

LAUREN FOSTER: Hello and welcome to the *Take 15* podcast from CFA Institute. I'm Lauren Foster. And this is the show where we bring you an unbiased lens on investing and capital markets through short conversations with some of the world's most interesting and accomplished people. Today is part three in a three-part mini series featuring authors of Research Foundation briefs.

And I've got another terrific guest to introduce you to, Allison Schrager, author of *Learning About Risk Management Insights from Unconventional Risk Takers*. Now, in case you're not familiar with it, the CFA Institute Research Foundation publishes independent, practitioner-focused research that is academically rigorous and easy to read. Its briefs are short papers intended to provide content that is easy to consume.

Allison is a senior fellow at the Manhattan Institute and cofounder of Lifecycle Finance Partners, a risk advisory firm. She has a PhD in economics from Columbia University and is the author of the book, *An Economist Walks Into a Brothel*. We cover a lot of ground in a short time from lessons investment professionals can glean from big wave surfers to retirement risk and what the US retirement picture looks like postpandemic. We also discuss whether, in the light of what happened recently with GameStop, retail investors should be allowed to buy individual stocks.

I hope you enjoyed today's conversation with Allison Schrager. And don't forget to check out our YouTube channel and subscribe. Allison Schrager, welcome to the show.

ALLISON SCHRAGER: Thank you so much for having me.

LAUREN FOSTER: So I'm really excited about this episode because I think it must be the first time that we may be able to get big wave surfing, movie making, and poker all into the episode under the umbrella of risk management. So we've got lots to cover. And we're going to sort of dive straight in.

So a few months ago, I had a guest on the show, and we started out our conversation with her being in prison. So she wasn't an inmate. She was actually doing a researcher, doing some research there. So we're going to also start in a kind of an unconventional place today. We're going to start in a brothel, which features in the title of your book. So how did you end up in a brothel talking to a pimp about risk management? And what did you learn?

ALLISON SCHRAGER: Well, it all started when I was trying to start the book. And I had this idea that I was going to find cool parables to illustrate risk. And then I realized my training as an economist meant I really did not know how to do such a thing.

So I was complaining to a cousin of mine that I needed a good story. And he's a lawyer. So I'm like, you know anyone who's a criminal? I feel like a criminal would have a good story.

And he goes, well, no. But my girlfriend runs an illegal business. She matches submissive sex workers with their clients. And because this is such a risky thing, her value add-- it's easy enough to find clients online. She does all the risk screening. And for this, she gets 30%.

And I'm like, oh, that's a good risk story. Because I'm always looking for, how do you put a price on risk reduction? So I wrote a story about this. And the next thing I knew, I heard from the Bunny Ranch, the famous brothel in Nevada.

And it turns out there's a hierarchy within the sex work profession too. And they were like, well, if you're going to be writing about a brothel, you should be writing about ours because this is like the Goldman Sachs of brothels. Like if you're working in the sex trade, this is where you want to be. And they're like, instead of these small-time internet things, you should be writing about us. And I'm like, well, I don't write about brothels. I write about pension economics. But I don't get this conversation call every day. So let's indulge this.

So he explained how this all works. And he explained to me that there's no set prices, that everything's individually negotiated. And I was like, huh? That's interesting. So I mean, you have women who are like 19 or 20 negotiating for tens of thousands of dollars with rich men in their 60s?

And he goes, yes, all the time. And no one's ever asked about that. They come here not really knowing their values. We have a negotiation training program. And I was like, really? I'm not very good at negotiating. All the pitfalls about women in a negotiation, I'm guilty of. I never ask for enough. I'm shy. I'm worried I'm going to offend people, all these things.

So I had this wonderful editor at the time. And she insisted I go to Nevada and go through this negotiation training program, which meant I go out there, again, as an economist, not really trained to speak to people at all. Really have to get into with these women about what they charge and how they set their prices and how they feel comfortable. And I became a much better negotiator along the way, obviously, as I learned all their tricks.

But it really struck me, first of all, that they gave up 50% of their earnings to the brothel. That seemed like a really high cut, much more than that legal business. And two, how much they charged compared to the illegal market, which I had some data on. And it turns out this was all in the name of risk reduction.

So I did the negotiation story. I was there on and off for like two weeks. And then when I started the book in earnest, I asked to come back and do a survey on pricing.

**LAUREN
FOSTER:**

So I also did listen to there was a Tedx Talk that you did about that experience. And something struck me that you said in that talk. You said it gave you a whole new philosophy, a life philosophy. And you said you need to hear more nos than yeses. Just elaborate that a little bit for us.

**ALLISON
SCHRAGER:**

Yeah. So my fear around risk taking with negotiating was that people would say no. And I just was like, well, how does the relationship move on? And I always be a little offended when people say no to me, or maybe they feel offended they have to say no to me.

And so I got to know the owner of the brothel, who has since died, named Dennis Hof, who is a fascinating character. I like people, I guess, I feel conflicted about. And I definitely had a lot of conflicting feelings about him. But he had this sort of weird feminist energy.

And one of them was this sort of message of like you shouldn't feel ashamed to hear no. In fact, that's how you know you're asking for enough. And in fact, 50% of negotiations here fail. And if you're not failing enough negotiations, you're not asking for enough. Otherwise, you know that you're worth more.

And so that really helped me get past this because I still hate hearing no. It still makes me nervous. I still hate saying no to people. But every time I do, I'm sort of like, all right, sucks to hear no. But I know I've asked for enough. And I've pushed it as far as I need to go.

And you also learn from him, again, how to hedge that risk or manage it by giving the negotiation other room to go. So it doesn't become this confrontational yes or no. But sometimes you're just not going to make a deal. And that's OK too.

LAUREN FOSTER: So I guess the key takeaway is if you're not hearing no enough, you're not asking for enough. Is that right?

ALLISON SCHRAGER: Exactly. Exactly.

LAUREN FOSTER: OK.

ALLISON SCHRAGER: And you have to be comfortable with that and comfortable that sometimes you're just not going to make a deal with people.

LAUREN FOSTER: I think it's a fascinating story. So your Research Foundation brief is a terrific read. And I just want to tell listeners that in the show notes, we'll include a link. And I would really encourage you to go there, download it. It's free. And read it. And it contains three parables, that's the word that you use, about risk takers. So I guess illustrate risk management.

And you also talk about the power of storytelling. So before we go into the actual stories, I would love if we to talk a little bit about storytelling because I think it's really underappreciated. And you didn't exactly set out to be a storyteller when you graduated.

ALLISON SCHRAGER: No. I think, like most economists, you want to push the frontier forward. And then when I got involved in finance and I've always been involved in retirement economics, finding new solutions for that problem, that's what you're trained to do. But I started to notice as I got more involved and I sort of ended up, for a variety of reasons, ending up with a side career as a journalist, that so much of what was going wrong was just we weren't really communicating risk to people.

We seem to just operate under this assumption people can't understand risk and that it's too challenging for people to make decisions. But on the same time, we never really have taken the time to really think about risk communication and how can we communicate risk in a meaningful way to people. And it turns out, there's a whole burgeoning area of this in data science of people figuring out like for tech firms how to communicate risk in ways that are meaningful to people visually. But we kind of already knew the answer, which was storytelling.

I mean, we've always used parables as a tool to explain concepts to people that maybe are a little abstract. Like you can think of how Christianity took off. These sort of moral stories came through parables about people. They connect with it.

And so I had this idea that maybe a different way. I mean, like I said, we're all finance professionals. We've all spent a lot of time learning about risk, which is a very esoteric and complicated thing. But how much time we spent learning on how to explain risk to people, which is ultimately a huge part of our job, if not the most important part of our job? Probably more useful than having a very complex sophisticated risk strategy. So I want to experiment with a parable structure to explain risk to people. And that, I guess, was the foundation of the book and how it all got going and how I went to all these strange places.

**LAUREN
FOSTER:**

So there are three terrific parables. And since I grew up in a place called Durban, which is known as sort of South Africa's Surf City, I would love to spend a bit of time on the big wave surfing because I was, frankly, quite surprised. I think, like other people, I have this notion in my head that big wave surfing can be pretty risky. And it was really enlightening to read your section about big wave surfing and risk management. So for the listeners, walk us through that story and the lesson and especially what lessons investment professionals can take away from big wave surfers.

**ALLISON
SCHRAGER:**

Well, I mean, there's a lot there. And I think there are a lot more like us than we realize. I ended up going to it's called the Big Wave Risk Assessment Group, which is actually an annual risk conference of big wave surfers. Like they also sit in a windowless conference room and look at slides with lots of numbers.

It reminded me. I was shocked how much it reminded me of one of our conferences where people are just talking about risk. And not only that, the big question they had, which is a question we also face, and there aren't easy solutions but there definitely needs to be more dialogue, which is, if you take a risk and it poses harm to other, like some sort of systemic risk, where does responsibility lie? With you? With regulators?

And that is the big question for them. And it's the exact same issue we're facing. Because as they gain more technology, they gain the ability to take more and more risks. And sometimes those risks become systemic. And how do you take risk responsibly, particularly when you have a new technology and you're not even sure of what those risks are?

So one of the men I met there, this amazing man named Brian Keaulana, who comes from a long line-- he's a native Hawaiian-- of famous surfers. He's part of this Hawaiian big wave surf dynasty. And he brought jet skis to big wave surfing.

Now, jet skis to big wave surfing, it turns out, are a lot like options contracts in financial markets because it is effectively insurance, which is what options are supposed to be, right? It's like you can buy a put option on the stock market. And if it falls below a certain level, you know you'll still get paid. So it is technically insurance.

But like any insurance or any risk management technique, you can always flip it around to take more risk. You can use options to lever up quite a bit. And it's the same thing with a jet ski, which was initially, as I said, insurance. If you wipe out, it's there to rescue you.

But after a while, surfers realized they could use it as leverage. They found out they could take these jet skis to push themselves on higher waves. Like when you look at pictures of people surfing those crazy waves in Portugal like 80 feet high, there's no way the human body can paddle fast enough to get on a wave that big. You have to be pushed on by the jet ski.

So all of a sudden, when jet skis came into the picture, people were safer in some ways because they had this insurance. But now instead of surfing maybe a 30, 40-foot wave, they could surf an 80-foot wave. And this really upped risk. And it really got people thinking about the role of technology.

Because, well, if it could get a great surfer on an 80-foot wave. It could get someone like you or-- I don't know about you. Maybe you're a surfer. I am not. But if I had a jet ski, even I could get on like a 20-foot wave now where I have absolutely no business being.

So the question they just really spent a lot of time debating, because there was a new technology coming out with an inflatable vest, what's this going to do to the industry? You know? This makes us safer but also is going to raise risk in other ways. And how do we make that balance?

LAUREN FOSTER: So we didn't have time to go too deeply into the poker and the movie making. But just for the sake of the audience, maybe you can give-- to keep the movie theme going-- a little trailer for the audience or a teaser as to why they should go and either read your book or read the brief about why you included parables about a poker player and about someone who wants to go and finance movies.

ALLISON SCHRAGER: Well, for the movie one, I think it's a very pressing issue now, which is, how do you measure risk when a risk is unmeasurable? Which I think now that we're in this COVID world where we had a risk we're not dealing with before, how can you use data when the past doesn't tell you much about the future? I mean, you could think even the movie industry, how much that COVID has changed their economics. How are they going to know what to make in the future?

And for poker, I spoke to this-- I think we all know about all the behavioral biases, particularly how we tend to take more risk when we're down and too little risk when we're up or at least are consistent about that. So I spoke to a really famous poker player who's known for not having a lot of control yet manages to play in the opposite way, just be very disciplined and consistent in his play and learned how he managed to overcome that as evidence that we're not really doomed to our behavioral biases. We can overcome them.

LAUREN FOSTER: So I guess one of the things I took away from the brief is that there is a real science or art to risk taking. And I just want to make sure that the audience is very, very clear. We haven't actually defined any of these terms. Define, for us, so that they can take away very clearly in their minds, what is risk? How do you define risk? And what is prudent or good risk management? And again, this all adds up to why it's so critical.

ALLISON SCHRAGER: So risk, to me, is very simple. It is the measurement of uncertainty. The world is uncertain. We don't know what's going to happen in the future. But risk is an estimate of all the things that could happen.

And for us in finance, that usually takes the form of a probability distribution. It's all the things that could happen and how likely they are. It's never definitive. It's just our best guess of what's going to happen. Some guesses are better than others.

And for me, that is risk. It's downside and upside, which. I guess. Is different than how other people define it. Because any time you take a risk, there's a possibility of a good thing or a bad thing. Prudent risk management or prudent risk taking is one, I guess, choosing the right risks, taking risks that have a possibility of good upside and upside you want and a probable upside. And two, thinking about how to manage downside risk and being prepared to pay to reduce it if that's appropriate.

LAUREN

FOSTER:

So you're a risk economist. And you've done a ton of work in retirement finance. I think you told me it's your first love as an economist. This is a really tough environment for people who are, I guess, on the verge of retirement. I think the COVID-19 pandemic has disrupted many people's plans for retirement.

So from your perspective as a person who studies risk, who studies retirement, what does the retirement picture in the US look like to you at the moment? And two questions, what worries you? And on the flip side, is there anything that gives you a little bit of hope?

ALLISON

SCHRAGER:

Well, I'll start with hope because I think this gets undersold is I think we're in better shape than people realize.

Actually, I mean, these golden days of DB plans never really existed. They never really covered that many people.

If you actually look at people's adequacy, people have more money for retirement than they've ever had. It still might not be enough, for sure. But it's definitely more than people have ever had before. And rates of poverty and retirement are really the lowest of any age group.

So I think we're not, in terms of asset readiness, well, people don't have enough. At least, they've had more than they've ever had before. So I think things aren't quite the crisis people make it out to be. But that doesn't mean we can't do better. And there's a lot of room for improvement. People definitely should save more.

And also, the problem with the shift to defined contribution world away from defined benefit world is we've never really thought about what a good retirement looks like. We have a lot of thoughts on the accumulation phase. But how do you have an income strategy? How much should you be spending?

And I think the solutions, by far, right now are just completely inadequate. Everyone wants this sort of magic number of what they can spend each year but then are agnostic about how they actually invest their assets. But really, we know from good risk taking that you need to have a strategy of what your income is going to be and match your asset allocation to that strategy. And I think that's really where we're falling down is we're not really talking about the retirement part, just the saving part.

LAUREN

FOSTER:

So you mentioned what a good retirement looks like. And it reminds me of an article that I just read actually. It was in the *Harvard Business Review*. It might have been from a couple of years ago. And just to know to listeners, I'll link to this in the show notes.

And I talked about Dan Buettner and his fellow researchers at National Geographic and the work that they do settings of longevity. And in this particular case, it was the Okinawans. And I'm just going to read some of the things that I've scribbled down.

One of the things they do is they eat off smaller plates. They stop eating when they're 80% full. And they also have a very different outlook on life than people in the West.

So what I found really interesting is that they don't have a word for retirement. They have a word that they use called [NON-ENGLISH SPEECH]. Hopefully I'm pronouncing that correctly, which roughly translates to the reason you wake up in the morning, the thing that drives you the most. So that's kind of the preamble to the question that I have, and that is, should the idea of retirement be reimaged? Or said another way, is retirement a flawed concept?

ALLISON SCHRAGER: I think so. I mean, I think it's healthy and better for people to still have some purpose, still have some socialization. I certainly have encouraged my parents. They're both self-employed in services. So it's easier for them to really never retire. I just tell them, phase out the aspects of your job you don't like. You know? And maybe work only like 15, 20 hours a week eventually.

That's not possible for everyone. But maybe there's always something you can do. If you have a more traditional employer, maybe go to them as a contractor. Or even as I said, there's even a lot of evidence that people who work in a lot of lower skill service jobs actually report high levels of satisfaction and aren't even doing it necessarily for the money.

So I think, as I said, especially if retirement lasts longer, not only does it financially make a huge difference. But I think, first and foremost, I discourage full retirement. Because I don't think it's really healthy for people.

LAUREN FOSTER: So I'm going to shift gears a little bit to something that's been quite topical, and that's GameStop. And I just want to read out for the listeners a couple of things that I saw that you posted on Twitter. So the first one was, there's a school of thought that retail investors shouldn't be allowed to buy individual stocks. I can see the argument but can't imagine it ever happening.

And in another tweet, I am all for democratizing stock ownership. I've long argued more Americans should own stock. But this is not the way to do it. Buy an index fund. So that begs the question, why shouldn't Americans own stocks?

ALLISON SCHRAGER: Well, I'm not completely on board with this. My mentor, Robert Merton, has always said buying an individual stock is like owning a single part of a car. It's expensive and kind of useless. Because I mean, the GameStop has really exposed how little we've really taught people what investing is.

You're not investing as in just picking a couple of good stocks that make money. It's a cohesive risk management strategy, which is choosing a strategy that's less likely to lose money or is efficient to not take more risk than you need to. And this maybe even accounts for other sources of assets or an income that you have to sort of manage that risk. And so owning individual stock, let alone picking it on Reddit, isn't risk management.

That said, I know a lot of people who've never invested before and have really found it empowering during the pandemic to buy individual stocks. It's not something I personally would do. If people do it with the little money they are prepared to lose and it gets them more engaged with stock ownership, as I said, I think stock ownership is important. Only 50% of Americans have it.

I think owning stock's a really important part of wealth accumulation and with growing your wealth. So I would encourage that. But I think we need to push more literacy on investing, which isn't very hard, which is why index funds are important. It's not a cop out on risk. It's actually just a way to get more for less risk.

When I was watching the GameStop hearings, I was sort of horrified that the owner of Robin Hood or the CEO was really quite annoyed that he had to compare his users' performance to a benchmark, which I think the congressman suggested S&P 500. He was like, that's not how you think about Robinhood. It's, how much would you have lost if you just spent the money?

First, I'm like, what does he mean? Does he not know what a benchmark is? But when I thought about it more, I was like, well, maybe he's right. Because if you are day trading, maybe you should look at this as consumption and not investment.

LAUREN FOSTER: So you've had a very interesting career. You have a PhD in economics. You've also worked as a journalist. You've written a book. And so I'm wondering what's next on Allison Schrager's to-do list? What are you working on? Do you have another book that's in the wings?

ALLISON SCHRAGER: I'm working on a new book. I still haven't sold it yet. But it's all about exploring why we're taking less risk. We're seeing a lot less risk taking in the economy. As I said, even with stock ownership, I mean, that is up more than normal.

But people, not taking a lot of risk is a big reason they're staying further behind. We're seeing declining self-employment rates, job turnover rates, and even wage variability. But the flip side of that is the wage stagnation we're seeing.

So exploring why the economy has become less risky and why we're becoming more risk averse and how we can break that cycle, so I'm working on a book on that. And also, working on, I guess, my work at Manhattan Institute is policy prescriptions on how we can encourage people to take risk, but not just any risk, how to take good risks, those risks I mentioned before that are sensible risks and well-insured risks.

LAUREN FOSTER: So maybe you could expand on that just a little bit before we go to our closing questions. How do you encourage people to take on more sensible risk.

ALLISON SCHRAGER: Well, I think part of it's education. It's partially giving people good opportunities. And also, I think insurance plays a large role. I think we're largely underinsured in a lot of areas in our life. There's no reason why we can't insure income. There's no reason why more people can't take advantage of asset insurance.

I mean, there's all sorts of ways we could be insuring. And there is evidence that said people actually perform better when they have some level of risk in their lives. But also, they do get concerned about catastrophic downside risk. So if they are more insured, they might feel more empowered to take risks. We normally assume that's bad because it's moral hazard. But if we want people to take more risk and we don't excessively provide too much insurance, then it can actually be quite.

LAUREN FOSTER: Great. So we're going to go to closing questions that I ask every guest. And I'm glad that, earlier, you spoke about going for the optimistic solution first. Because one of the questions is what I call the ray of sunshine question, just trying to find something positive that's come out of the last, I guess, year in the pandemic. So what, for you, is one, I guess, positive, long-lasting change that you hope to see as a result of the pandemic?

ALLISON SCHRAGER: That's a good question. I like to think that we'll appreciate each other more and a sense of community. When people do get together, it feels so joyful now. So I hope that we'll appreciate what we've had a little bit more and how lucky we were.

I mean, humans lived through death and disease for most of human history. And I mean, this has been just so hard on everyone. But you realize how people live like this and much more deadly things for most of human history. So I hope people realize how lucky we've been.

LAUREN FOSTER: That's true. So the second one is what I call the NASA question. And it was an idea I got from a NASA middle school education model where they were asking kids, you're about to take a long-duration space flight. You have to take one thing with you. What do you take?

So that's what I've been asking my guests. You're about to take a long-duration space flight. But you can only take one item with you. What do you take?

ALLISON SCHRAGER: They've supplied food and stuff like that?

LAUREN FOSTER: Hopefully. This is a bonus item.

ALLISON SCHRAGER: OK. Good eye cream.

LAUREN FOSTER: Good eye cream. That's a good one. I have not heard that answer before. That is a good one. And then the final question is on superpowers. And it's what I call flight or invisibility. So people who have heard the podcast before know that I got this idea because I was listening to a *This American Life* episode. And John Hodgman was asking a lot of his guests, which would you choose, the power of flight or the power of invisibility? And what it tells you about the person.

So that's also my question for you. You can only choose one of the superpowers, so either you can fly, or you can be invisible. But you're the only person in the world who has that super power. Which one do you choose? And what do you do with it?

ALLISON SCHRAGER: Well, flight. I mean, I don't even-- I have no interest in being invisible. So especially, I think, after this year, the idea that you could go anywhere in the world and not have to do with an airline, I mean, that just sounds wonderful. I mean, you can see people. You can talk to people. You don't have to do with flying, well, the airline flying. So for me, it's no question.

LAUREN FOSTER: Well, that's tough. Just before, waiting for our call reading about COVID passports, and it's just one more wrinkle in sort of the bureaucracy of flying. So yes, being able to sort of take to the air would be super liberating. So thank you very much for joining me today, Allison. It's been a tremendous pleasure.

ALLISON SCHRAGER: Thanks for having me.

LAUREN FOSTER: You've been listening to the *Take 15* podcast from CFA Institute. If you haven't yet subscribed, you can do so on our YouTube channel or wherever you listen to the show. That way, you never miss an episode.

And if you enjoyed today's show, we do appreciate a rating and review. Or if you'd simply tell a friend about the show, that would help us too. And a quick reminder, this podcast isn't intended to provide expert advice on the topics we covered. If you need tax, accounting, or legal advice, please consult a professional. I am Lauren Foster. Thanks so much for listening, and see you next week.