Taylor Pearson:

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Jason Buck:

Tobias Carlisle, just plug away right at the top, for the folks watching, we see Acquirers Funds on the step and repeat behind you, but plug away right at the top. Where can people find you? What's the best spot for them to go to?

Tobias Carlisle:

My midcap large cap fund is Zig Acquirers Deep Value Fund, and my small and micro fund is Deep Roundhill Acquirers Deep Value Fund. I have a website acquirersmultiple.com. I'm on Twitter at Greenbackd, G-R-E-E-N-B-A-C-K-D and I've got a heap of books on Amazon under my name Tobias Carlisle. Acquires Multiple is the last one.

Jason Buck:

Jesus, there's so many things I want to dig into there, but also I brought Toby on today because topical news is SVB. We're having a Silicon Valley Bank kind of collapse here and Toby's an expert on bank collapses. So no, I'm just joking with you. I just want to see your face when I started with that. Normally-

Tobias Carlisle:

I have an answer.

Jason Buck:

Yeah. Oh, okay. Yeah. Well we scheduled this weeks before, so we didn't know this was going to happen, but at the same time, everybody, I don't normally like to talk about things topical and everybody comes out of the woodwork as an expert, but you do happen to be a value investor with a law background. So I'm curious what your hot take is.

Tobias Carlisle:

The reason I have an answer is because I was watching, I subscribed to a few channels on YouTube and Meb Faber popped up on one of them, and Meb's explanation is what I'm going to give you. So Meb said, this is what I've been telling everybody who asks, my wife and so on. Meb said, Silicon Valley Bank put too much money into assets that went down when interest rates went up and when interest rates

went up, their assets traded well below the liabilities. And then you crystallize some of those losses when you have a little bank run in and then you're gone. I guess that's like, I'm no expert, but that's all investing, right? Matching your assets to your liabilities.

Jason Buck:

Well, yeah, it actually sparks an interesting conversations in my household over the weekend where my girlfriend was, now explain it to me simpler. Now explain it to me simpler. Now explain it to me simpler.

Tobias Carlisle:

I can't, I can't.

Jason Buck:

I know. I was like, I kept trying.

Tobias Carlisle:

That's my understanding.

Jason Buck:

But I was like, it was interesting because she is I guess millennial generation and she was like, I've been told my whole life to just put my money in banks. Banks are safe. Don't put it under the mattress, as soon as you make some money on your minimum wage job, put it in a bank and everything. And she was saying that nobody really taught us in school or anything that banks are not necessarily safe, that our deposits are liabilities and they're going to lend out against those and it's fractional reserve on those lending.

Tobias Carlisle:

Well, it's insured up to 250 grand. I mean, how successful are you being straight out of school?

Jason Buck:

That would've been a fair response. I wish I would've come up with that one because I think just like most of the things they teach us in school, it applies to most people that work nine to five jobs. And that would be, yeah, the fairness on that would be who's really got a quarter million in cash in the bank? So most people-

Tobias Carlisle:

Congrats, first of all, if you had more than the quarter million to lose, but presumably by the time you get to that kind of level of cash, you've also got some other assets. So that represents some portion of your assets, but not all of them. Yeah, I don't know. I've always thought, I think everything's shaky all the time. I just think everything's a chance of blowing up, but I'm talking about Volcker, so you probably further along then...

Jason Buck:

This is why we like hanging out. And then she was like, yeah, most of the conversation over the weekend was like this is why we have Cockroach for this very reason. So we could sleep at night when these things happen. But she was also sending me this morning, I liked Meb's description, but she was also

even sending me this morning, I think it was a congressman on TikTok was basically saying about the emergency overnight. But he said, in his explanation, Silicon Valley Bank lost a lot of money. And I'm like, yeah, I think we need to explain things simply but I think if people could just understand a duration mismatch is they take in short-term deposits as a liability and then they lend out on long-term assets. And it's not like they did lose money mark-to-market and also mark-to-model, but at the same time it was more of a duration mismatch. And if they didn't have a run in the bank, they're usually fine. And so to your point, it's like we all live under this fiction that as long as normal withdrawal rates are within a normal band of what's expected, then banks are fine. And then as soon as we have a run on the bank, you find out that they're using leverage. Is that like-

Tobias Carlisle:

But isn't like, the banks are definitionally insolvent all the time. They can't meet all of the money on deposit as defaults to which just the function of the Federal Reserve is supposed to be to create a window where if they get that run they can access liquidity on the other side. That restores confidence, obviates the need for the run. But I think the interesting thing to think about are the implications for, so we've had now this mark-to-model has become more of a pressing concern. So if you're a director of a small regional bank or anything that has this sort of exposure, you've now got to start thinking about do we need to raise some more capital? Do we need a cushion here?

And I think that that's why you don't really see bank runs very often. You don't really see credit crises very often, but when you do see them, they tend to cluster together because all of the banks now will start thinking, everybody who's got this kind of exposure needs to start thinking about it. And that will suck up some liquidity, which is, I think this is one of the other classic stages in this long term. This is a long slow train wreck crash. But I don't think this is completely, I think this is totally expected in the context of what we've been going through for the last, it's almost two years now.

Jason Buck:

And we really haven't seen it since the SNL crisis. I mean it's been a long time for people to see-

Tobias Carlisle:

Well I don't think GFC was, that was a big one. I don't think this is the GFC. I think banks are much better capitalized now than they were then. Might be a regional bank thing, could be the regional-

Jason Buck:

How do you think about that contagion? How do you think about that contagion? Because as a Californian, we're out here and all of our friends bank like I've heard some horror stories, people just closed on their house. The Silicon Valley Bank, they had all their savings there. Now it's all gone. I mean it's just some nightmare scenarios I heard over the weekend. But how do you think about that? Is this a California regional thing or does this contagion, because you just said most of the people have been saying and far better experts than I that the banks are well capitalized. But then how much does this contagion, like you're saying banks are technically insolvent at all times. So how would you think about the contagion effect?

Tobias Carlisle:

I think that will be some contagion. I don't think it'll be anywhere near as bad as 2007. I think that there's always a little credit component to every crash. There needs to be some, liquidity needs to dry up for the crash to progress. And it always happens. It's just hard to figure out where it's going to come

from. I don't think it's going to be like 2007 where it's a systemic credit crisis that impacts the very biggest banks. But I do think it's more like a valuation type story where it doesn't surprise, the Silicon Valley part of Silicon Valley Bank might be the bit that is more important to the story than the fact that it's a bank. It's just in an area where they had a really good time up until kind of February, 2000... Was it 2020? 2021? When did ARC top out, February, 2021?

Jason Buck:

Yeah. Yep.

Tobias Carlisle:

So they're now two plus years into their drawdown. And if you go back and look at any of those kind of classic collapses of the stock market, because the credit crisis is kind of secondary to my interest in the matter. I want to know how the credit crisis impacts the stock market. Because that's where I'm focused. So if you look back at say any of the earlier collapses, they all sort of seem to follow the valuation type collapses rather than a credit type collapse, which is a 2007, 2008. That was a real credit event. 2000, 2002 was more overvaluation from speculation in the stock market that created sort of it. It's a little bit self reinforcing, I guess it's a little bit of that Soros reflexivity where the market goes down, people are on leverage, forces them to sell. It creates this cascade of selling.

So I think ARF topped out February, 2021. They're two years into their drawdown. The rest of the stock market didn't find out about it really until start of last year. First day of last year we started selling off and we've been kind of selling off basically since then, although we've had little rallies. But you would always say a year into the selloff, you can go back and look at 2007, 2009, 2000, 2002. Not much had really happened by this point in the proceedings because the market's off a little bit. But it tends to follow this pattern where two-thirds of the time there's about one third of the selloff and then the last third of the time is the two-thirds in terms of the depth of the selloff.

So I think we're coming into now that and combining with other things like the ten three inversion and just general weakness across inflation supply side issues, I kind of think we're getting to the business end now. It's either it's March to kind of August I think is when you see the action. If it doesn't happen in that period, then I don't really know where. It's not that kind of environment. I think it's really got a six months of complete fireworks to come though.

Jason Buck:

As and as long as we've been tracking the VIX and everything, I think said Russel Rhodes have said too that we haven't really hit the bottom of the session and made a turnaround until VIX has peaked over 45. But just because that's just a handful of data points though, I wouldn't take that seriously. It could potentially be a slow grind down recession to slow climb back up. I mean that's possible. But it's interesting like you're saying is that final capitulation usually has to take effect and how much is that behavioral or people, and there's so many things you said in there. One I want to pull on is the idea too of 2000 to 2002 was Silicon Valley and the equity bubble. There was no real debt involved and it was just really an equity implosion in the VCs and startup space. What's interesting, like you said, is how Silicon Valley Bank is really a Rorschach blot for people's political views. And everybody we found out, I like some of the stuff on Twitter it's like we found out how much everybody hates Silicon Valley and wants it to burn to the ground basically.

But at the same time, all this speculation is like, oh, they were lending to startups, they were buying MBS. It could be as simple as, no, they actually had great long duration treasury assets. It's just a duration mismatch and they had a bank run. I mean granted, I'm sure when we eventually dig through it

and we won't even have perfect hindsight is I'm sure there's some MBS in there lending to startups. But that has been interesting though that they do lend to startups. But what I really want to point out that you are talking about is with ARC and everything else, it's like the VC and the PE world has just been marking the model and they just play this game and keep marking it up, marking it up. And many people, great people have said, volatility doesn't get destroyed, it gets transmuted or transferred. And it just so came out of Silicon Valley Bank. They're basically like, Hey, these startups have no cash left and we're in a pickle here. And so finally somebody had to admit that these marks are wrong. Is that a fair way of looking at it?

Tobias Carlisle:

Well, I think that's my understanding of what has happened with the bank. That as far as I'm aware, it's not investing in excessively risky assets. It's just investing in, they've had this enormous flood of money go into them to make them from basically nowhere into the 16th biggest bank in the states. They've put that into treasuries when treasuries were trading very, very near 0% interest rates, very, very tight in the treasuries and just interest rates have moved against them. And so they've been bitten up in their book. So it really is just, but then you could have been in just about any asset. It didn't really matter where you were. I don't know why they were the first impact that I guess they've, they've also got problems on their, they may have some problems on there, the people who they've lent to, there must be some issues there as well.

Jason Buck:

Can you imagine, to me, so many interesting things that, like you said, it's like they allegedly didn't hedge their treasury rate risk of rates rising. And then I don't know how much the lending to startups is in there, but that's kind of amazing that well they go, but then they get warrants. I'm like, yeah, that's basically a VC. There's no reason for banks to be doing this kind of thing.

Tobias Carlisle:

I mean it seems the equities, it seems the equity's got some value if the warrants, the warrants are an upside, that's not downside protection. That's just upside return if it works.

Jason Buck:

The other part of it is, I don't know if you've ever done this, but maybe a decade ago I spent years trying to figure out if it was possible to create a bank that didn't lend, that basically just retained all those deposits and basically besides, I mean you can make a little bit of money, you could take a little bit of risk of maybe overnight lending rates, bank to bank, that sort of thing to maybe try to make the business profitable. Obviously you'd have to run it like a nonprofit or a community bank or a co-op. But the other part of it is I think the only way to make it work is people would have to pay a monthly fee. So it's just like if we buy physical gold, you had to pay-

Tobias Carlisle:

We did.

Jason Buck:

Right. But that's what I'm saying. They don't like, people don't realize everybody wants everything for free and it's like it's not free. Right? That's my point. So have you ever looked into trying to start a bank

or what a bank would look like if it was actually secure and is there a viable option for that in the modern economy?

Tobias Carlisle:

So I haven't, but I do think that's a good question. I think the problem for these banks, problem for the regional banks is that the loans make up such a big portion of their book, whereas the bigger banks have lots of other sources of income. For the regional banks, it's all the loans that they make, that's where they make their money. As you point out, there's, there's not very much money with the cash on deposit that they have to be lending it out to earn a decent return. So they are really subject to the business cycle. We just haven't seen much of a business cycle for a long time. So I guess you get things like Silicon Valley Bank where they're not thinking about what happens if the rates go the other direction. They did, they had some other problem where they had a risk officer, they lost their chief risk officer or something like that 12 months ago. I haven't really followed it that closely. This is a casual conversation between you and in the context of it's an equity investor talking to a Volcker, not a bank specialist.

Jason Buck:

Yeah, we are not specialists. No.

Tobias Carlisle:

I tend to, I hold very few banks. I hold across 130 positions across two funds, 30 in the big one and 100 in the small one. I hold very few financials for this reason, they're just all little black boxes. You can't get a good read on what's going on inside them. Bank experts get blindsided all the time. The bank expert funds are deepen all of this stuff. So banks are tough to invest in.

Jason Buck:

That was part of trying to figure it out myself. It's like this is a terrible business. Why would you want, everybody's one thinks they want to be a banker and be bank, during risk on times this is a great business, but during risk off, you don't have a lot of levers you can pull. So what was interesting, the other interesting part about to do it properly as a nonprofit, it's a co-op bank and it's like the little anecdotes that are interesting is you have to have a loose assemblage of membership that's semi related. So I was like, people with Facebook accounts, this is back in the day, or Twitter accounts. So you can have that loose assemblage that way. And then what's interesting is the co-ops can also tap into all of their ATM banking network. So you could tap into 60,000 ATMs and offer free ATM withdrawals if you are part of the co-op banking network. These are just some random things there that I thought that thought were interesting.

Tobias Carlisle:

That's old technology, cash.

Jason Buck:

Yeah. Yeah.

Tobias Carlisle:

You're not going to be need take cash out in the future.

Jason Buck:

Well that was the problem when people went to take the cash out of Silicon Valley bank account.

Tobias Carlisle:

Take it out, this is the future. There's no cash.

Jason Buck:

Exactly.

Tobias Carlisle:

Welcome to the future.

Jason Buck:

So part of that though, so then you go into the secondary effects. This is what I thought has been interesting over the weekend. Well I want to point out again, we are not experts, but what I love about our industry is how, especially on, this is my deep level global macro. Everybody has a hot take about everything and all of a sudden they're experts. It's like they're such unbelievable experts on such a panoply of topics that they apparently have never even looked up the word dilatant. It's amazing. Everybody comes out of the woodwork. It's amazing on the Ukraine, on banking, everything. So you and I are just two more on shooting the shit, except for you know a lot more than I do.

Tobias Carlisle:

I don't know if that's true.

Jason Buck:

We'll put a caveat out there. Or at least in general, in life in general.

Tobias Carlisle:

Again, I don't know if that's true.

Jason Buck:

So here's the one that I find the conundrum. So we're here on Monday the 13th, and the government's going to backstop Silicon Valley Bank. So depending on what political beliefs you are and everything, this is where I vacillate between my libertarianism and socialism is like, what do you do in this situation? Everybody, your libertarianism says just let them fail. Let the dust settle. This is what we have to do. This is risk taking. And people are going to find out if they have over 250K in there that this is the risk that you are taking and you should have been aware of those risks. That's what say a libertarian would say. And then the other side of it is like, well, there's a cascade of consequences here, not just across Silicon Valley businesses, but across all of their vendors and their vendors, vendors. And the cascade of consequences is like this hurts the person on Main Street, but then the bailout, does it come from the FDIC insurance but then comes from the taxpayer? Do you see what I'm saying? I'm curious how you would walk through this conundrum in your own mind, whether it's in your industry or not, versus a bailout versus saving the actual system.

Tobias Carlisle:

Yeah, it's a sickening thought. I saw there a whole lot of payroll that wasn't going to get sent out if it didn't happen. So it sucks when little people who've taken no risk, they're just trying to do the right thing and put their money in the bank and they get hurt by it. I don't know. The banks are, it seems to me that it's bare knuckle capitalism on the way up and you get as much as you possibly can in terms of comp, and then when it goes the other direction, you just get a bail out. There's got to be whatever the decision is, if we're going to decide to bail these guys out every single time, which we are, because it seems you don't want the little people getting hurt. The big guys have to eat some of the pain. The people who are in there have to eat the pain too. They have to go first. It can't be, you get paid all of the comp that you've had for all those other years, that's in a lockbox somewhere. You can't touch that.

Jason Buck:

We keep increasing the moral hazard, but we haven't set the parameters for how to rectify the moral hazard. Is that kind of what you're saying is obviously we're going to keep bailing it out because you're just in a terrible situation. Do you want people to learn their lesson or these people, like you said, they can't make payroll. By the way, people don't even know that Silicon Valley Bank has a wine division. There's 400 wineries around me that use Silicon Valley Bank that just got their assets frozen and they can't make payroll. And some of those people are the cleaners that clean the winery. So it's like it's a tough call. I don't, so do you have any thoughts on how do you maintain that moral hazard? Do you do claw backs of their salary or how would you think about that?

Tobias Carlisle:

Well, I'm talking about the very senior executives who are most directly responsible for this. Yeah, I think you should do something like that. Their comp should be paid out over a period of time, five years or something like that. You can't have this. It's just, it's asymmetric where your upside is uncapped and your downside... Your upside is you become Jamie Diamond and you're multi-billionaire having never started a business, just being an employee the whole way through in an industry that gets bailed out when something bad happens. I mean, I don't know if that works. I think that's going to encourage the wrong behavior at every step of the way. I don't know about the bailouts, that's a question for politicians, but I hate seeing little people get hurt, but there has to be some way of stopping the problem before we get to this point, right?

Jason Buck:

But it's a conundrum that I've been mulling overall we can, yeah, it's like what do you do? Because your heart wants to save the people that are not necessarily involved, that are tertiary shrapnel consequences of it. But how do you maintain that people just don't take these inordinate risks and we keep having this moral hazard over and over and over.

Tobias Carlisle:

I think it's a problem with the system. The system doesn't work like the system where they can borrow from the fed and lens and lend multiples out. That doesn't work. We need a different system to that.

Jason Buck:

So I'm saying the cash bank, just cash is there.

Tobias Carlisle:

Bitcoin. Bitcoin sources. What are the Bitcoin guys?

Jason Buck:

Oh man,

Tobias Carlisle:

Crypto sources.

Jason Buck:

Oh God. Right. Well, in hindsight we might go back into was the demise of Silver Gate that led to the demise Silicon, that was the camel that broke the straw's back is crypto, actually crypto banks were the one that caused this-

Tobias Carlisle:

Crypto broke it.

Jason Buck:

Yeah, crypto broke the banks. God, there's so many. I just, and then moving forward, yeah, I don't know what we do. Yeah, I struggle to really, this one really, it really boggles my mind with the moral hazard versus bailout issue and how do you actually set this system up. But part of it too is don't you think the, okay, so this is a good question then to what steps can you do? It's kind of arbitrary that FDIC insurance is up to 250K, right?

Tobias Carlisle:

Yeah.

Jason Buck:

That's just an arbitrary number. But like you said, as an individual-

Tobias Carlisle:

It's been 250 for a long time. So it's clearly it should be indexed to inflation or something.

Jason Buck:

But even in an individual, that's a sizeable number. But what if you're running a business? What do you do with your cash?

Tobias Carlisle:

Yeah, that's [inaudible 00:22:41].

Jason Buck:

So let's start with there. How do you think about that? Obviously we buy T-bills and we can use T-bills as collateral. We also buy some physical gold just in case things like this happen. That's not somebody else's liability. We have different banks that we use. But if you have a banking system collapse, it's really hard to think through this because this is, to me, a problem I've been thinking about for two decades is like, what is money?

Tobias Carlisle:

It becomes, it's not a completely abstract philosophical problem. It is a somewhat concrete policy question about how you run the banks. Banks aren't, there's no reason why banks are set up the way that they are with the Federal Reserve able to, the Federal Reserve has two mandates, both of which are silly. The they're supposed to keep the money supply, keep inflation under control. So we've got a stable money supply and full employment. Fed can't do anything about employment. Putting interest rates up has some sort of statistical association with employment going down because you choke off liquidity and it leads to lower growth and vice versa. But I don't think they should have the two mandates. I think that's silly. I think they should be what they were set up to be, which in 1913, and there were examples before then where when there was a bank run, they were the last stop for liquidity.

And the liquidity should be expensive. It should be like going to see Warren Buffet. You can get the money from him, but it's very, very expensive money. And so with that in mind, you're always thinking, well, I should run more of a buffer. I should run less optimized profit and I should run more for survival and durability. Do you know what I mean? There should be safeguards built in for the business. There should be safeguards built in at every stage. And the problem is you just, you're not paid regularly enough to do that. I mean, that's why the Cockroach fund exists. That's why volatility strategies exist because there are people out there who ignore all of the risk at all of the time and they're the guys who are piling into the riskiest stuff right at the very top of the market and they look smart for 12 or 18 months or two years.

Everybody else has had it before, sort of stands back a little bit and tries not to get blown up. And then those are the guys who get wasted. And the volatility guys who've been picking up those 5 cent out of the money VIX calls get paid with some regularity once, but it's every seven years. So it's not so regular that if you've only been in the market for five, you haven't seen them before. And I think this is unusual because we had, until the market kind of took its dive in 2021, it had been a very long time. I guess we had 2020, we've had sort of crashes, but every single crash has been, we've recovered so rapidly from them. Even 2009 was a, we got down to the long run mean for the shilap. And you could say the shilap is a flawed measure, but it wasn't like we got cheap. You can go back through history and see we've got much, much cheaper than...

Jason Buck:

You can at least look at the trend line, the shilap, you can argue about the actual, if the multiples are correct, but at least the trend is gives you an idea.

Tobias Carlisle:

We're expensive, right? We're very expensive and we're expensive then. So I think that there's a reasonable risk that if you interfere too many times in the market, you lose that business cycle. I think the business cycle is kind of almost a natural phenomenon, it's not something that it's an emergent property of a dynamic system, which is just, it's one of those things that happens where people get too excited.

If you go back pref Federal Reserve and you go back pre sort of all the interventions, there were many, many more short-term sort of recessions and depression to happen with some frequency. And since we've introduced the Federal Reserve and they manage it, they become much less frequent but much bigger in terms of the magnitude. So I think that what we've done is, as Corey might say, we haven't eliminated that risk. We've just transformed it into this other form that seems to be more disruptive and requires more interventions. So maybe we would be better off going back to one where we have these

little hiccups every now and again, but everybody knows how you got to run sufficiently liquid and sufficiently solvent. So when that happens, you see the other side.

Jason Buck:

This is kind of a perfect question for you. So part of the discussion with my girlfriend over the weekend was also like, yes, this is why I've been yelling from the rooftop for years about Cockroach fund for these very scenarios that we can't predict but you can prepare for. But at the same time, what you also just reference is March, 2020, we were thought was one of those events, but you just said we V-shape or K shape recovery so quick people didn't get scared enough. And then so same thing with Silicon Valley, I was like, look, everybody's scared on Friday here, but now on Monday nobody cares again. And so it's like, yeah, maybe over the weekend you worried about where your money is, but now you don't care, as the government's got your back. And so you as a deep value guy so to speak, you could feel my pain. It's like how do you just trudge along when nobody seems to care about, I'm sure you've just been ripping your hair out for a decade. Just going value actually matters but just nobody, or it doesn't during risk on until it does during risk off. How do you just sustain yourself through these periods?

Tobias Carlisle:

I think that that's the answer, that it always matters and you just don't know when it matters. So you have to always be prepared for it to matter. There's the idea of ergodicity. There's a book about ergodicity, really beautifully written. Basically it's path dependency or it's the idea that whatever your long run returns could be, if they get truncated in the interim, you don't get those long run returns. So if you understand, if you're in the market and you have a little edge, which we all think that we do, but we've got this little, I think I have this little statistical edge in the market for a variety of reasons. Some of them are very simple and boring and some of them are a little bit more esoteric. But I think that I do. So given that I think that I do, the thing that I'm trying to avoid most and foremost is losing it all.

Because if I do that, then I can't show this little edge over time. So I have to run, so I look at the individual positions and I make sure individual positions can survive. I make sure I'm not too invested in any individual position because even doing that analysis, there are things that happen that they have black swans, there are things that happen that you just can't foresee.

And so I think at every single stage of the process, how do I make sure that I see the long run? So I always think about it, do they have cash on the balance sheets? Do I have enough cash? Can the business survive? Can the funds survive? Will the economy survive? Are there other existential risks out there that I need to think about? And I think that that's a healthy thing for everybody to think about, to think in those terms. But people definitely don't. And there are periods of time in the market where thinking that hurts you. And we've, the more bullish the market gets, and the more there seems to be no risk in the market, the more that kind of position hurts you because you lose assets. People don't want to be with the guy who's always complaining about, always saying, nobody likes that guy at the party that says the hangover's going to be bad the next day.

Jason Buck:

Nobody likes the Cassandra at the party, but also-

Tobias Carlisle:

Nobody likes that guy.

Jason Buck:

But there's so many things on that. One is, so the point of ergodicity economics, the way I try to simplify it is just time. And if we think about time over time, your investments over time, that's compounding right? And that's all the point is volatility tax or losing everything means you can't play anymore. But also, I was talking about this over the weekend is think about the banks in this scenario. This is why Ole Peters from ergodicity economics would say that modern economics is flawed because it doesn't take into account time. And to your point, the banks we're solvent if we don't factor in time and duration mismatch, if people want their money today, they got a problem. But in general, most people don't want their money today. So otherwise they don't have a problem. They're solvent, they have plenty of assets. But that's why ergodicity is all about time and path dependency. And that's why exactly what we find out with a bank run, it changes the path dependency. They just don't have enough time to realize those assets or liquidate those assets.

Tobias Carlisle:

To be fair though, this was coming. The big move in interest rates, clearly that's impacted asset values. I mean it should impact that. You can see it most directly in bonds because there's sort of mathematical calculation, there's a little bit of speculation or there's a little bit of trading built into the price. But it is mostly a mathematical computation about what the thing's going to do through to, there's risk and other factors, but it's mathematical. For equities it's like you can kind of ignore it a little bit for equities through a short period of time. It absolutely matters. It matters just as much as it does for bonds, as does for equities. It's just that it's a little bit more abstract. And so that extra steps seems to be the thing that means that people can argue with a straight face that it doesn't matter, although eventually it does.

So all of those assets, with interest rates going up, all of the assets which were very, very low yielding assets in a higher yield environment become worth much, much less. And that's what happens when asset values happen, when that happens to asset values, if you've got a matching liability, you've got a little bit of trouble because you've got this liability that's so much bigger than your assets and you have to resolve that at some point. You can hold to maturity if you can, but this is the ergodicity, that if you get called in between, you've got a real problem. And all of the banks have lent long, have borrowed long, borrowed short, lent long, and that's what happens.

Jason Buck:

Yeah, I think-

Tobias Carlisle:

It's nasty.

Jason Buck:

Mike Green describes it well, I think with bonds he is like it's a football, you know what your payoff is in terminus, but the ups and downs to get there, that's like you said, that path to dependency where you can get smoked as Silicon Valley Bank did. The other thing you brought up though is kind of behaviorally about people doing risk on versus risk off times. And I'm curious because shout out to Corey, we just talked about this on our last episode of Pirates of Finance. It's like thinking about is behavioral finance as interesting, and I am empathetic to the people that are behavioral finance is because you can't replicate it. But at the same time, behavioral is everything because it's human beings interacting in a market. So to me it's almost like water. It's both everything and nothing at the same time. How do you think about behavioral as relation to value investing?

Tobias Carlisle:

That's the opportunity for value investors. I believe that behavioral stuff influences everything, but ultimately it is the underlying economics of the business that determines what you earn. So you take advantage of the behavioral thinking that you'll get the quantitative return on the other side. The big risk for value investors is that the future doesn't look like the past. And that's true for just about every human endeavor. All of our philosophy and science and medicine is built on the future looking like the past. So that's kind of a risk that I acknowledge that it is real. And it might be more real in relation to some businesses, buggy whip type manufacturing businesses. I've, I've invested in CD businesses, CD making businesses because they had too much cash on the balance sheet. You can make money in businesses that are in decline provided that you pay a cheap enough price for them. So it's not necessarily what the business is doing, it's what you're paying for the business. But let one question here. Is it more pretentious to say finance or finance?

Jason Buck:

Oh, okay. So this is a good question. So you obviously didn't get why we call it Pirates of finance and it's-

Tobias Carlisle:

Well because it's Pirates of Penzance. I get that part.

Jason Buck:

Exactly. And then do you remember the part from Pretty Woman?

Tobias Carlisle:

No, no. Give me the Pretty Woman part.

Jason Buck:

She goes, so they're at the opera and she goes, oh my god, I enjoyed it so much I peed my pants. And in the old lady's like, what'd she say? And he goes, she said she enjoyed it more than Pirates of Penzance. So it's like it's remember it's like a double. Yeah, it's like a double. So it just makes Corey and I laugh. So it's not pretentious, it's the opposite.

Tobias Carlisle:

I think the name is brilliant. But I worry because I say finance and occasionally there's a Twitter poll that goes around, how do you say it, is it finance or finance and I don't know, is it a regional thing do you think?

Jason Buck:

I think, no, I think in this country it's finance, but we just say it finance because it reminds us of Penzance and I think it's funny.

Tobias Carlisle:

It is funny. It's great. It's hilarious.

Jason Buck:

That's the only, yeah, because every time somebody asks me about it, I had to think a Pretty Woman. So it makes me laugh and I peed my pants. So that's the other reason why, but.

Tobias Carlisle:

I almost peed my pants.

Jason Buck:

I want to go back to this idea though of like, okay, say you're fortunate, you run a business and you've got over 250K in cash. What do you think one should do with that?

Tobias Carlisle:

I don't think you necessarily, I mean business making payroll with $250,000, that's not a particularly big business. You know what I mean? That's medium sized.

Jason Buck:

Right, so what do you do?

Tobias Carlisle:

Payroll, that's like, what is that $4 million? Am I out of my mind here? Is that right? 3 million?

Jason Buck:

Yeah.

Tobias Carlisle:

Of payroll year. That's not that much in payroll. I don't know. That's a tough question. I don't know. The well answer is you either invest in the bigger banks, but that's not a protection either. You have it with bigger banks. I think that probably from a policy perspective, bailing out Silicon Valley Bank or their depositors at the least is a good thing for regional banks because if they didn't do it, there's just no reason to put your money in a regional bank.

Jason Buck:

Right.

Tobias Carlisle:

We're just taking downside risk. So the fact that they've done this means that it probably saves all the regional banks, in this cycle anyway.

Jason Buck:

[inaudible 00:36:08] now is the bigger banks, what are they? Basically they're government backed banks, right? So that would just wipe out the entire regional banking industry.

Tobias Carlisle:

Right.

Jason Buck:

And then what you think of, yeah, there's other companies, I've looked at before that were like, they'll algorithmically cascade your deposits into dozens of banks so you stay under 250K in dozens of banks. I'll try to find that.

Tobias Carlisle:

That would be the solution.

Jason Buck:

Yeah, I'll try to find one of those for the show notes. But then that can only be so much size. Look at some of these tech companies sitting on these war chests. You got to probably just buy like 90 day T bills. But then people don't realize even in 90 day T bills, you're still lending to the US government. And the US government will be the first one in history to pull off a non-monetary collapse if that happens. I mean, we don't just know when it's going to happen. It's eventually going to happen.

Tobias Carlisle:

I mean I think it's interesting that, who knows whether Jay Powell actually means what he says, but they kind of asked him to what extent when you put these rates up, this makes it much more expensive for the treasury to borrow. To what extent does that enter into your calculation? And he said, none at all. We don't think about that at all. That's not our concern. And I thought that's the correct answer. That's the correct policy answer. I mean that's what's written into their documents. That's true. That's the case. But the Bank of Japan was in exactly the same position and that was the big catalyst a few years ago, I don't know if you remember this, but there was going to be this point in time where there just weren't going to be enough buyers of JGBs and there was going to need, someone needed to step in and the question was, will it be the BHA? And everybody said no, it's not in their, they won't do it, it's not their mandate. Of course they did. You're not independent when you're staring at oblivion, I guess. You stare to the void, you're no longer independent. So does Powell blink as well?Does Powell blink, that's my question, do we get to that point?

Jason Buck:

I like to also that everywhere, I can't say when everybody says that too about the Fed. It's like it's not in their mandate. And if I studied the history of the bylaws and everything, like a stroke of a pen changes that immediately, I just love people, they can't do that. It's illegal. Oh watch, they'll just change it now it's legal. You're welcome.

Tobias Carlisle:

It is true that it's, yeah, that's right. They're not allowed to do it, but they'll still do it.

Jason Buck:

It's just so...

Tobias Carlisle:

When it's the end of the world, what are you going to do? You just follow what's written in your documents, you nerd, or are you going to go and solve, save the world? You're going to go save the world.

Jason Buck:

So also-

Tobias Carlisle:

They're all looking for, they all want to write the Bernanke book, The Courage to Act.

Jason Buck:

Yeah. Yeah, they all think they're Volcker too. Yeah, it's just, and people forget about how many times that was tried before Volcker, and Volcker's just one of four people that tried. It doesn't, it's the serendipity of it.

Tobias Carlisle:

He only let them just roll off. He didn't even intervene that much. He just sort of letting them mature. And that just sucked up a whole lot of the liquidity.

Jason Buck:

Well, a lot of people think he exacerbated inflation and it rolled off on its own. But that's a whole lot other story that's beyond both your and I pay grade. But I was thinking though, go ahead, sorry.

Tobias Carlisle:

Oh, I was just going to say, it's the cool thing about macro. There's nothing scientific about it. Oh, it's just politics. You can just argue politics all day long.

Jason Buck:

Just throw out my nonsensical hot takes all day long. But I was thinking if I put my Tony Deden hat on for a second, what I did think may be interesting is Tony Deden in Switzerland, and I think it's Edelweiss or whatever they hold, he holds almost all his cash in gold. I think his gold positions like 50, 60% of his fund. And then he just tries to find these de valued family run companies around the world that he thinks will, he'll just be in forever. Kind of almost like a semi Buffet model. But what I was wondering, going beyond just holding gold, that's not somebody else's liability, but then you have to deal with the variances of gold. And that's tough to deal with at that large position size of maybe 50, 60% if it is that high. But the second part is, I wonder though, if you actually get the certificates of stock in the company, is that a form of collateral that's better than, so for example, is most deep value algorithm people trading in value stocks, is that really being held at the bank that they're working with as their prime? Or can you get the actual stock certificates and is that a more pristine form of collateral, for lack of a better phrase?

Tobias Carlisle:

100% it is. I was surprised that, it's hard to get your certificates out of the prime out of the system, but that's not, in Australia where I come from, that's not the case. You just don't hold, you would never leave your certificates on deposit with the prime broker. That's insanity. Because what happens if something happens to the prime broker and they haven't-

Jason Buck:

Right.

Tobias Carlisle:

What do they call that? They've rehypothecated your certificates. Remember that word?

Jason Buck:

Yeah.

Tobias Carlisle:

We're going to relearn that word again. I'm guessing sometimes soon. Rehypothication.

Jason Buck:

So do you go through that process or is that too, is the system set up to make it too difficult?

Tobias Carlisle:

Yeah, it's too hard. It's too hard. That's too foreign. If you were to, I don't know what happens to gold over the next five years or 10 years. Could half or double or triple or third or whatever, I have zero idea. But it is also true that in a thousand years time, they dig up a Roman treasure box in Britain from Roman times and it's filled with gold that's still spends, you really can use that stuff in the future. I don't know. I really like Deden's approach and I've read all of those letters and he's had a few, he's, he's very similar. He thinks a little bit like Buffet. He's taken a few shots at Buffet more recently for some of Buffet's inconsistencies. I like the way they think. I don't know if gold is where I would do it, but I understand the rationale for doing it that way. I can't fault them for doing that. I can't argue against them.

Jason Buck:

If I'm honest, I still don't understand gold. I think, like you said, you can go back millennia and it seems to maintain purchasing power, but it's variable. Not in the interim period when you need it in any specific year. It might be everybody sold the baby with the bathwater like March, 2020 and it's not providing that value you need it for. So it's like over the long run, yes.

Tobias Carlisle:

Very long run.

Jason Buck:

And then it's just Lindy Effects and you're like, how will this work in the future? I don't know. But it's worked in the past. You're saying that rear view mirror aspect earlier and then I was talking about over the weekend, to me it's more for these interim periods of liquidity or when the system gets shaken up a little bit because it's not like we own physical gold with our funds, but am I going to go to the vault and then shave off gold for this? No, it's like it's for having something that's not somebody else's liability. And then the price should spike in reflection of that. And then hopefully you maintain your purchase power parody. That's like all you're hoping for and it's just during this interim thing of who has collateral, it's like, well, we have this other thing that could be used as collateral. You're not using it to actually pay for anything though.

Tobias Carlisle:

The long-term argument for gold, it's like a history of gold thing where it's like it doesn't decay, it's infinitely divisible. It's not used in really very many commercial applications. So it's not like silver where

there's a supply and demand thing going on all the time for silver that makes it much more less like money. Gold is useless other than in kind of jewelry, which is why it's useful I guess as money and for those other reasons. I wouldn't do it that way. But then if I was Tony Deden and I was in Switzerland and I was looking to hold family businesses and run this thing for a thousand years, that may be what I would do. I think maybe that would be a good idea. I don't know. But then you've got to have it. There's no point having it on in a vault somewhere. Now you've got to have it, you've got to hold it in your own thousand year vault. There's a whole lot of, there's real costs involved in something like that.

Jason Buck:

Yeah. And I've talked to everybody in the industry and Brent Johnson's gone way deep down this rabbit hole we talked about initially we were looking at global diversification of vaults, but nobody figured out March, 2020 then you can't move the gold around. And during COVID-

Tobias Carlisle:

It's still there. It's still there.

Jason Buck:

It's still there. But you couldn't move it around.

Tobias Carlisle:

But I could give you a note. I can have a note that says I own it. I can give you a note and say, Hey, we've transferred ownership of it remotely.

Jason Buck:

Well that's what I'm saying. I think it's just pristine collateral during interim periods when markets become dislocated or shut down or there's a run on banks, that's what it's there for.

Tobias Carlisle:

You get that, there's a great line at the bottom of the Great Depression when John Maynard Kanes was, he was managing these two funds and one is an insurance company and the other one was an endowment and when the market went down that much, everybody said, we've got to get out of equities, and he said, you can't sell out of equities at this point that because this sort of introduces this, if we stay here and it's all over, then it doesn't matter that we continue to hold them. But if we sell out and it rallies, then we'll miss this massive rally. And I think gold is a little bit like that too.

Physical gold you're going to need in the after period when Master Blaster runs Barter Town and it's Mad Max and you get motorcycle and a shotgun and stuff like that. But there's a period in the, as you point out, there's a lot right up to that point you're fine having, you could have a gold ETF, at least you get the performance in your portfolio. You won't be able to take it into the next world.

Jason Buck:

Yeah.

Tobias Carlisle:

You have to become a warlord in the next world to get access to. But that's what's going to happen anyway. The guy who's got the guns in the biggest gang, he's going to have all the gold.

Jason Buck:

Yeah, no. Similar to Tony Deden, that's what we think about is how do you manage money over hundreds of years. And I think that there's only once every a hundred years probably that you need this physical gold for anything. And like you said, it's an intervening period. I think about it's when you have these shimmies and shakes in the global market during risk on times when all of a sudden people start questioning what is money and what's collateral, that's what it's good for. But like you said, we go to the Mad Max side, you want guns and butter or I always say, I just want to be friends with the CEO of Blackwater. Because the idea too that people are going to store all their stuff is like-

Tobias Carlisle:

He's got an army, yeah.

Jason Buck:

Whenever militia comes through your town, it's taking all of your protein sources and your water sources. So I'm just like, I'm cozy enough, I'm going to be the court jester for the Blackwater. But they, Blackwater changed their name too. I can't even keep track of all of that stuff too.

Tobias Carlisle:

Yeah, it's just smart to keep the same name all the time. Right?

Jason Buck:

It's just like the tobacco companies. No, it's under a different name now. It doesn't really matter. Related to that stuff, I'm going to get this wrong, which is great because it'll give you a chance to correct me, but would you call them indestructible industrials or what's-

Tobias Carlisle:

Invincibles.

Jason Buck:

Invincible.

Tobias Carlisle:

Yeah.

Jason Buck:

So give me the spiel on Invincibles.

Tobias Carlisle:

Just the ideas that when the world sort of collapsed through 2020, six months into it sort of somewhere in September, 2020, I had been reading, I like to read old literature. That's kind of one of my, and stuff that's available for free on the internet. And there are, all of these terrible things have happened throughout history. And typically when something really bad happens, somebody has written a book about it. So there's the history of the Peloponnesian War written in 430 BC by Thucydides, who's a Athenian strategy, which is one of the 10 generals who's elected to fight. So Athens was a little walled

city, but they were becoming more prominent probably on the edge of empire. They'd figured out how to use their navy and a few other things. The Spartans get upset with them. Spartans want to go to war with them. So I had read that and that sort of, the terms of engagement is known as grand strategy.

The decisions that you make when you, so Athens famously huddles inside the walls while the Spartans go and destroy the countryside. The Athenians get the plague, it kills their main leader and then the war goes on for 30 years. So it's devastating world war for them. That engulfed everything. And I read that and then I read The Art of War, which I've read, I read it in high school. I've read it every five years or so since. I've never got anything out of it really. There's lines in there like if you find yourself in a salt marsh, get up against some, get your back against the trees. I just never used that in my day-to-day life, when I traverse the salt marshes, taking my kids to school with my big sword drawn. But I started reading through it and there was several different translations of it.

There's one by Giles who was the first in 1910, and there's a Patrick Cleary one which came out, which is the one that I read in high school. And there are lots of others and they all give, because it's written in ancient Chinese and it's written full of analogies and they talk about the swoop of a falcon or the bending of a bow, all this sort of things. The thing that really stood out to me was that he talks about make yourself invincible first. That should be the first thing that you do. Make sure that you don't make mistakes. He goes through this whole process for preparing yourself for conflict or preparing yourself for very bad things. There's always a possibility that this stuff could happen. You have to know the designs of your neighbors, know what your allies are planning, know what your enemies are trying to do, know the territory, know the seasons. Know heaven, know earth.

And he goes through this list of things and I thought, this sounds incredibly like Buffet. This is the way Buffet thinks. And I think that it's all just trying to deal with ergodicity. It's all trying to deal with that risk of a truncation of a very long, Buffet would call it compounding over a very long period of time. You got to look out for these downside events and the way that you look at, and you have to get the fragility out of whatever you're doing or find ways of protecting yourself. And it just occurred to me, and I've read this now, many other variations of this philosophy, but I think it's come down through history. It's a very well known kind of approach to basically dealing with ergodicity. So Taleb would say that his approach to it is he bets on the fact that it's going to happen and everybody else undervalues it because it doesn't happen frequently enough for them to understand that it's going to happen.

So Taleb bets on it. He takes calls out of the money on the VIX or he takes out of the money, puts on the index. So there's a various ways of expressing it. How does Buffet deal with it? Because he's on the long side. Well, he looks at the individual companies that he invests in, make sure they have a durable business, good balance sheet. And it's run by sort of competent, honest, and sensible managers who've got reasonably good character and temperament. And that's one of the things that comes through all of it. There is this psychological element to it. Know yourself, know your enemy.

And there's a character element to it too, which is you would rather associate with people who basically do what they're going to say and you know how they're going to behave under various conditions. And I think that all of that stuff together is, it all rhymes. I think Sun Tzu and Buffett rhyme. I think there are lots of other guys in between who have said exactly the same thing. And it expresses itself in lots of different ways. It expresses itself as like gamblers ruin over betting ergodicity. We have the mathematics to back this stuff up but I don't think that the mathematics is particularly interesting. I think that the history and the philosophy of it is more interesting, but I think the fact that it's supported by the mathematics sort of indicates that there is something rigorous to it. So that's basically the idea. It's just trying to find Buffet style stocks, I just described in the context of Sun Tzu and more interesting sort of events rather than business. But that's the idea.

Jason Buck:

Well it's really smart of you because quite frankly we traffic a lot in ergodicity and as soon as people hear the word, their brain shuts down their eyes gloss over.

Tobias Carlisle:

It's hard.

Jason Buck:

They shouldn't do, yeah, ergodicity. Yeah, narratives work a lot better. And that's a good point is historical narratives work best, but part of the invincibles, okay, it's one thing to understand that narrative and the idea, but how do you find them?

Tobias Carlisle:

There are indications in their financial statements that they are that way. One of them is that they earn a lot of money, so they have to have some protection. Buffet would call it a moat. Some sort of competitive advantage. Moat's not protection forever. The moats get crossed all the time. It's just the idea that you can earn a supernormal return on your assets because the nature of capitalism competition is for most businesses that earn a supernormal return that just attracts entrance to them. We see this all the time. Oil and gas will be drained of capital for a long period of time. Oil price will spike, there'll be a rush back into oil field services and those businesses will go well for a while. But there's no protection. It's just a man and a truck and you're an oil field services guy.

But there are businesses that can withstand competition for years and years and years. And they tend to be not particularly high-tech businesses like Coca-Cola, people just prefer Coca-Cola over store brand sodas, it's all that kind of stuff. It's just behavioral type stuff. So it's reflected in the financial statements over time. They should earn pretty good margins. They should earn better returns on invested capital than other businesses and they should be able to, there shouldn't be that much volatility in their returns because they can control basically what they earn over time. So it's identifying those kind of businesses. If you do that, you don't necessarily get the best returns because this kind of idea in the markets that you don't get paid for taking, for buying something that is good. You get paid for taking on risk, you get paid for finding things that are undiscovered. So often you earn a slightly lower return with these things, which would be fine if you just bought them as a basket, you would expect to earn probably a sub-market return because you have to overpay for them.

So Buffet's innovation has just been, he's got a small, he has 300 businesses or something like that in the states say that he wants to own and he just waits until they get cheap enough to give him a 10% return. And when they do that, he puts a whole lot of money into them and then he just continues waiting, which is very much, that's again, that's the Sun Tzu type approach to this stuff where just you know that most opportunities aren't going to be good enough. You just have to sit there and wait and wait and wait until you finally see something that you just can't figure out what's wrong with it. And it's like this reverse process of analyzing things. You're not trying to find the good things, you're trying to find the things that don't have any problems with them, just the perfect egg. And so he sits there and he waits until that turns up and then he buys it.

Jason Buck:

So there's two things in there I want to start with that. I wrote down a list of questions, but one is sub market returns. And I think that this is once again an ergodicity problem, let's call it a time problem, or a volatility tax problem. sub market returns, people just look at the average annual returns and they're

not even thinking about the downside risk, what's their max drawdown. So if you can actually have sub S and P returns but your drawdowns cut in half or a third, that's a much better risk profile and you're going to compound more effectively and efficiently over time. But everybody just looks at the top line number, that's all that anybody cares about and they don't think about what is my drawdowns? And that's why you're finding better companies. So that's the whole point is you're reducing-

Tobias Carlisle:

Once, if you held the whole 300 without regard to valuation, you would expect to earn sub market returns. But if you are prepared to wait until you get a valuation that doesn't acknowledge the valuation that you're buying into, then you can get sufficiently good returns. And so Buffet's approach has been to wait until the Ford returns are about 10% and then because the markets tend to recover faster and you earn, he's judging that Ford returns based on price to what the underlying business can earn. And then he knows that over a long enough period of time, your own return profile starts looking like the return on invested capital profile of the business. So because these are super earners, you should earn more. It's just that for the most part they trade extensively, which everybody's already realized that they're super earners. So they trade at a price that takes away that possibility of now they're sort of a have to be super earners just to earn market return.

Jason Buck:

The other thing related to time in that though too is you're talking about incredible amount of patience and that's really hard for people. So do you just think at 65, 70 is when you're going to get vindicated and you're willing to wait that long and beat your head against the wall? How do you think about that?

Tobias Carlisle:

I think that the vindication comes over time, but I feel in some respects you're a captive to when you start a fund. You start a fund, so my deep value fund started in February, 2020, sorry, June, 2020, we took it over and then October, 2020 we turned it into a smaller microcap fund and it caught the bottom and the returns were pretty good for that fund. My Zig started in May, 2019. So it started at the wrong time of the cycle. So it got crushed at the start and it's outperformed since sort of September, 2020 as well. So the return profile looks pretty similar to the other fund. It's just at the timing issue means one looks very good and one looks like it's less good, but it's the same strategy in both. I know that I have a small advantage or I think that I have a small advantage over time at some point the external matches the internal.

So I'm not too worried about it at all, provided there's always a business risk in there you have to perform at some point through there. But I think honestly, I think so far in the future that I, that's not a brag, I'm trying to think. I'm doing it on purpose. I'm forcing my horizon out as far as I possibly can. There's this great idea, which I get this from Jake Taylor and he got this, I think it comes from Poor Charlie's Almanac or Peter Kaufman who's the gentleman who wrote Poor Charlie's Almanac, he calls it Galilean relativity. And this is the idea, when you were 16, the first time you were 16, you weren't very good at being a 16 year old because it was the first time you did it. By the time you were 30, you had some great advice for you as a 16 year old, right?

But at 30 it's the first time you a 30 year old, by the time you're 40, you were back on your thirties and you think, yeah, there's clearly a whole of things that I should have done then. And all of life is like that except you get to this point where it's happened enough times to you that you should start thinking you are now 50 or 55 or 60 or 65 as you say. So I put myself all the way out at the very end of that nest. Let's

say I'm lucky enough to live to 80, what should I be doing now? What would my 80 year old self tell my 43 year old self to do? And so that's what I try to do. That's Galilean relativity,

Jason Buck:

Man. Once again, the intestinal fortitude you have is mind boggling to me. Because like you said, it's the conundrum is usually you have to make a lot of mistakes to realize those things that Charlie's talking about. And by then you're too old for compounding to take effect because you're in your forties and you're probably going to die by 70 or 80. So it's like that's hard to deal with and I can't-

Tobias Carlisle:

That's a long time though.

Jason Buck:

Right. It's still a long time, but it's just like, it's hard because I think one of the eternal conundrums is our present self thirst, just future self. And you're somebody like you're saying that could put yourself into rewarding your future self and at the cost of your present self. And I think without those are the things that we are always fighting is how much do I want to reward my present self versus my future self when the future self is kind of an abstraction. But that's the thing, we have the human animal of our present self and we have the societal animal of the future self and those two are all kind of always in conflict with each other.

Tobias Carlisle:

Well the nice thing about the business that we are both in is it really does reward patience and a long-term perspective really more than anything else. There's no other business like this. So I think that that is the single most important thing. And then everything else flows backwards from that. So once you can program yourself to do that, once you can force yourself into that Galilean relativity and start thinking in those terms, everything else follows along, you start thinking about ergodicity when you think about the world in those terms, you start thinking about, I'm sure that the Cockroach fund as a result of you thinking in these very long terms. There are lots of ways. I could market much harder on short-term things that get a lot more attention and raise much more money doing that.

But I don't want to do that at all. I just don't want to live my life like that. I think that there's a way that you can have this peaceful, calm, relatively peaceful, calm existence and it gets rid of that feeling of FOMO for me, people are doing really well, should have been in these things, it's just a different game. That's not the game that I'm playing. I'm playing my own game over a very long period of time and that there are certain rules and there's certain dictates that flow from that. And so I'm not hurting anybody else but myself and I don't follow my own rules.

Jason Buck:

But there's so many things related, like I broke my own rule today, we talked about something topical with Silicon Valley Bank because at the same point you're saying is I don't think it behooves us to talk about short term or topical things because that's not aligned with the philosophy of our funds. So subconsciously you're telling your clients that I'm focused on short term when no, you should be, everything should be about long term. So you should say this doesn't matter, this too shall pass. That's the way you should really kind of focus on it is not talking about the topical at all. But [inaudible 01:01:09]-

Tobias Carlisle:

Don't you view these events like the fact that I'm not impacted by this is a result of decisions that I made previously and those were good decisions and I should continue to make good decisions like that. I could go, I don't think I need to see the news at all. I get plenty of news flow from Twitter, but I could live without the news. I think you can go back and it's crazy to go back and read ancient literature that's like two and a half thousand years old. They're dealing with exactly the same problems that we are over exactly the same timeframes. It's all unexpected for them. They're famous events now, but nobody knew it was a famous event going into it. And they kind of talk about them.

The Peloponnesian war between the Athenians and everybody there, they went for 30 years and the plan at the start was to hide inside the walls of the city, which was clearly not going to work for a 30 year war. But I don't think that's a bad solution for the first whatever period of the war, but it's just funny. But we now know that that was the wrong thing to do, but in the moment they had no idea. And I don't even know if that was the wrong thing to do, it's just that's what happened. But it's sort of regarded in the people who are philosophers of grand strategy that that was the wrong thing to do. So I think you got to-

Jason Buck:

With hindsight bias.

Tobias Carlisle:

Yeah. With two and a half thousand years of hindsight you're able to say that's the wrong thing to do. I think there's this, we tend to overreact to events that we see and so it's good to either ignore them or underreact to them, let everybody else overreact. But the other thing is that we underreact to longer term high impact events. So Taleb this a little bit like Taleb's idea, but there are, it's actually, Cardinal de Retz is the guy who said this, but he said everybody's too worried about their present day troubles. They're not worried about the things in the future, in the far future. And I try to reverse that. That's one of the nice things about the idea, sorry to keep on going back to this Galilean relativity, but it really is, it's a big part, ergodicity is a big part of that process.

There are big, we don't know that the stock market is going to crash now, but the stock market is going to crash in the future. We do know that's going to happen. So why not just be prepared for it now? And we don't know when it's going to happen. But it's the same thing that the earth has been struck by meteors many, many, many times. The earth is covered in meteor craters. We are going to be struck by another civilization ending meteor at some point, possibly today, possibly tomorrow, hopefully not for thousands and thousands of years. I don't know if you can prepare for them, but there are things that are absolute certainties over a long enough timeframe and you should think in terms of surviving certain events over long timeframes when they could come tomorrow.

Jason Buck:

Yeah, I think about, I can't remember whose line it was, but it was basically, we live in a convertible and it sits with me every day that the world is a convertible. And like you said,

Tobias Carlisle:

[inaudible 01:04:06].

Jason Buck:

Yeah, it's tough to think about. But to your point, our original working title before we started any funds, the firm was called Adaraxia, which is ancient Greek for unperturbed by external events. So like you said, we had the forethought to build it. So when Silicon Valley Bank happens, I'm like, I just shrug my shoulders. Like yeah, it wasn't that specific one they expected, but I expect banks to fail. Banks have failed historically. And so it's, I wonder though if we just become these hardened, embittered grizzly vets just like, oh yeah, shrug it off, these things happen and you just become so jaded. But at the same time, let's be honest, you're an entrepreneur. So how do you manage your shiny object syndrome though while you're just waiting on these funds to pay out over time?

Tobias Carlisle:

There are a few things that I do that I know that I have some advantage in. I don't have a lot of advantages and a lot of things. So I have a few things that I have an advantage in and one of them is that I've just like congenitally built this way. I am risk aware. That's one of the things that, I'm risk first guy and I have this expectation that things that have happened in the past will happen in the future. And I think that everybody should, to me those just seem, all those things seem to be completely logical. That should be the way that you're behaving. And I can't understand people who don't behave this way, but most of the rest of the world doesn't, judging by the way that they invest. When I look at stuff that people are piling into, particularly the way the attitude that people had when they were piling into this stuff that this is a new paradigm, you don't understand it, you're too risk averse.

Jason Buck:

But that's one thing, and you have the sucker of Buffet and Munger and all that stuff with that. But going back to ergodicity, in the meantime, let's say exogenous of your investing styles, you have a family that has needs and that those time durations are mismatched. So it's like, do you see what I'm saying? Life gets in the way of maybe your investing style sometimes.

Tobias Carlisle:

True. I've got a wife and three kids, so it hasn't held me back that much. I don't think that to the extent that the business is kind of carved off from, well, that's a good question. So how do I deal with that? The business has to be able to survive on its own two feet and has to be cauterized and carved off from everything else. So the business exists us outside the family environment. My kids don't really understand what I do. I kind of explain it to them and we rang the bell of the New York Stock Exchange. So that was a tangible event where they saw that something was happening but they still didn't really, like I try and tell them that it's just too abstract for them. But I feel that given that I have studied history enough and that there's nothing, you don't have to go back and read ancient history to do this.

You could have just the last 20 years in the stock market would probably be enough to tell you that well, maybe not last 20 years, you need the last 23 years. You need to capture .com bust, capture 2007, 2009, look at the performance of value stocks through there. Value stocks had that first great decade had a second bad decade. That's all of the things that can happen in the stock market to my business. The stock market can collapse and my strategy can underperform. So those are the two worst things that can happen. If you can survive those things, you're going to be okay. And so that's what, I'm survival first. Ergodicity is the collapse is the enemy of my strategy. So that's the thing that I spend the most time worrying about. And once I know that I'm going to survive those things, this is the only thing that I really know how to do. Outside of that, I'm not going to be, I'm not going to be able to advise people on marketing or legality. I don't really, as much as I'd like to run something like Buffet does, I don't think I

have the skills to run something that scale. This thing that I run is complex enough and that's enough for me.

Jason Buck:

And there's so many things in there, but I want to touch on a few other quick topics because I've already gone beyond time, so I want to-

Tobias Carlisle:

No, you're fine, you're fine.

Jason Buck:

So going back to the invincibles, I was thinking besides, are you sector agnostic? I mean besides maybe staying away from banks or financials is-

Tobias Carlisle:

We have some.

Jason Buck:

Could like LVMH and Hermes, are those great invincibles or at the right price or how would you think about those? More because luxury and brand are sometimes things that people don't understand and can't quantify.

Tobias Carlisle:

Yeah, absolutely. Yeah, that's potentially the source of it. I think of those companies not so much as being luxury or brand, but as being that quality brand middle stand, which is this idea, that they're these, they're found particularly in Europe, that these basically family owned businesses that they just take a long time to create the product and the product is an exceptional quality and there's a finite limited run of whatever the product is. And every year they basically set their price for the product and everybody pays it and they all sell out. And then the next year, because capacity's still really constrained, they put the price up a little bit more and it all sells out.

I think that's what really the LVMH is, even though some of it's like, I know some of it's faster moving fashion and there's a lot of other stuff in there, but the quality portion of it is that quality brand middle stand. So those are certainly potentially invincible businesses. The longer, that's a great mode. If it takes 25 years to grow your cork tree, not that cork's a great one, but you know what I mean? 25 years to make your scotch or whatever it is then or it's a leather handbag that it just requires a level of detail and precision and craftsmanship that it's hard to replicate and hard to create that trust in the marketplace that they're great businesses, they're potentially invincibles.

Jason Buck:

And then I hope you disavow me of this because it just seems to me like, you segued me perfectly into this is when I look at a lot of these businesses that are great cash flowing business that are invincibles, but they're maybe in a dirty commodity business is now the children of these boomers do not want that business. And it just seems like there's tremendous opportunity there. But am I not seeing things clearly?

Tobias Carlisle:

In commodity businesses?

Jason Buck:

Yeah, for example, it doesn't need to be necessarily commodity. I mean obviously the kids are now wanting to take over are LVMH, that's obvious. But if somebody is running some sort of, I don't know, a steel galvanizing facility in Buffalo, New York or something like, the kids don't want to take that over. And so there's like opportunity seems like for boomers, this is more on the, I guess the private side than the public, where there's just not a lot of succession planning just the way that society's structured these days.

Tobias Carlisle:

It could be a good thing. I love that, there's this idea of a search fund. You've probably heard of search funds where people raise money to, but raising the money to do the search I think is kind of, that's whatever, maybe that's important, maybe it's not. But the important part of it is potentially you get people who are first year MBA or people who've just graduated from MBAs or they've got consulting background or an investment banking background. So they're used to working long hours, they are very smart, they've got a lot of energy and they come into some of these older businesses where there's no succession plan, where you don't need to be a great genius to run it. But it would help if someone was young and energetic and had an MBA and had some ideas for these things. I think that there'll be a lot of that. There'll be a transition from boomers to millennials or Gen Z or whatever happens to be who've got that energy. I think that that's potentially a very good thing that could happen.

Jason Buck:

And part then on the public side, how do you start to screen define these invincibles? Like do you screen for cash flow but then at the same time, do you want it under a certain percentage of cash flow because you know how everybody else is screening crisp data? So it's a beauty pageant contest, it's secondary tertiary effects. You want a nice compounder but that nobody else notices. So you're trying to traffic in maybe a eight to 11% free cash flow or how do you think about that?

Tobias Carlisle:

I think that for the most part, the safest way of investing in value is just to buy things that are pretty cheap. If you look at what it's predictive. So there's very, very little that's predictive as a sort of quantitative indicator of how a business is going to do. And certainly once you get past five years, valuation is not predictive anymore either. Valuation is very, very useful in the first year, less so in the second year. Asymptotically trends towards zero by about five years out and then return on invested capital is variable. All these things, it's very, very hard to predict. So I think given that it's so hard to predict, my approach is less like Buffet's where Buffet is like, Buffet has this incredible understanding of everything that's going on in the economy because he reads a lot because he is got BNSF, he's got these other businesses in there that give him feedback about those things.

If you didn't have that kind of certainty about what you are buying, a better approach would be to do what I do, which is more of a portfolio construction approach where I say I'll buy enough of these things which have those good cash flow characteristics, which have good reinvestment type characteristics, which earn reasonable returns, which seem to be bottoming out in their business cycle rather than topping out in their business cycle. And knowing that over time we can adjust and we can keep on iterating and we'll move away from the things that aren't working and move towards the things that are

working. And I think that that's sort of my, I can't see the future, I don't know what's going to happen. I like the invincibles, but I don't really trust them either because everything can get, every remote gets crossed, everything, every big business is eventually a commodity. There's nothing that resists the market's eventual sort of trend towards commodification of business. So you want to be careful overpaying for businesses is the main lesson. So you want to pay less for them, however you define that.

Jason Buck:

And by the way, I would happily argue that Buffet actually uses portfolio construction technique similar to yours as well, as you know, if you study his history, the amount of folly with his companies and everything that he's invested in are pretty tremendous. But everybody only looks at the upside over time and people don't real realize all the ones that kind of fell apart or they had to get really hands on that they didn't want to be in.

Tobias Carlisle:

That's the great skill of it that even making mistakes, when I think about it as part of my sort of invincible philosophy is this, you're going to make mistakes. That's absolute certainty too. So how do you not blow yourself up with mistakes? I try to find any source of risk and I include myself as the first source of risk and then I work out outwards from that. And so that's essential. You have to have survived your own mistakes. The first, know yourself is, that's the first thing that Sun Tzu and Buffet would say as well.

Jason Buck:

That's why people that need to study Buffet better realize it's not batting a thousand too. It's to your point. But do you think that, I'm curious and I don't want to make an assumption because I hate assuming anything, but I would think that if you're screening and figuring out the invincibles, how I would assume a good chunk, if not the majority of the portfolio you end up in quote unquote sin companies or non ESG companies and in-

Tobias Carlisle:

[inaudible 01:15:06].

Jason Buck:

I'm just curious, yeah, how do you think about that?

Tobias Carlisle:

I look at businesses from a perspective of risk and so one of the risks that they can have is reputational risk or they can have regulatory risk where there's no regulation impacting them now, but there will be some regulation impact or they can be sued. All of those things are genuine risks. It leads me to this slightly differentiated, it's not an ESG approach necessarily because I own some things like [inaudible 01:15:33]. I own a Warrior Met Coal, I own things like that because I think that if we want civilization to continue to grow, we are just going to need a whole lot of energy. If we are going to reverse course in civilization, then we won't need as much energy. But those are the choices. It's not less energy, it's not going to be all clean energy. We're going to be stuck on fossil fuels for a very long period of time and ultimately we probably have to be on nuclear or something like that.

So I think that you just can't avoid that stuff and so you need some exposure to it. But I look at things like cigarette companies, like cigarette companies earn a lot of money, uninvested capital, they've got

pretty good margins and they're available pretty cheaply. But I just personally don't want to own them because I think that every now and again, they're going to be whacked with the stick, like a pinata because they pay out, they've got the money to pay out. And I just think that's a bad business to be in where you're killing your clients over time. So I would avoid those type of sin companies. I don't own any casinos in Zig because casinos have terrible, casinos are, if you look at the long-term performance of casinos, they're like leveraged real estate plays and when you go through bad times, they look nasty. They're the worst sort of sin company to own.

Alcohol, who knows with alcohol type businesses, but they seem to be pretty good businesses. There's a death rate attached to them as well. But it seems to be, doesn't necessarily kill you to drink alcohol. So I think that's okay in the portfolio at the moment. But I wouldn't be surprised if over time alcohol sort of starts looking a little bit more like cigarettes. I don't know, there's a lot of different things in there. I think that there's this rule in sort of applying a quantitative systematic approach that you don't interfere with the output of the system because you haven't tested those parameters where you interfere outside of the system. But I still think that there's always this risk in a purely quantitative system that it winds up concentrated on a whole lot of things that have these, it's not even an off balance sheet risk, but have just metaphysical risk in them.

And so I try to avoid, that's the only time I exercise any discretion to go through and just remove things that I think have metaphysical risk or balance sheet risk that's not captured in the system. So that's kind of the way that I think about it. But in terms of things that are actually invincible, I think it's very, very hard to find them. So I think you have to assume that almost nothing possesses it. Be very careful paying it for things that you think that do. The things that have earned more on their assets do warrant a higher, that if they have earned that in the past, it looks like they can continue to do it in the future. They should be earning more if they're more consistent. Commodity businesses are not like that because commodity businesses, they'll be more supply when the demand goes up.

They'll be a lot more supply. There's all, as the price goes up, all the marginal mines become more valuable. Their margins don't actually go up much over the cycle because everything gets more expensive, the inputs get more expensive. But when they're underinvested, which they seem to have been for a long period of time, the market, if you're a value investor and you're contrarian and when the market is not putting capital into something, you should be putting capital into it and vice versa. When the market's throwing capital at something, you should be pulling your capital out of it.

Jason Buck:

Just like Buffet and Munger. All these things are easy to say but hard to do. And that's why it's fascinating for me whenever I talk to-

Tobias Carlisle:

Well, valuation, they are very hard to do, but valuation should drive a lot of what you do. You've, when things get cheap on the historical numbers, you should be attracted to them and looking at them. I don't worry, I've sort of trained myself enough now, but the fact of their cheapness is the thing I think that will make them work in the future. And you wind up in these things that they are hated and you just have to know that everybody's overreacting or expect that everybody's overreacting, even when they're not, you're still sort of paid to be in these things because if they're not overreacting, you've already sized, it's a donut. If it doesn't work, you haven't lost that much. If they are overreacting, it recovers and you get paid. That's sort of, that's value investing.

Jason Buck:

I also love the bifurcated duality of searching for invincibles, but then being dubious if any of them are invincible. So it's like constantly conflict with each other, trying to find it.

Tobias Carlisle:

Constant.

Jason Buck:

Yeah. So the other thing you brought up a few times, I would have a shout out from Meb because I definitely, I think I stole this from him and we were all at lunch together a few weeks ago, but the idea of in this business, surviving's the only success. So we've been talking about ergodicity and everything, that's it. Surviving's the only success and you know, better not [inaudible 01:20:06] there. The other thing Corey and I often talk about is it's hard for us, I think in this industry, industry in quotes, is everybody wants a hot take or a tip. And to us, me, all of us are in the stay rich business.

Tobias Carlisle:

Yes.

Jason Buck:

Where a lot of the industry's in the get rich business and everybody wants that hot take, hot tip. And so it's a very weird space where we're be in, but once again, we're, we're trying to just survive. So related to that, I also owe you a thank you because people like Meb's podcast, your podcast, your Value After Hours podcast, especially Resolve Risk, the Writ Hold Screw, they paved a way for all of us to be able to do these more off the cuff, more enjoyable podcasts to talk about other things that necessarily hot takes or hot tips or our global macro thing. So I really always appreciate what you started with value after hours and all the content you constantly put out. But my last question is Great White Cafe in Venice, California. Is it the best Australian cafe in America? And therefore you would argue the best cafe in America?

Tobias Carlisle:

I do love Great White. I love that little, I love their logo too. I've tried to rip off their logo and stick it on a shirt for myself. Yeah, I do like that cafe. It's great. Last time I was there, I saw she's the actress, now I can't think what her name is. She was in, I'm so bad at actresses names and movies that people are in. You're probably going to have to edit this part out, but the, who cares? In Los Angeles you see-

Jason Buck:

You see actresses there all the time. Yeah.

Tobias Carlisle:

Anyway.

Jason Buck:

But I love, they moved down from the acai bowls to the blueberry bowls to you get like, yeah, it's just a cool spot in Venice. If you ever get a chance, check out Great White Cafe. But it's always that argument, Australians think that they're the best at coffee and cafes now or something.

Tobias Carlisle:

I think that Australians are the best at coffee and cafes.

Jason Buck:

There you go. You heard it here first, but let's plug away again at the end here. I'd like to do it at the top and at the end, tell everybody where they can find you. There's a lot of places they can find you so run down the list again.

Tobias Carlisle:

So my first fund is Acquirers Deep Value. Sorry, I've lost my mind completely. So Zig is The Acquirers Fund. Deep is the Acquirers Deep Value Fund. That's the smaller microfund. I have a website Acquires Multiple and I have some books. The last one was The Acquirers Multiple, and I'm on Twitter greenbackd.com. That's for greenback, G-R-E-E-N-B-A-C-K-D. Haven't done this sign off for a little while.

Jason Buck:

And then you have two podcasts though. You have Value After Hours and then don't you have an Acquirers podcast as well?

Tobias Carlisle:

Well, the Acquirers podcast was where I was interviewing, I was doing individual interviews. I've just done fewer of them recently. We just tend to do this Value After Hours, which is the three of us. But we've been sort of expanding it out to get other people into it. So they're, the two are merging a little bit. The last one we had was Porter Collins and Vinny Daniel, who, they're both characters in the Big Short, they were played in the Big Short because they're in Steve Carell's firm in the Big Short, where they have all the great scenes where they're quizzing Ryan Gosling about the short. So they were on the podcast. It's always fun chatting to those guys because they're kind of deep value guys, but they've got a little bit more of a macro credit bent to them as well. And I like [inaudible 01:23:41] talking bearish stuff with guys. So it's funny, because we do it live, one of the comments in the theme is, why is Tobias always so bearish? I'm like, well, I've been running this thing from 2000, the podcast came out in 2019. I wasn't very early on. I think I remember Meb doing his and thinking, gee, so late. Meb was really, really early.

Jason Buck:

But yours is, doing Value After Hours different, more of that topic round table. I mean, I think you guys still have kind of brackets, you try to put it in, but it's more free flowing than doing an interview podcast.

Tobias Carlisle:

To be fair, I stole it. I think I stole it from [inaudible 01:24:14] guys.

Jason Buck:

Yeah, no, we still great artists steal.

Tobias Carlisle:

And then they said they stole it from Sports Center or something like that.

Jason Buck:

Yeah.

Tobias Carlisle:

Everybody's stealing from somebody else all the way along the line.

Jason Buck:

And they stole it from people around the campfire. And either way, at the end of the day, everybody run out, subscribe to Value After Hours. And Toby, thanks for coming on. I always enjoy talking to you.

Tobias Carlisle:

Likewise, Jason. Thank you for having me, man. It's always fun.

Taylor Pearson:

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