

Hollow Men, Hollow Markets, Hollow World



Apocalypse Now (1979), based on "Heart of Darkness" by Joseph Conrad

Kurtz: Did they say why, Willard, why they want to terminate my command?

Willard: I was sent on a classified mission, sir.

Kurtz: It's no longer classified, is it? Did they tell you?

Willard: They told me that you had gone totally insane, and that your methods were unsound.

Kurtz: Are my methods unsound?

Willard: I don't see any method at all, sir.

Kurtz: I expected someone like you. What did you expect? Are you an assassin?

Willard: I'm a soldier.

Kurtz: You're neither. You're an errand boy, sent by grocery clerks, to collect a bill.



It is my belief no man ever understands quite his own artful dodges to escape from the grim shadow of self-knowledge.

The question is not how to get cured, but how to live.

Joseph Conrad (1857 – 1924)

Billions of dollars are flowing into online advertising. But marketers also are confronting an uncomfortable reality: rampant fraud.

About 36% of all Web traffic is considered fake, the product of computers hijacked by viruses and programmed to visit sites, according to estimates cited recently by the Interactive Advertising Bureau trade group.

-- *Wall Street Journal*, "The Secret About Online Ad Traffic: One-Third Is Bogus",
March 23, 2014

Over the last decade, institutional management of equity portfolios has increased from 54% to 81%. ...

Institutional buys and sells accounted for 47% of trading volume between 2001 and 2006, but only 29% of trading volume since 2008. ...

One of the most significant results of the tension between fewer market participants and larger parent order sizes is that the share of 'real' trading volume has declined by around 40% in the last five years.

-- *Morgan Stanley QDS*, "Real Trading Volume", Charles Crow and Simon Emrich,
April 11, 2012

I first saw *Apocalypse Now* as a college freshman with two roommates, a couple of years after it had been released, and I can still recall the dazed pang of shock and exhaustion I felt when we stumbled out of the theatre. Nobody said anything on the drive back to campus. We were each lost in our thoughts, trying to process what we had just seen. Our focus was on Marlon Brando's Col. Kurtz, of course, because we were 18-year old boys and he was a larger than life villain or anti-hero or superman or ... something ... we weren't quite sure what he was, only that we couldn't forget him.

When I reflect on the movie today, though, I find myself thinking less about Kurtz than I do about Martin Sheen's Capt. Willard. Both Kurtz and Willard were self-aware. They had no illusions about their own actions or motivations, including the betrayals and murders they carried out. Both Kurtz and Willard saw through the veneer of the Vietnam War. They had no illusions regarding the essential hollowness of the entire enterprise, and they saw clearly the heart of darkness and horrific will that was left when you stripped away the surface trappings. So what made Willard stick with the mission? How was Willard able to navigate within a world he knew was playing him falsely, while Kurtz could not? I don't want to say that I admire Willard, because there's nothing really admirable there, and this isn't going to be a web-lite note along the lines of "Three Things that Every Investor Should Learn from *Apocalypse Now*". But there is a quality to Willard that I find useful in recalling whenever I am confronted with hard evidence that the world is playing me falsely. Or at least it helps keep me from shaving my head and going rogue.

The WSJ article cited above – where it now seems that **more than one-third of all Web traffic is fake, generated by bots and zombies to create ad click-throughs and fake popularity** – is a good example of what I’m talking about. One-third of all Web traffic? Fake? How is that possible? I mean ... I understand how it’s technologically possible, but how is it possible that this sort of fraud has been going on for so long and to such a gargantuan degree that I don’t know about it or somehow feel it? I’m sure that anyone in e-commerce or network security will chuckle at my naïveté, but I was really rocked by this article. What else have I been told or led to believe about the Web is a lie?

But then I remember conversations I have with non-investor friends when I describe to them how little of trading volume today is real, i.e., between an actual buyer and an actual seller. I describe to them how **as much as 70% of the trading activity in markets today – activity that generates the constantly changing up and down arrows and green and red numbers they see and react to on CNBC – is just machines talking to other machines, shifting shares around for “liquidity provision” or millisecond arbitrage opportunities.** Even among real investors, individuals or institutions who own a portfolio of exposures and aren’t simply middlemen of one sort or another, so much of what we do is better described as positioning rather than investing, where we are rebalancing or tweaking a remarkably static portfolio against this generic risk or that generic risk rather than expressing an active opinion on the pros or cons of fractional ownership of a real-world company. Inevitably these non-investor friends are as slack-jawed at my picture of modern market structure as I am when I read this article about modern Web traffic structure. How can this be, they ask? I shrug. There is no answer. It just is.

My sense is that if you talk to a professional in any walk of life today, whether it’s technology or finance or medicine or law or government or whatever, you will hear a similar story of hollowness in their industry. The trappings, the facades, the faux this and faux that, the dislocation between public narrative and private practice ... it’s everywhere. I understand that authenticity has always been a rare bird on an institutional or societal level. **But there is something about the aftermath of the Great Recession, a something that is augmented by Big Data technology, that has made it okay to embrace public misdirection and miscommunication as an acceptable policy “tool”.** It’s telling when Jon Stewart, a comedian, is the most authentic public figure I know. It’s troubling when I have to assume that everything I hear from any politician or any central banker is being said for *effect*, not for the straightforward expression of an honest opinion.

The question is not “Is it a Hollow World?”. If you’re reading Epsilon Theory I’m pretty sure that I don’t have to spend a lot of words convincing you of that fact. Nor is the question “How do we fix the Hollow World?”. Or at least that’s not my question. Sorry, but being a revolutionary is a young man’s game, and the pay is really bad. More seriously, I don’t think it’s possible to organize mass society in a non-hollow fashion without doing something about the “mass” part. So given that we are stuck in the world as it is, my question is “**How do we adapt to a Hollow World?**”. As Conrad wrote, the question is not how to get cured, but how to live. How do we make our way through the battlefield of modern economics and politics, a world that we know is hollow and false in so many important ways, without losing our minds and ending up in a metaphorical jungle muttering “the horror, the horror” to ourselves?



Two suggestions for adapting to the Hollow Market piece of a Hollow World, one defensive in nature and one for offense.

On defense, recognize that modern markets are, in fact, quite hollow and everything you hear from a public voice is being said for effect. But that doesn’t mean that the underlying economic activity of actual human beings and actual companies is similarly fake or bogus. The trick, I think, is to recognize the modern market for what it IS – a collection of socially constructed symbols, exactly like the chips in a casino, that we wager within games that combine a little skill with a lot of chance. There is a relationship between the chips and the real-world economic activity, but that relationship is never perfect and often exists as only the slimmest of threads. The games themselves are driven by the stories we are told, and [there are rules to this game-playing](#) that you can learn. But it’s a hard game to play, and it’s even harder to find a [great game-player](#) who will bet your chips on your behalf. A better strategy for most, I think, is to adopt an attitude of what I call *profound agnosticism*, where we assume

that ALL of the stories we hear (including the narratives of economic science) are equally suspect, and we make no pretense of predicting what stories will pop up tomorrow or how the market will shape itself around them. What we want is to have as much connection to that underlying economic activity of actual human beings and actual companies as possible, and as little connection as possible to the game-playing and story-telling, no matter how strongly we've been trained to believe in this story or that. I think what emerges from this attitude can be an extremely robust portfolio supported by [more-than-skin-deep diversification](#) ... a portfolio that balances historical risks and rewards rather than *stories* of risk and reward, a portfolio that looks for diversification in the [investment DNA](#) of a security or strategy as well as the asset class of a security or strategy.

On offense, look for investment opportunities where you have information that reflects an economic reality at odds with the public voices driving a market phenomenon. This is where you will find alpha. This is where you can generate potential returns when the economic reality is ultimately revealed as just that – reality – and the voices shift into some other story and the market matches what's real. These opportunities tend to be discrete and occasional trades as opposed to long-standing strategies, because that's the nature of the information beast – you will rarely capture it in a time and place where you can act on it. Almost by definition, [if the information is being generated by a public voice it's probably not actionable](#), or at the very least the asymmetric risk/reward will have been terribly muted. But when you find an opportunity like this, when you have a private insight or access to someone who does against a market backdrop of some price extreme ... well, that's a beautiful thing. Rare, but worth waiting for.



I'll close with a few selected lines from TS Eliot's *The Hollow Men*, because I'm always happy to celebrate a time when poets wore white-tie and tails, and because I think he's got something important to say about information and communication, authenticity and deception.

**Between the idea
And the reality
Between the motion
And the act
Falls the Shadow**

What is the Shadow? I believe it's the barrier that communication inevitably creates among humans, including the mental barriers that we raise in our own minds in our internal communications – our thoughts and self-awareness. Sometimes the Shadow is slight, as between two earnest and committed people speaking to each other with as much authenticity as each can muster, and sometimes the Shadow is overwhelming, as between a disembodied, mass-mediated crowd and a central banker using communication as “policy”. Wherever you find a Shadow you will find a hollowness, and right now the Shadows are spreading. This, I believe, creates both the greatest challenge and opportunity of our investment lives ... not to pierce Eliot's Shadows or to succumb to Conrad's Heart of Darkness in our hollow markets, but to come to terms with their existence and permanence ... to evade their influence as best we can, all the while looking for opportunities to profit from their influence on others.

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