"The Placebo Effect"

BOTOX® is the only FDA-approved, preventive treatment that is injected by a doctor every 12 weeks for adults with Chronic Migraine (15 or more headache days a month, each lasting 4 hours or more). BOTOX® prevents up to 9 headache days a month (vs up to 7 for placebo). BOTOX® therapy is not approved for adults with migraine who have 14 or fewer headache days a month.
– Allergan website, April 18, 2016

I've had four or five true migraines in my life, mostly from getting whacked on the head with something like a baseball or a sharp elbow in basketball, and I honestly can't imagine how horrible it must be to suffer from chronic migraines, defined by the FDA as 15 or more migraines *per month* with headaches lasting at least four hours. So I was happy to see a TV ad saying that the FDA had approved Botox as an effective treatment for chronic migraines, preventing up to 9 headache-days per month. That's huge!

But in the fast-talking coda for the ad, I heard something that made me do a double-take. Yes, Botox can knock out up to 9 headache-days per month. **But a placebo injection is almost as good, preventing up to 7 headache-days per month.**

Now 9 is better than 7 … I get that … and that's why the FDA approved the drug as efficacious. Still. Really? Most of the reports I've read say that the cost of a Botox migraine treatment is about $600. That's just the cost of the drug itself. So what the FDA is telling us is that a saline solution injection (costing what? $2) is almost 80% as effective as the $600 drug, *so long as it was presented to the patient as a "true" potential therapy*. If I'm an Allergan shareholder I'm thanking god every day for the placebo effect.

And not for nothing, but I'd really like to learn more about why Botox was NOT approved for migraine sufferers with fewer than 15 headache-days per month. If I were a gambling man (and I am), I'd be prepared to wager a significant amount of money that Botox significantly reduces headache-days at pretty much any level of chronic-ness, from 1 day to 30 days per month, but that at lower migraine frequencies a placebo is just as efficacious as Botox. In other words, I'd bet that ALL migraine sufferers would benefit from a $600 Botox shot, but I'd also bet that ALL migraine sufferers would benefit from a cheap saline shot so long as the doctor told them it was a brilliant new drug, and they'd get as much or MORE benefit from the cheap saline shot than from Botox if they're "just" enduring eight or nine migraine headaches. Per month. Geez. Of course, there's no economic incentive to provide the cheap placebo injection nor the unapproved (and hence unreimbursed) Botox shot if you have fewer than 15 headache-days per month. Bottomline: I'd bet that *millions* of people who don't meet the 15 day threshold are suffering from terrible pain that could absolutely be alleviated at a very reasonable cost if it weren't criminally unethical and (worse) terribly unprofitable to lie about the "truth" of a placebo treatment.

Of course, we have no such restrictions, ethical or otherwise, when it comes to monetary policy, and that's the connection between investing and this little foray into the special hell that we call healthcare economics. **The primary instruments of monetary policy in 2016 – words used to construct Common Knowledge and mold our behavior, words chosen for effect rather than truthfulness, words of "forward guidance" and "communication policy" – are placebos.** Like a fake migraine therapy, the placebos of monetary policy are enormously effective because they act on the brain-regulated physiological phenomena of pain (placebos are essentially useless on non-brain-regulated phenomena like joint instability from a torn ligament or cellular chaos from cancer). Even in fundamentally-driven markets there's a healthy balance between pain minimization and reward maximization. In a policy-driven market? The top three investing principles are pain avoidance, pain avoidance, and pain avoidance. We're just looking to survive, not literally but in a brain-regulated emotional sense, and that leaves us wide open for the soothing power of placebos.

I get lots of comments from readers who don't understand how markets can continue to levitate higher with anemic-at-best global growth, stretched valuation multiples, and an earnings recession in vast swaths of corporate America. This week I'm reading lots of comments post the failed Doha OPEC meeting that oil prices are doomed to see a $20 handle now that there's no supply limitation agreement forthcoming. Yep, that's the real world. And there's zero monetary or fiscal policy in the works that has any direct beneficial impact on any of this.

But that's not what matters. That's not how the game is played. So long as the Fed and the ECB and the BOJ are playing nice with China by talking down the dollar regardless of what's happening in the real world economy, then it's an investable rally in all risk assets, and oil goes up more easily than it goes down, regardless of what happens with OPEC. The placebo effect of insanely accommodative forward guidance that has zero impact on the real economy is in full swing. Oil prices are driven by forward guidance and the dollar, not real world supply and demand. Every day that Yellen talks up global risks and talks down the dollar is another day of a pain-relieving injection, regardless of whether or not that talk is "real" therapy.

Does this mean that we're off to the races in the market? Nope. The notion that we have a self-sustaining recovery in the global economy is laughable, and that's what it will take to stimulate a new greed phase of a rip-roaring bull market. But by the same token I have no idea what makes this market go down, so long as we have monetary policy convergence rather than divergence, and so long as we have a Fed that loses its nerve and freaks out if the stock market goes down by more than 5%. So long as the words of a monetary policy truce hold strong, this isn't a world that ends in fire and it isn't a world that ends in ice. It's the long gray slog of an Entropic Ending. Anyone else intrigued by the potential of a covered call strategy in this environment? I sure am.

But wait, Ben, isn't a covered call strategy (where you're selling call options on your long positions) the opposite of convexity? Haven't you been saying that a portfolio should have more convexity – i.e. optionality, i.e. buying options rather than selling options – rather than less? Yes. Yes, I have. But optionality isn't the same thing as owning options. In the same way that I want portfolio optionality that pays off in a fire scenario (a miracle happens and global growth + inflation surges forward) and portfolio optionality that pays off in an ice scenario (China drops a deflationary atom bomb by floating the yuan), so do I want portfolio optionality that pays off in a gray slog scenario. That's where covered calls (and covered puts for short positions) come into play. It's all part of applying the principles of minimax regret to portfolio construction, where we don't try to assign probabilities and expected return projections to our holdings, but where we think in terms of risk tolerance and minimizing investment pain for any of the market scenarios that could develop in a politically fragmented world. It's all part of having an intentional portfolio, where every exposure plays a defined role with maximum capital efficiency, as opposed to an accidental portfolio where we just slather on layer after layer of "quality" large cap stocks.

The Silver Age of the Central Banker gives me a headache. I bet it does you, too. Let's take our relief where we can find it, placebo or no, but let's not mistake forward guidance for a cure and let's not forget that sometimes pretty words just aren't enough. The truth is that the global trade pie is still shrinking and domestic politics are still anti-growth in both the US and Europe. Neither math nor human nature gives me much confidence that the currency truce can hold indefinitely, and I still think that every policy China has undertaken is exactly what I would do to prepare for floating (i.e. massively devaluing) the yuan. It's at moments like this, though, that I remember the short seller's creed: if you're wrong on timing, you're just wrong. I don't know the timing of the bigger headaches to come, the ones that words and placebos won't fix. What I do know, though, is that an investable rally in risk assets today gives us some breathing space to prepare our portfolios for the even more policy-controlled markets of the future. Let's not waste this opportunity.

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