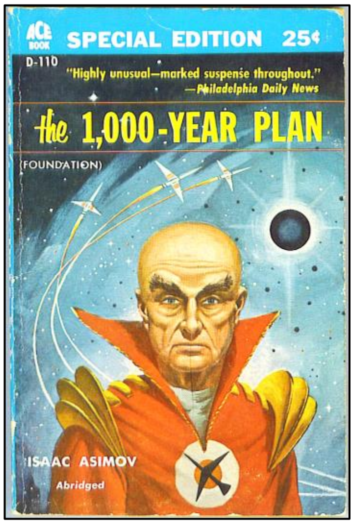
Epsilon Theory

Clear Eyes, Full Hearts, Can't Lose

October 4, 2018



In 1942, fresh from reading Edward Gibbon's *History of the Decline and Fall of the Roman Empire*, 22 year-old Isaac Asimov published the first short story in what would become the most famous and influential science fiction series of his or your lifetime – the *Foundation Trilogy*. In these books, Asimov invented the fictional science of ***psychohistory***, a combination of history, sociology and mathematics that could make accurate predictions about the behavior of crowds.

The scientists who developed psychohistory called themselves the Foundation, and they wrote down their research and principles on a giant screen called the Prime Radiant. **The Radiant displayed the Plan, a path forward that recognized how we humans are hard-wired and soft-wired to respond to Narrative and other invisible social interactions in estimatable ways.** It was a path to be followed – not to prevent the inexorable and inevitable Dark Age – but to reduce its length from an unimpeded 30,000 years to "only" 1,000 years. All the wisdom in the world is insufficient to stop the great cycles of human history. We do what we can.

The Plan goes awry only a few centuries into its efforts, thrown askew by a unique mutant psychic named the Mule, a force totally unforeseen by the Plan. The Mule's great power is the ability to manipulate the emotions of any human, a power he first uses to make a planet's population fearful, then, once conquered, to make them intensely loyal. First the Mule takes over the machinery of Empire, turning the supposed leaders into his puppets. Then he diminishes the Foundation into near irrelevance. And so the galaxy descends into a 30,000 year Dark Age.

But the Radiant survives, kept alive by a small band of psychohistorians determined to get humanity back on the right path, no matter how long of a game they must play. This is **the Second Foundation**, established at the same time as the highly public Foundation, working in anonymity and behind the scenes. Hunted by both the Mule's Empire and the still powerful Foundation, it is the Second Foundation, using similar mental powers as those of the Mule, that ultimately prevails.

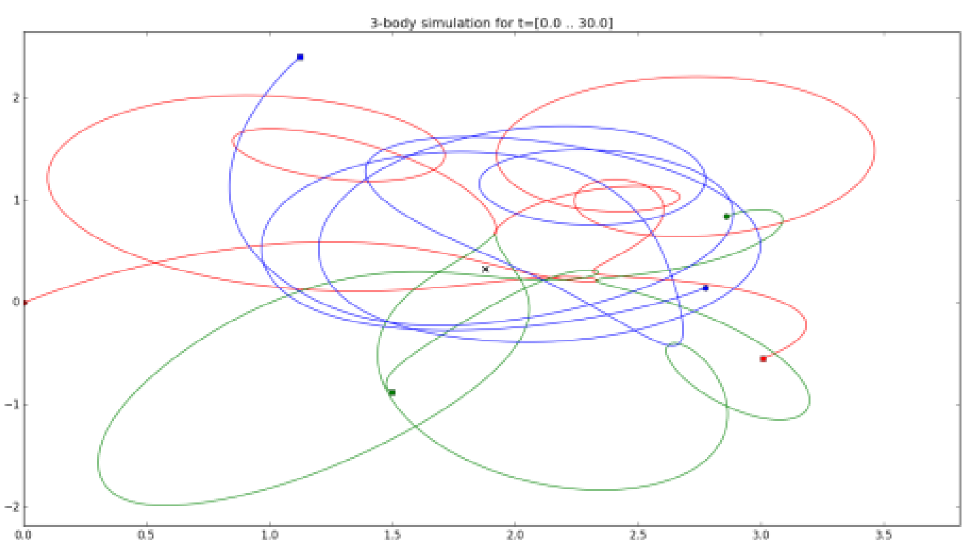
Their secret for survival and success? ***The Second Foundation hides in plain sight.***

And you thought this was an investment blog.

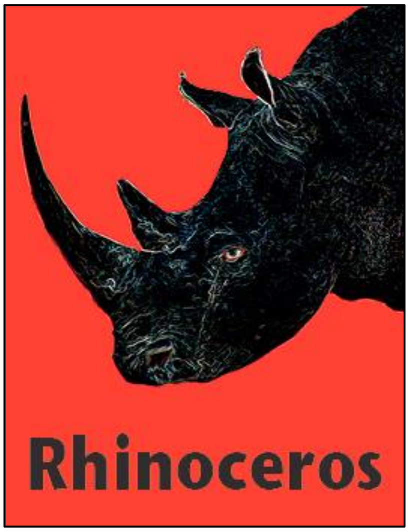
I won't go into long detail on the first two essays in this new Manifesto – ***Things Fall Apart (Part 1)*** and ***Things Fall Apart (Part 2)*** – except to say that they are examinations of what it means to have a polarized electorate and a monolithic market. **In politics we have what Yeats called a *widening gyre*,** where a steady stream of extremist candidates, each very attractive to their party base, pulls all voters into a greater and greater state of polarization, leaving a center that does not and cannot hold. **In markets we have a *black hole***, where the massive performance gravity of passively managed U.S. large cap stocks pulls all investors into its clutches over time, subverting both the reality of and the faith in portfolio diversification. Both phenomena have a common cause – the extraordinary and coordinated monetary policies (including Narrative-control policies) in place for a decade within every major economy on Earth – and both phenomena are remarkably powerful, as the $22 TRILLION in central bank asset purchases over the past ten years exerts enormous "gravity" to render apart in politics and crush together in markets.

Geometry is not true, it is advantageous.
— Henri Poincaré (1854 – 1912)

But the polarized electorate and the monolithic market are not stable. They're not permanent. Both our political and market lives are governed by the ***Three-Body Problem***, a physical geometry first noted by Henri Poincarè in 1887, where multiple bodies that *act on each other* – like stars and their gravity or humans and their strategic interaction – form a system that, in the lingo, has no general closed-form solution. In other words, the future of a Three-Body System *cannot be predicted*. There is no algorithm, no Answer with a capital A, that *solves* the Three-Body Problem. At best we can *estimate* the future position of objects in the system, with exponentially greater information processing power required the farther out into the future we try to look. ***So even though the polarized electorate and the monolithic market aren't permanent, we have NO IDEA how long they will last or where they will end up.***



That's a problem, because humans crave the Answer, in both our political and our investing lives. We are hard-wired to seek it. And just because the Answer does not exist … well, that doesn't mean that people aren't constantly going to fool themselves into thinking that they've found it. That doesn't mean that raccoons and true-believers alike aren't constantly going to sell you on an Answer. That doesn't mean that readers of this note who want me to tell them what to invest in or who to vote for aren't going to be disappointed.



Oh, a rhinoceros.
— **Eugène Ionesco, *Rhinoceros* (1959)**

There's one essential book for understanding the social dynamics of the brutish know-nothing State, and it's Ionesco's *Rhinoceros*. Or you can watch the play.

To see your fellow citizens and family members transformed into rampaging rhinoceroses, not in a miraculous sort of way but in an ordinary "oh, look, there's another rhinoceros" sort of way … absurd, yes?

No. Not at all.

Spoiler Alert: the scientists and logicians are the worst.

In both politics and markets, the Answer is, by definition, totalitarian in nature. That's what it *means* to be a general closed-form solution. It explains *everything*. Gold bugs and central banker fan boys, Trumpkins and Bernie Bros … they're all oh-so confident that they have the Answer. They're all half-way to becoming rhinoceroses, to use Ionesco's perfect imagery.

But, Ben, if there's no Answer, what do we DO?

Twiddle our thumbs? Mutter darkly about the Fed for the umpteenth time?

[*looks uncomfortably in the mirror*]

Fall back into snarky cynicism?

[*looks around even more uncomfortably*]

Isn't this just the path to nihilism, where we end up prancing around like comic villains in *The Big Lebowski*, except our prancing is done on Twitter instead of the parking lot of a bowling alley?

[*okay, now you've gone too far*]

No, Donny, we're not Nihilists.

We have nothing to fear from Nihilists.

Clear eyes, full hearts, can't lose.

— Peter Berg, *Friday Night Lights* (2006)

"Friday Night Lights" is a great book, a good movie, and a great TV series – an amazing trifecta of creative accomplishment by Buzz Bissinger and Peter Berg. It's about high school football in Odessa, Texas. Which is to say it's about how to make your way in a fallen world. Or not.

What's the secret to life, the universe, and everything? *Clear eyes, full hearts, can't lose.*

It's not an Answer. It's a Process.

In markets, we hear all the time about the "investment process", about how that's the most important thing in predicting the long-term success of a portfolio manager. And that's exactly right. It really is the most important thing.

In sports, we hear all the time about how we should "trust the process", about how that's the most important thing for the long-term success of a sports franchise. And that's exactly right. It really is the most important thing.

Process is the most important thing in *every* walk of life.

***Clear eyes, full hearts, can't lose* isn't just a sports slogan. It's a process for living a non-alienated life, a life of *meaning* as a citizen and as an investor. It's a process for *perceiving* the invisible social dimensions that subsume and control the visible social world of politics and economics. It's a process for *resisting* the corrupting blandishments of the Nudging State and the Nudging Oligarchy.**

Because all of this has happened before.

Sola scriptura. Sola fides.
— Martin Luther (1483 – 1546)

As the story goes, on October 31, 1517 Martin Luther posted "95 Theses" on ~~his blog~~ the door of the Wittenberg church, and so began the Protestant Reformation. At the core of Luther's call to action against what he saw as ~~the raccoons~~ the corruption infesting the Catholic Church were two principles of Process: *sola scriptura* and *sola fides*.

Sola scriptura means "by the Bible alone". It is a rejection of the prevalent idea, then and now, that the only way to be free of sin is to work through a priestly caste that interprets the Bible for you and tells you its "true" meaning. Instead, Luther believed that ALL baptized Christians are a priesthood in and of themselves. We're ALL wise enough to see the Truth for ourselves without the intermediation of self-interested and self-aggrandizing institutions, and we're ALL smart enough to evaluate good counsel on the merits of the advisor and his arguments, not his position or title or anointed status.

Sola fides means "by Faith alone". It is a rejection of the prevalent idea, then and now, that good deeds can buy you a place in heaven. As in literally buy you a place in heaven, because supporting the Church with your donation of land or gold is *defined* by the Church as a good deed, indeed. Instead, Luther believed that salvation is *free* for *everyone*. Rich or poor, man or woman, young or old … just live an *authentic* life of Faith. That's how you get to heaven.

Everything Luther said 500 years ago rings so true for me today, not in a religious sense but in an intensely secular sense. **In both our political and our economic lives, we are confronted by a priestly caste of pundits and politicians and central bankers and economists who interpret the World for us and tell us its "true" meaning.** Game theory calls them Missionaries. Luther would understand this game.

We are told that the path to a Better World is through "good deeds", where those good deeds are *defined* by self-interested and self-aggrandizing institutions as:

- **voting for ridiculous candidates**
- **investing in ridiculous securities**
- **borrowing ridiculous sums**

Voting for Roy Moore or Bob Menendez for the U.S. Senate in 2018 because the Republican or Democratic Party tells you this is what makes you a "good Republican" or a "good Democrat" is exactly like buying an indulgence in 1518 because the Catholic Church tells you this is what makes you a "good Christian". So is putting your money into a structured security because a Wall Street bank tells you this is what makes you a “good investor”. So is having both parents work and still borrowing vast amounts of money for your child’s education because the Nudging Oligarchy tells you this is what makes you a “good parent”.

It’s all as much of a con in 2018 as it was in 1518.

You don’t beat a con with an Answer, because an Answer IS a con. You beat a con with a Process … a Process for making sense of the world with your own eyes, and a Process for acting in the world with your own heart. Martin Luther had his Process. We have ours.

Sola scriptura	***Sola fides***
Clear eyes	**Full hearts**

What do we DO, you ask?

1) We train our mind’s eye to see clearly the invisible dimensions of ***Narrative***, ***Abstraction***, ***Metagame*** and ***Estimation***, dimensions that subsume and control the visible worlds of politics and economics. **In so doing, we visualize the worldly truths of citizenship and investing *for ourselves*, not as some received truth broadcast by the Missionary caste.**

2) We use that visualization of these wordly truths with a full heart, meaning that we act according to the principles of ***Reciprocity*** and ***Identity***, principles that organize a pack of like-minded and truth-seeking individuals for long-term success. **In so doing, we defeat the alienating efforts of the Nudging State and the Nudging Oligarchy over time. Every time.**

That’s what we do.

Clear Eyes	
See the Narratives	***See the Abstractions***
See the Metagames	***See the Estimations***

➕

Full Hearts
Act for Reciprocity
Act for Identity

That’s the Process.

For every stock you buy and every vote you cast, the Process requires that you ask yourself:

- What are the Narratives (story arcs) I am being told?
- What are the Abstractions (categorizations) presented to me?
- What are the Metagames (big picture games) I am playing?
- What are the Estimations (the roles of chance) shaping outcomes here?
- Am I acting to promote Reciprocity (potentially cooperative gameplay)?
- Am I acting in a way that reflects my Identity (autonomy of mind)?

Okay, Ben, but how do we do THAT? How do we train ourselves to see Narrative, Abstraction, Metagame and Estimation? How we apply those visualizations to specific questions we have about markets and politics? What does it mean to say that we should act for Reciprocity and Identity in order to succeed as citizens and investors alike? How do we implement the Process?

This is the *why* of *Epsilon Theory*.

This is the reason we started a totally independent publisher, ***Second Foundation Partners***, with zero obligation to any asset manager or loyalty to any political organization. We are here to write and speak and consult and train and advise on how to put a Process based on *clear eyes, full hearts* into practice for the benefit of as many citizens and as many investors as share our goals.

***Epsilon Theory* is the Radiant.**

Epsilon Theory is the giant screen we use to display our research and our principles. Second Foundation Partners will have other initiatives and subsidiary methods to spark and wage this New Reformation. But *Epsilon Theory* is the core.

Through *Epsilon Theory*, Second Foundation Partners will share the tools and techniques we have developed for seeing and acting on the six Process dimensions of Narrative, Abstraction, Metagame, Estimation, Reciprocity and Identity.

What can the citizen or non-professional investor expect from *Epsilon Theory* to support the Process?

- *To see the Narratives, Abstractions, Metagames and Estimations* … example after example of how invisible social forces – story arcs, categorizations, big picture games and the role of chance – shape both our individual decision-making as well as our collective decision-making.
- *To act for Reciprocity* … example after example of the underlying game theoretic structures of common market and electoral interactions, so that investors and voters can avoid paths that encourage single-play games and sub-optimal Competitive equilibria.
- *To act for Identity* … a forum for expressing and discussing the small-l liberal virtues that support an individual autonomy of mind, and a structure for organizing a non-partisan, bottom-up movement to promote those virtues.

What can the professional investor or advisor expect from *Epsilon Theory* to support the Process?

- *To see the Narratives* … Natural Language Processing (NLP) visualizations of unstructured texts, and an analytic framework for understanding how market-moving and election-shaping narratives wax and wane.
- *To see the Abstractions* … Information Theory visualizations of structured market data and behavioral interpretations of that data (like technical analysis), together with a critical perspective on macroeconomic cartoons, investment style boxes, derivative securities (like ETFs) and factors.
- *To see the Metagames …* non-myopic Minimax Regret strategy applications for financial advisors and capital allocators, in contrast to the Utility Maximization strategies that dominate current economic theory.
- *To see the Estimations* … a focus on "invisible" structured data indicators of investor sentiment, such as money flows and option open interest, and the stochastic (random) processes that underpin ALL market outcomes.
- *To act for Reciprocity* … a resource for identifying the underlying game theoretic structures of common market interactions, so that investors can "play the players" in a way that encourages repeated games and optimal long-term outcomes.
- *To act for Identity …* a forum for expressing and discussing the small-l liberal virtues that support an individual autonomy of mind, and a structure for organizing a non-partisan, bottom-up movement to promote those virtues.

I know, I know … a lot of ten dollar words in that list. If you've been reading *Epsilon Theory* for a while, though, most of these ideas and tools will be familiar to you. If they're not, you can get up to speed on your own terms and your own speed, because every note we've written on *Epsilon Theory* to date, and every note we will write on *Epsilon Theory* in the future, will be available to everyone to read, free of charge. I'll say that again, with feeling. ***Epsilon Theory* is now and will continue to be a free publication.**

Will we have a professional offering and a consulting practice where we will charge professional investors and institutional clients real money? Yes, we will. Will we have a premium version of the *Epsilon Theory* website that we really, really hope everyone will subscribe to? Yes, we will. Will we run ads on the non-premium *Epsilon Theory* website? Yes, we will. After all, in the immortal words of Don Barzini of *Godfather* fame, we are not communists.

But here's what we're not doing. We're not putting up a paywall. We're not restricting any of our content.

We are hiding in plain sight.

I'm going to close out this note with a quote and a few thoughts on the notion of Identity, because it's the common strand between the professional and civilian readers of *Epsilon Theory*. Also, of all six strands in the Process rope it's probably the one that feels most amorphous and least familiar to the *Epsilon Theory* audience. It's also the most important. Especially here at the (new) beginning.

Marchese: *So you think liberals who talk about Trumpism's effect on a declining discourse are being hysterical?*

Penn: I do. But I'm not sure I want to talk about you as being part of one team and me as being part of another. … There was this sentence said to me — at the time I heard it, I ridiculed it and now it seems like the most profound thing ever said. You know Siegfried & Roy?

Marchese: *Of course.*

Penn: I was having lunch with Siegfried and he was telling this story about dating a woman. I guess he saw a quizzical look on my face and he said in his German accent with his coiffed hair, "I am not gay. I am not straight. I am Siegfried." I think that's the only real truth I've ever heard. I don't want to be atheist, libertarian, gay, straight. I don't even want to be a man anymore. The only team I want us to be talking about is all 7 billion of us human beings.

— **Penn Jillette, *interview by David Marchese for Vulture* (August 14, 2018)**

I've always liked Penn, but didn't quite know why. Then I read this interview. Now I know why. Penn is right, by the way. It's a profound statement. *It's the only antidote to the Rhinoceros disease.*

"I am not gay. I am not straight. I am Siegfried."

What's the most important quality to instill in our children? *Courage*. I don't give a damn how smart they are, or how beautiful they are, or how accomplished they are. I mean … I do, but that's ego talking.

The only thing I *really* care about for my children is that they are brave enough to say, "I am."

Just do THAT.

It goes back to what got Martin Luther all riled up in 1517 and has me all riled up today. It's not necessarily a BAD thing to give gold or land to the Church. It's not necessarily a BAD thing to buy a structured security. It's not necessarily a BAD thing to go into debt to pay for your kids' educations. It's not necessarily a BAD thing to vote for the candidate of your choice, even if that candidate is (I can't believe I'm writing this) someone like Roy Moore or Bob Menendez.

But are you doing it for the right reasons? Because if you're not, then it IS a bad thing.

And yes, I know “there for the right reasons” is a bagholder quote from just about every episode of *The Bachelor* or *The Bachelorette*, as the earnest contestants lash out at the pretty boy or pretty girl who’s caught the eye of the star but is just out for 15 minutes of fame, not “for love”. But it’s also the gist behind a decidedly non-bagholder quote from another German thinker who lived 200 years after Martin Luther.

> **Do what is right, though the world should perish.**
> *— Immanuel Kant (1724 – 1804)*

And yes, I know this is Kant riffing on a far older Latin quote, not original to him. But it’s the key to his notion of duty and the categorical imperative and the whole Kantian enchilada, if we can use a foreign cuisine term with a guy who famously lived almost his entire life within a 10 mile radius of Königsberg.

The truth, though, is that for the first 50 years of my life I thought this was a really stupid quote.

Seriously, you wouldn’t pull a few fingernails on the terrorist who knows the secret to the bomb that’s about to detonate in a crowded Times Square? I’m no Jack Bauer, but c’mon, man. Seriously, you wouldn’t tell a lie to protect a friend from a criminal? Seriously, you wouldn’t do ANYTHING to save the freakin’ world? Clearly this is foolish. Clearly John Stuart Mill has it right when he says we should make rules that do the most good for the most people, including a rule that sometimes you have to break the rules if enough people are going to be harmed badly enough. Like, you know, the end of the world kind of bad.

But then a few years ago I was thinking seriously about this quote, also by Kant – ***Freedom is the alone unoriginated birthright of man, and belongs to him by force of his humanity*** – when I realized that you couldn’t have one without the other.

When you start down the instrumental path … when you start cutting corners and telling white lies and selling just a teensie-weensie piece of your integrity to accomplish what you calculate will be a MUCH greater good that’s CLEARLY worth this small and inconsequential sacrifice of your duty … it ALWAYS ends terribly. Whether we’re talking about a nation or a company or a family or an individual … it always ends terribly. Why? Because once you start down the instrumental path, there is no limit to the instrumental path. There is NOTHING that is not theoretically contingent on a “greater good”, including all those rights and freedoms that you hold oh-so dear. And who defines what this greater good might be in a social system? You? Don’t make me laugh. We know who decides what the greater good is … it’s whatever collection of self-interested and self-aggrandizing institutions wield power at the time of the decision, at whatever scale of social system we’re talking about. Which means that YOUR freedom and YOUR rights are NEVER inalienable in any social system that acts contingently, even if it’s just on the small stuff. Because it never stops with the small stuff.

You want freedom? You want an autonomy of mind and spirit? You want that as an inalienable right? A right that is yours simply because you are a human being? Well, that comes at a price. And the Kantian price is this: ***everything you do, you must do for the right reasons.***

It’s really as simple – *and as difficult* – as that.

What are the right reasons? You don’t need me to tell you. You already know what they are, in every situation you’re in. You have a moral compass. But I’ll tell you anyway. Acting for the right reasons means acting in a way that reflects who you ARE as a moral human being. It means acting for your *identity* as a moral human being, not as a *propitiation* to some god or potentate, not as an *exchange* for some "greater good" that *someone else* has talked you into pursuing. Not even for gaining a Supreme Court seat. Not even for denying a Supreme Court seat.

I've written these words a couple of times now in *Epsilon Theory*, and I'm happy to write them again.

Our core freedom – our autonomy of mind and spirit – is not granted to us by the State or the Oligarchs. It is not theirs to give. It is not a reward for good behavior or an allocation from a central pot. It is, as Kant writes, our birthright. It has always been our birthright. It cannot be taken away.

But we can give it away.

And that's what we do when we act instrumentally rather than for our identity as a moral human being, when we treat other human beings as a means to an end rather than as an end in themselves. We give away our birthright of freedom. We take on a *process* of lying – continually, habitually – until one day we can't even remember where the truth ends and the lies begin. It's all just one big narrative that we've constructed about *ourselves*, and that's the most powerful and the most damning narrative of them all. That's when we become a Rhinoceros.

On the other hand …

when we vote and invest and advise and make and speak because it reflects our "I am" … when we vote and invest and advise and make and speak because it is in service to our pack, meaning in service to those who share and honor and reciprocate our "I am" … that's when we become a human in full.

Do this, and you will be AMAZED at how so many of the decisions that we ceaselessly wring our hands over – decisions like portfolio construction and strategy evaluation and manager selection, decisions like who to vote for and how to participate as a citizen – are resolved so quickly and so well and so solidly.

There's a *positive energy* – I wish I had a better term for it, but really I don't – that comes from knowing your "I am", from acting for the right reasons and from finding your pack. It's a positive energy that can carry you for life, in any walk of life.

All it takes is the *courage* to act for Identity.

Tanzan and Ekido were once traveling together down a muddy road. A heavy rain was still falling. Coming around a bend, they met a lovely girl in a silk kimono and sash, unable to cross the intersection.

"Come on, girl," said Tanzan at once. Lifting her in his arms, he carried her over the mud.

Ekido did not speak again until that night when they reached a lodging temple. Then he could no longer restrain himself. "We monks don't go near females," he told Tanzan, "especially not young and lovely ones. It is dangerous. Why did you do that?"

"I left the girl there," said Tanzan. "Are you still carrying her?"

— Nyogen Senzaki, *Zen Flesh, Zen Bones: A Collection of Zen and Pre-Zen Writings* (1957)

We live in an Ekido world, a cowardly world of abstraction built upon abstraction, where every narrative can and will be used against you at every level of society and at every level of metagame. We live in a world where our personal outcomes are determined more by the roll of a die than by our own qualities or smarts.

But *Epsilon Theory* is a Tanzan pack.

We don't have an Answer. But we do have a Process.

Clear eyes, full hearts, can't lose.

To join the *Epsilon Theory* pack:

Sign up here: www.epsilontheory.com/contact

OR send an email to ben.hunt@epsilontheory.com with your name, email address, and company affiliation (optional). Your email address will not be shared with anyone.

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