Episode 122 Thinking Like A (Financial) Economist

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SPEAKERS
Ken French, Bob French

Bob French 00:00
The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Hey, everyone, welcome to our podcast this week here, obviously, I've taken this over completely today, I'm not just doing the intro here. But for those of you who are watching the recording, you can see we've got someone here. For those who who just looked at the title, you see, we have we have someone here, someone that I am really, really excited to have on here, we've got Ken French here, he is a professor of finance at the Tuck School of Business at Dartmouth College and is a board member over at dimensional funds. And just so happens to share last name with me and just so happens along with that to be my father, along with being a well known financial scholar who specializes in asset pricing, and portfolio management. So, you know, this is something that I think is really, really useful for a lot of people. Because we've been getting a lot of questions around, you know, how to think about some of these big picture type of things around investing. And this is something that well, you specialize in here. And as we've been talking, you know, kind of putting this episode together, you put it in a really interesting way, what you really want to kind of cover here, which is kind of have the more organized version, if you will, of, you know, the stuff that you were trying to impart to my sisters and I around the kitchen table at dinner, you know, that really understand how to think like an economist, don't think like a financial economist, I should say, you know, so with that, you know, to kind of kick things off, I think a good place to start is if you could teach people kind of one concept about economics. Where would you start? What will be the most useful thing that someone could understand, you know, for how to kind of operate, both investing and the world.

Ken French 02:41
First, thanks for inviting me to chat with you, Bob. Yeah, I, I'll confess many of the dinner conversations had a subtext. And I'm proud to say, you certainly learned the lessons well, even though they were less than direct, then I'm probably going to Well, listen, I'm going to try to make the points today. So your your questions, really interesting one, if I got the opportunity to

communicate just one concept, to try to make people's lives better. Constrained talking about economics, it would be the notion of marginal cost and marginal revenue. So the simplest case, imagine you're working for a company. You're making umbrellas. You can sell umbrellas for $30. You can sell as many as you want. You're in what an economist would call a perfectly competitive market. You can sell as many umbrellas as you want. For $30 A piece. How many would you sell? Well, what you need to know is what your cost function looks like. What's the incremental cost per each additional umbrella? If you could make a lot of umbrellas at $20 apiece, sell all of those. If the next bunch costs you 25 continue to sell that next bunch. You what you would want to do is go to the point where the last umbrella you make just cost you $30. So what I've assumed here is as you're trying to make more and more and more, your costs are going to go up for each incremental unit. And where you would stop right at the point where you're breaking even if you're making them at $32 apiece, and you can sell them at 30 You're going way past you're losing $2 on it. rewind yourself. So you can see the logic, simple argument go to the point where the benefit of the last one exactly offsets the cost, the marginal revenue equals the marginal cost. And that's a general principle. If you're trying to maximize in any sphere of your life, you can always figure out, what's the gain I get from this, ignoring the costs? And what's the cost I bear from doing that. And you go to the point where the marginal cost, the last unit cost, equals the marginal benefit, or the marginal revenue, the last unit revenue or benefit that you get from producing. And it's great. I mean, it helps you think about, you know, how many books should you read? Well, as you read more and more, you get more and more bored. So the cost of reading each and dreamin incremental book goes up, and presumably you sorted the books before you started. So the first one you start with is the one that you would personally gain the most from reading. Just go to the point where you stop when the gain equals the cost on that last book. If you go beyond that, then you're just suffering needlessly.

Bob French 06:24
So, you know, one of the interesting things that that I think is, is really useful here is actually thinking about how this relates to risk aversion. Because you've used this in a couple places in the past, and I thought it was a really nice way of thinking about it. So do you mind talking a little bit about about that?

Ken French 06:47
Yeah, let me come at it a little less directly than risk aversion immediately. Because if I think about increasing my allocation to stocks, suppose right now, I have 100% of my portfolio in fixed income. And I think, you know, maybe I'll be better off, if I add some stocks to the portfolio. If I do that, I think the marginal benefit is going to be an increase in the expected return. Marginal cost is forcing me to take some additional risk. Although, interestingly, if I really am 100%, fixed in my portfolio, I might actually reduce my risk by adding replacing some of the fixed income with stock. But let's imagine we've gotten to the point where, in green, increasing the allegation to stock would increase the risk of my portfolio. Well, I still may want to do that, because I'm getting a benefit of a higher expected return. So when I look at the marginal benefit of increasing the stock allocation, it's an increase in the expected return. What's the cost? It's an increase in the risk. And what I want to do is go to the point where those two offset each other, that's my optimal portfolio, if I was able to better measure the change in the expected return and the change in the risk and think about how does that affect my utility? I'd look at what's the incremental utility from increasing my expected return? What's the incremental utility from increasing my risk, presumably, that's a reduction in my utility, I get to the point where those two

exactly match. And I say, I can't do any better. If I increase my allocation to stock share, I'm increasing my expected return, but at a greater cost than the benefit from that expected return, greater cost in terms of risk. If I slide backwards, I already know from my movement up that curve, that I'm going to be losing something if I slide back the other direction. I'm at the top of the hill. That's where I really want to be. So your original question had to do with risk aversion. And it's an really interesting thing to think about, where does risk aversion come from? Because once people grasp it, it helps them see, particularly the way I think about what people want to maximize when they're designing their own portfolios. So where's risk aversion come from? I think risk aversion comes from an ag This isn't unique to me, this is sort of the way probably all finance professors think about it. It's decreasing marginal utility of wealth. What do I mean by that? Suppose you have 100 your $1,000 in your bank account. And that's what you have to live on next year. And I say, let's do a coin toss, fair coin, half the time you're going to win half the time you'd lose, or lose even more precise 50%, your probability of 50% of winning and 50% of losing? You got $100,000 for next year. And I say, Would you be willing to take a 5050 bet? For $75,000. So if you win, you now have 175,000 in the bank to spend next year, if you lose, you only have 25,000 in the bank to spend next year. Does that sound like a good bet to you?

Bob French 10:48
Now particularly? No. And the reason

Ken French 10:52
that doesn't sound like a good bet, is the incremental gain moving from 100 to 175. Yeah, that makes you better off, but not nearly as the change in your utility and your happiness from that gain is much smaller than the change in your happiness from the loss of going from 100 to 25. What I mean by that is, you know, when you only have 25,000, and I give you another 75. That's a huge gain. If you start with 100,000, I give you 75,000. Yeah, that's good. But it's not nearly as good is the gain from going 25 to 100. In the same way, starting at 100, losing 75, that hurts you a lot more than the addition of 75 get you if you win this bet, well, if you think about investing in the stock market, that's similar to that bet. If you win, now, you gain wealth relative to your original location, or your original wealth. If you lose, you're losing more valuable dollars, then you're winning when you win. That's the key, the marginal utility of each additional dollar gets higher and higher and higher as you lose, as you when the marginal utility gets lower and lower and lower. Why? Let's say I give your you're a billionaire now. And I give you $3, that's got no consequence at all for you. Versus all you have in the world is $10. And I take three of them away from you. Well, that's a real big hit, or all you have is $10. And I give you three more. That's a huge gain in what you can now do in your life. So that's the decreasing marginal utility of wealth as you get richer, and because of that decreasing marginal utility. You don't like taking your bat over on the overall stock market, you when you get dollars, but they're worth very much, because you were already pretty well off, you lose. The ones you lose are really worth a lot. Because now you're poor than you used to be. So it's that difference in marginal utility of wealth. And what that leads to is an understanding that, in fact, it's consumption that you should be thinking about here, not wealth, because that's what's driving your utility. How much am I going to be able to consume what's what's the increase in my marginal utility from consumption? If things work out. And then if you think about the capital asset pricing model, probably most of the people that are watching this, are familiar with the capital asset pricing model. The whole idea that and

Bob French 14:13

I apologize for those of you who aren't, do you mind providing just a quick 1015 Second synopsis of of what the cap m is?

Ken French 14:23
Sure. This is a theory developed by Bill Sharpe, John lintner, a few other people at roughly the same time, that basically says, companies that have a high beta, and what that means is, they move a lot when the market goes up or down. So a beta of two you'd say, well, we expect them to have, in essence, double the game. It's not literally that but roughly double the game. of the market when the market goes up, and double the loss of the market when the market goes down. So these are companies that are really sensitive to the mark. There's other companies that only have a beta of point five, the market goes up 10% More than the risk free rate, that point five says, we expect this company to go up 5% relative to the risk free rate, and the same on the downside, market goes down 10, this company's not so sensitive to the market, they only go down five, relative to the risk free rate. Now, go back to this notion of risk aversion. Remember, when you when you win cheap dollars, because now you're rich, when you lose, you lose expensive dollars, because now you're poor, it's a decreasing marginal utility of wealth. If both companies have the same expected return a company with a beta of two, they go up double what the market did, or porn five, they go up or down half of what the market did. So you can double the gain in the market, or really the gain relative to the risk free rate, or only take half of the gain in the market. And I force you to invest in one of these two, they have the same expected return and one moves double the market. The other only moves half the market. Which of the two would you like?

Bob French 16:43
I would probably choose the the lower beta stock exactly

Ken French 16:46
why? Because you don't like the bet that I'm forcing you to take. Right? If the odds are the same. You're not going to like this any more than you like the coin toss on 75,000. Up 75,000. Down. Yeah, same problem here. And so how can I induce you to take the beta of two, instead of the beta of point five, or make you indifferent between the beta of two and the beta of point five, I have to kick up the expected return on the higher beta stock. And that's exactly what the capital asset pricing model says. expected returns are higher on companies that are more sensitive to the overall market that move more with the market. When the market moves. What's driving that? If you were the only one that was thinking about, Okay, I'm holding the market, I want to add one more stock to it. You're not going to drive in equilibrium. The assumptions of the capital asset pricing model are everybody holds the same market portfolio. And basically, the model makes an up assumptions that everybody wants exactly the same portfolio. And the only way that everybody can hold the same portfolio is if that portfolio is the market portfolio. So now if I say the market does well, that means everybody got richer, the market does poorly, that means everybody got poor. And it's because we've made enough assumption that everybody's holding the same portfolio. So now you can see how the equilibrium is gonna work. Everybody's holding the same portfolio. Everybody says, Oh, we won, that's good. But the dollars I'm getting paid off in aren't as valuable as the would have been it had I lost these dollars. What that tells us is okay, in order to induce you to do this investment of the high beta guys, I have to promise you a higher expected return, low beta guys, not such a higher expected return, a negative beta portfolio would have an expected return below the risk free rate. Why cuz it's a hell of a hedge for all of these market portfolios, that everybody's out there holding, right? And if they're trying to

control their risk, they'll say, I like going with his negative beta stock. And I will pay to get that negative beta stock in my portfolio, because it helps me manage the risk of my portfolio. So that's the logic. Where does risk aversion come from? Is that idea that as I get wealthier, each incremental dollar means less to me. In terms of my added utility, I'm

Bob French 19:57
curious if you should be looking at a Roth convert version or what a Roth conversion even is head over to clean am.com/roth to get McLean's free ebook is a Roth conversion right for you, and learn about when you might want to do a Roth conversion. And when you might not, just head over to McLean am.com/roth, to download your free ebook today. And actually, one thing that you called out there, a little bit in the middle was kind of what the nature of risk is. And actually, I want to call this out, because that's something you're going to be talking about next week in our webinar that we're going to be doing over on the retirement researcher side, the five things I know about investing, you know, if you have not had a chance to register for that, just head over to Risa profile.com/podcast, you'll be able to get that registration set up we're going to be doing on Wednesday, April 24. So next Wednesday, at two Eastern a lot of really great stuff in there. But I wanted to call that out since we are going to be talking about how to envision risk and how to think through what risk actually means to you, especially within the context of investing and retirement planning. But the next thing I want to ask about here, was was actually the Winner's Curse, you know, this is something you talk about a pretty good amount, you know, because it's something that really gets into some really interesting concepts of you know, how we actually think through what it is that we're doing. And you know, how we make decisions about the things we want to spend on or the things that we want to be doing?

Ken French 21:42
Yeah, the Winner's Curse, the easiest way to understand it, is to think about oil companies bidding on offshore oil leases. So if you're not familiar with this, there'll be tracts of land, that the US government is willing to lease, you know, offshore, and different companies will put in different bids, trying to get the right to drill in a particular area that was leased. And to make this story easy to understand, assume all the companies have the same production technology. So their costs of drilling their cost of extracting the oil, it's going to be the same per barrel company to company to company. The only reason they would bid different amounts, is because each company makes its own estimate of how much oil is there. Random mistakes, you know, each one tries to do the best they can, but they have different data. They draw different inferences. We're going to get a sequence of bits. If I tell you Company A, you know, let's say it's Exxon Mobil that they put in the highest bid. What did we know about their estimation? Or what do we know about the mistake they made? In estimating how much oil is in the ground? There are how much oil can they extract from that lease? What did they know is they must they had the highest estimate? Right? They were willing to pay the most why? Because their estimate of how much oil they can extract is more than anybody else's. What that tells you is they've almost certainly overestimated. We got all these independent estimates. If I take the most extreme estimate, that's almost certainly upwardly biased to high, higher than the truth. It's in the ground. Doesn't have to be but probably it is. So if I'm Exxon Mobil when I make my bid, what I want to say is if I win this, the fact that I won the auction tells me I was the most positively biased in my estimate. And I would shade my bid, can as if I knew I was going to win. The only time my bid matters is when I win. So what I say is, let me condition on me being the most over optimistic about how much oil is here. adjust for that and then put a bid in based on that adjusted number. If you think about it, Exxon is still going to win this auction. Why do I say say that, because they still are the

most biased, and everybody else is making this same adjustment, it won't literally be the same quantity adjustment. Because the other folks will have different estimates of the variance and things like that. But they'll all scale their estimates back, they'll all put lower bids in the auction to adjust for this Winner's Curse, you can see where the name comes from. The winner is cursed, with the most positive estimate, they all control for that bias in their estimate. And sure enough, exon still gonna win the auction, but at a lower price. And they can afford to put in a lower price, because everybody is adjusting for the Winner's Curse. Under the assumption, it's only relevant if they win. So they start by saying, Okay, what would my bias be if I win and adjust for that bias in their in their bid? Well, that's the prototypical example of the winner's curse, but the Winner's Curse is all over the place. So I'll give you a good example. As an academic, we're always searching to get the best colleagues weekend. So I teach at Tuck, Dartmouth College, we're trying to get the best colleagues, we can. And we have internal candidates, folks who come up for tenure, for example, and we have to make a decision. If we think they weren't tenure, we give them tenure. If we don't think they're good enough, they're out. It's a merciless thing. And then there are 1000s of finance professors around the world. We could do it to attract one of them. If I'm thinking about the colleague that I have, that's up for tenure, I look at that colleague and I say, oh, okay, I'm gonna give it my best shot, I want an unbiased estimate of their long term productivity. There's no particular bias there. But then if I say no, there's 1000 candidates out there across the world. I'm going to pick the candidate that I think has the best prospects going forward. I've searched across 1000, I've got estimation here on every one of them. Whichever one I select, almost certainly, I've overestimated their ability. In the same way, if Exxon really had a highest estimate, probably, they're the most positively biased in their estimate. I selected out of the out of the 1000 potential candidates, this one I'm most favorably inclined toward, probably have overestimated. So what you see at faculty do and we do this systematically, if you're hiring from the outside, the standard for getting tenure is substantially higher than the standard for getting tenure on the inside. Some would say, well, you're just giving tenure to your friends. Well, we're hiring partners for life here. tenure is a commitment from the college that they will fire you. In fact, it would be really hard for them to even cut your compensation. So it's a sinecure, a job for life. We're not being we're not be casual about giving people these jobs for life. So the real reason that we set the higher standards for outside candidates is this Winner's Curse. Now let's think about it from a finance perspective. I'm looking at all the active managers out there trying to decide which active manager do I want to hire. The natural inclination is to focus on the one that has delivered the best returns. Often it's the best returns over the last year or the last three years. That's a whole nother conversation that we probably should have at some point, but my argument will be your

Bob French 29:46
last 10 years, give them a real time period to work with here. Okay,

Ken French 29:49
even 10 years is not long enough, Bob. I'm gonna want somewhere between 30 and 200 years. It takes a long long time to draw many inferences or draw very good inferences.

Bob French 30:06
Actually, you know, I mean, I think one way to kind of illustrate that point is, you know, you have that anecdote about, you know, how long it takes to prove that stocks outperform bonds, you know, from a reliable, reliable basis. How many years that is that,

Ken French 30:23
that yeah, you use the wrong word there with prove?

Bob French 30:26
Well, excuse me. This is why I'm not the academic. Yeah,

Ken French 30:30
so let me clarify your question, please, we, we can always identify which group one or which asset class was, in the past, when we're trying to do is draw inferences about the future. And it depending on what asset classes I'm going to be comparing to, it takes a lot, a lot of years, decades, sometimes centuries, to make reasonably informed forecasts about which asset class is likely to win over the next 10 years, 20 years, 30 years. It's just an incredibly noisy process. So let's go back to this trying to choose an active manager. If you adjust for the winner's curse, and you're only using, say, 10 years, when you look at all the different active managers pick now is imagine it's instead of having 1000 academics, you could hire, you have 1000 active managers you can hire, it's the same Winner's Curse. You're gonna have fixate on the manager that has succeeded best over the last 10 years. Right, probably, you'll be overconfident about what you can infer, if you're saying, oh, man, I'm going to hire this manager. Because she's almost certain to do a great job, given how well she did over the last 10 years. That's missing the winners curse. If you really understood the winners curse, and the imprecision of securities returns, most of us would just step back and say, This is a fool's game here. I don't want to play. But we can pick this up next week. There's, there's more to say about this. But the bottom line is easy. Most of us should expect to lose when we start chasing active managers like that. I didn't say all of us. And I did not say there aren't any active managers that can beat the market. Don't ever quote me as having said that. All I'm saying is these active managers, they're the scarce resource. There's no reason they should be leaving any of the money on the table for me, even if they tried. I think the actions of other investors are just going to take that money right off the table. Not put it in their pockets, but put it back in the scarce resource, the active manager. So yeah, this this notion of winners curse, and randomness and securities markets. It's a really powerful way to think think about things. Absolutely. And

Bob French 33:19
I think kind of the next piece off of that is always kind of that overconfidence discussion about, you know, how investors well, they're overconfident? Well, not even investors, just people are wildly overconfident in their abilities that bet everything. Yeah,

Ken French 33:39
it's I think you're overstating it when you say people are wildly in their abilities about everything. As you know, I'm a bike rider, and I ride real seriously. I ride with large group of friends. It's hard to be overconfident when you're bike riding. Why? Because there's not a lot of randomness. If I'm riding with the same set of 20 people, I can tell you who's going to get to the top of the hill first. And who's going to join me getting to the top of the hill last. It's it repeats. unless somebody's sick, I know where they're going to slot in. And then what you hate are days where somebody new shows up. Because now you got to figure out where does this person belong? And we're all going to be going as hard as possible so that we don't get left behind, even though we should have beaten the new person who just showed up. So there's some areas where it's hard to be overconfident. When you don't see almost every bike ride or do is what we call sandbag. So it's basically they'll say Oh, no, no, no, you're gonna beat me for sure here. Just

trying to change people's expectations so that they can do better than expected. But normally we have so much information. There's, there's no noise in the process. Plenty of other situations where there's lots of noise. Yep. Including investing. So that's, that's the key thing here. There's so much noise. And people are so confused about how financial markets work. I mean, I've been to parties where people who are not financial experts have bragged about how well they've done in their portfolio. And the ones I love are the ones who report, they've had a positive return over the last 10 years. And it's like, it's not really the right benchmark. I don't tell him that. I mean, there's no upside to telling people they're not really as smart as they think they are. But that's the confusion. I won't even call that overconfidence. That's just confusion about how the world works. The overconfidence comes when I look at folks who really spent a lot of time trying to do this, and end up deciding they know how to pick great active managers, for example, or that's just one of my favorite statistics, is to look at turnover. One thing that people should remember, is, if you think you're going to win by buying some stock, in other words, you think you've under identified an undervalued asset, you're going to buy it, you're going to get a superior return. As a result. Anytime you put yourself in that position, you should ask yourself, who's on the other side of that trade? Do they think they're going to lose? Are they selling this stock to you? Because they think the stock is undervalued? Probably not. You think it's undervalued? So you want to buy it? They think it's overvalued. That's why they want to sell it. No one is wrong. And if your answer every time if I ask you who's on the other side of this trade? Your answer is somebody that's dumber than me. That should make you question. What is it that you really have? That nobody else seems to understand? I'm trying to reframe the problem, right? People are less overconfident.

Bob French 37:47
Right, and I get back

Ken French 37:48
to this overconfidence. One easy thing you'll see if you look at the data, is what turnover looks like. In the stock market. It used to actually be people were holding their stocks for roughly eight months there, they would literally, if we just averaged it across all investors, they were turning their portfolios over about every eight months, 100%. Every eight months, these days, the world is slowed down. They seem to be turning their portfolios over about once every year and a half. What's particularly interesting is, if you look at ETFs, people argue that the amount of ETFs that people are holding these days are evidence that investors have become more passive. They're not trying to beat the market. I disagree. And the reason I disagree is I've looked at what turnover looks like for ETFs. The typical ETF and let me be more precise, the table dollar invested in ETFs turns over about five times a year. So roughly every it's actually less than two and a half months EGD each in ETF investor is turning over their ETF portfolio once every two and a half months. That is hardly a passive strategy. Just because they're buying indexes, they seem to be buying indexes, because they want to trade them very aggressively. So I don't think that's evidence that passive has really won the day. I it just doesn't seem like that's what's going on to me. It's just a remarkable statistic.

Bob French 39:51
It is a remarkable statistic. I didn't I knew it wasn't going to be a pleasant number, but I was I was shocked when you told me it was that Fast that high of turnover, actually want to go back to something you said a minute or two ago about the thinking about who's on the other side of the trades that you're making? Because you're you're absolutely right. I mean, when you trade,

someone is doing the exact opposite thing from you. One of the things that that I think a lot of people in this audience can get a little bit trapped in is kind of paralysis by analysis, if you will. And, you know, thinking about if we know, as a group, were overconfident, and that if we're going to be doing something, we have to be thinking that we're smarter than these people, by and large. How do you reconcile the fact that we do need to make changes to our portfolio? We do need to make trades? You know, how do you think through when to make those adjustments to your portfolio? Or or do anything in the market? Basically?

Ken French 41:05
Well, you have to tell me why you need to make a trade. Okay, I trade, but I'm not trading to beat the market. Right? I'm trading because I want to change my risk allocation, because my personal circumstances have changed. Or I just need to pay college tuition. So I need to sell some stock to do that. There's, there's plenty of reasons other than to beat the market that people need to trade. Okay, there's an absolutely no problem with, you know, one of my kids is about to get married. It's not true, all three of my kids are happily married. But one of my kids is about to get married. I need to get some cash. Let me sell some of my stock portfolio and and pay some of the costs associated with the wedding. perfectly legitimate reason why nobody would have to ask you who's on the other side of that trait. Presumably, it's somebody who's saving for retirement. And they're investing some of the money that they've made. Because they want to save it for retirement, perfectly legitimate both sides of that tree. The trades that make me uncomfortable, are when two parties each think they haven't got a leg up on the party on the other side. So that's, that's the challenge here.

Bob French 42:37
Okay. And, you know, one of the things that you really you made a point of saying we really want to be sure we talked about here today is actually stock buybacks. You know, this is something that is pretty consistently in the news is, I think news for all the

Ken French 42:59
wrong reasons. But I

Bob French 43:00
think it's pretty fair to say it's been a little demagogued in the news. Yeah, so I'll just give you

Ken French 43:06
the sorts of things that drive me nuts. There's lots of problems in the world where the answers are not obvious. You know, really, we worse than not obvious, you know, it's going to be really hard. Even if we had the will to solve a problem. If you can't figure out the solution, you know, all the will in the world isn't a good thing. stock buybacks is is just shooting ourselves in the foot. When politicians get out there and argue that companies should not be allowed to buy back their stock, or let's put a big tax on companies that tried to buy back their stock. Why do I say that? Well, there's lots of reasons, companies might choose to buy back their stock. But I want to focus on what I think are the two big ones. One is management knows a lot about a company's prospects about what their competitors are likely to be doing. What they have in the pipeline. They can often decide, you know, they they're pretty, they don't know, but they can make a pretty solid guess that their company is undervalued. The market just isn't valuing the company as much as the management believes it should be. One thing they might do is take cash that they have and buy some shares. What that will do is act as a signal to the market, that

in fact, the stock price is too low. There's a transfer that happens from the people that choose to sell back to the company to the shareholders that chose not to sell back to the company. So yeah, there's a transfer. But from society's perspective, that's a zero sum. Some people win, some people lose exactly the same amount. And there is a little bit of a benefit. We make prices more accurate. Company has a belief, reasonable belief, their stock price is too low, they take an action to bring it up. Okay, so that's something that we would, there's another even more important issue, to think about when you're deciding whether stock buybacks are actually evil, or good. If I think about what society wants corporations to do, fundamentally, we want corporations to take assets that we currently value at 90 cents, and then turn them into something we value at $1. That makes the world better off. That's a good thing. What are politicians saying, when they do not allow, they don't want companies to be allowed to buy back their shares? Politicians are saying, we know that you really don't have any great ideas, you really don't have any great investment in what you want to do. Let me let me start this over. There's another reason that I think is even more important, why we want companies to be able to buy back their shares. Ask yourself, What does society want corporations to do? Fundamentally, we want companies to take assets that are worth 90 cents, and turn them into something that society values at $1. That makes the world a better place. But suppose the company doesn't have anything good to do with the money that it has in the bank. What it would like to do is just take that money, turn it back to the shareholders and say, You do what you want with this money. If politicians are you gonna say, Nope, that's illegal to do that buyback, what we're forcing companies to do is take assets, that society values at $1 and turn them back into something that society only values and 92 cents, take negative net present value projects, if they were positive, management would have been happy to do them. The problem is they're negative. We're destroying value for society. When met when politicians tell management, I'm sorry, you're not allowed to do those buybacks. What they're really telling them is, and we want you to destroy wealth. We want you to make our society worse off. Obviously, there's some other reasons why companies might be doing buybacks. But I think there's second order relative particularly to the idea of not allowing the company to redistribute or give shareholders back their money, when they don't have something better to do with. It just seems crazy to me. Okay, I Oh, is, in essence, you make enough mistakes by mistake? We shouldn't make one on purpose. This seems like we're making a mistake on purpose.

Bob French 48:47
Absolutely. And I want to get to kind of a big picture statement that you made in that explanation about, you know, when prices when we improve the accuracy of market prices, you know, that's a benefit to society. You know, Can you can you kind of elaborate on that why is, you know, Ford stock price being a little bit more accurate. Why is that such an important thing,

Ken French 49:18
the accuracy of securities prices, it's sure it's important for people who are out there trying to trade and beat the market. That's fine. The much more important part of it is the information it provides to other companies about how much society values different activities. So during what I'll call the high tech phenomenon, 9098 9099 backup when the internet was just going, you know, pets.com is my favorite example. The market was signaling. These are financial I'm in a really valuable enterprises, we want more of this stuff, we want more of this stuff, we want more and more and more of this stuff. And we got it. Most of what we got was a waste. The market basically was sending the wrong signals, and causing people to take the wrong actions. So instead of taking assets of society valued at 90 cents, turn them into $1. We were doing this

abroad, we were sending the wrong signals, and inducing entrepreneurs, to go out there and do all sorts of crazy things. Because they were getting rewarded for doing it. Even though in the end, all the crazy things they were induced to do, didn't produce the valuable stuff that everybody was hoping that it would. That's not to say it was all a mistake, there were a lots and lots of mistakes in what people were doing. I mean, just, I'd love to go back and look to see who bought ads at the Superbowl. In 1998 1999. They were, you know, my again, my favorite is pets.com. And the argument for pets.com was, we don't need bricks and bricks and mortar. What they were really arguing is there's no barriers to entry here. Well, where's the rents gonna come If there are no barriers to entry, it just the deteriorate into perfect competition at best, with no barriers to entry. So it's just you, you would like to have really accurate prices, really efficient markets, because it's really useful in terms of where society ought to be allocating, it's really, I

Bob French 51:48
think that's actually a really, really great place to close it here. Because it kind of gives us that big picture perspective on not just what we're doing as retirement investors or people focused on retirement, but you know, what we're doing with the the financial markets, why, why these things exist. You know, but again, I do want to call out if, if you've enjoyed this if you want, if you want more of my father, you know, we've got him coming back again, next week, to really talk through, again, the five things that well, he knows about investing, you know, what he's learned throughout his career, and, and really, very specifically, how to think about putting your portfolio together, what are the things that you should be paying attention to, as you're making that asset allocation decision as you're putting that portfolio together? Again, that will be Wednesday, next week, April 24, at 2pm. Eastern, and if you haven't had a chance to sign up, just head over to Risa profile.com/podcast. And you'll be able to sign up over there as well. And again, that's going to be in the description here. So with that, thank you so much. I really do appreciate you taking the time here today. And you know, some really, really great stuff to be thinking about and more next week.

Ken French 53:11
Thanks, Bob. I look forward to doing it again next week.

Bob French 53:14
Absolutely. Talk to you later. Bye now everyone. Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you. consult your financial advisor. All investing comes with a risk including risk of loss. Past performance does not guarantee future results.