

PLACE YOUR BETS: THE EXISTENCE OF GOD and SMART INVESTING

Blaise Pascal was a 17th century French mathematician who is considered the father of the theory of probability. In 1654 he put forward a wager: “God is, or he is not. Which way should we incline?” Would you bet that God exists or does not exist? While at first this seems like a 50-50 bet (such as the toss of a coin), Pascal went further.

He said you could wager that God exists by living a life of virtue. People who cannot be bothered with that kind of thing are wagering that God does not exist. If this is the choice, with even odds, how do you determine the value of the two outcomes? By considering the consequences of being on the losing side of your bet: If you bet that God exists and you are wrong, you will have given up some naughty behavior during your brief life, but that’s all you’ll lose. If you bet that God does not exist and you are wrong, by leading a licentious life you will suffer damnation into eternity.

Pascal’s insight was this: Probability alone is often an insufficient basis for decisions. *Consequences usually outweigh probability.*

What does this have to do with investing? Consider the notion that the market is efficient; that information moves so rapidly to skilled investors that beating the market, systematically and adjusted for risk, is an impossibility. If you believe the market is efficient, the best strategy is passive management: Buy index and asset class mutual funds. If you believe the market is inefficient - that you can find active managers with the skills to outperform - you should invest with those managers instead of index funds.

What are the consequences of being wrong in each case? If you bet that the market is efficient and you are wrong, you will still do okay with your index funds. You will at least earn the market return, even though some actively managed funds will do better. But if you bet that the market is not efficient and it is, the probability of your under-performing is high. The risk is much greater if you bet on inefficiency than on efficiency.

Our position: Don’t take the risk of active management.

Passive Management:	Markets work
Active Management:	Markets don’t work