



Epsilon Theory

Notes From the Field

The Arborist

August 11, 2017



Shape clay into a vessel;
It is the space within that makes it useful.
Cut doors and windows for a room;
It is the holes which make it useful.
Therefore benefit comes from what is there;
Usefulness from what is not there.

— Lao Tzu (c. 530 BC)

This is the only quote I've used three times in Epsilon Theory notes, previously in "[The Tao of Portfolio Management](#)" and "[Who's Being Naïve, Kay?](#)", because it's such a powerfully wise observation about the vessels we create when we put together a portfolio.

But its wisdom goes way beyond investing. Our days are spent shaping clay into vessels ... our homes, our businesses, our friendships, our marriages, our children ... our lives themselves.

Not every empty space needs filling.

"It is hard to find good explanations for the low-inflation era being experienced by the U.S."

— Jim Bullard: St. Louis Fed Governor, waver of hands, charter member of the *Epsilon Theory* Self-Parody Hall of Fame.

I actually feel bad for Bullard. The cognitive dissonance between what the job requires and what any thinking human being observes must be crippling.

QE and negative real rates are ice-nine. If you don't know what ice-nine is, read "Cat's Cradle", preferably both [the Vonnegut book](#) and [the Epsilon Theory note](#).

Spoiler alert: the world ends.





Lianas are woody vines that climb up trees to get to the light. They're what Tarzan would swing on from tree to tree. They're also the incarnation of evil in the natural world.

The particular bane of my existence is a liana called Oriental Bittersweet, now endemic in the Eastern U.S. and Canada. Like other creeping plagues such as privet and kudzu, the Oriental Bittersweet was originally introduced as an ornamental plant, but found easy pickings in North America once it escaped captivity.

How do you kill the Oriental Bittersweet? Per the latest intel from the U.S. Forest Service, you need to cut the stem and then immediately douse it with Garlon 4 herbicide mixed with diesel fuel or kerosene. Just be sure that you don't get any of that Garlon 4 on anything that, you know, you don't want to kill. Or on your skin. And for god's sake please don't use it in wetlands or anywhere it might get into a stream or pond. That would be ... umm ... not good.

This is what crowding-out looks like in the forest. It's no prettier in the real economy.

I'm a reluctant gardener. I'll work in the dirt because I like the outcome, but it's just that to me — work. I don't get any intrinsic pleasure from the act of gardening, from the growing of plants from seeds to maturity, because I don't see the human art in it. I can appreciate the form and function of the plant itself. But that's nature's art, not mine.

On the other hand, I'm an enthusiastic arborist. Working with trees isn't about the growing, it's about the pruning. It's about identifying the natural, healthy lines of a tree and shaping the tree to follow those lines over time. It's about having a vision in your head of what Treeness *means* in this particular place and this particular plant, and then bending nature to fit that vision. It's this imposition of human will that makes working with trees an art, whether you're expressing it in miniaturized form through bonsai or massive form through four acres of maple trees. That's why I'm an arborist.

At the heart of being a good arborist is recognizing that less is almost always more, that the absence of a branch or limb is as necessary in expressing Treeness as presence. Filling space is easy. That's the default because that's nature's blind imperative, to grow and spread and get more light, regardless of the internal or external consequences. Nature will grow itself into structural ruin, and the arborist must be imaginative enough to see the alternative and brave enough to act. The courage is always in the cut. The imposition of human will and vision is always in the cut. The art is always in the cut.

I rarely use a chainsaw to cut a living tree, or at least a tree that I want to keep on living. For starters, I'm even more scared of my chainsaw than I am of my tractor, which really only goes to show that **I'm not scared enough of my tractor**. More importantly, if you've gotten to the point where a limb is so thick that you need to use a chainsaw on it, then either you're doing some sort of medically necessary surgery or you're making a terrible mistake in the imposition of your vision for this particular tree in this particular place. No, my instruments of choice are the handsaw and the lopper. Just because the courage is in the cut doesn't mean that you need to cut with abandon and leverage.

So as per usual with these [Notes From the Field](#), I've got two arborist-as-metaphors to relate, one for investing and one for the economy.

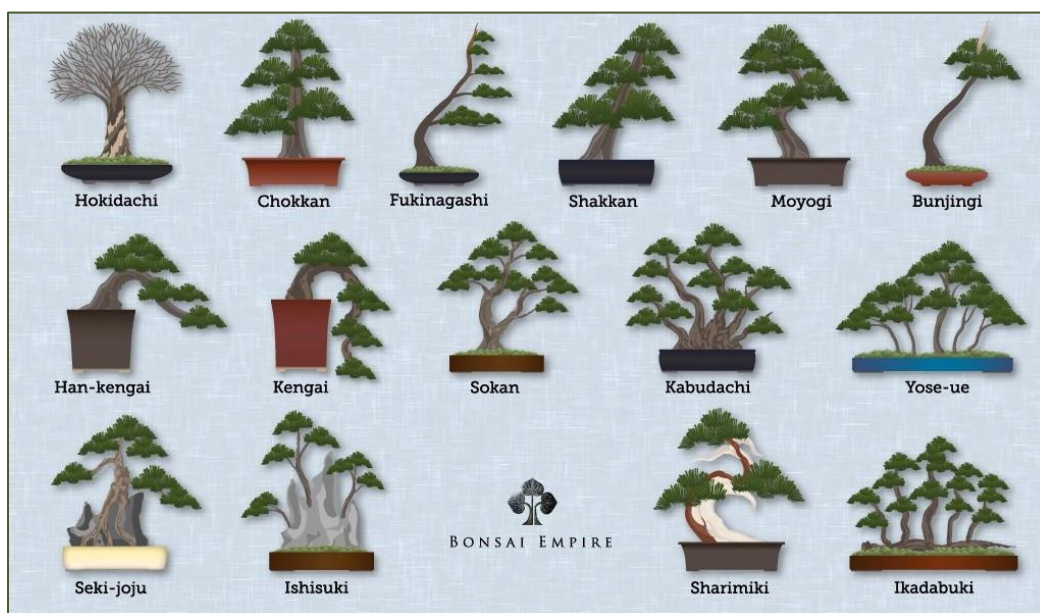
On the investing side, this is the math-free companion piece to Rusty Guinn's "[You Still Have Made a Choice](#)", where we're both saying the same things about portfolio construction and healthy diversification thereof, just in different dialects.

Left to its own devices your portfolio will grow wildly — not to structural ruin, but to structural inefficiency. Of course, by its own devices I really mean by your own devices, and by growth I mean number of positions, not value. The human tendency to keep adding "good ideas" to a portfolio as they come available is at least as powerful and natural an imperative as a tree growing more leaves for more sunlight, and unchecked is just as destructive. A tree pays a price for each branch and limb and leaf it grows. So do you in your portfolio. Each of these investments may be, in and of itself, truly a good idea. But they are *merely* good ideas. Show me a portfolio chock-full of good ideas and I'll show you a tree that is not growing to its full potential, and here I do mean value.

A portfolio doesn't grow to its full potential by having lots of good ideas. It grows to its full potential by having a few *great* ideas. Okay, that seems obvious. Here's one that's not. A portfolio will reach a better outcome by having *fewer* branches and limbs and leaves that all work together to create a harmonious whole — *even if those branches and limbs and leaves are merely good, not great* — than by having *more* branches and limbs and leaves of the same good quality.

The ordinary investor is always looking for a good idea to put *into* the portfolio. The arborist investor is always looking for a merely good idea to take *out* of the portfolio.

Now, there IS a science (or at least a methodology) for calculating whether or not the addition or subtraction of a limb in your portfolio adds or subtracts value compared to the shape of your portfolio now, and that's where Rusty's note ends up. My message is that there is also an art to this assessment, and that we end up in the same place. How? By the marriage of art and science within the mathematics of harmony and aesthetics.



Above is a depiction of the 15 classic bonsai styles, shapes, and forms. There are more, but pretty much every bonsai tree you ever see will be a variation on one of these themes or archetypes. This is the art of bonsai, and an experienced bonsai artist like Mr. Miyagi (you didn't think I could write this note without a movie reference, did you? "Remember, best block, not to be there" is pretty much the finest advice ever on risk management) can instantly look at an actual bonsai plant and tell you its underlying archetype and how to shape the actual plant to fit the archetype more perfectly. OR (and this is the cool part) a true bonsai artist can tell you how to *differ* from the archetype to take advantage of something special about either the plant or its environment or its owner.

Each of these 15 classic bonsai themes can ALSO be expressed in geometry and math. I mean, you can see it pretty clearly with even a cursory knowledge of tessellation (turning everything into triangles), fractals (repetitive forms at different levels of aggregation or magnification), and catenary curves (self-supported minimal surfaces). You have to wave your hands a bit at some of the basing objects (although mountains are also fractals), but you get the idea. This is the science of bonsai, and I have no doubt that a modern scanner plus a rudimentary AI could also measure a real bonsai plant and tell you which archetype it most closely matched and how to optimize it to match the archetype more closely. It can't do the cool part, though, of accounting for uniqueness in the specific plant or its environment and intentionally diverging from an archetype to make something truly special, at least not yet.

Robo-advisors today are based on the scanner + math approach to portfolio construction. A good human financial advisor embodies the Mr. Miyagi artistic approach. Both are arborists. Both know that it's as important to leave things out of a portfolio as to put things in. Both are effective counters to the all-too-human impulses to build a portfolio myopically and without consideration of the whole. Both get you much closer to a more useful and effective portfolio.

In my opinion the best human financial advisor still has an edge over the best robo-advisor, in the same way that human artists still have an edge over non-human artists. Humans are clearly NOT as good in the optimization exercise, which is why robo-advisors have such an advantage in the mass market for financial advice. And to be clear, the robo-advisor is giving high quality advice, definitely not one-size-fits-all. But it's never extraordinary advice. To be fair, the vast majority of human financial advisors don't provide extraordinary advice, either. But if you can find that exceptional arborist, someone who knows when to deviate from the archetypes rather than just optimize ... well, that can create extraordinary value.

So that's my investment arborist-as-metaphor. I'm afraid my economics arborist-as-metaphor won't be as uplifting.

That's because we have no arborists today in the public spheres of politics and economics. We are overrun with Oriental Bittersweet, privet, and kudzu — or as I like to call them, monetary policy, the regulatory state, and **fiat news** — invasive species that crowd out the small-l liberal virtues of free markets and free elections. Even our strongest trees are girdled by the lianas, choked of resources and at risk when the next Nor'easter hits.

This is what I've been writing about in the [recent Epsilon Theory notes](#) on the death of productivity. Why do we have low growth, low inflation, and low productivity, despite the most accommodative monetary policy in the history of man? BECAUSE of the most accommodative monetary policy in the

history of man. Why does the economic ground feel so unsteady beneath our feet, despite the immense power of the regulatory state providing insurance against every ill? BECAUSE of the immense power of the regulatory state providing insurance against every ill. Why are we so profoundly divided and mistrustful as a political society, despite the unprecedented quantity of political news and analysis available to inform us? BECAUSE of the unprecedented quantity of political news and analysis available to inform us.

What's the solution? I don't think there is a top-down solution. It's not Donald Trump. It's not the human equivalent of aerial spraying Garlon 4 on anything and everything. It's not the usual suspects from Team Elite, the Jim Bullards of the world who are so ... lost ... in their mind palaces and hand waving and cognitive dissonance and **magical thinking** that they are hardly recognizable as human beings. I mean that seriously and with sadness. How do you ever come back from a stint as a Fed Governor?

I'm pretty sure that there is no single person, no miraculous candidate for the Fed or the White House, no Moses to lead us out of our liana-infested wilderness. I'm pretty sure that the answer is a Fight Club-esque grassroots movement devoted to Making, Protecting, and Teaching, where *really* old school notions like feudal bonds of personal obligation and trust are reinvigorated through modern technology like blockchain, mitigating both the limits of geography and the unblinking stare of the State. I'm pretty sure that it's a work of decades in school districts and local elections, that it's bird by bird, to paraphrase the wonderful book by Anne Lamott. And that's okay. That's as it should be. A bonsai tree is the work of decades. So is a four-acre grove of maple trees. So is a family office portfolio. So is a local community built on liberty and justice.

You don't need anyone's permission to be an arborist. You just decide to be one. You just start cutting down the evil vines in your backyard. And you cut them down again when they grow back, because they always do. And you teach your children and neighbors how to cut. And that's how the future changes.

The courage is in the cut.

To remix Margaret Mead, never doubt that a small group of thoughtful, committed arborists can change the world; indeed, it's the only thing that ever has.

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