Demetri Kofinas:	00:00	Before we begin today's episode, it's important to remember that nothing we say on this podcast can or should be viewed as financial advice. All opinions expressed by me and my guests are solely our own opinions and should not be relied upon as the basis for financial decisions.
Demetri Kofinas:	00:18	If you want more information about this week's episode or for easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you listen to the show on your Apple Podcast app, take a moment to write us a review. Each review helps more people find the show and join our amazing community. And with that, please enjoy this week's episode.
Demetri Kofinas:	01:03	What's up, everybody. My guest on this episode of Hidden Forces is Jim Chanos, founder and managing partner of Kynikos Associates, the world's largest, exclusive, short-selling investment firm. Jim is a legend in the investment space. Having identified and sold short the shares of numerous, well-known corporate financial disasters of the last 40 years. Companies like Baldwin United, Commodore International, Conesco, Tyco, and most famously, Enron, which Barron's dubbed at the time the market call of the decade, if not the past 50 years.
Demetri Kofinas:	01:44	And yet, in the two decades, since the arrests of key executives at Enron, Tyco, WorldCom and a host of other companies, we've seen very little in the way of white collar prosecutions and investigations of large scale corporate fraud. Indeed, prosecutors have seemed content to simply charge the companies involved while letting their executives off the hook. Why is that? Have America's executives suddenly become more law-abiding or have prosecutors become more reticent? Are they afraid of losing cases? Do regulators not have the resources they need to investigate claims of fraud and malfeasance? Or is the problem regulatory capture and a revolving door of executives from corporate America to the government?
Demetri Kofinas:	02:30	These are just some of the questions that Jim and I explore in this nearly two hour long conversation, where we also discuss Jim's philosophy on investing, the foundational elements of a successful short sale, the role of the news media in both unwittingly facilitating and then helping to expose corporate fraud and the regulatory backlash that often accompanies similar periods of financial access, like the one we are arguably living through today.
Demetri Kofinas:	02:59	I also asked Jim for his view on specific companies, which he has been openly short for a number of years and why he thinks some of them have rocketed to valuations that were previously unimaginable to many value investors focused on facts and fundamentals. Is today's economy truly different or will we look back at this time as one of the greatest periods of financial access and euphoria in the entire history of American capitalism?
Demetri Kofinas:	03:30	Those of you who are regular listeners to this program will know just how much time and effort I put into bringing you these conversations, unfiltered and unbiased by the requirements of corporate sponsors and the interruptions of commercial advertisers.
Demetri Kofinas:	03:47	The entire show is funded, from top to bottom, by listeners like you. It's not a model you will find elsewhere, at least not for a podcast like this, but it's one that gives me the freedom to focus exclusively on you, the listener, by bringing

you some of the best quality content and conversations on geopolitics, public policy, science, technology, culture, markets and investing. I make the second half of my conversations along with the transcripts to each episode, as well as the research and notes that I put together ahead of each and every conversation available to Hidden Forces premium subscribers.

Demetri Kofinas: 04:29 These are the tools that I use to become not only a better investor, but a more knowledgeable citizen who can make more informed choices about the things that matter most, not only to me, but also to all of you. Your investments. Your health. Your families. And your communities. To be in a position to exercise power over your own life. And in today's hyper-connected information economy, knowledge is power. And on that note, please enjoy yet another deeply insightful conversation with my guest, Jim Chanos.

Demetri Kofinas: 05:11 Jim Chanos, welcome to Hidden Forces.

Jim Chanos: 05:14 Thank you. Thank you for having me, Demetri.

Demetri Kofinas: 05:16 The pleasure is all mine. So, Jim, for those who either may not know who you are or who may not know much about short-selling, how do you describe who you are and what you do to people outside the financial industry?

Jim Chanos: 05:34 Well, I'm the president and founder of Kynikos Associates, which is a private money manager based in New York. And we just celebrated our 35th year. So, I founded it in 1985. And I like to joke that for institutional investors globally, I'm in the insurance business, that we basically are fundamental short sellers. We create portfolios for our clients of securities that we think will dramatically underperform the market with the idea that allows them to either hedge their exposure or allows them, more likely, to be more long than they otherwise would in markets particularly like the one we're in right now, that are highly speculative.

Demetri Kofinas: 06:17 So in other words, most of your clients are people who use your fund to hedge a larger portfolio of investments?

Jim Chanos: 06:24 Exactly. Almost predominantly. We have very, very few people who give us money because they're bearish on the stock market. There are better ways to do that than ... If you're just making a short-term trade, you can do that in the futures market or in the options market. What we're looking for in our portfolio is really companies that will structurally underperform and also provide a hedge on top of that. So, the idea being that there's a pretty good sized idiosyncratic alpha that's on the fundamental short side for all kinds of reasons and that having a portfolio of those kinds of securities definitely is a good offset to the long side and maybe additive on both sides actually, and has been in the past in some years.

Demetri Kofinas: 07:06 I think that when most people hear that someone is selling something short, they tend to synonymize that with "so-and-so," Jim Chanos in this case, "thinks XYZ stock is going to go down." The person shorting it, in other words, is bearish on the asset. How do you define or describe what short-selling is?

Jim Chanos: 07:28 Well, first of all, I'll step back and say there's all kinds of transactions that people conduct every day that are in effect short-selling. Short-selling, broadly speaking, is taking in cash up front for goods and services to be delivered later. So, if we think of the largest short-selling business in the world is insurance, in which an insurance company collects premiums either upfront or annually with a promise to pay under some circumstances in the future. An airline that sells an advanced purchase seat to you is short-selling that seat. A farmer that sells his crops at an attractive price in the futures market a year down the road is short-selling his crops.

Jim Chanos: 08:11 So again, any business transaction where one side receives cash up front for goods or services to be delivered or performed later is a short sale. So, that's the broad definition of it. In the securities markets, short sale is affected by borrowing the securities for a small fee usually, sometimes a large fee, from a lender. Could be a large mutual fund, could be a passive ETF. These kinds of portfolios lend their securities out routinely for extra amount of income. And then those lent shares are sold. The concept being to buy them back later and return the shares at a lower price, locking in a profit. So, that's what a short sale is in the securities markets or futures markets.

Demetri Kofinas: 08:59 Right. In other words, the profit is what you got paid when you sold it, minus the price you paid for it when you bought it back, plus the fees to carry it. So, that's a natural segue actually to something else I wanted to ask you about, because I spent some time in preparation for this discussion trying to think about what a successful short would look like beyond the obvious fact that it would have to be profitable. But what the recipe would be?

Demetri Kofinas: 09:29 And I came to the quick conclusion that it's more or less the same thing as what you would need for a successful long. And the components I thought about, one is social psychology, what do most people believe about X. Then there's also empiricism and reason. How do their beliefs about this match up to reality, "reality". And then narrative, how can I erect or perpetuate a narrative that people can adopt in lieu of this consensus view to become the new consensus, which then will drive the value of the stock to where I want it to go, whether that's up or down. Is that more or less right?

Jim Chanos: 10:14 It's more or less right, Demetri, on a very clean level, but there's one major asymmetry. And I always used to think that going short was just the mirror image of going long. You did the same kind of hopefully detailed work. You came to a conclusion that was meaningfully different from the market. You took your position and you basically at that point did whatever you could from a legal point of view that would change that narrative, to point out to people why you're right and why the market's wrong.

Jim Chanos: 10:44 That's not the way I think anymore after almost 40 years of doing this because of a number of behavioral finance asymmetries. And the most important one is simply the concept of negative reinforcement. And by that I mean, I've always said that the studies have shown that most rational people have their decision-making impaired in an environment of negative reinforcement. An interrogation would be the ultimate example of that, where you basically, your will to withhold information is broken down.

Jim Chanos: 11:19 In the securities markets you have to understand that there is just an entire infrastructure that is built around promoting stocks and being bullish. The companies themselves, press releases, today, the use of aggressive proforma metrics and accounting, sell side analysts, financial TV. I mean, it's an entire ecosystem that's designed to have you purchase securities. So, if you are a short seller, fundamental short seller, you come in every morning and in our portfolio of 50 or 60 stocks, I can pretty much count on 5 to 10, having some sort of positive commentary, sell-side analysts raising estimates or target price targets or takeover rumors or the CEO on TV promoting the company, whatever you have.

Jim Chanos: 12:14 And if you're a short seller, that's an environment of negative reinforcement. You are being told every day pretty much across the board you're wrong and here's why. When you're on the long side, you're floating with that behavioral finance current, but when you're a short seller, you're swimming against it. And for most people, life is too short and they just sort of, "Yeah, I know I've done my work and I know this company seems to be making up its numbers and it's heavily leveraged and it looks like it's about to go off a cliff, but boy, five investment banks love it and the CEO is very charismatic and everybody on Twitter seems to think it's the greatest thing since sliced bread. Life's too short."

Jim Chanos: 12:58 And that's a problem. That for most investors they'll simply say, "Why do I need to do this? I'm being told I'm wrong every single day." And then maybe once a year, once every two years the company comes clean, then you make all your money in one or two days. There are real, structural and behavioral finance barriers, which is why, by the way, I think that the idiosyncratic alphas from the short side historically have been so high. Note that I said historically. Recently that has not been the case, but things change always. So, I think that that behavioral finance aspect of the short side, the fundamental short side versus the fundamental long side is a really important concept that a lot of people miss.

Demetri Kofinas: 13:46 I guess the question is, what kind of a person can operate successfully in that type of environment? Because it's very difficult for people to break with the consensus. It's very difficult to sit outside of the group.

Jim Chanos: 13:58 Right. That's the corollary to my observation. And that is, I used to think that really great short sellers or good short sellers could be made and were not born. I've modified that over the years because I think there is certain kind of personality that can say, "Okay, well, yeah, I know they're all screaming that I'm wrong, but I have the facts on my side and the price probably already reflects all that bullishness. And what they're not considering is A, B, C and D" That is not everybody. And I've known an awful lot of good analysts who turn out not to be great portfolio managers on the short side. And for that reason, then it just seems to be psychologically a very difficult place to stand.

Jim Chanos: 14:43 So, as I said, I've modified my view on that over time. And that I think that good short sellers probably are some combination of both the ability to do that work and then to be able to take the heat inside that bubble of people saying, "You're wrong."

Demetri Kofinas: 15:01 Although you must've had some hint of that because you named your fund Kynikos. And that's a reference to cynicism. And the cynics did stand somewhat apart, though I imagine you probably don't live in a clay pot.

Jim Chanos: 15:19 Well, the Kynikos means actually dog-like in ancient Greek. So, the cynics where the dog people quite literally, but I don't know. I might challenge you on that. The cynics lived outside. I mean, they actually were there to prevent and question demagoguery and other things in ancient Athens that they saw could be the ruin of society and they did so within the confines of the Algoa and elsewhere. I mean, they were in downtown Athens, if you will. Although, the Dionysus, of course, supposedly did live in a barrel. You're right.

Demetri Kofinas: 15:49 Yeah. Yeah. Well, there were gadflies. It's in many ways, I'm not a student of cynicism, but as a philosophy, it resembles a lot of what Socrates or the way I think in which Socrates was described to have lived his life, sort of attitudinally. And of course I think the school originated from a student of Socrates. It is also very stoic.

Jim Chanos: 16:10 The stoics derived from the cynics.

Demetri Kofinas: 16:13 Right. Exactly. To follow on the point about social psychology, to what degree financially speaking, does it also become more difficult to be short in the face of an unusually long expansion, like the one we're living through today?

Jim Chanos: 16:31 You're also basically making the assumption that we are also not long, either the market or being compensated that way. And I changed my business this bottle in the mid-'90s to reflect that. So, we have hedge funds that are long the market and short our stocks. And then for our short accounts, for the most part, we're compensated on an inverse benchmark. So, again, I'm providing insurance and if the market is up 30% that year and we're flat, for the client, that's the same as if we were up 30%.

Jim Chanos: 17:02 So I've taken the stock markets, the systematic risk out of most of what I do for obvious reasons. Stock markets tend to go up over time with economic growth. I mean, I understand that. Now, the flip side of that is, is most businesses fail. That's the flip side of our creative destruction of capitalism. So, most of the returns or a big chunk of returns and stock market investors get are in the survivors, in the winners. Which is one of the reasons why passive indices tend to outperform active management over time on top of transactional costs.

Demetri Kofinas: 17:38 Because they recycle the winners.

Jim Chanos: 17:40 Yeah. Well, the indices are constantly basically investing in those that are survivors and the companies that fall by the wayside are discarded from the index. And so again, there's a small amount of factor that, but the fact of the matter is most public businesses do not make it. So, the discrete aspect of that is interesting and we can get into the granularity of it, but I'm surprised that more people do work on the fundamental short side, given that simple fact.

Jim Chanos: 18:08 And it's why relative returns have been so good. But when you get into an intergalactic bull market like the last couple of years of the dot-com era or the last couple of years more recently, then it becomes much more difficult because actually the kind of craziest or most questionable businesses are those that outperform the most. And that's when you really begin to challenge your own sanity to say, "Well, am I losing my mind here or is this company that was clear evidence of fraud really worth $20 billion?" And every day you come in, it's still worth $20 billion or more. And you really do begin to question, no matter how good a short seller you are and how tough your skin is, your financial sanity. Because in really epic bull markets, people do really silly things with their capital.

Demetri Kofinas: 19:03 I have so many questions for you, but let's start with, how do you manage that? That uncertainty and self-doubt? When you're looking at something and it looks like a duck, but everyone keeps telling you as a cow. How long can you continue to stare at a duck before you start to believe that it's a cow and what do you do to manage that?

Jim Chanos: 19:24 Yeah. Well, first of all, it helps to really, really be able to ascertain what reality is. Do you think it's a duck or is it really a duck? So it helps for us to do some reasonably good work to understand that in fact, that it's not a cow, that it's a duck. Then the whole idea becomes, okay, what kind of environment are you in? Do people believe that this was a cow for years now? Do you need to size your position differently, if you have a strong view fundamentally that it really is a duck, but it may take another couple of years for people to come around to that view.

Jim Chanos: 19:59 Should you basically have that view in the way of a short position? Should you use options to limit your risk? I mean, there's lots of different things that come into the mix in this and what's going to change the mass hallucinations. Typically in that environment, it's not just one duck that is perceived as a cow, it's lots of them. And is this the best possible duck to be sure that people think is a cow? Are there better ones? I mean, all these things go into the mix as a portfolio manager, but there's not a whole lot you can do if the entire world for some short period of time or intermediate period of time wants to believe that a duck is a cow.

Demetri Kofinas: 20:39 I wonder if there are times when ... Now, to take this metaphor to absurdity, but our definition of what a cow is changes. I guess what I'm sort of saying is it does feel different today. Things feel different. And I worry because of the deep structural problems in our economy and our financial markets and how markets have become in many ways a political liability or a political problem, that we might be at a place where with government support prices are what policymakers say they are or make them. So, the value metrics that are normally used to assess and to make decisions about investing are perhaps no longer applicable.

Jim Chanos: 21:31 That's a really interesting concept. I don't know that anyone really has brought that up before. I'm kidding. That seems to be overwhelmingly what most investors think, that they cannot lose money in questionable companies. Again, I'm not making an argument about the stock market as a whole, but that they can't lose money in questionable accompanies, bad business models, accounting fraud, whatever, because the government won't let me lose money. That's a very dangerous place to be. It may work for a while, but you really don't want to be a rational financial decision maker saying, "Well, I just, I really am going to throw money at anything that just looks kind of crazy because the federal reserve has my back."

Jim Chanos: 22:18 That was actually, people forget this, that was actually the thought process late in the dot-com era. People forget that. There was the talk of the Greenspan put and that because the FED had cut rates after the 1998, default of Russia and

LTCM, they had been hiking rates as the economy got some speed to it. And when LTCM hit and the stock market took a drop in August, September of 1998, the FED reversed course, and everybody said, "Aha, see. They're more worried about the stock market than they are anything else." And people threw caution to the wind. And we had 1999 and early 2000.

Jim Chanos: 23:04 And then the market just started going down and it didn't matter what the FED did. And the FED started easing again and it still didn't matter. And the S&P went down 40%. I mean, NASDAQ went down 80% and most retail investors wished they'd never heard of the stock market. So, we've seen periods where people say, "It's different this time and the FED has my back and I can't lose money because the government won't let the market go down."

Jim Chanos: 23:32 Now, I would point out that this last round of easing by our FED was not due to the pandemic, really. It was due to the market beginning to wobble in the fourth quarter of 2018. If you remember, they'd been raising rates and all of a sudden credit spreads widened out and the S&P was down 20% by Christmas. And the FED reversed its tightening and began easing aggressively. And again, people have said, "Aha, see, I can't lose money. The FED," as you indicated, "this is a policymakers decision now and they don't ever want the stock market to go down. So, I can now leverage up and equities." And that's what they've done. So, we'll see. I mean, if indeed the central banks have solved the problem of risk in markets, it will be a first. Some might say that they've actually added risk to the markets, but we'll see.

Demetri Kofinas: 24:27 Yeah. I would agree with you there. There's a rule that I first heard back in the early days of ... Actually, it might've been ... Either before the outbreak of the war in Iraq or right afterwards, but it was Colin Powell that told Bush ... It's the pottery barn rule that if you break it, you own it. It almost feels like we've done that to markets or policy makers have done that to markets. So, that's also why I give more credence to the notion that they may simply do everything they can to prevent markets from declining because it's no longer like it was in the late '90s discretionary. It's actually mandatory that they intervene because they're holding everything together and they can't just step away. What would be the conditions in your view that would be required in order to get us to a place where we could actually see values retreat to, let's say, closer to reality?

Jim Chanos: 25:23 Well, look, things change. And I've been investing since 1980 in an environment where the treasury bonds basically went from 14% to zero. That is almost an unprecedented move and people don't realize to what extent the secular decline in interest rates have helped the financialization of our economy. I mean, you take the risk-free rate from 14% to zero, good things happen to asset prices for the most part. Now, are we going to replicate that and go to negative 14%? I don't think so, but who knows? Number one.

Jim Chanos: 25:58 Number two is I've always said, you can't hedge against torches and pitchforks. I think one of the risks that the market is completely overlooking is political risk. And by that, I mean, increasingly this policy that you talk about has benefited people that own assets and people that have stock portfolios and 401(k)s and homes in the mountains or the beach or whatever the case might be. That is not the majority of this country. And I think that you ignore that at your own peril. That there is a sense of people that benefit from these implicit government policies versus those that don't, that have seen stagnating wages, difficult to make ends meet or the brunt of the pandemic, whatever you might think.

Jim Chanos: 26:51 And to the extent that people forever just vote in a way that they think benefits holders of assets, you could see a sea change in that. And I think that that's a risk that really is being underappreciated. For example, a different government could decide that while the central bank can't let the markets go down for all sorts of structural and debt reasons, they certainly might tax those profits to capture more income to fiscally distribute in a different way.

Demetri Kofinas: 27:23 Well, what impact would that have on prices? I mean, if capital gains taxes went up, I mean, I imagine it would have some impact on equity prices?

Jim Chanos: 27:31 You would think so, or corporate taxes going up.

Demetri Kofinas: 27:33 Yeah. And you actually haven't seen the anticipation of that reflected in the market yet.

Jim Chanos: 27:38 I mean, clearly the Biden administration has called for both. Now, they may not be able to get it through the Senate, but the point being is there are ways in which politically you can take advantage of this central bank put that investors may or may not be appreciating. So, again, things change, but counting on policymakers to have your back is a very dangerous place to be. Policy makers are often wrong.

Demetri Kofinas: 28:07 To that point, I wonder ... Let's assume that the Democrats win the Senate seats in Georgia and they flip the Senate. I know that's like, everyone keeps saying that that's unlikely, but I don't know how unlikely it really is, given how incentivized both parties are to duke it out. And this is, 2020 is a different animal. Let's say the Democrats take the Senate. What do you think we're going to see over the next two years or what's more likely that we could see?

Jim Chanos: 28:34 Well, okay. Yeah. First of all, that is still probably unlikely. And as you know, I identify as a Democrat, but maybe a one in four chance of that happening. If you say that both races have a 50/50 chance. And so the Dems have to win both seats. So, 50% times 50% is 25%. But if that were to happen, if 2021 becomes like 2020 and anything can happen, there's a further challenge. And I don't want to get too wonky into the politics, that any policy that will have to go forward would have to basically go through what's called reconciliation. If you can't change the filibuster rule.

Jim Chanos: 29:14 So remember, for most legislation to get through the Senate, you need 60 votes, not 51. So, reconciliation, depending on how broadly you interpret it really only applies to budget and tax issues. So, that's how Trump got his tax cuts through in 2017. They had the Senate, but they didn't have 60 votes. It passed in the house. It passed in the Senate through reconciliation and Trump signed it. So, the Biden administration would have to use reconciliation to basically get budget and tax proposals through. But some of the broader issues might be more difficult. And I'm not a parliamentarian, but I do know enough about how Washington works that just because the Dems might hold the Senate doesn't necessarily mean everything can get passed.

Demetri Kofinas: 30:02 When you say some of the broader issues, what are you referring to?

Jim Chanos:	30:05	Well, I mean, there's certainly ambitious things like Green New Deal possibilities, lots of things that would require new legislation. Now, as we also know that the executive branch has taken more and more power via executive orders in the past handful of administrations. So, I would suspect that Biden will reverse immediately many of the things that Trump did by executive order. And I mean, it also means that that regulation, which is done via the executive branch, which implements the laws is much different in a democratic administration than a Republican administration. And you can see it already in how they've talked about things like education, environment and places where they can make a difference through regulation immediately.
Demetri Kofinas:	30:52	What do you expect or hopeful that we'll see when it comes to financial regulation? And that actually, let me tag onto that an additional question, which is to what degree do you hold regulators accountable for the accesses that we've seen in the last 20 and in particularly, the last 10 years?
Jim Chanos:	31:11	Yeah. I mean, I've dubbed this, the golden age, a fraud. And after a flurry of regulatory and legislative and criminal actions following the wave of fraud in the dot-com era, post Enron, we really saw a laxness, particularly post the global financial crisis, come back in into how we've really treated corporate wrongdoing. And we've seen things like deferred prosecution agreement. There was a wonderful review in the New York review of books by judge Jed Rakoff, who actually guests lectures in my class, my fraud class from time to time, in which he's calling for a more prosecutions of executives in corporate wrongdoing.
Jim Chanos:	31:58	And he's not alone in thinking that. That's the whole idea, that we go after companies on a civil basis for a lot of corporate wrongdoing simply means that for a lot of them the cost of doing business includes legal settlements. And as long as no one's being taken away in handcuffs and put away for five or 10 years, Which we did see post the SNL crisis in '89, '90 and post Enron in 2001, in 2002, you begin to see more and more corporate wrongdoing infiltrate the system. And if nobody really cares and you have a laissez faire regulatory system, it makes sense. Companies will push the envelope then.
Jim Chanos:	32:41	And I think that that is an externality that policy makers are missing, the sense that there is a sense by the public that there's two sets of laws and that a lot of laws about lying and stealing don't apply to corporations or executives. And I think that that's a really, really bad road to keep going down that. There's really two sets of justice for those in the corporate suite and those in the rest of America. And I really, really hope that we pull back from that and we give some teeth to places like the SEC and the Consumer Finance Protection Board and others to go after companies that are lying and cheating and stealing.
Demetri Kofinas:	33:25	Well, so to that point, how much of this is that the regulations need to change and how much of it is actually that prosecutors need the prosecutor. And if it's the latter, what accounts for that? Is it lack of resources or? Yeah.
Jim Chanos:	33:40	No, look, the laws are there. I mean, with Sarbanes-Oxley and the general securities laws and anti-fraud laws and the laws and regs are in place, there's just a lot of discretion in how you apply them. And if you remember, after the global financial crisis, the head of criminal at the department of justice gave an

interview in which he said that they were factoring in economic and financial impact on whether or not to prosecute individuals.

Demetri Kofinas:	34:08	Fraud was a cost of business.
Jim Chanos:	34:10	Well, yeah, exactly. So, if the DOJ is saying, "Well, we're not going to go after criminals in the executive suite because we're worried that will hurt the markets." Then you've gotten back to what we originally talked about, about policymakers trying to protect markets to the detriment of basic concepts like justice. So, I think that that was a really worrisome sign that things had changed. And that was 2009, 2010. And things have only gotten worse since then. And it's not just the US. Look at how the German financial regulators protected Wirecard over the course of 2019 and 2020.
Jim Chanos:	34:48	When it was just clear and mounting evidence this company was committing fraud, but because it was a DAX 30 company and a technology darling, the financial regulators actually went after the journalists and short sellers who were pointing this out, until the company finally admitted that it had missing billions of euros and what was in effect a fraud. So, there's lots of evidence of this in the marketplace today, and it's very worrisome and I think it's one area. Hopefully the new administration will address in at least enforcing the laws and enforcing the regs that are already in place and going after bad guys. I think long-term, that actually does a lot for consumer confidence and for investor confidence.
Demetri Kofinas:	35:31	If Enron were around today, would Ken Lay and Jeff Skilling still have gone to jail?
Jim Chanos:	35:39	It's a really, really good question. I don't know. I mean, I don't know. There's one little thing I want to add to this, and that is I've always joked that accompany stock price itself is not only the best defense lawyer, but the harshest prosecutor. So, it's also with the theory I teach in my course, that the fraud cycle follows the financial cycle, but with a lag. So, fraud doesn't get going until well into a bull market and doesn't generally crest or get revealed until after things start going down. And that's when people start losing money, they begin to politically get upset and scream for the regulators or law enforcement to get involved here or portfolio managers themselves begin to reopen the file. It's, "Now, why do we own this Enron?" "I don't know."
Jim Chanos:	36:30	Keep in mind that Enron was down before the Wall Street Journal, October 28th, 2001 article detailing the actual fraud came out. I mean, Enron's stock was already down 60, 70% at that point.
Demetri Kofinas:	36:44	You're referring to Bethany McLean's Is Enron Overpriced?
Jim Chanos:	36:47	No, no, no. Bethany's piece was what set it off in February of 2001, her innocuous sounding a piece. It was the first sort of mainstream article raising questions about Enron and their numbers. But it was the Wall Street Journal front page story last week of October, that revealed that the offshore entities had secret provisions where Enron would make good any losses by issuing stock, which nobody knew, including me. And that's when everybody suddenly realized, oh my God, the whole thing is just a façade.

Jim Chanos: 37:23 But the stock was already down massively prior to that. I guess to my point, that the fraud was already starting to be priced in by the marketplace. And that's when the regulators and law enforcement really stepped in. So, I suspect that we're going to need probably a bear market before a lot of the things that people like me are pointing to right now get resolved.

Demetri Kofinas: 37:51 Are most types of frauds accounting frauds?

Jim Chanos: 37:55 Most types of financial frauds, if you really boil them down are basically Ponzi schemes. The business is not profitable. So, the company uses accounting in a way to basically keep raising capital to pay off old investors or pay off maturing debt or whatever the case might be. Now, accounting is the tool used to hide that. But again, another reason why the fraud cycle follows the financial cycle, because it's easy to keep raising money for that in a bull market. But in a bear market, people want their money back or don't fund questionable businesses anymore. So, that's the issue. Now, today, what I've been saying that a lot of the fraud is hiding in plain sight through the aggressive use of proforma metrics, that companies just are telling investors that we're going to be profitable or we are profitable on some adjusted metric, while in the meantime, their Gap financial statements show losses. And that was the Valeant fraud, for example.

Demetri Kofinas: 39:01 How was that allowed?

Jim Chanos: 39:03 Well, I mean, it's allowed because the SEC, again, has given wide latitude to what companies can put in press releases and say publicly.

Demetri Kofinas: 39:11 Why is that?

Jim Chanos: 39:12 Well, again, we go back maybe to the Public Securities Litigation Reform Act of the '90s that took a lot of the tooth of plaintiff's lawyers away from suing companies, giving companies wide latitude to make projections or use proforma accounting standards. Do you know the first company that the SEC went after for misuse of proforma accounting?

Demetri Kofinas: 39:34 No.

Jim Chanos: 39:36 Donald J. Trump hotels and resorts in 1999.

Demetri Kofinas: 39:40 Really? That's so interesting. How many times have they used it since?

Jim Chanos: 39:43 I mean, not as much as they should. And really, because he put it in his SEC documents. He put it in his SEC form 10-Q as opposed to leaving it in the press release. So, it's one of the big sort of dichotomies we have in the marketplace is just how easy it is for an Uber or Lyft, for example, to tell you that they are adjusted EBITDA profitable, or they're going to be adjusted EBITDA profitable. And then you look on the financial statements and an Uber lost a billion dollars this quarter and Lyft lost half a billion dollars. And it's there. It's in the financial statements, but it's certainly not what the CEOs are on CNBC crowing about, or that the talking heads are saying, "Well, Uber was EBITDA positive and it's whatever division this quarter. And Lyft was EBITDA positive, adjusted EBITDA positive." And then you look at the financial statements and no, the losses are as big as they've ever been.

Demetri Kofinas:	40:41	We did an episode on Uber back in very early 2017 with Hubert Horan. And as part of that episode, I did a lot of research into the company and it looked spectacularly unprofitable. And in fact, if my memory serves, that the investors were subsidizing billions of dollars with a free rides, basically. And the economics were all backwards. And similarly, I've done a number of episodes on Tesla. And if you simply go by the price, man, have I been proven spectacularly wrong?
Jim Chanos:	41:08	Yeah. Yeah. Well, Uber is still losing spectacular amounts of money. Tesla now is basically breaking even, except the tax credits they sell. I think they finally eked out a small profit this last quarter. But prior to that, I think for the trailing 12 months, they're still not profitable selling automobiles, which is, as we know, their main business.
Demetri Kofinas:	41:29	And capital investment's obviously important for the valuation of a stock. I think yesterday, they were announced ... We're recording this on Tuesday, November 17th. I think it was announced yesterday that they're going to be joining the S&P, which is only going to sensibly boost their stock higher.
Jim Chanos:	41:46	Well, I bet it's certainly boosted it today as people have factored that in. But interestingly, if you talk to a lot of hedge funds and whatever, that this company is overowned by lots of funds, because it was one of the few stocks that had a $400 billion valuation that wasn't in the S&P. So, you could outperform an S&P benchmark by being aggressively in Tesla.
Demetri Kofinas:	42:08	What do you think explains that company's remarkable success as a stock?
Jim Chanos:	42:16	Let's keep in mind. Let's step back a year. This is a company that basically underperformed the stock market for the five years from late '14 to late '19. It underperformed the NASDAQ and it basically went sideways that five-year period. Again, we kind of forget that. So, it had run up and then as the company had production issues or remained unprofitable the stock basically went sideways. It wasn't really, till we saw the advent of the next wave of retail investors, which we saw across the board in the fourth quarter of '19, as commission rates got lowered to zero and trading ... And you can see the numbers, trading in Robinhood and E-Trade and Ameritrade has taken off pre-pandemic, in the fourth quarter of 2019.
Jim Chanos:	43:04	And that's when a lot of these stocks have just gone to the moon. So, the narrative took over from the fundamentals in the fourth quarter of 2019. The fundamentals had been kind of crummy for five years and then people said, "Aha. This is an ESG play. This is Elon Musk changing the world. This is going to be robo taxis. This is going to be full self-driving, level five autonomy. This is going to be new batteries." And the narrative took over for the fundamentals in a major way, because as you know, most automakers trade at less than one times revenues. Most of them trade at 0.6, 0.7 times revenues, which would put Tesla at about $30 a share, not 450. So, obviously $400 of that is due to the perception of people of great businesses in the future and great technological breakthroughs in the future.
Demetri Kofinas:	44:05	What justifies that perception?

Jim Chanos:	44:06	I don't know. We'll have to see. I don't think anything does actually, but I've been wrong. Remember a year ago now we were supposed to have a million robo taxis on the road this year.
Demetri Kofinas:	44:17	I think Charlie Grant had tweeted something out about how people should actually sell their Tesla stock and buy a Model 3 because the yield on the autonomous taxi fares would actually be higher than the spread on the equity.
Jim Chanos:	44:30	Right. Well, there's all kinds of sort of craziness that surrounds these narratives. People say that the reason Uber and Lyft are valued where they are is because once they get rid of the drivers, we have autonomous vehicles, they won't need the drivers, which are 80% of the costs to which more than just me keep pointing out, if cars don't need drivers, we don't need Uber.
Demetri Kofinas:	44:52	Yeah, exactly.
Jim Chanos:	44:55	I mean, these narratives sometimes break down when you apply some common sense to them. Keep in mind. So, battery day, there were no batteries shown at Tesla. Literally, there were no batteries shown at battery day. It was all kinds of talk of new technology, but they didn't show anything. And they're still at level two to 2.5 and in the autonomous driving scale versus 5.0, full autonomy. So, it's still as we enter 2021, shockingly, a car company. And that's the reality of what they are. They can talk about all this other stuff, but that's in fact where they make almost all their revenues and they're capital-intensive and they're building new auto plants and they're competing with Volkswagen and competing with Audi and Ford and the rest of them. They're a car company. And no matter what people want to say that it's a cow and not a duck. They're a duck.
Demetri Kofinas:	45:49	Well, I've heard people say different things about what Tesla is every so many months. It's a data company. It's a tech company. Or the data story is like a big one. The same story with Uber. It's that this is all a data play and Uber is subsidizing this giant vacuum cleaner of data. It's going to have so much that it's going to achieve escape velocity.
Jim Chanos:	46:12	Tell me a company that doesn't collect that on its customers at this point. And I'll basically tell you a company that's already dead. I mean, every company now collects data on its customers. I mean, that goes without saying. And this whole idea that they're collecting data, I've been hearing that on Tesla for years now. To which I keep saying, "Well, if that's the case, why haven't they advanced beyond level two autonomy?" If they've collected all this data, where is it? Where is it showing up in new autonomous technology? And the fact of it is, it's not.
Jim Chanos:	46:42	So I always wonder about that, the collecting of data and what exactly that means. And of course, everybody points to the granddaddy, Amazon, of a company that collected data on people then figured out a way to sell them things. But I've always joked that people have lost far more money looking for the next Amazon than they've made in Amazon. And having grown up in the '70s and '80s and been a young investment banker for McDonald's in the early '80s, I can't tell you how many consumer concepts were sold to investors in the '70s and '80s as being the next McDonald's, which was one of the great, great stocks of the '60s and '70s.

Jim Chanos:	47:27	And the fact of the matter was, for the most part there wasn't really a next McDonald's. There was no one who did it as profitably as they did and staked out the real estate and figured it out and expanded internationally like they did. There were a couple of also runs, but no one that compounded like McDonald's did. So, be careful when you use that as your investment mantra. Often it's just better to invest in the company itself, not the next company of that ilk.
Demetri Kofinas:	47:54	Well, I remember months ago I tweeted this out. Cathy Wood was on CNBC. If I remember correctly, she said, this is the best answer of all, she said, in terms of what is it, is it a car company? Is that of this? And she said, "It's something for everybody." Which I just thought was absolutely perfect.
Jim Chanos:	48:11	Yeah. That's a pretty good investment thesis, is what it works.
Demetri Kofinas:	48:16	Yeah. Well actually, that actually gets to something which I do want to ask you about, but I want to put a pin in it, which is that when you were at Grant's conference this year, you talked about that the real innovation here is in ... I forgot how you extra said it, but your reference was to total addressable market, TAM. And that actually the best business is space because it's infinite.
Jim Chanos:	48:39	Yeah. That was a joke. And it kind of spun out of control. I gave a talk on TAM sanity with the whole idea now that we've gone beyond metrics to justify lots of valuations beyond not only earnings and cashflow and even revenues, but in the total addressable market. As long as I am addressing some big market, I can have a big valuation without having executed. So, I joked that we were going to go along some of the space travel stocks because there's no bigger TAM than space. The TAM for space is infinite. So, therefore, the valuations on these companies should be infinite, QED.
Jim Chanos:	49:21	Virgin Galactic, I think, went up 10% immediately. And then when Grant's and I pointed out, "No, no, we're just joking." It dropped a 10% and then some. And people started tearing me a new you know what, because I cost them money. It's like you can't win. And it just goes to show the lack of irony, I think, of work in this market.
Demetri Kofinas:	49:46	Amazing. Well, Elan's in that market too. I want to ask one more question about Tesla and then we'll actually move onto some other questions. How important is competition, the fact that more companies are entering this TAM. How important is that for Tesla's prospects in your view?
Jim Chanos:	50:08	It's very important and it was much delayed, which I think to the bulls' credit. They were far more right than the bears were, but that doesn't mean it's not arriving, delayed as it might be. And for years they had this first mover advantage. And one of my concerns was that they weren't making money, having that advantage from 2012 on, when the Model S came out. They owned that market. And to Tesla's credit, what they did was they made EVs sexy. They made the Model S in particular and the Model X were desirous cars for high-end consumers.
Jim Chanos:	50:44	And yes, there was some virtue signaling involved, but it doesn't mean they weren't selling the cars, but those sales peaked out at very, very small numbers a couple of years ago. So, really the only way Tesla was going to justify its valuation was to get into the midsize vehicle, which they did with the Model 3.

		And although at first, the Model 3 was priced as basically a medium luxury car, over 50,000. Now, it's pretty solidly in the 40,000 plus range, but that's a different market and that's the market that players like Volkswagen were going to clearly be entering and have entered in a major way.
Jim Chanos:	51:27	And we've seen it already in Europe where Volkswagen's ID.3 is already now outselling Tesla Model 3, and they've got more models coming out. So, what a lot of people are missing in Tesla is that sales in the US and Europe have basically now flattened out or are declining, even with Model 3. And they grew this year in China, where they opened up a new plant. But if China flattens out, then it's going to get interesting because at that point you've now introduced your car into the three major markets and you're facing competition.
Jim Chanos:	52:07	And the competition is only going to get stiffer. Ford's got the Mach 3 Mustang coming out. Mercedes finally has its vehicles coming out. Volkswagen and Audi, which is division of Volkswagen, has more cars coming out. Porsche has more cars coming out. So, they don't have this market to themselves anymore. And then there's what, I think, eight EV companies in China now. So, increasingly, their first mover advantage is still there, but it's much, much diminished.
Jim Chanos:	52:34	And we also kind of forget that the market for luxury vehicles, $50,000 and up is only 2 million cars every year globally. It's about 1 million in the US, 1 million in the rest of the world. And that was something we pointed out a long time ago, that focusing on the very high end is a very limited market. And that's not just EVs, that's all cars. So, in order for them to really do lots of units, they were going to have to get down into the 30 to $40,000 area. And there it's going to be a dog fight. There's going to just be much more competition. And there already is. We would urge people to take a look at what's going on in Europe, where now you have a lot of models coming out from European car makers and they are taking share.
Demetri Kofinas:	53:20	Jim, I have so many more questions for you, but I'm going to move us into the second half of the podcast to discuss those things. One of the things that I want to talk about when we get to the other side is how to diagnose a fraud. I know that you actually talk about this in your class quite a bit, but what do you look for? What are the red flags that stick out to you and perhaps where have you seen them? I'm also curious to apply your epistemic lens to some of the broader phenomena that have taken place in our society.
Demetri Kofinas:	53:52	I'm thinking very specifically about this, what I've described as an epistemic or epistemological crisis around fake news and truth and it feels like we're living in a really demented time today. It's qualitatively different than any other time that I've lived in, which is why I find myself often asking myself, is it different? Because it doesn't feel like the bull market of the late '90s. This feels like the after-party. This feels like the end of a long night.
Demetri Kofinas:	54:23	For anyone who is new to the program, Hidden Forces is listener supported. We don't accept advertisers or commercial sponsors. The entire show is funded from top to bottom by listeners like you. If you want access to the second part of my conversation with Jim, as well as the transcripts and rundowns to this episode and every other episode we've ever done, head over to patrion.com/hiddenforces. There's also a link in the summary page to this episode, with instructions on how to connect the overtime feed through your

phone so that you can listen to these extra conversations just like you listen to the regular podcast. Jim, stick around. We're going to move the second half of our conversation into the subscriber overtime.

Jim Chanos: 55:06 Okay.

Demetri Kofinas: 55:08 Today's episode of Hidden Forces was recorded in New York City. For more information about this week's episode or if you want easier access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you want access to overtime segments, episode transcripts, and show rundowns full of links and detailed information related to each and every episode, check out our premium subscription available through the Hidden Forces website or through our Patrion page at patrion.com/hiddenforces.

Demetri Kofinas: 55:45 Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at hiddenforces.io. Join the conversation at Facebook, Twitter and Instagram at Hidden Forces Pod or send me an email. As always, thanks for listening. We'll see you next week.