KEYNES AS THEORIST AND INVESTOR
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There is an abundance of literature that extensively explicates how various factors, notably probability theory, influenced John Maynard Keynes’s thinking and economic theories in regards to the behavior of financial markets and the agents making decisions in those markets. Commentators, however, have largely ignored the influence of Keynes’s practical speculative experience on the evolution of his economic theory. I find this neglect baffling because Keynes spent more than 40 years speculating and a substantial chunk of time and effort in his role as investor for his friends and family, his alma mater, King’s College, and as director of several insurance companies. The aim of this honors thesis is to contribute to the history of economic thought with respect to the evolution of Keynes’s thinking specifically about financial markets in the context of his role as an investor. More specifically, I trace the evolution of his beliefs about uncertainty, expectations, and fundamental values through his early speculative period (1905 – 1923) and his later investment period (1931 – 1946). As indicated by the distinction between earlier and later periods, I find that Keynes underwent a significant evolution in his beliefs about these subjects between the years 1923 and 1931. His failure to beat the market in his early years motivated this evolution. Moreover, I infer what Keynes would have to say, retroactively, about the rational expectations hypothesis and the efficient market hypothesis.

I find that Keynes, in his early days, would have agreed with the rational expectations hypothesis based on his presupposition in an objective epistemic probability theory. Nevertheless, he would have rejected the efficient market hypothesis because he believed that expert speculators possessed an informational advantage and could earn above average risk-adjusted returns systematically. In his later days, stemming from his shift in thinking about uncertainty, which introduced subjective, incalculable psychological variables, he would have rejected the rational expectations hypothesis. Additionally, he would have rejected the efficient market hypothesis on the grounds that speculators underweight some evidence while they overweight their expectations of others’ expectations of others’ expectations. That is, he would have rejected the efficient market hypothesis but for different reasons. Lastly, he provided a prescription for investors who wished to beat the market systematically and obtain both above average safety and superior performance. The investor must develop a strong knowledge base of only a handful of select equities of which he can confidently estimate the long-run prospects of the enterprise. Most importantly, he must possess the patience and freedom to hold his positions for unknowable durations while the market moves prices based not on fundamental values but on psychological variables. Once stock markets are filled with investors employing this strategy, nevertheless, they will become efficient and no investor will be able to earn above average risk-adjusted returns.