In the Trenches

Episode Transcript · Mark Higgins

STEVE 01:29

Hello, everybody, and welcome to another episode of *In the Trenches*. I am your host, as always, Steve Divitkos. So maybe I'm biased, but I think that today's episode is a really interesting one and one that might elicit some strongly held opinions. Today, financial historian Mark Higgins joined me for an in-depth discussion on the history of the private equity and venture capital ecosystems, including their creation, evolution, and subsequent maturity.

I first learned about Mark when I picked up his book entitled *Investing in US Financial History: Understanding the Past to Forecast the Future*, which is an incredibly comprehensive guide to the entirety of US financial history. The book starts as far back as 1790 and explores the role that Alexander Hamilton played in the creation of the first US central bank. And over the subsequent 500 pages or so, Mark brings us all the way to the current day.

Throughout, he covers everything from the history of interest rates, fiscal policy, tariffs, wars, recessions, depressions, global trade, new investment products, and pretty much everything in between. Mark's primary motivation in writing this book was to explore the entire financial history of the United States so that we might extrapolate lessons from that history to inform the various decisions that individuals, companies, and governments must make today.

Though the book is incredibly comprehensive and covers much, much more than the history of the private equity and venture capital ecosystems, these two asset classes were of particular interest to me as an active participant in the market for small privately held businesses over the past fifteen years or so.

Though this market likely differs in many ways from traditional private equity and venture capital, there may be lessons to be gleaned from how these ecosystems evolved and matured over the past few decades. Or maybe there aren't. My dear listener, I will leave that decision to you. Before we dive into today's episode, allow me to conclude with my usual reminder that I am an active investor in search funds and the companies that they acquire through my firm Mineola Search Partners, which is now investing out of its recently launched second fund.

So if you're interested in raising a search fund yourself or if you have an equity gap, I would welcome the opportunity to speak with you. But for now, I hope you enjoyed today's conversation with Mark Higgins.

STEVE 03:50

Mark, welcome to the show.

MARK HIGGINS 03:52

Thanks for having me, Steve.

STEVE 03:54

It's a real treat to talk to you. I'm a big fan of your book and that's something that we're going to talk about in short order. But before we do that, let's start with a little bit about yourself, so that people know who they're listening to. Just walk us through some of the major stops along your career, including what you're doing today.

MARK HIGGINS 04:09

Sure. I think that focusing on today is probably the most useful. I've been in the investment industry for more than 15 years at this point. The last few years, I've been a senior vice president at Index Fund Advisors. And then also — and this is coloring a lot of what we're going to talk about today — I published a book almost two years to the day, February 27th when we were recording this podcast, on the financial history of the United States.

This was a big project. It walks through the major financial events that really shaped the nation from 1790 into 2023. So I do a combination of serving as a writer and financial historian, and also as an investment advisor for institutional clients and high net worth individuals.

STEVE 05:09

So the topic for today is essentially understanding the history and the evolution of both venture capital and private equity. I'd love to start in kind of the early days of both asset classes, and maybe let's start with venture capital for no particular reason. Can you walk us through the origin of the VC asset class? What problem did it emerge to solve, and what was happening in the broader economy at the time that made its emergence helpful or necessary?

MARK HIGGINS 05:37

So it really emerged in the post-World War II period. For those interested, I published an article on this for the Museum of American Finance called 'A Whale of a Tale' — there are some similarities with the whaling industry, hence the name. After World War II ended in 1945, the United States was very wealthy and there were a lot of war-related technologies that could be commercialized. But the problem was that the banks were very skittish, for understandable reasons — they had suffered devastating runs and thousands of failures during the Great Depression. So they weren't willing to provide capital to promising ventures. A number of academics, government policymakers, and financiers got together

and they formed a company called American Research and Development Corporation. It was eventually led by a man named Georges Doriot — some people may have heard of him. It was actually designed as a closed-end fund, and the goal was to fund promising ventures that didn't have access to capital through the larger banking system. And it took a long time. They funded a number of ventures, but

it took almost 20 years before they really proved the model. What proved the model was an investment they had made in Digital Equipment Corporation, which went public — I think it was around August 1966 — and had a monster return. They invested like $70,000 and made something like $35 million. That really made the fund. And it was at that moment that the model was legitimized.

And a lot of former protégés of Doriot went out and founded their own firms. They founded them as partnerships for a variety of reasons — the investment company model of venture capital really didn't work. And that's how it got started.

STEVE 07:49

So it sounds like the ecosystem was established on the basis of a tail or power law outcome. And certainly today, VC is subject to power laws: you have a portfolio of 20, 18 lose money, one gives you a one-X return and one gives you a thousand-X return, and that's how you return the fund. Has that always been the case?

MARK HIGGINS 08:12

The modern venture capital firm was actually very similar to the model used for whaling in the later mid-1800s. And it's the same model when you think about it: whaling ventures would fund a ship that went out for three and a half years on average. Most came back with mediocre or disappointing yields. I think about 6% would never come back — you don't even know what happened to them. And then you'd have one blockbuster ship that would just outdo everybody. So people in New Bedford — which was sort of the capital of whaling

— would buy shares in different ships. It was a partnership model, very similar to venture capital.

Modern venture capital has always had that kind of home run-type return profile — but even predecessors of that model had the same basic dynamic.

STEVE 09:27

Correct me if I'm wrong, but isn't that the origin of the term carry? Something about the shipping industry and the fact that whoever —

MARK HIGGINS 09:32

That might be. I don't know that offhand, to be honest with you.

STEVE 09:34

Yeah, I think I heard something to that effect.

MARK HIGGINS 09:36

They did employ similar models. The captain and the crew would have shares in the voyage, like options in startup companies. And there was the whaling agent — kind of like the general partner — who would have a management fee and an incentive fee based on the profits. I think the share was even higher than what venture capital firms get today. The number that's sticking in my mind is 39% on average, but I could be off on that.

STEVE 10:16

Okay, so private equity as an asset class emerged a little bit later and in a different context. At a high level, how would you describe the original role of private equity, and what did the early days of PE look like in comparison to the early days of VC?

MARK HIGGINS 10:35

Yeah, so private equity — or buyouts, which is what I would call them — started in the mid-1970s but really took off in the 1980s. I think the first one was Thomas H. Lee. And then KKR and Forstmann Little — which a lot of people haven't heard of, but it was actually an early buyout fund. They really took off in the early 1980s and benefited from a bunch of tailwinds.

First of all — this is a long story and was actually more directed at venture capital — but the Department of Labor changed its interpretation of the prudent man rule, which allowed institutions to invest in venture capital firms. The main purpose was to allow them to invest

in venture capital, but it also affected private equity firms. So they had greater access to capital.

But the more important thing was the environment was just almost perfect. You had interest rates at high levels, but then Volcker tamed inflation and ended the great inflation in 1982. So you had a decade of declining interest rates and a decade of rising equity multiples as interest rates declined. Plus, you had just a ton of inefficiency in companies that had accumulated during the great inflation.

It was a wonderful opportunity to buy companies with a lot of debt and then refinance that debt consistently at lower rates. Equity multiples for exits were rising, so you could spin off companies at a higher multiple and then exit the entire company at a higher multiple. And there was just a lot of inefficiency that you could wring out — and they generated enormous returns in the early 1980s. But just like everything that attracts a lot of competition, by the late 1980s and early 1990s, it had run its course.

STEVE 12:34

I remember reading about the prudent man rule in your book. Maybe you could just briefly touch on what it was and what impact it had on the creation of the private equity ecosystem. And if you think it makes sense, maybe talk about the emergence of institutional investors — pension funds, endowments, et cetera — and the role they played in the creation of the private equity asset class.

MARK HIGGINS 12:54

The prudent man rule — it's now called the prudent investor rule — but it's not just one single issue. The issue that got solved in 1979 was an interpretation of the prudent man rule under ERISA, which was passed in 1974. That interpretation essentially meant that institutional investors felt they couldn't invest in any company that was expected to be a major loss. So it was really looking at investments at an individual level. For venture capital, you are by definition investing in a lot of companies that are going to be total losses — but it's offset by the big wins.

So the reinterpretation of the prudent man rule in 1979 changed that. Trustees now felt they had the guidance that they were allowed to invest in a portfolio of companies, as long as in aggregate those companies were expected to provide acceptable returns — you don't have to worry about individual companies. So that change is what essentially released institutional capital.

MARK HIGGINS 14:07

Let me take some more questions. Maybe we can just go back and forth.

STEVE 14:11

Well, I guess related to that, you mentioned that private equity effectively got its start as we recognize it today in the 1980s. And the other thing that happened in the 1980s was the emergence of the junk bond, or high-yield bond, asset class. What's the causation relationship? Did the emergence of junk bonds in effect create or at least help create private equity? Or is it the inverse — did the rise of private equity necessitate the creation of a high-yield bond market?

MARK HIGGINS 14:37

They both fuel each other. If you have a chicken-and-egg problem, it was the emergence of buyout funds that prompted the demand for junk bonds. And as these companies could raise debt so fast through junk bonds, that fueled the growth of the buyout industry. So it was kind of mutually reinforcing.

STEVE 15:08

So we understand the general context and backdrop in which both ecosystems emerged. I'd be curious if you know this — and it's certainly fair if you're not aware of it — but the early returns of private equity and venture capital: do you have a sense for how those early returns compare to today's returns for both asset classes?

MARK HIGGINS 15:29

I don't have specifics on buyout funds. I do remember — I believe it was in the book or in some research — the IRRs of the early funds were just high double digits. I think I remember something like 60% for one of the KKR funds. It was just off the charts — like shooting fish in a barrel in the early days.

Venture capital is interesting. I do have some stats in a paper I published — 'A Whale of a Tale,' with the Museum of American Finance. The 20-year period ending in 1999 was somewhere around — I think it was high 20s — around 28% average IRR. But that dropped. The next 14-year period — it was hard to judge beyond that with the data — had dropped to about 11%.

And that's something you'll probably ask about: the long-wave cycles, how they work. Once you've seen enough of these and witnessed some of them firsthand, you see how this works. A void opens in the capital markets for a very legitimate reason — in 1946, it was the commercialization of World War II technologies coupled with the skittishness of banks;

in private credit after 2009, it was the need for capital following the financial crisis. What happens is the early capital providers, for legitimate reasons, find great opportunities, and the scarcity of capital lets them get very good terms. They generate very good returns, that attracts followers, and over a decade or two, the returns go from exceptional to not worth it. And that's the cycle.

STEVE 17:31

So before we get to the growth and the institutionalization of these asset classes, I'd love to ask you an opinion question, because it's completely impossible to know this for certain. But when Greylock and Kleiner Perkins and folks like that established their early VC funds, and when KKR and Forstmann Little established their first PE funds, do you think they had any idea what their respective ecosystems would eventually grow into? Do you think where we are today was ever on their radar?

MARK HIGGINS 18:00

No — in fairness, I don't think they did. If they did, they had a crystal ball I've never seen, because to predict something like that, there are too many variables to even come close. But I think they did what every entrepreneur does: they saw a glaring gap in the market and they filled it. And that's the same for Microsoft, KKR, Google — any entrepreneurial venture. I don't think they ever envisioned becoming what they are. They were just focused on filling a gap in the market.

STEVE 18:38

Okay, so let's talk about how these ecosystems have grown and institutionalized over time. I think it's safe to say that returns are effectively lagging indicators of where an ecosystem is in its lifespan.

MARK HIGGINS 18:56

Yes, very lagging — which is often a source of confusion.

STEVE 19:00

Yeah. So as VC and PE started to demonstrate real success, I'm curious: before the returns started changing, what were some of the early signs that these models were moving away from being niche strategies and toward something more institutional?

MARK HIGGINS 19:17

I think the inflection point — I don't know if it was obvious at the time — was in 2000 when David Swensen published his book *Pioneering Portfolio Management*, which outlined the

strategy that the Yale University endowment used to massively outperform its peers.

He didn't say this explicitly in the book if you read it closely, but really what Yale did is they had exceptional people, exceptional governance, exceptional access, and they got in early on venture capital and buyout funds. They should be credited with that — it was a very astute and bold move. But the problem is that when he published his book, a lot of people just interpreted it as: oh, he allocated to buyout funds and venture capital funds, so we should do that too. And since that time, you just saw an explosion of allocations at public pension plans, endowments, and foundations to alternative asset classes. And just like whaling, just like railroads, just like canals in the early 1800s, a great opportunity got broken by scale.

I remember when I first went into investment consulting in 2009, I bought into the whole alternatives argument. By 2014 or 2015, I just looked at what was happening and said: this is not working. First of all, everyone's doing it — and by definition, if you want to get a mediocre outcome in investing, do what everyone else is doing. That basically guarantees mediocrity.

I remember some distinct moments. When I was at an investment consulting firm, we were evaluating an OCIO provider and I went for a full day of meetings. They were talking about how they were differentiated, but once you've seen enough of these, they all say the same thing. And I remember talking to the CEO about how they were differentiating themselves in venture capital. She just kind of leaned back and said, 'Gosh, it used to be so much easier.' That's the one thing I remember. She was articulating what I was seeing: it was just too crowded at that point.

STEVE 23:24

So just reinterpreting your answer — it sounds like, at the risk of using a brute-force metric, the number of investors following the strategy in question is at least one warning sign that pre-dates the compressing returns. But how does one know what 'a lot' is? Is it 10 endowment funds? Is it a hundred? Is it a thousand? As any given asset class attracts more investors, how does one know what constitutes 'a lot'?

MARK HIGGINS 24:00

If you're reading about it in the Wall Street Journal, it's probably too late. Those are just some general rules. I don't know — it's taking a lot of variables and putting them together. Some of it is just time. Some of it is a feel for...

There's a group of us — I don't know if you're familiar with Lava, Kunamoto, and Tim McGlenn — that just kind of email each other. And I don't know how to quantify it, but the level of absurdity that you're seeing right now: I locked myself in a basement for three and a half years to write a book on US financial history. If you locked me in a basement for three and a half years and told me to come up with the most absurd thing I can think of to describe this time, I don't think I'd be able to do it.

I just saw a podcast — it's going to sound a little mean, but I just don't know another way to say it. It's called 'Alt Going Mainstream,' and it starts with this little jingle that goes: 'Everybody gets a piece, we're going mainstream. Everybody's going to eat, we're going mainstream.' And when you hear something like that, they're basically singing a jingle that describes a market that is completely saturated. By the time you hit mainstream for alternatives, it doesn't even make sense anymore. And it's reached the level of absurdity — at least in my mind, from what I've read of the past.

STEVE 25:44

Well, at least specific to private equity, you have the management companies of the private equity firms as publicly traded assets, which never used to be the case.

MARK HIGGINS 25:53

Yeah.

STEVE 25:55

And I don't think this is permitted by law yet, but I've at least heard rumblings that private equity investments — there is talk of making them available to retail investors, including them in things like 401(k)s and Roth IRAs.

MARK HIGGINS 26:10

They're already available to retail investors, actually, through evergreen funds — which I do want to talk about. But the 401(k) thing, I think, would be a huge mistake. I believe Lloyd Blankfein — the former CEO of Goldman Sachs — just came out speaking against it, and I think he's right.

The irony of what's going on is that when I wrote *Investing in US Financial History*, I literally read my way to the present. And a key inflection point was 1934, with the passage of the Securities Exchange Act and the Securities Act of 1933. Before that, securities were unregulated. And it's almost like these private markets want to have access to public markets, but without the regulation. It's like bringing back pre-1933 and pre-1934 markets,

and nobody remembers it.

And putting these in 401(k) plans is a huge mistake. This is late cycle. If you've studied history, you know: when they start going after retail investors, that's the end. They're not doing it because they want to give retail investors access to something wonderful. It's because they need to get rid of something bad.

STEVE 27:40

Okay, so at this point in history, both asset classes exist. We are starting to see early warning signs before the compression of returns. You mentioned the number of investors in the ecosystem —

MARK HIGGINS 27:55

I would say late warning signs. They're not even early at this point.

STEVE 27:58

Okay. We've got lack of differentiation among investors, we've got frequency of reporting in the mainstream media. So let's talk about what happened after the inception of these ecosystems and after these warning signs. Maybe walk us through the next stage of life in these ecosystems before they hit saturation and maturity — if that's where you think both of them are today.

MARK HIGGINS 28:21

What's hard to predict is the timing of what's going to come next. What concerns me most right now about private markets is these evergreen semi-liquid funds, which have just been in the news. I don't know if you were following what happened to Blue Owl when they permanently ended redemptions for one of their funds.

Semi-liquid funds violate probably one of the most fundamental rules of finance, which is: you don't offer liquidity that is a significant mismatch for the duration of the assets you're investing in. It's like banking, right? If you invest long-term and offer people the ability to take out their deposits at any time, you're going to have a run eventually. And what evergreen funds are doing is more like an unregulated bank than an investment fund. What they're doing is buying private assets — interests in private equity funds and private credit on the secondary market. Through a weird accounting loophole, a lot of them are immediately marking those assets up. They buy something for a 20% discount and immediately mark it back up to NAV, so they get literally a one-day return. And so they're buying up these secondary interests — and doing some direct investment as well — and

then investors in these funds can redeem their investment every quarter.

And the problem is that works as long as inflows keep coming in or at least don't drop, and investors don't all redeem at once. History shows — and I can't tell you how many times I've seen this time and time again — that that will break. We're already starting to see cracks, especially without a lender of last resort, a central bank to support you. It's just repeating. And when it breaks, I feel like that is going to be where it breaks. I never try to call timing, but there are a lot of signs that we're at the breaking point.

STEVE 30:46

So speaking of that arc — the arc from inception to growth to success to institutionalization, and finally to saturation — would you say that arc is inevitable for any private market or alternative asset class? Or is it more context- or situation-dependent? Is every asset class bound to follow the same arc based on history?

MARK HIGGINS 31:14

The alternative ones are a little different because they're appraisal-based valuation — you're not getting a market price every day. I can't say it's inevitable. It's definitely likely that when you get some kind of gap in the capital markets, the early capital providers are going to generate exceptional returns. Eventually people start chasing those returns, and the dynamic flips: you have too much capital chasing too few opportunities. And eventually that catches up to people, then everybody flees, it becomes completely unattractive, and the cycle repeats. Usually these things take a couple of decades to go through.

STEVE 32:11

Let's talk about the dispersion and compression of returns as we are in the middle to late innings of any given asset class. You've talked about how, as large amounts of money flow into an ecosystem, returns compress. That makes intuitive sense to me, but I'd love to double-click on specifically why this happens. Is it entry prices rising because there's more money chasing the same number of opportunities? Is it investors losing discipline because they don't want to lose deals to competitors? Is it investors ending up in less attractive businesses because they feel like they have to deploy capital? What specifically drives it?

MARK HIGGINS 32:53

It's all of the above. When you have too much capital chasing too few opportunities, people are going to bid up prices — and that's going to squeeze returns. You're already seeing this; there's a lot of evidence of it in private credit. They're going to relax covenants, which exposes them to more risk when they're funding deals, because they have to relax

covenants to get the deal.

And then there's the Jamie Dimon issue that keeps getting tossed around: when you see one cockroach, you see many — that's not a coincidence. What happens when you have a lot of capital that needs to get deployed fast, and firms are deploying more and more of it so they can't do the same level of due diligence? That attracts cockroaches — people who are willing to bend the rules or break the rules. They're attracted to an environment where there's a lot of money being deployed fast and with increased recklessness. One cockroach — that's why you don't usually see just one. At this point, there's so much capital, it's been going on too long, underwriting is eroding, and cockroaches love that.

STEVE 34:15

What role did scope creep play as VC and PE funds got larger? Just thinking about it intuitively, the focus and strategy of a $50 million private equity fund almost has to be different from that same firm on its third or fourth fund with $500 billion in AUM. Can you just talk about the role that scope creep either played or didn't play in the dispersion and compression of returns in both asset classes?

MARK HIGGINS 34:48

Well — the funny thing is I don't invest in any of these areas, but I do hear stories. My wife works for a fertility benefits company and has been in healthcare for about 30 years, and she always talks about just the proliferation of garbage digital health companies. And we often talk about how that's a function of there being too much venture capital money out there — they're funding all kinds of ventures, and it's creating confusion in the market.

I don't know the details well enough to answer this on a detailed basis, but the more venture capital that gets deployed, my suspicion is — and this goes for buyouts too — they're entering areas that are not really conducive to venture capital, that don't have those home run dynamics. But that's my suspicion. I don't really have a detailed perspective on that.

STEVE 35:56

Let's talk a bit about differentiation — what separates the good VC firms from the average ones and the good PE firms from the average ones — because both spaces have become quite crowded, as you've noted.

STEVE 36:08

So as we fast forward to today, what seems to separate — or at least historically, what has separated — the small number of firms that continue to produce great results versus the larger group producing less compelling returns? Can history tell us anything about what makes the difference?

MARK HIGGINS 36:25

This is a lot like whaling. If you were a good whaling agent, the best captains would come to you. You could choose the captains that managed a crew well, and you knew the secret routes that might yield something particularly attractive in terms of a fishing spot. The same principle applies to venture capital firms. And this was especially impactful in the 1970s, 1980s, and 1990s.

There's a quote I used in the book from Jim Clark, who founded Netscape. He talks specifically about not wanting to take venture capital — but it was a monster return. And he talks specifically about how taking money from Kleiner is different from taking money from somebody else. The best entrepreneurs are attracted to the best venture firms because it's a stamp of approval. If you take money from Kleiner, clients are going to take you more seriously. Sequoia, Andreessen Horowitz — that's a more modern one. So there's this magnetism where the best entrepreneurs are attracted to the best venture capital firms. And that's very key for persistence of returns.

Now, is it possible for an upstart to enter? Yes, but the odds are lower. In this era, where funding a company that is going to be worth hundreds of billions of dollars, being in that small ecosystem where the best entrepreneurs are attracted to the best VC firms is very important.

STEVE 38:07

So maybe you've answered this already, but there's a longstanding question in VC specifically. The question is basically: are the top-decile VC firms truly better investors than everybody else? Or are they kind of the best marketers who attract the best founders, who are destined to produce top-decile results regardless?

MARK HIGGINS 38:28

Well, I think it's both. If you're an effective marketer, the best entrepreneurs will come — and attracting the best entrepreneurs is what's required to be a good investor. So I think it's kind of the same thing. The best VCs are the ones that can attract the best entrepreneurs.

It's like being a head football coach — you have to train the team and be a good coach, but you also have to be a good recruiter. And so I think it's part of the package. The best VCs are the ones that attract the best entrepreneurs and can get the right board in place, the right partnerships. They are really like a head coach, and I think it's a rare skill. I wouldn't differentiate between investing and marketing — the marketing is part of the package. Sure, that makes sense — a big part of the package.

STEVE 39:28

I want to ask a few questions about what inning we're in. I think I know your answer based on what we've discussed, but I do know it's easy for observers to suggest that any given ecosystem is in its later innings, and that isn't always the case. One example close to my heart: one of the world's most successful podcasters almost didn't launch his show ten years ago because he consistently got the feedback that podcasting was in its late innings and it was kind of too late. And obviously that advice was misguided.

So certainly a tangent relative to the history of PE and VC, but just an anecdotal data point to suggest that observers aren't always correct about what inning we're in. So can you just talk to us about what inning you think we're in in PE and VC and what makes you say that?

MARK HIGGINS 40:22

Well, first of all, I actually don't like the inning analogy, because this is a perpetual game. I like thinking about it in terms of waves. And you have these long-wave cycles that are very difficult to detect. I would probably categorize this as the alternative asset classes wave — 45 years in the running, really starting around 1980. And we're at the crest.

My gut feeling is that it's going to be a long and painful way down before we hit the trough. It's a 10- to 20-year cycle to finally hit the trough. That's really the way I look at it. After you've studied history, you understand there's no certainty. I actually don't think that podcast example violates the wave analogy.

It's just a matter of probabilities. When something's attractive, maybe there are 60 good eggs out of 100 to invest in. When things are really unattractive, maybe there are five. That doesn't mean you can't find five good eggs — it's just that the odds are really bad. So if you're going to try it, you better be really good at it, or you're probably going to lose.

In the early 1980s, it was probably like 60 or 65 [good eggs out of 100]. Now it's like 10. So are there good opportunities out there? Sure. But the odds are really against you.

STEVE 43:28

What if I asked you that question, hypothetically, of course, 10 or 15 years ago? What if I asked you what inning we're in 10 or 15 years ago? What are the specific indicators that have proven more reliable in terms of signaling whether an ecosystem still has room to run versus nearing saturation? Does anything come to mind?

MARK HIGGINS 43:48

I thought it was saturated 15 years ago. I didn't see the level of absurdity that I see right now. If there's one distinguishing factor, it's the sheer level of absurdity and the arguments and rationalizations being made. It is so mainstream. When everybody is talking about private equity and private credit and trying to get it into 401(k) plans, it is just a glaring sign that it is late cycle.

I didn't see that 10 years ago. But I did think it was overextended 10 years ago — I will say that.

STEVE 44:32

Are there any ecosystems today that you think are akin to venture capital in the 1970s or private equity in the 1980s — any ecosystems where absurdity has not yet run amok that you find to be particularly compelling?

MARK HIGGINS 44:50

Honestly, my gut feeling is you have to have a correction for those to emerge again. Are they there somewhere in private equity and venture capital? Private credit, maybe — but there's just too much capital there. I feel like there needs to be a correction, and then it goes too far in the opposite direction.

And there are great opportunities that need capital. I just don't feel like, generally, we're in that environment. Is there a pocket somewhere that I — and others — don't know about? Sure. By definition, it would probably be something I don't know about, because if it's mainstream, it's not attractive. So it's a hard question to answer. But my general feeling is we are at the crest — it appears to be breaking already in this long-wave alternative asset class cycle — and the brunt of it is in private equity and private credit.

STEVE 46:04

You mentioned that the exit environment has been constrained of late in both private equity and venture capital. Can you speak a little bit to why that might be happening?

MARK HIGGINS 46:13

It's just too much capital. The valuations that private equity and venture capital firms have on their funded investments are too high to exit. I think it was the Wall Street Journal — or someone — that came out with a stat that there are 32,000 companies awaiting exit. And if anyone wonders why there's a big secondary market with LPs willing to sell their positions at steep discounts, it's because they don't have confidence that the NAVs are real or that they're going to get their money in a reasonable amount of time.

It's the end result of a multi-decade flood of too much capital into these areas. They funded too many companies. They can't exit at the values that they've marked them to. That's the consequence.

STEVE 47:17

I always conclude with the same question, and I'm particularly interested to hear your answer because — as you said — you locked yourself in your basement for three and a half years to study financial history starting in the mid-1700s. So you've learned a lot recently. Which makes me particularly interested in your answer to the following question: what is the most meaningful lesson that you have learned over the past year, across any domain of your life?

MARK HIGGINS 47:42

A lot of people think I'm negative and I'm actually not. I feel like financial history knowledge is most valuable when you're identifying some type of systemic problem. Maybe you're wrong — but to the best of my ability, I try to use financial history to identify systematic problems that are dangerous and very few people see.

And the funny thing is, it's hard intellectually, but it's so much harder psychologically. And dealing with that psychological challenge is really, really hard. You have to put yourself out publicly. If you're wrong, you're going to be humiliated. Everybody will tell you you're wrong. People will ridicule you.

I've had friends who won't talk to me anymore because it threatens their livelihood. It's a very lonely place to be. And for a long period of time, there's no promise you're going to be right. And even if you are right — that's the other thing — you can't celebrate. Because if you are right, that means everybody else is wrong and they're about to get hurt.

But on the flip side — and I've actually thought a lot about this — it is rewarding to have found a way that I can, as a profession, just dedicate myself to figuring out what I think is the truth, acknowledging I could be wrong. And I will admit it when I'm wrong. I have a rule: anything I publish, I never delete. That's a personal rule of mine. But you can really help

people. And I think it's worth it. I think in the grand scheme of things, if you can push this industry toward progress, even when it's painful to you and others, I think it's a worthy thing to do.

STEVE

Yeah, that's what I thought.

STEVE 50:10

Anything that you would do differently with the benefit of hindsight in terms of the book? Or would you do it exactly the same if given the opportunity?

MARK HIGGINS 50:19

I feel like you have to have enough time pass to do a second edition — you can't do it just a couple of years later. But I definitely have things I would change in the book. Nothing too fundamental, but I think the biggest miss — and I actually thought about doing it — was that I had Richard Sylla, who's an extremely well-known economic historian. He looked at a couple of my early chapters and asked me why I didn't write about Andrew Jackson and extinguishing the debt. We almost got the federal debt all the way down to zero.

And I'm definitely going to add something on that, because I think the debt is the biggest threat in my mind to the nation's future. I think we'll solve it, but it's a big deal. And I wish I'd put that in it. There's a lot I would do differently. I've learned a lot over the past couple of years since I published it.

STEVE 51:31

Mark, where can people go if they want to learn more about you, learn more about the book, learn more about the other writing that you do? Where should they go?

MARK HIGGINS 51:41

I just launched a new website called finhistory.com — F-I-N-history.com. That has all the articles, and there are a few speeches I've done that are public. There's a newsletter you can subscribe to. Those are the main places, and there's a link to the book there.

STEVE 52:04

That's great. And I'll say just from my own personal experience, when I first bought the book, I was slightly intimidated by its size — it is a big book. And speaking perfectly honestly, I thought it would be one of those books that I wouldn't finish, but I found myself not only finishing the entire book but really enjoying it. I don't know how you did it, but you

found a way to make it read in quite an entertaining, engaging fashion. Reading about financial history from the mid-1700s would seem like a particular flavor of dry, but somehow you found a way to make it very engaging and very interesting and always kind of tied into something that's quite topical. So those three and a half years locked in your basement, at least from this person's perspective, were very much worth it.

MARK HIGGINS 52:51

Well, thanks. One key was that I would run every chapter by my parents — they're very smart people, but they don't have a financial background — to make sure they could understand it. Because the goal was not just for investment professionals, but for anybody who wants to understand finance. And I tell a lot of people this: it's not that complicated. At the end of the day, there's so much complexity in this industry, but the core things that you see repeating over and over are really not that complicated.

STEVE 53:27

Yeah, and they seem to be fundamentally human at their core.

MARK HIGGINS 53:30

They are. Well — that's the thing; that's another misconception I began to appreciate as I read my way to the present. People do not change. Everyone thinks that things are different now. The human brain does not evolve very fast, and people in 1790 were no different than they are today.

STEVE 53:51

Great place for us to leave it. Thank you for joining us today.

MARK HIGGINS 53:54

All right, thanks, Steve.