The Great Simplification

Nate Hagens (00:00):

Greetings. I've got some pretty intense Frankly's coming up, one on probability, certainty, and identity. That's going to be next week because it's a little more involved than I thought. I just got back from a snowshoe with the dogs. And here's some thoughts going through my mind about a topic called loss aversion, which is the cognitive bias where our human brains care more intensely about losses than we do about equivalent gains. I was exposed to this at a young age in my mid 20s when I was managing money and doing trades for billionaires at Salomon Brothers and at Lehman Brothers. Here's a couple stories just to, I mean, have hundreds of stories. One guy was 80 years old and he owned a lot of apartment buildings in New York City. He had $850 million worth of US treasuries, and all he did every day was wait for the coupon payments to hit his bank account.

(01:10):

And I remember one day there was a problem with the CUSIP number and his payment hadn't arrived of like $50,000 in interest on one of his treasuries. He called me and he was so ballistic. So polite all the time, except he missed one interest payment. And so his brain, this was a super normal stimuli that that little bit of interest disrupted his entire day because he wanted it. And I was like, what the hell? And a little bit later I had a guy that owned a lot of stock that he had gotten in a company he used to work for, and it was valued at like $2. And we found out one day that some buyout happened for $24 a share. So he just had an immediate windfall of like $80 million and he was pretty happy about it. But then a few weeks later, it turns out there was some due diligence and the buyout price was going to be reduced by 15%.

(02:18):

So he was only getting $68 million instead of 80 and he was just absolutely freaked out, mad, livid, sad, outrageous, going to fight this and what's going on. And I was like, what is going on here? Many years later, I discovered this is an example of the psychological cognitive bias called loss aversion, where if we start with say $10,000 and we get an immediate windfall gain of 1000 or 10%, and we measure the psychic utility of that, and then we'll simultaneously, we lose $1000. So we're right back to where we started at 10,000. But the negative psychic feeling from losing, research has shown in our species and in other species is twice as strong emotionally.

(03:14):

Now, there are good evolutionary reasons for this because when we had enough food to survive, either as humans or pre-humans, a little bit extra food wouldn't have made a difference. But if we lost food, it might have made the difference between surviving or dying. So we are intensely focused on loss aversion. And as followers of this podcast can surmise, I think loss aversion is going to be one of the main cognitive biases that hit our society writ large in this financial biophysical rubber band snapping moment in the coming decade where our musical chair claims of digits and electrons and paper in our wallets on what our biophysical situation can afford to service and maintain is going to cause a loss in people's physical circumstances of what they think they own and the perception of the future.

(04:30):

I'm quite worried about this because loss aversion is very strong. I've witnessed it on Wall Street. I mean, think of The Great Depression. When there was the stock market crash in 1929, there were people jumping out of windows because they had lost 80% of their wealth in one day on what otherwise was a

beautiful autumn day in New York because the shock of such an immediate loss causes people to lose perspective of all else.

(05:02):

And I think that's coming our way financially for sure, in many areas of the world. But it's not just finance and it's not just the end of growth per se, because what ends up happening is this story itself, The Great Simplification about how we've papered over our financial claims with debt, and we're going to have to tighten our belt and live with 30% less - that story itself causes a threat to people's identity because they've made decisions in their life based on the cultural story of we're following progress, we're going to be richer in the future. And so the end of growth has a physical connotation, but actually the idea of the end of growth has an immediate identity loss aversion to people that hear it.

(05:59):

Also with social media. When we shout down someone else on a Twitter or YouTube thread, people attach their identities to their tribe, their network, their ideologies and belief. And when someone hears evidence to the contrary, this is a loss aversion because in the same way that calories in our ancestral past led to potential survivability, identity in social media is a super normal stimuli that makes us feel we are losing calories because we're losing status, reputation, et cetera. So in our brain, the currency is the same thing, which is why people are so vitriolic on our current social media. And it's why artificial intelligence is a huge risk coming ahead because we're not going to know what to believe and we're going to feel a loss in our own identities. Loss aversion also shapes our cultural stories and our paths like the Green New Deal and others such fixes are popular because as a culture, we're not willing to give up anything that we've become accustomed to possessing, which means we limit ourselves to the subset of responses that actually can't physically work.

(07:29):

So I've often said that PV and wind turbines and other things can power a decent civilization, just not this one. But loss aversion keeps us from looking at pathways that might really work. On a different lens, as we head to a lower material throughput existence in the future, do we really want to be the things that we own, much less the things that we could theoretically own? Some of the world's happiest people, and I've been to Ecuador and Zambia and many places, have little material possessions, but a smile.

(08:12):

So personally, I think knowing about loss aversion, perhaps shifting one's definition of self-worth away from material net worth could be a great adaptive strategy. Not to mention being true. As per usual, there are wider boundary lenses on this topic of loss aversion. What about deep time loss aversion? Our species owns a world in a very real sense, and we have since the beginning, but we're losing it and have been blinded to this slow motion loss by highly stimulating illusions of immediate gain. How much do each of us really feel about the loss of X number of species per day and the deterioration of earth's ecosystems? We only have an aversion to losing what we know we have and care about. So perhaps we need to reset our loss aversion heuristic to minimize the loss of the only things we could ever really have in the long term, those things that are priceless in a lonely universe. So I think about loss all the time. I understand the human impulse to react more strongly to losses than to gains.

(09:42):

And if you really understand this, you can make changes in your own life ahead of The Great Simplification to maybe measure your self-worth by natural social built and human capital instead of financial capital. So you won't have this feeling of loss. And loss aversion to an end of growth isn't always the appropriate response. Ask any cancer survivor. So here, just some quick thoughts on the concept of loss aversion. I think it's going to be important one in the years and decades to come. I'll see you next week and I will make a social contract. There will be a podcast or a Frankly on probability, identity and certainty. Talk to you soon.