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Truly sustainable investing

If the planet's very survival is up in the air, how much more precarious is the future of your money? Why, the stuff is made of paper, if that. Besides, the Federal Reserve is out to reduce the purchasing power of the dollar by 2% a year (only consider what the central bankers have done to its value over the past 100 years). Your descendants would revere you the more if you take steps to protect what could be theirs.

And not just to freeze it in amber or stuff it into a safe-deposit box, but to make it prolific. "The Allegory of the Hawk and the Serpent: How to Grow and Protect Wealth for 100 Years," newly issued by Artemis Capital Management, L.P., Austin, Texas, is a guide to investing after you (probably) won't be around to attend to the details.

"Imagine," the author, Chris Cole, Artemis's founder and chief investment officer, leads off, "you have the opportunity to grant your family great wealth and prosperity for 100 years. The opportunity is subject to one final choice. You must decide what assets to invest in and maintain that allocation for an entire century without ever changing it. . . . What do you do?"

Spoiler alert: What you do is put 20% in American equities, 20% in U.S. Treasurys, 20% in gold and the remaining 40% in hedge-fund strategies designed to provide exposure to commodity-price trends and the coming sea change in volatility.

One of the top merits of this imaginative, contrary, lavishly illustrated epic is to take the historical measure of the present day—to see ourselves as posterity may see us.

Do you realize how lucky you are? Cole seems to ask. "By any measure of financial history, the last four decades were one of the most significant periods of asset-price growth ever," he writes. "A remarkable 91% of the price appreciation for a classic 60/40 portfolio over the past 90 years comes from just 22 years between 1984 and 2007." All you had to do was show up, get long and apply leverage (easy enough to say, of course).

Not that the average investor is grateful for the parentally conferred advantages of a timely birth. He or she probably thinks that this is the way it's always been. Cole is at his best in demonstrating the falsity of that smug assumption.

Consider, for instance, the now-reflexive tactic of "buying on weakness," so integral to the grand (and, to date, lucrative) stock-market strategy of "staying the course." "If," Cole goes on, "you had bought on market declines consistently between 1929 and 1970, you would have gone bankrupt three times. A passive index realized a minus 86% peak-to-trough decline in the 1930s and two decades of lost performance."

Cole writes with special authority on volatility, or, recently, the lack of it, subjects on which he has been widely quoted. Observing how little prices have oscillated in the past decade or more, people have come to expect that they will never oscillate. At least, one may so conjecture from the billions that have poured into what Cole terms "explicit short volatility" strategies (e.g., selling short exchange-traded volatility ETFs). Many sell vol to generate the yield that bonds no longer pay.

Lucky for them, Cole proceeds, that they're doing it in this time of financial serenity. "Based on replication using defensible assumptions," he relates, "all explicit short volatility strategies we tested demonstrated complete impairment of capital when implemented robotically over 90 years, even when fully collateralized.

"In a secular decline like the 1930s, or a stagflationary recession like the late 1960s to 1970s, there is a perpetual trend lower in equities and trend higher in volatility. In the 1930s volatility averaged 35-plus. In the late 1960s, day-to-day movements of the markets were correlated, wreaking havoc on mean reversion trades. With this history in mind, consider that between 2017 and 2018, a total of $8 billion in short volatility products collapsed even though volatility and asset trends remained near historic lows. At current leverage levels, what could happen if volatility shocked higher and remained elevated at 30-plus for an entire decade, with minus 50% and plus 50% price swings, as experienced during the Great Depression? Is there a short volatility version of Lehman out there?"

(The Interest Rate Volatility and Inflation Hedge ETF, IVOL on the Big Board, is one of the few listed long-volatility securities available to public investors; for more, see the issue dated May 17, 2019.)

If the allegory of the hawk and the serpent fails to advance your understanding of long-term asset allocation (it seems to have something to do with "cosmic duality"), there's plenty in Cole's pages that will. Admittedly, to an editor of a publication concerned with the art of security analysis, it is reassuring to read: "Passive investing has evolved into a crowded 'liquidity momentum' trade driven by once-in-a-generation capital flows from retirement savings that will reverse in the next decade."

Also pleasing to a reader not a million miles from here is Cole's assertion that "any student of the market or debt history will understand why gold is an essential part of wealth preservation. Gold is also severely under-allocated in pension and retirement portfolios."

Not unrelated to the monetary question is the political question, which Cole addresses with this prediction: "The pendulum is swinging from wealth creation to wealth redistribution."

To be sure, Cole is not the first to write on the evanescence of business organizations (yes, buy stocks, he says, but don't expect Amazon.com, Inc. or Facebook, Inc. to exist in their present form in the year 2120) or on the dangers of what we today call "recency bias."

Edward Atkinson (1827–1905), inventor and economist, lived through the creative destruction that roiled late 19th-century America. Here is what he concluded:

> In the last analysis, it will appear that there is no such thing as fixed capital; there is nothing useful that is very old except the precious metals, and all life consists in the conversion of forces. The only capital which is of permanent value is immaterial—the experience of generations and the development of science.

Cole's "Allegory" will open your mind to just these experiences. It's available at www.ArtemisCM.com.

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