Hello Everyone,

Speed dating, love, war, physics, and money make it into today’s transcript. Who knew business reports could be so fun!?

The bigger question is, “Why do we (as investors) behave the way we do?” I believe the word “incentives” goes a long way in answering that question…but, is responding to incentives a logical or emotional choice? I’ll leave that answer to your healthy imaginations.

In the meantime, I hope today’s missive helps you understand a little better why investors do what they do.

Signed, Your Happy-The-Lobo-Basketball-Team-Is-8-2-And-Off-To-A-Strong-Start Financial Advisor,

Greg

KKOB 12.06.2018 Love, Money & Incentives

Bob: OK, Greg, so this morning we are going to cover subjects like love, technology, and money. And, we are going to do this in three minutes, right?

Greg: Right. It’s kind of like speed dating.

So, let’s begin with a question. Bob, is human history linear or is it cyclical? In other words, is humanity constantly advancing? Or, are we in something of a do-loop of birth, growth, maturity, decline, & death?

Bob: Well, that’s a pretty heavy question for a Friday morning. I don’t know. I guess could take both sides. I mean we are advancing, but I also see us repeating the same mistakes.

Greg. I agree. I would say in the hard-science areas of mathematics, technology, physics, and so on, it's linear. We're getting smarter---and each generation builds on the last.

With respect, however, to things like love, war, and politics--- we tend to repeat old patterns. That's cyclical.

Bob: OK-- but wait----before you go on, you left out a big one---your world of finance. Is finance linear or cyclical?

Greg: I was hoping you would ask. :>)

Obviously, financial technology has advanced from barter, to coins, to ATMs… and now maybe digital currencies. That's linear. Still, it's remarkable to me how we repeat the same mistakes with respect to taxes, currency debasement, and debts.

So, I guess I would say this, in finance we do learn…but not in the same way mathematicians learn. In finance, I believe ***we learn by responding to incentives.***

And, to support my hypothesis, let's do a quick quiz.

Scenario number one. Bob, let's pretend, there is hardly any inflation, and CDs at the bank are paying 15% interest. Under those conditions, would you have an incentive to save?

Bob: No inflation? And 15%! Of course. I would save as much as I could.

Greg: OK---but, if you do that, that's money you're not spending at Wal-Mart, or eating out, or on a new car. And, what if everybody did that? Can you see how millions of Americans saving every dime they could, would make it tough on businesses trying to sell you stuff?

Bob: Sure. In that scenario, businesses would have to contract…which could lead to a recession.

Greg: And recessions are a constant concern for politicians and the Federal Reserve.

So, now let's reverse it. Let's say inflation is running at say 10%...but CD rates are at zero…or even negative. Do you now have any incentive to save?

Bob: No. In fact, at zero, I am punished for saving because inflation is eating away my buying power. So, under this scenario, my incentive is to spend…maybe even overspend…and as fast as I can.

Greg: Exactly. Yet it's from savings we get the seed capital for capitalism. Plus, without savings where is your cushion for emergencies?

Bob: But I do save. I save money in my 401K Plan. There, I get a tax break plus a chance for some growth.

Greg: Right. But I'd say when you do that, you have been incented to transition from saving to investing. Still your point is well-taken--- and it helps me bridge back from our scenarios to the real world.

The consequence of zero percent interest has been this---- it incentivized tens of millions to abandon savings…and instead embrace spending, stock buying through 401K and IRAs, and real estate purchases.

And while this seems great, do you see how that incentive could distort banking, Wall Street, & mortgages?

Bob: Sure. And I think I know where you are going with this. Artificial incentives can lead to imbalances…which must eventually be balanced.

Greg: That's my take. If everyone is incentivized to do the same things, we all end up on the same side of the boat. And if we are all there, it's almost certain we all can't get rich.

Bob: So, to wrap this up, money isn't like mathematics or love. It has elements of both linear growth and repetitive cycles. Therefore, the lesson for investors is to focus on incentives instead.

Greg: I love how you said that---and by loving it, I mean in a reasonable and rational way, of course.

Bob: That was a fun segment. How do people reach you?

Greg: My number is 508-5550. Or, go to my website at zanettifinancial.com

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