THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

Ep. 17: Where to Put Your Money Now

with guest Mark Yusko

Announcer: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks over Beer hosted by hedge fund veteran and newsletter writer, Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street, to help you focus on what really matters in the markets. Now here's your host, Mike Alkin.

Mike Alkin: It's Tuesday, June 5th, 2018 and welcome to the podcast. If I sound a little echoy, it's because I'm sitting in a hotel room in Monterey, California. Actually, I recorded this on Monday, but you listen to it on Tuesday. I flew out here yesterday to San Francisco, took the nearly two hour drive down to Monterey after I landed. I am here for the Nuclear Fuel Marketing conference, which is a gathering of uranium buyers, nuclear fuel buyers, if you will, because they buy more than just uranium, they buy conversion and enrichment and other stuff ... And a bunch of different industry people. There are traders who trade the physical commodity, a bunch of those here, and there are industry consultants, there's a few journalists.

Mike Alkin: There's a few hundred people that are here, because you get to see the roster. There are four investors, me and three other people that are here. That is a conference that I love to attend. It is way away from Wall Street. When you think about the investment conference landscape that Wall Street puts on, it could be Goldman Sachs, it could be Morgan Stanley, Credit Squeeze, you name it, and some of the smaller firms have them too. They get everyone in a room, the big rooms, and the companies come up and they do their presentations, the dog and pony shows. Then they have breakout sessions where the management teams will meet with investors one-on-one. They can't say anything there that they don't tell anyone else, but it gives investors, professional investors who do business with that firm an opportunity to get to know the management teams a little bit. You can have 500, 1,000 investors in some of these.

Mike Alkin: If you go to, during conference season if you will, the fall and the spring in New York or San Francisco or Dallas, wherever you are where there's big money centers, and Dallas has a great hedge fund population down there. If you're in any of these bigger money centers where there's big money management firms, you will see these conferences, and they start to hit one after the other after the other. You have, in the corner of the room looking up top, what you would see is hundreds of people scurrying around, all looking for that insight, that investment edge, all gathered in the same place. It's kind of hard. When there's a lot of eyeballs looking at something, it's kind of hard for that investment edge to be gleaned. What do you know, what can you learn that other people aren't learning?

Mike Alkin: I learned early on in my career to try and look, look elsewhere where others ... I started out as a short seller, and when you're taking that kind of risk of shorting stocks, because there's unlimited downside, if you will. Meaning the stock could keep going higher and you can get carried out, you have to look for an information ledge, and you tend to do that by looking where others aren't. Fish where, fish in a corner of the lake where no one is. When I come to a conference like this and I see just so few investors ... If you're new to the podcast, you may not know but I spent a lot of my time in the uranium space for the last couple of years, last two and a half years or so, something like that, because I'm a contrarian investor.

Mike Alkin: Wait, I know, I'm going to get a few emails that say, "Stop saying contrarian. That means you're a value investor." Actually, for those who write those emails, sorry, no. Because contrarian means you're taking an opposing view, and when you're shorting stocks, you're not a value investor. Just a point of note, I digress. I've seen in the uranium world, and I'll just use that as an example. It happens to be my travels today and that's why I'm taken here. It's been a bear market for seven years, and the narrative is extremely long in the tooth, my opinion. You try to get a gauge, and I've gone to these conferences before. I like to see who's in attendance.

Mike Alkin: My opinion is a year from now, we'll see 30 or 40 investors here. All of a sudden, they'll have gotten this great idea that they should go to this pretty new, cool conference they heard of. When you're forming a variant perception as our friend Jonathan Tepper's firm is called, and I love it, you're having a view that's quite different than others, that's contrary to others' view. To do that you have to kind of go and look outside the norm for information. Being around people who are in the industry, who live it, breathe it and sleep it, who are sucked up in the narrative, if you go to these things for a while, you could kind of see if that narrative starts to change.

Mike Alkin: The conference starts this morning. I was able to spend some time with a couple of people last night, and I'm quite glad I came. It also got me thinking. I had time to listen to podcasts on the plane, the advent of Wi-Fi makes that easy. I love to listen to a lot of other investment podcasts, and there's some really good ones out there. What I realized is ... I'm new to this. I think this is my 17th episode of the Mike Alkin Show. What I've realized is that, I try and open up, I'm learning how to do this. What do people want to hear? I wait and I get some emails. For a while, we were joking. If you're new to this, my podcasts tend to go lengthy. Boy, I used to get some really, emails saying, "Hey, love the podcast. way too long."

Mike Alkin: I'd get people tweeting me, I'm @FootnotesFirst on Twitter, complaining about the length. I brought that up and people said, "No." The overwhelming majority of emails and tweets I got was, "Keep it this long, because you're willing to give your time and your experience, to share your insights. We're happy to have it." It's not just a 20 minute soundbite. Again, it's a little lengthy. One of the things, so as I'm learning and morphing into a podcast host, if you will, for what I do, this hour and a half of every week or sometimes two hours is, what is it that the listeners will take the most value? What will you find the most value? I started out and I did the, "Here's the market overview of last week, and here's my macro view, and here's this and here's that." I'd give you my view. My views are more bearish than bullish, and I'm not calling for the world to end, but I think that you got to be really cautious here.

Mike Alkin: I spend probably 15 minutes each week talking about that. That's way more time to an hour program, hour and a half, two hour program that I think is really warranted. Because I don't spend too much time focusing on the macro. I have a view, I know what I look at, and it doesn't change that much. All the other stuff that happens week-to-week, the headlines, the jobs reports and this and that, it's all kind of noise to me. I kind of know what I'm looking for, and when I have a change to that, I will share that with you. I'm not going to open it up with the Dow, the S&P. You could look at that, and I'm just wasting your time, I'm wasting everyone's time with talking about that. If I have something that's meaningful, I'll talk about that.

Mike Alkin: Today, I really wanted to talk about variant perception. I wanted to talk about, I've started this portion of the podcast called Hedge Fund Corner. Because I, trying to bring to listeners, to you the experiences that I've had throughout my career. You have to recall, when I started I was not a young guy coming out of college who knew that I wanted to buy a stock with my first paper route money at 12 years old. I had no idea what I wanted ... I didn't know anything about stocks 'til I was probably older. I had no interest in it. I'm not going to rehash my story, but it's atypical of winding up as a partner at a big hedge fund, because it was the last thing I even, forget about wanted, I didn't even know about.

Mike Alkin: Through a circuitous route, I wound up at Financial World Magazine with an accounting degree as an intern, and then a cub reporter. The thing that landed me there, besides not being qualified but having an editor who liked the fact that I was a hockey player. When I walked in for the internship interview and I saw that he had hockey stuff all over his office, I thought, "Wow." After speaking, 20 minutes, a half hour later, I was an intern, so that helped me. I didn't really know, but I had gone, I had an undergrad in accounting but I was going to night school to get a master's in journalism, which I didn't finish.

Mike Alkin: Halfway through, I got Financial World internship and then a full job, but then I figured I didn't need it because then I went to work at hedge fund. I did, I was a curious guy, a skeptical guy. I had like a reporter's nose, if you will. When I started at Financial World, I started to work with reporters there, and I had a knack for the numbers with an accounting undergrad. It wasn't 'til one of the editors there said to me, "You should, you know as much as these hedge fund guys. You should go work at a hedge fund." Long story short, one thing led to another and here I am 20 something years later.

Mike Alkin: I always, but in doing that job, you're looking, you're digging, you're trying to find out information. I started in the hedge fund business at a short only fund. When you're betting against the consensus on the short side, like I said in the opening, it's not easy, so you better go do your own field research away from where everyone else is congregating. You better go do your work away from what the sell side analysts, the consensus are saying. Because when you hang out with consensus, you become consensus. You have to figure out where to go. Over the years, last couple and a half years, one of my ... On the long side. Has really, my primary, only focus on the long side has been uranium. I say "only," I mean it's 98 percent, 95 percent. On the short side, I look at anything except uranium. I came at the uranium thesis a couple years ago through the eyes of a short seller.

Mike Alkin: I don't like mining companies, typically. They're cash consumers, but they're deeply cyclical and there are times that I do like them. I come at investments with, "Can I break the short cases?" With uranium, if I was able to prove the short case, then I'd go on and look at something else. For me, when something's down 90 some odd percent, it's worth my time and attention, spend some time and away you go. I'm not going to turn this into a uranium podcast, but it is ... I know if you're listening to this podcast, I have a lot of individual investors, and that's who I do this for. You have full-time jobs. You can't be getting on a plane and going to Monterey California, because you don't invest for a living. You might, but you likely have a full-time job. I want to open up your mind to thinking about how to start to form variant views and anti-consensus views and how to think about going about the research process or where to look for, try to find people who are doing that type of research if you can't do it yourself.

Mike Alkin: Now interestingly, I mentioned the roster of people who are here. Who is not here is I don't see a single sell side analyst here, the guys who form consensus. Now, somebody might show up this morning, but I tend to doubt it, they weren't on the roster. Think about that. There's a handful of guys covering this ... I say "guys," people covering this industry, where you can find out tremendous information that's perfectly legal by talking to industry participants. They're not here. Why? Because they talk to management teams. Well, that's great. Management teams can only tell you what they tell everyone else. We're going to talk, my guest today, we're going to talk about this because I want to talk about the way to think about allocating capital because there is ... I often, I see this through the emails I get. Talk about position sizing and portfolio management, I see, I can just tell by the emails with the questions I get, they don't ask that, but there's a pattern that I see, and pattern recognition, probably to me, is one of the really most important things.

Mike Alkin: You learn from experience what pattern recognition is, how to recognize things. It could be in management teams, in cycles, in trading. It could be in anything. The pattern that I see is, I got a feeling that portfolio composition, asset allocation is not high on the priority or if it is, it might be stuck in the past. Things change. There are different asset classes when you think about it. We're talking stocks, bonds, currencies, commodities. You could say real estate and all that stuff, but real estate is backed by something, debt to bonds. Those are kind of like the four things that you could look at. Then there's different geographies and different regions, but that's kind of how you think about it.

Mike Alkin: I often, you know what? When we're talking about like uranium mining, for instance, you have to think about what that is. It's a mining company, so it's highly speculative. People might be investing in speculation. I think it's important that people understand what role that plays in their portfolio. You have to think about, where are you? What's your investment objectives? Where are you in the lifecycle? Are you in your 50s or 60s or should you have a more conservative bent? It doesn't mean you can't participate in a speculative investment, but as a percentage of your assets it should be very small because of the speculative nature of it. If you're younger and you're in your 20s and you're in your early earning years, it could be a greater percentage because you could recoup those losses. Now as a professional manager, you have an investment mandate, or an analyst, but you have a mandate and it doesn't mean that you ...

Mike Alkin: You might have a portfolio, you might be a deep value manager, but you could see something really highly, highly speculative that may have a chance of working. If it works, it could be a 20, 40, 50, a 100 to 1 return, and if it doesn't, it could be a donut. I'd say you do your work, but if that's the case where the asymmetry is so exceptional, there's still that potential for total loss, then you have to size it appropriately. Maybe there's a very, very tiny percent. You can't just think one way. You have to think about your portfolio in all different manner. I do believe that asset allocation drives returns. I've seen the hedge fund industry evolve amazingly.

Mike Alkin: My guest who's coming on today is going to talk about that. I'm going to ask him a lot of questions regarding that because he allocates money to hedge funds. When you think about that asset class, if you will, long/short equity, it's been an unbelievable evolution that we've seen take place. We've seen that George Soros, Julian Robertson, those early pioneers, Stan Druckenmiller, put up massive returns. Stan, I think, was up 30 percent a year, and a lot of that was done on macro, big macro bets that they made. Then that led its way to a newer crop of managers coming out, when hedge funds were starting to really grow. It's just when I started as an analyst. In the mid-'90s or so, you started to see it grow more. As these big assets came in, you started to see more just long/short equity with a little less risk taking, because to generate those type of returns, those guys were making big bets. I think it was either Soros or Druckenmiller who had a ... Their view at the time was if you have a really big investment edge, be a pig. Go for it.

Mike Alkin: Then as the institutions and the endowments came in, it was more stable money, but they didn't really like that volatility, and so you started to see the ability to step back and do something really unusual by these managers. They were managing big pools of capital by this time, it started to grow, and they were generating nice fees. These managers had made a ton of money, and that kind of takes away your risk appetite a little bit, takes ... When you have a very small amount of money in the fund, as a fund manager, you really want to grow it, but when you've already made a lot of money for yourself and for your investors, you kind of tone it down a little bit. Your institutions don't want too much, they don't want a lot of volatility, they just want steady returns, and that kind of dampened returns for a while. You heard me talk about, if you listen to the show, a couple of shows ago or maybe last show, I forget.

Mike Alkin: I talked about how hedge funds are not fully invested. They could be 20 percent long, 30 percent long, 40 percent long in the market, so they're going to underperform the big, rising market. I think it's important to think about when you're making your individual investments, it's important to look at who owns these stocks, whatever it is. Who are the big shareholders? Are they big hedge funds or are they coming into the stock after it's had a huge move? Is it big mutual funds? Is it a private equity firm that owns a big stake of the company?

Mike Alkin: It's important to understand when you're investing in any of these companies who the larger shareholder bases are and what their motivations are. Are you investing in a smaller cap mining company that has a huge fund that owns it? How's that fund doing? Is that that fund, do they own, is their MO to own 10 positions? Is it to own 15 positions? Are they having a tough couple of years? Are they likely to get withdrawals? Because if they are, that could put undue selling pressure on the stocks you own. It's always good because there's a lot going on behind the scenes other than just the fundamentals. There are some times when I'm looking at a stock that I might know pretty well and I see unusual movements and there's no news.

Mike Alkin: Why is this stock going down? Why is it going down a point a day and why is volume picking up? Conversely, why is it going up? There's no news. I can't understand really why that's doing it. Well, you know why? Because it could be that one of these really big funds is having withdrawals and they have to clear out some positions, or they just got a ton of money in and they have to go buy it, so in the day-to-day trading of these things there are some different things, but sometimes it can really impact the way some of these stocks trade. I think it's important, really to think about sizing your positions. It's important to think about what your objectives are. The way that I think about it is when I look at each company, the risk, reward for me, the ones with the best risk, reward. Risk, I'm thinking about whether it's speculative, whether it's more of a stable company. You size it based on that and then depending on how the position's moving, you have to keep reevaluating that.

Mike Alkin: I want to talk more about, start getting into stuff like that than I do just giving you my quick macro view and stuff. Today's guest, we're going to focus on that. You might know him if you're a Twitter follower. He's @MarkYusko, Mark Yusko, who's going to be our guest today. Mark, I'll let him tell you his background, but he has a story background. He's a capital allocator, and he ran the endowment at the University of North Carolina. He now runs Morgan Creek. Mark had the benefit of seeing, in the early days, the evolution of the hedge fund industry. He got to see the Julian Robertson and the Lone Pines and the Vikings and the Mavericks. These may not be names that are familiar to you, but they're the legendary hedge fund managers of the second generation.

Mike Alkin: Mark got to see them in the early days and he's seen the evolution of the industry. He's got to see how they allocate assets and how he, as a fund manager at Morgan Creek, how ... He may not be investing in the individual securities, how he thinks about allocating assets across geographies, across market caps, inter-managers who manage these different ways. I think that Mark has some really interesting insights. He's a friend of a friend of mine, Reid Walker down in Dallas, Texas. I met Mark at a get-together that Reid had about a year or so ago. I think you're going to find that he has some interesting insights. Without further ado, Mark Yusko. Good to talk to you.

Mark Yusko: Great to be here, and thanks for catching up from beautiful Monterey, California.

Mike Alkin: It is a treat. Yeah, you and I met about a year ago and we have a mutual friend, Reid Walker, who's a retired hedge fund manager. Reid puts on an annual conference where he has emerging managers come down to talk to investor friends. I think he puts like 50, 60 people in the room and he puts a lot of effort into that and he does a really good job of matching capital allocators with young managers. It's interesting because you've seen all sorts of hedge fund managers in your career. For the listeners who might know you, obviously, if anyone's a Twitter follower, you have a huge Twitter following and you're very active, and I love watching your stuff. Share with people your background, if you can.

Mark Yusko: Yeah, so I love it. I love a couple of things. One, I love the idea of Reid being associated with the word "retired." Because the guy works more than all of us put together.

Mike Alkin: He's still the- [crosstalk 00:26:26]

Mark Yusko: He calls it the VFW, right? The Veterans Fund Warriors, and there are a lot of people who, because this industry has changed so dramatically, I'm sure we'll talk about that later. The industry has changed so dramatically that a lot of really smart, talented people who have basically ditched the headaches of the industry with Dodd Frankenstein and Regulation FD. One of my good friends from the business from many years ago, Jim Pallotta, at Raptor Group, when Regulation FD came out, he's a good South Side Irish guy from Boston. He's like, "Regulation FD, fucking disaster." It just changed all this idea of doing more work than other people.

Mark Yusko: I mean, you were just, before we got started, you were telling me you're out at a conference where it's mostly industry people, and only a couple investors. That's a huge contrarian indicator when there are no investors there, where they were tripping all over themselves at a big conference in China earlier this year, according to our guys on the ground in Shanghai. To talk to industry people, it used to be a good thing. It wasn't frowned upon, it wasn't considered inside trading, so it's just crazy how the world has changed.

Mark Yusko: To answer your question, so my background is pretty simple. I got into investing by accident. I say my life is actually a series of happy accidents in the sense that I went to school to become an architect, decided I didn't really like that. My dad wanted me to, then to study engineering and become a consultant like him. I didn't like that either, so I decided to do what I liked, which was science, and thought I was actually going to be a doctor but couldn't answer the question, "Why do you want to be a doctor?" on the med school apps, and decided to go to business school. Went to business school right out of undergrad, which I don't recommend to anybody but it worked for me because it was just like an extension of undergrad.

Mark Yusko: Then I took a job with an insurance company and then I had my first happy accident, which is the guy who was doing investments retired. I took over the portfolio with my boss, the CFO, and I learned how to manage bond portfolios, which didn't seem very exciting but it was 1987, a lot of stuff was happening in the markets, so it actually was a kind of fun time. I say I got to hire Dan Fuss before he was famous, one of the most famous bond managers from Loomis Sayles.

Mike Alkin: Right.

Mark Yusko: We did a lot of interesting stuff. Then I went to work for an equity management firm run by two professors at Northwestern. They had a billion dollars back when a billion dollars was a lot of money. Think about that. Two professors at Northwestern form a shop called Disciplined Investment Advisors. They were the first customers of Compustat. They got the tape and because it was snail mail back then, they had a four-day head start on everybody else in running the tapes and finding- [crosstalk 00:29:29]

Mike Alkin: Mark, didn't we used to ... Then we got a disc, I think, once a month sometimes they used to send it out. I felt like there was always an update disc that would come along, if I'm not mistaken.

Mark Yusko: Absolutely, and that's another great point, right?

Mike Alkin: Yeah.

Mark Yusko: Is they were dealing with the source data, not the revised data. When people go back and do these back tests, they always look at the data as revised instead of the true source data, because you can't make decisions in real time. Like right now, here we are, we're just coming past the end of the month. Well, you don't have the month-end data, but people then, two years from now are going to go back and do a back test and say, "Oh, the May data was this." Like, "No it wasn't. Not in real time."

Mike Alkin: Exactly.

Mark Yusko: We did that and I, again, had my second happy accident here working for this firm, there are only five of us, we had a billion dollars. Now that didn't pay the young guys anything, but eventually maybe we did okay. I got a call from my alma mater and I wanted to go back to Notre Dame more than I wanted to manage stocks, so I went back to Notre Dame and I discovered the endowment model of investing. What does that mean? It's a term around ... The bottom line is it's really three things. One, it's a value orientation. You try to buy things that are on sale and sell things that are expensive.

Mark Yusko: Two, you try to take advantage of time horizon arbitrage, which is you try to take advantage of you being a perpetual life fund and everybody else having a finite life and so you can accept illiquidity in private real estate, private energy, private equity, private debt, venture capital, and that's a huge windfall. If you look at difference between endowment returns and everybody else, that's where the bulk of it comes from.

Mark Yusko: Then the third is it's really an active management focus, and not that passive management doesn't have a role, but unless you're trying to deploy hundreds of billions of dollars, I just think you're better off being an active manager and finding the highest, the best talent. Now it's hard to find talent in this business. There are 10,000 hedge funds. Are there 10,000 good ones? No. My joke on that actually, Mike, is that there really aren't 10,000, there are 40,000. Because we've actually met all 10,000 and they're all in the top quartile somehow, so there must be 30,000 bad ones somewhere, I just never met them.

Mike Alkin: They're hiding out, right?

Mark Yusko: Yup. Anyway, fast forward really quickly. I spent five years at my alma mater, I was the number two guy, I was always going to be the number two guy. Scott Malpass has done a great job there, he was going to be there forever. Job offer came up in North Carolina. Told my wife, "There's a job in North Carolina." She said, "Take it." I said, "Don't you want to know what it is?" She said, "No, I just want to live in North Carolina." As usual, she was right. Moved down here in 1998 and the great thing about coming to North Carolina is their portfolio was so broken. It was in the 84th percentile, one of the worst performing funds in the country, and everything I did ... I use the basketball analogy. Everything I did the first year was a reverse tomahawk slam. Second year, layup. Third year, free throws. Fourth year, had to take a jump shot, and not 'til year five do we have to shoot a three pointer. We- [crosstalk 00:32:49]

Mike Alkin: It was like the CEO taking over a company after the deck has cleared, right? After they- [crosstalk 00:32:54]

Mark Yusko: Oh my gosh. You absolutely always want to come into a bad situation.

Mike Alkin: Exactly.

Mark Yusko: The key is they had no alternative, literally zero alternatives when I showed up. By the way, I hate the term "alternative" because [crosstalk 00:33:07] alternative to what? Right?

Mike Alkin: Yeah.

Mark Yusko: There are stocks, bonds, currencies and commodities. Those are the only four things you can own, there's nothing else. Whoever thought of the word "alternative," by the way, was not a marketing genius because people don't like alternative stuff. Alternative medicine, alternative education, alternative music. They don't like alternative stuff, they like traditional stuff. I came in saying, "Hey, I want to put us 60 plus percent in hedge funds, 30 percent in private, that's where all the talent is." Think about it. In every business that you and I know, the best person charges the most money. [crosstalk 00:33:41] Doctor, lawyer, football coach, basketball player. I think LeBron probably makes more money than other players, right?

Mike Alkin: Yeah, yeah.

Mark Yusko: Stephen makes more money than other players. It's just the way it is. In investing, somehow we've been bamboozled, I say "bogalized," that we've been convinced that paying low fees is what matters. It's the dumbest thing I've ever heard. If you have your money managed by the lowest fee products, you have your money managed by the worst people in the business because if they were better, they'd charge more.

Mike Alkin: [crosstalk 00:34:05]

Mark Yusko: They key is that we did change, and in fact, you'll love this. When I showed up in North Carolina, I said, "Here's my plan" to the board. The board meetings are open, so the press gets to come. What they wrote after my first board meeting was, "What Mark Yusko wants to do is akin to taking grandpa's CDs and exchanging them for Wall Street's riskiest schemes." I was like, "Well, welcome to North Carolina."

Mike Alkin: Yeah, welcome to, yeah. Sounds- [crosstalk 00:34:31]

Mark Yusko: Now to be fair, the rest of the article actually wasn't horrible. It talked about Markowitz diversification and low volatility compounding. Now that was on page 16 behind Hints from Heloise, so they didn't see that. They just saw my young face on the cover selling grandpa's CDs, but we did take it from the 84th percentile to the top five percent. Then in 2004, I got approached by a couple wealthy families, another happy accident and they said, "Would you be our outsourced CIO?" I'm like, "Great. Don't even know what that is." The term didn't exist yet, and so we created an OCIO business back in '04. We morphed that into more of a fund-to-funds business. Then we morphed that into a hybrid fund business, where we manage about half the money internally. We outsource about half of it to managers. Now we're recreating ourselves again to really focus on the crypto economy and blockchain technology, et cetera, which I'm sure we'll talk about later.

Mike Alkin: Absolutely.

Mark Yusko: That's the long version of my background, so I apologize.

Mike Alkin: No, that's fabulous. You grew up in the hedge fund industry, essentially the alternative space around the same time I was. I started in the '96, '97 timeframe, and there were not a lot of hedge funds at the time.

Mark Yusko: No, no.

Mike Alkin: Obviously, right? It was a handful.

Mark Yusko: Yup.

Mike Alkin: You had Soros and Robertson. One of the things at the time I recall, and this fund I was at was a short only fund, and so I was running a small amount ... The whole firm had 120 million in assets so-

Mark Yusko: Oh, you were one of those evil, un-American guys, Mike.

Mike Alkin: One of the evil, un-American guys who ran around the country posing as students in for-profit education centers to get them to do their bad stuff and turn it over to the Department of Education and the House and Senate sub-committees, and point out the fraud that was taking place. It was good old fashioned Sherlock Holmes type detective work. At the time, I don't think, and when I think back to it, I don't think we were sending out monthly letters, and I don't think we sat around, as I was learning the business, sit around in meetings ... I don't remember the general partner talking about, worried about his monthly volatility. It just wasn't part of the thought process.

Mike Alkin: Other guys, as I started to meet them, were not as concerned with the allocators on a month-to-month basis. Somewhere along ... Right? Somewhere along the way, as we've seen the huge growth in hedge funds, like you say, the 10,000 and I don't know how many trillions of dollars sitting there, we've seen this institutionalization take place. I mean, you've got the brilliant ones, the Tiger Cubs, the Mandels and the Halvorsens and all those guys, and then a whole spade of them who've done so well, but it seems like there comes a point where, I don't know if it's too much assets or too much institutionalization where guys get so big, they're afraid to take ... Not afraid to take risks, but they don't need to take risks anymore and it's-

Mark Yusko: Oh, they don't want to jeopardize the gravy train. Look, you bring up the most important issue of, and we could spend the whole day talking about it. We don't have all day, so ... You brought up the most important issue in the alternative investing space and the hedge fund space and the private investing space, which is size is the enemy of alpha, first of all. The second problem is, look, I had a venture capitalist tell me at the peak in 2000, I was busting on venture capital funds for raising a billion dollars because I don't think you can do early stage venture capital with a billion dollars. He said, "Look, let's face it Yusko, I've done the math and at 800 million, I make more off management fees than I do off carry."

Mike Alkin: Wow.

Mark Yusko: I look at my partner, I'm like, "Did he just say that out loud?"

Mike Alkin: Wow. He didn't cop to that, did he?

Mark Yusko: Then it was worse. Then he said, "Look, this is a game of enriching the general partner, not the limited partner." I was like, "Oh my gosh."

Mike Alkin: Wow.

Mark Yusko: Okay, so really the world has turned completely upside down. What's really amazing is, as you said, we came up in the business the same time. Back when I started at Notre Dame, I started '93, '94, we went to the board for the first time to recommend doing some investment hedge funds. You would have thought I'd asked them to sell their kids into slavery or something. I mean, "Oh my gosh. You don't ... That's where all the criminals are. That's where all the bad people are. These people, these aren't institutional, quality investors. These people are doing shady things in shady places. There's no risk management." "Wow, are you kidding me? Have you been inside Julian Robertson's shop? The guy controls risk way better than any of you, by far. I mean, it's not even close."

Mark Yusko: By the way, when you take leverage plus short selling, both of which enhance risk, if you lever an asset, you're enhancing the risk, and if you make a short sale, you enhance risk because you have unlimited loss. When you put the two together and you take a dollar of equity and you increase the long side by 50 percent in terms of leverage, so you have $1.50 long, and then you take a dollar short, okay, so now you have $2.50 of equity, or of assets for your dollar of equity, so the classic Jones model, A.W. Jones was the founder of this.

Mike Alkin: Absolutely.

Mark Yusko: That is only 50 percent net exposed to the market, so by definition, you have less volatility. If, now this is a big if, if the manager has any skill and can generate alpha, then you've actually got this beautiful wins in both worlds, where you win in the up markets because the alpha is leveraged, and you win in the down markets because your net exposure's lower. The idea that these were bad people doing bad things, which is crazy. It doesn't mean that there weren't some bad people. There are some bad people in every business. There are bad people in manufacturing, there are bad people in hedge funds, there are bad people in law, there are bad people everywhere. If you can do your due diligence and you can build your relationships ...

Mark Yusko: To make a long story short, we convinced them that hedge funds were not evil, and we did a little bit. Then when I got to UNC, you'll love this, I came in, and this is, I came in in '98 and by '99, late '99, markets were really frothy. In our fourth quarter of '99, our equity portfolio, our domestic equity portfolio was up 40 percent, 4-0, in a quarter. You say, "How is that possible?" Well, we were super overweight, micro-cap-

Mike Alkin: Well, I know how it's possible, because I was on the short side of a portfolio getting run over, so I know how that's possible.

Mark Yusko: Oh no, no, I mean you were right there, because this was the craziness. This was the Fed putting half a trillion dollars, back when 500 billion dollars used to be a lot of money, into the economy to try to prevent Y2K, which was a big hoax, but they were worried about it, and so all these micro-cap stocks, all the things you were short, went crazy up. We had Nicholas-Applegate and Oxley and all these great managers, Tom Marsico, and we crushed it.

Mark Yusko: I come into the February board meeting, I said, "Guys, we need to rebalance. We need to take chips off the table. Long, long, we need to buy hedge funds." The Chancellor turns to be says, "Oh, jeez. That's going to be a problem because the board banned hedge funds two years ago." I was like, "Okay, well first of all, that was not disclosed in my interview. Second, that's going to be a problem because we have to get hedged here because valuations are crazy, like stupid crazy." I said, "All right, here's the deal. We won't do hedge funds. We'll do long/short equity, absolute return, enhanced fixed income and distress debt."

Mike Alkin: Semantics.

Mark Yusko: The Chancellor looks to me, he says, "That's just nomenclature, right?" I said, "Yeah." He says, "Good, as long as we're clear," so we did go to 60 percent. We did stay flat from 2000 to 2002, when everybody else lost 30 percent. Again, I'm never going to break my arm patting myself on the back for not making money. Our job is to make money, but preserving capital is job number one. My hero in the business, Roy Neuberger, went in the office every day 'til he was 94, managed his own money 'til he was 101. Finally passed at 105. I mean the man said, "There's three rules to managing money. Rule number one, don't lose money. Rule number two, don't lose money. Rule number three, don't forget the first two rules."

Mike Alkin: I worked for Joe DeMenna around that time and that was in our rule book. It was just as you said. You think about that, you talk about risk management and the risk management that takes place in these hedge funds is tremendous, in most of them. I shouldn't say all of them, but so when did it change? I try and think about this because after a lot of the hedge funds did well after the Internet bubble and capital started flowing into them, I think back to my days, whether it was at Reid's or when I was at Knott, we would meet with a lot of institutional investors and it seemed the allocators changed. It became much more of a box checking exercise.

Mike Alkin: If you were lucky enough to ... Malpass, they were an investor of ours. If you were lucky enough to get the guys running the firms come in, the running the endowments, you could tell there was that level of sophistication. Then there was other layers that formed, and it seemed as though those box checkers who would come every six months or once a year, and they would come in with their questions, and they'd have their laptops open. They didn't understand the art, sometimes, of what we were trying to accomplish.

Mark Yusko: Oh, no way.

Mike Alkin: How has that ... Because I personally think it's really affected, especially newer managers who are afraid to take the risk necessary to outperform. It seems, so the big, huge hedge funds are, they're happy doing what they're doing, and they're not going to lose their investor base if they underperform a little bit, but for the newer crop who's afraid of their own shadow because they're afraid of being down, but being sometimes if you're, in my view, if you're taking, if you're looking for asymmetrical risk, reward and you have a variant perception, you are going to be early sometimes.

Mark Yusko: Always, always.

Mike Alkin: Time arbitrage, what you said earlier, time arbitrage is such a wonderful strategy, it's such a wonderful thing to employ. It's harder and harder for hedge funds to do it. Why has that happened?

Mark Yusko: Yeah, look, I mean it's a combination of a lot of things and it happened over a meaningful period of time. Yeah, go back to when we were kind of getting our teeth cut in the industry and really becoming experts in this area of hedge funds, is the people who had gone into hedge funds were the talent. They were the all-stars that left the long only business for this new place where you could make 1 in 20. Up until 1998, it was 1 in 20. It wasn't 2 in 20. The original A.W. Jones, remember was 0 and 20.

Mike Alkin: Yeah, absolutely.

Mark Yusko: He wanted full alignment. What was interesting is the people then, it was all about making money, and they believed, as all investors should believe, that investing is about taking intelligent risk. That's our job. Our job is to take risks. These guys actually took risks. What really worked great was in that period, in 2000 and 2002, that was the golden age of hedge funds, so a couple things were working. One, you had high interest rates, and high interest rates are fantastic for anybody that does market neutral or relative value or arbitrage investing. If you're a dollar long, a dollar short and your dollar sits in cash and you're making seven percent, that's really good. If you can add 400 basis points of alpha, now you're at 11. Now you put a little leverage on it, now you're at 15. Take out some fees, and you're net 12, 13 percent? Awesome, nirvana. Okay, so that was the first part of hedge fund nirvana.

Mark Yusko: Second was long/short equity actually worked because companies were incredibly overvalued in 2000 and guess what? We hadn't got into this central bank will save everything, and participation trophies, and everybody wins, and we let all the bad companies keep going, and we extend and pretend the loans. We let bad companies fail. We let recessions happen. We understood that you can't have bad people doing bad things destroying capital, and so there was a huge opportunity to make money on the short side. Fast forward to 2007, you had this one great trade that we and others really took full advantage of, which was short subprime, but the problem was because that created this global financial crisis, what happened in that was people thought hedge funds didn't do well. Well, hedge funds did great. You lose 20 instead of 42, that's awesome, right?

Mike Alkin: Without a doubt.

Mark Yusko: You got to be up 70 to get back if you're down 40. You only have to be up 25 if you're only down 20, so that's awesome, but people didn't perceive it to be awesome. What did the world do after the global financial crisis? Well, central banks went to a ZIRP policy, so they basically wiped out arbitrage. Arbitrage is not profitable at zero interest rates, because you're a dollar long, a dollar short, now you're making zero. Your short interest rebate goes away, so now you're paying to borrow, and even if you can generate alpha, you really can't get leverage because nobody's lending you money, so you're ... Then you have fees, which had bumped up to 2 and 20 after AQR was founded and Cliff Asness raised his fee to two, so everyone should write him a little check for royalty.

Mike Alkin: A little royalty.

Mark Yusko: For increasing to two percent. It wasn't just Cliff, but it was ... I never remember the name of the law firm, but it was AQR's law firm that basically said to anybody, "Well, if you don't charge two, then you must not be as good as AQR." "Okay, well then we'll charge two," so everybody started charging two, which is a silly number unless you keep assets really, really low. What happened is suddenly we stopped allowing failure, and so now we've got all these zombie companies. We have the highest ratio of zombie companies in history.

Mark Yusko: What's a zombie a company? A zombie company is that their trailing three year EBITA doesn't cover their debt service. If they were forced to pay normalized debt interest rates, they would fold, they would go bankrupt, and so we're in this weird period over the last seven, eight years where the central banks, globally, cut the volatility of assets to the lowest level in history. These stats are amazing. Last year, 2017, the S&P 500 had a standard deviation of 3.9 percent, okay? That's 25 percent of the long-term average of 15 and a half. That's the lowest in history, the previous low was eight, okay?

Mike Alkin: Yeah.

Mark Yusko: 3.9 is a stupid number. Worse than that, the sharp ratio was 4.3. That was 40 percent higher than the previous high, which had only been that high one time at 2.6 in 1965. The normal is .52. You get

.5 units of return for every unit of risk, that's life in equities but not last year. Last year, '17 was the pinnacle. Now we're in this period where suddenly, shorting is working again. Interest rates are normalizing, bad companies are being allowed to fail, and so I think we're about to enter, to reenter the golden age of hedge funds. It'll be the long/short guys will win first. I'll give you a good example. We run this hybrid fund, so it's half the money is outsourced to managers and we run half the money internally with our best ideas. That fund is up 10 percent year to date.

Mike Alkin: Wow.

Mark Yusko: That's significantly better than the markets. Why is that? Because our guys are crushing it on the short side. We've got a Honk Kong bubble basket that has absolutely killed it. We've got some longs in the biotech space, which was a really cruddy space last year that's worked out really well. It's been really interesting to watch. You meet with these guys and they're finally happy for the first time in a decade because it's been a tough decade since the global- [crosstalk 00:51:37]

Mike Alkin: It's a stock picker's market again now it seems.

Mark Yusko: Yes.

Mike Alkin: Right, and it is, when you're on the other side of it and you're in these funds, and I could tell you from being on the short side of stuff, even when it works, sometimes it doesn't work. I mean a catalyst comes and there's just money piling in, and you don't get nearly the bang for your buck that you would get if you-

Mark Yusko: Oh, don't get me started on Tesla, man. That's exactly what's going on here. The equity of that company, I'll say it, I've said it on Twitter, is worthless, right?

Mike Alkin: Right.

Mark Yusko: The bond holders are going to own that company. The only way out is a stupid merger, which I wouldn't put it past him, because the guy does seem to have nine lives. It just, it's so crazy to think that you can have a Ponzi exist in today's day and age after all the suffering we went through with the real Ponzi's. A company that only exists because they've raised new capital is not a company.

Mike Alkin: Mark, you started out as a bond guy. How do bonds trade in the 80s, and your equity keeps going up and that you think you can ... How does that ... I don't understand how that happens-

Mark Yusko: Look, I'm a Chicago guy, I went to Chicago business school and so I actually believe that the cap structure matters and that bonds are a senior claim to equity and preferred and so if your bonds don't trade at par, then your equity is worthless. Now, I will say that I have been victimized by that not being true in a world where the banksters can change the rules. A couple of really bad examples of that was, remember General Growth?

Mike Alkin: Sure.

Mark Yusko: General Growth went bankrupt. They filed bankruptcy, which in my world of logic and rules means the equity must be extinguished, the common equity must be extinguished, but there was a certain manager who owned a lot of that equity, who was friendly with the bank that held the debt and somehow the bank didn't foreclose on the assets. It became the largest stock winner since the global financial crisis in all of stocks. It went up like- [crosstalk 00:53:46]

Mike Alkin: Provided the rebirth to that manager, if I'm not mistaken.

Mark Yusko: Yeah.

Mike Alkin: In a sense.

Mark Yusko: It's just crazy. I had another one like that with Brunswick Corp. They make the bowling stuff.

Mike Alkin: Oh, sure. Oh my gosh, yeah.

Mark Yusko: Stock was a dollar, the bonds were 50 cents and I'm like, "Oh, I'm a genius. I'm going to buy these bonds, I'm going to make 100 percent owning debt. What a genius, and you should short the equity against it." Oops. Stock went from 1 to 20.

Mike Alkin: It did, yeah.

Mark Yusko: Because they kept extending and pretending. I have learned the hard way as we ... It's like, one of my favorite friends in the hedge fund business has this great line. He says, "With every investment, we get richer or wiser, never both."

Mike Alkin: That's fabulous. I, post mortem, my best learnings are my big mistakes.

Mark Yusko: It's so good, right? Because you only learn from your mistake. When you make money, oh, you pat yourself on the back and you don't analyze and you don't even pay attention because you were so smart, you were so good. When you lose money, now you're like, "Oh, what the hell did I do wrong?" The reality is I've made so many mistakes. That's the cool thing about, I turned 55 this year, and I dedicated the year that I'm not going to act my age, so I'm singing Sammy Hagar, I Can't Drive 55, all year. That's probably why I'm hanging out with the crypto kids, because they energize me to no end. I haven't seen this passion and this migration of talent to a space since the early '90s in the Internet and the hedge fund industry. The amount of talent that's going into crypto today is unprecedented, and it's really, really exciting.

Mike Alkin: Well, so we're going to talk about crypto in a second. If you can, for listeners, how do you think as an allocator? Because before I had you on, I was talking to listeners in my opening about how to allocate assets and how to think about asset classes. If you're running a family office, you could allocate across, I don't know, eight, nine, ten different asset classes, if you will, but it ultimately comes down to are you buying stocks, bonds, debt ... I mean stocks, bonds, what are you buying? Currencies or ...

Mark Yusko: Currencies and commodities. Look, Mike, that is the ultimate right there, is everyone thinks there's all these asset classes. They think hedge fund are an asset class. They're not, they're an access class. They think real estate's an asset class. It's not, it's an access class. Same with private equity. Think about hedge funds. What do you own in hedge funds? I own stocks, I own bonds, I own currencies and I own commodities. What do I own in private equity? I own common stock, preferred stock or a convertible bond. What do I own in real estate? I own equity of the deal, the debt of the deal or the land, the commodity.

Mark Yusko: There are only four asset classes. Actually, you can even get a little more focused than that. You can say, "You're either an owner or a loaner," and you can dominate it in whatever currency you want. At the end of the day, we own equity, we can own public equity, we can own private equity, and the difference is the illiquidity premium. Why does private equity make more than public equity? Well, it makes more because you can't get to your money every day

Mike Alkin: That's right.

Mark Yusko: You get paid a premium by people who have liquidity preference, right?

Mike Alkin: Yeah, yeah.

Mark Yusko: All of us listening to this call or participating in this call, unfortunately, we have a finite life, and it means we have a liquidity preference. We need to spend some of our money at some point, unless we're lucky and we have money that we're going to pass on and be multi-generational, but endowments, foundations and multi-generational families have a perpetual time horizon, and that money has this ability to think longer term and take advantage of this time horizon arbitrage that we talked about. From an allocation perspective, the way I think about allocating is really pretty simple, is I look forward not back, and that's because you can't buy previous results, right?

Mike Alkin: Yeah.

Mark Yusko: That disclaimer is true, but the real thing is, is I got spend an hour with Mike Krzyzewski once. I'm a Carolina guy and I'm not a real big fan of the Dukies, but I'm a fan of Mike Krzyzewski. The man is one of the greatest, if not the greatest basketball coach of all time. He had this great line. We're talking he says about halfway he says, "Mark, our businesses are exactly the same." I'm like, "Okay, Coach. Tell me what I have in common with the legendary Mike Krzyzewski, I don't see it." He says, "Well, look, we both recruit talent. We both put together teams. We both drop a game plan, we send the kids on the court, and then we sit down." He said, "I never take a shot, you never make a trade. You hire managers, I hire players." I'm like, "Oh my gosh. Our businesses are exactly the same."

Mike Alkin: It's exactly the same.

Mark Yusko: "My hedge funds business and coaching is exactly the same." Coaching is really all about identifying and training and nurturing talent. Then he said something that really sticks with me, and he said, "Look, what's the difference between great players and average players?" He said, "The difference is an average player always focuses on the last play, whereas a great player focuses on the next play. How many times have you seen a player go down, miss a shot, and go back and make a stupid foul?"

Mike Alkin: Absolutely.

Mark Yusko: He said, "A great player misses the shot, instant erasure. He doesn't even remember making the shot. He goes back, plays good defense, makes a steal, makes an easy layup," and so I always look forward and I sit down ... We do this as an organization, once a quarter. We say, "What are the forward returns for stocks, bonds, currencies and commodities, and all the perturbations of that? International stocks, emerging market stocks, U.S. stocks, big cap stocks, small cap stocks. What are the returns for fixed income? Traditional fixed income, high quality fixed income, low quality fixed income."

Mark Yusko: Then we look at the private markets and we say, "Okay, what's the illiquidity premium for investing in private markets?" We lay all these numbers out and we say, "Okay. Let's allocate capital based on where we can get the highest best and return," so let's take real time, okay? Bonds are simple. The 10 year forward return on bonds is the yield on the 10 year bond on the day you buy the bond, so today, 10 year bond yields a little less than three percent in the treasury market. Corporates are maybe three and a half, four, and high yields a little less than five. That's it. You can buy a diversified portfolio of bonds today, there's no chance over 10 years you make more than four percent. No chance, right?

Mike Alkin: Yep.

Mark Yusko: Now you might make less, actually, if you don't hold to maturity and you panic if interest rates rise and you sell at a loss, but it's impossible to make more. Bonds are really simple. I met this guy pouring money into bonds today. I said, "Why are you buying so many bonds?" He says, "Well, my clients need to make seven and a half percent." I said, "But you're going to make four." "No, no. The last 10 years I made seven and a half." I said, "Well yeah, because 10 years ago, the yield was seven and a half. 20 years ago it was 11, and 30 years ago, it was 17, but today it's four, so I don't care that your clients need to make seven and a half, they're not going to make it in bonds, so that's a dumb trade." [crosstalk 01:01:08] The second thing is equities are really simple. There are only four ways you can make money from stocks, only four, and there are no more. Hope, by the way, is not one of the four-

Mike Alkin: In a plan.

Mark Yusko: Hope is a four letter word not in investment strategy. The only way you can make money is from dividends, okay? We know what dividends are, a little less than two percent. Inflation, because inflation gets passed through in the form of higher prices, so that's around two percent. Then you've got real earnings growth, which is one percent less than GDP growth, because it costs money make money, so GDPs growing too, so that's another one, so that's five. Then there's multiple expansion or contraction, the PE ratio that we pay for that earning either goes up or down. If PE ratios were to stay where they are today, which is the second worst in all-time history, let's just say they could stay that way for the next decade, which I think is unlikely, but let's assume they could, the best you could hope for from stocks is five percent, from U.S. equities.

Mark Yusko: Now, I can make the same numbers work at eight or nine percent for emerging markets, but the problem now is we have to think about multiples. If interest rates are to normalize, which I think is possible or even likely that they will, then that multiple's got to go down, so your return on stocks from here, from this point going forward is even lower. If you could Jeremy Grant them or Cliff Asness or Rob Arnott or any of these guys who are forecasting future return, they're saying equity returns are going to be zero. That's less good than the last 10 years. Everybody says, "Oh, the last 10 years, they were 15." Well, of course they were. Because the Fed created this low volatility bubble.

Mark Yusko: There is one little nuance to this, which is there is a scenario that could play out, and it won't be very good for anybody except the kleptocrats. If you think about what banana republics do historically, and banana republic, what I mean by that is somebody that has a lot of debt at the government level and no growth, okay? Basically, that's the description of all of the developed world today, so we've turned into banana republics. What are the banana republic, what's the playbook? Well, what you do is you get to power, you concentrate the assets in the hands of a very small number of people at the top, and then you devalue your currency and cause great inflation of assets, right?

Mike Alkin: Mm-hmm (affirmative).

Mark Yusko: A single painting just sold for $450 million. You buy land, and it's skyrocketing. Somebody just showed me a house, 1,900 square feet in Palo Alto for $3.4 million. The reality is stocks and property and assets are rising because the kleptocrats own them. Remember, 54 percent of people in America don't own stocks. That's a frightening stat.

Mike Alkin: It is.

Mark Yusko: Only 14 percent own stocks outside of their 401K. I think it's 24 percent of people don't have any retirement plan at all. They don't have a 401K, they don't have a defined contribution, I mean a defined benefit pension plan. I mean we're heading for a nightmare when the boomers start to retire that is going to be of obscene proportions. This is a long-winded way of saying equities here look pretty unattractive in the developed world, but they actually look really attractive in the developing world, particularly in Asia and parts of Latin America where the growth rates are still high, where demographics are still positive.

Mark Yusko: If you're going to own equities, you want to own growth. The second thing you want to own ... I actually think there might be one new asset class. I'm thinking about writing a paper about this, so I'm probably giving away my secret before I should. I'm thinking about writing a paper that I think innovation might be a separate asset class.

Mike Alkin: That's fascinating.

Mark Yusko: It's the only way I know where you can actually create new wealth. If you go back in time and you think about innovation, the automobiles and all the street sweepers in New York being pissed because they were going to lose their jobs sweeping up horse poop, and that's kind of a good job to lose, actually, and be a cab driver. They were all afraid of the automobile, and the automobile industry created great wealth. Then there was air travel, and that new industry, and my grandfather-in-law, his parents were mad at him because he was giving up a safe job in the train industry to go into the high risk job of airline, and he did okay.

Mark Yusko: I think what's interesting is innovation, whether it be the Internet revolution or the mobile-net revolution, smart phones, or what I think is coming, which is the blockchain era and the bitcoin standard in 2024, I think that innovation ... If you look where's the highest rate of innovation in the world today? It's not actually Silicon Valley anymore. It used to be. Now it's China, because

China is spending way more than we are. They are focusing on creating innovation zones. They graduated ... Here's a frightening stat. They graduated 4.5 million engineering graduates in the last five years.

Mike Alkin: Wow. That's staggering.

Mark Yusko: 4.5 million.

Mike Alkin: Wow.

Mark Yusko: They're doing all the things you want to do to promote innovation and wealth creation. I talk about this ... In every presentation, you see these big disclaimers at the end, all this fine print. I actually put one in my presentation, I always make the joke, it's actually not a joke, it's real. I say, "The reason I have to put that in is because for every engineer we graduate in the United States, South Korea graduates 17."

Mike Alkin: Wow.

Mark Yusko: For every lawyer that they graduate in South Korea, we graduate 40. They're a country of wealth creation and innovation, and we're a country of wealth redistribution through lawyers.

Mike Alkin: Yeah.

Mark Yusko: All of that goes back to, the way you have to think about allocation is, "What's the future hold? Where is the expected return for the asset class? Stocks, bonds, currencies commodities. How do we want to own them?" I just did a webinar last week about "Get Real." What I mean is, it's time to get real assets. Real assets are the most undervalued they've ever been relative to paper assets, in history. That makes sense, right?

Mike Alkin: Absolutely.

Mark Yusko: We've been deflating our debt by inflating our asset prices, our paper asset prices, at the expense of hard assets. If I'm an allocator today, I want to do a couple things. I want to own more hard assets, I want to own fewer equities, I want to own fewer bonds. I want to own more innovation, more venture capital, more true innovation, and I want to be hedged. I want to have people on the short side, who can look at the companies that are egregiously and wildly overvalued, and those zombie companies that need to go away and profit from them as they disappear. It's a really long answer to your question.

Mike Alkin: Well, it's interesting ... No, it's interesting that you say that too, because if you think about the commodity complex and how undervalued it is, this is where time arbitrage can really be tremendous, if you can employ it. Because you don't know when it's going to turn, but that valuation disconnect has to revert.

Mark Yusko: It has to. A year ago when we met, we talked about what's been going on in uranium. It's been a tough market, but there does come a point when those 40 ... I think, I don't know if it's 40 or 43 or 38, I don't know the exact number, but 40-ish reactors come online in China that they're building and they restart some of the ones in Japan, and the demand for uranium goes up. Now, it has gotten easier to mine, so there's some fundamental challenges, but it's an asset that's so cheap. It's the rule of 95 percent. Any asset that goes down 95 percent, you must look at, you must.

Mike Alkin: Absolutely. It's interesting to see ... Now, I've been looking at the space just to talk on uranium for a couple of years now and the narrative gets adopted by these so-called experts and the industry people and they all fall prey to it. The narrative overwhelms them. Whether it's the mining companies or the fuel buyers, but I've had a baseline of a couple of years now, and you could see how time just is starting to knock some of that narrative away and supply destruction comes into play. You see it across a lot of different commodity in the complex.

Mike Alkin: You said something earlier about looking forward, and I love your quarterly letters. Anyone who's listening has to go to Morgan Creek's website. Mark has great media on there, and he writes a fabulous quarterly letter. In this one, you talk about the crypto class, and you talk about looking forward in innovation. 30 years ago, I never knew this. Tim May came out with a paper that was just spectacular. He essentially called what is today the crypto market, 30 years ago.

Mark Yusko: That lingo.

Mike Alkin: Right, just incredible. I suggest everyone go to Mark's website and read it. Talk about what you're doing in crypto and how you view the crypto world and how you're expressing that view.

Mark Yusko: Yeah, so look, this is the most exciting thing I've seen in my career. I've been lucky, one, I'm old, and two, I've been around the markets for a long time. The neat thing about the markets is they follow a 14-year technology cycle. It started back in the '50s with the mainframe computer. You basically have a four year period where an innovation then turns into a bubble. Then the bubble pops and then you have to pick up the pieces and have a new innovation 10 years later, and then you do it all over again. From '54 to '58, we had the mainframe bubble, and Wang and DEC and all those computer companies that were great. Then they all died away, and then in 1968, we had this invention called the microchip, and Fairchild Semiconductor and Intel and all these great companies created the bubble into '72, and then we had the crash in '73, '74.

Mark Yusko: Then you fast forward to '82, we had the PC and Microsoft and Wintel and all these great companies, and from '82 to '86, and in '87 we had a crash. That was a mini-crash because we had great demographics backing us up. Then you come fast forward to 1996, and we invented the Internet. Remember when people were saying, "The Internet will not be very valuable at all"? "Why would anybody want anything more than basically an encyclopedia at their fingertips?" Well no, what the Internet did is it brought all the world's information to all of humanity at the same time, and then also did some good stuff for commerce, and Amazon sort of came about by the Internet, which was formed around 1996.

Mike Alkin: Paul Krugman said by 2005 it would be similar to the fax machine, I think he was quoted as saying.

Mark Yusko: Yeah. Exactly, exactly. That's exactly right, yeah. "The Internet was no more important than the fax machine."

Mike Alkin: Right.

Mark Yusko: Not so much. The 2000 bubble pops, and then you go to 2010 and you have the mobile-net, and you have the Facebook phenomenon and all these things on social and mobile, and it was Internet ubiquity. Now we have the cellphone in our hand nine hours a day, and people are talking about addiction and all these things. Well now, the next ... That bubble started to crash in '15, '16, and so we would have had a recession then and a real cleansing, but for the Fed holding everything up and China spending a trillion dollars to hold everything up. Now, we're going to have this next innovation wave, which to me is the blockchain era and the Internet of value. With blockchain technology, blockchain technology's not new.

Mark Yusko: Tim May wrote this, the Crypto Anarchist Manifesto back in 1988. Around the same time, The Economist put a story on the cover saying that we'd have a global currency by 2018, 30 years later. Here we are 30 later, and we have a global currency called bitcoin. Then Satoshis came along in 2008 and because of the global financial crisis and because of people's fears about the banana republic devaluation of currencies, created the ultimate global currency, bitcoin.

Mark Yusko: Now it's in its infancy, so if you think about what's happening here, is we're taking blockchain technology, which is an amazing technology ... If people are interested, I did a whole presentation on this on our YouTube channel, Around the World With Yusko on blockchain technology. You can go watch that. What it does is it creates this opportunity to create and exchange value over the Internet, and we go from the analog age, which is where everything is done with paper ... Think about it. We're still trading securities the same we did 400 years ago, using pieces of paper. [crosstalk 01:14:25] Everybody says, "No, no. It's electronic." I'm like, "No, no, no. A CUSIP is just an alpha numeric representation of a physical piece of paper," so we go from- [crosstalk 01:14:32]

Mike Alkin: How about title insurance, buying a house? I mean, the steps involved are ridiculous. Yeah ...

Mark Yusko: Oh, ridiculous. How's it take two days to settle an equity trade? If I want to trade stock with you on the blockchain, we can do it instantaneous, and we don't need a third party to verify it, and we don't need an auditor to audit it because it's permanent, immutable on the blockchain. What this does is it goes away from the 1,400K vintage technology, dual entry accounting, and it takes us into the new age of digital ownership. What's happening is we had crypto, we had bitcoin and we had the other things that have launched, but crypto is a small asset class. Cryptocurrencies, ultimately global currencies, I think will ultimately replace fiat. Tim Draper says within five to ten years, when you try to pay for something with fiat, with a piece of green paper, they'll laugh at you. I mean, they'll just laugh at you. "What is that? I don't know what that is." We'll get to cryptocurrency as a medium of exchange. It will also serve as a store of value.

Mark Yusko: I think bitcoin today is digital gold and a great store of value. Then you got a second classification, which is ICOs. These are utility tokens, they're not cryptocurrencies. People conflate the term all the time. Most of the 1,700 tokens are not crypto currencies, they are utility tokens. Utility tokens are points in a reward system or a token that allows you access to a database or a file sharing system. They are not securities, they are utility token, it's a new asset. Those are basically just crowdsourcing and a replacement for early stage and seed venture capital, and they have great winners but there are going to be 90 percent losers, so 90 percent of those tokens are going to disappear just like 90 percent of real estate venture capital companies disappear.

Mark Yusko: The ones that win, you're going to hear a lot about, but for every Apple that's made thousands and thousands of percent, you're going to have a whole bunch of computer companies start in a garage that didn't work. In fact, a great story about that is CPM was a much better machine, but the couple that invented CPM missed the meeting with the IBM people that were going to use their operating system so it never caught on. Crazy story. That's why Bill Gates became a multi-billionaire.

Mark Yusko: The key is that there's a third class of tokens that are coming, and this is where I'm really excited, the most excited I've ever been in my career, which is security tokens. Security tokens is essentially the tokenization, the conversion of traditional paper ownership to digital ownership of every asset of value on the planet. Real estate assets, oil and gas assets, securities, stocks, bonds. I'm not that interested in trading digital tokens for stocks. Like Apple token, it'll be better than the Apple physical share, but it won't trade any differently. There's no premium that I can capture, whereas with illiquid assets, I can compress that illiquidity premium by turning the asset liquid. Let's take an iconic hotel or an iconic building in New York City. What investor in China wouldn't want to own a fractional share of the Empire State Building? I think a lot of them would, and they would pay a premium for that.

Mike Alkin: It's a no brainer for them.

Mark Yusko: It's a no brainer, it's a no brainer. Because they are constrained in how much currency leaves the system, but they are not constrained in how many assets they own. They can own an asset, they can't do more than $50,000 of currency, so we can sell them these tokens and give them a way to buy into great U.S. assets, and they'll be willing to pay a premium. We, as the token holders, will capture that illiquidity premium because we'll be creating illiquid assets into liquid assets. Security tokenization is a monster opportunity. What I'm doing at Morgan Creek is, if you go back to 2004 when I formed Morgan Creek, hedge funds were scary, private equity venture capital was scary, and knowledge of and access to talent was worth paying for. People would pay us for our knowledge of and access to talent. Over the past 14 years, people have said, "Hedge funds are not scary anymore. They've been institutionalized. I can get them myself, I don't need you, and I don't want to pay you for it."

Mark Yusko: Today, crypto and blockchain and all of the tokenization strategies are scary, and people don't know who to trust. Can you trust the crypto kids with their flat brim hats and their baggy pants? Or with no experience but many of them hundred millionaires and some billionaires because they were in early. Do you really trust those people or do you want a firm that's got a long experience in the traditional world, who is embracing this transition to digital world? I'm pivoting Morgan Creek to say, "We want to be the trusted advisor in the crypto economy." Now, Neil deGrasse is doing it too. He's good competition, but friendly and Burbank's doing it. I think there's an interesting opportunity to be one of the leaders in this new area, and we're going whole hog.

Mike Alkin: You're a pioneer in a pioneering field, essentially.

Mark Yusko: Yeah, well the cool thing is I did a really smart thing. There's this group called Full Tilt Capital, and they were some early stage investors. They're starting to get involved in crypto and I met this guy, Anthony Pompliano, and he's on Twitter. He's got a way bigger following than I do. One of the top 10 influencers in crypto. He and I, we just, it's almost like looking at myself in the mirror 25 years ago, because he's better looking than I am, but he thinks the way I think, he acts the way I act. Every time he tweets something I'm like, "I just said that. I feel like I would have said that exact same thing." We think the same, and he has an energy level ...

Mark Yusko: My other new partner, Jason Williams, not the basketball Jason Williams but the guy who created a $500 million urgent care center business, Jason Williams, has really brought this new level of energy and got us really excited about what we can do in this nascent industry as everybody is going to have to go here. Everybody's going to have to move into cryptocurrencies. Everybody's going to have to move into security tokens. It's coming, there's no way to stop it. What I wrote this last letter about, it's called The Virus is Spreading, is people think of viruses as negative, and I can attest to it because my letter was late this year because I got a nasty virus from Europe and was basically out of commission.

Mike Alkin: I read that, yeah, yeah.

Mark Yusko: What we're talking about is not virus as in bad, we're talking about either the good viruses, like there are certain viruses that live in your gut that make you more healthy, but even more than that, what we're really talking about is going viral. How does something go viral? It has what's called patient zero. Patient zero back in 1988 was Tim May, and he wrote this Crypto Anarchist Manifesto. The problem was, not everybody wanted to be an anarchist. Not everybody wanted to be off the grid. Not everybody wanted to be fighting against the government. They kind of liked the idea of his technology and what he was writing about, and cryptography, but he didn't have enough ... It turns out that if you're off the grid, you're not going to infect many other people.

Mark Yusko: Then Satoshis comes along and takes a different approach of basically saying, "I've created this beautiful solution for store of wealth, and it can't be diluted by central banks." He told two friends and they told two friends and it was like, we're old enough to remember the Breck commercial, "Tell two friends, and they tell two friends and so on and so on." Suddenly 2 to the 20th power is a really, really big number. We're going viral and there's no way this genie's going back in the bottle. There's no way people aren't going to realize the benefits of true digital ownership. There's no way people aren't going to realize the benefits of a non-dilutable asset like cryptocurrency versus fiat currency, and we're going there. It's just, it's a really exciting time. I get psyched talking about it.

Mike Alkin: One question. Do you have to wear skinny jeans and drive a Lambo, or are you ...

Mark Yusko: No, that's so funny you asked that. For one, I don't drive a Lambo, I drive a Kia because I'm a value guy. Second is I did, when I gave the speech of my paper last week at the Investment Institute, I actually did wear a hoodie just for fun.

Mike Alkin: There you go, all right. That's good. Hey Mark, I can't thank you enough. It's been a pleasure to chat with you.

Mark Yusko: Ah, this is so much fun. Look, there's nothing better than talking to someone like yourself who's done so many amazing things, built great businesses, been involved in so many great markets, is a contrarian thinker, holds variant perceptions. I mean I could talk to you all day, so it's been great.

Mike Alkin: Same here. Thanks, Mark. We'll be in-touch.

Mark Yusko: All right.

Mike Alkin: Okay, take care.

Mark Yusko: Thanks, Mike.

Mike Alkin: Thanks. Bye, bye. Well, I hope you enjoyed listening to Mark. He's a fascinating guy. I really enjoyed, when I spent time with him down in Dallas last year, he and my, like I said, a good friend of mine, Reid Walker, are friends. Mark's really a very thoughtful guy and it's a pleasure to speak with him. At the hedge fund, you see people come in like Mark, and very rarely though. You see a lot of guys come in and try and ... They're investors in your fund, but to have a thinker like him is really a treat. I hope you enjoyed it. I am here in Monterey for the next couple of days and taking a red eye back Tuesday night. I'll be back with you next week, so have a good week. Take care.

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