shared hatred for behaving like Nazis, a common culture, and physical likeness, and you can you see why this war was unimaginable to anyone who had spent any time in the Soviet Union.

Another thing I missed.

The Russia I knew 30 years ago is gone. The flame of democracy that was lit with Perestroika died out a decade later. Today, Putin’s dictatorial regime is starting to resemble Stalin’s Russia of 1937 or Hitler’s Germany in 1939.

My father always said that Russians may be skeptical of their government, but they love their leaders to death. I have watched interviews with historians who studied Stalin, and they are convinced it was impossible to predict that Stalin would turn into a despot, propped up by a cult of personality, who would kill millions of Russians. I have also read interviews with people who knew Putin well, and there was no sign that he would turn into the dictator that he is today.

But Dalberg-Acton’s quote “Power tends to corrupt, and absolute power corrupts absolutely” is like an immutable law of the human condition. After a while, unlimited power poisons everyone’s soul. You start taking little shortcuts to achieve results that will bring about an even greater good. Little by little, taking shortcuts becomes the norm. The rule of law becomes an inconvenience that you either ignore or change as you wish.

People you surround yourself with may be good people but are terrified of you and thus tell you only what they think you want to hear. You find yourself surrounded by sycophants.

You lose touch with the outside world. Money and possessions lose their luster. Power is the only drug you're after. So, as a dictator you have only two goals – stay in power and get more power. This is why, despite appearances, there are no free elections in Russia and any candidate that dared to run against Putin is either dead or rotting in jail.

Putin did not become a dictator overnight. He became the president of the democratic Russia in 2000. But then he asked for a little bit more power. People loved him and gave it to him. He kept asking for more and more. With every little tweak to the law, the country became a little bit less democratic. Fast forward to today. Putin is a dictator for life and no longer needs to ask. He just takes it.

I also missed this point: I was looking at the Ukraine situation from the perspective of Russia. But we are not dealing here with a rational national leader – or at least his rationality has nothing to do with Russia or geopolitics. As we do analysis of the situation going forward, we have to keep this in mind. Putin doesn't care about Russia; he only cares about Vladimir Putin. Trying to predict what Putin will do to maintain power is very difficult. There are no ex-dictators, there are only dead dictators, and Putin knows it.

This is a lesson not just for Russia but for any democracy, including the United States. The law should not be crafted for a person in office today – no matter how much you admire the person. Never love your politicians unless you are married to them; you lose your objectivity. People change – power corrupts them. Also, you don't know who will be replacing them. It is a miracle that the US has been a democracy for this long. We should never take it for granted.

I was not going to include music with this email – I don't feel like writing about composers right now. But then I remembered the origin of Dmitry Shostakovich's 7th, "Leningrad" Symphony. Listen to it here.

Shostakovich completed it in 1941. He was in Leningrad (now Saint Petersburg), and the city was surrounded by the Nazis, blockaded, completely cut off from the rest of Russia. The Germans were bombing day and night. People were dying of hunger.

This symphony starts out peacefully – the first 7 minutes are just about normal everyday life. Then in minute 7 you start hearing the faint sound of drums – that's the German army marching on Russia. Minute by minute the drums grow louder, and then all peace is gone and all there is war. This symphony portrays well the irony and tragedy of what is happening right now. If Shostakovich were alive, he would have renamed this symphony "Kiev."

Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

War in Ukraine: Part 2 – The New World

Click to listen to a narration of this article

3/3/2022

At 4 AM on February 24th, the world changed. This was the 9/11 moment for Europe and much of the rest of the world. Just as 9/11 dramatically changed the flow of history, resulting in two wars and hundreds of thousands of deaths and millions of lives ruined, so too will Putin's invasion of Ukraine. Right now, we are seeing only the first effects and getting glimpses of second-order effects. The broad third-order effects will not be visible for a long time, though they'll be obvious in hindsight.

Just as 9/11 dramatically changed the flow of history, resulting in two wars and hundreds of thousands of deaths and millions of lives ruined, so too will Putin's invasion of Ukraine. Right now, we are seeing only the first effects and getting glimpses of second-order effects. The broad third-order effects will not be visible for a long time, though they'll be obvious in hindsight.

On March 7, 1936, the German army violated the Treaty of Versailles and entered into the Rhineland. Here is what Hitler later said:

"The forty-eight hours after the march into the Rhineland were the most nerve-racking in my life. If the French had then marched into the Rhineland, we would have had to withdraw with our tails between our legs, for the military resources at our disposal would have been wholly inadequate for even a moderate resistance."

Those two days determined what Germany would do next: build out its army and start World War II.

Putin's 1936 moment was in 2014 and 2015 when Russia invaded Crimea and Eastern Ukraine. (Some would argue it started earlier, in 2008, with the excursion into Georgia.) At the time, the West put toothless sanctions on Russia. Despite pleas from the US, the EU did not even consider increasing its defense budget. This inaction emboldened Putin to start his war with Ukraine. Today we are close to 1939, with Germany's invasion of Poland and the start of what later became known as WWII. Except that it seems that Europe, acutely aware of its dark history, has finally woken up.

A day or two after Russia invaded Ukraine, the US and European countries started to come out with sanctions. They were pathetic and laughable. The low point was when Italy excluded exports of Gucci bags to Russia. It seemed like 2014–2015 all over again, in line with what Putin was expecting.

Then something changed on February 26th.

I don't think it was just one factor but a confluence of events:

- The horrors of this war were broadcast on social media for the world to see. This time it was not happening far away but just a few countries over to people who looked just like most other European citizens.

- When Sweden and Finland declared in recent days that they were exploring joining NATO, Putin threatened them with political and military actions (war!). Let's pause. I want you to process this for a second. Russia was threatening war with two other nations, neither of which had even been part of the Soviet Union, if they made decisions to determine their own fate. This time it did not feel like an empty threat.

- Volodymyr Zelensky did not escape to Poland or to the US. In a rejoinder to the US's offer of safe haven, he said, "I need weapons, not a ride." He reenergized not just Ukraine but the rest of the world. (I wrote this article about this wonderful man when he was elected). The bravery of the Ukrainian people was and is inspiring.

European countries suddenly woke up and realized that they might be next.

As I have mentioned, this is the third (!) incursion by Russia into Ukraine. In the first one it chopped off Crimea, and then it invaded and destabilized the Donbass and Lugansk areas of Ukraine. These first two incursions were accomplished through lies. Just imagine this: Somehow Russian soldiers and tanks (yes, tanks!) ended up in Eastern Ukraine. Neither tanks nor soldiers were officially Russian. The soldiers were ex-Russian Army (though you did not have to have much imagination to understand that they were on the Russian payroll, which Putin of course denied). Crimea was invaded without a shot and "had a referendum".

Until now Europe had chosen to take Putin's lies lying down. It could see through them, but the truth was inconvenient for anyone other than Ukraine.

This time there were no pretenses. Putin has sent a good-sized chunk of the Russian Army into Ukraine. The Europeans realized that instead of fighting Russia with their own armies in the future, they could arm and support Ukraine today.

A dictator's thirst for power is insatiable. After Russia swallowed Ukraine (with a lot of indigestion – more on that next) it would continue to try to put the Soviet Union back together, gobbling up other ex-Soviet republics. Europe could continue to ignore it and come out with more toothless sanctions, but at some point Putin would go after Estonia and Latvia, which are NATO countries. If NATO didn't defend them, Europe as we know it would be over.

Before February 25, Germany (insultingly) sent helmets to Ukraine. Today it is sending anti-tank weapons. The EU is providing hundreds of millions of dollars' worth of weapons to militarily outmatched Ukraine. Today every country in Europe wants to outshine the next with its real, tangible support to Ukraine.

European countries have closed their airspace to Russia (and the US just joined them). The West has frozen Russian Central Bank foreign reserves – I did not even know that was in anyone's arsenal of sanctions. Many Russian banks have been removed from SWIFT, the foreign interbank payment system. Not all banks were cut off from SWIFT, because Germany and Italy rely heavily on Russian gas for their power generation.

What is really amazing is that the corporate sector has joined the fight, too. Google Pay and Apple Pay no longer work in Russia. Apple has even stopped selling iPhones in Russia. Mastercard and VISA have blocked their networks in Russia. Soccer teams are canceling their matches with Russian clubs. I did my little part: My next book was also going to be published in Russia. Now it will not, but I will be happy to see it published in Ukraine.

Russia is being canceled, excommunicated from modernity by the West. It is being treated as the pariah it is.

I want to stress this point: Putin considers these post-February 26 sanctions which far exceed what he expected as declarations of war by the West against Russia. No, we don't have the West's armies on the ground in Ukraine, but the Russian Army is being fought with the planes and other weapons that are arriving nonstop to Ukraine from the West, and the Russian economy is being crippled by the West.

I fully support sanctions. Part of me is celebrating, and another part of me is sad. The Ukrainian people are not the only casualty of Putin's war. The Russian people have suddenly found that they are facing a serious depression. I have read that a majority of the population supports this war and that Putin's popularity is soaring. I am not sure I believe this – it is coming from media controlled by Putin. But even if it is true, these people are brainwashed and zombified by state-controlled media to a degree you cannot imagine. They have no sense of reality; they live in Putin's Matrix. I'll talk about that at length next time.

Then What?

Putin did not just miscalculate the West's response, he completely missed the Ukrainians' will to fight. This is in part why I was utterly convinced the war would not happen. I wrote:

"I think Putin is bluffing – Russia doesn't want a full-blown invasion of Ukraine. It would result in endless guerilla warfare in Ukraine. The Russian Army is superior to Ukraine's, but there would be no victory in that war. Russia occupies Ukraine, and then what?"

Then what? I vividly remember how Russians and Ukrainians and the rest of the Soviet Union fought the Nazis in WWII. I remember self-sacrifice. I grew up a block away from a statue of Anatoly Bredov, a Russian hero who blew himself up to keep the Nazis from reaching a strategic high point in 1944. Russia would not let me forget, and rightfully so. Statues of heroes who gave their lives while fighting Nazis are all over Russia.

During WWII both Russians and Ukrainians displayed plenty of heroism, but they had the "why" – they were fighting Nazi Germany for their families, for the future of their kids, for their homeland.

My thinking was, if Russia invades Ukraine to kill their democratically elected government and to install their own military puppet government and thus turn Ukraine into another, smaller version of dictatorial Russia, the Ukrainians will not stand for that. Ukraine is not a perfect democracy; it has its share of problems. But it is a democracy. It has things we in the West often take as much for granted as we do running water (I know I often do): freedom of speech, free elections, the rule of law, and due process.

I knew Ukrainians would fight to preserve that. And that is exactly what they are doing today. Ukrainians are behaving the same way they did when they fought the Nazis. Here is just one example: The Ukrainian soldier Vitalii Skakun blew himself up detonating mines so Russian tanks couldn't cross a vital bridge. (I am proud to share a first name with this hero!)

In a delusional act of self-deception (or just plain arrogance), Putin thought Ukrainians would throw a welcoming party for Russian tanks roaming through Kyiv. The Ukrainians threw him a party, but by tossing Molotov (Zelensky) cocktails at the tanks, fighting till their last breath. Tens of thousands of volunteers have enlisted in the Ukraine Army. Even Kharkiv, one of the most eastern cities in Ukraine, with a predominantly Russian population, is fighting the Russian Army with all its will.

US General H. R. McMaster said, "To win a war you need both capability and will." Ukrainians definitely have the will, and now they are getting the capability shipped to them from the West. Will it be in time?

The ineffectiveness of the Russian Army is somewhat surprising. But when you think about it, maybe it shouldn't be. Russian soldiers don't have the will – the "why." What are they fighting for? Putin? Even if they believed in the "ridding Ukraine of neo Nazis" nonsense (I'll address this topic in the future), their families were not threatened by Ukraine. Many have friends and family in Ukraine. They are them. I have a hard time imagining Russian soldiers sacrificing their lives to invade Ukraine.

This is why Russians soldiers are surrendering to Ukrainians. They are not cowards. I watched a dozen short video interviews with captured Russian soldiers. Their stories were one and the same. They were on training exercises. They were told they were going on a peace-keeping mission to Donbass and Lugansk. They crossed the Ukrainian border but found they were going to Kyiv or Kharkiv instead. I'd argue that these soldiers who surrendered are heroes. Unless there is a regime change in Russia, they cannot ever go back to Russia or they'll be imprisoned for 15 years as deserters.

I know the Russian soldiers who are dying will not get much sympathy from us, after we have watched Ukrainian cities being demolished by Russian artillery. But these are just 18-year-old kids who were conscripted into the army. Even the ones that signed up voluntarily did not know that they'd be facing their Ukrainian brothers. These young soldiers who have been killed have parents and siblings who just lost their loved ones. I am maybe extra sensitive because I have a 20-year-old son who has been taught to love, not hate. He was born in the US. But he could have been born in Russia if my family had not been lucky enough to move to the US in 1991. I also remember being 18 years old in Russia and terrified that I might be drafted into the Russian Army. (I wrote about that experience here.)

The Russian Army is also not as capable as we feared. It is handicapped by kleptocracy. A lot of Russian tanks have been gutted, the metals from them sold for scrap and the instruments are taken out and sold on the black market. I am not surprised. Some things haven't changed over the decades since I left Russia.

Also, just like any dictator, Putin staffs people in key positions based not on their capability but on their loyalty to him. Take the Russian Minister of Defense. Unlike in the US, where the Secretary of Defense is a political not a military position, in Russia the Minister of Defense is also a general in the army. Notably, the current Minister of Defense, despite being a general in the army, has no military background. None.

This is why I am so optimistic and worried at the same time. Ukrainians have the will and an increasing capability. The Russian Army has no will and the army is somewhat sclerotic. I am worried because, in place of tanks rotting on Ukrainian roads, either abandoned or out of gas, Putin will start using heavy artillery and missiles to level these cities. We already started seeing that on March 1st. But this war is not winnable for Putin even if he invades every major city. The Ukrainians will keep fighting and the West will keep supporting them.

Just to clarify, my main occupation is value investing and I did not become a rear admiral and military expert overnight. Please take what I just wrote with a grain of salt – I certainly do.

The World Has Changed

Ironically, before Putin started this war, the NATO that was "encroaching" on Russian borders was a toothless one. It was in semi-retirement and collecting peace dividends from the Cold War. The Ukrainian invasion brought it out of retirement. Today we see the NATO that existed during the Cold War, the one that Putin should fear. The peace dividend got canceled by Putin (together with coupon payments on Russian bonds held by foreigners). European defense budgets are going up. Germany is boosting its defense spending by more than 30%. Other European countries will follow. NATO is more united than ever before. It now has a clear objective, which it did not have for over three decades.

China is paying close attention to what is going on in Ukraine, and it probably doesn't like what it sees: a stronger, more coordinated West. Europe finally awakened to its dependence on natural gas from Russia. Even if the war ends tomorrow, Europe is on an irreversible course to reduce its reliance on Russian gas. Unfortunately, Germany is doubling down on green energy and coal instead of going back to nuclear. (I wrote on this topic here.)

As Russia has been cut off from the rest of the world in everything from planes to smartphones, it has been pushed into Chinese hands. Russia has what China needs – commodities. Before the Olympics Russia signed a large deal to sell its natural gas to China. China in turn will likely be providing Russia with everything the West is depriving it of.

The newly invigorated NATO and the extent to which the West has slapped sanctions on Russia make a Taiwan invasion by China – which would have a much greater impact on the global economy than the Ukraine invasion – less likely now. This topic requires a lot more thinking and analysis because China is economically much stronger than Russia and our dependence on China is much greater. Apple, for instance, cannot stop shipping iPhones to China if it invades Taiwan, not just because China is one of its largest markets, but because almost all of its iPhones are made in China. But it is a given that, just like the pandemic (which Putin made us forget about), the Ukraine war has reinforced and accelerated the movement toward deglobalization.

Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

War in Ukraine: Part 3 – The Future of Russia

Click to listen to a narration of this article

3/7/2022

> *"Putin cannot bring the Soviet Union back together, but he can bring back breadlines."*
>
> —IAN BREMMER

Sanctions will likely have a very significant impact on the Russian economy. Unlike previous (2014) sanctions, which were toothless and slow to have an impact, these went straight for the jugular of the Russian financial system, possibly crippling it overnight. The Russian central bank had to raise rates to 20%, banks stopped giving out loans, and the ruble collapsed. The Russian economy is likely going to be engulfed in inflation, the magnitude of which it has not seen since the early 1990s. Russia has been cut off from the West overnight. Russia has turned into a toxic pollutant on corporate ESG checklists. Even Coca-Cola is leaving Russia.

The thinking in the West is that the Russian people will revolt against their dictatorial ruler, and this will bring an end to the war. In addition, the sanctions should in theory deprive Russia of the economic oxygen it needs for Putin to be able strengthen the Russian military and put an excruciatingly high price tag on future wars.

Will sanctions bring an end to Putin?

Sanctions have a checkered history. They didn't get rid of Castro in Cuba or the Kims in North Korea. It took more than a decade for sanctions against South Africa in the 1980s to bear fruit. Sanctions in the past have been an effective stick that was turned into a carrot when both sides came to the negotiating table.

But the world has never seen sanctions like this. Ironically, these sanctions may give Putin even more power.

How?

Sanctions have a checkered history. They didn't get rid of Castro in Cuba or the Kims in North Korea. It took more than a decade for sanctions against South Africa in the 1980s to bear fruit. But the world has never seen sanctions like this. Ironically, these sanctions may give Putin even more power.

To control the masses, Putin tells them what to think. How does he manage that?

In 2014, I was perplexed by how the Russian people could possibly support and not be outraged by Russia's invasion of Eastern Ukraine. But I live in Denver, and I read mostly U.S. and European newspapers. I wanted to see what was going on in Russia and Ukraine from the Russian perspective, so I went on a seven-day news diet: I watched only Russian TV – Channel One Russia, the state-owned broadcaster, which I hadn't seen in more than 20 years – and read Pravda, the Russian newspaper whose name means "truth." I wrote a lengthy article on this topic – you can read it here. An excerpt:

"In my misspent youth, I took a marketing class at the University of Colorado. I remember very little from that class except this: For your message to be remembered, a consumer has to hear it at least six times. Putin's propaganda folks must have taken the same class, because Russian citizens get to hear how great their president is at least six times a day.

We Americans look at Putin and see an evil KGB guy who roams around the country without a shirt on. Russians are shown a very different picture. They see a hard-working president who cares deeply about them. Every news program dedicates at least one fifth of its airtime to showcasing Putin's greatness, not in your face but in subtle ways. A typical clip would have him meeting with a cabinet minister. The minister would give his report, and Putin, looking very serious indeed, would lecture the minister on what needs to be done. Putin is always candid, direct and tough with his ministers. [In Part 1 of this series I discussed how Russians love their leaders to death. Russian TV is an unending infomercial for Putin. Russians get huge helpings of Putin-love for breakfast, lunch and dinner.]

I've listened to a few of Putin's speeches, and I have to admit that his oratory skills are excellent, of J.F.K. or Reagan caliber. He doesn't give a speech; he talks. His language is accessible and full of zingers. He is very calm and logical. [I've heard that isolation during the pandemic had an impact on him and he lost some of his eloquence over the last few years.]

I have to confess, it is hard not to develop a lot of self-doubt about your previously held views when you watch Russian TV for a week. But then you have to remind yourself that Putin's Russia doesn't have a free press. The free press that briefly existed after the Soviet Union collapsed is gone – Putin killed it. The government controls most TV channels, radio and newspapers. What Russians see on TV, read in print, and listen to on the radio is direct propaganda from the Kremlin.

Before I go further, let's visit the definition of propaganda with the help of the Oxford English Dictionary: "The systematic dissemination of information, especially in a biased or misleading way, in order to promote a political cause or point of view."

I always thought of the Internet as an unstoppable democratic force that would always let the truth slip out through the cracks in even the most determined wall of propaganda. I was wrong. After watching Russian TV, you would not want to read the Western press, because you'd be convinced it was lying. More important, Russian TV is so potent that you would not even want to watch anything else, because you would be convinced that you were in possession of indisputable facts.

Russia's propaganda works by forcing your right brain (the emotional one) to overpower your left brain (the logical one), while clogging all your logical filters."

I know exactly what I am going to hear back from some of my fellow Americans. They are going to say: Don't you think Americans are brainwashed by Fox News, MSNBC, CNN, and other news outlets? There is no question in my mind that American news is more biased today than ever before. But there is a difference between bias and what is happening in Russia. At least by watching different news outlets and reading different newspapers, Americans can triangulate to the truth.

Most importantly, the US government doesn't tell networks what to say. The editor of The Washington Post doesn't have to worry about a trumped-up charge if he writes a scathing article about Biden. In Russia there is only one media voice and that is the voice of the government. All other voices were silenced by the government. The government has zero accountability. Think of Watergate, Irangate, and other "gates" scandals – they could never happen in today's Russia.

I never appreciated the free press as much as I do now. The free press shines a light on government actions. It provides a much needed feedback loop between government and the public.

Over the last few days things have gotten tremendously worse on this front. Russia passed a new law: If you call this war with Ukraine a war, not a "special operation" or publish any views that contradict stories put out by the Ministry of Defense (i.e., create "fake news") you can get up to 15 years in prison. Providing assistance to foreign organizations that oppose the war (sorry, "special operation") with Ukraine will be considered treason, which may result in up to 20 years in prison. Needless to say, most independent local and foreign news organizations immediately closed their doors. Since the invasion, Facebook, Twitter, and other social media have also been blocked in Russia. In other words, Russia turned into China overnight.

Today, cognitive dissonance between reality and what the government says rose to a comical level. A day after the Russian government passed the aforementioned laws, Putin gave a speech, where he said (I am loosely translating):

“In Russia, our people are expressing their views about what they like or don’t like about the situation in Ukraine. But there, in Ukraine, those who express the same opinions as the liberal part of our citizenry are grabbed from the street and shot. They are just simply shooting them. In Russia, our liberals are protesting. In Ukraine they just kill them without due process.”

Remember, this speech was given just a day after he passed a law that you can get up to 15 years in prison for calling a war a war.

Here is another example of how official Russian news has little resemblance to reality. I went to Pravda, clicked on the first article I saw, and read: “The Ministry of Defense has repeatedly stated that no missile, artillery, or airstrikes are carried out by Russian forces on the cities of Ukraine; and the civilian population will not suffer during the operation, since its purpose is solely to disable the military infrastructure.”

Ruins of apartment buildings that have been destroyed by Russian artillery are figments of our imagination. Who do you want to believe, the Russian Ministry of Defense or your lying eyes?

Here is another example: a message on Instagram by a Ukrainian young man:

“My dad works as a security guard in a monastery near Nizhny Novgorod [Russia]. He is a deeply religious person and congratulates me on all church holidays. Yesterday I wondered why my father did not call (the war is the same) and called him [my]self.

I told in detail about what was happening – my father replied that this was nonsense, there was no war, and the Russians were saving us from the Nazis, who were making human shields out of civilians.”

I could not believe it when I read this. I wanted to see if it was true on my own. I was already in a WhatsApp group chat with my classmates with whom I went to middle school in Russia. This is what they told me: Russia was forced into this war. It is getting rid of neo-Nazis in Ukraine. The Russian Army is liberating Donbas and Lugansk from Ukrainian genocide. Their admiration for Putin was at a new high. (The stories I read that Putin’s popularity is hitting new heights seem to be true.) At the end of the conversation, I was convinced that they are brainwashed, and they were convinced that I am brainwashed.

We had no common reality to stand on. None. We all agreed that we don’t want people to die on either side. They were convinced that the civilians who are dying in Ukrainian cities are killed not by Russian artillery and rockets but by neo-Nazis and Banderovtsi (Ukranian nationalists) shooting and bombing their own people. (The war in Donbass and Lugansk and neo-Nazis are a very important topic that I’ll have to discuss separately, hopefully in the next part.)

These are folks I went to school with, played in the snow with, and even had crushes on a couple of them. They are kind, good people, but Putin's TV has completely zombified them. As one of my friends said, they have Russian TV on their brains. (Of course, there is another possibility: that I am zombified and am completely oblivious to that fact.)

People in Russia are brainwashed beyond what any Westerner can possibly imagine. They live in their own version of the Truman Show, in an alternate reality that is deeply divorced from the world outside their dome. This point is paramount: Control of the media allows Putin to completely deform and carefully craft his version of the truth. And this is why I am worried that sanctions may not be as effective as we hope.

I heard from my junior high school friends a line that I've seen in other places: "We are in the middle of a war. We have to finish that war." This war has further solidified Putin's position. He presents the sanctions as the West's aggression against Russia. It seems that zombified Russians have given him a blank check on the pain they are willing to endure and the lives of their kids they are willing to lose. This may change as the body count continues to climb and parents realize that their children who today are not picking up the phone are lying dead in the fields of Ukraine, and that sanctions from the West will continue to inflict tremendous pain on the Russian economy.

This brings me to the next point. Russia's next chapter looks very dark.

Not everyone is zombified in Russia. A few of my school friends reached out to me privately and expressed their disgust with the war. They did not want to voice their opinions in public. Even when we talked on WhatsApp, despite WhatsApp's claim of end-to-end encryption, they were still concerned that they might be listened to. These are not a paranoid people, but people who know the ugly Russian history and who are acutely aware that the newly passed laws carry punishment for being labeled an "enemy of the state" or a "collaborator with the enemy" (yours truly) is 15 years rotting in prison.

Let's zoom in for a second on Russia's dark history. Until the late 1980s, Joseph Stalin was a Soviet hero who led the Soviet Union in defeating the Nazis. You could often see Stalin's portrait hanging in classrooms right next to Lenin's. My father told me that when Stalin died in 1953 the whole country cried, including him (he was 20). It was one of the saddest days of his life.

After perestroika and glasnost in the late 1980s, we were shocked to learn that the evilness of Stalin, the father figure we admired so much, was fully on par with Hitler's. Stalin killed 20 million people, while 27 million people died in WWII. (I don't claim to know the validity of the precision of either number. It's irrelevant; both men killed millions of people). Stalin also eliminated the leadership of the Soviet Army, which made Soviet losses in WWII greater.

The Stalin regime was oppressive. If you were called an “enemy of the people” there was no due process; you were guilty and you were either shot or sent to a gulag, where you’d die from inhuman working conditions and hunger. In fact, a lot of magnificent Soviet infrastructure was built by slave labor (“enemies of the people”).

Today, Putin’s government is rewriting history. Stalin is back in vogue again. He is glorified as a leader who united the country, and you start seeing new statues of him popping up across Russia. In 2014 Russia passed a law that prohibits criticism of Soviet activities during WWII (and thus of Stalin).

Putin wants Russians to forget their history so he can repeat it.

I vividly remember my mom’s terrified face in the early 1980s when a guest at our dining table or my father said something that was not supportive of government policy. If it leaked to authorities, my parents would not have gone to the gulag, but they could have lost their jobs. I never thought I’d see fear of criticizing the government again in Russia. But it’s back. This is why my friends who don’t have a TV in their heads were afraid and did not want to speak up in my classmate WhatsApp group.

In less than two weeks since the beginning of the Ukraine war, with the passing of the new laws, Russia made an enormous leap back towards 1937 and an oppressive Stalin-like regime. While Ukraine, thanks to Russia, went back to 1941, as women and children started dying from artillery and rocket bombings.

The situation in Russia will get worse. Mothers will realize they have lost their children in Ukraine, and sanctions will cause enormous unemployment, breadlines, and maybe even hunger. People will start speaking up more – and the Stalin-era oppression will likely come back in full swing. The country will suddenly be swarming with “enemies of the state” and gulags will be back in vogue again.

There is talk in the media that the oligarchs and upper echelons of the government may revolt against Putin. If you are thinking about this, so is Putin. I don’t know what probability to put on this; I don’t think anyone knows. Whatever you think that probability is, I’d reduce it by half.

In the meantime, though, this war is lasting longer and going worse than Putin expected. Putin has the time to continue the war, because Russians are either brainwashed and supporting the war or being arrested the second they voice their displeasure with the war. My biggest concern, since there is no feedback loop by which to accomplish the goal of “freeing the Ukrainian government from drug addicts and Nazis” (I kid you not, Putin’s words) and basically replacing the Ukrainian government, Putin will resort to the strategy he employed to win the war in Chechnya – he leveled Chechnya’s cities.

A silver lining here is that it is usually the young people who don't "have a TV in their heads," as they watch less Russian TV, spend more time on social media (I never thought I'd be thankful for social media), and are more aware of what is going in the West (no, NATO was not about to invade Russia). The army is full of young people, and maybe Russian soldiers will continue to surrender or, even better, become the source of dissent.

Unfortunately, to my shock, this war is more popular in Russia than I ever thought it would be. Maybe by the time you read this it will already be over, but I doubt it. Putin is under little pressure to conclude it, and, as my middle school friends said, "The war has already started; we have to finish it."

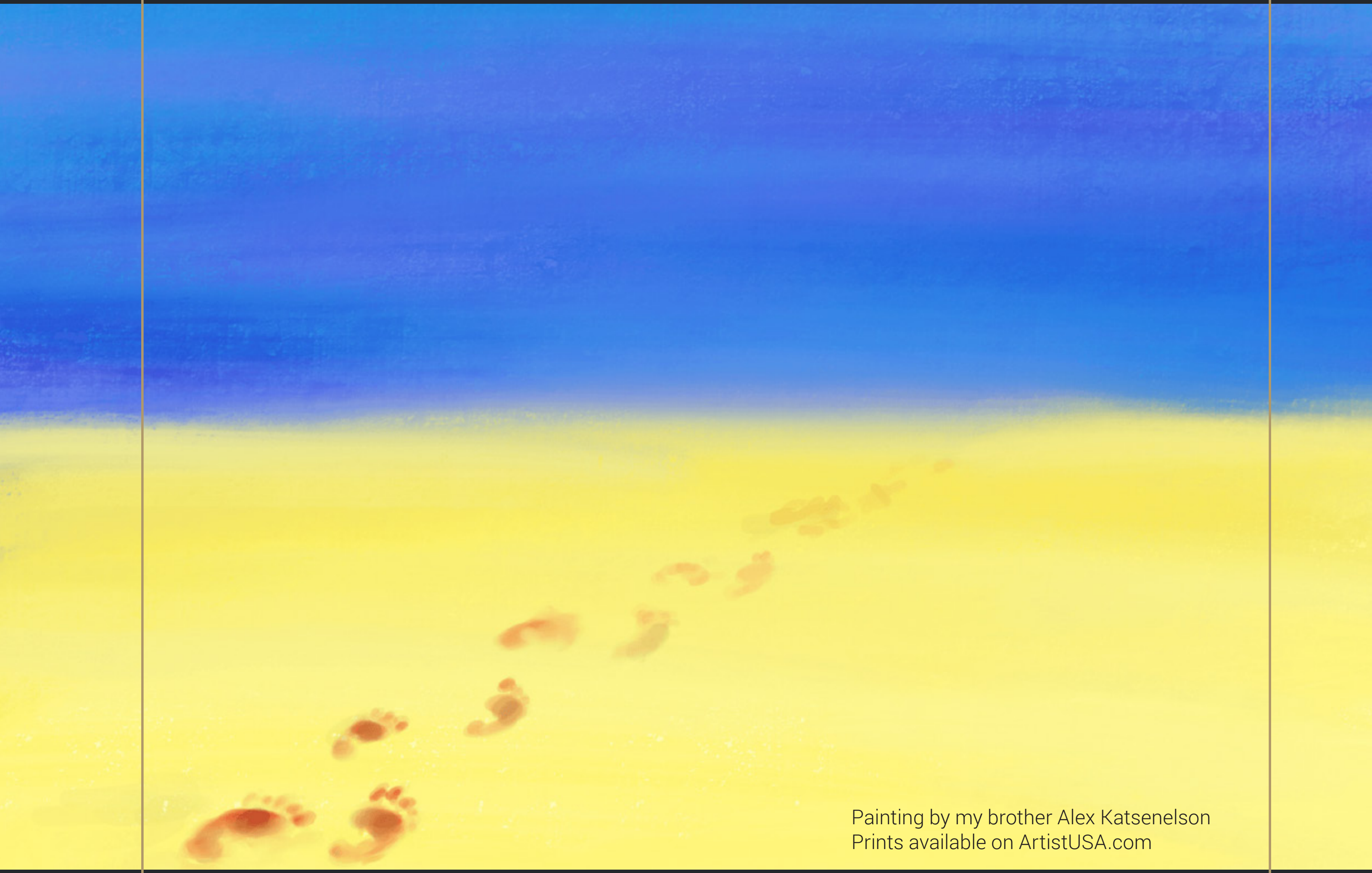
The thinking part of the populace, who understand what is going on and are against the war, are going out onto the streets and protesting or are too afraid to do so. As of this writing, more than 2,000 peaceful anti-war demonstrators have been arrested. Any appearance, even a pretense, that Russia is a democracy is gone. The mask is off.

Post-Script:

As I was working on this article, though it is about Russia and Ukraine, I realized how lucky we are in the US. With all our problems we still have a fully functioning democracy. We have a free press. It is biased, but it is free. Without a free press we will have tyranny. I really did not appreciate that as much as I do now.

Also, I realized the beauty of our federal system. Russia is almost destined to oscillate between democracy and authoritarian control. It is a very large country with a very diverse population that has different value systems and cultures. When you try to govern it from the top, you quickly discover that you have little control. In the early 2000s, at Putin's request, Russia switched from locally elected governors to Putin-appointed governors, consolidating power not at the state level but at the top, with Putin. Putin's argument was that local governors were corrupt. In truth however, the only way to govern Russia and preserve democracy is to have a US-like system. The federal government provides basic services –defense, interstate police (FBI), the legal system, etc. The majority of decisions are made on the local and state levels, based on the needs and values of those entities.

My Russian school friends and I were reminiscing about our school years. We started asking, "Where is this person? What happened to that one?" Sadly, we discovered that close to 15-20% of our class has died. None of them were even 50 years old. Most died under 40 from alcoholism. The demographic crisis is real in Russia. There are fewer people alive in Russia than when Putin took office 22 years ago.



Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

War in Ukraine: Part 4 – Are There Neo-Nazis in Ukraine?

Click to listen to a narration of this article

3/23/2022

In his speech declaring war on Ukraine, the (not so great) dictator of Russia, Vladimir Putin, said the goal of his "special operation" was the demilitarization and de-Nazification of Ukraine and ridding it of drug addicts. The goal of demilitarization made sense, at least from Putin's perspective – he wanted a regime change. He'd remove the democratically elected government and install a Russia-friendly puppet government instead, thus expanding the power and influence of the Russian empire.

But de-Nazification?

Putin made it sound like Ukraine is swarming with Nazis. But Putin was not talking to me or my Western readers; this speech was directed to the Russian people. A large majority in Russia is convinced that the Russian Army is doing God's work, removing from power neo-Nazis that were committing genocide in Ukraine and especially East Ukraine (I discussed this in part 3 of this series). To my shock, I found that the majority of my middle school friends in Russia believe this, too.

This was inconceivable to me. How could Ukrainians, who, based on my interactions with them, were culturally indistinguishable from Russians, suddenly became Nazis? I wanted to understand where this neo-Nazis belief was coming from. I spent more time than I'd like to admit reading and watching Putin's propaganda to understand it.

In his speech declaring war on Ukraine, the dictator of Russia, Vladimir Putin, said the goal of his "special operation" was the de-Nazification of Ukraine and ridding it of drug addicts. He'd remove the democratically elected government and install a Russia-friendly puppet government instead, thus expanding the power and influence of the Russian empire. But are there neo-Nazis in Ukraine?

All propaganda usually has a kernel of truth. To understand that tiny kernel of truth about neo-Nazis in Ukraine, we have to go back to the beginning of the 20th century. That century was terribly unkind to Ukraine, just as it was to most European countries. Ukraine found itself caught between two empires, the Austro-Hungarian and Russian, that fought each other and stepped all over Ukraine. Its people were constantly victimized. Ukraine fought the Poles in the Polish-Ukrainian War in 1918. And then the Ukrainians became casualties of both the Red (Bolshevik) and White (anti-Bolshevik) factions during the Soviet revolution.

As the Soviets came to power, things got a lot worse. In the early 1930s about a quarter of the country died from hunger, a catastrophe that went into the history books as the Holodomor or Great Famine. The Holodomor was caused by the "brilliant" policies of Joseph Stalin. Ukraine at the time was a mostly agrarian society – over 80% of the population lived on farms. Stalin's great idea was to collectivize the farms. All land was expropriated from its farmers and put into a collective called Kolhoz (an acronym loosely translated as "collective farm"). Farmers became laborers on the lands they used to own. Those who refused to give up their farms were called "kulaki" (which translates as "tight-fisted") – they were shot.

When everybody owns everything, nobody owns anything. You are not going to have soul in the game when you labor for the collective good, an abstract concept. Production from the collective farms was drastically lower than when they were privately owned, while Bolsheviks were collecting "the vig," based on pre-collectivization output. Add some bad weather into the mix, Ukraine starved, as millions of people died from hunger (I've seen figures as high as eight million). As an aside, when politicians who never spent a minute running a business come out with social-redistribution or economic policies, think of Comrade Stalin and how his theoretically feasible policies failed in practice and killed millions of people.

In pictures of starved Ukrainians from this era, they look no different from prisoners at Auschwitz. Ukrainians often look at Holodomor as Russian genocide against Ukrainians. I am not a historian, but it seems that Stalin's policies were not directed specifically towards Ukraine but also impacted Russia and Kazakhstan. The Ukrainians were also terrorized and abused by those who collected their wheat. They were often killed if they did not report all wheat that was collected. Needless to say, many Ukrainians looked at the Soviets as oppressors.

I am trying to simplify a very complex history in just a few paragraphs, and I am describing Ukraine as a monolithic country. It is anything but. It is a country that often holds opposite views on issues in different parts of the country. Keep that in mind while reading this.

At the beginning of WWII, when the German Army entered Ukraine, some Ukrainians (especially in the western part of the country) looked at Germans as "the enemy of my enemy is my friend." They welcomed the Germans as their liberators from Soviet oppression. Some joined the Nazis and became their henchmen, exhibiting cruelty similar to that of the Nazis. Russian propaganda will never let you forget that.

Also, today we look at Nazis as heartless aggressors who killed millions of people and perpetrated the Holocaust, and deservingly so. But we have the benefit of hindsight. At the opening of WWII, Eastern Europeans did not know what would ensue. This had not been the experience of Eastern European populations when they dealt with the Germans during the First World War.

I read Sam Zell's wonderful autobiography, Am I Being Too Subtle? Sam's Jewish relatives did not want to leave Poland in 1939. They were not afraid of Germans, because the last time they were occupied by Germany, during WWI, the Germans treated them well. Luckily, Sam's father traveled around Europe and realized that Hitler's Germany was much different from the one twenty years before. Sam's family left Poland hours before their town got bombed by the Germans.

But I still have to stress this point: The majority of Ukrainians, including my grandfather, fought against the Nazis. They were no less brave than the Russians, and many gave their lives to liberate the world from Nazism. Again, Ukraine is a large and diverse country.

Ukraine's dark history gives plenty of material for Putin's propaganda machine to work with. But many countries have dark histories. Let's take the United States, for instance. If Putin's propagandists wanted to convince Russians to invade America to liberate Black people from "racist neo-Nazi White Americans," our history would provide plenty of raw material, too.

Putin's propaganda documentary would start with slavery. It would tell you that the founding fathers of America owned people as private property. It would go on to tell you that racism is embedded in the DNA of our constitution. The documentary would have historians narrating and showcasing the horrible lives African-Americans had in the US for centuries. None of them would be lying. There would be videos featuring the KKK lynching and tar-and-feathering Blacks. The film would show footage from the 1950s—not that long ago—of segregated public facilities with signs "Whites only."

Then the documentary would fast-forward to recent times. You'd see video clips of police shooting Blacks in the back or choking them to death. Or of last year's BLM and anti-BLM protests, like the one in Charlottesville. Then it would mix in some footage of Hitler and then of neo-Nazis marching in Nazi regalia, brandishing torches and giving the "sieg heil!" salute – there are plenty of those videos circulating in the US, too. After you were done watching this film, if you were a kindhearted Russian, your blood would boil with anger and disgust toward White Americans.

This propaganda video would carefully filter out any positive developments that have happened in our country in the past century: the civil rights movement, the end of segregation, and general public outcry from all corners of our society against anti-Black racism. It would not show that as a country we progressed, we changed, we improved.

The propaganda machine would not stop with one documentary. Russian TV would feed you little clips of White Americans exhibiting neo-Nazis tendencies several times a day on the one and only government news channel. Marketers know that for you to remember a message and then to believe it, it has to be repeated many times. The propaganda machine would bring a Hubble telescope to bear on every racial injustice that has ever been perpetrated in our country. It would magnify them so much that if you had never been in the US, you would believe that Black people are so oppressed today that there is little difference between their treatment by White Americans two hundred years ago and today. I am in no way glossing over the many glaring and painful examples of racism in our current society. But, by the time Russian propaganda was done with you, you'd be convinced that Black people are afraid to go grocery shopping and that White Americans all wear KKK hoods instead of baseball caps.

Russian propaganda doesn't stop at just dredging up dark history that has little semblance to current reality. It makes up stories and stages fake events. Let me give you a very real example from Ukraine. After I wrote part 1 of this series, a reader from Russia sent me a video with the subject line "And you say there are no neo-Nazis in Ukraine." I watched the video, and I could not believe my eyes. Then I googled and found several reputable newspapers writing about it. Here is what The Times of Israel wrote about it:

"[The video shows] shoppers climbing up and down the staircase [in a shopping mall in Kyiv], whose middle-section stairs feature a large swastika locked in a white rhombus encircled by red, similar to Nazi Germany's flag. The street where the shopping mall is located is on the street named for Stepan Bandera, a Ukrainian nationalist who briefly collaborated with Nazi Germany in its fight against Russia."

Note the Stepan Bandera reference; it is important. I will address him soon.

I kept looking and found the same story everywhere. And then I found an explanation of what had happened:

"The LED stairs of the "Horodok" shopping mall in Kyiv lit up with a giant swastika for a few minutes on 16 February 2019. The shocking display bewildered shoppers, and after several minutes, security turned off the power of the LED lights. Horodok's management apologized for the incident and claimed their computers were hacked."

We will never know whether the LED display was hacked by a Russian disinformation operation or Ukrainian neo-Nazis. The point is, this video would have you believe that a gigantic Nazi swastika in a shopping mall in the center of Kyiv is just another day in Ukraine. Of course, it is anything but. Displaying swastika is a crime in Ukraine. The same newspaper I quote above wrote the following: "On 21 February, Ukraine's security service opened a criminal probe into the swastika show under p.1 of article 426-1 of Ukraine's criminal code, which prohibits propaganda of Nazi and Communist ideology."

This is just one of many examples where Russian propaganda tries to portray Ukrainians as neo-Nazis.

We cannot discuss the topic of neo-Nazism in Ukraine and not discuss Stepan Bandera. You hear Bandera's name on Russian TV nonstop. In fact, they'll call Ukrainians "Banderovtsi," which means, to them "Russia- and Soviet-hating, Jew-killing neo-Nazis."

Stepan Bandera fought for the independence of Ukraine and became the head of the Organization of Ukrainian Nationalists (OUN) in 1933. He orchestrated the assassination of the Polish minister of the interior, for which he was sentenced to death. The Nazis invaded Poland and Bandera escaped from prison.

Bandera collaborated closely with Nazi Germany. The Nazis led him to believe that Ukraine would get its independence under German rule. The Nazis broke their promise shortly after the invasion of Ukraine. Afraid that Bandera would start a revolt against Germany, they arrested him in June 1941. Bandera spent most of WWII in a German concentration camp. While he was there, his organization, OUN, fighting on Germany's side, committed atrocities against Russians, Jews, and Poles, murdering as many as 100,000 people. Bandera was assassinated by the KGB in 1959.

Jewish people suffered from pogroms (organized massacres) all over Europe for centuries. Most governments throughout Europe either encouraged it or closed their eyes. Ukraine was not any different. However, Lenin put in place an anti-pogrom policy. This is why a lot of Jews joined the Soviets. Since Soviets were the enemy, and thus so were Jews, this gave Ukrainians another reason to hate Jews. (Being Jewish, the first reason still escapes me.) Here is what Bandera said about Jews: "The Jews in the USSR constitute the most faithful support of the ruling Bolshevik regime, and the vanguard of Muscovite imperialism in Ukraine." I hate finding a nuance in someone hating a race (my race), but his hatred of Jews was very different from Hitler's belief that "Jews are an inferior race."

When we discuss Bandera we need to define two terms, nationalist and patriot. We are entering into the murky entrails of social science. Patriotism often carries a positive connotation and nationalism a negative one, though until the 20th century they both meant the same thing. They have a common core: love of and dedication to one's country. A patriot wants sovereignty for his country. A nationalist is often patriot who believe in the superiority (exceptionalism) of his or her country or race, as was the case with the Nazis). A lot of nationalists will tolerate minorities as long as they don't interfere with the majority – that was the case with Bandera. Nazis are a modern example of an extreme case of nationalism. However, the lines between the two terms often get blurry, as you'll see.

Was Bandera a nationalist or a patriot? We know he wanted an independent Ukraine, as any patriot would. However, since in addition to Ukrainian independence he wanted to rid all other nationalities from Ukraine, that would make him a nationalist. Bandera is a polarizing figure in Ukraine. A third of the country has a negative image of him as a murderous nationalist and a third a positive one as a fighter for Ukraine's independence (I get the feeling those who suffered the most from the Soviets belong to this group). He is unpopular in Eastern Ukraine (the territory closer to Russia) and very popular (a 76% favorable rating) in Western Ukraine.

In 2015, Ukraine passed a law focused on the de-communization of Ukraine, which resulted in the removal of Soviet monuments and the renaming of 52,000 streets previously named after Soviets, replacing them with the names of Ukrainian historical figures. The law gave a lot of raw material to Putin's propaganda machine. First, Russians, who, just like Ukrainians, suffered huge losses during WWII, are very sensitive to anything concerning WWII. If you want to get into a bar fight with almost any Russian, tell them that the Americans, by opening a second front, helped to win WWII.

Thanks to Russian propaganda reminding them about it several times a day, Russians are insulted by Ukrainians removing from their streets the names of Soviet generals who fought the Nazis. Also, since they see Bandera only as a Nazi sympathizer, they portray this move as Ukraine reverting to its natural state of being neo-Nazi and thus showing its true colors. But here's an important point: This law also banned Nazi symbols.

I tried to discuss this topic with my classmates from Russia. I'd tell them that I understood that they had an issue with Bandera (I am not a fan, either). But I could see how some Ukrainians look at him as the fighter for their independence that this country always needed. This doesn't make Ukrainians automatically neo-Nazis; after all, (paraphrasing Forrest Gump), a Nazi is what a Nazi does.

Irony arises when I ask my Russian classmates, don't you think that what Stalin did to Russians, Ukrainians, and the rest of the Soviet Union was exponentially worse than what Bandera did? After all, Stalin killed twenty million people in the Soviet Union. He beheaded top ranks of the Soviet Army (just like Putin, or any dictator, he was afraid of strong leaders), which resulted in much greater losses of life in the Soviet Union during WWII. I'd tell them, you criticize Ukrainians for naming streets after Stepan Bandera, but Joseph Stalin is in vogue again in Russia and his statues are popping up all over the country. My Russian middle school friends tended to reply that Stalin was a complex, non ordinary individual.

And then there is the Azov Battalion. This name pops up in every other conversation and Putin's propaganda. The Azov Battalion is named after the Azov Sea. It started out as a private militia funded and formed by a Ukrainian oligarch to fight off the Russian invasion of Eastern Ukraine. At the time of its formation the Ukrainian Army was very weak, and the formation of the battalion seemed like an act of desperation. Russians are terrified by this battalion, as it fought successfully in the second assault of Mariupol in 2014. (Mariupol is the city being turned into rubble by Putin's bombing today.) In 2015 the Azov Battalion was folded into the Ukrainian National Guard. It remains one of the best-trained units in Ukraine. I have read reports that the battalion has been trained by the US. Its sole goal is to defend Ukraine from Russia.

There is plenty of raw material here for Russian propaganda. The insignia of the battalion somewhat resembles a swastika, though the battalion denies that. It says that it derives from a Ukrainian symbol that dates back to 1918. Call me a skeptic. More importantly, at one point as many as 20% of its members identified themselves as neo-Nazi sympathizers.

I struggled with Azov for a long time, and then had this insight: Imagine my neighborhood is overrun by invaders (zombies, if you like). My next-door neighbor is a neo-Nazi, wears a Nazi swastika, lights a candle every day to Adolph Hitler, and bakes a cake for Hitler's birthday. We, my neighbor and I, take up arms to fight these invaders, who are determined to kill our families. At this point I don't care what beliefs my neighbor holds, I just want to make sure he has a gun and knows how to use it. We don't share the same values (an understatement), but at this point we are united by the same goal. My neighbor may be a nationalist, he may think our neighborhood is superior to others (though he doesn't do anything about it), but at this point we are both patriots fighting to protect our loved ones.

This is exactly how I view the neo-Nazi 20% of the Azov Battalion. Today they share the same goal as the rest of the battalion and 100% of the country: Free Ukraine from the Russian invaders who are killing their loved ones and leveling their cities. Also, I have to remind you that the Azov Battalion is a battalion, not the whole army. I've seen numbers that it has 900 soldiers, so in the worst case 180 are sympathetic to neo-Nazis; but the Ukrainian Army has a quarter of a million people, so 180 is a rounding error. Russian propaganda would have you believe that 20% of that battalion is the whole Ukrainian Army.

As much as Russians would love to point to neo-Nazis in the Azov Battalion, they should look at their own ranks. In 2015, Russia (unofficially) sent their military to support Russian separatists in Eastern Ukraine fighting the Ukrainian Army. Putin also sent a Russian neo-Nazi group, the Russian Imperial Movement. I was going to say that Russian-sponsored neo-Nazis are a clear instance of nationalists, not patriots, but then I realized that they are just neo-Nazis thugs hired to kill Ukrainians.

(If you'd like to learn more about the Azov Battalion, these two videos provide an objective overview: one and two.)

"Is there a neo-Nazi problem in Ukraine?" I'd ask my Ukrainian friends (who I was quite certain were not neo-Nazis). They'd be somewhat puzzled by it, as if they had not given it much thought, just as you'd draw a blank look if you asked me or any of my friends in Denver (or most of my readers, probably) the same question about the US. I know I'd be puzzled by it. I see occasional clips on TV of white supremacists having political rallies. There was a tragic shooting at a synagogue in Pittsburgh in 2018, which has now been shuffled in my memory with a dozen of other mass shootings unrelated to neo-Nazis that have happened since. I have read that anti-Semitism is on the rise in the US and Europe. But when my wife and kids and I go to synagogue, I don't worry about our safety. Thankfully.

But then I read that almost one out of ten Americans thinks it is acceptable to hold neo-Nazi views. I don't know a single one of those "one out of ten." I doubt many of my friends and readers do, either. Maybe these "one out of ten" fall outside of our myopic circles (I discussed the concept of myopic circles here) and normal, kind hearted, civilized people don't usually associate themselves with scum (I am not apologetic about it). Or just maybe, those "one out of ten" are around us and they just don't publicize their neo-Nazi sympathies.

In 2019 Ukraine held democratic elections. 73% of the country voted to elect a Jewish president in a country that also had a Jewish prime minister. Ukrainians must be a unique breed of neo-Nazis, as Ukraine is the only country in the world whose head of government and head of state are Jewish (outside of Israel). By the way, in the same election, the far right party got only 2.3% of the vote. So no, Ukraine doesn't have a neo-Nazi problem. Just like any Western country, Ukraine is affected by the neo-Nazi cancer, but it represents only a tiny portion of the society.

I was talking to a dear childhood friend who lives in Russia, and he told me something that stuck with me. He said, "The problem with Russians is, we don't apologize." I didn't understand it at the time, but then I stumbled on this speech by the Ukrainian prime minister to Israel's Knesset in 2015, apologizing to the Jewish people for the role Ukrainian collaborators played in executing 33,000 Jews in less than two days during the Babi Yar in 1941.

That apology will not bring these perished souls back. But it will do two things: It is an admission and it takes ownership of this event. That may sound like a little thing, but it is not. We live in a society where history is written not by the guy with a pen but by the guy holding a gun to the head of the guy with a pen. History is constantly being rewritten – in Russia, Stalin went from being a monster to celebrated hero again in less than two decades. An apology by a president of a country cements truth into the history books. Though it is not a guarantee, it reduces the chances of repeating an atrocity in the future. Neo-Nazis don't make apologies like that.

For the last three weeks, as I was working on this four-part essay series, I deepened my appreciation of so many things we take for granted in the Western world: democracy, free elections, due process, and the rule of law, but especially these two things: freedom of speech and a free press.

Today in Russia, people are put in jail not just for speaking against this war but for simply calling this "special operation" in Ukraine a war. Participating in a peaceful demonstration or posting a picture of killed Ukrainian civilians on social media will also land you in jail. And then there is freedom of the press, which dies without freedom of speech. This is exactly what has happened (again) in Russia.

Propaganda coupled with the dismantling of the free press has created a weapon of mass distraction. This combination is incredibly dangerous; it gives a dictatorial government unlimited power over the mind of its people. It allows the government to precisely curate what people think and thus provides an almost unlimited carte blanche for government actions – this is what allowed the unthinkable, barbaric war against Ukraine.

Propaganda strips away all independent thinking, turning people into mindless drones. Propaganda works by causing our right (emotional) brain to overwhelm our left (analytical) one. The more you "think" with your right brain, the less thinking you do. Over time, emotions evoked by propaganda prevent you from objectively analyzing the subject at hand. You have a hard time telling what is true and what is not. Over time, peer pressure sets in, and it is hard to be the only enlightened one. This is how people get zombified.

I remember watching The Walking Dead – that show about a zombie apocalypse. This moment stuck with me. A husband sees his wife-turned-zombie walking down the street. He runs up to her and tries to talk to this shell of a person. He desperately attempts to appeal to any particle of soul left in the body of what used to be his wife. He cannot get through to her. She is dead. He is talking to an empty shell. Strangely enough, this is the experience I had when I tried talking to Russians zombified by Putin's propaganda about Ukraine and neo-Nazis in Ukraine. This experience is not unique to me. I've read about and met young Russian adults who have had this experience with their parents, who were otherwise intelligent people and still are when it comes to other parts of life.

If you look deep enough into the history of almost any country, you'll find dark, tragic holes in it. But we are not our history. We are not our past. We are what we learn from it. We are our actions today. Ukraine had a tragic and painful history, but unlike Russia, it has learned from it.

Ukraine's fault was that it was a budding democracy right next to a shriveling, dictatorial ex-empire. Putin could not live with the fact that a democracy next door, a country that did not want to live under his thumb, also wanted to embrace Western values. It also dared to attempt to prosper while the ex-empire under his rule became a bit less relevant every day.

The dictator next door needed an excuse to invade Ukraine. The nonexistent threat of NATO seemed like a good one. But it was not enough justification for starting a war and killing people who look just like his own population. He had to dehumanize the people he was about to kill. He convinced his populace that by his bombing cities and killing Ukrainians by the thousands, the Russian Army was doing God's work and de-Nazifying the country – he even threw in the bonus that he'd also get rid of drug addicts. (I'll touch on that next.)

In all honesty, neither an excuse to invade nor his dehumanization campaign really mattered. With the mind control his propaganda has over Russians, given enough time he could have convinced them he was de-Marsifying Ukraine from Martians.

One last note:

In his speech Putin said that in addition to de-Nazification he'd be ridding Ukraine of drug addicts. My close childhood friend told me an interesting story about this. One week into the war, Volodymyr Zelensky was giving an interview to the Western media, and he was falling asleep. For several days Russian propaganda replayed this clip. For several hours a day the propaganda machine paraded an army of psychologists and drug addiction experts to explain to the thirsty-for-knowledge Russian public that this Jewish neo-Nazi (the new kind) was behaving just like a typical drug addict. Of course, any person with just a slight awareness of the situation wouldn't need an army of experts to tell them what was going on with Zelensky – he was terribly sleep-deprived.

But here is where the interesting part comes in. My friend was talking to his mother-in-law. She was telling him how Zelensky is a drug addict. He asked her, "Don't you think he is just short on sleep because his country is at war?" She gave him a puzzled look. He continued, "Where do you think Zelensky is?" She replied, "In Poland, with his family." My friend threw up his hands and said "I give up!" I rest my case.

Putin: The Mask is Off. Europe is Next.

Click to listen to a narration of this article

6/16/2022

This war is not about Ukraine

When Putin started the war, he tried to shift the blame to NATO, calling it the instigator. He argued that Russia had no choice but to defensively launch the war to prevent NATO from surrounding Russia from all sides. Reality, of course, was very different. NATO was a sclerotic, toothless, mission-less defense (not offense) alliance in retirement, collecting its "peace dividend" from the breakup of the Soviet Union. Most of its European members maintained their defense spending below NATO charter rules.

Yes, the US, arguably NATO's most important member, was increasing its defense spending. But Russia was an afterthought in the rationale for this increased spending. Our single focus was on China. Of course, ironically, this offended the sensitive Russian ego. Russians felt that nobody feared and respected them anymore.

Another excuse Putin used to sell the war to Russians was that the mighty Russian army was purifying Ukraine from Nazis and drug addicts. This was a lie. Ukraine has about as many Nazis as any other country in Europe, no more and no less. I wrote a lengthy essay on this topic. And if Putin was really worried about drug addicts, Russia should have invaded San Francisco instead.

A few days ago, Putin finally lifted his veil of pretense. He compared himself to Peter the Great and the war in Ukraine to Russia's 21-year war with Sweden. He said (I am paraphrasing) that Peter had returned land to and fortified Mother Russia, and he added that now it was his time to do the same. Putin openly wants to be Vlad the Great, and Russia looks at Europe as its oyster.

> When Putin started the war, he tried to shift the blame to NATO, calling it the instigator. He argued that Russia had no choice but to defensively launch the war to prevent NATO from surrounding Russia from all sides. A few days ago, Putin finally lifted his veil of pretense: this is a war of conquest.

Most (not all) Russians outsource their thinking to a few TV channels controlled by the government, where they are told what to think by a few propagandists. You may see a parallel between this and some Americans and their favorite TV networks. Take this American image and multiply it by a thousand and you'll get the level of brainwashing of an average Russian. The message on Russian TV is carefully curated by the Kremlin, and you can, for instance, go to jail for calling this war a war.

Russian propagandists packaged Putin's empire-building message so that it seemed not to have come from a shirtless KGB thug but to have come down from Mount Sinai. Suddenly, Russians started looking at themselves as the descendants of Genghis Khan, destined to expand Russia's borders to the old extents of the Tatar-Mongol Empire (basically encompassing all of Europe). The propagandists even started quoting Peter the Great: "We'll take from Europe everything we need and then turn our bare ass to it," And they openly used the threat of nuclear weapons, accompanying their threats with, "It is not our fault that you [Europe] are weak and we are strong."

What in the past was an educated surmise has now become as clear as rain: If not stopped in Ukraine, Putin's Russia will continue its excursion into the rest of the ex-Soviet republics – defenseless Moldova, Belarus (which is already a Russian vassal state), Kazakhstan, Tajikistan, Kyrgyzstan, and others are next.

After Putin is done Frankensteining the Soviet Union back together with countries that are not part of NATO, he may move on to Baltic countries that are NATO members. I know, that is unimaginable. But so was the invasion of Ukraine and a shirtless thug openly discussing his plans to return land to and fortify Stepmother Russia by invading other countries and carelessly threatening the use of nuclear weapons.

This war is not about Eastern Ukraine or even Ukraine. It is about stopping Hitler in 1939 after he had already invaded Poland but before he marched on the rest of Europe.

As Gary Kasparov says, Russia under Putin has turned into a mob state. Mobsters respect strength and feast on weakness. I truly hope that as we start feeling the effects of the war on our wallets and war coverage gradually slips from primetime news to once a week updates, our resolve in supporting Ukraine doesn't wane. Let's be honest; Ukrainians are losing their lives on our behalf. If we don't support them with weapons now, it will be our soldiers fighting the Russian Army in Estonia or Poland in a few years on behalf of NATO.

Ukrainians are fighting for their freedom

It is easy for some people to just look at a map, redraw a couple lines, and say that what used to belong to Ukraine now goes to Russia. That is what French President Macron told President Zelensky: that the West needs to let Putin be spared humiliation and that Ukraine should consider ceding some territory to Russia. This makes my blood boil; it is like asking a rape victim to leave a good review for their rapist on Yelp. Putin completely controls what the Russian people see and what they think. He can create his version of reality, divorced from facts and truth. He does so daily.

Ukrainians are not just fighting for their land; they are fighting for their freedom.

Thanks to Putin's propaganda machine, the majority of Russians believe that Ukraine is on the brink of becoming Nazi Germany. I was talking to my brainwashed middle school Russian classmate, and he was telling me, "Did you see the swastikas tattooed on the Azov fighters who surrendered [after holding out for two months] in Mariupol?" I had not. He continued, "When they surrendered, some of them were shirtless, and you could clearly see that they were Nazis."

I told him that he and his countrymen should look in the mirror.

I'm as reviled by Nazi symbols and beliefs as much as any Jew that had relatives murdered in the Holocaust, but being a Nazi is a lot more than just having a swastika tattooed on your body. It is about what you do and how you act. I paraphrased Forrest Gump: "A Nazi is what a Nazi does". These Azov fighters, despite a tiny minority in their ranks that actually have swastika tattoos, were fighting for the independence of their country against a foe that proclaims it hates Nazis but is in fact a modern Nazi regime.

(I realize that this topic contains an incredible amount of complexity and nuance; to understand it, please read my essay on Nazis in Ukraine).

When we see the Nazi symbol we immediately stop thinking. Our emotions overwhelm us, and with good reason. But let's think about it calmly – what is Nazism today?

It is the most recent, extreme version of nationalism, where one race or country believes it is superior to others and is willing to do any amount of killing to enforce its dominance.

It pains me to say this, but Russia today is sick with its own sort of Nazism. Just as Nazis believed they were the superior race, Russia believes it is superior to Ukraine and other nations. Russia wants to delete the Ukrainian identity, as though the country has no right to exist.

Don't believe me?

This article (you can use Google Translate to read it) is the Russian version of Mein Kampf. It was published by the Russian Information Agency, a state-owned domestic news agency – an information arm of the Kremlin.

"Ukraine, as history has shown, is impossible as a nation state, and attempts to "build" one naturally lead to Nazism. Ukrainism is an artificial anti-Russian construction that does not have its own civilizational content, a subordinate element of an alien and alien civilization.… Further denazification of this mass of the population consists in re-education, which is achieved by

ideological repression (suppression) of Nazi attitudes and strict censorship: not only in the political sphere, but also necessarily in the sphere of culture and education.

Denazification will inevitably also be a de-Ukrainization – a rejection of the large-scale artificial inflation of the ethnic component of self-identification of the population of the territories of historical Little Russia and New Russia, begun by the Soviet authorities."

As Russia captures Ukrainian cities, it immediately starts "de-nazifying" and "Russifying" them. It prevents people from traveling elsewhere in Ukraine and allows them to travel only to Russia (think: the Wall in East/West Germany). It switches the functional currency to the ruble. It starts rewriting history by canceling the Ukrainian curriculum in schools. It wants Ukrainians to forget their culture and their language. Just like a rapist asking his victim to love him, Putin wants to force Ukrainians to fall in love with their new Russian nation.

Ukrainians are not just fighting for their land. They are fighting for the right to speak their own language, for their culture, for freedom of thought, for the right to be part of the West and maintain its liberal values.

My advice to Mr. Macron: If you want to save Putin from humiliation, I have heard that Burgundy is nice in August. Though Russians prefer potato vodka to French wine, they'll adapt, and you can benefit from learning to say "I surrender" in Russian.

On a cheerier note, Ukrainians have chosen the design for a new stamp. It is called "Good evening, we are from Ukraine."

Random Thoughts on the Russian War in Ukraine (Hint: It's Not Going Well for Russia)

Click to listen to a narration of this article

11/1/2022

I wrote two very timely pieces last week: one on housing and one on the Russian invasion of Ukraine. This is the latter; the housing piece is very long, so it will be broken up into two articles. Part one of the housing article will go out this week. But I wanted to share with you this piece on Ukraine today.

What follows are some very, very random, loosely connected thoughts. This is not an article. An article has a beginning and an end, with a conclusion. These random thoughts don't follow that pattern. I am just trying to think through complex issues early in the morning and sharing with you my thoughts.

The following is a loose collection of random thoughts and observations on the Russian invasion of Ukraine. Rather than a coherent article, I offer some insights that have emerged as the war has dragged on.

War in Ukraine outcome

I am cautiously optimistic on the outcome of the war. To win a war you need both will and means.

The Ukrainian will to win increases with every mass grave of murdered civilians uncovered with every liberated Ukrainian village. For Ukrainians, this war is no longer about territory but about survival as a nation – its invader believes Ukraine doesn't have the right to exist (I wrote about that here).

The means of the Ukrainian army have increased substantially over the last few months. In addition to receiving more modern equipment from NATO, when they pushed the Russian army out of Kharkiv Oblast, the Ukrainians enjoyed a larger weapon transfer from the Russian side to the Ukrainian side than NATO had provided to date. Also, Ukrainians know how to use this equipment and can start using it immediately.

I heard a statistic. I couldn't verify it, but the numbers made sense. In the early stages of the war, for every tank or other piece of heavy equipment the Ukrainian army lost, it captured three pieces of heavy equipment. In early summer this ratio fell to 1:1 (when Ukraine lost ground in the East). But in August it rose to 7:1 and it might have been as high as 17:1 in September/October.

Before the war, the Russian army was feared to be the second most powerful army in the world (after the US). Over the last eight months we discovered that it's the second most powerful army in Ukraine.

Putin still has several strategies in his arsenal:

First, win the war by force – this one is not working out so well.

Second, scare the West economically. So far this has not worked. Europe filled up its gas reserves and through economizing, it thinks it can get through the winter.

The last card Putin has left is the threat of nuclear war. From what I've read, tactical nuclear weapons will accomplish very little from a military perspective, but they do have a significant psychological impact. The West has drawn a red line, telling Putin that if he uses nuclear weapons, we'll destroy the Russian army overnight using conventional forces. The Russian army is barely defending Kherson; it is not a match for NATO.

To show how serious we are, the US has moved the 101st Airborne Division to Europe – the last time it was there was 80 years ago. I am not sure if Putin is bluffing, but NATO is not. We are sending a message to other nations, including Iran and North Korea. Also, China is watching this very closely.

The mobilization

The mobilization Putin has enacted may destabilize his regime. As I was growing up in Russia, my parents were terrified of my brothers and I turning 17 and being drafted into the Russian army. The Afghan war was over; Russian parents of boys did not fear for our lives but for our sanity. Being drafted into the Russian army then was like serving a three-year prison sentence. Older soldiers constantly abused younger ones.

I can only imagine the agony Russian parents go through, fearing that their sons will be drafted and, without proper training or equipment, sent to the frontlines within two weeks to become cannon fodder for Ukrainian artillery. Russia has never valued human life (this is something in common with China).

The Afghan war lasted nine years. It resulted in the death of 15,000 Russian soldiers. In eight months in Ukraine, Russia has already lost 71,000 lives. One thousand died in a single day last week.

With every grieving parent, the Russian political system becomes a little bit less stable. It is impossible to tell if or when a spark sets the system on fire, but we are observing something like this in Iran. A young woman died in police custody, arrested for violating the Islamic dress code for women. Her death has sparked protests in Iran for more than a month. It took a long time for the system in Iran to come to this boiling point, but suddenly it has.

Large-scale protests in Russia could happen tomorrow or years from now, but the chances of it happening are exponentially higher with parents living in fear for their sons' futures. And the chances rise higher and higher with every grieving mother. The people who are the most scared of the Russian army today are young Russian men and their parents.

I have many reasons to be thankful to my father for immigrating to the US 31 years ago, and today I have a new one: I don't have to worry about my 21-year-old son, Jonah (who was born in the US) being drafted to die in this senseless war.

The Russian economy

This war has set the Russian economy back forty years. On the surface this Russia looks very different from the Russia of the 80s I remember. This one has beautiful, modern supermarkets which still, to my surprise, are full of food. Due to sanctions and the voluntary withdrawal from Russia of Western companies, Russia will eventually freeze in time. I'm thinking of Cuba when I say this. Cuba looks today the same way it did in 1959 when Castro came to power and the West imposed a trade embargo.

Yes, Russians will miss McDonalds and Coca-Cola, but that is not a great loss; it's probably good for their waistlines and overall health (more of them will be spared from diabetes). But the modern world runs on technology – semiconductors, software, complex manufacturing – and Russia has little of it. Today you cannot build a car or washing machine without semiconductors. This is why Russian auto production is down by half since the war started and washing machine production dropped from 600k units a month to 100k.

A wild card here is China. China has some technologies that Russia needs. For instance, it has antilock brake and airbag technology that Russia needs to restart factories that were "sold" for 1 ruble to Autovaz by Western companies when they left Russia. Russia needs oil drilling equipment, and spare parts for their planes. Will China risk sanctions from the US and Europe by exporting these things to Russia? I don't know. After Visa and Mastercard cut off Russia from their networks, basically preventing Russians from using rubles outside of Russia, China stopped onboarding Russians to their credit card network. The Western economies combined are 20x larger than Russia's economy.

However, the US just banned sales of advanced semiconductor technology to China. This ban sounded like the opening shot of a new Cold War with China. US companies are prohibited from selling not just certain microchips but also their latest versions of chipmaking equipment. A US citizen may lose his citizenship if hired by a Chinese semiconductor company. Our relationship with China is not getting friendlier, which naturally pushes China towards Russia.

The Ukraine war and sanctions turned Russian weapon exports into a thing of the past. First of all, sanctions have crippled Russia's ability to produce enough weapons to fight its war. Modern missiles require semiconductors, which Russia has a hard time getting (though I have a feeling they'll smuggle some in).

Second, today Russia needs every weapon it can get its hands on to replace the ones it lost over the last eight months. It has already resorted to using tanks from the 1970s. Finally, this war has been a sad infomercial for Russian weapons. India used to import half of its weapons from Russia. Now, the US and Europe will likely become the sole providers of weapons to India – another tailwind for defense contractors (we own plenty of those). After the war is over, Russia will be selling its weapons to rogue regimes like Iran and North Korea, but the market for its weapons has shrunk considerably since February 24th.

Until the war, the Russian economy was doing fairly well. Russians shouldn't thank their leaders for this, but give a warm hug to their neighbor to the East. China's insane growth (by any modern standard) drove demand for all commodities (China is a commodity-poor nation). Prices of most commodities have gone up a lot, and one-trick commodity pony Russia benefited from it. Putin jumped right aboard and took the credit for the economic rebirth of Russia. (Any smart politician does that. I see American politicians do it all the time – just follow the Twitter accounts of the last three presidents.)

However, other than mastering the production of commodities and food with the help of Western technologies, Russia has achieved very little over the last three decades since I left it for the US. Russia even imported from Germany the steel it used to make its tanks. Sanctions will likely have a significant crippling impact on the economy. We ain't seen nothing yet.

Starting in December, Europe and the US will stop buying Russian oil. There will be a cap placed on its price – I hear it will be $60/barrel. If India or China pays more than the cap, it will face secondary sanctions from the West. India and China will embrace this chance to buy oil at below-market prices.

It is unclear what will happen to Russian production of natural gas. Most of it has been pipelined to Europe. This gig is over. The majority of oil and natural gas extraction in Russia takes place in very cold (permafrost) areas. Once you stop production, the wells freeze and it takes an enormous effort to restart them. Russia will still be selling oil, but it will have to accept any price it can get. But what is it going to do with its natural gas? Even if it builds another pipeline to China, that will take years.

Also, Western oil companies have left Russia. In addition to providing capital, they brought technology and knowhow. Both are now gone. Russia is the third largest producer of oil, behind the US and Saudi Arabia, producing 11 million barrels a day. The recession that we are going to find ourselves in will reduce demand for petrochemicals, though not by much. (Historically, recessions have reduced the rate of growth of demand for petrochemicals but did not lead to declines.) The supply of oil and natural gas from Russia will not be growing and will likely be shrinking. Europe will have a challenging winter, but it appears that the Russian economy will be challenged just to survive.

The Future of Russia

The political setback from this war has been even greater for Russia than the economic toll – it has rolled back the clock 80 years. Overnight, the country has started to resemble Stalin's Russia. Any unkind word about the war or the Russian army lands people in jail. It is a matter of time before people start telling on each other and Russia starts reopening gulags.

History provides conflicting lessons on how long Putin will stay in power. Castro and Sadam Hussein were in power for decades. Castro peacefully died in his bed, and Sadam would have ruled Iraq for another 30 years if the US had not "liberated" it.

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2004 was probably the most important year in shaping the direction of the rest of my life – I started writing. First I wrote for TheStreet.com, but I couldn't sit still, and so I wrote for almost every major financial publication you can imagine, from *The Financial Times* to *The Christian Science Monitor* and *Barron's.*

Writing forced me to think exponentially more than I had thought before and accelerated my growth as an investor and human being. If the articles in this almanac have helped your thinking too, go ahead and subscribe to my newsletter here. You'll receive both articles fresh off the press as well as older pieces that are still relevant today.

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Painting by my father Naum Katsenelson
Prints available on Katsenelson.com

INVESTING

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How to Invest When There's Nowhere to Hide

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1/6/2022

I was having lunch with a close friend of mine. He mentioned that he had accumulated a significant sum of money and did not know what to do with it. It was sitting in bonds, and inflation was eating its purchasing power at a very rapid rate.

I was having lunch with a close friend of mine. He mentioned that he had accumulated a significant sum of money and did not know what to do with it. It was sitting in bonds, and inflation was eating its purchasing power at a very rapid rate.

He is a dentist and had originally thought about expanding his business, but a shortage of labor and surging wages turned expanding into a risky and low-return investment. He complained that the stock market was extremely expensive. I agreed.*

He said that the only thing left was residential real estate. I pushed back. "What do you think will happen to the affordability of houses if – and most likely when – interest rates go up? Inflation is now 6%. I don't know where it will be in a year or two, but what if it becomes a staple of the economy? Interest rates will not be where they are today. Even at 5% interest rates [I know, a number unimaginable today] houses become unaffordable to a significant portion of the population. Yes, borrowers' incomes will be higher in nominal terms, but the impact of the doubling of interest rates on the cost of mortgages will be devastating to affordability."

He rejoined, "But look at what happened to housing over the last twenty years. Housing prices have consistently increased, even despite the financial crisis."

I agreed, but I qualified his statement: "Over the past twenty, actually thirty, years interest rates declined. I honestly don't know where interest rates will be in the future. But probabilistically, knowing what we know now, the chances that they are going to be higher, much higher, are more likely than their staying low. Especially if you think that inflation will persist."

We quickly shifted our conversation toward more meaningful topics, like kids.

It seems that every year I think we have finally reached the peak of crazy, only to be proven wrong the next year. The stock market and thus index funds, just like real estate, have only gone one way – up. Index funds became the blunt instrument of choice in an always-rising market. So far, this choice has paid off nicely.

The market is the most expensive it has ever been, and thus future returns of the market and index funds will be unexciting. (I am being gentle here.)

You don't have to be a stock market junkie to notice the pervasive feeling of euphoria. But euphoria is a temporary, not a permanent emotion; and at least when it comes to the stock market, it is usually supplanted by despair. Market appreciation that was driven by expanding valuations was not a gift but a loan – the type of loan that must always be paid back with a high rate of interest.

I don't know what straw will break the feeble back of this market or what will cause the music to stop (there, you got two analogies for the price of none). We are in an environment where there are very few good options. If you do nothing, your savings will be eaten away by inflation. If you do something, you find that most assets, including the stock market as a whole, are incredibly overvalued.

This is why what we do at IMA is so important.

We are doing the only sensible thing that you can do today. We spend very little time thinking about straws or what will cause the music to stop or how overvalued the market is. We are focusing all our energy on patiently building a portfolio of high-quality, cash-generative, significantly undervalued businesses that have pricing power.

This has admittedly been less rewarding than taking risky bets on unimaginably expensive assets. It may lack the excitement of sinking money into the darlings you see in the news every day, but we hope that our stocks will look like rare gems when the euphoria condenses into despair. As we keep repeating in every letter, the market is insanely overvalued. Our portfolio is anything but – we don't own "the market".

If you'd like to better understand how we determine the quality of a business and find stocks that are undervalued, check out the 6 Commandments of Value Investing.

*A question may arise: Why did I not tell my dentist friend to pick individual stocks? He runs a busy dental practice and wouldn't have the time or the training to pick stocks. Why didn't I offer him our services? IMA manages all my and my family's liquid assets, but I have a rule that I never (ever!) break – I don't manage my friends' money. I'll help them as much as possible with free advice but will never have a professional relationship with them. I intentionally create a separation between my personal and professional lives. After a difficult day in the market, I want to be able to go for beers with friends and leave the market at the office. Also, this simplifies my relationships with my friends. There is no ambiguity in our friendship.

I Kid You Not Crazy

Click to listen to a narration of this article

1/13/2022

We all played this game when we were kids. You say a number. Your friend tries to demonstrate his knowledge by saying a bigger number. At some point you proudly get to infinity – the largest number of all. Your friend doesn't blink; he says, "Infinity times a hundred," then he thinks for a second and spouts out, "Infinity times infinity!" How do you beat that? When assets get overvalued and get into crazy territory, explaining their overvaluation feels like playing this "infinity times infinity" game. But at least, if we line up different crazy valuations next to each other, it is going to be easier to distinguish levels of craziness.

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Let's start with the least crazy of all the crazies – bond-substitute type stocks.

In this example I'll focus on Coca Cola, but I could have written this about almost any consumer goods company – the likes of Kimberly Clark, McCormick, WD-40, and many others that pay a stable dividend.

Coca Cola has been spreading joy (and diabetes) globally since 1886. It is truly an incredible business: the company makes a concentrate and ships it to bottlers, who put in the hard capital, bottle that syrup, and distribute it to every corner of the world. Coke, in concert with its bottlers, has the best distribution system in the world.

Since bottlers do all the heavy lifting, this business earns a very high return on capital. Coke is one of the most beloved brands in the world (unless you are a Pepsi person). This company has experienced incredible growth over the last century. However, unless Coke gets penguins at the South Pole to consume its fine bubbly, it has run out of new markets to sell into. This is exactly what has happened to Coke since 2010 – its revenues and earnings have stagnated. If you look at its financials, only two things have grown: its dividend (due to an increased dividend payout) and its debt – which has tripled.

Coke is a high-quality company – it can raise prices along with inflation on its namesake product, which is about half of its revenue. It may struggle to do this on other more commoditized parts of its product portfolio, but nobody questions whether Coca Cola will be around in ten or twenty years. Most importantly, investors are convinced Coke will continue to manufacture its 2.6% dividend till the end of time. They are so focused on the shiny object – the dividend – that they are ignoring how much they are paying for this seemingly endless income stream. Mr. Market will let you have Coke today at 30 times earnings.

But.

What happens to Coke's stock price if interest rates dare to go up? Coke's 2.6% "infinite" dividend will not be so shiny when interest rates go up a few percentage points. If the 10-year Treasury is yielding 5%, Coke's dividend will lose its luster and the stock will decline to a valuation multiple with a "1" in front of it. Today, many Coke shareholders are experiencing what behavioral economists call the "empathy gap." They tell themselves, "I am fine even if the stock declines 30–50%. I will stick with getting my 2.6% dividend, which will rise with inflation." However, when the stock price declines and safe alternatives offer double the yield, they'll change their thinking – thus the gap.

Side note: Dividends don't need to be a shiny object that lead you to eventual financial ruin if/when interest rates rise. Just change the sequence of your analysis. Here is what we do at IMA in dividend portfolios: We identify the universe of stocks in the US and other countries that pay stable dividends, but only the ones that are both high-quality and undervalued end up going into the portfolio.

Coke is a lightweight on the crazy spectrum. The degree of crazy will increase with each further example, culminating with smelly, hot air, I promise.

The next one is Tesla. I've spilled a lot of ink on this company. I even wrote a series of essays that I turned into a small book (you can get it here). I love my Model 3. Almost three years after I bought it, I still enjoy driving it, and I am not even a "car guy." We are about to get my wife a Tesla. I like a lot of things about the company.

But.

The stock is a very different matter. An important lesson that many tech investors learned after the bursting of the Dotcom 1.0 bubble in 1999 and the Dotcom 2.0 bubble in 2021 is that there is a difference between a good company with great products and a good stock. The connecting tissue between the two is valuation. The price you pay determines your future return. The price did not matter when valuations were rising. It will when they aren't.

Tesla arguably has the best EV on the market. Customers love its products. This is not a little thing. Unlike the Detroit Three, the German Three, and the Asian Five, which spend tens of billions on advertising, Tesla has zero advertising budget. Hundreds of thousands of its fanatically loyal customers are its marketing force. Most car companies don't have that type of goodwill. These billions of dollars of savings Tesla can put into more R&D or lower prices or higher profitability.

But.

Tesla has a market capitalization of a trillion dollars, or roughly equivalent to what the whole rest of the global auto industry is worth. When it was at half a trillion dollars (half an infinity ago), I described its valuation as "discounting a temporal wormhole into the future." Today it is priced at double infinity.

Let's move on to the next level of crazy.

GameStop is in the hands of self-described "apes" that are standing for the little man against the corrupt system and are willing to blow themselves up financially while propping up the prices of worthless companies. GameStop is a retailer of packaged games while the world is moving to digital downloads – a tsunami that is going to wash away this brick-and-mortar retailer. At its peak in 2016 the company made $400 million of profit. Its revenue has declined by half since and it is losing money. The apes are pricing this dying relic at a $10 billion market cap. Its valuation is at almost an all-time high, when its financial situation is at an all-time low. Imagine you won a $10 billion lottery. Would you invest it in an imminently melting, money-losing ice cube whose revenues will eventually dwindle to zero?

GameStop makes Tesla look like a value investment. At least Tesla is a company of the future.

Of course, there is another "ape" stock – AMC, the movie theater chain. AMC has often lost money throughout its existence; before the pandemic it made $110 million. Its revenues are down by two thirds since then, while its share count is up 4x and debt is up 5x. Today, after the stock has declined by 50%, you can have this darling for only $11 billion, and it comes with $10 billion of debt. At least GameStop has a net cash balance sheet.

Then there is the crypto universe insanity. I've spilled a ton of ink on Bitcoin in the past, but I'd like to point out again that there are thousands of competing cryptocurrencies fighting for dominance. For Bitcoin maximalists, Bitcoin is their only lord and savior and all other cryptos are heretics. Many, however, believe that Bitcoin is an inferior, crypto-stone-age type of technology and that new, technologically advanced alternatives are better (thus the thousands of cryptocurrencies). As I am typing this, it dawns on me that arguments about which cryptocurrency is superior are not unlike medieval debates about which religion is better. We all know which one. Unlike religious debates and ensuing wars, the crypto debate will end quite peacefully, with people losing money.

Since cryptos have no cash flows, I have no idea what their value is. However, considering that prices of all speculative assets have skyrocketed recently (just look around you), my gut sense tells me that the price of cryptos today reflects an overabundance of both optimism and easy money.

But.

Then we have the whole new level of crazy: NFTs (nonfungible tokens). You put a drawing of a flying monkey or a happy goat on a blockchain and you have got priceless, “finite,” “nonfungible” art. NFTs of apes that happened to be bored are selling for hundreds of thousands of dollars.

My son Jonah, a student at CU Boulder, told me that many of his friends are making money in NFTs, and most importantly, they’re bragging about it. They have suddenly become connoisseurs of digital art.

Jonah told me about the latest and greatest NFT: Ozzy Osborne of Black Sabbath fame recently decided to become a crypto artist and will drop “only” 9,500 drawings of bats, which Ozzy calls “crypto bats.” To get Ozzy’s art at a “wholesale” price, you must go on his discussion board and tell the world how much you love it. If you do this enough then board moderators may let you buy it at wholesale, so you can flip it to a greater fool at “retail,” who’ll try to flip to another even greater fool for a higher price after he brags how much money he made on NFTs, which are our digital future! Jonah asked me, “Dad, is that not by definition a pyramid scheme?” I am a proud parent!

As I am typing this I have caught myself wanting to say, every other sentence, “I kid you not.” So maybe we’re approaching the pinnacle of crazy.

When I discuss Coke, its overvaluation is not an abstract concept; it is quantifiable in brush–stroke terms. Even Tesla’s overvaluation is not entirely abstract – you are paying more for a company that produces a million cars a year than the rest of the industry that produces 40–50 times more cars.

Everything beyond that, from GameStop and AMC to crypto and NFTs, might easily be worthless and thus quickly turns into an abstract discussion. How much will Ozzy’s crypto bats be worth when the last college kid blows his tuition on them? I have an answer for you: zero! When zero is priced in relation $300 or $30,000, it is overpriced by infinity; in either case the loss is 100%. Actually, in many cases the losses will be greater than that. What we learned from previous bubbles is that greed and FOMO eats people from the inside and causes them to resort to leverage. Leverage ruins people's lives, and it has never been easier to borrow money than it is today. Sadly, a lot of people who are beating their chests and bragging how much money they are minting today will lose their temporary gains and a whole lot more.

The ultimate prize for crazy goes to Stephanie Mato – actually, not to her but to the people who spent $200,000 buying her farts in a jar. Stephanie had to make a personal sacrifice in order to produce them, resorting to an unhealthy, gas-producing diet. She had a mild health scare and decided to quit, but don't worry (I kid you not), she is now making NFTs.

McKesson: Why the Best is Yet to Come

Click to listen to a narration of this article

1/20/2022

We have owned McKesson and its competitor Cardinal Health a few times over the last twenty years. This time around, we bought McKesson in November 2016 when the stock almost halved from a previous high. Going into 2015, MCK's business was overearning; it was benefiting from patent expirations of branded drugs. As a patent expires, a generic drug company that challenges the branded patent and drug distributors makes temporarily high profits for six months. In 2014–2015 there was a tsunami of branded drugs going generic.

What we have today in MCK is the largest drug distributor in the US, with a very stable and growing business. It is very cash-generative, doesn't need much capital to grow, and has a very high return on capital. Owning the stock was very stressful at times but also very rewarding. But the best is yet to come for MCK.

In 2015 MCK was owned by growth investors that were looking for a continuation of double-digit earnings growth and price-to-earnings expansion. In 2016, earnings did not expand but contracted, and growth investors ran for the exits. The stock collapsed. This is when we made our first purchase (in this most recent ownership period). Our rationale was simple: We normalized (lowered) MCK's margins to pre-branded expiration levels, and the stock looked attractive. There was a lot to like – three drug distributors (McKesson is the largest) control over 90% of the drug distribution market. All three distributors are at scale and none has a competitive advantage against the others, thus none has a reason to start a price war.

Our thesis started to play out. Earnings stopped declining and were about to start growing, and then… Amazon announced that it was entering the retail pharmacy space. MCK stock dropped, and we added to our position. The market had misunderstood the industry structure. Amazon was not going to be competing with McKesson. McKesson has highly specialized warehouses; in fact, it is the Amazon of drug distribution. Amazon will be selling drugs online, and it doesn't have and most likely is never going to have enough scale to be a formidable competitor to a major drug distributor (read my article).

Our thesis began to prove out. The market started to agree with us, and then…

States sued drug distributors for their complicity in the opioid epidemic. I wrote a lengthy article on this topic. Bottom line: Drug distributors were not responsible for the opioid crisis, but they were the largest identifiable entity, and thus they got sued. The drug distributors could have fought and probably would have won, but the lawsuits would have been a long haul, and thus they have settled with the states.

The opioid mess is mostly behind us. What we have today in MCK is the largest drug distributor in the US, with a very stable and growing business – revenues are growing about 3–5% a year (depending on the level of inflation, maybe even higher). It is a very cash-generative business, doesn't need much capital to grow, and has a very high return on capital. McKesson has a significant competitive advantage against new entrants. It carries very little debt.

Owning the stock was very stressful at times (this is how opportunities are created) over the last few years but also very rewarding. After accounting for about $25 we made for McKesson's distribution of shares in Change Healthcare last year, MCK returned about 15–20% a year (this number will vary from client to client).

But the best is yet to come for MCK.

As of this writing MCK is a $220 stock. Its immediate earnings power is around $21 (up from $13–15 at the time of our first purchase). Historically, MCK has traded at about 15–17 times earnings, which would suggest the potential for a $315–350 stock price. The combination of revenue growth and share buybacks should result in high single-digit earnings growth. In four years, we get earnings of about $27–30, which gives us a price of about $400–500.

McKesson is a perfect business for the uncertain environment that lies ahead of us. The demand for its product is not dependent on the whims of the global economy. It can pass price increases on to its customers.

Pause for a second and ask yourself a question: How does the silliness of the stock prices of AMC, GameStop, or some overpriced electric vehicle company impact McKesson? It doesn't.

Why Green Energy is a Luxury Belief – But Won't Be One Forever

Click to listen to a narration of this article

1/27/2022

Question: How is our portfolio going to be impacted by the transition to new "greener" energy sources? (VK: I rephrased the question.)

Answer: The transition to "green" energy will be rocky, expensive, and not-so-green – our CO_2 emissions will likely go on rising. The beauty of being in my seat: IMA clients are not paying me for political views or political correctness. I am getting paid for pragmatism. Let me make this point clear – I want clean air and I don't want temperatures to rise. Really, my coworkers at IMA put a parka on when they come into my 65 degree overly-air-conditioned office. Spending the formative years of my life in Murmansk, a city located above the Arctic Circle, where the ground was permafrost, must have rewritten my DNA. As you can see, I have personal reasons not to be a fan of global warming. I also very much want to leave a better planet for future generations.

Now that I have hopefully convinced you that "Big Oil" is not my middle name, let's discuss a topic that should not be politically sensitive but somehow is – energy.

Solar and wind are not good sole sources of energy – they are intermittent, relying on the kindness of Mother Nature, who is temperamental and not always kind. To compensate for this weakness in our green sources, when Mother Nature takes a break, we need either cheap and ample batteries (we have neither), or to turn on peak demand power plants that run on natural gas (if we are lucky) or coal.

> Being a rich country has allowed us to develop what some call "luxury beliefs" – ideas that make us feel good but that fail upon contact with objective reality. We ignore inconvenient truths about green energy and keep marching on, trying to convert an even larger portion of our economy to wind and solar, without contemplating the related costs. When it comes to electricity generation, luxury beliefs can be dangerous.

Being rich has allowed us to develop what some call "luxury beliefs" – ideas and beliefs that make us feel good about ourselves but that horribly fail upon contact with objective reality. We ignore inconvenient truths about our green energy weaknesses and keep marching on, trying to convert an even larger portion of our economy to wind and solar power.

The US is not the only country that is inhibited by luxury beliefs. Take Germany for instance. After Japan's Fukushima incident, it gave up nuclear and went "green." Except that “green” was anything but. Germany’s CO_2 emissions went up and so did its electricity prices. Yes, the coal-fired peak power plants that Germany uses to provide electricity on the days when the wind doesn’t blow or the sun doesn’t shine are more expensive and produce more greenhouse gasses than nuclear power plants. Another example, just a few months ago, electricity prices in Europe skyrocketed because (I kid you not), the wind stopped blowing in the North Sea.

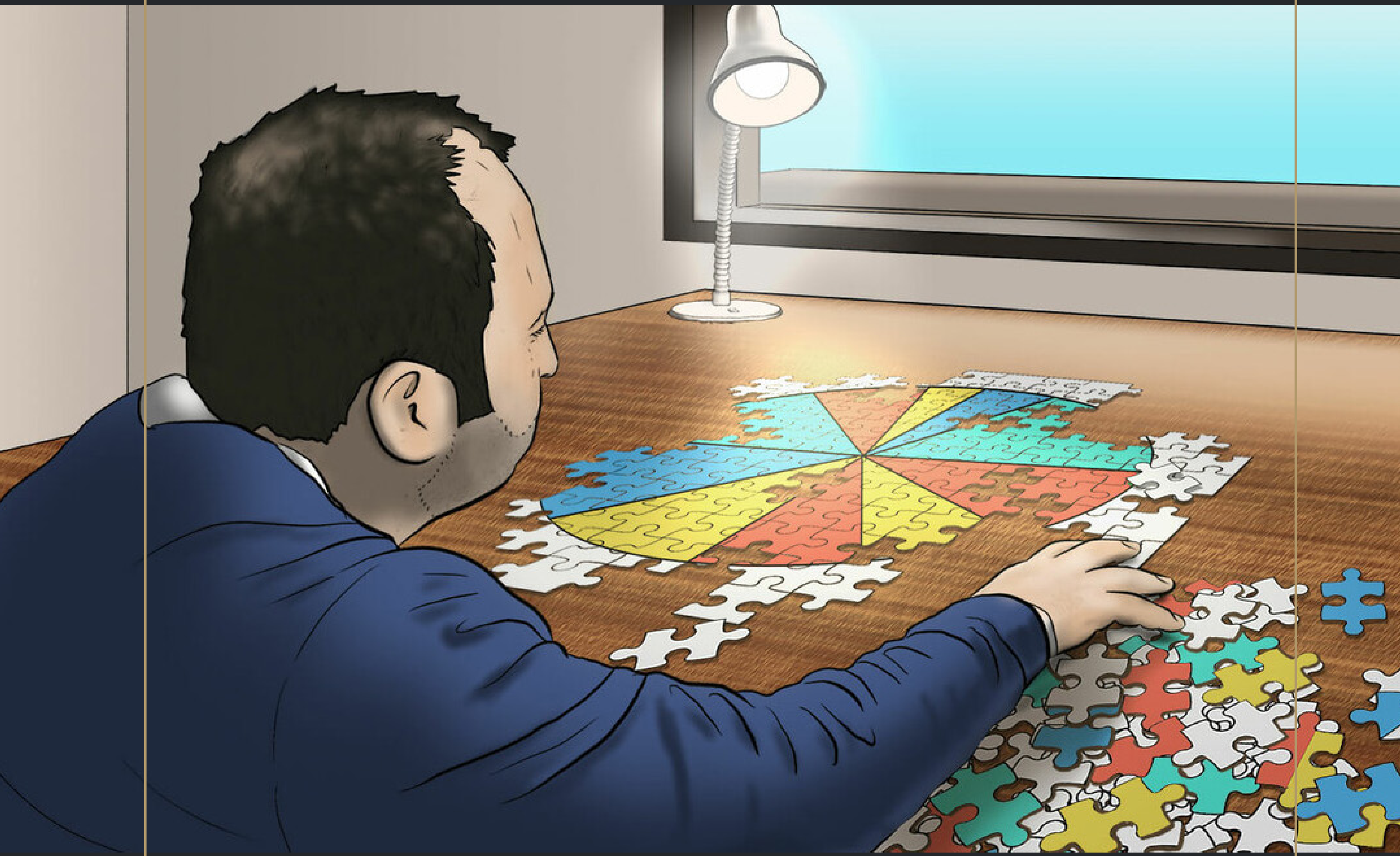
When it comes to power generation, luxury beliefs are dangerous. Electricity is anything but a luxury; it is a necessity. In addition to powering the internet, which allows us to watch cat videos on Facebook, it is what separates our society from our ancestors in the Stone Age. As we keep decommissioning nuclear power plants and going “green,” in the end we’ll go “brown” as our CO_2 levels mount, or in the worst case it will simply be lights out as we are forced to ration power.

China is not as rich as we are and struggles with horrendous air pollution which must be killing tens of thousands of people a year. China cannot afford luxury beliefs; it is pragmatic. It has announced that it will be building 150 (!) nuclear power plants over the next twenty years.

Still, I am optimistic about future greener, more stable sources of energy. Billions of dollars are being poured into research and development of alternatives to fossil fuels. Just as we have seen with Covid vaccines, if incentives are high enough, scientists and entrepreneurs make great efforts and success follows. This is the beauty of capitalism. Unfortunately, for the short run, and fortunately, for the long run, there is a good chance these incentives will only become greater over the next few years, as energy costs globally are likely to skyrocket.

Doubling or tripling electricity bills and $6-9 gas prices will bring pragmatism back and divorce us from luxury beliefs in solar and wind. I have a hunch higher energy prices will trigger more politicians calling for FTC investigations into utilities and energy companies. Politicians know the true cause of high energy costs: the capital cycle (low oil and natural gas prices result in less exploration and production of oil) and their own policies (throwing sticks in the wheels of energy and pipeline companies, decommissioning nuclear power plants, doubling down on wind and solar). Politicians will deflect their responsibility onto “evil big oil.” I really don’t want to come back in my next life as an oil company – I am damned if I produce and damned if I don’t.

These are my thoughts on investing during climate change – in the short run we’ll most likely have higher energy prices, which in the future will bring us more truly green energy.



Position Sizing: How to Construct Portfolios That Protect You

Click to listen to a narration of this article

2/3/2022

Question: How do you construct portfolios and determine position sizing (weights) of individual stocks?

Answer: We have wanted to discuss this topic for a long time, so here is a very in-depth answer.

For a while in the value investing community the number of positions you held was akin to bragging on your manhood– the fewer positions you owned the more macho an investor you were. I remember meeting two investors at a value conference. At the time they had both had "walk on water" streaks of returns. One had a seven-stock portfolio, the other held three stocks. Sadly, the financial crisis humbled both – the three-stock guy suffered irreparable losses and went out of business (losing most of his clients' money). The other, after living through a few incredibly difficult years and an investor exodus, is running a more diversified portfolio today.

Some investors think the fewer positions you own, the cooler you are. I remember meeting two investors at a conference. One had a seven-stock portfolio, the other had three stocks. Sadly, the financial crisis humbled both. On the other hand, too many positions breeds indifference. At IMA, our portfolio construction process is built from a first-principles perspective.

Under-diversification is dangerous, because a few mistakes or a visit from Bad Luck may prove to be fatal to the portfolio.

On the other extreme, you have a mutual fund industry where it is common to see portfolios with hundreds of stocks (I am generalizing). There are many reasons for that. Mutual funds have an army of analysts who need to be kept busy; their voices need to be heard; and thus their stock picks need to find their way into the portfolio (there are a lot of internal politics in this portfolio). These portfolios are run against benchmarks; thus their construction starts to resemble Noah's Ark, bringing on board a few animals (stocks) from each industry. Also, the size of the fund may limit its ability to buy large positions in small companies.

There are several problems with this approach. First, and this is the important one, it breeds indifference: If a 0.5% position doubles or gets halved, it will have little impact on the portfolio. The second problem is that it is difficult to maintain research on all these positions. Yes, a mutual fund will have an army of analysts following each industry, but the portfolio manager is the one making the final buy and sell decisions. Third, the 75th idea is probably not as good as the 30th, especially in an overvalued market where good ideas are scarce.

Then you have index funds. On the surface they are over-diversified, but they don't suffer from the over-diversification headaches of managed funds. In fact, index funds are both over-diversified and under-diversified. Let's take the S&P 500 – the most popular of the bunch. It owns the 500 largest companies in the US. You'd think it was a diversified portfolio, right? Well, kind of. The top eight companies account for more than 25% of the index. Also, the construction of the index favors stocks that are usually more expensive or that have recently appreciated (it is market-cap-weighted); thus you are "diversified" across a lot of overvalued stocks.

We determine position sizing through a well-defined quantitative process. The goals of this process are to achieve the following: Shift the portfolio towards higher-quality companies with higher returns. Take emotion out of the portfolio construction process. And finally, insure healthy diversification.

If you own hundreds of securities that are exposed to the same idiosyncratic risk, then are you really diversified?

Our portfolio construction process is built from a first-principles perspective. If a Martian visited Earth and decided to try his hand at value investing, knowing nothing about common (usually academic) conventions, how would he construct a portfolio?

We want to have a portfolio where we own not too many stocks, so that every decision we make matters – we have both skin and soul in the game in each decision. But we don't want to own so few that a small number of stocks slipping on a banana will send us into financial ruin.

In our portfolio construction, we are trying to maximize both our IQ and our EQ (emotional quotient). Too few stocks will decapitate our EQ – we won't be able to sleep well at night, as the relatively large impact of a low-probability risk could have a devastating impact on the portfolio. I wrote about the importance of good sleep before (link here). It's something we take seriously at IMA.

Holding too many stocks will result in both a low EQ and low IQ. It is very difficult to follow and understand the drivers of the business of hundreds of stocks, therefore a low IQ about individual positions will eventually lead to lower portfolio EQ. When things turn bad, a constant in investing, you won't intimately know your portfolio – you'll be surrounded by a lot of (tiny-position) strangers.

Portfolio construction is a very intimate process. It is unique to one's EQ and IQ. Our typical portfolios have 20–30 stocks. Our "focused" portfolios have 12–15 stocks (they are designed for clients where we represent only a small part of their total wealth). There is nothing magical about these numbers – they are just the Goldilocks levels for us, for our team and our clients. They allow room for bad luck, but at the same time every decision we make matters.

Now let's discuss position sizing. We determine position sizing through a well-defined quantitative process. The goals of this process are to achieve the following: Shift the portfolio towards higher-quality companies with higher returns. Take emotion out of the portfolio construction process. And finally, insure healthy diversification.

Our research process is very qualitative: We read annual reports, talk to competitors and ex-employees, build financial models, and debate stocks among ourselves and our research network. In our valuation analysis we try to kill the business – come up with worst-case fair value (where a company slips on multiple bananas) and reasonable fair value. We also assign a quality rating to each company in the portfolio. Quality is absolute for us – we don't allow low-quality companies in, no matter how attractive the valuation is (though that doesn't mean we don't occasionally misjudge a company's quality).

The same company, at different stock prices, will merit a higher or lower position size. In other words, if company A is worth (fair value) $100, at $60 it will be a 3% position and at $40 it will be a 5% position. Company B, of a lower quality than A but also worth $100, will be a 2% position at $60 and a 4% position at $40 (I just made up these numbers for illustration purposes). In other words, if there are two companies that have similar expected returns, but one is of higher quality than the other, our system will automatically allocate a larger percentage of the portfolio to the higher-quality company. If you repeat this exercise on a large number of stocks, you cannot but help to shift your portfolio to higher-quality, higher-return stocks. It's a system of meritocracy where we marry quality and return.

Let's talk about diversification. We don't go out of our way to diversify the portfolio. At least, not in a traditional sense. We are not going to allocate 7% to mining stocks because that is the allocation in the index or they are negatively correlated to soft drink companies. (We don't own either and are not sure if the above statement is even true, but you get the point.) We try to assemble a portfolio of high-quality companies that are attractively priced, whose businesses march to different drummers and are not impacted by the same risks. Just as bank robbers rob banks because that is where the money is, value investors gravitate towards sectors where the value is. To keep our excitement (our emotions) in check, and to make sure we are not overexposed to a single industry, we set hard limits of industry exposure. These limits range from 10%–20%. We also set limits of country exposure, ranging from 7%–30% (ex-US).

In portfolio construction, our goal is not to limit the volatility of the portfolio but to reduce true risk – the permanent loss of capital. We are constantly thinking about the types of risks we are taking. Do we have too much exposure to a weaker or stronger dollar? To higher or lower interest rates? Do we have too much exposure to federal government spending? I know, risk is a four-letter word that has lost its meaning. But not to us. Low interest rates may have time-shifted risk into the future, but they haven't cured it.

How to Build a Portfolio for Today's Crazy Markets

Click to listen to a narration of this article

2/10/2022

Question: We own a lot of high-dividend-paying companies. How much does the dividend factor into the decision to buy one of these companies?

Answer: In our analysis, dividends are one of the inputs in the total-return calculation.

Total return = stock appreciation + dividends.

To take it a step further, we can break up stock returns into two components: earnings growth and price-to-earnings (valuation) expansion/contraction.

So the comprehensive total-return formula looks like this:

Total return = Earnings growth + price to earnings expansion + dividends

The higher the dividend yield, the less other engines of total return must work.

> We don't know what the stock market will do next. We have opinions and hunches, and we never act on them. We never try to predict the market's next move. Neither we nor anyone else is good at it. The only thing we can do is to trim the sails of our portfolio to align with the winds of inflation.

Question: If the yield is so high and the company is solid, why not use MLPs as a cash position.

Answer: Let me answer this question through a very real example. I was extremely comfortable with Tanger Outlets (SKT) in January 2020 when we originally bought the stock. We'd done a lot of work on it. Its dividend was well covered. It was a very high-quality, well-managed REIT. We liked the management a lot. It was run by a second-generation owner-operator. SKT was experiencing short-term, fixable issues. We bought it cheap.

A client reached out to me in January 2020 asking if we should just put all his cash in SKT. I advised against it. I told him, "Risk happens," and SKT is not a riskless security.

And then… the pandemic knocked on our door, shopping malls closed, SKT had to cut its dividend, and the stock collapsed. It was a 3—5% position, and we added more to it when it declined and came out fine at the end. Imagine, though, if we had used SKT as a cash substitute, if it was a 30% position. We would have lost plenty of sleep over it. When you have a diversified portfolio of stocks, there is some safety in numbers.

The same logic that applies to MLPs applies to other high-quality dividend stocks. Risk happens. We are comfortable with them in the portfolio setting, but we wouldn't have the same level of comfort if each stock represented a very large portion of the portfolio.

Question: Now that the infrastructure bill has passed, and the Build Back Better bill is being considered, please comment on whether this injection of trillions of dollars into the economy will or will not affect inflation and why.

Answer: Fitch and Moody's think it won't be inflationary, as infrastructure spending will improve productivity. They may be right about the benefits to productivity in the long term. The skeptic in me, however, says it is impossible to add billions of dollars of spending to an economy that is suffering from a deficit of available labor and not see inflation, at least in the short term.

Question: How are we positioning the portfolio for inflation and a potential selloff that it may trigger?

Answer: We don't know what the stock market will do next. We have opinions and hunches, and we never act on them. We never try to predict the market's next move. Neither we nor anyone else is good at it. The only thing we can do is to trim the sails of our portfolio to align with the winds of inflation. We've been doing this.

High-valuation stocks will get destroyed – we don't own any of those. Long-term bonds will not do well, either. Our goal is to have a portfolio of businesses that have pricing power and buy them at great valuations. This has been our single focus, and we are comfortable with how our portfolio is positioned for inflation.

We receive a lot of questions about inflation. I want to refer you to three articles I've written on the topic.

Inflation Update – Not Transitory, Yet
How We Invest in Inflation
Inflation is Here, But for How Long?

An additional thought: Undervalued companies that can raise prices are the best place to be during inflation. Inflation will compress the valuations (price to earnings) of fantastically priced companies. This is less likely to happen to the stocks we own. At the same time, companies will be passing on cost increases, and thus their earnings will get an additional boost from inflation.

Question: Do you have a plan to protect the portfolio if the market goes into a panic free fall?

Answer: There is absolutely nothing we can do to fully "protect" the portfolio if the market goes into free fall. Even if the put options were cheap today and we could hedge, they would still be too expensive to hedge the full portfolio.

Folks that run long-short portfolios might be able to "protect" a portfolio through their short book by betting on the decline of some stocks. However, I have many friends who run long-short portfolios or short-only portfolios, and they have been in a world of pain for many years. They'd go long common sense (what we do) and short insanity. What they have discovered is that in the short run insanity has no bounds. The problem when you are short "insane" stocks and they double or triple on you is you're in a world of immeasurable hurt. That the short run turns into the long run because you have to cover your short position (buy back the stock) at a tremendous loss that you have cemented till the end of time.

To be a good short seller your DNA has to confer immunity to pain when a stock doubles or triples on you (you are down 100-200%). I have never shorted a stock in my life and never will.

The best protection against stock market declines is to make sure the businesses you own are worth a lot more than what you paid for them.

Let's try a new analogy. Let's say someone insults me. My first instinct is to get upset and react. But then I'm reminded by the Stoic philosopher Epictetus to "Remember that the person who taunts or hits you does not insult you, but your opinion about these things as being insulting does. So whenever somebody upsets you, know that it is your own opinion that upsets you. Accordingly, first strive to not be carried away by the appearance. For if you take the time and pause, it is easier to control yourself."

Why should I be upset at Mr. Market for calling our stocks ugly and taking them down 30%? That's just his opinion. Once Mr. Market sobers up, he'll change his mind. There is a saying, "Don't take criticism from someone who you wouldn't take advice from." We work very hard at analyzing and valuing each company we invest in so that we don't have to take advice from a deranged Mr. Market.

So how do we protect your and our portfolio if the market goes into free fall? By playing a very different game. By not trying to protect the portfolio from temporary declines. Yes, you read that right. What does it matter if on any given day moody Mr. Market coughs up the opinion that our portfolio should be priced 30% lower? That's just Mr. Market in one of his depressed moods. We don't need to do anything about it. The value of businesses we own has not changed by 30%, and that is all that really matters in the long run. Long run is the key term here.

If you don't have a long-term time horizon you should not be in stocks, period. If your personal situation doesn't allow you to tolerate a 30% decline of the portfolio, please give us a call. We'll need to discuss allocating a portion of your portfolio to cash. If you'll need some funds over the next three to five years, you'll need to set them aside in cash. These funds should not be in stocks.

Question: Are there certain business sectors you see being most favorable to a value investor during the next couple of years, and why?

Answer: I'd say not sectors but factors. Value investing has been in the doghouse for a long time due to low and declining interest rates. At low, actually negative, real (after-inflation) interest rates, any stock with a sci-fi business plan and possible earnings decades into the future got a valuation as if we were already living in that future. As interest rates settle at a higher level, value investing – a commonsensical way of looking at business – will be in vogue again.

Question: Being a German citizen, I might be negatively biased against Uber, as German court rulings against Uber are probably particularly problematic, and yet these legal issues do not seem endemic to Germany. The question is, how do you allow for legal issues when estimating future profits of a company – Uber is, of course, just a current example.

Answer: There are two questions here, one specific to Uber and one that applies to any company we own.

Let's start with Uber. Most of Uber's legal issues stem from three sources:

First, it disturbs the status quo of legal monopolies – taxis. Taxis are a highly regulated monopoly. In NYC, for instance, the government allows only so many "medallions" (tax licenses) to be issued, and each medallion used to sell for millions of dollars. In the UK taxi drivers had to go to school for a few years so they could navigate London streets without a map. As you can imagine, GPS made that skill obsolete. Germany has similarly restrictive laws.

Uber is a disrupter – it is a much better service than a taxi, so consumers love and vote for it with their hard-earned dollars every day. Eventually in most jurisdictions the archaic laws have been changed. Today Uber is a legal competitor to taxis. After enough German citizens take Uber while traveling in other countries, I suspect that Uber's legal problems in Germany will go away. This logic also applies to other countries where Uber is currently “breaking the law.”

The second source of Uber’s legal problems is the legal status of its drivers. Again, current laws were not really made for today’s gig economy. Maybe I am naïve, but I believe that at the end common sense will prevail and governments worldwide will come up with a third, hybrid category that classifies Uber drivers (and other gig economy workers) somewhere in between contractors and employees.

The third source of Uber’s legal problems is a problem shared with all companies that have legal issues. Some legal expenses are going to hang around Uber’s neck for quite a while, and these few hundred million dollars that the company spends every year on legal costs will make lawyers richer and Uber slightly poorer. Every company we own is being or has been sued in the past. That’s life. We look at these lawsuits pragmatically as an expense item on the income statement and as negative cash flows. One thing we’ve learned over the years is that governments want to punish companies for their misdeeds but are always careful that these punishments bite but don’t kill. Killed companies go bankrupt and employees lose their jobs – governments don’t want that.

Question: I read recently a book called The Outsiders, by William Thorndike. When you research various companies, how easy is it to find the CEOs who are strong capital allocators? For example, those who prefer share buybacks vs. high dividends. Also, CEOs who focus on cash flows. How easy is it to find companies run by CEOs who focus on cash flows over reported net income, dislike dividends (because of tax), are very disciplined if they do acquisitions, use leverage selectively, buy back shares generously when valuations are attractive, care about tax minimization, and run their corporate firms in a decentralized manner?

Answer: Amen to everything you wrote. At IMA we make a distinction between “professionally” managed companies and the ones run by owner operators. If we could, we’d love to own only companies that are run by owner operators who own a lot of the stock. I’ve stressed this point many times before in these letters: People, management matter. Every time I have compromised on management – bought a company with questionable leadership – to get the stock cheaply, I have paid for it, dearly. We own a few companies that are run by owner operators and are always looking for more.

Owner operators create value not just because they buy stock instead of paying dividends, but because they don’t misallocate capital. They make appropriate capital allocation decisions consistently. I’d argue that a lot of “professional” managers are aware of what the right capital allocation should be, but they behave like “hired hands.” Their incentives are to maximize their own pay, and they really don’t care in what state they’ll leave a company after they are done with it and move on to something else.

We are not stock buyback maximalists. I understand the tax advantages of stock buybacks versus dividends. But today companies are buying their stock indiscriminately, whether it’s undervalued or not. We are proper capital allocation maximalists.

Question: I am a relatively new client. I have noted an approximate 4% swing in portfolio value even though the overall market has remained relatively steady. Is this normal for value stocks in a sideways market?

Answer: Our portfolio is very different from “the market.” It comprises a small platoon of eclectic businesses that are in many different industries and even countries. Investor enthusiasm over how they are priced at any given point in time is completely random and has little to do with what these businesses are worth. A lot of the time their price action has to do with extraneous factors, including investor interest in shiny objects. We pay very little attention to these movements because they are mostly noise and carry little to no data with them.

The most consistent advice we give to all our clients – though few take it – is, don’t look at your portfolio on a daily basis. I wrote about that in this article.

Question: Do you think some of your accounts may end up with surplus cash positions because of current (elevated) valuations? What’s your advice, if any, on how to manage surplus cash in a low-interest-rate environment and expectations of rising inflation, the subjects you described in your recent emails?

Answer: Our cash balances are a byproduct of the attractiveness of opportunities we see at any given point in time. Interestingly, despite the market being very expensive and some parts of the market toying with insanity, we are still finding, without compromising on quality or valuation, companies we really like. Looking internationally has something to do with it.

If the market continues marching higher and our stocks start hitting their fair value, we’ll be selling, and this will cause cash balances to rise. We’ll try to maximize what this cash earns. In the past we bought Treasury bills. Today Treasury bills yield very little. The last thing we want to do with this cash is to “reach for yield” by buying something risky or illiquid (I discussed this above).

Question: We would like you to address your thoughts on precious metals as a hedge against rising inflation, continued reckless government spending, and the potential devaluation of the dollar, given all of the helicopter money that has been dropped in the past two years. Also, what are the chances that the dollar will lose its status as the world's reserve currency? Should we be concerned about these issues as it relates to our portfolio and everyday living costs?

Answer: I addressed this topic head on in this article: "Beloved Country. Unloved Hedge." We have a tiny exposure to gold (and we hate it). We have been slowly increasing our allocation to foreign undervalued, high-quality companies, which should do much better than inflation.

Question: What is the end game? Do you expect that at some point the S&P 500 companies will fall as people will realize that they are overvalued, while value companies will retain their valuations?

Answer: I discuss this topic in much greater detail in these two articles:

- Nifty FAANG and Other "One Decision" Investment Strategies
- Sideways Market

This was also the topic of my two books, Active Value Investing and The Little Book of Sideways Markets. The price-to-earnings ratio stops going up, then starts declining, and these stocks fall as valuation decline overpowers their earnings growth.

If you look at what happened to Walmart, Microsoft, Cisco, and many other great (non-dotcom) companies in 1999, they did not stop being good companies, but their price-to-earnings got decimated, their stocks declined, and it took investors a decade or longer to get their money back. This has happened many times throughout stock market history. Looking at what companies or a portfolio does in the short term is pointless. Our stocks barely budged in 1999, while Walmart, Microsoft and Cisco, which were very expensive at the time, marched still higher.

Tribal Dinners & What Worries Me the Most

In 2021 I made a goal to see clients – the IMA tribe – when I came to a new city for business or pleasure. This year, we had tribal dinners (and a breakfast) in Chicago, Santa Fe, Newport Beach, Richmond, Atlanta, Fort Lauderdale, Denver, and more. These events are very informal. There is no presentation. A small group, ranging between six and twenty, gets together over a good meal, enjoys a conversation, gets to know one another, and I answer questions.

We welcome IMA clients to bring their family members and a friend or two to these gatherings, but they are not marketing events. We put these dinners together for the IMA team to meet our clients and for IMA clients to meet the team. Our ultimate goal is to build a strong IMA tribe.

These dinners also allow me to measure the temperature of what worries clients. In late November we had a tribal dinner in Fort Lauderdale. Inflation was the number one worry on everyone's mind. I have written three articles on this topic – I referenced them above, so I won't bore you with them again.

One question stood out to me: "What stands between you and long-term investing success?" The answer just rolled off my lips. I was on my second beer, so my response was completely manufactured by my subconscious: "Clients!"

I truly believe in what we do. I, and the IMA team, will be learning and evolving and hopefully getting better. But our values will not change. We won't own the latest and the hottest stocks; instead, we'll be armed with our Six Commandments of Value Investing; we'll strive to be rational, and process-driven. We'll have our own money invested along with our tribe's. Our goal is to produce the uninterrupted compounding of your and our wealth. We aim to grow it at the highest rate possible without taking existential risks. We'll be honest – not just tout our successes but also admit our mistakes. And we will make mistakes. We'll try very hard to limit the impact of mistakes on the portfolio.

I am confident in our ability to navigate whatever the economy and the world throws at us (short of nuclear war). But every client comes to us with their own background, their own experiences and biases. This is why I want to meet as many clients as I can and host these dinners. This is why I write these long letters. I want to bring you around to our way of thinking. Paraphrasing Buffett, we get greedy when others are fearful and fearful when others are greedy. At the opposite times when most people do.

For this relationship to work, we need three things from you: Buy into our philosophy, have a long-term horizon, and do your homework (i.e., read these letters). If you are reading this sentence, unless you skipped directly to the end to see how this movie would end, you are doing your homework. Thank you!

COVID, Inflation, and Value Investing: Answers to "Millennial Investing"

Click to listen to a narration of this article

2/17/2022

I was recently interviewed by the Millennial Investors podcast. They sent me questions ahead of time that they wanted to ask me "on the air". I found some of the questions very interesting and wanted to explore deeper. Thus, I ended up writing answers to them (I think through writing). You can listen to the podcast here.

By the way, I often get asked how I find time to write. Do I even do investment research? Considering how much content I've been spewing out lately, I can understand these questions. In short – I write two hours a day, early in the morning (usually from 5–7am), every single day. I don't have time-draining hobbies like golf. I rarely watch sports. I have a great team at IMA, and I delegate a lot. I spend the bulk of my day on research because I love doing it.

This is not the first time I was asked these questions. If you'd like to adapt some of my daily hacks in your life, read this essay.

I was recently interviewed by Millennial Investors podcast. They sent me questions ahead of time that they wanted to ask me "on the air". I found some of the questions very interesting and wanted to explore deeper. This article is that exploration.

How has Covid-19 changed the game of value investing?

Value investing has not changed. Its fundamental principles, which I describe in "The Six Commandments of Value Investing," have not changed one iota. The principles are alive and well. What has changed is the environment – the economy.

I learned this from my father and Stoic philosophers: You want to break up complex problems into smaller parts and study each part individually. That way you can engage in more-nuanced thinking.

Let's start with what has not changed. Our desire for in-person human interaction has not changed. At the beginning of the pandemic, we (including yours truly) were concerned about that. We were questioning whether we were going to ever be able to shake hands and hug again. However, the pandemic has not changed millions of years of human evolution – we still crave human warmth and personal interaction. We need to keep this in mind as we think about the post-pandemic world.

What we learned in 2021 is that coronavirus mutations make predicting the end of the pandemic an impossible exercise. From today's perch it is safe to assume that Covid-19 will become endemic, and we'll learn how to live with it. I am optimistic on science.

Let's take travel, for example. Our leisure travel is not going to change much – we are explorers at heart, and as we discovered during the pandemic, we crave a change in scenery. However, I can see business travel resetting to a lower base post-pandemic, as some business trips get resolved by simple Zoom calls. Business travel is about 12% of total airline tickets, but those revenues come with much higher profit margins for airlines.

Work from home.

I am still struggling with this one. The norms of the 20th-century workplace have been shaken up by the pandemic. Add the availability of new digital tools and I don't need to be a Nostradamus to see that the office environment will be different.

By how much?

The work from home genie is out of the bottle. It will be difficult to squeeze it back in. My theory right now is that customer support, on-the-phone types of jobs may disproportionately get decentralized. The whole idea of a call center is idiotic – you push a lot of people into a large warehouse-like office space, where they sit six feet apart from each other and spend eight hours a day on the phone talking to customers without really interacting with each other. Current technology allows all this work to be done remotely.

On another hand, I can see that if you have a company where creative ideas are sparked by people bumping into each other in hallways, then work from home is less ideal. But again, I don't think about it in binary terms, but more like it's a spectrum. Even for my company. Before the pandemic, half of our folks worked outside of the IMA main office in Denver. Most of our future hires will be local, as I believe it is important for our culture. However, we provide a certain number of days a year of remote work as a benefit to our in-office employees.

From an investment perspective, we are making nuanced bets on global travel normalizing. We don't own airlines – never liked those businesses, never will. Most of their profitability comes from travel miles – they became mostly flying banks.

Office buildings I also put into a too-difficult-to-call pile. There was already plenty of overcapacity in office real estate before the pandemic, and office buildings were priced for perfection. The pandemic did not make them more valuable. Maybe some of that overcapacity will get resolved through conversion of office buildings into apartments.

By the way, this is the beauty of having a portfolio of 20–30 stocks: I don't need to own anything I am not absolutely head over heels in love with.

What is the importance of developing a process to challenge your own beliefs?

My favorite quote from Seneca is "Time discovers truth." My goal is to discover the truth before time does. I try to divorce our stock ownership from our feelings.

Let me give you this example. If you watch chess grandmasters study their past games, they look for mistakes they have made, moves they should have made, so in the future they won't make the same mistake twice. I have also noticed they say "white" and "black," not "I" and "the opponent." This little trick removes them from the game so that they can look for the best move for each side. They say "This is the best move for white"; "This is the best move for black."

You hear over and over again from people like Warren Buffett and other value investors that we should buy great companies at reasonable prices, and I'd like to dig deeper on that idea and its two key parts, great companies and reasonable prices. Could you tell us what it takes for a company to qualify as a "great" company?

This question touches on Buffett's transformation away from Ben Graham's "statistical" approach, i.e., buying crappy companies that look numerically cheap at a significant discount to their fair value, to buying companies that have a significant competitive advantage, a high return on capital, and a growth runway for their earnings.

The first type of companies often will not be high-quality businesses and will most likely not be growing earnings much. Let's say the company is earning $1. Its earnings power will not change much in the future – it is a $5 stock trading at 5 times earnings. If its fair value is $10, trading at 10 times earnings, And if this reversion to fair value happens in one year, you'll make 100%. If it takes 5 years then your return will be 20% a year (I am ignoring compounding here). So time is not on your side. If it takes 10 years to close the fair value gap, your return halves. Therefore you need a bigger discount to compensate for that. Maybe, instead of buying that stock at a 50% discount, you need to buy a company that is not growing at a 70% discount, at $3 instead of $5. This was pre-Charlie Munger, "Ben Graham Buffett."

Then Charlie showed him there was value in growth. If you find a company that has a moat around its business, has a high return on capital, and can grow earnings for a long time, its statistical value may not stare you in the face. But time is on your side, and there is a lot of value in this growth. If a company earns $1 today and you are highly confident it will earn $2 in five years, then over five years, if it trades at 10 times earnings, a no-growth company may be a superior investment if the valuation gap closes in less than 5 years, while one with growing earnings is a superior investment past year 5.

Both stocks fall into the value investing framework of buying businesses at a discount to their fair value, looking for a margin of safety. With the second one, though, you have to look into the future and discount it back. With the first one, because the lack of growth in the future is not much different from the present, you don't have to look far.

There is a place for both types of stocks in the portfolio – there are quality companies that can still grow and there are companies whose growth days are behind them. In our process we equalize them by always looking four to five years out.

What qualifies as a "reasonable price"?

We are looking for a discount to fair value where fair value always lies four to five years out. In our discounted cash flow models, we look a decade out. Our required rate of return and discount to fair value will vary by a company's quality. There are more things that can go wrong with lower-quality companies than with the better ones. High-quality companies are more future-proof and thus require lower discount rates. We are incredibly process-driven. We have a matrix by which we rate all companies on their quality and guestimate their fair value five years out, and this is how we arrive at the price we want to pay today.

Why do you believe that buying great companies sometimes isn't a great investing strategy?

Because that is first-level thinking, which only looks at what stares you in the face – things that are obvious even to untrained eyes and thus to everyone. First-level thinking ignores second-order effects. If everyone knows a company is great, then its stock price gets bid up and the great company stops being a great investment. With second-level thinking you need to ask an additional question, which in this case is, what is the expected return? Being a great company is not enough; it has to be undervalued to be a good stock.

We are looking for great companies that are temporarily (key word) misunderstood and thus the market has fallen out of love with them. Over the last decade, when interest rates only declined, first-level thinking was rewarded. It almost did not matter how much you paid for a stock. If it was a great company, its valuations got more and more inflated.

You're a big advocate of having a balanced investment approach that is able to weather all storms. What investments have you found that you expect will be able to hold their buying power if inflation persists through 2022 and 2023?

There are many different ways to answer this question. In fact, every time I give an answer to this question I arrive at a new answer. You want to own companies that have fixed costs. You want assets that have a very long life. I am thinking about pipeline companies, for instance. They require little upkeep expense, and their contracts allow for CPI increases (no decreases); thus higher inflation will add to their revenue while their costs will mostly remain the same.

We own tobacco companies, too. I lived in Russia in the early ’90s when inflation was raging. I smoked. I was young and had little money. I remember one day I discovered that cigarette prices had doubled. I had sticker shock for about a day. I gave up going to movies but somehow scraped up the money for cigarettes.

Whatever answer I give you here will be incomplete. It’s a complex problem, and so each stock requires individual analysis. In all honesty, you have to approach it on a case-by-case basis.

With higher inflation, you’d expect bond yields to rise, since bond investors will demand a higher return to keep pace with inflation. However, CPI inflation is currently over 6%, and the 10-year Treasury is sitting at 1.5%. Why haven’t we seen Treasury yields rise more, and what does it mean for investors if a spread this wide persists?

I am guessing here. My best guess is that so far investors have bought into the Fed’s rhetoric that inflation is transitory due to the economy’s rough reopening and supply chain problems. I wrote a long article on this topic. To sum up, part of the inflation is transitory but not all of it.

I am somewhat puzzled by the labor market today. I’ve read a few dozen very logical explanations for the labor shortage, from early retirement of baby boomers to the pandemic triggering a search for the meaning of life and thus people quitting dead jobs and all becoming Uber drivers or starting their own businesses. Labor is the largest expense on the corporate income statement, and if it continues to be scarce then inflation will persist.

I read that employees are now demanding to work from home because they don’t want to commute. The labor shortages are shifting the balance of power to employees for the first time in decades. This will backfire in the long run, as employers will be looking at how to replace employees with capital, in other words, with automation. If you run a fast-food restaurant and your labor costs are up 20–30% or you simply cannot hire anyone, you’ll be looking for a burger flipping machine.

If we continue to run enormous fiscal deficits, then the US dollar will crack. The pandemic has accelerated a lot of trends that were in place. We were on our way to losing our reserve currency status. Let me clarify: That is going to be a very slow, very incremental process. It will be slow because currency pricing is not an absolute but a relative endeavor, and the alternatives out there are not great. But two decades ago the US dollar was a no-brainer decision and today it is not. So we'll see countries slowly diversifying away from it. A weaker US dollar means higher, non transitory inflation.

You wrote The Little Book of Sideways Markets, in which you point out that history shows that a sideways market typically occurs after a secular bull market. With the role that the Federal Reserve plays in the financial markets, do you still anticipate that valuations will normalize in the coming years?

I say yes, in part because declining interest rates have pushed all assets into stratospheric valuations. Rising bond yields and valuations pushed heavenward are incompatible. Yes, I expect valuations to do what they've done every time in history: to mean revert. In big part this will depend on interest rates, but if rates stay low because the economy stutters, then valuations will decline – this is what happened in Japan following their early-1990s bubble. Interest rates went to zero or negative, but valuations declined.

The stock market today is very much driven by the Federal Reserve's monetary policy. Is there a point at which they are able to take the gas off the pedal and allow markets to normalize?

I am really puzzled by this. We simply cannot afford higher interest rates. Going into the pandemic our debt-to-GDP was increasing steadily despite the growing economy. In fact, you could argue that most of our growth has come from the accumulation of debt (the wonders of being the world's reserve currency). Our debt has roughly equaled our GDP, and all of our economic growth in some years equaled the growth in government debt.

During the pandemic we added 40% to our debt in less than two years. We have higher debt-to-GDP than we had during WWII. After the war we reduced our debt. Also, we were a different economy then – we were rebuilding both the US and Europe. As a society we had a high tolerance for pain.

Just like debt increases stimulate growth, deleveraging reduces growth. Also, I don't think politicians or the public care about high debt levels. So far debt has only brought prosperity. However, higher interest rates would blow a huge hole in government budgets. If the 10-year Treasury rises a few percentage points, interest rates will increase by the amount we spend on national defense. One thing I am certain about is that our defense spending will not decline, so higher interest rates will lead to money printing and thus inflation.

I am also puzzled by the impact of higher interest rates on the housing market. Housing will simply become unaffordable if interest rates go up a few percentage points. Loan-to-income requirements will price a huge number of people out of the market, and housing prices will have to decline. Higher rates will also reduce the number of transactions in the real estate market, because people will be locked into their 2.5% mortgages, and if they sell they'd have to get 4-5-6% mortgages. There are a lot of second-order effects that we are not seeing today that will be obvious in hindsight. Housing prices drive demand in adjacent sectors such as home improvement. And think of the impact of higher rates on any large purchase, for example a car.

We're seeing the continuing rise of China as a big player in the global economy, and I know you like to invest internationally. As a value investor, how do you think about China's rise as a global powerhouse and how it might affect the financial markets?

During the Cold War there were two gravitational centers, and as a country you had to choose one – you were either with the Soviets or with the West. Something similar will likely transpire here, too. I have to be careful using the Cold War analogy, because the Cold War was driven by ideology – it was communism vs. capitalism. Now the tension is driven by economic competition and our unwillingness to pass the mantle of global leader to another country.

We are drawing red lines in technology. Data is becoming the new oil. China is using data to control people, and we want to make sure they don't have control over our data. Therefore, the West wants to make sure that our technology is China-free. The US, Europe, and India will likely be pursuing a path where Chinese technology and Chinese intellectual property are largely disallowed. We have already seen this happening with Huawei being banned from the US and Western Europe. Other countries, including Russia, will have to make a choice. Russia will go with China.

Also, we are concerned that most chip production is centered in Taiwan, which at some point may be grabbed by China. The technological ecosystem would then have to undergo a significant transformation. This has already started to happen as we begin to bring chip production back to the US and Europe.

The pandemic made us realize that globalization had made us reliant on the kindness of strangers, and we found we could not even get facemasks or ventilators.

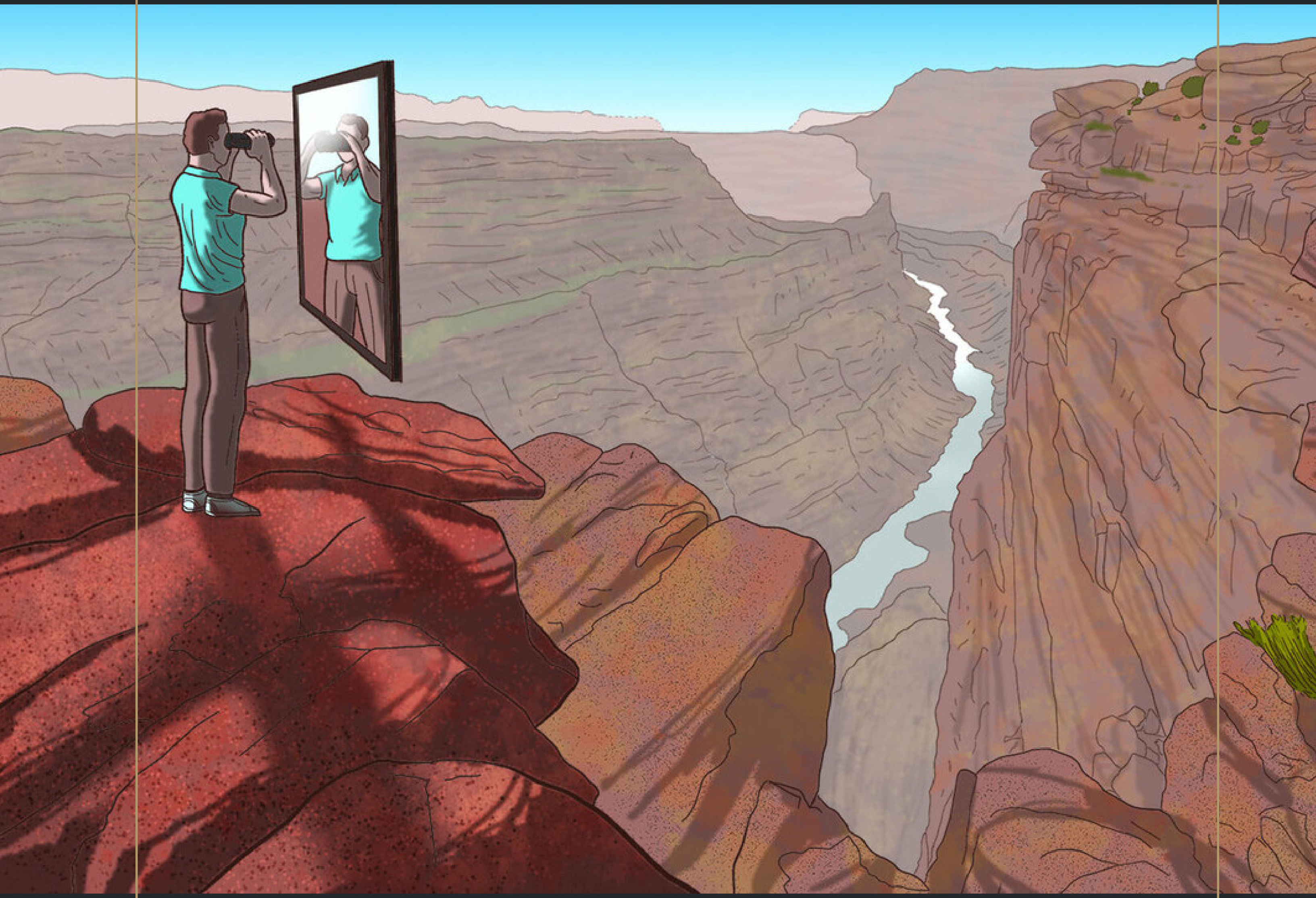
Globalization was deflationary; deglobalization will be inflationary.

This increased tension between countries has led to your investing in the defense industry. Could you tell us how you think about this industry?

Despite the rise of international tensions, the global defense industry has been one of sectors that still had reasonable (sometimes unreasonably good) valuations. We have invested in half a dozen US and European defense companies. The US defense budget is unlikely to decline in the near future. There is a common misperception that Republicans love defense and Democrats hate it. Those may be party taglines, but history shows that defense spending has been driven by macro factors – it did not matter who was the occupant of the White House.

There are a lot of things to like about defense businesses. They are an extension of the US or European governments. Most of them are friendly monopolies or duopolies. They have strong balance sheets, good returns on capital, and predictable and growing (maybe even accelerating) demand. They are noncyclical. They have inflation escalators built into their contracts. I don't have to worry about technological disruptions. They are also a good macro hedge.

We added to our European defense stocks recently for several reasons. Europe has underinvested in defense, relying on the US Yet we have shown time and again that we may not be as dependable as we once were.



See More Clearly With These Two Mental Models

Click to listen to a narration of this article

2/24/2022

I am a big fan of mental models. Mental models are explanations of how things work. They allow you to think through analogy, often folding complex concepts into simple ones and transporting them from one discipline to another. Mental models are thinking shortcuts. I am wired to think through mental models – my brain doesn't handle complexity well and constantly tries to simplify things. If you arm yourself with mental models, you'll often see what others don't.

Another beauty of mental models is that you can combine them. I am about to share with you two mental models. I used both in our seasonal letter to explain one of the companies we bought for our portfolio. I am going to stop short of sharing our analysis of the company or its name. It is a small, $600-million market cap company, and I don't want my writeup to influence its stock price. But I really hope you find value in these two mental models.

I'm a big fan of mental models. They allow you to think through analogy, often folding complex concepts into simple ones and transporting them from one discipline to another. They're thinking shortcuts. If you arm yourself with mental models, you'll often see what others don't.

Myopic circles

I don't smoke. This was not always the case with me. I smoked in my teens. I quit when I was 21. I was one of the first people in my circle of friends to quit smoking, then gradually all my friends quit smoking, too.

Today I don't have a single close friend who smokes. I didn't look for this outcome intentionally; I didn't stop being friends with smokers. Nor do I choose friends based on their (harmless, at least to me) vices. So this was not a conscious or even a subconscious decision. Very simply, people in my social demographic circles have a set of values, and a healthy lifestyle is one of them. It's very hard to have a healthy lifestyle and smoke.

Humans are tribal, and we try to conform to the values and behavior of our tribe. At some point in the late 1990s or early 2000s smoking stopped being cool and became uncool in my tribe. (For me, a girl I was dating was the impetus for my quitting).

On the other hand, I have a relative who smokes. This is where it gets interesting. He has a few dozen friends who smoke. His friends know a lot of people who smoke. The overlap between his circles of friends and acquaintances and mine is very small (near zero).

Why is this important? In my daily life I encounter very few people who smoke, and thus it is easy (if I am not careful) to form a belief that nobody smokes. When we started doing research on tobacco stocks, I was shocked to discover that 35 million Americans – 14% of the adult population – still smoke. The numbers are much greater in Asia and Eastern Europe.

Another example: vaccinations. If you are vaccinated, then it's likely that most of the people you know are vaccinated. Now, if you have a friend or a relative who is not vaccinated (other than for a unique medical reason), most likely that person knows a lot more unvaccinated people than you do. And his/her circle of unvaccinated friends and your circle of friends have little overlap.

This myopic circle framework applies to many parts of our lives. Here are more examples: What we watch on TV is influenced by our values and our willingness to share our experience with others; how we watch TV – over the internet or over cable; our political beliefs – we tend to surround ourselves with people we agree with; our shopping habits (our preferences for shopping at malls, on QVC, or online); even the type of cars we drive (electric vs ICE).

When we live in our micro circle we forget about the existence of other circles. If we are not careful, the lens through which we look at the world may get strongly tinted with our perspective and turn myopic.

You'd think that as you venture out on the world wide web this would change. It does a little, but not much. Maybe a guy you went to third grade with, who is now your Facebook "friend", has different political views from yours. You argue with him over the occupant of the White House and then unfriend or unfollow him. But mainly, your social networks will feed you content that agrees with your biases.

For an analyst (and, I'd argue, for a human being, too) myopic vision is dangerous. It leads to missing both opportunities and potential threats.

David vs. Goliath

A book that has had a profound impact on me not just as an investor but as a business-person is Malcom Gladwell's David and Goliath. It reexamines one of the oldest biblical stories. Three thousand years ago in the Elah Valley of the Judean Mountains, an army of Philistines and an army of Israelites, led by King Saul, faced each other.

The armies were stalemated. To attack, either army would have to go down into the valley and then climb up the enemy's ridge. The Philistines ran out of patience first and sent their greatest warrior, Goliath, to resolve the deadlock in one-on-one combat. Goliath was a 6-foot 9-inch giant, protected from head to toe by body armor and a bronze helmet.

He yelled, “Choose you a man and let him come down to me! If he prevails in battle against me and strike me down, we shall be slaves to you. But if I prevail and strike him down, you will be slaves to us and serve us.”

There were no volunteers in the Israelites’ camp. Who could win a fight against this giant? Then an ordinary-looking shepherd boy stepped forward. His name was David.

To me, David vs. Goliath was always just an inspirational story about a young boy defeating an evil giant. Or as Gladwell puts it, for most people David vs. Goliath is a story of “when ordinary people confront giants.”

But Gladwell presents the story in a very different light. When David goes to face Goliath, King Saul offers him his sword. David refuses. Instead, he picks up a few polished stones and throws them in his pouch. Gladwell explains that, as a shepherd protecting his flock, David was a skilled rock slinger.

When Goliath saw David, he yelled something along the lines of “Come here; I’ll have a piece of you!” Instead, David kept his distance, then put a stone in the leather pouch of his sling, fired it at Goliath’s exposed forehead, and struck him down.

Had David taken Saul’s sword and gone to fight one-on-one, he wouldn’t have had a chance. But where everyone saw strength in Goliath’s physical might, David saw weakness. David was a craftsman rock slinger; he could knock a bird down in mid-flight with a stone – Goliath was a sitting duck.

Suddenly we see a very different story. Goliath’s size, physical strength and armor are only competitive advantages if his opponent chooses to fight him in a conventional way, on Goliath’s terms. But his strength can quickly be turned into serious weakness, as Goliath was immobile, slow and had no defense against a skillful rock slinger. In other words, Goliath brought a sword to a gunfight. Or in financial parlance, David turned Goliath’s assets into liabilities.

I keep this framework in the back of my mind when I run IMA – the investment industry is full of Goliaths. Twenty years ago they would have had a competitive advantage over IMA – they would have had access to better tools and more information (before Regulation FD management would have whispered in their ear information it would not share with the public.) The internet and new regulations have changed all that. We don’t have a large research department staffed with twenty analysts. Thank God!

We don't have the bureaucracy or the politics that comes with that sort of department. We chose to compete with Goliaths on our terms – we deliberately created a large network of investors we respect. We share our ideas with them, and in exchange they do the same. It's a two-way street. We have our industry or country experts to whom we reach out when we need to get constructive feedback on the idea we are pursuing. We even organize a conference, VALUEx Vail, open only to our network to foster this exchange. Large firms are also constrained by their size – we are not; we can buy a company of almost any size in the US or overseas. If our size becomes a constraint for us, we'll put the brakes on our growth.

The lesson of this story is to always look for asymmetry. When you face a formidable competitor, don't settle for symmetrical one-on-one combat; understand the competitor's strengths and see if you can turn them into weaknesses by changing the domain of the fight.

Why Is Inflation So High Right Now? 6 Reasons + What Happens Next

Click to listen to a narration of this article

5/19/2022

I spilled a lot of ink warning that a large portion of the market was playing a "bigger fool" game – investors were buying overvalued stocks and otherwise worthless cryptocurrencies and NFTs, hoping to unload them on bigger fools (I wrote about it in January). Over the last six months the market started to run out of fools. Higher interest rates and inflation returned some rationality to the market. There is a saying on Wall Street: Bear markets return money to its rightful owners. This is what we've been experiencing lately.

The war in Ukraine will likely pour more gasoline on the already raging inflationary fire, threatening to send the global economy into stagflation. Stagflation is a slowdown of economic activity caused by inflation.

Several clients thanked us for the placidity of their portfolios in otherwise turbulent times and told us we should do a celebratory dance. I'd be lying if I told you that seeing our portfolio remain relatively stable while many "greater fools" stocks decline as much as 80% doesn't bring us a certain satisfaction.

But we are not doing a celebratory dance, for several reasons:

First, we realize that there are real people with shattered hopes and dreams on the losing side of what we call the dotcom 2.0 burst bubble. We sincerely feel bad for them.

Second, the last thing we want to do is to let our relative success go to our head or suggest to us that we have got all of this figured out. I don't want my teammates at IMA to become less vigilant and lose what one of our IMA clients, who has become a personal friend over the years, calls "Russian Jewish paranoia." He tells me that he sleeps well at night because his money is run by a "paranoid Russian Jew." Okay, there is only one "paranoid Russian Jew" on our investment team – yours truly. But this healthy dose of paranoia – looking not just at what is in front of us but thinking about risks lurking around the corner – has deeply embedded itself into IMA's DNA.

As you'll see later in the letter, the list of things to be worried (paranoid) about is only growing. In fact, when you are abuzz with feelings of either success or failure is when you want to tighten your process to make sure emotions (and over- or under-confidence) don't mess with your head and decision making. We are constantly double, triple checking every stock we own to make sure our thesis on each is intact.

And third, the "greater fools" wreckage is likely going to turn a lot of ex-darlings, which investors could not get enough at much higher prices, radioactive. These stocks will have the stink of an uninvestable asset class, at least for a while. Just as people confused great companies with great stocks on the way up, they'll mistake bombed-out stocks for bad companies.

To be fair, some of the stocks that are crashing to mother earth today are bad businesses, while some are mediocre and some are excellent. A massive change in sentiment usually waters down the distinctions between them and they all are treated equally as radioactive waste. Our job is to carefully go through the wreckage and identify great businesses that are trading at great prices (with a significant margin of safety). This recent pile-up has given us a larger universe of stocks to study – we welcome the opportunity.

Inflation is everywhere

The war in Ukraine will likely pour more gasoline on the already raging inflationary fire, threatening to send the global economy into stagflation. Stagflation is a slowdown of economic activity caused by inflation.

Before we go into the messy entrails of stagflation, let's review what is going on in the US and global economies. I discussed some causes of inflation in previous letters, therefore let's focus on the new culprits.

Oil

First, higher commodity prices. Even before the pandemic, the supply of oil and gas was getting constrained by a decline in investment caused by low oil and natural gas prices and petrocarbons falling out of favor with the ESG cult. The pandemic caused a further falloff of investment in the sector. Russia's invasion of Ukraine forced the world to excommunicate the third largest producer of petrochemicals from modernity.

The oil market has slightly different dynamics from the natural gas market. Oil is a fungible commodity and is easily transported by tankers, and thus it can be (relatively) easily redirected from one customer to another. For instance, if China used to buy oil from Saudi Arabia and now buys oil from Russia, the oil that China stopped buying from Saudi Arabia can now be bought by Germany. That said, Russia produces heavy crude and the Saudis light crude, so refineries need to be reconfigured, and that takes months.

Sanctions on oil will only have an impact on the Russian economy if everyone stops buying Russian oil. If all countries embrace sanctions, then about 8 million barrels of daily oil exports will be removed from the market. That is a lot of oil, considering that the world consumes about 88 million barrels a day.

It is unclear if China and India, the largest and third largest importers of oil, will go on buying significant amounts of oil from Russia, as doing so risks damaging their relationships with the West. Neither country wants to be told what to do by the West. They have their own economic interests to consider, but their trade with the US and Europe is significantly greater than it is with Russia.

It seems that both countries have been slowly distancing themselves from Russia. For example, the Chinese credit card network UnionPay has quietly cut off its relationship with Russia. Though Russia has an internal credit card network called Mir, since Russia was cut off from the Visa and Mastercard networks and now from UnionPay, Russians have no easy way to spend money when they travel outside of Russia.

This war was a horrible infomercial for Russian weapons, and there is a good chance India may decide to switch to Western weapons, which would bring it closer to the West.

In the short term, the supply of oil from Russia to the world market will likely shrink; it is just hard to tell by how much. The demand for Russian oil has clearly declined, as the (Urals) price is down 30% while global oil prices are making new highs.

Long-term, the oil-supply picture from Russia looks even worse. There was a good reason why Western companies participated in Russian oil projects. A great love for the West was not the motivator that drove Russia to share oil revenues with BP and Exxon. Western companies brought much-needed technical expertise to very challenging Russian oil and natural gas fields. With the West leaving Russia, long-term production of oil and gas is likely to decline, even if China and India continue buying Russian oil and gas.

Gas

Let’s turn to the natural gas market.

Call me Mr. Obvious, but I will say it anyway: natural gas is a gas and oil is a liquid. Shipping gasses is much trickier than shipping liquids. Natural gas can be transported two ways: by pipelines (the cheapest and most efficient way, but they take years to build) and by LNG ships. LNG stands for liquified natural gas – the gas is cooled to -260F and turned into a liquid. Western Europe, especially Germany, is heavily reliant on Russian gas, which today is transported to Europe through pipelines.

Side note: In the future, when you put your livelihood in the hands of well-meaning politicians (especially if you are a resident of California), just remind yourself that German politicians, in their fervor to go green, abandoned nuclear power, which produces zero CO_2, switched to intermittent “green” wind and solar (and fell back on dirty coal) and tied their future to a shirtless Russian dictator. I discussed this topic before – you can read about it here.

Some smaller European countries are already abandoning Russian gas. Germany and Italy, the largest consumers of Russian gas, promise that they can delink themselves from Russia's gas in less than two years. This trend will continue; it just won't happen overnight (or in two years). Call me a skeptic, but I think it will take a long time for Europe to completely abandon Russian natural gas, as building LNG terminals takes years, and so does increasing natural gas production.

Oil and natural gas prices will likely stay at elevated levels or even go higher over the next few years, and the US production of natural gas and oil will likely have to go up substantially. This will benefit some of the companies in our portfolio, which I'll discuss in part two of the letter.

Food

The second new source of inflation is food. It's a significant concern for us. Russia and Ukraine produce about 15% of the world's wheat supply. They account for about one third of global wheat exports (or about 7% of global wheat consumption). Russia has slapped a ban on wheat exports. Ukraine's planting season was likely disrupted by the war. The global wheat supply may decline by as much as 7%. This sounds like a large number, but it is not outside the historical volatility caused by droughts and other natural disasters, which have historically driven up wheat prices by a few percent.

This is not what worries us.

We are concerned about the skyrocketing prices of nitrogen and potassium fertilizers since the beginning of the war. Russia and Belarus are the second and third largest exporters of potash used to make potassium fertilizer (Canada is the largest producer). Nitrogen fertilizer is made from natural gas. Natural gas prices are up a lot. High fertilizer prices will lead to significant increase in prices of all calories, from corn to avocados to meat.

Food inflation impacts poor countries and the poor in wealthy countries disproportionately. US consumers spend 8.6% of their disposable income on food (down from 17% in the 1960s). In poor countries this number is significantly higher. For instance, the average Ukrainian spends 38% of disposable income on food. Food prices have been going up, but we are afraid that we ain't seen nuthin' yet.

Interest Rates

The third new source of inflation is higher interest rates, which make all financed goods more expensive, from washers and dryers to cars to houses. Over the last decade we got used to cheap, abundant credit. If inflation continues to stay at elevated levels, cheap credit will become a relic of the past. Mortgage rates have almost doubled from the lows of 2021 – 30-year mortgages are pushing 5.1% as of this writing. The median home price is $428,000 (up from about $330,000 before the pandemic). The interest increase from 2.7% to 5.1% will cost the average consumer $7,000 a year, or 12% of the total median income of $61,000. About a third of the country doesn't own a home but rents. Rents increased 11.3% in 2021 and continue to rise in 2022.

Now, if you add the increase in energy prices (gasoline and heating), food inflation, and the higher cost of anything that has to be financed, you'll see how the consumer is being squeezed from every direction. Government-massaged inflation numbers show a 7–9% increase in prices. We think these numbers are low, despite their having set multi-decade records. A more realistic number is much higher, as is suggested by import and export inflation numbers, which are not adjusted by the government and are running 12–18%.

Supply Chain Problems

Another culprit responsible for higher inflation is supply chain issues. China is going through another partial shutdown of its economy. Putin made us forget about the coronavirus, but the coronavirus did not forget about us. China – the initial source of Covid-19 – has suffered among the lowest per capita numbers of infections and deaths from Covid. The downside of this is that China has very low herd immunity. And though China has locally-made vaccines, they are not very effective, and China refuses to import Western vaccines.

Chairman Xi banked his reputation on a "zero Covid" policy. Today this policy is being sorely tested. China is shutting down cities that are the size of a largish European countries to keep the virus from spreading. Since China makes a lot of the stuff we consume, they'll make less of it. "Transitory" supply issues from China will persist and add to inflation.

Deglobalization

Finally, the War in Ukraine has accelerated deglobalization. Globalization was a great deflationary tsunami. The pandemic exposed the fragility of our vaunted just-in-time inventory and global supply system. The war in Ukraine reminded the West that the global trade system is built on the assumption that we don't go to war with our trading partners. The war in Ukraine broke that assumption and accelerated the pace of selective deglobalization, which will lead to higher prices of everything in the long run.

This brings us to stagflation.

Stagflation may be our next stop, but that is not what I am worried about.

If rising costs (inflation) were predictable, then wages would match this increase and the impact on the consumption of goods would be benign. This has been anything but the case lately. Though wages have risen 3–4%, they significantly lag official inflation numbers and are left in the dust by actual inflation. And this is before high interest rates and high fertilizer prices caused by the war in Ukraine hit food production, food prices, and consumer wallets.

As inflation outpaces the growth in wages, consumers find themselves poorer and thus their ability to buy discretionary goods declines. This is how inflation turns into a headwind for economic growth, and it's called stagflation. The impact of inflation on the economy will depend on the differential between the inflation rate and wage growth. The higher the difference between these two numbers, the more inflation slows down the economy, causing stagflation.

We are not worried about a recession.

Recessions are natural cleansing mechanisms for the economy. Over the course of economic expansions, companies start to drip with fat. Their processes loosen, they hire too many people, they accumulate too much inventory. Recessions are nature's diet plan for companies that need to shed some fat. Recessions are not fun (especially for those who lose their jobs), but historically they have been short-term interruptions between economic expansions.

To see what the economy and stocks will do during a high-inflation environment, you can look at what they did in the 70s and 80s. Or you can just look at the last 20 years and invert.

Over the last twenty years we had declining interest rates and low inflation, which in turn caused never-ending (with only short-term interruptions) appreciation of housing prices. This put extra money into consumers' pockets and drove prices of all assets up (especially stocks), which in turn boosted consumer confidence, as people felt wealthier and were encouraged to spend.

Credit flowed like beer at a Saturday night fraternity party. Stock market multiples expanded. Despite government debt tripling, the interest payments on our debt as a percentage of the Federal budget are near an all-time low. Low interest rates and government spending are stimulative. Now, invert all of that and you get anemic long-term economic growth and contracting stock market multiples. The tailwinds of the past turn into the headwinds of the future.

Over the last 20-plus years, every time the economy stumbled, Uncle Fed bailed it out – he lowered interest rates, injected the market with liquidity, and the economy and market were back to the races. The pain from which we were spared did not go away; it was being bottled up in the pain jar. This jar has nearly run out of room and is now leaking. Today, to prevent inflation turning into hyperinflation, the Fed will have to do the opposite of what it is used to doing in the 21st Century – it will be raising rates.

I have been doing this long enough to know that the economy is a complex, self-adjusting mechanism, and thus the grim picture I have painted in this and previous articles may or may not play out. One should never underestimate human ingenuity.

However, our job is to prepare for the worst, and hope for the best. Since hope is not strategic, we are focusing all our energy on the preparing part. Considering that the dotcom 2.0 bubble still has plenty of room to deflate (we rifled through the wreckage and did not find anything we liked), high overall stock market valuations, and grim global economic picture, we are continuing to position our portfolio very conservatively.

We have intentionally positioned the portfolio for a low-growth environment. The majority of our companies don't march to an economic drummer. In other words, their profitability should not change much if the economy goes through a protracted contraction or low (real) growth. Yes, the market is expensive and the economy is rife with uncertainty; but we don't own the market, we own carefully selected high-quality, (still-) undervalued companies.

ARKK Stocks Sunk

Click to listen to a narration of this article

6/9/2022

Over the last few years, I killed a forest of good-looking trees writing about the insanity of what was going on in the stock market. These trees did not die in vain. Rising interest rates and inflation making multi-decade highs served as a bucket of cold water, waking investors up to the fact that a vivid imagination is not the only skill required to be an investor. Until recently, the investors who had the richest imaginations seemed to make the most money – until they lost years of gains in months.

> The better ARK performed, the more money flowed into its main ETF, ARKK. It used this money to buy more sci-fi ARKK stocks, pushing up the prices of its holdings. This created a vicious cycle that has now reversed.

Let's take the ARK Innovation ETF (ARKK) – the poster child of the recent hysteria and until last year one of the best-performing funds in the market. It more than quadrupled from the pandemic lows to its peak in February 2021. Some companies it owned had business plans that looked like they were from sci-fi novels; many were going to revolutionize the world; most came with sci-fi-like (out of this world) valuations.

Cathy Wood, ARK's fund manager, turned into an instant celebrity. The media and Wall Street did what they usually do – they hailed her as the next Warren Buffett. The performance of the ARK fund was compared with the then relatively abysmal performance of Berkshire Hathaway, showing that relatively young, vibrant, future-thinking Cathy had left the has-been nonagenarian Warren in the dust.

The better ARK performed, the more money flowed into ARKK (its main ETF), and the more sci-fi stocks it had to buy. Often ARK became the largest shareholder in relatively small companies, pushing the prices of ARKK stocks higher, which in turn drove ARKK's net asset value higher. This created a vicious cycle, caused more FOMO for investors, and thus attracted more assets, divorcing stocks ARK held completely from reality. ARK's assets surged in less than a year from $2 billion to almost $28 billion at the February 2021 peak.

It is easy to pick on Cathy Wood. We should not. Her fund was in the wrong place at the wrong time. Most importantly, if it was not her, it would have been someone else, another fund. The stock market, just like many other asset classes, was overtaken by temporary insanity triggered by a combination of low interest rates and enormous liquidity flushed into the system by Uncle Sam. For some time, the market was rich on imagination and scarce on common sense.

This movie is ending in a very predictable way. Higher interest rates activated a dormant gravitational field in the market. ARK stocks turned into horror stories, crashing down to mother earth. Investors who bought the fund at the peak are down more than 70%. All investors who bought ARK after mid-April 2020 and held on to the fund are down on their purchase. Since the majority of inflows to the fund occurred near the peak, most ARK investors got annihilated.

There is an interesting parallel between the run-up and crash in “digital” stocks during the pandemic and the Y2K bubble of 1999.

The market was already frothy in the late 1990s, full of dotcom speculation. In 1999 corporations were concerned that at the turn of the century, computer clocks, instead of taking us forward from 1999 to 2000, would take us back to 1900. Though this was a true risk only for old mainframes, it triggered a tsunami of upgrades for everyone. It seemed like every Fortune 10,000 company upgraded its computers to a new system.

The fierce combination of Y2K fever and demand created by all the newly formed dotcoms that were going to ride the wave of the internet to revolutionize the world (which they did) led to a substantial rise of sales for computer makers and other technology companies, substantially boosting their earnings.

Then the clock turned to a new century.

Tech companies discovered that pre-Y2K sales had pulled forward future demand, and dotcom companies ran out of other people’s money to fund their profitless growth (sound familiar yet?). Investors expected hockey-stick sales to continue but faced a decline in sales instead.

Tech stocks collapsed.

I am not just talking about Pets.com here, but real companies the likes of Dell Computer, Cisco Systems, and Microsoft. Some saw their sales decline for a few years and then resume growing again. That was the case with Cisco; while others, like Dell, saw a pause in sales growth for a year; and some lucky ones, like Microsoft, found their sales marching higher as if nothing had happened.

Investors who held onto these companies waiting to break even had to wait a long time. They did not see their prices reach 1999 highs for more than a decade. That is how long it took for earnings to grow into their 1999 valuations. (Cisco to this day has not touched its 1999 high).

I have made this point many times: The price you pay matters, and great companies get overvalued, too.

Just like tech companies during the Y2K/dotcom bubble, digital companies (many owned by Cathy Wood's ARK) received a significant boost to their sales during lockdown. But sales only tell a small, surface part of the story. All of these companies went through a significant readjustment of their cost structure.

When a company is growing at a fast pace, management cannot help but draw straight or even parabolic lines into the future, preparing the company for current growth to continue, hiring new people, and investing in assets to support the future nirvana. As the rate of growth slows, comes to a stop, or god forbid goes negative, companies are forced to renormalize their employee and asset bases. This causes layoffs. This is contagious, as some of these companies consume each other's products, causing some to see even greater sales slowdowns.

Ronald Reagan said, "A recession is when your neighbor loses a job; a depression is when you lose yours." By this definition Silicon Valley is going through the early innings of either a recession or a depression, depending on where each person and each company sits.

Recessions are healthy, because they shift companies' focus from outward (growth) to inward (operations). Prolonged high growth is not healthy. It creates a lot of inefficiencies, inflating corporate cost structures. When imagination runs wild, a lot of sci-fi projects get funded. As I write this, I'm seeing a headline coming through about Tesla laying off 10% of its salaried workforce. Tesla, ARK's largest holding, is likely returning to its roots of building cars and holding off on the humanoid robots.

One can, of course, pray and hope for a bubble to get reinflated under these stocks. That may happen – stranger things have happened – but history suggests otherwise. Bubbles rarely hit the same group of stocks twice. There is a psychological reason for that: Holders who got burned on the first ride usually unload these stocks into run-ups. Also, this would require inflation to dissipate and interest rates to revisit new lows. Again, stranger things have happened.

From hope and pray land to what I think will likely happen

The news flow from Silicon Valley is likely going to get a lot worse in the coming months and maybe the next few years. Digital companies that were loved yesterday and still liked today will likely see their valuations get reevaluated and their stock prices decline further. Investors' affection for them may change to hate and then to indifference as they move on to other shiny objects.

It is still hard to see this today, but some of these companies will be left for dead. This is what happened to many tech/dotcom darlings in the early 2000s. Some of them will become attractive opportunities; others will fade into irrelevance, forgotten footnotes in the history books. It will be our job to plug our noses and go through the future rubble to pick up some past growth darlings at a value price.

Charter Communications (CHTR) Stock: Heads we win, tails we don't lose

Click to listen to a narration of this article

6/30/2022

Charter Communications (CHTR) is one of the largest cable companies in the US. In large strokes, we think of it as three businesses: cable TV, broadband internet, and wireless.

Cable TV is a high-revenue, low-margin business – most of the revenue (deservedly) goes to content providers. This business is in a mild, long-term, steady decline. Cable companies don't mind losing this business, for several reasons: First, after you factor in the costs of customer service, this business makes very little money. Second, people who quit TV consume almost double the amount of broadband (700 gigabytes vs. 400 gigabytes a month).

Broadband internet, on the other hand, is a growing, high-margin business. It is a utility, just like water and electricity.

Charter Communications (CHTR) is a significantly undervalued stock today. But are competition, 5G, and satellite internet significant threats to its business? How does its management compare to AT&T and Verizon? Read our analysis below.

Wireless is a high-growing but yet to be profitable business. Unlike traditional wireless companies (think AT&T or Verizon), which encounter significant costs in building and maintaining wireless networks and spend tens of billions of dollars on wireless spectrum every few years, Charter is an MVNO – a mobile virtual network operator. It buys a bucket of bandwidth from Verizon at a wholesale price.

Charter sells wireless services only to its cable and broadband customers. Most of Charter's wireless usage occurs at customers' homes or offices (80%), on Wi-Fi. The incremental cost of this usage to Charter is negligible. Compared to its wireless counterparts, Charter has a lower cost of providing wireless service and thus can charge less for the service. And it does.

Though the company argues that wireless will be a profitable product in the long run, we think Charter's mobile strategy makes sense if the business just broke even. Offering wireless services widens CHTR's moat as it makes customers stickier (reduces churn). It also makes it difficult for wireless competitors to steal CHTR customers, as they cannot underprice CHTR's wireless service. If wireless providers decide to go to the mattresses (wage a price war) with Charter on wireless, they'll destroy their business, as wireless service is the largest source of their cash flows.

CHTR stock has sold off significantly from its highs. The market is worried about threats from competing technologies: 5G, fiber to the home (FTTH), fixed wireless, and satellite (we'll discuss that one last). We spent a lot of time studying these competitive threats and concluded that they are unlikely to have a significant impact on CHTR.

All these networks/technologies look like this: a lot of fiber crisscrossing the country, which dead-ends in a neighborhood switch. This part is universal for all players other than satellites. Strategy diverges in how the signal is delivered from the neighborhood switch to the individual house – the last mile.

FTTH is bringing ethernet cable to the house. 5G bridges the last mile from the cell tower through a wireless connection. Fixed wireless does this through airwaves – a direct line-of-sight type of wireless (I am oversimplifying). Once the signal gets to our homes, most of our internet usage happens wirelessly through our Wi-Fi routers.

Each technology has its benefits and disadvantages.

Let's start with 5G. It is exponentially better than 4G. It is faster, has less latency, and drains batteries less. But it is still constrained by the scarcity of wireless spectrum – the "air pipe." This is why wireless providers usually limit how much you can download on your device. Typical wireless providers put a cap of 50GB a month of downloads per household. The average cable customer consumes 400GB of data if they have TV service and 700GB if they don't. (Remember, if you don't have TV, you stream it over the internet, and thus consume more data.) Our internet data consumption is only moving in one direction, at a very fast pace, indefinitely: up! This will put further stress on the finite 5G spectrum, whereas broadband's upward bound is virtually unlimited.

5G wireless customers will pay as much as Charter cable customers but will get 10-15x less data and slower speeds. If each 5G customer used as much internet as broadband customers, wireless providers would either go broke (they'd have to be spending hundreds of billions of dollars on new spectrum) or download speeds would slow to a crawl.

Fixed wireless doesn't work well in congested areas where there are obstructions – houses, trees, other buildings. Its impact on CHTR will be limited.

Fiber to the home is the Cadillac of all available services. Here, the last mile is actually not fiber but ethernet cable, but nevertheless it is twice as fast as cable on download and much faster on upload. When you go to the Netflix website and click through movies you might like to watch, you are uploading instructions to a Netflix server and downloading screenshots and video clips. This upload consumes only a tiny amount of bandwidth.

Once you are watching the movie, you are only downloading. Since both cable and fiber provide very fast download speeds, fiber's relative advantage on the download side is not noticeable. Its upload advantage is not relevant for most customers, unless they are uploading large files, which most consumers don't do.

The downside of fiber is that rollout is expensive. Telecommunication technology has made exponential leaps over the last decades. However, the technology of digging ditches and getting permits at local county offices is stuck in the mid last century.

The history of this industry is full of stories of telecom providers promising to build out their fiber networks, doing it, and then stopping short of rollout, complaining that the rate of return on invested capital is below the cost of that capital. The most infamous example is Google's thinking it could overcome the miserable economics of fiber and failing to do so, miserably. Things have only gotten worse since – today the telecom industry is experiencing shortages of both labor and fiber.

The wireless industry has a mixed track record of making rational decisions. Verizon spent billions on Yahoo! and AOL and then wrote those billions off as a bad investment a few years later. AT&T has been by far the worst offender in this space. It recently unloaded TimeWarner (a horrible $100 billion acquisition from a few years ago) into a new company and said that it would focus on its core business of wireless and fiber. We expect AT&T to do what it does best: blow a few billions of shareholder capital and then, just like Verizon, Google and others, throw in the towel on fiber to the home.

Low interest rates are more forgiving of capital misallocation than high interest rates. Thus, we don't expect AT&T's adventure into the fiber business to last very long. Most of AT&T's effort is likely to focus on its DSL customers, whom it is at risk of losing to cable competitors. DSL has much lower speeds than cable or fiber.

The last competitive threat is low-orbit satellites. They are wonderful for difficult-to-reach places, but quality of service is impacted by weather (heavy clouds or rain). They have slower download speeds than cable and face similar spectrum limitations as wireless carriers. They will unlikely find widespread usage in urban areas. We don't see them as a significant threat to cable. Charter's revenue growth over the few quarters did slow down a few percentage points. But the slowdown was not caused by new competition but rather a lack of activity in the housing market, which resulted in lower industry churn. When people move from one house to another, they switch service providers. They usually drop DSL and choose cable. At some point the churn will pick up, but CHTR stock is undervalued even if revenue growth remains where it is today.

I've written many times on the importance of management – the softer side of investing. Over the last few years we have made a deliberate decision to invest in companies run by great management teams. Great management is not only important because of the value it creates, but because of the value it doesn't destroy. Great managers make mistakes, but they'll work day and night to fix them.

Finding undervalued, high-quality assets is difficult in this environment, and not buying them because the management did not pass the smell test requires incredible willpower and discipline.

Management is what attracted us to Charter. They have created a lot of value for shareholders, have a conservatively managed the balance sheet, bought back stock at attractive prices, and did not blow money on stupid acquisitions – yes, they did all that. What really attracted us is that they are playing a long-term game. Charter's broadband service is priced at $60, which is $15-20 cheaper than fiber and cable competitors in other markets. They want to make it painfully uneconomical for new competitors (mainly fiber) to enter into their market. But as Charter's CEO, Tom Rutledge, said, it's the right thing to do for the customer.

Charter is a carnivore of its own shares: Over the last five years it bought almost half of its shares, and it will keep doing it. Charter is not shy about using debt, and it shouldn't be – after all, it has very stable, highly recurring revenues and cash flows. It uses debt intelligently: debt maturities are spread out in small chunks into the future. If the debt market freezes and has a 2008 déjà vu moment, Charter will be able to pay off all of its debt maturities with cash on hand and its annual free cash flows.

Charter is a perfect business for an inflationary environment: Internet is a necessity, and Charter has pricing power. If it raises prices, it will not lose customers (its competitors are getting away with 20-30% higher prices). A large chunk of its costs are fixed and thus will not rise with inflation. In fact, inflation improves Charter's cost advantage against new entrants. The bulk of its fixed costs were spent in pre-inflationary dollars and won't rise with inflation, while a new entrant has to spend newly inflated dollars to build out its network and is thus forced to charge much higher prices to recoup those inflated costs.

Charter should have about $45-50 of immediate free cash flows per share. The stock is about $450. However, the combination of slight revenue growth and share repurchases should lead to $70-80 of free cash flows per share in three to four years. At a 13-17 price-to-free cash flow multiple we get a $900-$1,300 stock. At the current price we see essentially no downside, only upside, in Charter's value. Let's say it only achieves $60 of free cash flows and the market decides to give it only a 10x multiple. It will then trade at $600. Heads we win ($900-1,300); tails we don't lose ($600).

Ironically, the worst thing that could happen to us would be for the stock to go up quickly, which would reduce the amount of its own shares it would be able to buy and thus the future free cash flow per share and upside.

Why Value Investing Requires Thoughtful Arrogance

Click to listen to a narration of this article

8/11/2022

Volatility can be both a feature and a bug of investing. Value investors attempt to treat it as a feature. We try to take advantage of the exuberance of the upswing and the pessimism of the downswing. I use the words attempt and try because though this approach sounds great in theory, reality proves to be a lot more challenging. This gap between theory and practice is created because volatility doesn't waltz in a vacuum.

> You need arrogance as a value investor, but it can also be your downfall. So how do you master the psychological side of value investing?

Upswings are accompanied by optimism and positive news, or at least the positive spin the crowd puts on the news – this pushes a stock up. Downswings don't happen in a vacuum, either; they are accompanied and usually driven by negative news, which results in Mr. Market marking down the value of your initial investment. Fear sets in. What if Mr. Market is right? What if this new news and the army of commentators on CNBC are right?

As the great American philosopher Mike Tyson said, "Everyone has a plan until they get punched in the mouth." Theory gives you the game plan (buy more when the stock is down), but then the market punches you in the mouth.

Our ultimate goal is to narrow the gap between theory and practice and take advantage of volatility. We do this through thoughtful arrogance.

Let me explain.

Investing is an act of arrogance. You are basically saying, "I am right and the person on the other side of the transaction, who is buying a stock from me or selling it to me, is wrong." Value investing takes that arrogance to an even greater extreme, as you are often buying unloved, if not hated, stocks.

However, arrogance comes in different forms. Plain vanilla arrogance is very dangerous in investing. Softbank CEO Masayoshi Son built Softbank out of nothing. He is one of the richest people in Japan, he is a visionary, and he has had one of the best multidecade investment track records. (I wrote about him when we bought Softbank a long time ago.)

However, today his Vision Funds are at the tip of the spear of dotcom 2.0 as it shatters against the rock-hard wall of economic reality, losing his investors tens of billions of dollars this year. Mr. Son is solely responsible for it. He recently admitted, "When we were turning out big profits, I became somewhat delirious." Success went to his head. He started thinking that he had the Midas touch. This is why temperament is so important in investing: We are our own biggest enemy.

And then there is thoughtful arrogance.

This arrogance requires amnesia of your past successes and failures; it is earned with your current sweat, through thorough research. Your research leads you to conclusions that often disagree but sometimes agree with the prevailing trends in the market. Arrogance – belief in your process and research – allows you to follow through on your conclusions, even if the market scorns them.

This is how we try to close the gap between theory and practice created by volatility. We continuously build and update our financial models, talk to companies and their competitors and to industry insiders, do a lot of reading, and debate companies with our peers. We have to keep earning the right to be thoughtfully arrogant through our hard work. When time passes, facts change, and new information comes out, we have to have the flexibility to change our minds. (I did this with Softbank when we sold it a few years ago.)

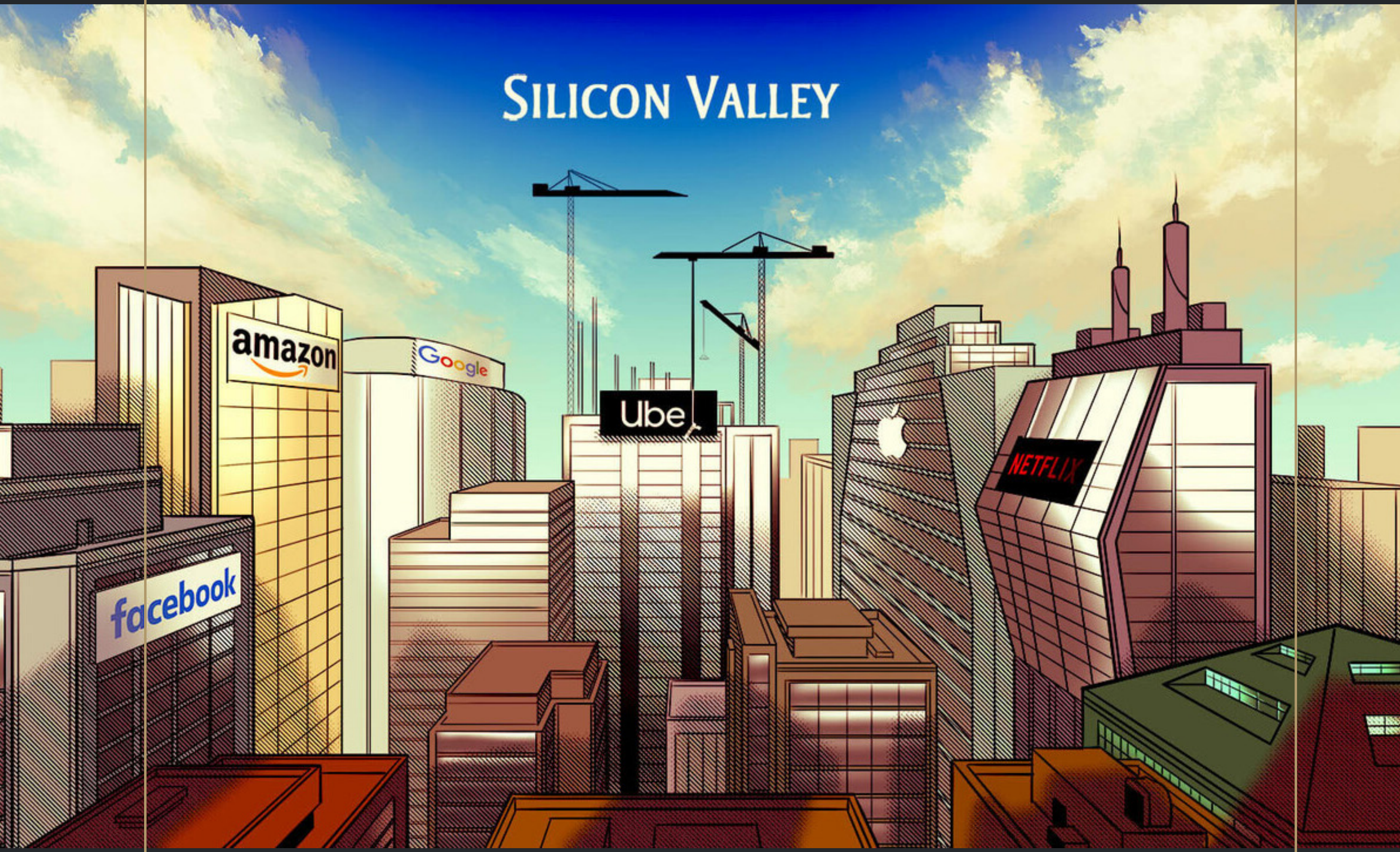
When you are making thoughtfully arrogant decisions, you are ignoring both what the crowd thinks and, just as important, your past successes. You are arrogant (I am paraphrasing Seneca here) because through your research you have discovered the truth (what the company is worth) before time did.

For example, our Uber investment required a lot of thoughtful arrogance. We endeavor to practice it daily, in every investment decision made.

I plead with you again: Earn thoughtful arrogance through your own sweat and research. It cannot be acquired through reading my articles. I am sharing this with you not to provide you with fish but to teach you how to fish.

Hidden Forces

One last thing. I was interviewed by the brilliant Demetri Kofinas on his Hidden Forces podcast. It is one of the very few podcasts I listen to every week. Along with discussing Soul in the Game, the economy, and the markets, I shared the story of how I got General McChrystal and others to endorse my book. You can listen to the interview here.



Why we bought more Uber shares as the stock fell

Click to listen to a narration of this article

8/18/2022

Uber is the second most controversial stock we've ever owned (first place goes to Softbank). Most people have used Uber's service, and thus everyone has an opinion and the media loves writing articles about Uber. The company has a history of not making any money. I've written a long research piece on why Uber, despite (or maybe because of) being a controversial company, has the makings of being a terrific long-term investment.

Despite being a very controversial choice, we believe Uber stock is still a great investment and have bought more on its way down. Here's why.

The pandemic had a mixed impact on Uber. Its core ridesharing business, which was supposed to turn profitable right before the pandemic, was significantly affected by the virus. The impact was immediate – people stopped traveling and started socially distancing.

But even after the economy reopened and people were willing to take Ubers again, the company did not just snap to profitability; it had to rebuild its driver network. Uber had to pay extra bonuses to drivers, whose pockets had just been stuffed with government stimulus checks, to get them to put their Netflix remote controls down, get off the couch, and start driving again. This was very expensive but necessary – one of Uber's competitive advantages lies in the depth of its driver network. Without drivers, Uber rideshare has no product. Consumers expect to push the button on their Uber app and get a car in 15 minutes or less. I remember worrying in spring 2021 that Uber would take a conservative stance in bringing their drivers back, in order to preserve cash. Uber did anything but – it showered its drivers with cash, burning billions of dollars in the process. It was the right thing to do. Lyft has been slower to respond and today is still struggling with a driver shortage, where Uber doesn't have this problem. We are glad that we bet on the right company and the right management.

At this point in time, Uber's international rideshare business has recovered to the pre-pandemic level, but the US business is lagging behind at 70% of its pre-pandemic highs.

The pandemic was a tremendous help to Uber Eats, which at the time was still a nascent food delivery business. Today Eats generates similar revenues to the rideshare business. During the pandemic Uber Eats was fighting with US competitor Doordash for market share and losing a lot of money in the process, but its profitability turned positive in the latest quarter.

Today, Uber Eats is barely profitable, but management believes this business has the potential to be very profitable, and it is profitable outside of the US. We'll believe it when we see it. But we think Uber can build a very profitable advertising business on top of this. The UberEats app is a giant marketplace for restaurants, where they are competing for consumers' dollars throughout the day. Just as Amazon is making billions on advertising on its platform, so can Uber. These advertising dollars come with an 80-90% margin, and it takes little effort (cost) to generate them. The bulk of these revenues will fall straight to Uber's bottom line.

Recent progress

Uber reported a terrific quarter in May. Its revenues and bookings were up 39%. It was the third positive EBITDA quarter in a row. The market yawned at these results and sent the stock down with the rest of the NASDAQ.

A week later, in a memo to Uber employees, CEO Dara Khosrowshahi admitted that the environment has changed – the market doesn't want EBITDA profitability, it wants cash flows. EBITDA is an acronym; it stands for "earnings before a lot of important stuff," like interest expense, taxes, depreciation, and amortization.

Dara pointed out in his memo that the company needs to pay attention to costs, to slow down driver incentives, to be more cautious in hiring (he wrote, "working at Uber is a privilege"); and the company needs to learn how to do more with less. In other words, EBITDA and the unlimited funding party are over; investors want the company to show them the money – free cash flows.

(Uber's EBITDA is about $1 billion greater than the company's free cash flows. Uber is guiding to be free cash flow positive by the end of 2022. It looks like an achievable goal.)

I feel somewhat conflicted about this memo. I really don't like it when a company takes cues from the market on what to do. On one side, the company is owned by shareholders, so the management is hired by shareholders, so it should listen to them.

But.

Uber has roughly 2 billion shares outstanding. 35 million Uber shares change hands daily. A simple calculation would show that the Uber shareholder base turns over every 57 trading days. The reality is that maybe 20-40% of shares are owned by long-term shareholders (like us) and the rest of the volume comes from short-term renters who have never opened the company's annual report and treat the stock as a four-letter trading vehicle.

Uber's management works for this silent minority that does not vote every day on the stock market with their buys and sells. Those who trade Uber's shares three times a day, the ones who sent Uber's stock down, don't know how to spell EBITDA or care about Uber's free cash flows.

In Dara's defense, I think he was reacting not just to the lower stock price but also to the meeting with shareholders he'd had the previous week (with the silent minority). Also, he was right with his message, which applies not only to Uber but to a lot of tech companies. The environment has changed.

Companies are complex organizations that are run not by computer-like superhumans but by regular people who are given as many hours in the day as everyone else. People who, in addition to managing thousands of employees, have families, drive kids to school, fight with their spouses, worry about their careers and retirement, etc. Yes, they may project the confidence of Greek gods; they may be more eloquent speakers, live in bigger houses, drive more luxurious cars than you and I and their poodles may get fancier haircuts; but their world is actually not all that different from ours. They are humans.

These people can only focus on so many things at a time. In a high-growth phase, when capital is abundant for everyone, their focus shifts to growth at any cost. There is a lot of competition for limited talent, and their hiring practices get loose. A lot of exciting ideas land on their desks, which results in too many balls in the air, too many projects with questionable profitability being funded. But more revenue rolls in every day. Capital markets are throwing money at you and everyone is fighting for market share, ignoring the cost.

I run a much smaller company, but I observed this in my own behavior a few years ago. As our growth accelerated, I found that I started paying less attention to our cost structure; I started working ungodly hours; I made questionable hiring decisions (which I have since resolved). I can only do so many things well. I have learned since to put many projects in the future pile, realizing that my team and I can only have so many balls in the air before we start dropping them.

Similar dynamics happen to executives of larger companies, just on a grander scale with more external pressure and more constituents to deal with.

Low interest rates are very stimulative to investors' imagination. Low interest rates love the promised land, far far away. Nothing brings this imagination back to mother earth like rising interest rates. Uber and the rest of Silicon Valley have entered into "show me the (free cash flow) money" land. I would not be surprised if we started seeing minor layoffs coming from Uber as it rationalizes some of its pie in the sky projects and focuses on doing more with less.

This is great news for shareholders, not so good news for tech workers who got used to the idea of making three hundred thousand dollars a few years after college, and not so good for the Silicon Valley housing market.

Let me explain why we are not swayed by the recent decline in Uber's stock price but actually welcomed it and bought more shares.

Uber is a dominant global business with a significant growth runway and an insurmountable competitive advantage. The rideshare and eats businesses still have a tiny share of the potential market and will be growing at a high rate for a long, long time (especially the rideshare business).

Uber's competitive advantage comes from several sources:

Network effect

Today a consumer pulls up an Uber app, taps a button, and a car shows up in 15 minutes or less. This two-sided network of consumers and drivers is incredibly difficult to build and disrupt.

Scale

Uber has the largest global platform. It is in 10,000 cities in 71 countries; thus it can spread its R&D across a large revenue base. Being in different markets allows the company to tinker with different business models and adapt what it learns in one market to others. For instance, in Japan Uber doesn't have its own drivers but the service is used to hail taxis. In 2022 Uber announced that by 2025 it will do the unthinkable; it will bring taxis onto its app in all of its markets. Taxi drivers love this, because how much they make per ride will not change, but they'll spend a lot less time driving without passengers. The user experience will not change, except that when you order a car, instead of a Toyota Corolla you'll get picked by a taxi. Uber's profit per ride will remain the same, but it will double the supply side of drivers in its network in 3 years.

On the last earnings call, Uber also announced that it will start pricing rides based not on miles traveled but on the attractiveness of the trip for the driver. For instance, when a driver drops off a passenger at the airport, he can pick up another passenger in a matter of minutes. Thus, he won't be driving back empty. This ride is more attractive and will be priced on a lower per-mile basis. However, if the passenger is going to the outskirts of a city, where the driver would have to drive back for half an hour without a passenger, this ride will be more expensive on a per-mile basis, compensating the driver for lower utilization. This is a very difficult math and data problem that requires a tremendous amount of R&D effort. Uber can solve it for the US market and apply the algorithm to the rest of the world. Its competitors may not have the ability to do this.

Being in different markets also diversifies Uber's regulatory and competitive risks. If a competitor in one market starts a price war, Uber can successfully wage this fight with other markets subsidizing the at-war market.

Name recognition

Uber is synonymous with rideshare. Uber is not the company that invented the rideshare business model – that was created by a company called Sidecar, which borrowed the concept from a nonprofit company called Homobile, which provided rideshare services for that LGBTQ community in San Francisco. Both Homobile and Sidecar are lost as footnotes in the history books. Uber is the app most people think of when they… actually, Uber is trying to expand what people think about when they think of Uber. Today in some markets you can order a ride, food, alcohol, and groceries; send a package across town; rent a car from other private owners and rent-a-car companies; and even buy bus tickets.

Providing all these services helps to increase drivers' earnings, as they drive people in the morning and evening and deliver food, packages, and groceries in between. Uber is achieving this by developing a super app – one app for everything. Super apps are very popular in China.

This brings us to another important advantage: UberOne, Uber's version of Amazon Prime – you pay $9.99 a month or $99 a year and you get discounts across all of Uber's offerings. Per Uber management, UberOne's users spend 2.7 times more than an average user of Uber. Amazon trained us to default to its website when we need to buy something. We stopped comparison shopping (especially for low-ticket items) and now we just hop on Amazon and buy. Uber's goal is to create a similar muscle memory with Uber customers, and UberOne may lead us there.

Uber competitors are coming out with their versions of loyalty products. This is good for the industry overall, as it will cement market shares and stop price wars.

Uber's valuation

To value a company, it needs to have earnings (free cash flow). This means that the company will stop relying on the kindness of strangers – capital markets. Very good news. But this doesn't mean that the company is worth much above zero. Uber will be free cash flow breakeven by the end of 2022. Uber's significant earnings (free cash flow) power doesn't lie that far in the future.

Unlike a traditional digital business, Uber lives in both the analog (real) world and the digital one. The analog business (recruiting and supporting drivers) brings a higher fixed-cost structure, and this is why, till this day, Uber has been losing money.

Our analytical model is very simple: Today Uber is at scale, and so 40-60 cents of every incremental revenue dollar fall directly to Uber's bottom line. Thus, Uber's profitability will grow not at a linear but at an exponential rate. Wall Street estimates that Uber will generate $7 billion of free cash flows in 2026 (or about $3.50 per share). Our own estimates are not much different, though Dara's focus on "showing the money" may lead to achieving this number sooner.

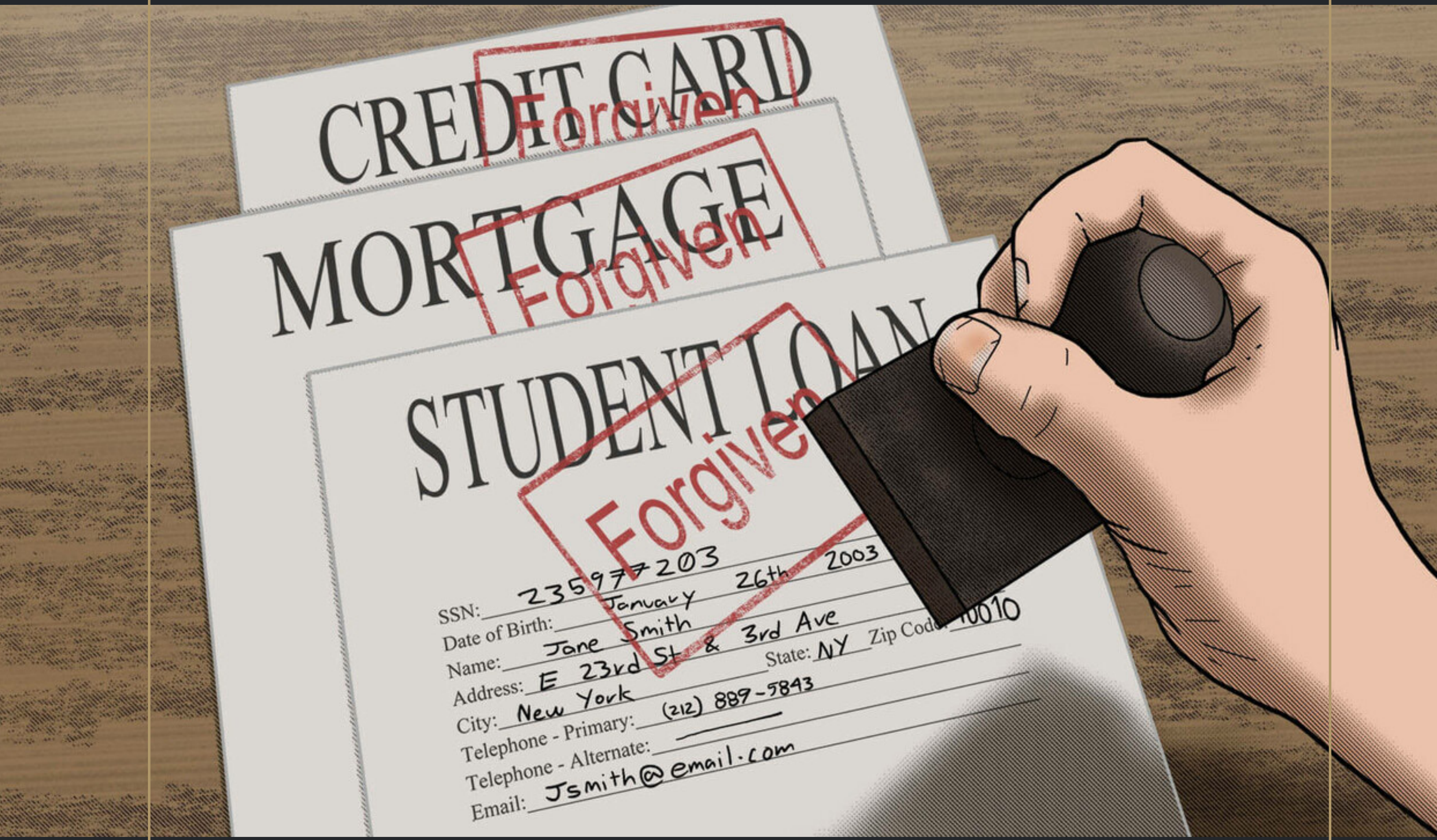
Uber owns a chunk of China's Didi and other rideshare businesses, which a few months were worth as much as $7 per share.

We find ourselves in the somewhat uncomfortable place of not knowing how much Uber stock is worth. But, we know it is worth a lot more than the current price. Uber has a lot of optionality that lies in the future. For instance, grocery and alcohol delivery are in a nascent state which may turn into real businesses. Uber Freight has the potential to become a larger business than rideshare and food delivery combined. Freight shipping (think of all those semi-trucks you see out on the interstate) is a very fragmented market that is mostly operated with technological efficiencies from the 1970s. Uber has a good shot at transforming and dominating this market. This business broke even last quarter and has about $600 million of revenues.

A client asked about the risk of investing in autonomous driving. I spent a lot of time thinking about autonomous when I researched Tesla (we'd be delighted to mail you my Tesla book). It will be a long time before it becomes ubiquitous. The technology is not ready for prime time unless the weather is perfect (God forbid it rains or snows) and the car operates in a very discrete environment (within a few city blocks).

We still need to develop a legal framework to answer a simple question: Who is responsible for an accident caused by an autonomous vehicle? But let's say autonomous cars hit the market tomorrow. There are 150 million cars on the road in the US today. You'll need to have millions of auto-cars on the road to be a threat to Uber. Remember, the key to a successful rideshare business is the car showing up in less than 15 minutes after you request it. It would take a long time to build an autonomous fleet. The most likely scenario is that autonomous cars will join Uber's platform as another, likely cheaper, service for brave souls.

We look at a portfolio as a portfolio. I know, this is the tritest sentence ever written. But it is important to remember that value comes in different shapes and sizes. Our goal is to build a diversified portfolio of high-quality, undervalued businesses. For a lot of stocks we own, value stares you in the face in the form of the earnings that are right in front of you. In fact, that is the case with almost all the stocks we own. Uber requires us to look a bit further, as its earnings power will be unveiled by revenue growth and time. In the context of the portfolio, Uber makes a lot of sense; and over the years, as the company shows us the money, it will look like a perfect fit in our portfolio; but at that point the stock price will, hopefully, be a lot higher.



A Value Investor's Analysis of Student Loan Forgiveness

Click to listen to a narration of this article

8/31/2022

My wife Rachel and I had our son Jonah in 2001. I was 28 and she was 23. Rachel quit her job and became a stay-at-home mom and part-time student at CU Denver, where she was finishing her bachelor's degree.

> Individual impact aside, Biden's student loan forgiveness will also affect the US currency and economy. Here's how we see it as value investors.

Both Rachel and I immigrated to the US ten years earlier, from the USSR. Now, I had a master's degree in finance and a CFA license but was just a few years into my career as an analyst. I was working for a small investment firm, IMA, making $40,000 a year. As soon as Jonah was born, we opened a custodial educational account and started saving $2,000 a year for Jonah's future education.

This $2,000 in 2001 was an enormous amount of money for us; it was around 7% of my after-tax income. We had a very modest lifestyle. We were still paying off our college debt. This education money could have let us afford to eat out, enjoy a daily trip to Starbucks, or take another vacation or two. We bought used cars, drove them for decades. We made a budget and lived by it (I wrote about it here). We felt it was our responsibility as parents to make sure that our son went to college and was not burdened by college debt. The value of education had been drummed into our heads by our parents. We wanted to give Jonah every advantage he could get in this country.

We opened similar education accounts for our daughters Hannah and Mia Sarah when they were born in 2005 and 2014. Though my income was growing as my career advanced, funding these accounts was always an effort. We needed more bedrooms – we bought a house. Also, when storks bring babies, what follows are unending new expenses: diapers, daycares, after-school activities, and the kids keep growing, so they constantly need new clothes.

As I look back at those years, though they were often trying, they were some of the happiest of our lives. This is the behavior I'd want my kids to replicate: Live within your means. Don't get into credit card debt; pay off debts quickly. Save for a rainy day. Create a budget – which is basically categorizing and mindfully allocating your spending to things that are important to you. But making sure you take care of your kids' education is at the top of the list. In advice to my kids, I'd throw in some Stoic wisdom, in that happiness comes from wanting what you have. Once your basic needs are taken care of, material things bring little happiness.

And then…

President Biden, with an executive order (a decision that did not go through Congress) "forgave" $10,000+ of many students' loans. Aside from the fact that every member of my household, including my 8-year-old daughter Mia Sarah, is now on the hook for about $1,000 for this "forgiveness", it felt like what Rachel and I were trying to teach our kids is now thrown out the window.

As I promised you, this is not a political essay, so here's the analysis part.

This loan forgiveness is a very dangerous, slippery slope. Some will argue it started with Uncle Sam bailing out the big banks during the Great Financial Crisis. That is debatable, and there are a few important differences: The government did not "forgive" the banks or give them money but provided high-interest loans. Uncle Sam came out ahead in the end. Arguably, if the US had not bailed out its financial institutions, our whole economy would have crumbled. However, I am aware these nuances are somewhat lost, as the public looks at the government's actions as a bailout. This sets a dangerous precedent. Yes, the government came out ahead, but it could have lost money.

Then, during the pandemic, the government opened the door wide-open by throwing trillions of dollars at anyone and anything with a bank account with a multi-trillion-dollar PPP shower. Arguably, this was necessary in the face of a global emergency, though the magnitude and follow-up stimulus are open to debate. Although this time around the government wanted to make sure that everyone got the money (not just the fat cats on Wall Street), due to its ineptitude a lot of this money was misappropriated. Some were showered with more PPP money than others.

Now today, anyone who went to college, has student loan debt, and makes less than $250,000 a year (per couple) receives "forgiveness" from Uncle Sam and my daughter Mia Sarah.

This executive order doesn't even attempt to fix the core issue of runaway inflation in college tuition. In fact, it will likely make tuition inflation even worse by throwing more taxpayer money at colleges and lead to endless "forgiveness" in the future.

But what about the plumber or truck driver who never went to college and thus has no college debt to forgive? This where the slippery slope turns into a giant landslide. They are next. As interest rates go up, people go upside down on their houses and mortgage interest cripples them. No worries, Uncle Sam and Mia Sarah will come to the rescue; they'll forgive those loans. But what if you are not lucky enough to own a house but have a mountain of credit card debt? Don't worry, you'll be absolved of those sins, too – you won't be left behind.

In the meantime, people who are like Rachel and I were 20 years ago, folks who give up vacations, new cars, Starbucks frappuccinos and Chipotle burritos to save for their offsprings' education are incentivized to do the opposite. Why bother?

Making choices as to what college to attend, selecting a major, and deciding how much debt to take on falls into the personal responsibility bucket, too. When the government decides to forgive student loans (and then, maybe, mortgages and credit card debt), that is a plain-vanilla wealth transfer to those absolved from their debt (their past choices) from the rest of the society, who made painful, responsible choices, and from future generations (the Mia Sarahs and those who are yet to be born).

The US has earned the right for its dollar to be a world reserve currency. It was earned because we had the strongest free market economy. There is a very good reason why most innovation doesn't take place in Europe but in the US. We are the country where people want to take risks, enjoy the fruits of their successes, and pay the price of their failures. A free market economy cannot exist without failure, just like heaven cannot exist without hell.

The reason companies fail, and empires collapse is simple – they become arrogant. They forget that their success was earned by sweat and paranoia. They start taking it for granted. They become fat, lazy, and happy. Just like companies and empires, the US is not absolved from the laws of economics.

As our government adds more debt and probably raises taxes, inflation will not be transitory but will become a nightmare of everyday life, and our economy will weaken. With every "forgiveness," the US dollar will become a less attractive currency, as it will buy fewer and fewer goods. It will be less differentiated from the currencies of other troubled countries.

As an investor who is hired to preserve and grow my clients' nest eggs, I'm finding, unfortunately, that diversifying away from the US dollar is becoming a responsible thing to do.

IMA is not for everyone. I'm fine with that!

Click to listen to a narration of this article

9/29/2022

Today I am going to do something I rarely do: share a note I received from an IMA client and my rather lengthy response. For obvious reasons I removed any private information about the client and changed his name to "John".

There are many investment lessons, and more importantly, insights about how to choose a money manager in the letter below. I'll provide additional thoughts on the topic in the post-script after the letter.

How great alignment with clients creates the perfect recipe for long-term compounding. (And I get to drive my kids to school.)

Here's the email from the new investor with IMA, "John":

"We transferred $3M to you to invest on our behalf 3 months ago,

As of yesterday the $3M had increased by 3.3% plus or minus, to $3,105,000

During the same period, the S&P Index, which we could have invested in via Vanguard (with whom we have an account), had increased by 8% plus or minus. If the same $3M had been invested there, the value now might be $3.24 million plus or minus. This comparative difference has maintained itself over the 3 months (we check our Schwab account frequently).

So how do you think we feel at this point? I appreciate, from reading the notes from VK, that your team would probably respond that your investment choices are intended to weather the bad times ahead (SUV value stocks vs. sedan growth stocks).

The results are an incentive to invest any $$ we have now elsewhere— and to seriously consider reducing the $$ we have invested with IMA."

Dear John,

Thank you so much for your email. I am glad you emailed us now, early in the relationship, because this gives you an opportunity to take a corrective action which I'll discuss at the end of the letter.

You are right, we are building an all-weather portfolio to handle any environment the economy sends our way. Our aspiration – whether we'll achieve it or not only time will tell – is to do better than the broad market. However, this is not where our energy is focused: Our main goal is to preserve and grow your wealth over the long run. This may sound contradictory to our aspiration to do better than the market. It is not.

Over the last few decades, investors achieved good returns with ease, simply by buying a broad market index. This is unlikely to be the case over the next decade or two. Stocks are expensive, global debt is high, and future economic growth has more headwinds than tailwinds.

As you have noted, we have a portfolio of all-terrain SUVs. We don't know when the terrain will turn from a flat, well-maintained highway into a rocky, rutty track. We are investing as if we were in the rocky part already. If the road ahead remains as it was over the last decade, then what we do will likely produce below-market returns. But if the excesses of the past catch up with the market and the economy, then our SUVs should handle the tough terrain while the sports cars will be left behind.

To finish first, first you must finish. We are focusing on the finishing part; being first (beating the market) would be a nice bonus.

But this is not why we are up 3% and the market is up 8% over the last three months. To be totally honest, I don't know why our stocks are up, not down and the market is up 8% and not up or down 15% in the three months you've been with us.

Though the army of experts on CNBC may sound very confident and convincing when they opine on what the market will do over the next three months or years, nobody actually knows. Nobody! I'll phrase it slightly differently. We simply don't have the tools to predict the future or what our stocks will do in the coming months and years. Thus we don't even try. I've been investing for more than two decades, and I am yet to meet someone who has done market timing successfully in the long run. And the behavior of stocks in the short run is completely random.

We are long-term investors. Actually, the preceding sentence has a redundancy – you cannot be an investor in the stock market and not have a long-term time horizon. We are investors. In our analysis we approach the stocks we own as businesses. Our attitude is not that we are buying digital bits stored on a mainframe, but real businesses. As we study each company, we analyze management, build financial models, try to "kill" the business, come up with a guesstimate (and it is a guesstimate) of what the company is worth, and then patiently look to buy the company at a significant discount to what it is worth. We do all this looking a decade out.

And then:

Every day we come to the office and Mr. Market – millions of investors – opine on what our businesses are worth by buying and selling them. We spend very little energy agonizing over these price changes, because they are completely random. The price you see today on any stock in your portfolio is an opinion, not a final judgment. In fact, our companies' fair value changes very little every day. On average it may go up a tiny, tiny bit every day, since in the long-term (key word here) our companies will grow their earnings and accumulate cash. In the long run, stock prices should converge with businesses' fair value. Historically they have.

You mention that you are monitoring your brokerage account "frequently." You've said it with pride, like you are doing your part of the homework as a responsible steward of your family's capital.

I can understand the intention, but I'd argue that looking at your portfolio daily will do you more harm than good. First off, what you are observing on a daily basis is complete and utter noise.

But it's not harmless noise.

This noise has a <u>net negative impact</u> on your (and on anyone's) mental state. We humans are wired in such a way that a 10% loss deals us more pain than the pleasure we experience with a 10% gain. In other words, when you observe your portfolio, in a span of three months, going from $3M to $2.7M, then to $3.3M and back to $3M, while your net worth has not changed, your emotional state has suffered a little. You would have been a lot better off if you had just looked at your account after three months and seen that your portfolio's market value was unchanged.

Early in my career I was glued to the flickering stock market screen all day long. I thought it was a responsible thing to do. It took me a while to realize that I was poisoning myself with worthless, toxic noise that shrank my time horizon and made me less happy. Today I look at clients' portfolios and our watch lists once a day. I do it for opportunistic reasons: I am looking to buy stocks on our watch list, add to stocks that have declined, and sell stocks or reduce positions that went up. I also don't want to miss important news.

My advice to you and to all clients: Don't look at your portfolio more than once a quarter. If you are a long-term investor, you have little to gain from it. We will suffer the toxicity of the stock market on your behalf; this is why you hired us.

When you hired IMA, you made a leap of faith. I am humbled by it and don't take my responsibility lightly. I have both skin and soul in the game: The bulk of my family's liquid net worth is invested in the same stocks you own. I don't have any other equity investments. I pour every ounce of my soul into what I do. I love it! I am IMA, and so are the team of individuals who work here. I would not dream of doing anything else.

Hiring IMA should have liberated you from worrying about your nest egg. Worrying should be our problem.

Now, I'd like to address whether you have made the right decision in hiring IMA. We put a lot of effort into educating prospective clients on what we do and don't do. Unlike other firms, which will take money from anyone who can fog a mirror, we are selective and request three things from clients:

1 – Buy into our investment philosophy.

2 – Have a long-term time horizon.

3 – Do their homework: read the in-depth letters I write three or four times a year.

The front page of the IMA website reads: "We grow your wealth. You don't worry about the market." These are not empty words to us, but neither the growth nor the worrying part will work if even one of the three things above is missing.

Your email indicates that though you entrusted your assets to us, you have not bought into our investment philosophy, nor do you have a long-term time horizon. The growth part will not work without those two things. You'll end up doing what most investors do – buying high and selling low. This is why being the right fit with IMA is so important. I don't want you to fire us when our portfolio is down, thus cementing your losses due to volatility. I don't want what we do to end up harming you.

I don't know if you have read my latest letter and the writeups on the companies we bought for you. If you have not, when you look at your IMA portfolio or statement, all you see is a collection of random tickers, not a carefully chosen group of businesses.

I spend 30+ hours on each letter I write to you for a reason: I want your portfolio to stop being Vitaliy's portfolio and become John's portfolio. Thus, when the market takes a 30% hit – and at some point, it will – the volatility of your blood pressure will not spike. You'll understand that while their prices may have declined, what this carefully assembled collection of businesses is worth has not.

During the last three months we've been in a benign market – it actually went up after a significant decline. That won't always be the case.

Based on your letter, I get the feeling that we are missing at least two out of the three, or maybe all three, of the required attributes for us to be a good fit. My advice to you is to seriously rethink our relationship. I am attaching our brochure in both PDF and audio formats. Please reread it carefully and evaluate if what IMA does and asks for from clients is for you. If the answer is yes, we welcome a long and prosperous relationship.

If you decide to terminate our services, there will be no hard feelings from us. I won't take it personally. We'll help you to transition to Vanguard or wherever else you'd like to move your assets.

Enjoy Life and Prosper,

Vitaliy

My (Vitaliy's) Additional Thoughts:

It is easy to villainize Wall Street and large investment firms. The mega-giant mutual fund complexes, which manage hundreds of billions of dollars, get very little sympathy. We can accuse them of having a short-term time horizon, hugging benchmarks, having no soul in the game.

They are all that.

But if you peel off a few layers from these corporate behemoths, you find that these companies are full of people who are just responding to incentives. Inflows and outflows of capital into their funds are driven by their short-term performance. They outperform the benchmark for 3 months, 6 months, a year, and they get inflows and thus huge bonuses.

Underperform and the capital will outflow into the fund of a competitor who had better short-term returns. In this game long-term doesn't and cannot exist. If you stayed away from investing in dotcom 1.0 or 2.0, you did the responsible thing. Instead, you bought undervalued companies with real cash flows – and you massively underperformed your competition.

As a disciplined, value-oriented mutual fund manager, it was a financially rewardless activity.

When the dotcoms predictably turned into dotbombs, declining 70%, you celebrated a pyrrhic victory. Your mutual fund was up, and most importantly, you preserved your clients' capital. The problem is just that 90% of your clients are gone.

Capital from your strategy seems to have flowed out to apparently "greener" pastures, which were actually just brown minefields painted green by the bull market. You've been fired by your firm as an old has-been after years of underperformance, and lack of assets to manage. You are divorced, trying to kick an acquired cocaine addiction, and your kids are driven to school in a fancy car by their new stepdad (who has great hair), that played the short-term dotcom game, wiping out his clients' assets in the subsequent bust but raking in giant bonuses in the process. Now he's starting a new fund with a slightly different name to capitalize on the latest fad, which won't end well either but will make him even richer.

Alright, I may be overdramatizing a little here. Sure, some value mutual funds survived. But many others went out of business, and some large mutual fund companies removed the value investing style box from their product offering. But the point still stands: If you are playing the long game on Wall Street you had better be right in the immediate short term (and the next one and the next one) or you won't have the capital to be there to see the long term.

So it's rare to find someone playing a long-term game, but they do exist.

If you want to have a sustainable business and still have soul in the game, you'd better have the right clients. Clients who are fully aligned with what you are doing. Mutual funds don't get to choose their clients. Their funds are bought and sold like canned soup in a grocery aisle.

Since IMA provides a service not a product, we have the opportunity to choose our clients. I say this, but it's only partially true. What we have discovered over the years is that clients who come to us have usually read my articles for a while and thus have their eyes wide open about what they are getting into. Occasionally we get a client who is not a good fit for us, and we'll ask them to reevaluate whether our services are for them, because we won't change our fundamental approach to investing.

I will never be on the Forbes 100 list. IMA will never be the largest kid on the block. I am absolutely fine with both. But, I get to wake up in the morning, look in the mirror, and feel good about the decisions we are making for our clients. I get to work with wonderful people who have every ounce of their soul in the IMA game. And most importantly I get to drive my kids to school.

Post-Script:

John said that he "got the hint," and we helped him transition his assets out of IMA.

Are housing prices about to drop? A value investor's take

Click to listen to a narration of this article

11/3/2022

Inflation is on the rise in the US. So are the interest rates. So what about the housing market? Are we going to see housing prices decline? Read below to find out.

Arthur Brooks, in his interview with Peter Attia, which I highly recommend, provides a formula for happiness: enjoyment (pleasure + elevation in relationships), satisfaction (reward for a job well done), and purpose (meaning in life).

I was reflecting on this and realized that it aligns perfectly with my personal definition of happiness: relationships, flow, net positive. People write books on this subject; I'll try to sum things up in a few paragraphs.

Relationships: Have good, warm, meaningful relationships with family and friends. This requires both addition and subtraction – allocating time to relationships that bring meaning and deallocating time from the ones that come with empty or, even worse, negative calories. Emphasize quality vs. quantity here. And to be happy in relationships I have to be present (mindful) – not going through life daydreaming about the past or the future.

Flow: In Soul in the Game I called it flow. Have a creative flow in activities that you love and that are meaningful to you. These are highly personal choices; for me they are: investing, writing, and running IMA.

There is a lot of subtraction in this category, too. A few years ago I identified all the activities that fell into my lap. I wrote them down in two columns: "Love doing" and "Able to delegate." I kept the ones that I loved doing and that were important ones that I couldn't delegate. But I delegated things like the scheduling of my appointments (this saves me at least an hour a week).

One activity that I discovered I don't like doing is giving presentations. I don't need to do them, but I mindlessly agreed to do them when I was asked. They occupied too much of my mental real estate as I kept thinking about them in the weeks before I had to give a speech. I realized there was a part of presentations I actually enjoy: the Q&A that follows the talk. Now, when asked to speak, I respond that I don't do traditional presentations but love Q&A in a fireside chat type of format. To my surprise, most people welcome it.

Net positive: This is a broad category. It applies to all my main activities, relationships, and interactions with other people (including perfect strangers).

In my day job, investing, I am making a difference in the lives of IMA clients. I know, I am not saving people from burning buildings, but IMA allows people to go through their lives and not worry about their retirement or ability to pay for their grandkids' education. I find meaning in it. Writing allows me to help people on a larger scale. I'll be doing it even when IMA closes its doors to new investors (and at some point, it will). My articles are read by hundreds of thousands of people. Being a net positive was one of my main reasons for writing Soul in the Game. There was a lot of altruism in that two-year endeavor.

What I am about to share with you is an excerpt from a fall letter I wrote to IMA clients. It is long; therefore I've divided it into two sections. Today I'll discuss the (sorry) state of the housing market; next week I'll discuss the economy.

The Housing Market is Worse Than You Think

In this letter I'd like to explore the impact interest rates will have on the economy and especially the housing market.

Currently, the 30-year mortgage rate is pushing 7.6%, up from less than 3% a year ago, while the median house price in the US is up 37% from $320k in 2019 to $440k today. You cannot have both interest rates and housing prices making new highs. Something's got to give.

Let's start with new home buyers, as they'll be impacted the most.

If you are a first-time home buyer, you don't have home equity to roll into a new purchase. If you bought a house in 2019 for $320k (assuming you put down 20% of the purchase price as down payment), your annual mortgage payment at 4% would have been $15k.

Two years later, in 2021, you would have paid $420k for the same four walls and white picket fence (dogs, spouse and 2.5 kids sold separately). However, despite a 37% house price increase, thanks to Uncle Fed, you would have been able to finance this purchase at 3%, and your annual mortgage payment would have gone up to $17k – a manageable $2k annual increase.

As I have mentioned, today the median house price is at $440,000, but the interest rate has skyrocketed to 7.6%. Thus, if you are a first-time home buyer, the same American dream would cost you $30k a year – that is a $13k increase from just a year ago.

Let me put this in proper context – median annual household income in the US is about $75k, or about $60k after taxes. In other words, half your after-tax income is now going to servicing your mortgage if you bought today at peak home prices and rates.

It is easy to see how the combination of high prices and rising interest rates have turned the American dream of owning a home into a nightmare. For affordability to come back to 2020 at current interest rates, housing prices have to decline more than 40% to $250k. If this were to happen, anyone who bought a house since 2012 would be underwater on their initial purchase.

It is hard to envision this rapid price decline happening overnight. Just like stock prices, housing prices are set by supply and demand. But houses are not like stocks. People live in their houses, raise their kids there, create memories, and thus get emotionally attached to them. Also, many decades of declining interest rates and rising housing prices have convinced the public that increasing housing prices must be guaranteed by the US Constitution in tandem with the right to the pursuit of happiness.

When we decide to sell our house and we receive offers that are below the highest price we saw on Zillow just a few months earlier, we wait for the right, higher offer to come in. This is why the fact that we live in our houses is important – we are emotionally attached to them and want the best offer possible. This is also why housing prices are quick to move up and slow to come down. It takes multiple painful conversations with a realtor to convince us to start lowering the asking price.

This is where things get even more complicated. There are two types of sellers: people who must sell their houses (moving to a new city, lost a job, got divorced) and those who would like to sell their houses (bored with their old four walls, need a bigger or smaller house, would like their kids to go to better schools etc.). I am generalizing here.

Our house is worth what someone else is willing and able to pay for it.

Let's contrast two transactions:

You are at a grocery store – you want to buy tomatoes, but the price of tomatoes has doubled. Your credit card company is not going to say, "Jane, you cannot buy tomatoes. They are too expensive. You cannot afford them." Unless you are maxing out your credit limit, your credit card company doesn't care how you spend your (borrowed) money.

This is not what happens when you take out a mortgage on your house. After being blamed for the last housing crisis, bankers became born-again bankers: they found underwriting religion. If an average consumer walks into a bank asking for a loan, this born-again banker will look at the cost of the house in relation to the buyer's income and will politely tell the buyer to look for a cheaper house or start driving Uber on weekends.

In the past, a lateral change from one house to another did not really cost you much, other than transaction costs. However, if you refinanced your house at 3% when rates dropped, as many people did, today this lateral move would cost you dearly.

How much?

The median mortgage on a house today is about $220k, and the median home equity loan is $40k. My goal here is to be vaguely right rather than complicatedly precise, so I assume that an average homeowner owes a total of $260k for their house. If the house was refinanced at 3–4% interest rates in 2021 and 2022, then that average homeowner is paying about $13–15k a year for their house.

Unfortunately, the mortgage is attached to a house. Selling a house cancels an existing mortgage, and a new house requires a new mortgage at market rates, which today are 7.6%. Thus, this new mortgage would cost $22k a year, or a $7–9k increase. Just selling your house and moving to a similarly priced house a few blocks away would cost about 10% of your annual income! This explains why the number of transactions in the housing market has hit a multi-decade low.

(When my brother Alex, a realtor, asked me if my housing market analysis came with any good news, I told him, yes, your family loves you.)

When prices go up, people who want and must sell a house are selling with ease. As prices decline, at first only people who must sell are selling. However, as time goes by, selling becomes less and less discretionary as a desire to sell turns into a need.

People who must sell their houses will have to accept lower prices. How much lower? That is impacted not just by a seller's willingness to accept a lower price (supply) but also by a prospective buyer's ability to borrow (demand).

I hear this argument at times: "In the 1980s interest rates were higher than they are today, and we had a functioning housing market." There is a substantial difference between then and now. Today the median house price in relation to median income is at the highest level in modern US history, even higher than it was at the height of the housing bubble in 2007. It is almost double the level of the early 1980s.

Side note: The situation I described above is not unique to the US. In fact, other countries, including Australia, Canada, and the UK, are experiencing much bigger housing bubbles.

Today, consumers' discretionary income is being attacked by inflation from different directions: The cost of everything is up, from trash collection to food. Gasoline prices have declined, likely due to our tapping into our strategic oil reserve and the slowdown in the economy. Food prices are less likely to decline, though I could be wrong, since they are driven by currently elevated prices of fertilizers (I wrote about that here.)

But it doesn't stop there. Higher interest rates make anything that needs to be financed more expensive – cars, refrigerators, iPhones, big-screen TVs, etc. Over the last decade we got spoiled by zero-percent financing. Unless interest rates go back down, those days are over.

It is important to mention that wage increases to date have lagged inflation by a large margin. The federal government has thrown a bone to retirees by promising to raise Social Security payments in 2023.

Spending is both a financial and a psychological decision. If you feel wealthy and confident in your future, you are willing to spend your savings and borrow (against future earnings) to buy stuff. The stock market decline and declining housing prices, along with rising unemployment, will undermine consumer confidence and willingness to spend. Also, falling housing prices will start to undermine the housing ATM (home equity), and rising interest rates will make borrowing against the house more expensive and reduce equity people have in their houses – thus fewer homeowners will undertake home improvement projects or tap out home equity to subsidize their day-to-day living expenses.

Why non-transitory recession is coming and how to face it as an investor

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Click to listen to a narration of this article

11/10/2022

I am not an economist, but, looking at this picture, it is hard to see how we can avoid a recession. Ironically, we've been in a recession most of 2022 – real GDP declined in the first and second quarters. Economists attributed declining GDP to a "transitory" recession caused by an overhang of pandemic-induced supply chain issues.

As inflationary pressures squeeze consumers from all directions, they simply will not be able to buy as many widgets as they bought the year before. Demand for widgets will decline; companies will have to readjust their workforce to the realities of new demand and thus reduce their employee headcount; and this will lead to higher unemployment. All this, in turn, will lead to lower demand, and voila, we'll find ourselves in a non-transitory recession.

Recessions do not worry us. Though I am sympathetic to people losing jobs and suffering economic hardships, recessions are a natural part of the economic cycle. They force both companies and individuals to become more efficient and thus make them stronger in the long term.

> Recessions are like forest fires – small ones are healthy for the forest. However, the longer you suppress fire, the more dead material the forest accumulates. Eventually, when it does pay a visit, it is more devastating and its effects are more long-lasting.The recession that is coming could be a big fire.

Recessions are like forest fires – small ones are healthy for the forest, as they get rid of dead wood and convert it to fertilizer. However, the longer you suppress the fire (with the best intentions, thinking you are doing a good thing) the more dead material the forest accumulates. Eventually, when fire does pay a visit, it is more devastating and its effects are more long-lasting.

Some folks are upset about what the Federal Reserve is doing now. First off, it is not clear that it is the Fed that is in control of interest rates today and is responsible for their going up. Since inflation is running 7–9%, where would we expect interest rates to be? Second, we should be upset at Uncle Fed for allowing negative real rates for almost a decade, manipulating the price of one of the most important commodities of all, the interest rate (the price of money). This caused bubbles across all assets except one: common sense did not experience much growth.

Since we are on the subject of uncles, we should also not forget to thank another uncle – Uncle Sam. The one who ran our debt from $10 trillion in 2008 to $31 trillion today. When our debt is $31 trillion, each incremental 1% interest rate increase costs the government about $310 billion in interest payments, which equates to a major category of our government spending. The cost of the first 1% increase equates to about how much we spend on Medicaid, a 2% hike in rates costs us about as much as our defense spending, and 3% about equals our Social Security outlays.

Though we have to accept the new reality that income tax rates are likely going higher, it is going to be difficult to tax ourselves out of the current situation we are in – the hole we have dug is simply too big and deep. Also, we are not going to cut Medicaid, Social Security, and especially defense (now that we are in the foothills of Cold War 2.0 with China and/or Russia). That would be a sure way for politicians to lose their jobs. No, we are going to do what every country that can issue its own currency has done since the beginning of time: We are going to print money and thereby try to inflate ourselves out of trouble.

Summing up, the economy is likely heading into a non-transitory recession, and this one may last longer than past ones (we have accumulated a lot of dead wood).

The recession should lead in time to lower interest rates (good news for the housing market) and higher unemployment (bad news for the housing market). Consumer spending is going to be under significant pressure from all directions – a significant headwind for the economy.

Recessions in theory should reduce inflationary pressures. However, the combination of lower tax revenues and higher interest expense (interest rates may decline from the current level, but they are unlikely to come back to 2021 levels) means that our government debt will continue to climb, and the resulting money printing will bring higher inflation (more money chasing fewer goods), thus keeping interest rates not far from their current level or even pushing them higher.

As unemployment rises and we slide into a recession, the Fed may start lowering rates and fall back on its old tricks (buying back government bonds) that we saw over the last decade and a half. However, if inflation persists the Fed may find that the problem it has created over that time is bigger than it can handle.

If reading this gave you a minor headache, imagine what I experienced writing it. Neil deGrasse Tyson has observed that “The universe is under no obligation to make sense to you.” This also applies to the current economy.

To make things even more interesting, while we are facing this economic whirlwind, the market (the average stock) is still expensive. Bonds, though they are yielding more than they did six months ago, still provide negative real (after-inflation) yields and are thus not an attractive asset from a long-term capital-preservation perspective.

What is our strategy in an economy that makes little sense and is under no obligation to do so? Invest humbly and patiently. Humbly because we don't know what the future will hold (nobody does!). You handed us your irreplaceable capital, and thus we'll err on the side of caution.

We'll invest patiently because we don't get to choose the economy or the overall market valuations we find ourselves stuck with – Stoic philosophers would call those externals – and we have no control over them. The only thing we can control is our strategy and how we execute it.

(Stoics would call that an internal.) We are going to continue to do what we've been doing: patiently and methodically keep building a portfolio of "all-wheel-drive," undervalued, high-quality companies that have pricing power and should get through anything the economy throws at them.

In fact, if you look carefully through your portfolio – and this is the beauty of custom, separately managed accounts – you'll see that the revenues of most of the businesses we own are not tied to the health of the economy.

Also, though we may end up being wrong on this (not the first time), the consumer seems like the weakest link in the economy. Though completely eliminating the consumer is an impossibility in a diversified portfolio, over the last year we have significantly reduced our exposure to consumer spending. Our current exposure to the consumer is tiny.

One last thing: We've been slightly reducing the size of individual positions to avoid the potential impact of unknown unknowns, shifting us from 20–25 to 25–30 stock positions.

Tax Loss Harvesting

I enjoy writing about taxes as much as I enjoy going to the dentist. But I feel what I am about to say is important. We – including yours truly – have been mindlessly conditioned to do tax selling at the end of every year to reduce our tax bills. On the surface it makes sense. There are realized gains – why don't we create some tax losses to offset them?

Here is the problem. With a few exceptions, which I'll address at the end, tax-loss selling makes no logical sense. Let me give you an example.

Let's say there is a stock, XYZ. We bought it for $50; we think it is worth $100. Fourteen months later we got lucky and it declined to $25. Assuming our estimate of its fair value hasn't changed, we get to buy $1 of XYZ now for 25 cents instead of 50 cents.

But as of this moment we also have a $25 paper loss. The tax-loss selling thinking goes like this: Sell it today, realize the $25 loss, and then buy it in 31 days. (This is tax law; if we buy it back sooner the tax loss will be disqualified.) This $25 loss offsets the gains we took for the year. Everybody but Uncle Sam is happy.

Since I am writing about this and I've mentioned above I'd rather be having a root canal, you already suspect that my retort to the above thinking is a great big NO!

In the first place, we are taking the risk that XYZ's price may go up during our 31-day wait. We really have no idea and rarely have insights as to what stocks will do in the short term. Maybe we'll get lucky again and the price will fall further. But we're selling something that is down, so risk in the long run is tilted against us. Also, other investors are doing tax selling at the same time we are, which puts additional pressure on the stock.

Secondly – and this is the most important point – all we are doing is pushing our taxes from this year to future years. Let's say that six months from now the stock goes up to $100. We sell it, and… now we originate a $75, not a $50, gain. Our cost basis was reduced by the sale and consequent purchase to $25 from $50. This is what tax loss selling is – shifting the tax burden from this year to next year. Unless you have an insight into what capital gains taxes are going to be in the future, all you are doing is shifting your current tax burden into the future.

Thirdly, in our first example we owned the stock for 14 months and thus took a long-term capital loss. We sold it, waited 31 days, and bought it back. Let's say the market comes back to its senses and the price goes up to $100 three months after we buy it back. If we sell it now, that $75 gain is a short-term gain. Short-term gains are taxed at your ordinary income tax bracket, which for most clients is higher than their capital gain tax rate. You may argue that we should wait nine months till this gain goes from short-term to long-term. We can do that, but there are costs: First, we don't know where the stock price will be in nine months. And second, there is an opportunity cost – we cannot sell a fully priced $1 to buy another $1 that is on fire sale.

Final point. Suppose we bought a stock, the price of which has declined in concert with a decrease of its fair value; in other words, the loss is not temporary but permanent. In this case, yes, we should sell the stock and realize the loss.

We are focused on the long-term compounding of your wealth. Thus our strategy has a relatively low portfolio turnover. However, we always keep tax considerations in mind when making investment decisions, and try to generate long-term gains (which are more tax efficient) than short term gains.

We understand that each client has their unique tax circumstances. For instance, your income may decline in future years and thus your tax rate, too. Or higher capital gains may put you in a different income bracket and thus disqualify you from some government healthcare program.

We are here to serve you, and we'll do as much or as little tax-loss selling as you instruct us to do. We just want you to be aware that with few exceptions tax-loss selling does more harm than good.

The Six Commandments of Value Investing

INTRODUCTION

This piece started as notes for a speech I gave at an investment conference. I then rewrote and expanded it to become a chapter in a book I wanted to write.

When and whether that book will ever be finished is unclear, but this chapter became one of the most important pieces I've written all on its own: to date, over 30,000 people have read it.

This chapter is broken up into 6 parts with a few addendums afterwards. Part 1 is below. If you'd like to read the rest, you can do so here.

THE SIX COMMANDMENTS

These are the Six Commandments of Value Investing. I don't expect any value investors reading this to be surprised by any one of them. They were brought down from the mountain by Ben Graham in his book Security Analysis.

1) A stock is fractional ownership of a business (not trading sardines).
2) Long-term time horizon (both analytical and expectation to hold)
3) Mr. Market is there to serve us (know who's the boss).
4) Margin of safety – leave room in your buy price for being wrong.
5) Risk is permanent loss of capital (not volatility).
6) In the long run stocks revert to their fair value.

These commandments are very important and they sound great, but in the chaos of our daily lives it is so easy for them to turn into empty slogans.

A slogan without execution is a lie. For these "slogans" not to be lies, we need to deeply embed them in our investment operating system – our analytical framework and our daily routines – and act on them.

The focus of this chapter goes far beyond explaining what these commandments are: My goal is to give you a practical perspective and to show you how we embed the Six Commandments in our investment operating system at my firm.

1. A stock is partial ownership of a business

The US and most foreign markets we invest in are very liquid. We can sell any stock in our portfolios with ease – a few clicks and a few cents per share commission and it's gone. This instant liquidity, though it can be tremendously beneficial (we wish selling a house were that easy, fast, and cheap), can also have harmful unintended consequences: It tends to shrink the investor's analytical time horizon and often transforms investors into pseudo-investors.

For true traders, stocks are not businesses but trading widgets. Pork bellies, orange futures, stocks are all the same to them. Traders try to find some kind of order or a pattern in the hourly and daily chaos (randomness) of financial markets. As an investor, I cannot relate to traders –not only do we not belong to the same religion, we live in very different universes.

Over the years I've met many traders, and I count a few as my dear friends. None of them confuse what they do with investing. In fact, traders are very explicit that their rules of engagement with stocks are very different from those of investors.

I have little insight to share with traders in these pages. My message is really to market participants who on the surface look at stocks as if they were investments but who have been morphed by the allure of the market's instant liquidity into pseudo-investors. They are not quite traders – because they don't use traders' tools and are not trying to find order in the daily noise – but they aren't investors, either, because their time horizon has been shrunk and their analysis deformed by market liquidity.

The best way to contrast the investor with the pseudo-investor is by explaining what an investor is. A true investor would do the same analysis of a public company that he would do for a private one. He'd analyze the company's business, guestimate earnings power and cash flows. Assess its moat – the ability to protect cash flows from competition. Try to look "around the corner" to various risks. Then figure out what the business is worth and decide what price he'd want to pay for it (your required discount to what the business is worth). For an investor, the analysis would be the same if his $100,000 was buying 20% of a private business or 0.002% of a public one. This is how your rational uncle would analyze a business – your Warren Buffett or Ben Graham.

How do we maintain this rational attitude and prevent the stock market from turning us into pseudo-investors? Very simple. We start by asking, "Would we want to own this business if the stock market was closed for 10 years?" (Thank you, Warren Buffett). This simple question changes how we look at stocks.

Now, the immediate liquidity that is so alluring in a stock, and that turns investors into pseudo-investors, is gone from our analysis. Suddenly, quality – valuation, cash flows, competitive advantage, return on capital, balance sheet, management – has a much different, more complete meaning.

This important question also brings up the next value investing commandment: having a long-term time horizon – but not just from the perspective of analyzing a company. We'll discuss it in more detail in the next part.

To read the rest of the 6 Commandments, click the link below:

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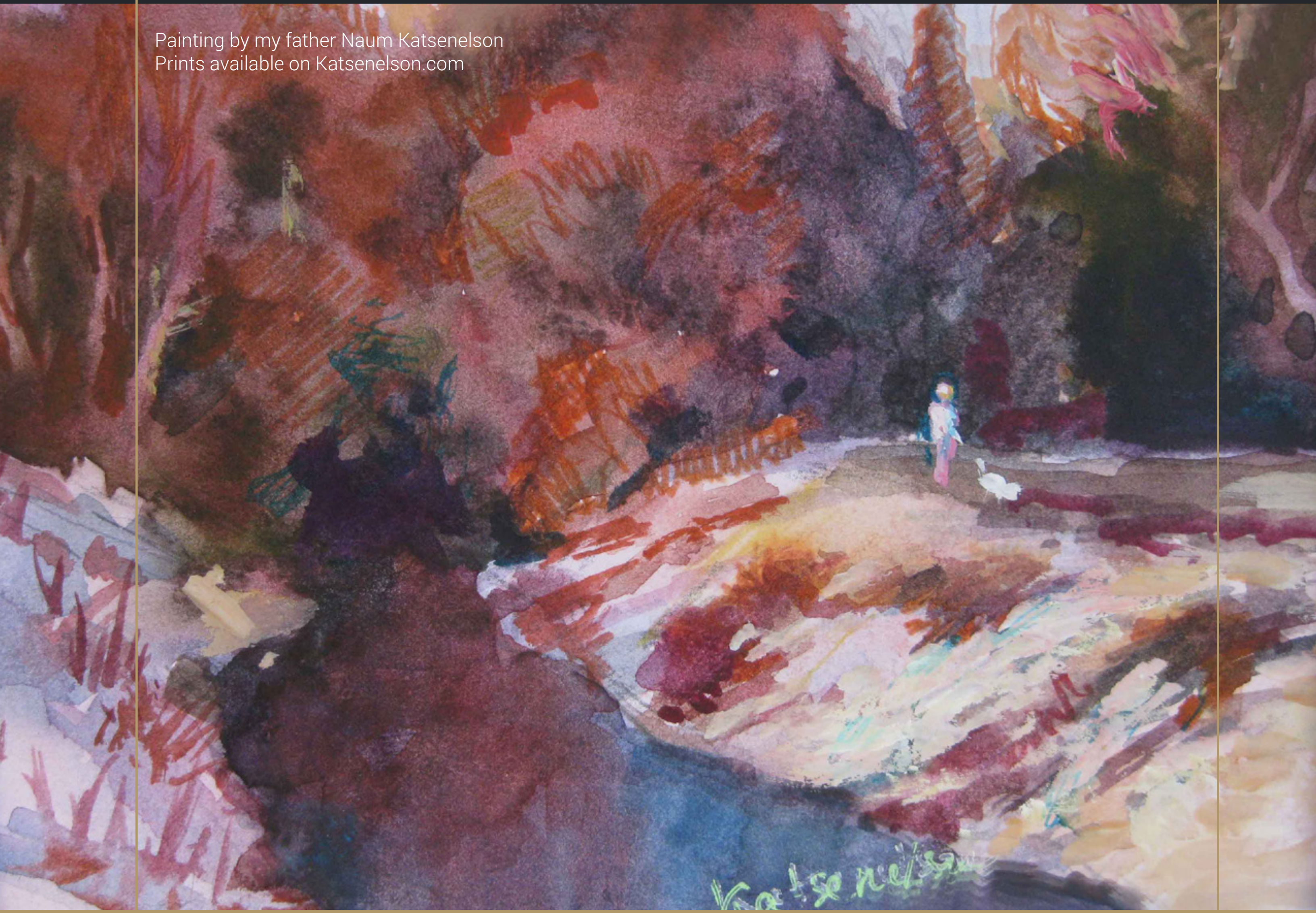


Painting by my father Naum Katsenelson
Prints available on Katsenelson.com

LIFE & PHILOSOPHY

LIFE & PHILOSOPHY

Turning a PBS Interviewer into Interviewee

4/14/2022

I was interviewed on PBS Newshour about the insanity that is happening in the NFT (non-fungible token) market. You can watch it here. If you read my "I Kid You Not Crazy" article, then you know everything I have to say about NFTs and cryptocurrency. I can sum up my thoughts on NFTs in one sentence: NFTs, just like cryptocurrencies, are a technology of the future, but a speculative bubble induced by excess global liquidity in the present.

I encourage you to watch this eight-minute video – PBS did a great job.

This interview was extra special for me because PBS also interviewed my son Jonah and his best friend Rhett.

My interview was conducted by Paul Solman, PBS correspondent and my loyal reader. A while back, Paul and I discovered that our ancestors came from the same small town, Vitebsk, in Belarus. Paul read "I Kid You Not Crazy", which aligned with the story on NFTs he was working on, and he interviewed me about it. During the interview I shared with him stories Jonah told me about the NFT speculation that is happening on college campuses. Paul asked me to connect him with Jonah.

> I was interviewed on PBS Newshour about the insanity that is happening in the NFT market. I can sum up my thoughts in one sentence: NFTs, just like cryptocurrencies, are not just a technology of the future, but a speculative bubble induced by excess global liquidity in the present.

Paul interviewed Jonah and Rhett for thirty minutes. Their part of the interview was compressed, and only two seconds made it into the show. But this was time well spent, because Jonah and Rhett flipped the conversation from being interviewed to interviewing Paul for another thirty minutes. They are young adults who are about to make life-defining choices. They asked Paul for life advice. Paul has lectured at Yale and West Point, authored several books and lived a long life. He's a veteran journalist who has met a lot of interesting people and is chock-full of wisdom. I am proud that Jonah and Rhett saw an opportunity to learn and took it.

Jonah took notes and summed up Paul's advice:

I asked Paul for his advice to a 20-year-old college student, and here is what he said:

- *"Look, I know you're a smart guy, I know you'll be fine in life, unless you get hit by a car. First piece of advice: "Don't get hit by a car." Don't do anything irreversible, don't damage your reputation, and NEVER do anything "for the money" or the apparent prestige.*
- *The key to having a gratifying career is to surround yourself with like-minded people. It is extremely difficult to succeed alone. Whether it's a business partner, boss, or employee, working with people that you deeply like tremendously increases your chances of success, whether financial or personal. "Stay away from assholes" and embrace people you admire, respect, and care about. Find a life partner who compliments you temperamentally.*
- *When you are 20 years old, take some risks. Whether these risks are financial or personal, this is the time when you can afford them the most. Once you start a family, have a career, and have liabilities, taking risks becomes much more complicated.*
- *It is advantageous to meditate – it is never too early to learn how to meditate. From Buddhist philosophy, we learn that people easily con themselves into narratives. This concept is not a bad thing; just make sure you don't con yourself into the wrong narrative. Keep an open and clear mind.*
- *You guys are in a very different position than I was when I was your age. When I was graduating college, my parents had little to no money. By my junior year I realized that the worst that would happen was that I would become a professor. Jobs were plentiful and housing was inexpensive. America was getting wealthier after World War II, and the gap between the people at the top and at the bottom was narrowing. You didn't feel like you had to get ahead of the other guy. Your generation is quite different, because traditional jobs don't cut it anymore; you need to have leverage. Today, college debt is much more expensive. If you take student loans, you start at a financial disadvantage.*
- *[I asked Paul what had helped him to succeed as a professional interviewer. He answered:] When interviewing, I make people feel comfortable by being myself. I take away the formal aspect of interviewing and make it casual. In our interview today, there were no bright lights, no one said "Action!," and we simply had a casual conversation that happened to be recorded.*

I am in between Jonah's and Paul's ages, and I can still relate to Paul's advice. I'll address Paul's first and second points here.

Point 1. Jeff Bezos breaks up decisions into two types: Type 1 and Type 2. He compares them to two types of doors. Type 1 decisions are irreversible. This door only opens one way – once you enter the room you cannot get out. It is very difficult if not impossible to reverse the decision. A Type 2 decision is like a door that opens both ways – you can get in and out easily. Bezos argues that corporations don't distinguish between Type 1 and 2 decisions. Type 1 decisions should be thoughtfully weighed. Type 2 decisions can be made fast.

In your early 20s, some Type 1 decisions require careful deliberation, some don't. Choosing a career and your soulmate do. Drinking and driving or getting in a car with a drunk roommate at the wheel, don't. There is an Uber app for that.

I can also relate to not being seduced into choosing a career for money but rather choosing to do what I loved. I don't think I had enough self-awareness to make that a deliberate choice when I was 20, but I was lucky. I benefited from a flaw in my innate programming. I am incredibly lazy. I don't like doing things I don't like. Some people are good at overcoming this. I am not. I tried different majors; even accounting for a few weeks. Money is a poor motivator for me to overcome my laziness. I was very fortunate that I fell in love with investing in my early 20s and have not worked a day since.

Point 2. I am embarrassed to say this, but have I arrived at truly valuing people quite late in life. This applies to people I let into my life as friends, people I hire, and even to people who work for companies I invest in (I wrote about the softer side of investing here).

When I became the CEO of IMA in 2013, I realized I could actually make choices about who works at IMA and who doesn't. I describe my travails of hiring and (unfortunately) firing in a bonus chapter called "Data-Driven Hiring" in Soul in the Game (you can read this chapter today, if you preorder the book. Here's how: Preorder the book on Amazon or BN. Email receipt to bonus@soulinthegame.net. Done!)

I look at Jonah today. He is 20 but has the self-awareness of a person twice his age. (I should know!) I would not have thought to turn interviewer into interviewee. I guess I have a lot to learn from my son.

Sitting on the Tarmac in The Land of Stoicism

Click to listen to a narration of this article

6/2/2022

At the end of May, I took my son Jonah (21), his girlfriend Molly, and my daughter Hannah (16) to New York City for a long weekend. Jonah and Molly were leaving for Israel and Hannah and I decided to join them for the weekend to inhale the art and culture that New York has to offer.

However. This trip to NYC started with me practicing a bit of Stoicism. We had tickets for La Boheme at the Metropolitan Opera on Friday night. Our plane was supposed to land at LaGuardia at 5pm. LaGuardia was about 40 minutes away from our hotel and the opera house. We were going to have dinner at 6:15 and go to the opera at 8.

Men make plans, the universe laughs.

Our plane took off and landed on time. So far so good. However, after we landed the pilot notified us that because of thunderstorms in the NY area, the airport was on lockdown and planes were still at their gates. We'd have to wait for a gate to open up. He said he'd inform us every fifteen minutes on progress, implying that this might take a long while.

> I recently took Jonah and Hannah to NYC for a long weekend. Jonah was leaving for Israel that Sunday and Hannah and I decided to join him for the weekend to inhale the art and culture that New York has to offer. However, this trip to NYC started with me practicing a bit of Stoicism.

I've been to many opera houses around the world, but this was my first time at the Metropolitan Opera, and La Boheme is one of my most favorite operas. Most importantly, I wanted my kids to experience La Boheme. It was Jonah's girlfriend Molly's first time at the opera, and I was really excited for her. I had got the best tickets the opera house had to offer, which were about to turn into a pumpkin at 8pm if we kept vegetating on the tarmac.

I could have gotten upset. The pre-Stoic version of Vitaliy would have. I have just written a book, Soul in the Game – The Art of a Meaningful Life, where I spend a third of the pages discussing Stoic philosophy and how I apply it in my daily life. Now, I had an opportunity to apply three Stoic philosophy exercises at once: dichotomy of control, reframing, and negative visualization.

Let's start with the dichotomy of control. Epictetus says that some things are up to us (they are internal to us) and some are not (they're external to us). Most things in life are external; we have no control over them – the weather, how other people behave –actually, almost everything. I have control over how I behave and how I interpret the situation I'm in right now.

As Marcus Aurelius succinctly put it, "You have power over your mind – not outside events. Realize this, and you will find strength." I could have thrown a fit, complained, gotten agitated. Other than losing more of my hair (which is already facing imminent extinction) and ruining the mood of my kids and everyone around me, I wouldn't have changed anything by such behavior. The gate would open when air traffic control decided it was safe for other planes to take off. We would either go to the opera or we wouldn't; either way, the money I spent for the tickets was already gone.

Reframing allows us to embrace life as it happens to us and to color the events that happen to us from a palette of our own choosing, instead of having life randomly choose colors for us.

At first, I reframed our predicament as an opportunity for more focused time. Another Stoic, Seneca, would remind me about the shortness of our time. I would not get this time back. I did not want to waste my time worrying about things I could not control, so I kept my headphones on and went on working on an article on my laptop.

After thirty minutes or so, I put my laptop away and focused on my kids, who had an innate stoical attitude toward missing an opera: Jonah and Molly were watching Netflix. Hannah was reading a book. Some would argue that a 16-year-old and two 21-year-olds would definitely prefer sitting for hours in cramped seats on an unmoving plane to hearing "fat ladies sing." There might be some truth to this. Maybe they were being polite or did not want to hurt my feelings, but all three were telling me how much they were looking forward to the opera. We discussed what we could do that night in place of going to the opera. NYC offers plenty of other nighttime activities.

I reminded myself to visualize that things could have been so much worse. Stoics call it negative visualization. Instead of safely sitting on the ground, we could have been… I let my (negative) imagination run wild, which is easy. We could have been in Eastern Ukraine, bombed by stepmother Russia. The list of bad things that could have been happening to us was unendingly long. By comparison, sitting in an air-conditioned plane for a few hours and missing an opera did not seem so bad.

Negative visualization is a powerful tool because it puts most problems we encounter on a daily basis in the proper perspective: They are not problems; they are just life happening not in precise accordance with our expectations. As I am writing this, I am reading about 19 kids who senselessly died in a Texas school shooting. The parents of these kids would have given anything to spend an extra 30 minutes stuck on a plane with their kids. That is not the negative visualization I want to go to too often, but it does put a lot of my everyday noise into a proper perspective.

We sat on the plane for almost two hours. Once we got off, while we were waiting for our luggage, I started to formulate a plan. We would go with our luggage directly to the opera. I called the opera house. I explained our predicament. They politely explained that they had no place for our luggage. We'd have to go to the hotel, which was a mile away from the opera house, and drop off the luggage first. I don't know if it was my positive attitude, the lady on the phone taking a pity on us for our predicament, or just the opera house's policy, but I was told that if we didn't make it to the opera before 8pm, I should call back and they would either give us a credit or refund the money.

The story doesn't have a traumatic conclusion, and that is a good thing. NYC had a bit more traffic than usual, and we arrived at our hotel at 7:50. If we had 20 extra minutes we would have made it to the opera. The opera house kept its promise and refunded me for our tickets.

We went to dinner and did the most touristy thing – we went to Times Square. Hannah's dream to play a NY street chess hustler came true – she played one. She got very close to winning, but came out with a draw. Over the next two days we walked in Central Park and even rented a boat and spent an hour on a lake in the park. We went to the Metropolitan Museum of Art, saw Phantom of the Opera, ate a lot of terrific food, and my kids and I hosted an IMA client dinner.

Hannah, inspired by her "almost win" in Times Square, wanted to play more street chess. We spent an afternoon at Bryant Park (which is now my favorite place in NYC), where both Hannah and Jonah played chess. Jonah, who is a big fan of Lex Fridman's podcast, ran into Lex next to our hotel. They had a short but pleasant conversation. Jonah, who is a proud son, quick on his feet, took this opportunity to pitch me to Lex as a guest for his podcast.

Despite spending two extra hours on the plane and missing La Boheme, this turned out to be a great trip. Life will often go according to its plan, not ours. We should look at these moments as little Stoic tests, or even better, opportunities to practice Stoic training. It's training because, by constantly practicing these Stoic techniques, we can reprogram ourselves, and by doing this we'll reduce the negative volatility of our emotions and thus make our days a bit brighter.

I'll conclude by quoting what Marcus Aurelius said in his Meditations: "Waste no more time arguing about what a good man should be. Be one."

Inspiring Stories & Hard-Won Life Lessons: Introducing My New Book

6/21/2022

I have been waiting for this day for almost two years. My book, *Soul in the Game: The Art of a Meaningful Life*, is out!

I spent a few thousand hours writing this book and poured every ounce of my soul into it.

Soul in the Game has received glowing endorsements from a lot of prominent people I respect, including General Stanley McChrystal, Nassim Taleb, Carl Bernstein, Wim Hof, and many others. But as much as I am humbled by and thankful for their praise, when I was writing the book I was visualizing my regular reader – you. I wanted this book to touch you, to brighten your day, to improve your life, even if just a little.

My newest book, Soul in the Game, is now live and available for purchase. It has nothing to do with investing, but has everything to do with something far more important: living a meaningful life.

I shared a digital version of the book with a few readers who preordered. I received a lot of wonderful feedback. However, an email from Gorden Lopes made my week. I've never met Gorden – hopefully I will one day. Here's what he said (I'm sharing it with his permission):

"This book has truly touched my soul in many ways, your amazing sense of humor makes difficult topics very easy to absorb, your ability to show your vulnerable sides of your life, and your story telling ability reminds me of Anthony Bourdain's writing style.

Both me and my wife discuss the content of the book like excited kids sharing their instagram posts! I just mentioned to her that we should have a 3rd child and she burst out laughing because she had read the chapter about your family!

This book and your writing has changed my life for the good and it's like a guiding north star for living a happy, satisfying life! Highly highly recommend this to everyone and this is going to be my most gifted book for this year for sure!"

Despite the glowing feedback, now that the book is officially out, I feel like a father letting his child out into the world. I am excited and nervous at the same time.

Soul in the Game is available in hardcover, Kindle, and Audible formats. You can get it here.

Keep in mind that due to supply chain issues, it currently takes 23 weeks to print a book, so you may have to wait almost six months to receive a copy once it is sold out. If you were planning to buy this book as a Christmas, Hannukah, or Festivus gift, you may want to consider doing your holiday shopping today.

Once you order the book, send a copy of your receipt to bonus@soulinthegame.net and we'll send new chapters (almost 50 pages) I wrote since the book went to press.

Oh, and do yourself a favor: forward this email to every person in your digital rolodex who will benefit from this book. In my unbiased opinion that is anyone between the ages of 16 and 120. They'll thank you later.

If you're wondering what *Soul in the Game* is all about, I am going to share with you the introduction I wrote to the book. It will shed light on the book's content.

Introduction – How to Read This Book

If someone had suggested a decade ago that I would write a book that had nothing to do with value investing, I would have laughed. Even after writing two books on investing, I thought of myself as an investor who thinks through writing, not "a writer." I preferred to leave that stuff to professionals – the Dostoevskys and Hemingways – and stick to what I knew best: value investing.

However, over the years, I brought "life" stories about my childhood, my kids, and classical music as supporting actors (often as analogies) onto the main stage of my writing about investing. Kids change you; the realization of your mortality changes you – and writing changes you. It was just a matter of time before these life stories wanted to grow out of their supporting roles into lead roles.

Thousands of emails from my readers had a lot to do with that, too. Readers wrote that they came for the articles about value investing but stayed for the life stories (and my father's art; but more on that later). They encouraged me to turn my life (non-investment) essays into a book. They told me that reading these stories had made their lives a little better. Reading my essays nudged them to reflect on their own lives. Often, I even seemed to inspire them into action: to travel, to spend more time with their loved ones, or to just simply slow down and inhale life. This book is about the most important investment you'll ever make: the investment in your life.

I hope a story or two in these "life" essays will touch you, add a ray or two of sunlight to your day, and motivate you to fill the gap in your life that needs filling.

This book is evergreen, and so I have structured it thematically, not chronologically (you will notice this in the variability of my kids' ages throughout the book). It started out just as a collection of stories I've written over the years. But as I was editing it, the writer in me took over. I ended up completely rewriting old essays and writing many new ones. Though it is not a traditional book with a story arc running through it, it morphed into more than just a collection of random stories. It is written to be read in sequence.

The book is loosely organized into six sections:

The **Student of Life** section has an autobiographical character. It takes you to Soviet Russia for my childhood, the fear that my aunt was an American spy, my family's emigration to the US, and our first (wonder) years in this great country.

Then it takes you on my most educational journey of all – being a parent. Those stories are full of joy and mistakes (kids don't come with an instruction manual), but also growth. Being a parent is the most transformative experience of all.

This section also features "Soul in the Game," an essay that provides a lens through which to view the rest of the book. It touches on everything one needs to find meaning in the creative part of their life. It is so important to me that I titled the book after it.

In **Inhaling the World** I share my experiences and impressions from visiting Santa Fe, San Francisco, Switzerland, France, and Italy with my family. I discuss topics ranging from how visiting a modern art museum can enhance your trip to an IKEA store, to Jeffersonian lunches, to the caloric content of uncooked fish. If this section inspires you to see a bit more of the world, I have succeeded.

One Day at a Time is the self-help part of this book. Well, kind of. I am not dispensing self-help advice; I am just taking you with me on my journey of learning about how to stick to a diet, sleep better, work out, meditate (a little), and firm up new habits through trial and (a lot of) error. I'll share personal finance advice that was given to me by a friend when I got married – advice that eliminated any bickering about finances from my marriage!

I was almost done editing this book when I stumbled onto Stoic philosophy. I was so taken by it that I put editing on hold and embarked on a five-month learning and then writing journey about Stoicism. This spilled into **Stoicism – The Philosophy For Life**. It's a mini-book within this book, with two sections of its own. One section focuses on Stoicism as an operating system for life, and the other outlines a value system that could lead you to a happier and more meaningful life.

Soul in Creativity houses my essays on… you guessed it, creativity. Creativity is a thread that runs throughout the whole book. I have found that creativity is a secret sauce that makes life more meaningful; it's what draws me out of bed every morning.

I share with you what I've learned about the art and process of writing, not to mention how the music of AC/DC can turn you into a better writer. And you'll learn how I structured my life to have time to run an investment firm, do investment research, spend time with my family, and still write the equivalent of a book a year.

The essay "Pain, Opera and Investing" explores an excruciatingly painful professional period in my life. Most importantly, it offers tools (based on Stoic philosophy) for coping with pain. This essay sat in my virtual drawer for years; I couldn't bring myself to publish it, until now.

After I finished writing the essay "Creative Roller Coaster," I realized that I had to take all my life essays and publish them as a book to share with others. There was an instigator who was singlehandedly responsible for my starting to work on this book: Pyotr Ilyich Tchaikovsky. I explore Tchaikovsky's struggles as a composer, which I can so relate to as a writer; though I get the feeling that this struggle is universal in all creative endeavors, not just composing and writing.

Tchaikovsky brings us to the last section, **Melody of Life**. In this series of essays, I delve into the lives of classical music titans –Tchaikovsky, Schubert, Liszt, Brahms, Chopin, Berlioz, and Bruckner.

Though these essays about classical music and composers may seem out of place in this book, they continue to tug on this thread of creativity. Today we listen to the music of these superstars, and it still moves us (to me it is the best drug of all). We call them geniuses. But their talent and success, which seems evident to us, was anything but evident to many of them. Just like the rest of us, they were full of insecurities and went through a lot of personal and creative struggles, accompanied by a lot of pain. There is a lot we can learn from them.

By way of summary and conclusion, in **The Art of a Meaningful Life** I collect the bread-crumbs I left throughout the book and connect the concept of soul in the game, Stoic philosophy, creativity, and lessons from classical music composers by means of an art and craft framework. Oh, and I break the fourth wall.

Finally, if you are questioning why a relatively young adult with plenty of life experiences still ahead of him writes an autobiographical book, read "Intermission – Stop Eating Sugar" (the book's conclusion): It will answer this question.

My advice to you: Read this book as if each essay is an email that just appeared in your inbox. You are invited to ponder for a while before you move on.

For reasons that will become apparent as you read the next essay, I also had to include a few of my father's paintings in this book. You can find them in the middle painting section. And you can always see more of his artwork at Katsenelson.com.

I approach this book the same way Zeno, the founder of Stoicism, approached his students. Zeno did not claim to be a physician – he saw himself as a patient describing the progress of his treatment to fellow patients in the hospital beds beside him. Grab a bed next to mine and let's have a conversation about life, creativity, Stoic philosophy, classical music, and other fun topics.

How Stoicism Can Help You Have Soul in the Game

Click to listen to a narration of this article

7/14/2022

I have a busy summer ahead of me. My company is hosting the VALUEx Vail conference in mid-July (you are probably reading this while I am at the conference). Then a week later my daughter Hannah and I are flying to Amsterdam – my favorite city in the world. We are going to spend a few days there and then fly to Zurich, where we are going to meet Jonah and his girlfriend Molly.

In my interview with "What is Stoicism", I discuss how stoicism can help us improve our personal and professional lives.

Jonah is going to be doing an internship with my friend Guy Spier's investment firm in Zurich. Before the internship starts, we are going to rent a car and all four of us will drive around Switzerland for six days. I've been to Switzerland many times, but never in the summer. This is Hannah's first time in Europe, and I am so excited for her.

A week or so after we come back from Switzerland, Hannah and I will drive to Santa Fe on what has become our annual pilgrimage to the Santa Fe Opera.

A little side story. I have always wanted my kids to become investors like me. I love what I do and cannot imagine doing anything else. I get to learn and solve intellectual puzzles all day long. From the time they were very young, I took my kids to lectures I gave to finance classes at local universities a few times a year. They went because I took them to Dairy Queen afterwards. But I never pushed them to choose investing as a career. My wife and I want them to choose the life journeys that will make them (not us) happy.

Jonah told me a few years ago, while he was in high school, that he was not interested in investing. I said, "Okay, find what makes you happy". However, an interesting thing happened this year. Jonah took an accounting class at CU Boulder and "did not hate it." Then he took a finance class and loved it. His test results set the curve in the class. He told me that he tried to do anything but finance, but finance came very naturally to him, and he found it very interesting.

A few days ago, my 16-year-old daughter Hannah asked me if she could shadow me at work to see what I do. My 8-year-old daughter Mia, copying her older sister, said, "Dad, I may join your firm one day, but we'd have to rearrange the letters IMA to MIA."

I hope you enjoy the rest of your summer.

Today I'll be sharing with you the interview I gave to the What Is Stoicism website about *Soul in the Game*.

You describe having "soul in the game" as having "every ounce of your attention and strength and love" invested in a creative pursuit. How do you personally judge when a pursuit is worthy of having your soul invested in it?

I have to admit, when I was originally writing about having soul in the game, I was visualizing "the game" as being one's occupation. In fact, the trigger to write the original essay was the realization that my investment industry often lacks in both skin and soul in the game. Choosing how you allocate about a third of your time is one the most important decisions you'll ever make. It's up there in importance with whom we are going to marry.

Lately, in talking to friends and my kids, I have found myself referring to soul in the game in activities that are not directly related to my main occupation. My kids now laugh and make bets on how many times I'll say "soul in the game" during family dinner.

For instance, I caught myself realizing that I don't have soul in the game when I am working out. I work out because I have to do it for my current and especially my future health. I wish I could take a pill and receive the benefits of working out and how I feel after working out, without subjecting my body to pain. I wish I could get to the "I have worked out" state without working out.

On another hand, even if I could outsource writing to a ghostwriter, I'd never do it. I love writing, and despite its often being excruciatingly frustrating, I am willing to suffer through this pain. The process of learning and creating is meaningful to me. I put writing in the category of good problems to have. I have soul in the game as a writer.

Recently, I found myself congratulating my wife that our 21-year-old son Jonah has soul in the game after I observed him studying for his courses at university. I've never seen anyone so dedicated to studying. This is the same young man who earned a 1.3 GPA his junior year in high school. Jonah has elevated studying (attending classes and doing homework) to be his highest priority. Despite going to CU Boulder – a university well known for being a party school, Jonah always puts his education above his partying.

He tutors his classmates; he finds satisfaction in helping others, and this helps him to learn subjects better. Observing his efforts gives me enough grounds to say that he has soul in the game as a student – and I am as objective as a father can be. His GPA of 3.97, arguably more objective, though not a perfect measure, confirms my conclusion.

Here's another example. My 16-year-old daughter Hannah wanted to earn some money. She started teaching chess lessons. Before she had her first lesson with an 8-year-old girl, I asked her, "Did you prepare a curriculum of what you want to teach this girl? Did you think of how you are going to teach? How are you going to make it interesting for her?" Hannah was so excited about earning money, she had not given teaching much thought. She said, "It'll be easy; I'll start with the basics." I gave her the following lecture:

"You should have soul in the game when you teach this class. Doing a great job should be near and dear to your heart. You need to be net positive to everyone you interact with, especially this girl. The girl's parents entrusted you with their precious child. Just imagine if the roles were reversed. Would you want your teacher to teach just to make money?"

If you focus on doing a great job, the money will take care of itself. Her parents will tell other parents and you'll have more students.

This admittedly lop-sided conversation changed how Hannah approached her lessons. I wasn't at home for the first lesson, but my wife told me Hannah was a terrific teacher.

Soul in the game is an attitude, wherein the game could be anything we find meaningful. For me, soul in the game must be present when I do something that has a direct impact on others; otherwise, I'd be going against my core value of being a net positive to others, and this is what I try to instill in my kids.

Finally, I think it is impossible for us to have soul in the game in the long term unless we are deeply passionate, deeply in love with what we do.

You tell a lot of great family stories in *Soul in the Game*. For those with children or young relatives, how can Stoicism help us navigate the difficult task of guiding those who look up to us?

Children pay more attention to what we do than to what we say. As parents we need to be practicing what we preach for our children to take us seriously. My kids know that I am a practicing Stoic. My older kids have read Soul in the Game, but even before they read it, we talked about Stoicism all the time. I don't always succeed in acting like a Stoic, and I tell my kids about my lapses. We discuss how I might have acted differently.

Since in practicing Stoicism we are trying to rewrite behavioral habits that we've formed throughout a lifetime, it requires patience and deliberate effort. When my kids have problems, we talk about them, and when appropriate I bring in Stoicism as a solution. (Reframing and dichotomy of control are my go-to frameworks.)

We all love Marcus Aurelius's line "Think of yourself as dead. You have lived your life. Now, take what's left and live it properly." But we are perhaps unsure how to apply it. You have the nice, practical idea of "setting your egg timer to six months." Can you explain the concept a little and how it informs your daily actions or attitude?

If you woke up this morning and discovered you only had six months to live, would you approach life differently? Would you value relationships and experiences more than material things? This framework puts what I really value at the forefront. It makes me aware that though time may be infinite, the time we have on this wonderful planet is not.

Here is one example.

I used to look at driving kids to school as a chore. I reframed it. Today I look at it as a gift. Hannah has only two years left in high school. I get to drive her to school only 400 more times. She'll grow up, and just like my son Jonah today, she won't need me driving her. The act of driving is not as important as actually being present while I am with my daughters in the car. We talk, we listen to music. The realization of the scarcity of time I'll have with my kids forced me to reframe how I view an activity I used to dread.

I remember catching myself wishing my kids would get on to the next stage of their lives. When they couldn't crawl, I wanted them to crawl. When they were crawling, I wanted them to walk. And so on. I stopped doing this. Now I am just "inhaling" every stage of their lives and trying to be present for them. I am teaching Hannah how to drive. I am not sitting in the car with her and wishing for her to already be able to drive. No, I am just living in the moment and enjoying the time I spend with her, knowing that this too shall pass.

Here is another example with a similar concept I discussed in *Soul in the Game*. I borrowed it from Seneca: Live each day as a separate life.

I recently watched an interview with Ilya Yashin, the Russian politician and journalist. At the time, Yashin was one of very few people still living in Russia who openly criticized the Ukraine war and the Putin regime. Nearly everyone who is openly critical of the war and Putin has left Russia and for a good reason: Russia has turned into a dictatorial, Stalinist sort of regime where even just calling the Ukraine war a "war" and not a "special operation" is a criminal offense that can land you in jail indefinitely. Yashin, a brave soul, refused to leave Russia and continued doing his antiwar show on YouTube from Moscow.

Marcus Aurelius and Seneca would admire Yashin – a man of convictions and principles. So do I. But something else piqued my interest in the interview.

At the time of the interview, Yashin was living on borrowed time; he could have been arrested at any moment. In fact, Yashin himself was puzzled by the fact that he was still a free man.

I was really touched by his answer to a seemingly simple question: What does your day look like?

He answered (and I am paraphrasing):

"I'd be lying if I told you I am not worried about being arrested. But I live every day as if tomorrow doesn't exist. I find that to be liberating. This absence of tomorrow makes me appreciate and value today so much more. I wake up in the morning, and I realize that I woke up because my alarm clock went off, not because there was a knock on the door by the police who came to arrest me. My mood instantly improves and I have this deep desire to live. I feel I am blessed. I feel like now I live a real, full life. I meet my friends, I work, I read books. I am more productive because I realize this day may be my last day as a free man, and you start valuing these things."

Yashin lives each day as if it is his last, as if there is no tomorrow. He is present for every minute of each day because he realizes he may not have that many minutes left as a free man.

About two weeks after this interview Yashin was arrested by the Russian police while walking in the park.

In *Soul in the Game*, you stress the importance of being a "student of life, for life." I find this chimes very well with Seneca's line, "As long as you live, keep learning how to live." What practical advice would you offer for maintaining this state of mind?

Let me tell you what I do. I look at myself as a constant learner. It is part of my identity. What we tell ourselves and what we do can reprogram us over time. If we do this long enough, eventually it will become our identity, our default behavior.

Student of life is an attitude I try to bring everywhere I go. I constantly keep asking myself what I can learn from the person I am interacting with – be it someone I am meeting for the first time or a friend I am having lunch with.

I found writing to be very helpful. I am constantly looking for new ideas to learn and explore. My writing is a sort of insatiable machine inside of me that is constantly looking for new knowledge to regrind into essays.

I reframe a lot. I initially approached doing podcast interviews to promote the book as a chore. Then I reframed them as an opportunity to learn. After all, I am discussing topics that are near and dear to me. Podcast conversations allow me to explore them from different angles. I try hard not to repeat myself from interview to interview, giving myself a fresh challenge each time (though at times that has proved difficult). These interviews went from being something I must do to spread the word about the book, to something I am really looking forward to. And I've learned a lot!

In the pursuit of being a student of life, you make the distinction that knowing and not doing is not knowing. How do you ensure you follow this important guidance in your practice of Stoicism?

I don't want to completely dismiss the importance of knowing Stoic concepts, but knowing them and not practicing (doing) them will have the same impact on your life as if you did not know them.

I approach Stoicism as a practice. I don't succeed in this practice all the time; I fail plenty. My stepmother read *Soul in the Game*. Her feedback on the Stoic section was, "Fascinating stuff. I learned a lot. But you need to practice more of what you preach." She's right. As I have mentioned, I am rewriting habits I formed throughout my life. It takes a lot of practice and therefore a lot of failure.

I approach my Stoic journey the same way I parent my kids. When they fail at something, we discuss what they can do better next time. I provide words of encouragement. We move forward. When they succeed, we examine the sources of success, and I congratulate the hell out of them.

Being kind and forgiving to yourself is very important. The self-punishment we inflict on ourselves when we fail often becomes counterproductive and unnecessary. We'll just give up on whatever we are trying to improve on.

You talk about the importance of measuring yourself against your internal value system as opposed to external factors. How do you form/update your internal value system, and what kind of reviews do you carry out to measure your thoughts and actions against it?

Dichotomy of control teaches us that there are very few things that are up to us. Most things, like the politeness of the clerk at the car rental counter, the timing of traffic lights, weather, telemarketers calling us during dinner, are not up to us – they are externals. Our value system is one of the few things we have control over in our life; it is internal to us (other internals are beliefs, perspectives, and actions).

We need to carefully calibrate our values and goals to make sure we don't accidentally tie them to external variables. Our values and goals should be process-based with short-term feedback loops. I'll stress this point again: We should not link them to external variables.

Here is a very recent example. Five months before *Soul in the Game* came out, the book's publisher asked my input of how many copies of the book they should print. I was puzzled by this question. The publisher explained that normally this was not an issue, but because of the pandemic it now took 23 weeks to print a book, as opposed to the normal week or two.

We had a dilemma. If they printed too many books, they'd be gathering dust on the shelves in the publisher's warehouse. On the other hand, if they printed too few, bookstores would be out of stock for months and we'd lose a lot of readers. After our conversation, the publisher placed an order larger than their regular first run.

I loved the confidence my publisher had in *Soul in the Game*, but I suddenly found myself feeling a great burden of responsibility for the book's sales. Selling out that first big print run inadvertently became my goal. Let me clarify this. If this book fails, if the first print run never sells and rots in the publisher's warehouse, my life will not change one bit. I want this book to succeed because I feel it can help the people who read it. But of course, the publisher took a risk in book printing, and I don't want to let them down.

However, once I caught myself being tied to a specific number goal, I immediately changed the goal. I told myself that I'd do everything I could to let the world know about the book for two months before and three months after it came out. After that I'd move on with my life. By that point I would have given the book a chance. People would either love it (it seems they do) or they wouldn't. Also, after three months, the additional effort I put in would produce only limited incremental results.

If I had set my goal as selling X number of copies of *Soul in the Game*, then my happiness would have been tied to something I had little control over. All I could do is write a good book (and I had written the best book I possibly could) and put my absolute best efforts in letting the world know about it.

Putting a timer – five months – on my effort in spreading the word about the book allows me to move on to different subjects. In fact, given my obsessive personality, I have already found a new obsession (addiction) – chess. I never took it very seriously, but I really enjoy the game, and it also provides a different type of exercise for my brain. But even as I approach chess, all my goals are process-based.

Thanks for taking the time to answer these questions, Vitaliy. Finally, the question I ask all interview guests: In terms of what the philosophy means to you, what is Stoicism?

I'll cheat a little and answer this question by quoting from *Soul in the Game*, because I answered this question in the introduction to the Stoic philosophy section:

We enter mindlessly into life, born almost as a blank piece of hardware. Mother Nature equipped us with a very rudimentary hunter-gatherer operating system. Then our parents start programming us and the external environment slowly kicks in. We get programmed by family, friends, co-workers, the media (and now social media), and, simply, by circumstances.

If we are lucky and we get the right parents, siblings, and friends, read the right books, and the road of life nudges us into the right direction, we may end up with better programming. But the reality is that most of our programming is random and happens without our direct intervention.

Life kind of just happens.

This is where mindfulness comes in. Mindfulness is thinking about thinking, or being aware of making decisions. It is being fully present. Mindfulness requires you to take a step back from yourself, to become almost an outside observer of yourself and your programming. Meditation is helpful in this regard; it allows us to get into the thinking about thinking mode.

Once we tune ourselves into the "mindfulness mode," which programs do we activate and which do we stop? Each one of us comes equipped with unique hardware, and thus we need to create and maintain the programs that work for us.

I feel like I had enough luck to qualify as a life lottery winner – great parents, relatives, friends, family, career; lucky to be born in Russia and also lucky to have moved to the United States. But until I started to write about life, I did not have much in the way of introspection, or self-awareness. I lacked mindfulness.

I realized I needed to consciously program myself (and my subconscious), with a program that worked for me (religion was not the answer for me).

Stoic philosophy was that program.

The trip to Europe that wasn’t about Europe

Click to listen to a narration of this article

8/4/2022

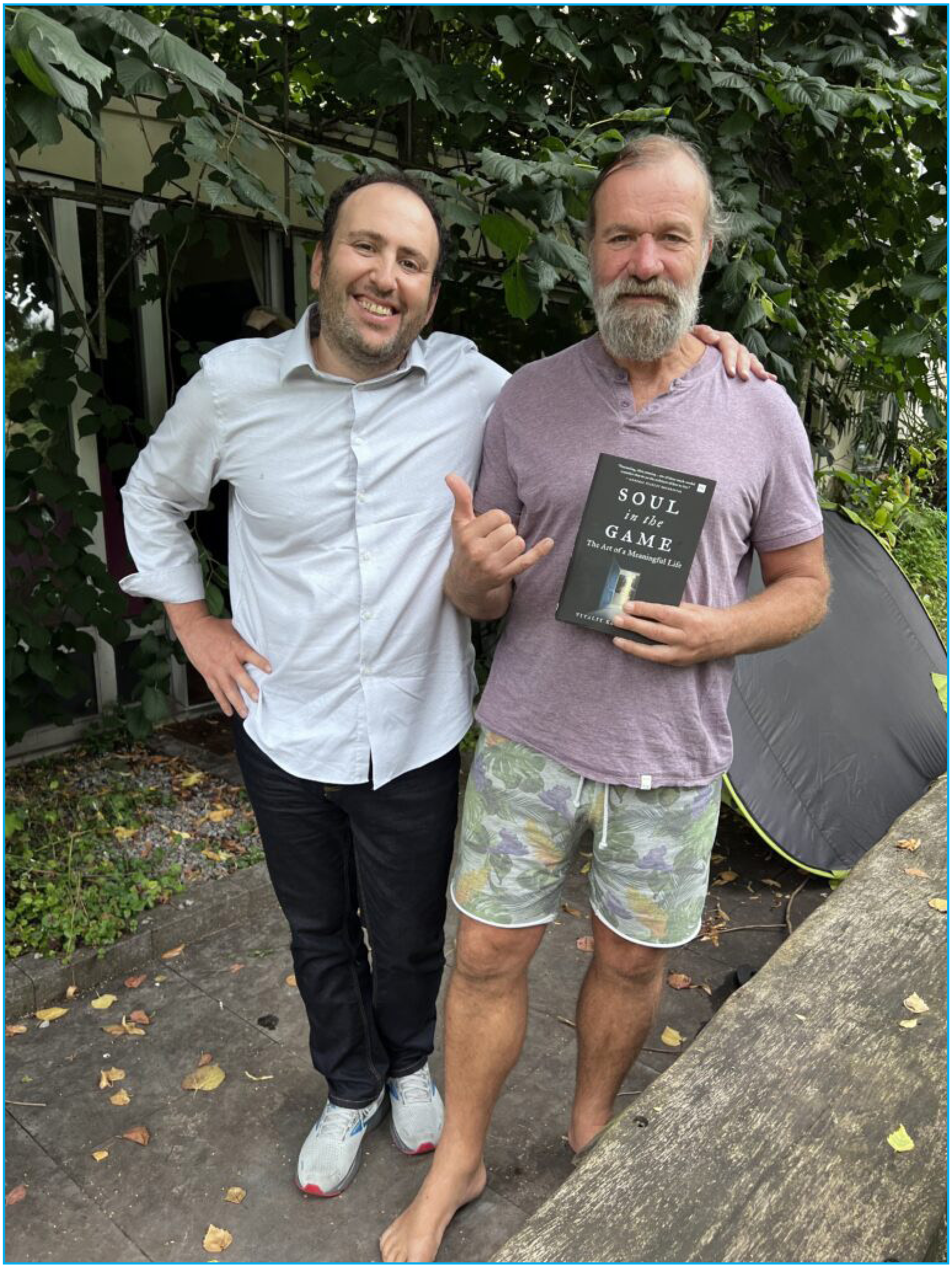
I love going to Europe. Sitting in cafes, watching people and sipping Americanos, waking up early in the morning and strolling through empty cobbled streets, eating wonderful food and not paying attention to its caloric content (I was in the 8% zone of my diet), going to museums almost every day, seeing things I have not seen before…. It recharges my spiritual batteries. Some people go to religious institutions of their liking; I go to Europe. This time around I was for the first time joined by both of my older kids, Jonah (21) and Hannah (16), as well as Molly (Jonah's girlfriend).

> As I am looking back at this trip, it was really not about Europe, the lakes, the ice cream that we had every evening, or the museums. The best experiences were the conversations we shared while we strolled the streets or had over dinner.

Hannah and I flew to Amsterdam, then took a train to The Hague. We spent an afternoon with Wim Hof, also known as "the Iceman." Wim holds a few dozen Guinness World Records doing insane stuff in extremely cold temperatures: swimming under ice, running a half marathon barefoot on ice, climbing Mountain Everest in his shirt, barefoot, etc. Wim's biggest achievement is training his mind to control his body, and as he told us many times, "Mind is the most powerful drug of all." Thanks to Wim I take cold showers daily. I also do his breathing exercises a few times a week (I do them using his app, but you can also do them here).

The most important part of his story is that Wim went through a spiritual rebirth when in his 30s he lost his wife to suicide. He had little money and four kids to take care of. This pain led him to rediscover himself and then, eventually, to international stardom. Now, he is changing millions of lives for the better

What really amazed me was the warmth with which the Iceman treated Hannah and me. Wim and I had communicated in the past, and he read my book *Soul in the Game*, was touched by it, and even endorsed it. But we had never met. He greeted us as though we were his old friends, with warm hugs. International fame has not gone to his head. I am used to people I admire disappointing me; this was anything but the case.


SOUL
in the
GAME
The Art of a Meaningful Life

In The Hague, Hannah and I spent the rest of the evening strolling the boardwalk by the sea (De Pier Scheveningen). The boardwalk alone is worth traveling to The Hague for – a lot of restaurants and attractions located on the sea.

The next morning we spent at Mauritshius, a small museum that houses some wonderful paintings, including Vermeer's *Girl with Pearl Earrings*, a painting you have to see in real life to fully appreciate it – Vermeer's custom-made paint doesn't show up in photos.

The following two days we spent in Amsterdam – the Venice of Northern Europe. We did all the typical touristy things – walked the streets and ate french fries dipped in mayo for lunch, took boat tours on the Amstel, rode bikes, relaxed in the park. We visited the Van Gogh Museum. Hannah thought we'd spend 30 minutes there. To her surprise we spent two hours and we had to leave because the museum was closing.

Then Hannah and I flew to Zurich, where we were met by Jonah and his girlfriend Molly. We rented a car and our Swiss-French-Italian adventure began.

Here is the map of our journey:

We stopped in Bern for lunch and spent the night in Montreux – a gorgeous little town on Lake Geneva. As we were walking by the lake we started seeing statues of famous musicians, and then it hit me, this was where we'd find the statue of Freddie Mercury, featured on his last, posthumous album, Made in Heaven.

Queen had a studio in Montreux, which we did not get to visit (left it for next time) because we had to hurry to our next stop – the Charlie Chaplin Museum.

Interesting factoid about the creative process: Chaplin shot over 400,000 feet of film for a final film length of 5,250 feet. Editing is creating.

This was the second time I had visited this museum – after the first visit I dreamed about bringing my kids there.

We had lunch in Lausanne. Our next stop was the Patek Philippe Museum in Geneva – the least interesting museum we visited. But I learned an interesting fact. The Swiss should thank the birth of their watch industry in the 16th century to the religious establishment headed by Jean (John) Calvin, which banned the wearing of ornamental objects (i.e., jewelry), forcing goldsmiths and jewelers to turn to a slightly different art – watchmaking.

We spent the evening in the little magical medieval French city Annecy, located on gorgeous Lake Annecy. We walked the streets of Annecy, the kids mesmerized by the sudden medievalness of the city. We got up early in the morning, had breakfast, rented a boat, and swam in the lake. The boat renting experience was surprisingly easy. We gave the boat rental place my driver's license, and three minutes later, after some brief instructions, we were in the boat. We did not have to fill out a five-page application, initialed in 12 places (maybe our US legal system is a bit too litigious).

The next morning we drove to Chamonix, the French ski resort located at the foot of Mont Blanc, home of the 1924 Winter Olympics. Parts of Chamonix look like a typical Swiss ski village (Klosters or even Vail, Colorado come to mind here), while other parts remind you of Paris. Very early the next morning we took a gondola up to Aiguille du Midi (translated from French, "Needle of the Mid-Day"), which is three miles high. All of us are Mile High veterans (Denver sits a mile above sea level) but we were lightheaded. The kids unanimously agreed that seeing Mont Blanc was the highlight of the trip.

After Chamonix we headed to Stresa, an Italian town of 5,000 on Lake Maggiore. We had gone from Switzerland to France and were now into Italy in less than three days. Often we could not tell what country we were in. We had to look for clues – whether the gas station was taking euros or Swiss francs, or which telecom provider was displayed on our phones. Stresa, however, had a distinctly Italian feel. It had Italian warmth, bright colors, and architecture. The people were a bit warmer and friendlier, too.

We spent the night there, and after a morning walk, went to Lugano, one of my favorite towns in Switzerland. Though it is located in Switzerland, almost everyone speaks Italian. The only reason you discover that you went from Italy to Switzerland is that prices in restaurants and grocery stores are quoted in Swiss francs and are instantly doubled. We stayed in a hotel in a picturesque small town, Morcote, 15 minutes outside of Lugano. In the evening we went out on the streets of Lugano and were mesmerized by its beautiful lake. Lugano has its own microclimate –you see lots of palm trees there. In the morning, after breakfast we rented a boat and went swimming again.

We said goodbye to the Italian side of Switzerland and drove to Lucerne, a city located on Lake Lucerne, in the German-speaking part of the country, though we found almost everyone we encountered spoke fluent English. We spent the evening strolling Lucerne and the next morning drove to Zurich.

After we dropped the rental car off, we went straight to one of my favorite museums in the world, the Kunsthaus. It has a wonderful collection of Impressionists. I was surprised by how much the kids enjoyed the museum. When Jonah was in his early teens he used to walk through museums as though they were a train station or airport, spending little time to look at the walls, mainly looking for the exit. Now he is enthralled by the art. I used to have to bribe the kids with sweets to go to museums; not anymore (the bribery is paying off).

We concluded our trip with dinner with my friend Guy Spier and his family. Jonah is doing an internship for the next two weeks at Guy's firm and will be staying with Guy's family.

In preparation for the internship, Guy gave Jonah half a dozen books to read, including his own (I reviewed Guy's book here). Another book Guy sent to Jonah was my friend William Green's Richer, Wiser, Happier. In this book William interviews a few dozen accomplished value investors. His book is as much about successful, accomplished people sharing their views on life as it is about value investing. Jonah was reading it on the longer stretches of our drive around Europe, and we discussed it. It is a perfect book for Jonah to read at this point in his life.

As I am looking back at this trip, it was really not about Europe, the lakes, the ice cream that we had every evening, or the museums. The best experiences were the conversations we shared while we strolled the streets or had over dinner. This trip was really about shared experiences, about spending time with your kids and maybe seeing the world through their innocent eyes. It was Hannah's first time in Europe, and I cannot tell you how many times, mesmerized by what she saw, she stopped me, gave me a huge hug, and said "Dad, thank you so much for this!" I'd look back at her and say, "No, Hannah – thank you!

BONUS

Intro to Stoic Philosophy

Buy on Amazon 11/17/2022

My introduction to Stoicism happened very slowly – one quote from Seneca or Epictetus at a time. And then it was very fast, and I found myself reading about Stoic philosophy nonstop.

Stoic philosophy offered to me what religion could not – an operating system for this life without any promises of an afterlife, no relationship with a friend up in the sky, no leaps of faith required. Just a very logical and practical way to approach life. This works great for me. If you are religious, Stoicism doesn't compete with any religious teachings and only complements them with insights on the human psyche.

Before we dive in, let's talk about Stoic philosophy and the Stoics.

Philosophy in its literal translation from ancient Greek is love of wisdom. To me, philosophy is a thinking framework; a framework full of interconnected mental models.

But Stoicism has gotten a bad rap (it needs a better PR agent). It is a common perception that to be a Stoic is to have as much emotion as the ancient marble statues that commemorate Stoicism's founders. A common definition of the word "stoic" is someone who experiences no feelings of pain, pleasure, joy, or grief.

Dear reader, you may not know me well, but I am a volcano of feelings. A philosophy that advocates having no feelings would not work for me. Though that may be a definition of the word, that is not what Stoicism – the philosophy – is. Stoicism seeks to minimize unnecessary negative emotions, which in turn amplifies positive emotions.

The less your mind is preoccupied with unnecessary negative emotions, the more room it has for positive ones. No, I am not going to turn into a Greek marble statue by the time I am done writing this, and neither will you by the time you finish reading.

Nassim Nicholas Taleb put it so well: "A Stoic is someone who transforms fear into prudence, pain into transformation, mistakes into initiation, and desire into undertaking."

Stoicism was started in ancient Greece in around 300 BC by Zeno, a wealthy merchant who lost all his wealth in a shipwreck and barely made it out alive himself.

Throughout this book I constantly make this point: Pain often unlocks creativity. It must have been a devastatingly painful experience for Zeno to lose everything overnight. Nevertheless, he later wrote: "My most profitable journey began on the day I was shipwrecked and lost my entire fortune."

For a while Zeno's philosophy was called Zenoism; but maybe because

Zeno did not want it to become a cult of Zeno, he named it after a place in Athens where he and his students gathered, the Stoa Poikile ("painted porch"). A few millennia later, this tradition was borrowed by the hedge fund industry in the US, which named their companies after places where the founders grew up, had their first kiss, etc.

Three Stoics whose writings have survived to this day are Epictetus, Seneca, and Marcus Aurelius (I'll refer to him as Marcus for brevity; yes, we are on a first-name basis). It is through the eyes of these three Stoic giants that we see Stoicism today.

I want to warn you, I'll be quoting them extensively in these pages. There is so much beauty, clarity, and wisdom in their original writings, and I want to bring you as close to the source as possible.

As I've been reading books by and about these great men, I have been shocked at how little people have changed over the last 2000-plus years.

Epictetus

Let's start with Epictetus (50–135 AD). We don't know much about him, other than that he was a slave. Epictetus was not even his real name – it translates from ancient Greek as "acquired." In his late teens, he was granted his freedom and proceeded to teach philosophy. Epictetus did not leave any writings behind. Luckily, his lectures were transcribed by his student Arrian into a series of eight books, titled Discourses, of which only four have survived. Epictetus's dichotomy of control framework is so simple yet so brilliant (we'll discuss it soon).

Marcus Aurelius

And then there is Marcus Aurelius (121–180 AD) – a Roman emperor, a general, a philosopher, and a practicing Stoic. He was the one who impressed me the most.

Let me clarify this. It is not his status as emperor that impressed me, but the fact that while being an emperor he remained a good human being. If you want to destroy a person, give him absolute power and unlimited wealth. History is littered with rulers destroyed by power and money. Marcus is a rare exception. Just imagine the Roman Empire in the second century AD. It controls every territory that touches the Mediterranean Sea. Marcus's word is law. He can have anything he wants. He could have taken shortcuts through life. But he did not.

During his 19 years of ruling the Roman Empire, Marcus did not abuse his power; he governed with justice and civility. He promised that he would not prosecute any of his political opponents, and he kept that promise.

The only piece of writing Marcus left us is his private journal, which he called Meditations. This journal was written not to be published but for Marcus to privately reflect on his life.

He wrote, "Waste no more time arguing about what a good man should be. Be one." And, "Never esteem anything as of advantage to you that will make you break your word or lose your self-respect." And, "A man's worth is no greater than the worth of his ambitions."

Seneca, to whom we shall turn next, remarked, "No man was ever wise by chance." Marcus was no accidental genius but a person who applied Stoicism to all aspects of his life and carefully cultivated, through deliberate practice, the person he became.

All that said, Marcus lived 2000 years ago, and we'll never really know if the image I painted above is overidealized or not. Epictetus said, "Imagine for yourself a character, a model personality, whose example you determine to follow, in private as well as in public." To me, Marcus is the "personality" I am trying to become, knowing that it's unlikely I'll ever get there. However, just constantly striving to be more like Marcus will elevate my life.

Seneca

And finally, there is the Spanish-born Lucius Annaeus Seneca (5 BC–65 AD), or just Seneca. A true Renaissance man (15 centuries before the Renaissance), in addition to being a philosopher, Seneca was an investment banker, a playwright and writer, a senator, and advisor to Roman emperor Nero. Seneca was the most prolific writer of the three.

Seneca's wisdom is often stunning in its simplicity. My favorite quote from

Seneca is only three words long: "Time discovers truth." It epitomizes a lot of things in life, for instance, it slices to the core of what investing is. As an investor, my goal is to discover the truth (what a company is worth) before time does.

If you keep this quote in the back of your mind when you have a conversation or debate with someone, the objective of the conversation may change from one ego prevailing over another to a search for truth. After all, eventually time will discover the truth. And if the conversation doesn't change your mind, maybe you shouldn't have the conversation. What's the point? (Read more about intellectually honest debate in "Abracadabra.")

Seneca is the most controversial of our three Stoics – he's full of contradictions.

He writes that wealth must be acquired in an ethical way. Here is the first contradiction: Seneca became one of the richest men in Rome at the service of the truly evil Emperor Nero, who assassinated his own mother and later ordered Seneca to kill himself. We don't know Seneca's true intentions. Nero was a despot, but Seneca may have felt it was his civic duty to provide him guidance for the benefit of Rome and its citizens. We do know that Seneca acquired a lot of his wealth by serving Nero.

Here is another contradiction. Seneca wrote, "Wealth is the slave of a wise man. The master of a fool." And, "He is a great man who uses clay dishes as if they were silver, but he is equally great who uses silver as if it were clay." It seems that at times Seneca was a slave to his own wealth, as he obsessed over material things – the high polish of his furniture, his exotic slaves, the age of the wine he drank, and the earrings he sported.

Seneca epitomizes the saying, "In theory there is no difference between theory and practice; in practice, there is" (which has been ascribed to that great American philosopher Yogi Berra). Seneca literally wrote books on the theory of Stoicism but often struggled to practice that theory. He self-admittedly did not live up to his own ideals. If you're listening for notes of judgment on my part here, there are none. Quite the opposite. Seneca's struggles make me appreciate that though theory is a prerequisite, it is not enough; success comes from practice.

In other words, my spilling of ink on these pages means absolutely nothing for me (other than that you are reading it) if I don't practice Stoicism every day. There is an Asian proverb: "Knowing and not doing is not knowing!" Therefore, my goal is to be a practicing Stoic who both knows and does.

Last Time

Buy on Amazon 11/23/2022

One day you ordered a Happy Meal for the last time and you didn't even know it." – McDonalds.

No, this McDonalds was not an ancient Roman contemporary of Seneca. This was a tweet by the McDonald's Corporation that appeared in my browser right when I sat down to write about this topic. It perfectly summarizes a type of visualization that William Irvine, in A Guide to the Good Life, called "Last Time."

For everything we do, there will be a last time. Yes, there will be a last time we'll take a breath, but that is not the focus of this exercise. There was a last time I changed Mia Sarah's diaper (though my wife will insist I did not change it enough); there was a last time I drove Jonah to school; there was a last time Hannah needed me to lull her to sleep with a story; there was a last time I saw my mother; and yes, there will be a last time I buy a McFlurry at McDonalds (I'm not a Happy Meal-type person).

The Last Time negative visualization is there to ignite the appreciation that time, though infinite, is given to us in limited amounts to spend. This negative visualization of the finite nature of the personal time granted to us can help us increase the value of the present moment.

"It is not that we have a short time to live, but that we waste a lot of it. Life is long enough, and a sufficiently generous amount has been given to us for the highest achievements if it were all well invested." This excerpt from Seneca's On Shortness of Life is very appropriate here, but here is the punchline:

"But when it is wasted in heedless luxury and spent on no good activity, we are forced at last by death's final constraint to realize that it has passed away before we knew it was passing. So it is: We are not given a short life, but we make it short, and we are not ill-supplied but wasteful of it…

Life is long if you know how to use it."

We, yours truly included, are often not here, not in the present; we are daydreaming away in the past or in the future, while time does what time does, turning future into past. As the great Freddy Mercury put it, "Time waits for no one."

When we go to graduations or funerals, we recognize the shortness of life, we contemplate it on the drive home, and then we forget about it.

I am writing this on Wednesday before Thanksgiving, at 5 a.m. We are in

Vail for a few days of skiing. In about two hours my kids will wake up; my wife will make breakfast; she'll worry that the kids are underdressed for the weather (that is what mothers do), and we'll get ready to go skiing.

I'll put my laptop away and not think about this book till tomorrow morning. I'll focus on inhaling life with my kids – helping Mia Sarah (6) put her cute ski boots on, reminding Hannah (14) not to forget her gloves, and being in awe of Jonah (19) as he teaches Mia Sarah how to ski.

Some of the things I do today I may be doing for the last time. The kids will grow up. Mia Sarah will not need help with her ski boots. Though I doubt Hannah will stop forgetting and losing her ski gloves, at some point her husband will be the one reminding her. Mia Sarah will not need Jonah's ski lesson, and Jonah will be teaching his own kids to ski.

Yes, there is something I'll be doing today for the last time. I don't know what it is and will only recognize it in hindsight. I want to be present for it. I need to keep reminding myself of this daily and not wait for funerals and graduations.

William Irvine writes: "By contemplating the impermanence of everything in the world, we are forced to recognize that every time we do something could be the last time we do it, and this recognition can invest the things we do with a significance and intensity that would otherwise be absent."

I am not a big fan of religion (blame the Soviets for that), but religion did figure out daily repetitions. The Last Time visualization is a useful daily repetition (or prayer, if you like). Just remind yourself every morning that there is a good chance there is something you'll be doing for the last time – the past is already past; the future lies forever in the future; we have only now.

Seneca puts it beautifully: "Let us prepare our minds as if we'd come to the very end of life. Let us postpone nothing. Let us balance life's books each day. The one who puts the finishing touches on their life each day is never short of time." Seneca's Eastern counterpart, Confucius, appropriately pointed out five hundred years earlier: "We have two lives, and the second begins when we realize we only have one."

SOUL *in the* GAME

Excerpt:

Each Day is a Separate Life

Each Day Is a Separate Life

Buy on Amazon a *12/1/2022*

We are horrible with our time. Our initial reaction is to blame it on Netflix and Facebook. I get it – but at the same time, I don't.

Seneca lived almost 2,000 years ago. Then, pictures of friends were carved in stone, not posted to Instagram. History was written in real time in the Roman Colosseum so it could later be dramatized on Netflix. But even then, according to Seneca's first letter in the book Moral Letters, "The largest portion of our life passes while we are doing ill, a goodly share while we are doing nothing, and the whole while we are doing that which is not to the purpose."

Even then, Seneca was really upset about how people wasted their time:

"What man can you show me who places any value on his time, who reckons the worth of each day, who understands that he is dying daily? For we are mistaken when we look forward to death; the major portion of death has already passed.

Whatever years lie behind us are in death's hands."

His advice: "Hold every hour in your grasp. Lay hold of today's task, and you will not need to depend so much upon tomorrow's. While we are postponing, life speeds by."

Think about this when you waste your next hour on cat videos on Facebook:

"Nothing is ours, except time. We were entrusted by nature with the ownership of this single thing, so fleeting and slippery that anyone who can will oust us from possession."

And there's this when you need to summon the bravery to say "no" to a meaningless "let's grab a coffee" invitation: "What fools these mortals be! They allow the cheapest and most useless things, which can easily be replaced, to be charged in the reckoning, after they have acquired them; but they never regard themselves as in debt when they have received some of that precious commodity, time! And yet time is the one loan which even a grateful recipient cannot repay."

Seneca struggled with managing his time, too, and he admits it: "You may desire to know how I, who preach to you so freely, am practicing. I confess frankly: my expense account balances, as you would expect from one who is free-handed but careful. I cannot boast that I waste nothing, but I can at least tell you what I am wasting, and the cause and manner of the loss..." And this is the part I really want my kids to read. Seneca writes:

"I advise you, however, to keep what is really yours; and you cannot begin too early."

After reading Seneca, it is impossible not to want to retake control of the most important, irreplaceable gift you are given as a birthright – time. But how do you do this? I borrowed my practical solution from Seneca: "Begin at once to live and count each separate day as a separate life."

"Each separate day as a separate life." What a brilliant idea. A life bookended by sunrise and sunset. A day is a perfect, meaningful measuring unit. I can look at each day and evaluate how I spent it. If I achieve mostly perfect days, then they'll spill into a perfect life.

Every January most of us set New Year's resolutions. Though we don't think about it that way, we really treat each year as Seneca's separate life. Except that a year is so long that we forget about our New Year's resolutions by March.

Each day as a separate life has many advantages. Every single day you have feedback that allows you to make micro course corrections. It focuses you on process versus outcome. If you want to lose weight, instead of setting a New Year's resolution to lose 30 pounds, set daily resolutions – eat so many calories per day, exercise so many minutes per day, etc. (I can see that setting a goal to exercise so many days a week may be better, and that is okay.) None of us knows how long we have been given on this Earth. But I am certain we will be given more days than years.

The perfect day doesn't depend on stoplights turning green on my way to work, or a rental car company giving me the car I ordered, or great weather,

or the people I come in contact with bending to my will. Epictetus provides great guidance here: "Don't hope that events will turn out the way you want; welcome events in whichever way they happen: this is the path to peace."

This gives you an opportunity to live this day as if it was your last (and one day it will be). Imagine if this day was your last day. What would you pay more attention to (your loved ones) and what would you pay less attention to (a rental car mix-up)?

The goal is not to change our activities but to change our state of mind as we carry out those activities. You don't want to stop thinking about or planning for tomorrow; instead, as you think about tomorrow, remember to appreciate today. Or as Seneca puts it, "Hurry up and live".

At the end of each day, as the sun sets, I evaluate the day.

Did I spend my time wisely on good problems? When I was with my family and friends, was I present; did I pay attention to them? Was I kind? Did I leave the world better than I found it? If life presented Stoic quizzes (red stoplights, rental car problems etc.), did I pass them? How close did I come to practicing tranquility in motion? (I'll discuss this in a bit.) Did I interrupt any habits I am establishing? Did I incur any new bad habits? (I am looking for a pattern here.

Ordering nachos twice in a row could be the beginning of a new bad habit.)

This brings me to the daily journal. We can examine our "separate life" at the end of each day.

Here is what Seneca wrote: "When the light has been removed and my wife has fallen silent, aware of this habit that's now mine, I examine my entire day and go back over what I've done and said."

He took this opportunity to reexamine that day's life, see if he made mistakes, forgive himself for these mistakes, and prescribe himself a corrective course of action. "I conceal nothing from myself, I pass nothing by. I have nothing to fear from my errors when I can say: 'See that you do not do this anymore. For the moment, I excuse you.'"

Reviewing your day presents an opportunity to learn from your mistakes and correct them. For instance, today I debated politics with a friend for an hour. As I look at that hour, the time was completely wasted, and I won't get it back. Neither of us changed the mind of the other. In fact, we got a little bit annoyed with each other. The next time the topic of politics comes up, I should let my friend speak his mind and not offer a rebuttal, hoping that the conversation will take a better turn. If it doesn't, I'll let him know that I don't talk politics.

Daily journaling – in the morning, evening, or both – can be a life-changing habit. In addition to being a record of your day and thus your life, the journal provides a canvas for self-reflection and self-examination. I promise you it is a lot cheaper than a therapist. It is a safe place for you to be honest with yourself. Just like meditation, it allows you to identify and address thoughts that are spinning around in your subconscious.

This has another benefit: If you do this before you go to sleep, you'll sleep better (it worked for me).

Seneca was not the only Stoic who kept a diary. Most of what we know about Marcus came from a personal diary he wrote to himself, which he called Meditations. This was a safe place for Marcus to have a conversation with himself – being an emperor is a very hazardous occupation.

How much to write? Do your best. If you struggle, one sentence may be enough. Just as in creating any new habit, consistency is more important than quantity or even quality.

You can also use your daily journal to time travel. Penn Jillette of Penn & Teller started keeping a journal when he was 30, and at the time he felt that it was already too late to start. He has kept the journal for 35 years without skipping a day. Every day he writes about important conversations he's had, and reviews books he's read and movies he's watched. He writes about things that happened that day. But most importantly, he looks at what he wrote a year, ten years, and 20 years ago on that day.

As Socrates said, "The unexamined life is not worth living."

The False Sophistication of Sophists

Buy on Amazon 12/8/2022

In ancient Greece and Rome, parents took their kids to study oratory skills from teachers called Sophists (the word sophisticated has sophist in its root). Sophists focused on the art of persuasion through both emotion and reason, and kids were taught to argue both sides of an argument. Stoics, on the other hand, put the emphasis mainly on reason (not emotions) in their communications.

The Sophist's oratory skill was like a spear; it was a powerful weapon that could be used for good or for evil, thus students needed morality taught by philosophy to know where to point it.

Stoics were extremely cautious about the Sophists – they thought the words you use to persuade others matter, since in persuading others you may impact your own thinking. In the attempt to persuade others through an appeal to their emotions, we use colorful metaphors; we dramatize the words we use. If we had two brains, one to talk to others and one to talk to ourselves, we'd be fine. But that is not the case; thus our words may turn on us and impact our own emotional state.

It is almost as though Stoics would not want to use the colors available in the rainbow to express their opinions, but resort only to black and white. However, I see the value of their thinking. We need to examine the words we use when we communicate with ourselves. When something stirs up negative emotions inside us, we need to be careful when we describe the problem to ourselves. We want to make sure we are not being Sophists against ourselves.

The best way to do this is to write it out. When you lay each word on the paper, examine it. Instead of "My husband drives me insane," you write, "My husband says the following … that upsets me." (I am not quoting from my wife's journal; I am reading her mind.)

Instead of "The stock market collapsed," write, "The stock market declined X%." Epictetus said something along the same lines. Instead of saying "Our ship is lost far at sea; we'll never get home," he suggested we go with, "We are at sea, and we don't know where we are."

We take fancy words, string them together, and add dramatic, superfluous colors. Instead of calling a dish, "Basel Honey Glazed Wild Alaskan Salmon," Marcus might suggest we describe it as "the dead body of a fish, with herbs and honey." He writes, "where there are things which appear worthiest of our approval, we should lay them bare and look at their worthlessness and strip them of all the words by which they are exalted."

We need to pull the fancy outer layer off our problems and strip them to their bones. Instead of "my life is horrible," you create a list of things in your life that bother you, spelling them out as plainly as possible (don't use big, colorful words; leave those for the Sophists).

Here is an example of breaking things down. I was a sophomore in college; I was taking five or six classes and had a full-time job and a full-time (more like overtime) girlfriend. I was approaching finals and had to study for lots of tests and turn in assignments; and to make matters worse, I had procrastinated until the last second. I felt overwhelmed and paralyzed.

I whined (I am sure I was using big, colorful Sophist words) to my father about my predicament. His answer was simple: Break up my big problems into smaller ones; create a list and then figure out how to tackle each item separately. It worked.

I listed every assignment and exam, prioritizing them by due date and importance. Suddenly, my problems, which all together looked insurmountable, one by one started to look conquerable. My father didn't have to tell me to use plain English, because my academic problems, broken down to bare facts, didn't even require that; they all simply had due dates.

The beauty of the Stoic advice of depreciating our problems by analysis is that our subconscious doesn't sense or understand sarcasm or humor. If you keep telling yourself you're a loser and will never amount to anything (even jokingly), you'll sooner or later be right.

This point is extremely important and has a lot of implications of its own; thus it requires another analogy. Look at the conscious mind as the captain of a ship and the subconscious mind as the ship's engine room. Those in the engine room don't see what the captain sees, and thus if the captain says to go forward, in reverse, to port, or to starboard, they just follow the command without questioning. Is this command good for the ship? The engine room doesn't know, nor does it care. Our subconscious doesn't exercise that judgment. The words you use to talk to yourself matter, so be careful with them.

To illustrate my next point, I'd like to share a story from my favorite book of all time: Fooled by Randomness, by Nassim Nicholas Taleb.

Around 155 BC, Athens sent Carneades, a philosopher, to Rome to plead with the Roman Senate for a favor. Athens had been levied a fine by the Romans, which Athens desperately wanted removed. Carneades delivered a brilliant speech. The audience was swayed by his passionate delivery. However, this was not the message Carneades wanted to convey. He felt the audience had been swayed by his delivery, not by the logic of his brilliant argument.

So the next day, Carneades came back to the same square and delivered another impassioned speech, making the opposite point from the day before. He managed to persuade the audience all over again! Unfortunately for Athens, Cato the Elder was in the audience this time; and enraged at Carneades' oratorical antics, he convinced the Senate to send the ambassador packing.

Though Taleb was trying to make a different point with this story, the lesson I got out of it was: beware the Sophists. A great speaker can bend logic with emotions and exert undue influence on your decision making.

In my day job, investing, I talk to executives who run the companies we are analyzing. I also listen to dozens of conference calls each month. To become a senior-level executive at a publicly traded company you need to be a good communicator. After I am done listening to a call or after a conversation with them, I often want to mortgage my house, pawn my wife's car, and turn all our money over to them.

Just to be clear, I don't want to imply that all executives with great oratory skills are frauds – not at all. We just need to have a Sophist filter – we need to depreciate the emotional content of their messages down to the core. Remove the emotional content of the message, identify the important points the CEO made, and break them down to their essence. The better someone speaks, the more discriminating your Sophist filter needs to be.

Your sophist filter should also be on when you deal with cynics. Not the ancient Greek Cynics (with a capital C), just plain old cynics; people who paint negative pictures. They always sound smarter than optimists, but they are not always right.

You also want to be beware of arguments made through jokes, especially at the expense of your own argument. By getting people to laugh, your opponent brings them over to their side of the argument. This doesn't make them more right though.

Finally, be careful with people who advertise their virtues of their own volition: "I am honest," "I never steal." Odds are that by advertising their virtues they are overcompensating for that void in their character. A fellow I know was beating his chest, boasting about the strength of his word and his character. He borrowed a large sum of money from another friend of mine, skipped town, and never paid it back.

I'll let Seneca conclude this discussion: "A sword never kills anybody; it is a tool in the killer's hand."

SOUL in the GAME

Excerpt:

Attend a Party in Your Own Head

Attend a Party in Your Own Head

Buy on Amazon 12/15/2022

Good thoughts bring you happiness; bad thoughts poison you with anxiety and pain.

Our brain is invaded by thoughts nonstop. In fact, invaded does not correctly describe this, because it implies that thoughts are foreign entities and not occupants of our brain to begin with. The reality, as strange as it sounds, is that we are a guest in our brain. Yes, we are a guest at the party of thoughts that is happening nonstop in our own head. Though we believe we have control over what we think, we really do not. Most of the time we are not even aware of what we are thinking.

This brings us to meditation. It allows us to mindfully attend this party and, like a well-intentioned chaperone, examine all the guests (thoughts) and their intentions.

There are many meditation techniques. The one I've been practicing is mindfulness.

I sit in a comfortable position and focus on my breath. I am attempting to have no thoughts other than the awareness of my breath moving through my body. When I catch myself thinking about something other than my breath, I lightly acknowledge that thought without judgment, and poof, it disappears.

This technique is called "noting."

My goal is to become a calm, reliable observer of my thoughts. There is a significant hurdle to clear here – and to keep on clearing: I'll fail to focus only on my breathing. The first time I attempted to practice meditation I gave up after only a few weeks. I got frustrated with my inability to "not think." I was constantly interrupted by thoughts barging in. I felt I had failed at meditation. It took me a while to understand that this "failing" is not a bug but a feature of meditation.

The benefits of meditation

I did not understand the true benefits of meditation until I started meditating again, after the first failed attempt. I thought it was just something you do to calm down, but I was wrong. Though it will calm you down, it is so much more than this.

Here are some benefits I've discovered.

Meditation reduces suffering. The poisonous, negative thoughts are either reevaluations (judgments) of our past or worries about the future. Our thoughts are chronically stuck in the past or the future, but ironically, life happens in between – in the now.

It is difficult for us to sustain negative emotions. Dwelling on them adds fuel to flames that would have died out otherwise. By meditating, we can identify these negative thoughts, and by "noting" and recognizing them, we cut off the fuel to the smoldering fire.

Sam Harris, meditation guru, sums it up perfectly: People who don't meditate experience unnecessary suffering. Imagine reducing your (unnecessary) suffering from days or hours to less than two minutes.

Meditation focuses on the present. Meditation transports us back to the present, interrupting our habitual tendency to be either in the past or the future. Meditation trains our brain to be right here. I have found that being present is – wonder of wonders! – starting to spill into my daily life.

Here is an example. I've been working out with a personal trainer for almost three years. I have a complex relationship with working out. I don't always look forward to it. But I am always happy when it is over. I do it purely for health reasons and because I get to spend time with my brother Alex – we work out together.

Before I started meditating, with every exercise I was impatiently waiting for the torture to be over. My mind was always counting down towards the future. However, after a few months of mindfulness practice, I noticed that while weightlifting I was much more in the moment. As I lifted the weight, my mind was following the tension in each and every muscle in the same way it had got used to following my breathing as I meditate.

Living in the future was a default setting for me, and not only with regard to things I hated.

My father and I were in Vienna in 2010. He remarked to me one afternoon as we were walking down the street, "You always want to be in the next place." He was right. Whenever we'd get to a museum or some other attraction, I was in a hurry to go to the next one. Inhaling the moment was not my default setting.

Now, being present, not goal-focused, has become my goal. (Yes, I do get the irony of this sentence.) Meditation has helped me with that. I have been inhaling life more lately – be it as I walk in the park, or spend time with my kids.

I keep reminding myself what Master Oogway teaches in Kung Fu Panda:

"Yesterday is history, tomorrow is a mystery, and today is a gift… that's why they call it the present."

Meditation increases emotional intelligence. It's about those few extra seconds. You know, those few seconds that you need in order to take a deep breath before you respond to a stressful event. Meditation gives them to you.

One of my employees called me to say that he had unintentionally deleted a database that, at the time, I was unsure we had backed up. I vividly remember the anger rising in me. But then I found myself the dispassionate observer of that emotion. This bought me a few seconds, and thus my response was,

"Well, let's figure out a solution." Since I had noticed the negative emotion, it was difficult to stay angry; and surprisingly, just a few minutes later, I found myself laughing.

Part of daily life

I wish I had started meditating 30 years ago. I think my perception of meditation was ruined by a poster. A beautiful, trim woman with a ponytail was sitting in a yoga posture with her eyes closed at the edge of a cliff overlooking a gorgeous mountain landscape, the sun's gentle rays bathing her perfect skin. That is what meditation was to me – and it didn't work.

But what I have discovered since is that meditation is probably the least space- and environment-demanding exercise you can do. I don't have to get up at 4 a.m. and drive to the mountains to meditate. I can literally do it anywhere.

I have linked my meditation to my walks. I usually do it at the end of my walk in the park, on my favorite bench. But I've also meditated in my office, hotel lobbies, my back yard, and lying in bed (though this one knocks me out very quickly). I am new at this and need quiet to succeed, but I have read that it is possible to meditate to the noise of a jackhammer or people chattering. Here is the key: Meditation is an exercise for your brain, and just like any exercise it requires consistency.

Everyone I know who meditates does it daily. I do, too. I am at it for ten minutes once or twice a day, and am starting to experiment with 20-minute meditations. I use an app: Waking Up, created by Sam Harris. There are other good apps, too. At some point, as I get more experience, I may be able to meditate without training wheels. There are meditation sessions you can listen to on YouTube or Spotify.

When I meditate during my daily walk, after I am done with the meditation itself, I sit on the bench and listen to classical music, gaze at the trees, and try to hear and follow the sound of each instrument and every note and try to "not think." This type of meditative listening changes music from background noise into a compelling immersive experience.

I have a dear friend who I thought would benefit from meditating. I sent him a draft of this essay. His reaction was, "Meditation sounds like a magic fix-it-all tool. I hope it is as helpful for me as it was for you." Mulling over his remark, I realized that meditation requires faith and patience. Yes, faith. Faith in your own mind. Faith that by gently spending time alone with it, you'll be better able to harness and direct the power that is already there.

During meditation we are rewiring our brain, each ten- or 20-minute session at a time. Your brain, my friend's brain, and my brain are different from each other. We have different personalities and so the process of learning to meditate will be different for each of us. Set expectations low – that way you won't be disappointed.

Meditation requires patience, too. Meditation practice (key word here) is not unlike going to the gym and lifting weights. Even if you and I lift the same weight the same number of reps, we have different bodies and so our results will differ. One thing is guaranteed: When we lift weights, we are going to experience some pain from muscles breaking down before we grow them bigger and stronger. It's much the same with meditation. We must put in the work, and be patient about it, if we want to grow. Again, faith is important here. Some people enjoy feeling that pain more than others. (Yours truly is on the less side.) How much should you meditate?

In "I Don't Eat Pork," I discussed minimum measuring units (MMU). My

MMU for meditation when I tried it the first time was not to have thoughts

– a set-up for failure. Today when I do a ten- or 20-minute meditation, I am aiming for a perfect minute. At the very end of a meditation, the Waking Up app alerts you that this is the last minute. I try to make this minute as good as I can. I still cannot not think for a minute, but I am improving a millisecond at a time. I don't really have a destination; my goal is to enjoy the journey.

Dr. Jill Bolte Taylor, neuroanatomist, in her book Stroke of Insight, discussed what became known as the 90-second rule: "When a person has a reaction to something in their environment, there's a 90-second chemical process that happens in the body; after that, any remaining emotional response is just the person choosing to stay in that emotional loop."

There are a lot of other benefits of meditation that I have yet to observe in myself. Harvard conducted a study, "Eight weeks to a better brain," and discovered that an "eight-week mindfulness meditation program appears to make measurable changes in brain regions associated with memory, sense of self, empathy, and stress. … Participant-reported reductions in stress also were correlated with decreased gray-matter density in the amygdala, which is known to play an important role in anxiety and stress." In other words, after eight weeks of meditating an average of 27 minutes a day, participants' brains had become rewired for the better. Other studies have shown similar results.

In an interview, movie director David Lynch mentioned that he has a notepad near him when he meditates. (He has been meditating daily for 47 years.) It's part of his daily fishing expedition for new creative ideas. He calls it "catching big fish." When ideas come to him, he writes them down and then goes back to meditating. Yes, some of the stray thoughts that wander in during meditation may be worth remembering! If anything worthwhile comes to me as I meditate, I write it down in the notes app on my phone.

Soul in the Game - The Art of a Meaningful Life

I vividly remember the moment when I decided to write Soul in the Game. Now, looking back at it, I am very proud of this moment as it was a completely selfless one.

Let me tell you what happened. It was early in the morning of August 10th, 2020. I had just finished writing an essay. At the time I didn't have a title for it, but in the book it's called "Creative Rollercoaster".

This essay started out as a short note about Tchaikovsky's Souvenir de Florence that was going to accompany one of my investment articles. As I started reading about this piece, I was touched by the emotional rollercoaster Tchaikovsky suffered when he composed it. I caught myself thinking that Tchaikovsky's emotional journey looked very familiar. I don't compose music, but I write. Both are creative processes where you try to fish content out of your subconscious. What started as a short piece that was going to accompany music started to turn into a lengthy essay about creativity and writing. After I finished writing it, I realized that this essay could actually help others. But this was not the only life (non-investment) essay I had written. What if I put the life essays I had written over the last fifteen years into a book? This selfless thought "it could help others" is the one I am proud of.

I started looking through my essays. I was going to self-publish them. Nine days later I received an email from Craig Pearce, an editor at Harriman House, a British publisher that had published books by my friends Lawrence Cunningham and Morgan Housel. Craig and I had communicated a few years earlier about possibly publishing an investment book I was working on, Intellectual Investor. (I have yet to finish it.)

I told Craig that I was working on a very different book and sent him a sample. I was expecting a very polite (he is British, after all) response along the lines of "Vitaliy, this looks great. Good luck!" To my surprise, Harriman House expressed interest in publishing it. Now I was a bit confused. I started to question their sanity. I thought there must be something wrong with them. What kind of joint could they be running if they wanted to publish this?

I reached out to Lawrence and Morgan and asked them about their experience with Harriman House. Harriman House had just published Morgan's Psychology of Money, which became an international bestseller and quite deservingly sold a million copies. Both gave Harriman House glowing reviews and confirmed that there was nothing wrong with either Craig or the publisher.

I was excited to get the book out into the world, and we agreed to a publishing date of March 2021. We were in the middle of the lockdown, so I had plenty of time on my hands. I worked mornings, evenings, and weekends on the book. At first, I was mostly rewriting existing published and unpublished essays. Then the writer in me took over and I wrote many new ones.

Everything was going according to plan, and then…

Well, I stumbled on Stoicism. It was love at first sight. I wanted to learn and to write about it and share it with the world. I told Craig that this detour might take a few months. I read everything I could get my hands on. This ended up delaying the book by about a year, but I don't regret it. I ended up writing a book inside a book about Stoic philosophy.

Soul in the Game – The Art of a Meaningful Life ended up being a very personal and autobiographical book. But I truly hope that despite its being personal, Soul in the Game becomes not my but your book. I can only hope that I carried the selfless intention that triggered me to write it throughout the book.

The book is finally out - you can buy the book today as in hardcover, Kindle, or Audible format on Amazon (or get the hardcover on Bookshop.org).

Since being released, Soul in the Game has received glowing endorsements from a lot of prominent people I respect, including General Stanley McChrystal, Nassim Taleb, Carl Bernstein, Wim Hof, and many others.

But as much as I am humbled by and thankful for their praise, when I was writing the book I was visualizing my regular reader – you. I wanted this book to touch you, to brighten your day, to improve your life, even if just a little. So I am particularly thrilled about the fact that this book has earned a 4.7 average reader rating on Amazon from nearly 200 reviews. Many write that Soul in the Game transformed their lives - what could be more fulfilling than hearing that?

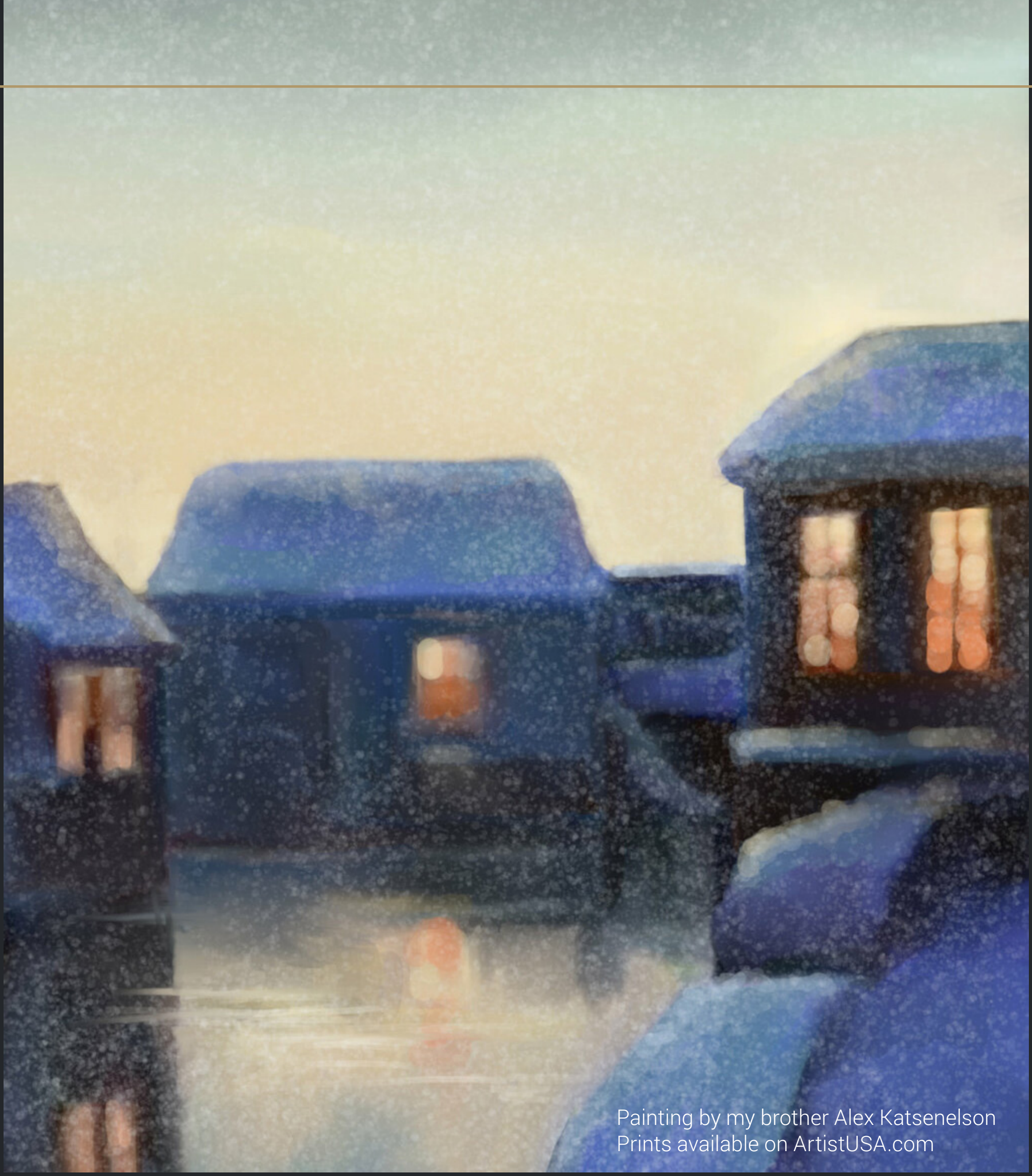
To be honest, I'm having a hard time letting go of this book. I haven't really stopped writing it. Since the final draft went off to the printer, I've now written several more chapters that I would've included in the book had I the ability to do so.

So if you purchase Soul in the Game, send your purchase confirmation over to bonus@soulinthegame.net. I'll send you four new chapters from the book (25 pages!) to read.

Painting by my father Naum Katsenelson
Prints available on Katsenelson.com

Music

MUSIC



Juno and Avos

1/12/2022

In December 2021 my wife and I took our girls Hannah (15) and Mia Sarah (7) to see Steven Spielberg's revival of West Side Story (my son Jonah was away at college).

To listen to the music referred to in this article, please follow this link.

As I started writing about West Side Story, I inadvertently wandered into deep corridors of memory and realized that musicals were an important texture in my life and I had not given them enough limelight in my writings. I intend to correct this unfair indiscretion with a series of articles about my favorite musicals. Strangely, I also realized that I don't have a favorite musical. Each musical I am about to write about was a favorite, just at different times of my life.

In separate installments I'll discuss Juno and Avos, Evita, The Phantom of the Opera, Les Misérables, West Side Story, Aida, Man of La Mancha, and maybe some others. (Those are all I have written about so far.)

To listen to the music referred to in this article, please follow this link.

Juno and Avos

My journey with musicals began almost forty years ago, in 1983.

Now, I am quite aware that I may lose some of my readers here, as I am about to write about a Russian musical. Feel free to skip this one – I'll write about Evita in the next installment.

I was ten years old, still in the USSR. My whole family – father, mother, two brothers and I – gathered around the TV to watch Juno and Avos. This musical was officially categorized as "rock opera," but the line between a rock opera and a musical is very thin. A rock opera is a musical with less speaking and more electric guitars.

Watching Juno and Avos was a big deal for us. It had premiered a couple years earlier at the Lenkom Theatre in Moscow and was an enormous success. This was before VCRs, and TV was the only way for us to see it other than traveling to Moscow. Juno and Avos are the names of two Russian ships that went on an expedition to North America in 1805. It is the tragic (true!) love story of the Russian explorer Count Nikolai Rezanov, who falls in love with Conchita Arguello, the daughter of the Commandant of San Francisco. Nikolai and Conchita get secretly engaged, but it seems that before they can marry, Nikolai must return to Russia to seek the Tsar's permission, since she is Catholic and he is Russian Orthodox.

Rezanov promises to return, but on the voyage home he contracts pneumonia. Then he takes a tumble from his horse. (Did I mention that Nikolai is 41, Conchita 15?) The combination proves fatal. Learning that Nikolai has died, Conchita refuses to believe it and vows to wait for him, which she does, refusing many suitors, until her own death 37 years later.

As I have mentioned many times before, sitting in front of the computer early in the morning for hours is for me like a trip to the psychiatrist. It is incredibly therapeutic, brings on self-reflection, unearths a lot of memories, is calming, and allows me to medicate on self-prescribed coffee.

One of those memories is of my brother Alex playing a guitar. Alex and my oldest brother, Leo, were sent to music school to study piano for a few years. They both hated it. A few years later, when he was fifteen, Alex taught himself to play the guitar. He had a very limited repertoire, but a song from Juno and Avos was part of it.

To listen to the music referred to in this article, please follow this link.

I got to see Juno and Avos live in November 1991 at the Lenkom Theatre with the original cast, a few weeks before we left Russia for the United States. It is one of the dearest experiences of my life.

Evita

1/19/2022

This is a continuation of my journey into musicals (I discussed Juno and Avos last time).

To listen to the music referred to in this article, please follow this link.

In the early 1990s I was mesmerized by Evita, a musical composed by Andrew Lloyd Webber.

Let's take a small detour and talk about Andrew Lloyd Webber. Webber composed Evita, Jesus Christ Super Star, Phantom of the Opera, Cats, Sunset Boulevard, and many other musicals. In 2001 the New York Times called him "the most commercially successful composer in history." What is interesting is that Webber composed another dozen musicals that saw the light of day for only a very short time and were then consigned to obscurity. Failure is an important constant of success, even for creative giants like Sir Andrew Lloyd Webber (he was knighted by the Queen in 1992).

If you'd like to relive Webber's best musicals and meet Sir Genius, watch this three-part concert:

To listen to the music referred to in this article, please follow this link.

Evita is a musical about Eva "Evita" Peron. Eva comes from a poor family in Argentina. She meets Juan Peron – a future three-time president of Argentina. During Peron's presidency Argentina fell in love with Evita. Evita tragically dies of cancer at the tender age of 33. A lot of political events happen in between and some romance, but this sums up the musical. I must admit, I am somewhat indifferent to the storyline of this musical. I don't see many redeeming qualities in Juan Peron. And unlike Argentina, I did not fall in love with Evita. But I love the music. Pop singer Madonna and Antonio Banderas did a terrific job starring in the 1996 movie.

Here are my favorite songs:

To listen to the music referred to in this article, please follow this link.

The Phantom of the Opera

1/26/2022

The Phantom of the Opera was composed by Andrew Lloyd Weber, with lyrics by Tim Rice. The musical is based on the book by French author Gaston Leroux, published in 1910. Laroux wanted to become a lawyer, but luckily for us he gambled his inheritance away and became a reporter instead. As a reporter he learned of rumors surrounding a ghost living in the Paris opera house. He combined these rumors with true stories of a chandelier crashing down during a performance and an underground lake (there is indeed a lake under the opera house) and turned them into a novel, which was first published in a newspaper and then as a book. Until his death Laroux was convinced that the ghost living in the opera house was real.

To listen to the music referred to in this article, please follow this link.

The Phantom of the Opera is the ultimate gateway drug to opera. At times, except for more modern instrumentation, you really cannot tell the difference between this musical and an opera. I've seen this musical performed live half a dozen times, and every single time I leave the theater touched, as if I have watched it for the first time. I'd argue this is Andrew Lloyds Weber's greatest creation.

The Phantom of the Opera is at its core a love story. Christine Daaé is a little-known soprano. From a young age she secretly takes music lessons from Erik – she calls him "Angel of Music" – who is the phantom of the opera, a ghost who lives in the entrails of the opera house and who has a deformed face (thus the mask he wears). The lead soprano calls in sick and Christine debuts at the gala performance to a great success. There she meets her childhood friend Raoul, and they fall in love. Erik, who is in love with Christine, feels betrayed… and there is a lot of jealousy, drama, mystery, kidnapping, and some murder in between. This musical does however have a happy ending. Despite his being the antagonist of the story, you feel sorry for Erik, who in the end comes through as a hero (okay, a weak hero but hero nonetheless): His love for Christine is so strong that he puts her happiness above his own and lets her be with Raoul.

I have a very personal story associated with The Phantom of the Opera. In April 2018 then-13-year-old Hannah and I went on a two-day father-daughter trip to Washington DC to see the cherry blossoms. I love Washington DC in April; it is truly a magical place. We did the usual touristy things, visiting the Smithsonian and the Newseum (the museum of news); and up to that point the highlight of Hannah's trip was scootering around DC. As we were getting ready to fly back to Denver, we learned that the Denver airport was closed due to a blizzard.

We were delighted.

Hannah and I took a train to NYC and spent two days in Manhattan. We visited the Metropolitan Museum of Art (I love the Impressionist and Flemish painter collections). We also did the Museum of Modern Art (MOMA). (I keep going back to museums of modern art, not just in NY but in San Francisco as well, in the hope that one day I may truly enjoy them. Not yet, but I am hopeful. Hannah and I also rented bikes and rode them in Central Park. But the highlight of our NYC adventure was The Phantom of the Opera. This was Hannah's first live musical. We were so energized after the performance that, holding hands, we played Phantom of the Opera on her iPhone, with shared AirPods, singing it while walking through Times Square. We hadn't a care in the world. We were intoxicated by the music, and though surrounded by other tourists, we were deep in our own phantom world. If you ask Hannah what she remembers the most about our DC trip, she'll tell you it was going to The Phantom of the Opera in NYC and singing it in Times Square.

To listen to the music referred to in this article, please follow this link.

Before we listen to excerpts from the musical, I must mention the 2004 Phantom of the Opera movie. It is a masterpiece. My favorite number in the movie, which highlights beautiful cinematography and singing, is called "Prima Donna," about a character who is an overrated singer, masterfully played by Minnie Driver. As you watch it, note the counterpoint singing – performers singing arias independently of each other.

Les Misérables

2/2/2022

In 1997 I went to London with two friends who at the time were dating for a week. I was having a tumultuous relationship with a girlfriend at the time and we were taking a break from each other (we broke up a few months later). It was just the three of us.

To listen to the music referred to in this article, please follow this link.

This was my first trip to Europe. Till this day I am amazed by the Continent's deep history. On one afternoon we went to Westminster Abbey and saw the tombs of Mary Stuart, Queen of Scots, and her rival, Queen Elizabeth I. The same evening, we went to see Donizetti's opera Maria Stuarda, which depicts the lives of Mary Stuart and Queen Elizabeth. Only in Europe.

The next evening, I wanted to see a musical and my friends wanted to spend some romantic time alone (I don't blame them), so I went to see Les Misérables (affectionately known as Les Mis) by myself. I knew nothing about the musical. I had no expectations. It was a random musical that I could get tickets to that evening. At the time I did not even know that Les Mis was based on Victor Hugo's novel by the same name. (In Russian it is known as The Rejected).

I remember walking out of the theater onto a wet London street completely high on the music. It was raining. I didn't care. This was a different high than the one from Phantom of the Opera. Les Mis is a rare marriage of an incredible story with great, complex characters and wonderful music. I was inspired. I was only 24, still in search of myself (I was a late bloomer). In Jean Valjean I found a role model – not perfect, yet a principled, honest, caring person who was in pursuit of always doing the right thing.

So I wanted to be like Jean Valjean. Les Mis is inspiringly optimistic. It also provides a hope that people can change for the better if you show that you believe in them. There is a scene in the musical that has really stuck with me till this day. Valjean is released from prison. A bishop feeds him and takes him in for a night. Valjean assaults the bishop and steals his silverware. The next day he is caught and brought by the police to the bishop. Valjean claims that the bishop gave him the silverware. The bishop confirms to the policeman that the silverware was indeed a gift and scolds Valjean for forgetting to take the silver candle holders. After the police leave, the bishop tells Valjean, "You must use this precious silver. To become an honest man."

Here is this scene from the 1998 movie starring Liam Neeson, Geoffrey Rush, and Uma Thurman:

To listen to the music referred to in this article, please follow this link.

This act of kindness shakes Valjean to his core and dramatically changes the trajectory of his life.

If you did not see the musical or the movie or read the book I don't want to give away any more of the story and ruin it for you. As I am reflecting on this now, my reaction that night in London was to the power of Victor Hugo's story, but the music was an amplifier of emotions. 1997 was literally a half-life ago, and I hope I have come a bit closer to being like Jean Valjean over the years.

I introduced my then-6-year-old daughter Mia Sarah to Les Mis in a very odd way – we watched James Corden's Crosswalk the Musical. It is funny and lighthearted. After the Crosswalk the Musical version, we watched the Les Mis 10th Anniversary Concert. I had to explain the story line to her. Her favorite song is "One Day More".

To listen to the music referred to in this article, please follow this link.

P.S. My gentle suggestion is, don't watch the 2012 Les Mis movie, or at least don't start your Les Mis journey with it. It has a great cast, but the singing is horrible. Unfortunately, I put it in the category of worst movies ever made, right next to Dune (1984 vintage). Some may say I am too harsh. Maybe, but it took sixty years for Hollywood to remake West Side Story, and I won't live long enough to see the remake.


Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

West Side Story

2/9/2022

West Side Story is a modern (1950s) version of Romeo and Juliet, set in New York. Leonard Bernstein (1918–1990) composed the music and Stephen Sondheim (1930–2021) contributed lyrics. Sadly, Sondheim passed away a few weeks before the 2021 movie release, though I have read that he got to see it.

To listen to the music referred to in this article, please follow this link.

West Side Story and my family go way back. When my kids were little, I sang "Maria" to them – it was the only song I knew by heart and that my very limited vocal range allowed me to sing. The 1961 version of West Side Story received 10 Academy Awards, and my kids and I have watched excerpts from it probably a hundred times. The new movie was the first time my daughters saw West Side Story from start to finish – my wife always fast-forwarded past the violent parts. At the end of the movie no Katsenelson in the audience had a dry eye. During "Maria," Hannah touched my shoulder and gave me the look "This is our song." My heart melted (it is still melting as I write this).

However, my favorite West Side Story recording and video is not Spielberg's or those of the 1961 movie or theater production, but a documentary of a 1984 recording session with Leonard Bernstein conducting. West Side Story was originally created for the theater, so in the musical we watch on stage or the silver screen the performers have to be able to both sing and dance and look the part. It is very difficult to find performers who are great at all three.

To listen to the music referred to in this article, please follow this link.

This 1984 production of the musical was not theatrically staged. It solely focused on recording the best soundtrack possible, thus it is as close to a perfect audio performance as you can get. Also, two opera legends performed the main parts: Spanish tenor Jose Carreras sang Tony, and New Zealand soprano Kiri Te Kanawa sang Maria.

I have to confess that the true reason I love watching this documentary is Leonard Bernstein. And it goes beyond the fact that seeing a composer recreate his own music as a conductor is a very rare experience. Leonard Bernstein, who was known to fellow musicians simply as Lenny, was not just another conductor; he was one of the best conductors who has ever lived. But still, the main reason I am attracted to watching this behind-the-scenes documentary is that it shows you a Bernstein that you don't see on stage – an emotional, volatile, charismatic, kind, funny, and at times even moody creative genius for whom every performer would take a bullet, but more importantly, will squeeze every ounce of their soul into the music they produce.

You can watch the full documentary here:

To listen to the music referred to in this article, please follow this link.

Painting by my brother Alex Katsenelson
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Man of La Mancha

2/16/2022

It is hard to name much writing that was published more than four hundred years ago and is still read today. Religious texts and the works of William Shakespeare come to mind, and that is about it. And then there is Don Quixote by Miguel de Cervantes, which was published in two parts in 1605 and 1610. I just finished writing a non-investment book, and I'll be lucky if it doesn't fizzle out two months after its publication. The fact that Don Quixote was published more than four centuries ago and that anyone who reads this sentence knows who Don Quixote is means that there must be something special about that book or about Don Quixote himself.

To listen to the music referred to in this article, please follow this link.

What is it?

I have to confess that I read Don Quixote in my early teens. It had little impact on me. I did not remember much about the book, other than it was about a crazy old man going on weird crusades, fighting windmills and seeing them as an evil army. I was too young to understand its message. I have yet to reread the book (something I plan to do soon).

A few years ago, I stumbled on the 1972 movie musical Man of La Mancha, and I finally understood what makes Don Quixote so special. In the movie Don Quixote is played by Peter O'Toole and Dulcinea de Toboso by the stunningly beautiful Sophia Loren. The movie is based on the musical, which in turn is based on Dale Wasserman's television play, which adapts the Don Quixote novel and brings Miguel de Cervantes right into the middle of it.

In Man of La Mancha Don Quixote meets Aldonza Lorenzo, a local farm girl who is vulgar and has very few virtues – she belongs to the oldest profession. On the surface Aldonza has few redeeming qualities. Don Quixote believes that he needs to have a lady, someone for whom he fights. He imagines and thus sees Aldonza as a model of female perfection and calls her Dulcinea. More importantly he treats her as bespoke royalty. It takes a while, but by the end of the movie Aldonza turns into Dulcinea – she starts seeing the Dulcinea in herself. This was (in part) the message of Les Misérables, too – you become what you believe you are. These three excerpts from the movie capture Aldonza's transformation perfectly.

To listen to the music referred to in this article, please follow this link.

This message is so important to remember as a parent. I always had low self-esteem. The Russian education system and my being different from other kids had plenty to do with it. My parents' unwavering belief that I could achieve anything is responsible for everything I have achieved to date.

Now let's talk about the musical. It is uplifting and optimistic. My favorite song is "Impossible Dream" – the words of this song are full of aspirational virtue.

To listen to the music referred to in this article, please follow this link.


Painting by my brother Alex Katsenelson
Prints available on ArtistUSA.com

Aida

2/23/2022

In this exploratory journey of musicals we'll briefly venture into the adjacent world of opera, as I'll discuss both Aida the opera and Aida the musical, both based on the same story.

To listen to the music referred to in this article, please follow this link.

Let's start with the opera. Aida was composed by Giuseppe Verdi and premiered in Cairo in 1871. It was commissioned by the ruler of Egypt to celebrate the opening of the Khedivial (Royal) Opera House in Cairo. The original Aida came with a five-minute prelude. A prelude is a short piece of orchestral music that sets the mood for the music to come. Preludes are usually played before an act of the opera – not at the beginning of the opera. Overtures are usually longer pieces that are played before the opera, as their job is to expose the most important motives of what you are about to hear. Before a performance in Milan in 1872, Verdi composed an 11-minute overture for Aida, which he then decided not to use. To this day most performances include the prelude, not the overture. You can listen to Aida's overture, which is terrific, here.

Today, 150 years later Verdi's Aida is still one of the most-performed operas.

Aida's story takes place in Egypt, which is at war with Ethiopia. Aida is an Ethiopian princess captured by the Egyptians and serves as a slave to the Egyptian princess Amneris. Amneris is in love with the young Egyptian general Radames, who is leading the war against Ethiopia. What complicates this picture is that Radames is in love with Amneris's servant Aida, and Aida is in love with him. To quote from Aida the musical, "Every story is a love story." The story here is not your typical love triangle, it is more like a love square where love for country is thrown into the mix: Radames has to make a choice between Aida, Amneris, and Egypt. You'll have to watch the opera or the musical to find out how this dramatic story unfolds. (You can watch a summary of the opera here).

To listen to the music referred to in this article, please follow this link.

Now let's move on to Aida the musical.

Aida was a continuation of the relationship between Disney and Sir Elton John (music) and Tim Rice (lyrics) after their previous successful collaborative effort on the Lion King musical. The Aida musical had a rough start. Its first production, in Atlanta, suffered a malfunction of a complicated $10 million pyramid contraption. I read a story somewhere that the malfunction was the best thing that happened to the production. As it broke, all the performers came out on stage and started to sing their roles as if it were not a staged musical but a concert. The audience did not care; they loved it. Aida's producers knew they had a successful musical – a great combination of terrific music and a powerful love story – and that it didn't need overcomplicated contraptions and super-fancy sets.

I love Heather Headley's singing of Aida, and here is my favorite recording of her singing Aida's main song, "Written in the Stars":

To listen to the music referred to in this article, please follow this link.

Painting by my brother Alex Katsenelson
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Beethoven Symphonies Conducted by Ivan Fischer

4/13/2022

I'd like to share with you a terrific interview with Hungarian conductor Ivan Fischer. He shows different sides of Beethoven. I love how he provides little, unique insights into the composer.

To listen to the music referred to in this article, please follow this link.

He explains how, before Beethoven, music was composed mostly for the aristocracy. Beethoven's music was more powerful and very different from the music that had come before. Beethoven called his Third Symphony Eroica ("Heroic"). It is about a hero – none other than Napoleon. Beethoven had been favorably impressed by Napoleon's efforts to reform society so that the working classes could enjoy more equality.

Here is Ivan Fischer conducting Beethoven's symphonies:

To listen to the music referred to in this article, please follow this link.

Giovanni Bottesini – Double Bass Concerto No. 2 in B minor

8/4/2022

Today I'd like to share with you a composer and concerto that are completely new to me: Giovanni Bottesini's Double Bass Concerto No. 2 in B minor.

To listen to the music referred to in this article, please follow this link.

Bottesini (1821-1889) was born in Northern Italy. He studied violin and would have become a violinist. But when he applied to the Milan Conservatory, they had no scholarships available for violin positions but had an opening for double bass (also known as the contrabass, the largest, lowest-pitched string instrument. Think of it as a giant cello). So Bottesini ended up studying double bass.

Bottesini changed the public's perception of the double bass, showing that it could be a solo instrument, and went into the musical history books as the Nicolo Paganini of the double bass. He was a virtuoso and greatly expanded the limited repertoire for the giant instrument. He composed 48 pieces for the instrument, including three concertos.

To listen to the music referred to in this article, please follow this link.

Bottesini earned a living as a conductor and was well known throughout Europe. Verdi chose him to conduct the first performance of Aida. But his first love was double bass, and while conducting opera, during intermission he would bring his double bass on stage and play his fantasies on the theme of the opera.

Painting by my father Naum Katsenelson
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About Vitaliy Katsenelson

I spent the first eighteen years of my life in Murmansk, Russia, a city located above the Arctic Circle in the northwestern corner of Russia. My family emigrated to the US in 1991. I received my formal education (both my graduate and undergraduate degrees) at the University of Colorado at Denver. While I was getting my master's degree I also studied for CFA exams and received my CFA charter in 2000.

2004 was probably the most important year in shaping the direction of the rest of my life – I started writing. First I wrote for TheStreet.com, but I couldn't sit still, and so I wrote for almost every major financial publication you can imagine, from *The Financial Times* to *The Christian Science Monitor* and *Barron's.* Writing forced me to think exponentially more than I had thought before and accelerated my growth as an investor and human being.

I must have been addicted to driving to the University of Colorado campus, because when I stopped going there as a student I started teaching there. In 2001 I taught my first investing class to undergraduates, and later I taught grad students. I did this dutifully until 2007, when my first book, *Active Value Investing*, came out. In 2010, the publisher, John Wiley & Sons, asked me if I could turn *Active Value Investing* into one of their "Little Books," and that's how *The Little Book of Sideways Markets* was born.

In 2022 I published my third book, and my first non-investing one, *Soul in the Game*. What originated as a simple collection of past essays on topics outside of investing turned into something more when I discovered Stoic philosophy and dedicated a third of the book to it.

In 1997 I joined Investment Management Associates, Inc. (IMA), at first as an analyst. Then I became portfolio manager, CIO, and today I'm IMA's CEO and its biggest cheerleader. I helped build IMA into a firm that I'd want to be a client of (which I am – all my liquid net worth is managed by the firm). Clients come to IMA (many of them nearing retirement), turn over the bulk of their net worth for us to build them an "all-terrain portfolio", and basically say, "Vitaliy, don't screw it up, please." I take that responsibility seriously.

Most importantly, I am married to a wonderful wife, Rachel, and we have three incredible kids, Jonah, Hannah, and Mia Sarah.

If you have made it this far, I suggest you sign up to receive my articles by email if you haven't yet. I share a lot of content in them that never makes it to my website or my annual almanacs.