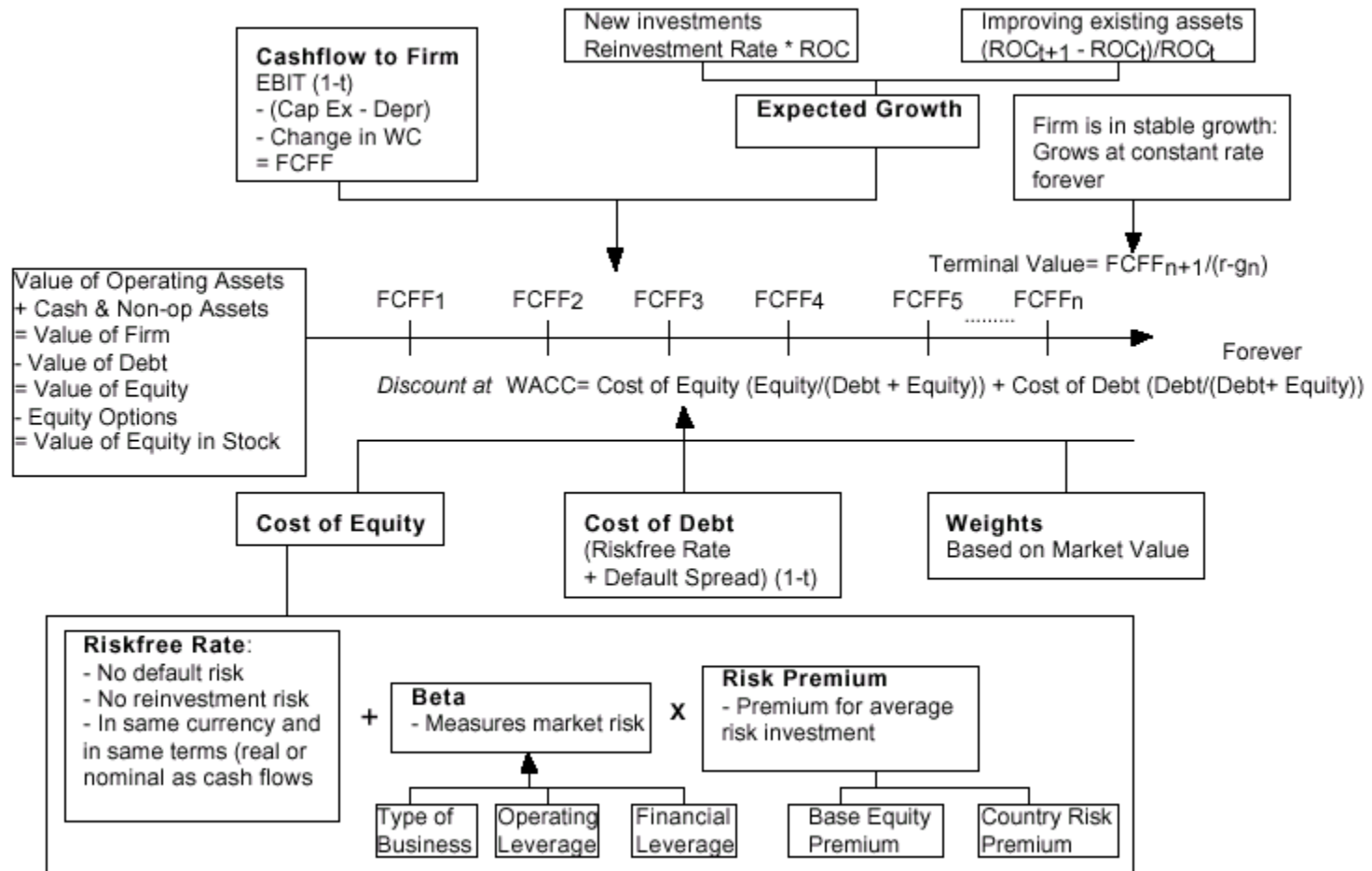


Navigating the Low Tide



Investing 101




Investing 201?

Dave Portnoy: Picking Stock Symbols with a Scrabble Bag — better returns than Buffett



 **Jonah Williams** Jun 20, 2020 · 5 min read ★



 **Dave Portnoy** @stoolpresidente · Jun 19, 2020 ...
\$RTX comes out of the scrabble bag. Smush letters and buy it. Give it a try Ron, you might not bankrupt your clients. #DDTG



198 650 2.9K

 **Dave Portnoy**
@stoolpresidente

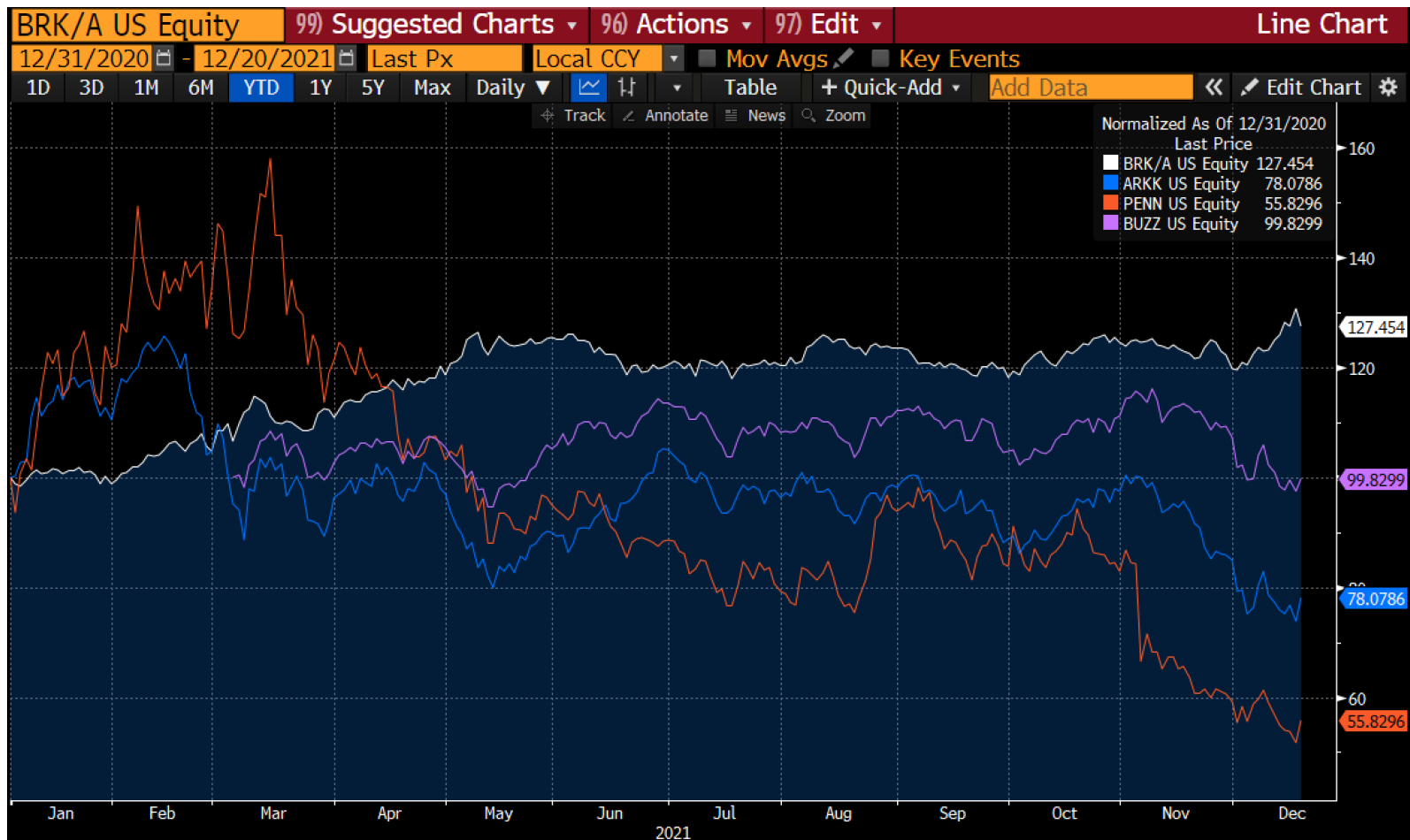
\$200k in \$RTX



3:39 PM · Jun 19, 2020 · Twitter Web App

How's that Working Out Lately?...

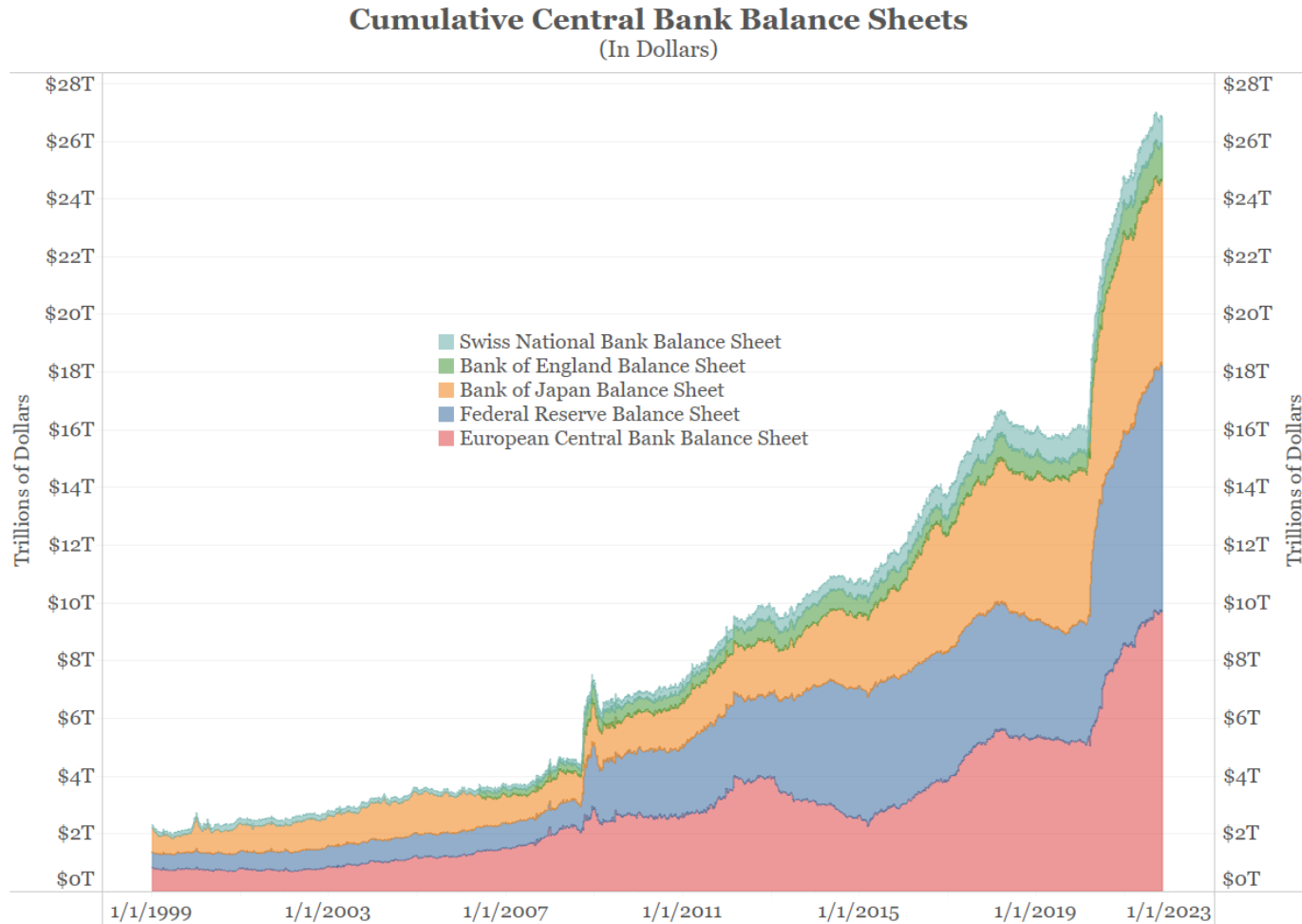
YTD Performance of Berkshire Hathaway vs ARK Innovation ETF, Penn National Gaming (owner of Portnoy's Barstool Sports) and VanEck Social Sentiment ETF



“Only when the tide goes out do you discover who’s been swimming naked.”

- Warren Buffet

Since the 2008 Global Financial Crisis, Investors have Benefitted from a Rising Tide of Liquidity



Data Source: Fed, ECB, BoJ, BoE, SNB, Bloomberg

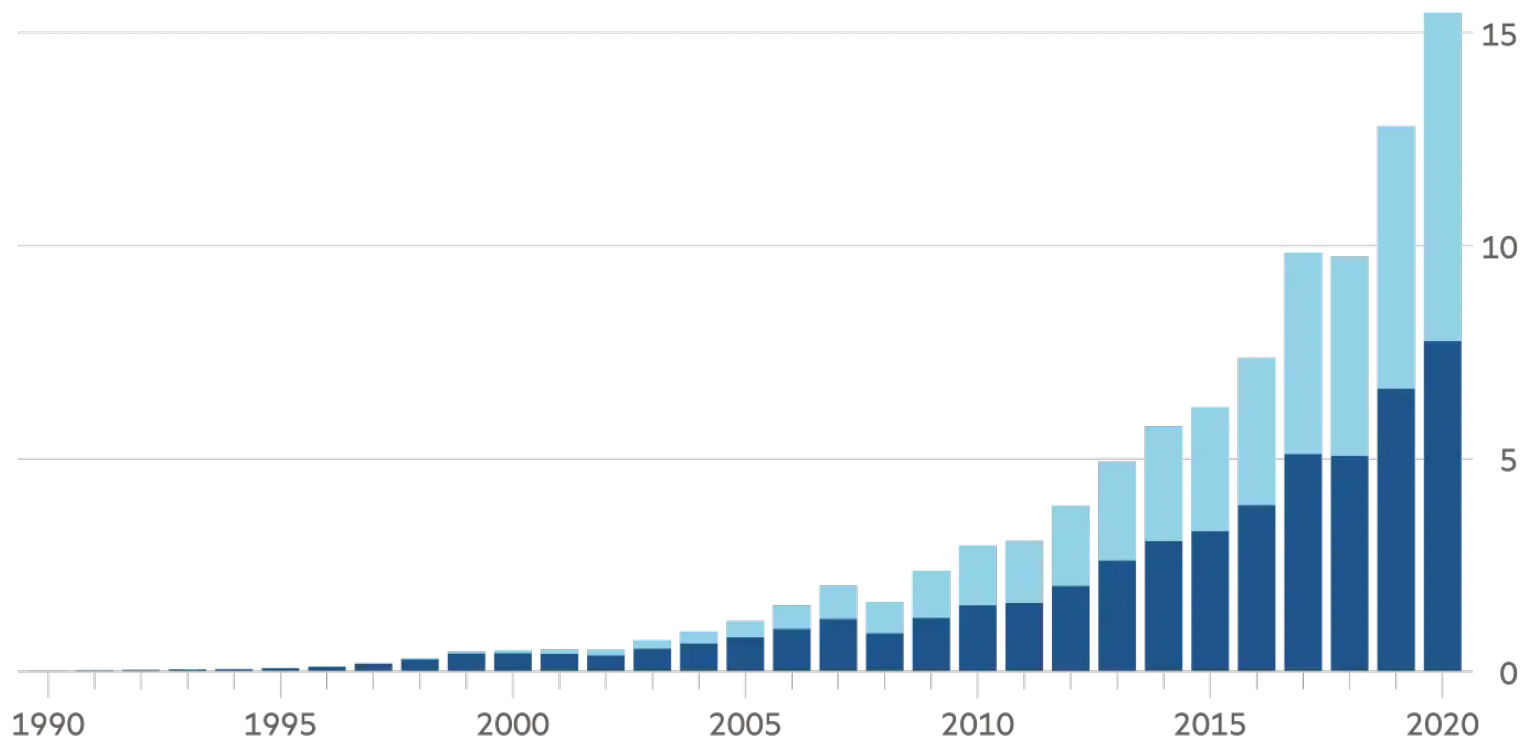
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<https://www.biancoresearch.com/>

As well as Accelerating Flows into Passive Products

Passive attack

Assets under management (\$tn)

Index funds ETFs

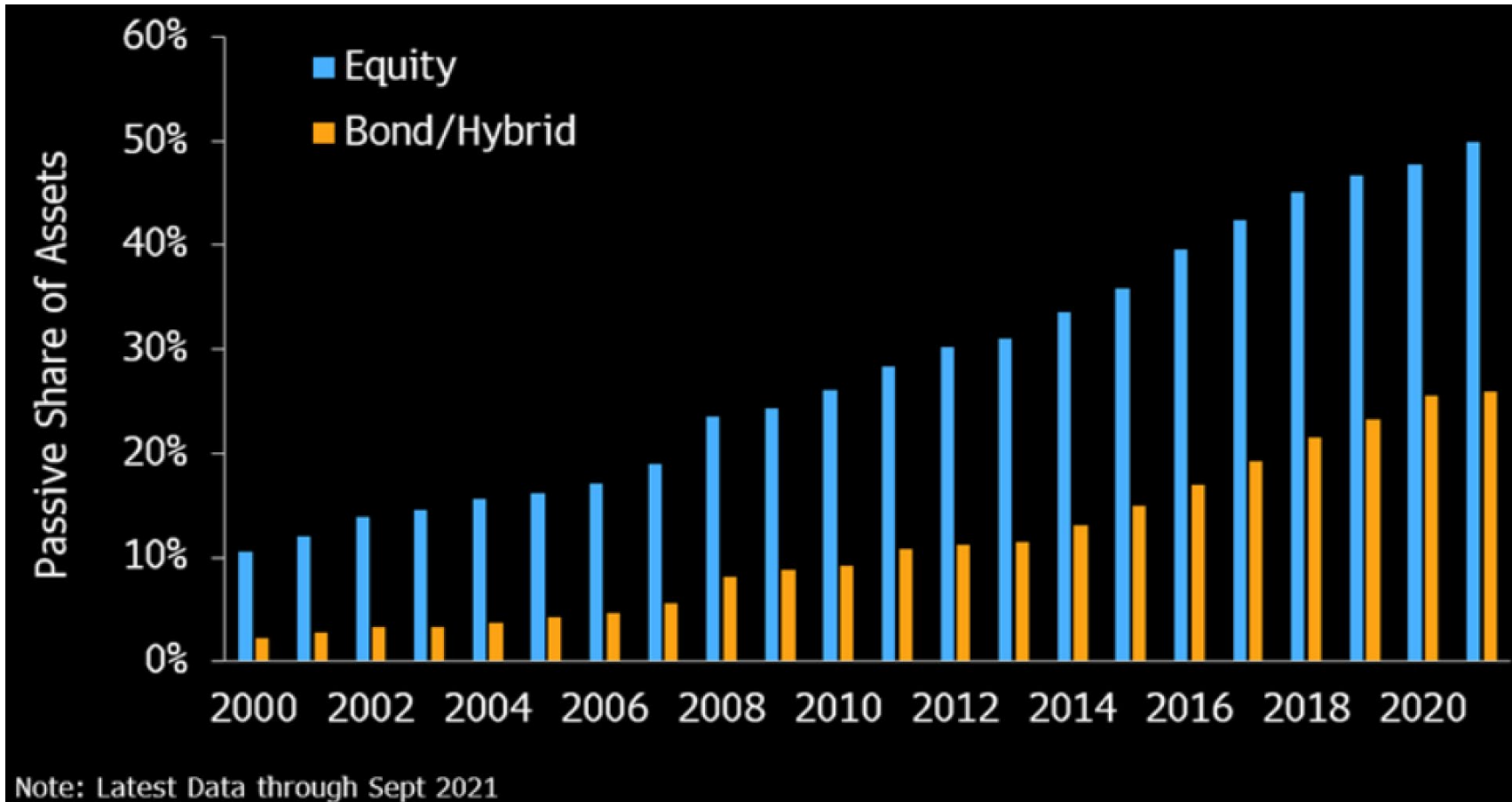


Source: Investment Company Institute, Morningstar Direct, and Strategic Insight Simfund

© FT

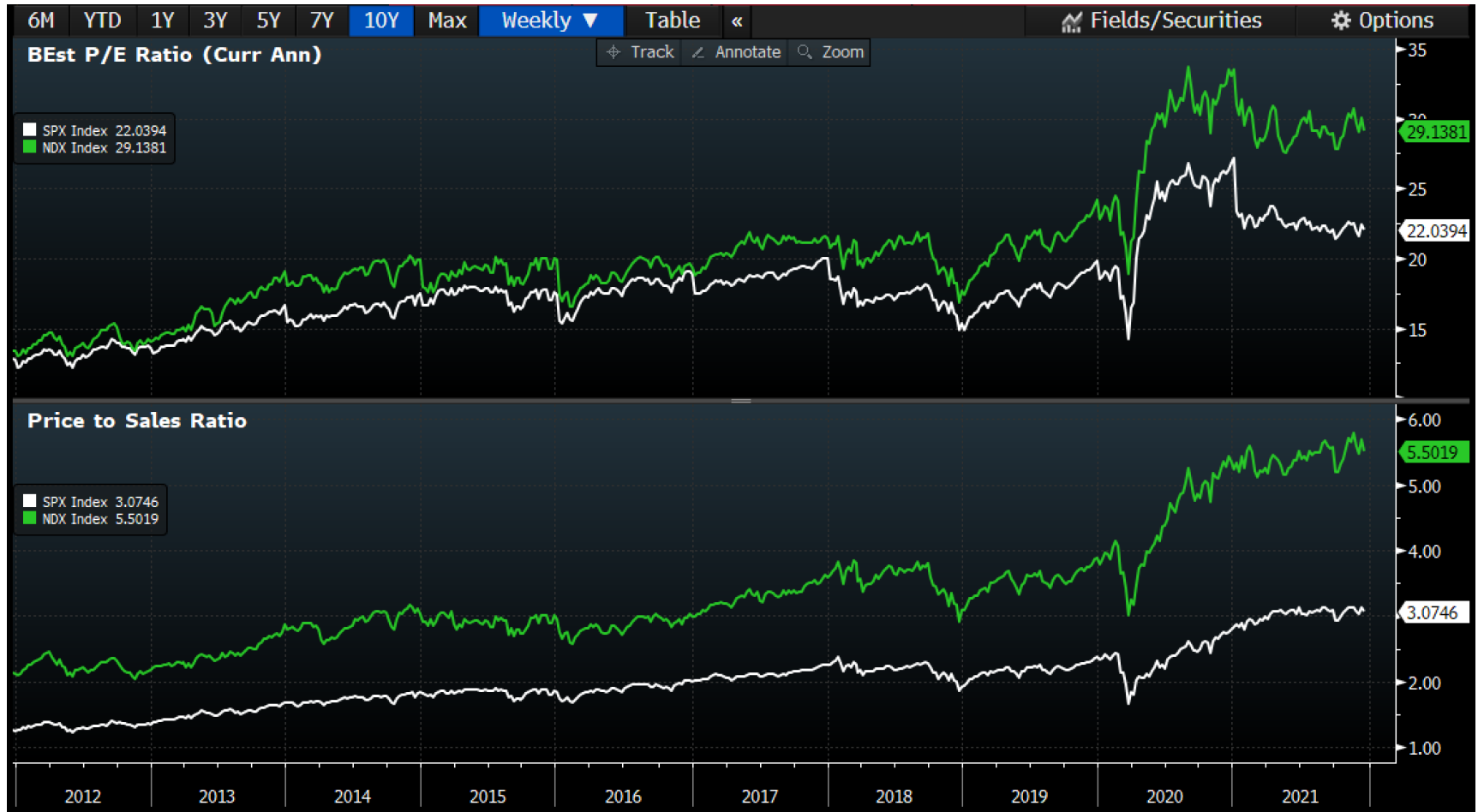
Which have Tilted Equity Markets Toward Valuation Agnostic Ownership

U.S. Markets Passive Share by Asset Class



Price Insensitive Investing Has Unsurprisingly Lifted Large-Cap U.S. Stock Valuations

S&P 500 and Nasdaq 100 Forward PE Ratios and Price to Sales



Flows into Products Constructed by Market Cap Lead to Market Caps Detaching from Earnings: By Design, the Big get Bigger

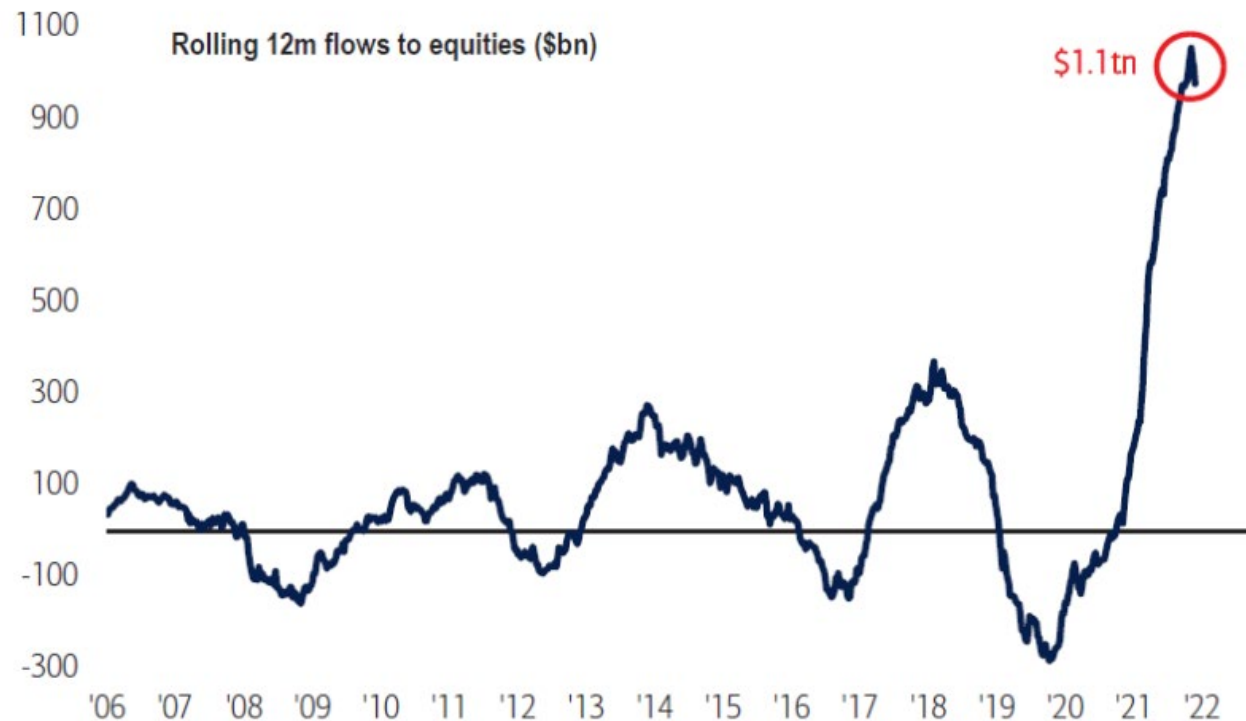
Exhibit 1: Top 5 stocks as a share of S&P 500 market cap and earnings



Source: Compustat, Goldman Sachs Global Investment Research

But Recent Inflows are Unlikely Sustainable

Chart 6: Inflow to equities exceeds combined inflow of past 19 years
Rolling 12m flows to equities (\$bn)



Source: BofA Global Investment Strategy, EPFR

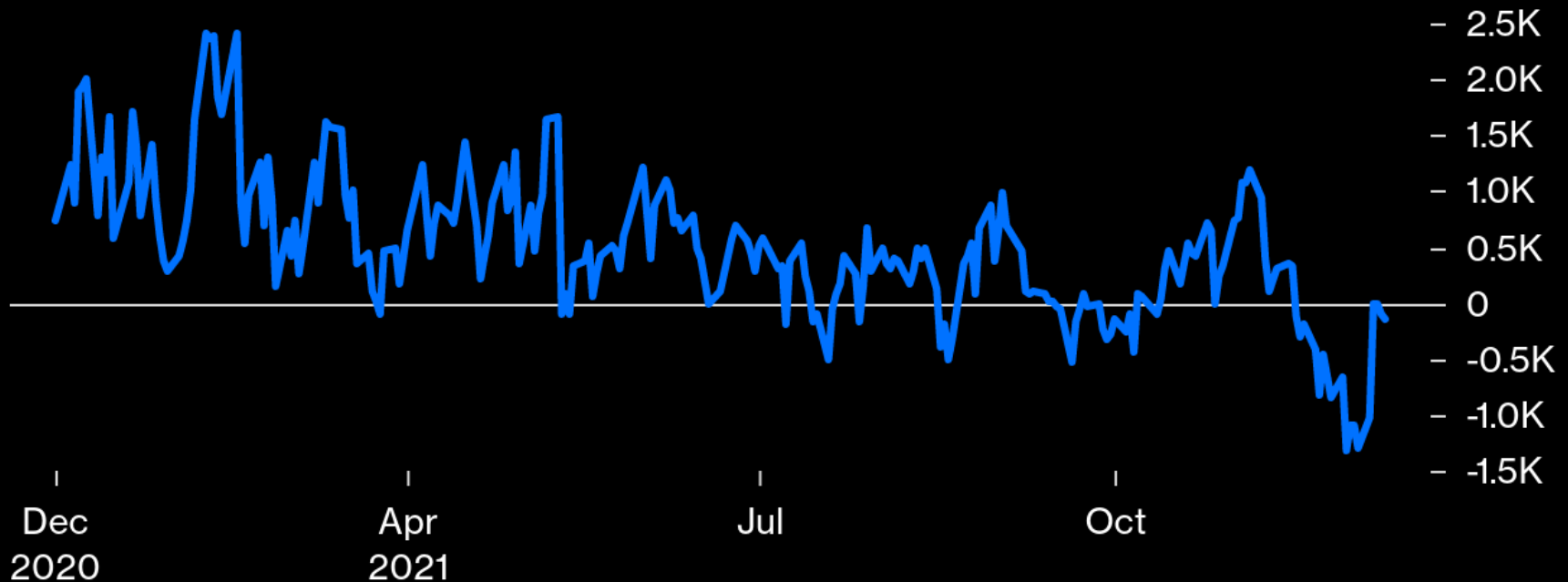
BofA GLOBAL RESEARCH

And Under the Surface, Not All is Well

Bad Breadth

Stocks hitting new 52-week lows far outnumbered those reaching highs

— Bloomberg US Composite 52-week new highs less new lows

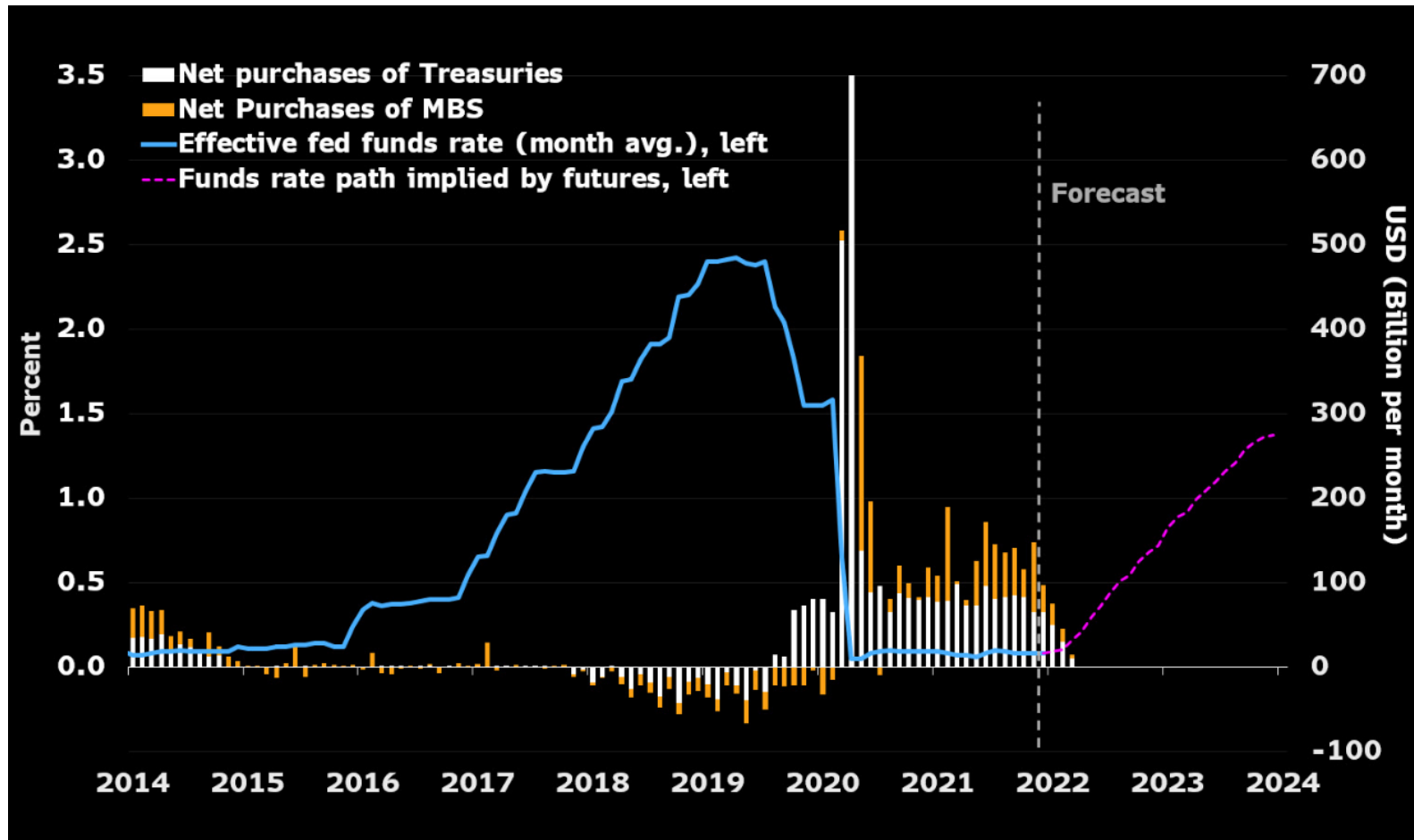


Source: Bloomberg

BloombergOpinion

If Liquidity Made Everyone a Genius, Then Tightening Financial Conditions...

Projected Fed QE Wind-Down and Rate Hike Path



Will Turn Geniuses into . . . ?

Law of Gravity (data as of 12/10/21)

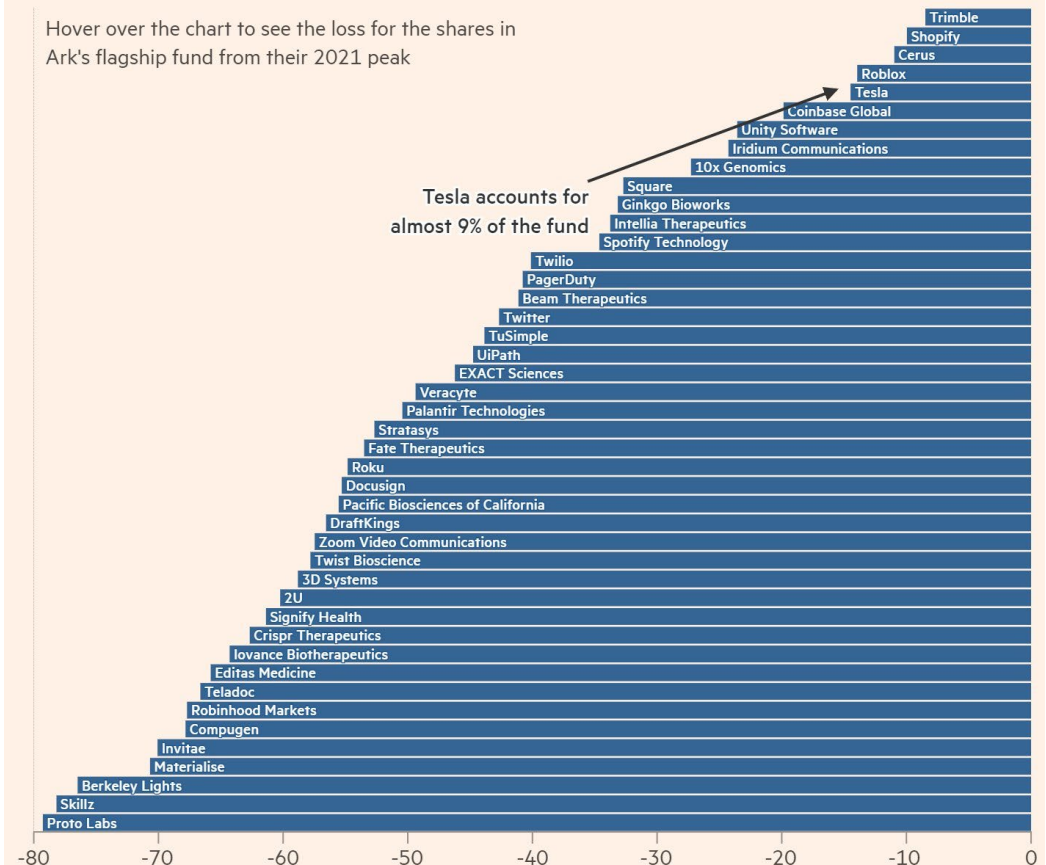
Company	Ticker	2020 Return	2021 Return
QuantumScape	QS	753%	-72%
Peloton Interactive Inc	PTON	434%	-75%
Zoom Video Communications Inc	ZM	396%	-45%
Pinduoduo Inc	PDD	370%	-64%
Fastly	FSLY	335%	-54%
DraftKings Inc	DKNG	335%	-35%
Appian Corp	APPN	324%	-57%
Lemonade	LMND	322%	-65%
Pinterest Inc	PINS	254%	-43%
Block Inc	SQ	248%	-17%
Twilio Inc	TWLO	244%	-22%
Penn National Gaming Inc	PENN	238%	-43%
C3.ai Inc	AI	230%	-76%
Redfin Corp	RDFN	225%	-41%
Chewy Inc	CHWY	210%	-42%
DocuSign Inc	DOCU	200%	-35%
Zillow Group Inc	Z	183%	-54%
CRISPR Therapeutics AG	CRSP	151%	-52%
Wayfair Inc	W	150%	-11%
Roku Inc	ROKU	148%	-31%
Teladoc Health Inc	TDOC	139%	-53%
Chegg Inc	CHGG	138%	-69%
Palantir Technologies Inc	PLTR	136%	-20%
Stitch Fix Inc	SFIX	129%	-68%
RingCentral	RNG	125%	-51%
PayPal Holdings Inc	PYPL	117%	-20%
StoneCo Ltd	STNE	110%	-79%
Opendoor Technologies Inc	OPEN	110%	-34%
Virgin Galactic Holdings Inc	SPCE	105%	-36%
Wix.com Ltd	WIX	104%	-42%



@CharlieBilello

The sinking ARKK

Percentage loss of ARKK investments from each stock's 2021 peak to closing price on Dec 7 (%)



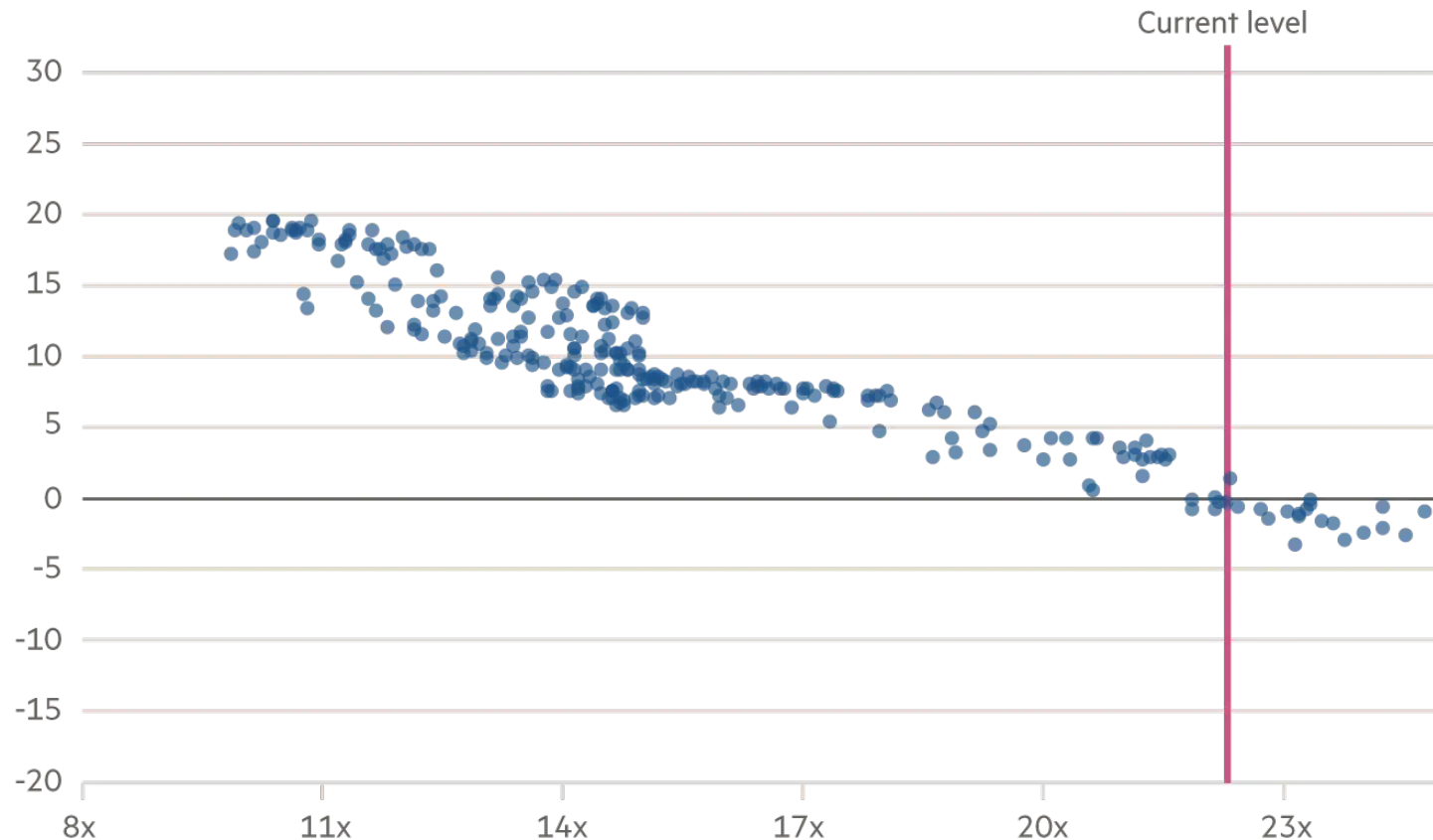
FINANCIAL TIMES

Source: Ramin Nakisa/Pensioncraft

As Valuations Rise, Investing Gets Harder

S&P 500 forward P/E ratios and subsequent 10-year returns

Total annualised returns in percentage points*

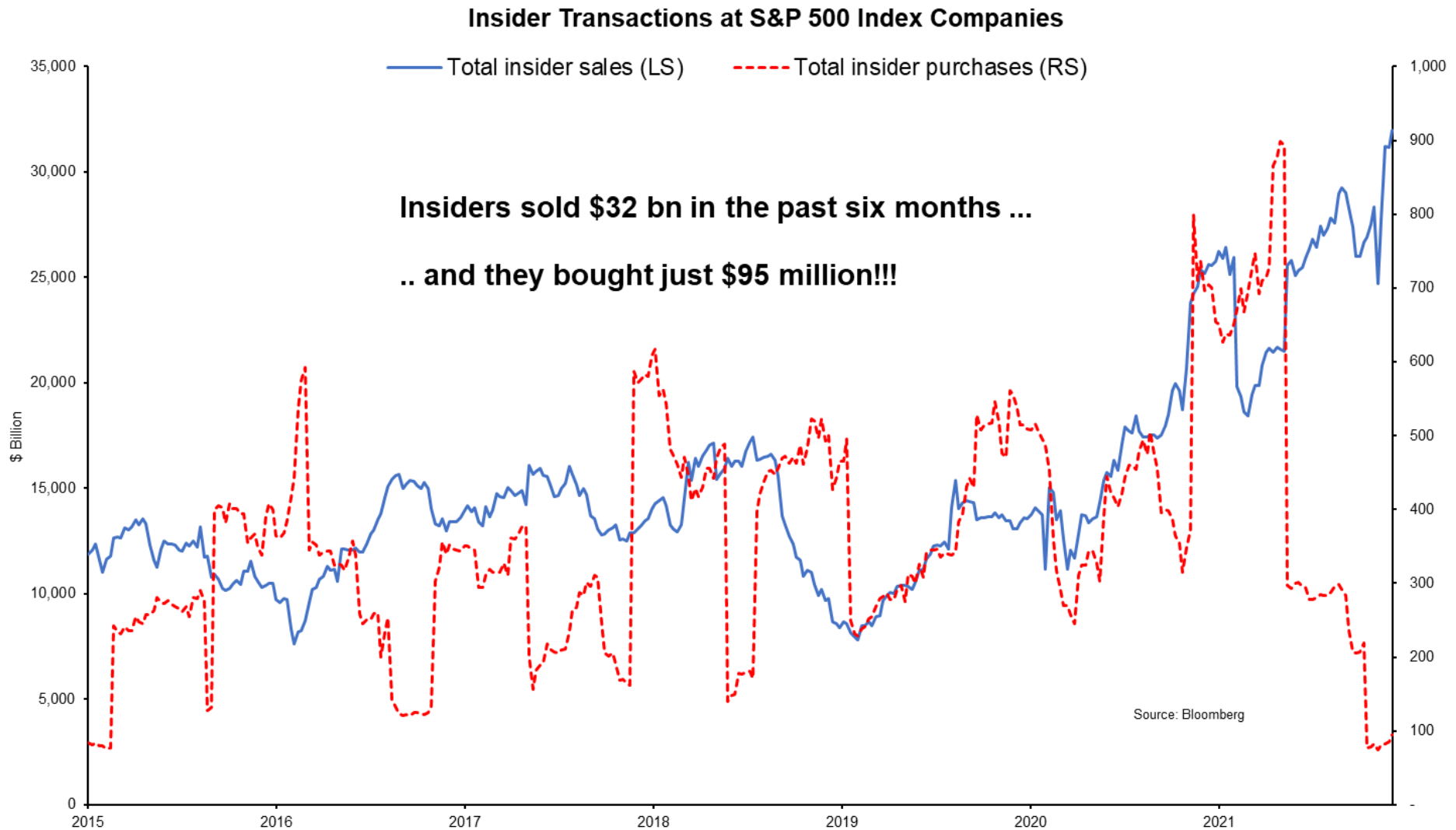


* Dots represent monthly data points since 1988

Sources: IBES; Refinitiv Datastream; Standard & Poor's; JPMorgan Asset Management

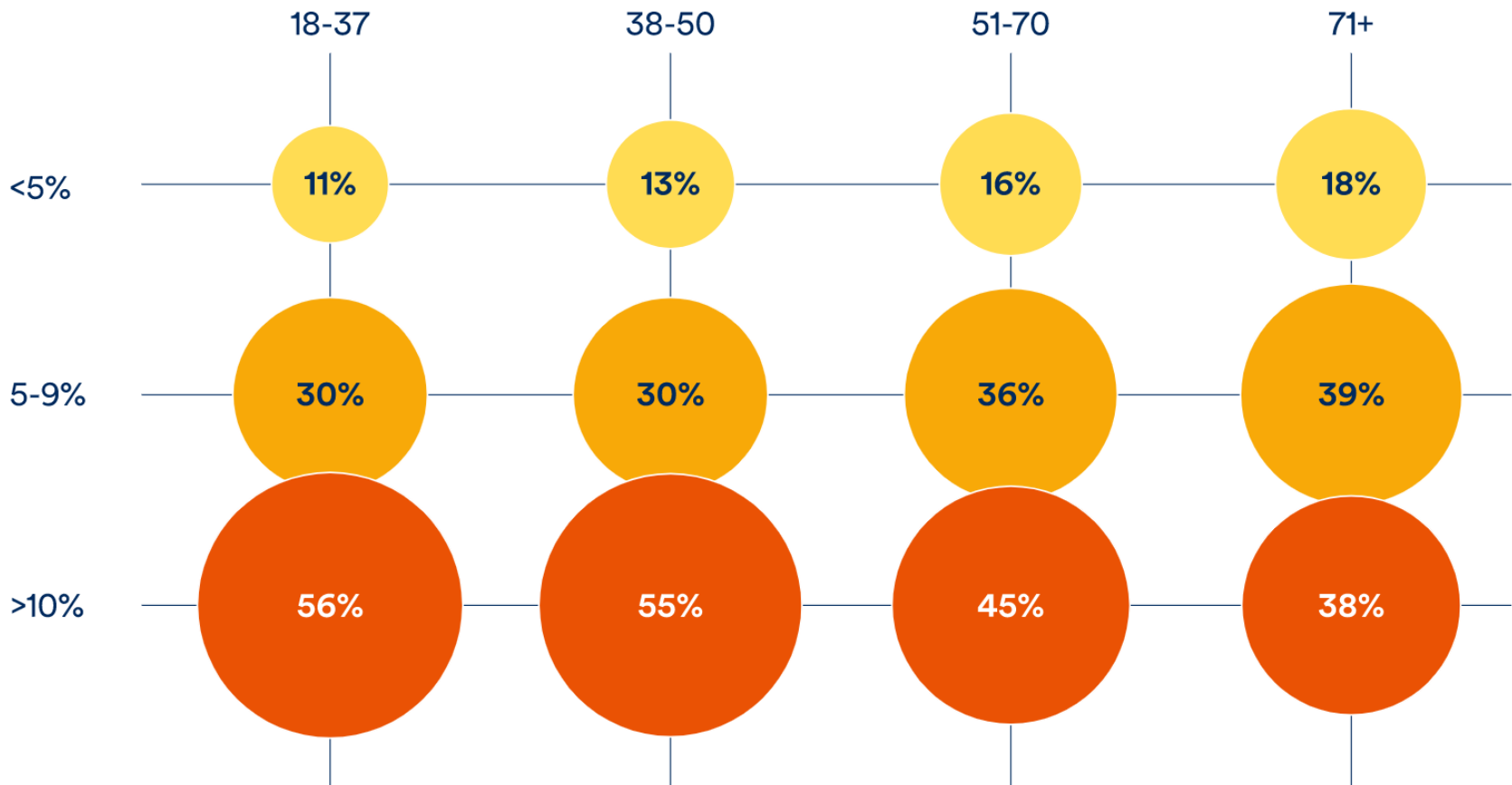
© FT

Company Insiders Seemingly Know This



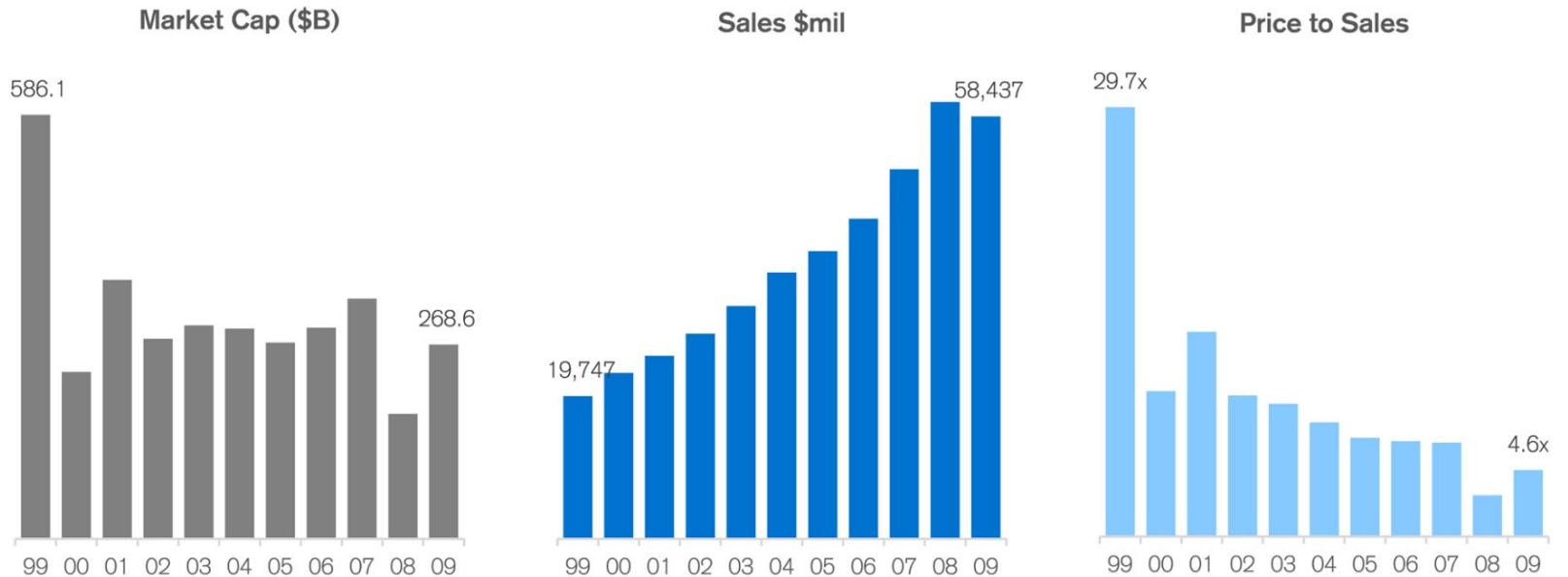
Yet Retail Investors Maintain Rosy Outlooks

The return-on-investment people expect from their investment portfolio annually for the next five years from both income and capital growth



Even Great Companies can be Bad Purchases At the Wrong Price and Valuation

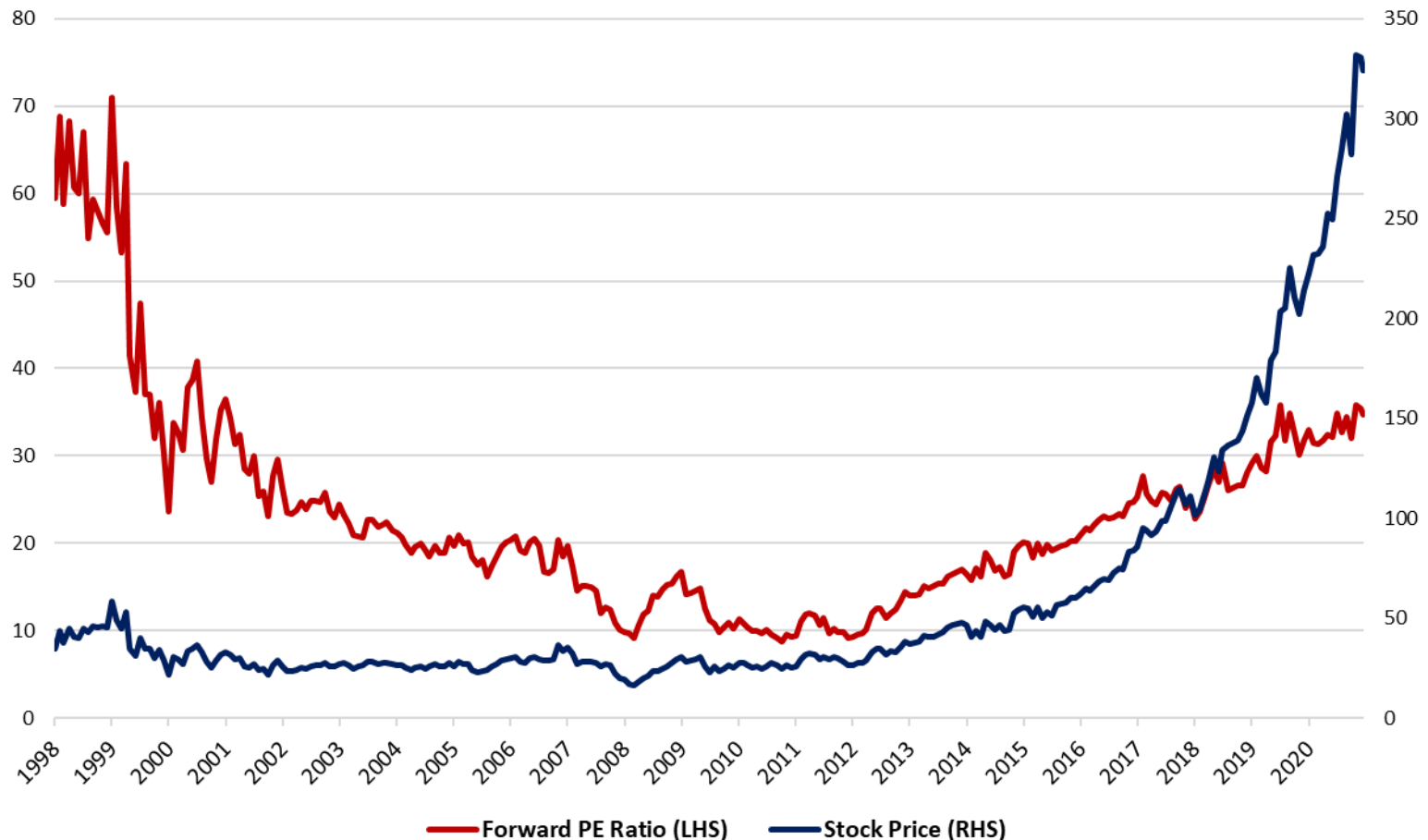
Microsoft 1999-2009: Sales Grow, but Valuation Declines and Multiples Compress



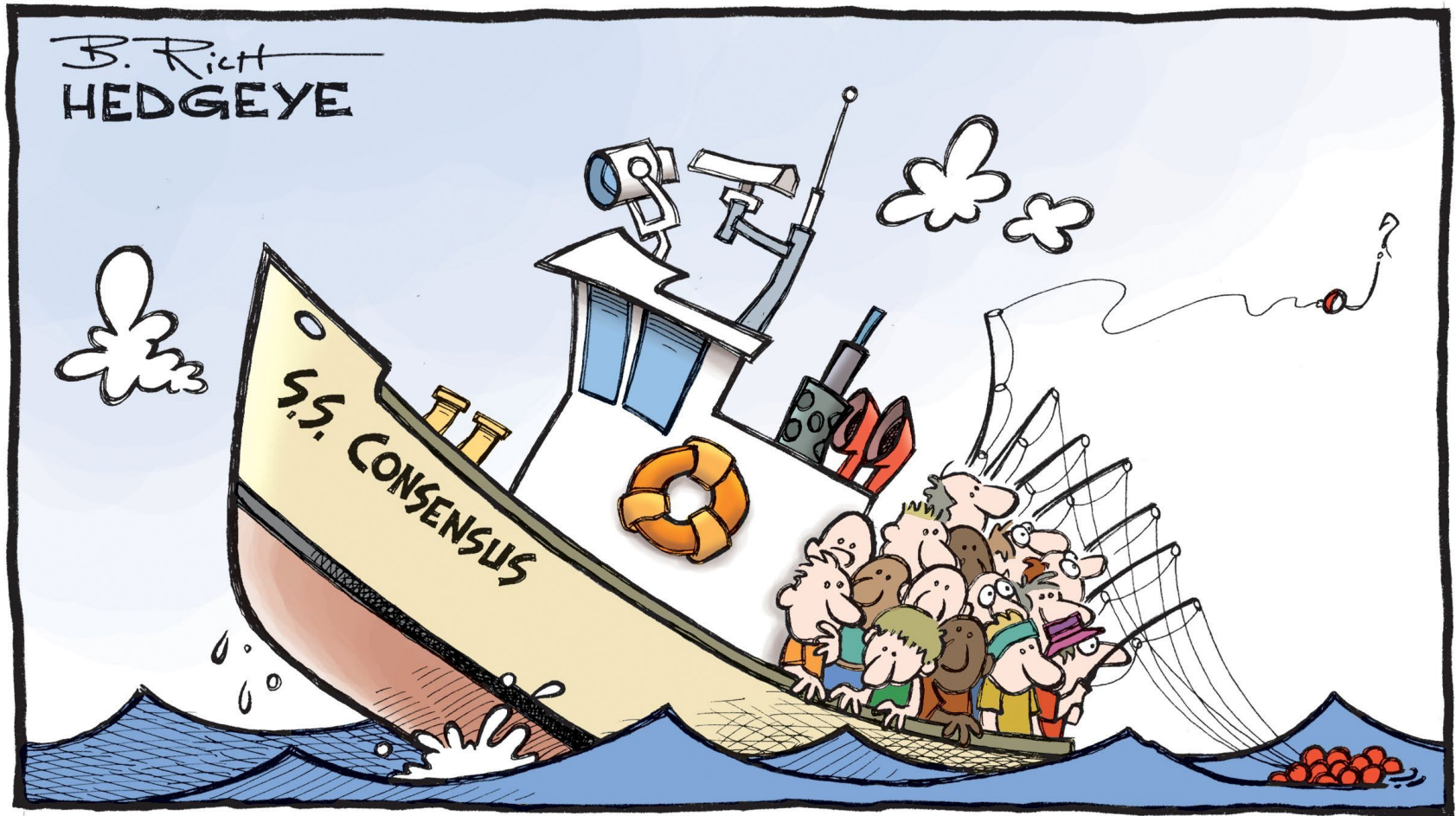
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Market Cap (\$B)	586.1	230.8	357.9	276.6	295.3	290.7	271.5	291.9	332.1	172.8	268.6
Share Price	\$ 58.38	\$ 21.69	\$ 33.13	\$ 25.85	\$ 27.37	\$ 26.72	\$ 26.15	\$ 29.86	\$ 35.60	\$ 19.44	\$ 30.48
Sales \$mil	19,747	22,956	25,296	28,365	32,187	36,835	39,788	44,282	51,122	60,420	58,437
YoY%		16.3%	10.2%	12.1%	13.5%	14.4%	8.0%	11.3%	15.4%	18.2%	-3.3%
Price to Sales	29.7x	10.1x	14.2x	9.8x	9.2x	7.9x	6.8x	6.6x	6.5x	2.9x	4.6x

How Many Waited 16 Years for MSFT's Recovery? And how Many Actually Bought During its Trough?

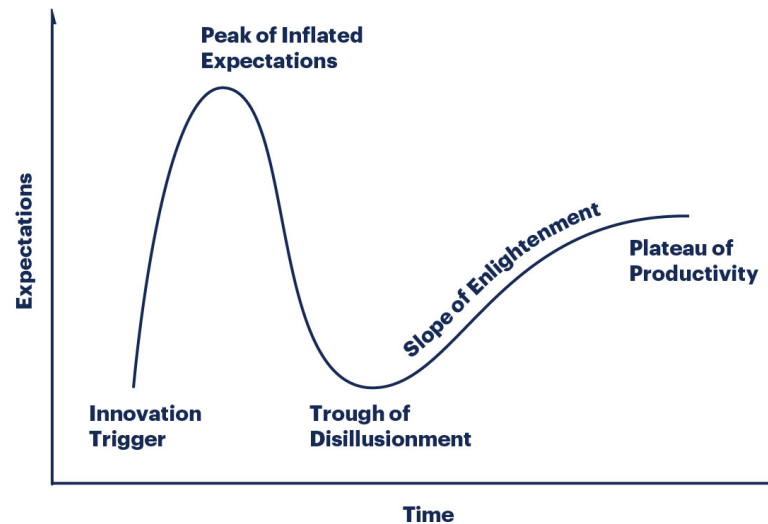
Microsoft Stock Price vs Forward PE Ratio (1998 – Present)



When the Consensus Gets Crowded, It's Usually a Good Idea to Think Independently



Picture the Market and Valuations in Gartner “Hype Cycle” Terms



Innovation Trigger: A potential technology breakthrough kicks things off. Early proof-of-concept stories and media interest trigger significant publicity. Often no usable products exist and commercial viability is unproven.

Peak of Inflated Expectations: Early publicity produces a number of success stories — often accompanied by scores of failures. Some companies take action; many do not.

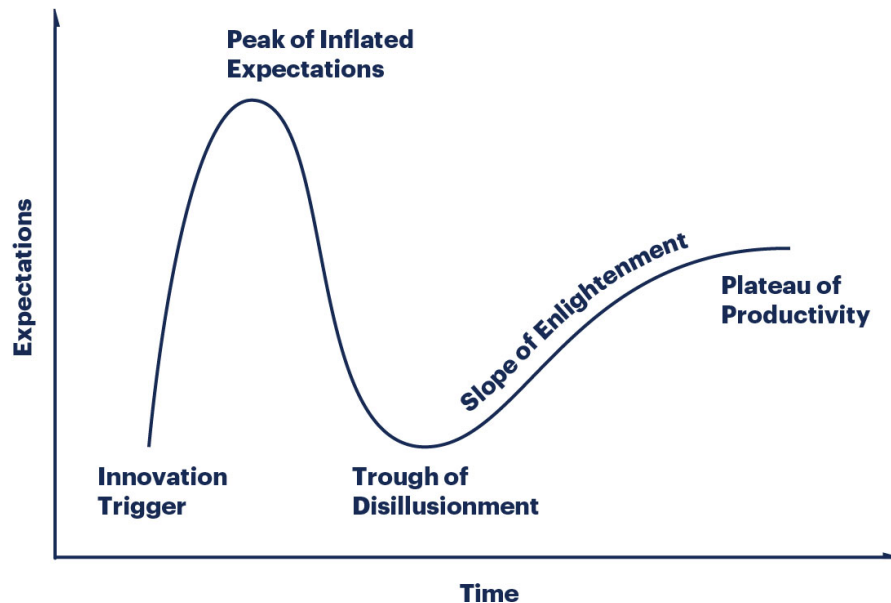
Trough of Disillusionment: Interest wanes as experiments and implementations fail to deliver. Producers of the technology shake out or fail. Investments continue only if the surviving providers improve their products to the satisfaction of early adopters.

Slope of Enlightenment: More instances of how the technology can benefit the enterprise start to crystallize and become more widely understood. Second- and third-generation products appear from technology providers. More enterprises fund pilots; conservative companies remain cautious.

Plateau of Productivity: Mainstream adoption starts to take off. Criteria for assessing provider viability are more clearly defined. The technology's broad market applicability and relevance are clearly paying off.

Innovation Trigger through Peak Expectations

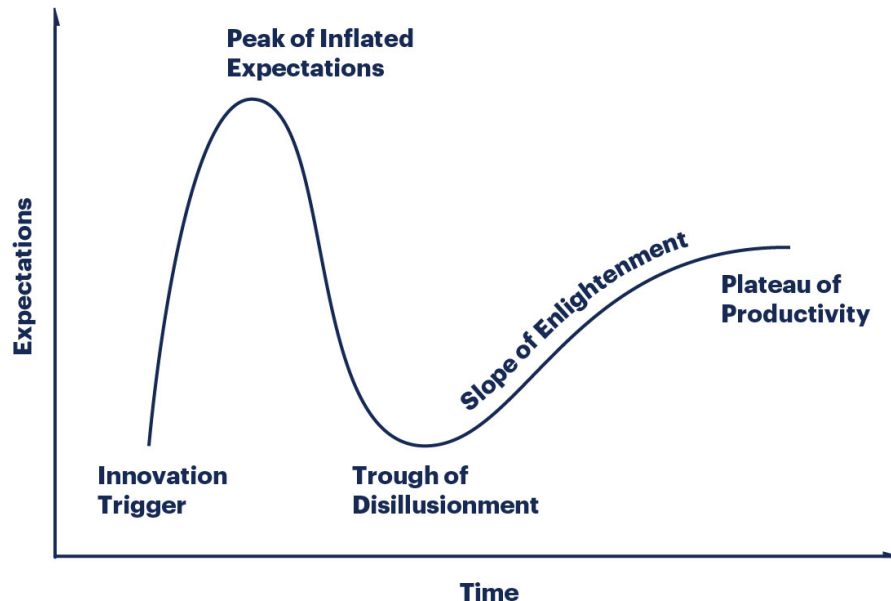
As an innovative technology or new investment theme emerges and ascends to peak expectations, there is usually more capital willing to invest than there are good ideas to invest in. Hence, valuations reach extreme levels and early investors can reap substantial gains.



Investment Ideas/Themes Yet to Reach Peak Expectations	Investment Ideas/Themes With Inflating to Peak Expectations
(High Risk/High Reward)	(High Risk/Low Reward)
<ul style="list-style-type: none"> • Artificial intelligence • Synthetic Biology • Precision Medicine (see adjacent caveat) • Quantum Computing • Advanced Materials Sciences/Manufacturing • Hydrogen Power and Nuclear Fusion 	<ul style="list-style-type: none"> • Passive Investing into S&P 500 • “Innovation” Stocks • CRISPR Gene Editing • Renewable Energy • Electric Vehicles and Autonomous Driving • Crypto and NFTs • Covid Forever

Trough of Disillusionment

As themes decline into a trough of disillusionment, there are usually more quality ideas worthy of investment consideration than there is capital willing to invest. Hence, valuations crash and an entire industry may become fertile grounds for lucrative investments so long as one is patient and – more importantly – correct in their investment analysis.



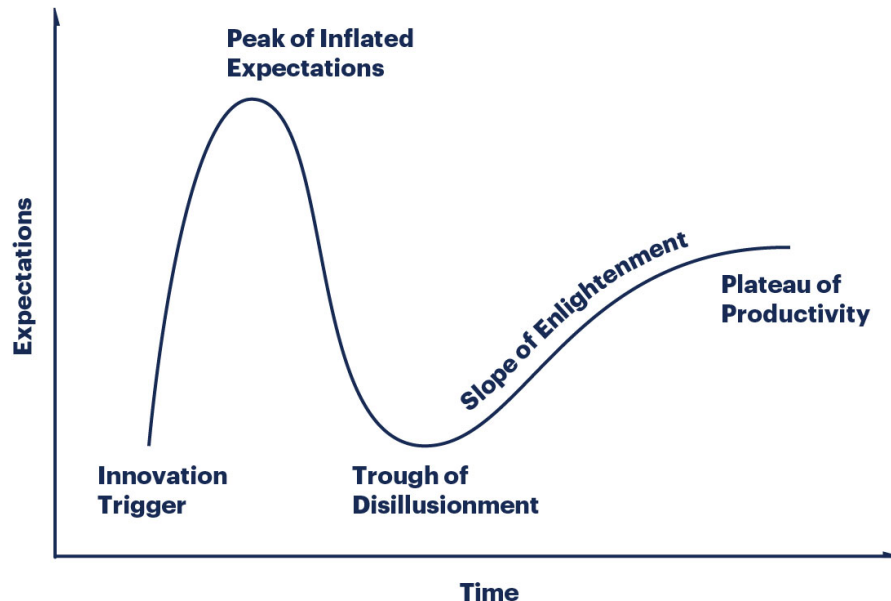
Investment Ideas/Themes In the Trough of Disillusionment

(Moderate Risk/High Reward)

- Conventional Energy (Oil, Gas and Nuclear)
- Industrial Mining and Natural Resources Firms
- Non-CRISPR Emerging Biotech (e.g., Gene Therapy, RNA Medicines and Precision Oncology)
- 3D Printing
- Emerging Markets

Slope of Enlightenment through Plateau

As industries mature, the evolution of a theme reaches a balance with investor capital and the driver of returns shifts from ascending or descending “hype” to industry fundamentals and company operational performance (i.e., company cash flows, sales, earnings).

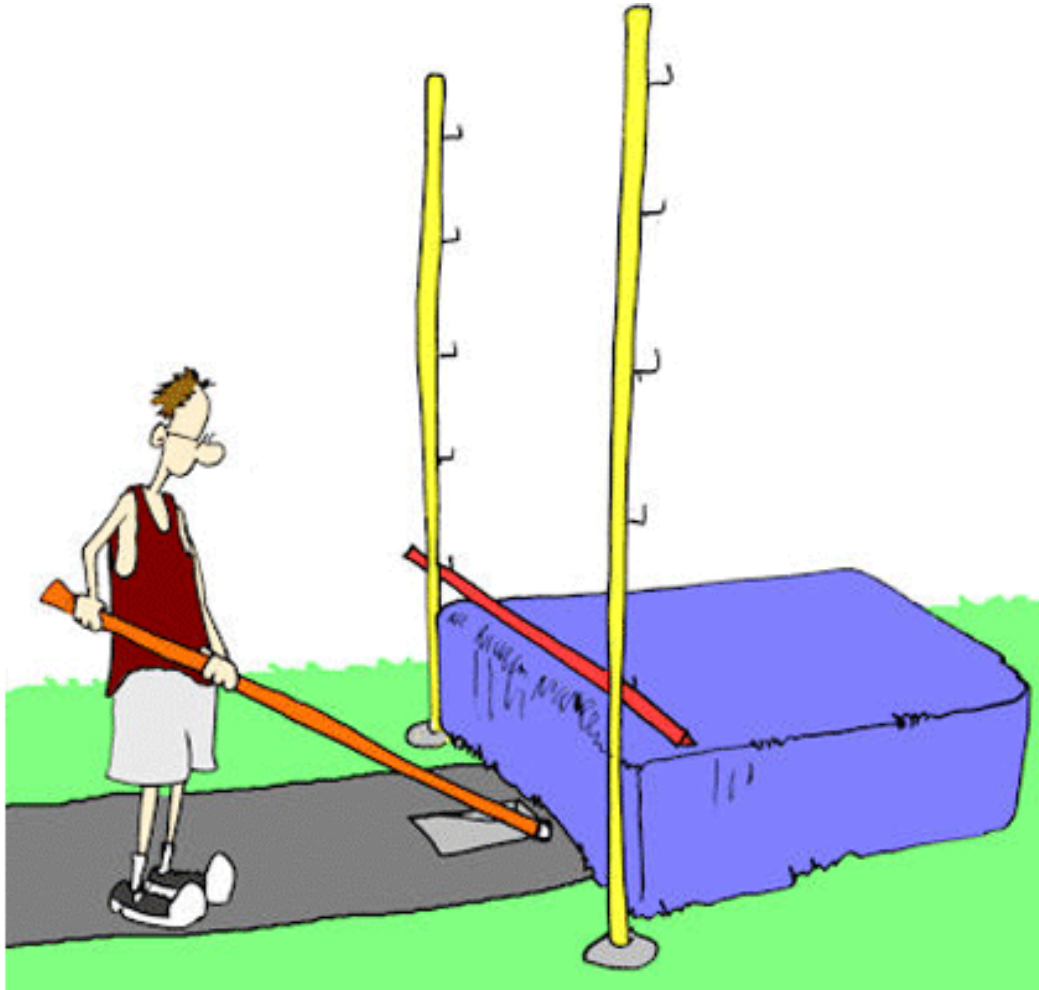


Maturing and Balanced Ideas/Themes

(Reasonable Risk/Reward)

- Electric Utility Industry Growth
- Defense Firms
- Online and Console-Based Video Games
- Semiconductor Manufacturing
- Large Cap Pharma and Healthcare Industry
- Cloud Computing
- Developed International Markets
- Industries Benefitting from a Return to Post-Covid Norms

If We've Passed Peak Liquidity, What are Some Ideas with Undemanding Expectations?



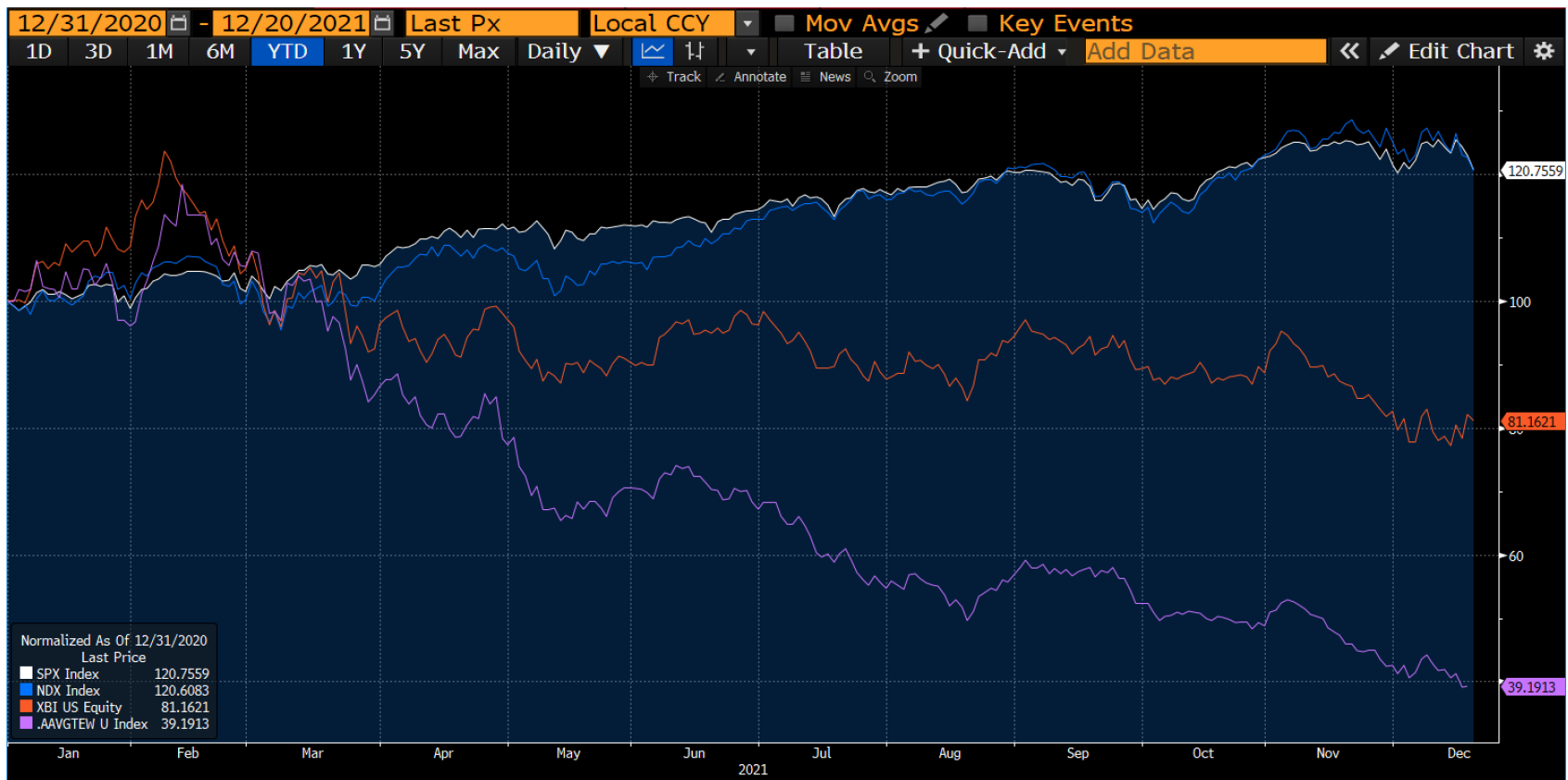
The Growing Electrification of Industry Has Yet to Electrify U.S. Utility Stocks

Utilities ETF (XLU) Stock Price (Last 3 Years)

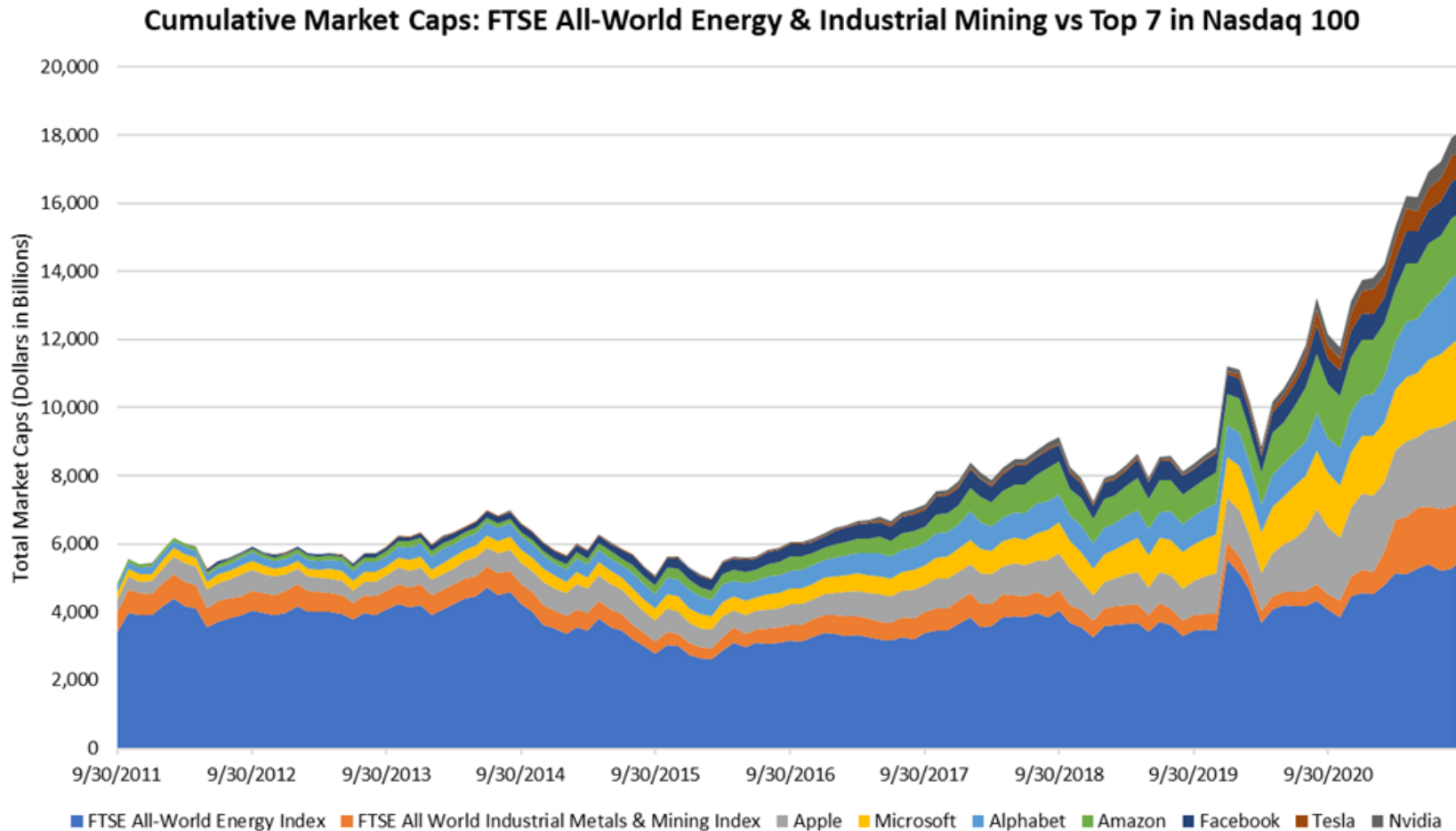


Despite Scientific Advances, Biotech had a Bad Year; Even Worse for Gene Therapy Firms

YTD Performance of S&P 500 vs Nasdaq 100, Biotech ETF (XBI) and
Proprietary Equal Weighted Index of Gene Therapy Firms

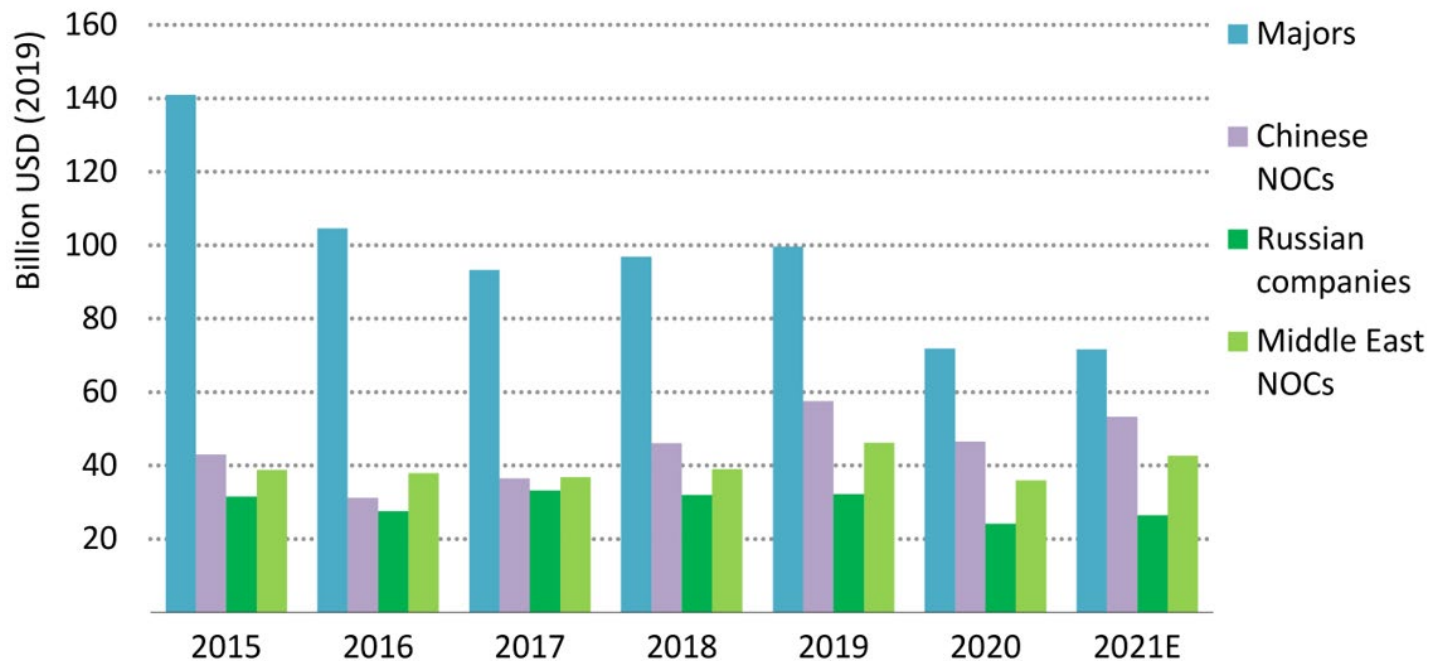


We've Overconsumed, Overinvested in and Overvalued Stuff We Simply Want, Relative to Stuff We Really Need



Conventional Energy CapEx has Declined Below Replacement Requirements

Upstream spending by selected company types



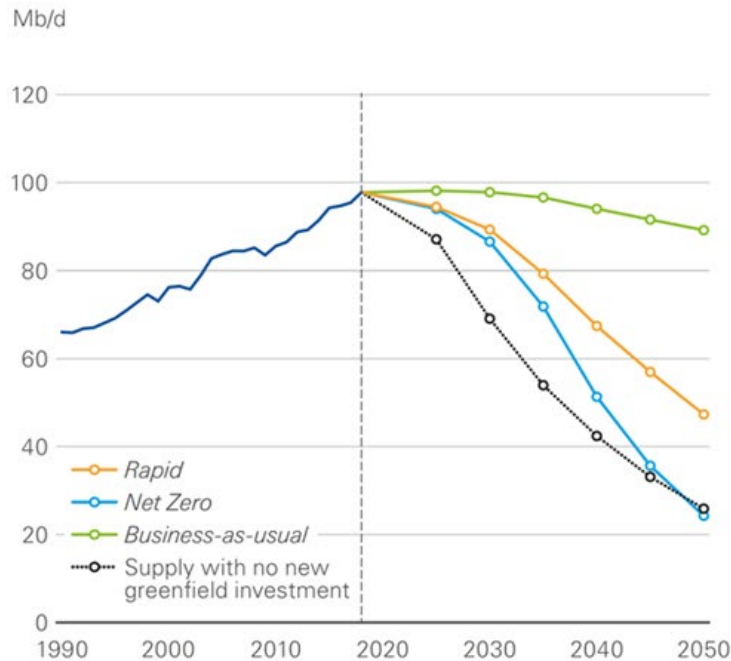
IEA. All rights reserved.

Source: IEA calculations based on company reporting.

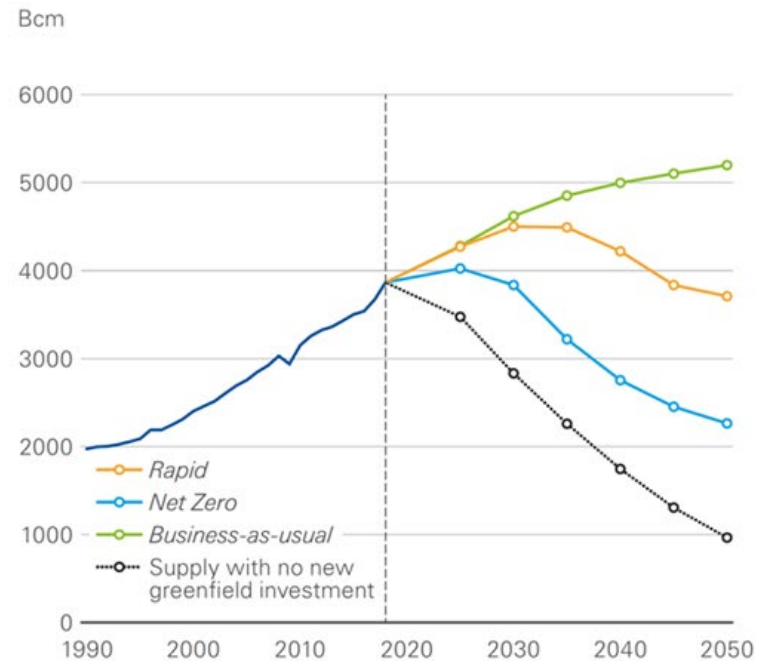
Even in Transition Scenario

Significant investment in new oil and natural gas production is still required

Consumption and production of oil



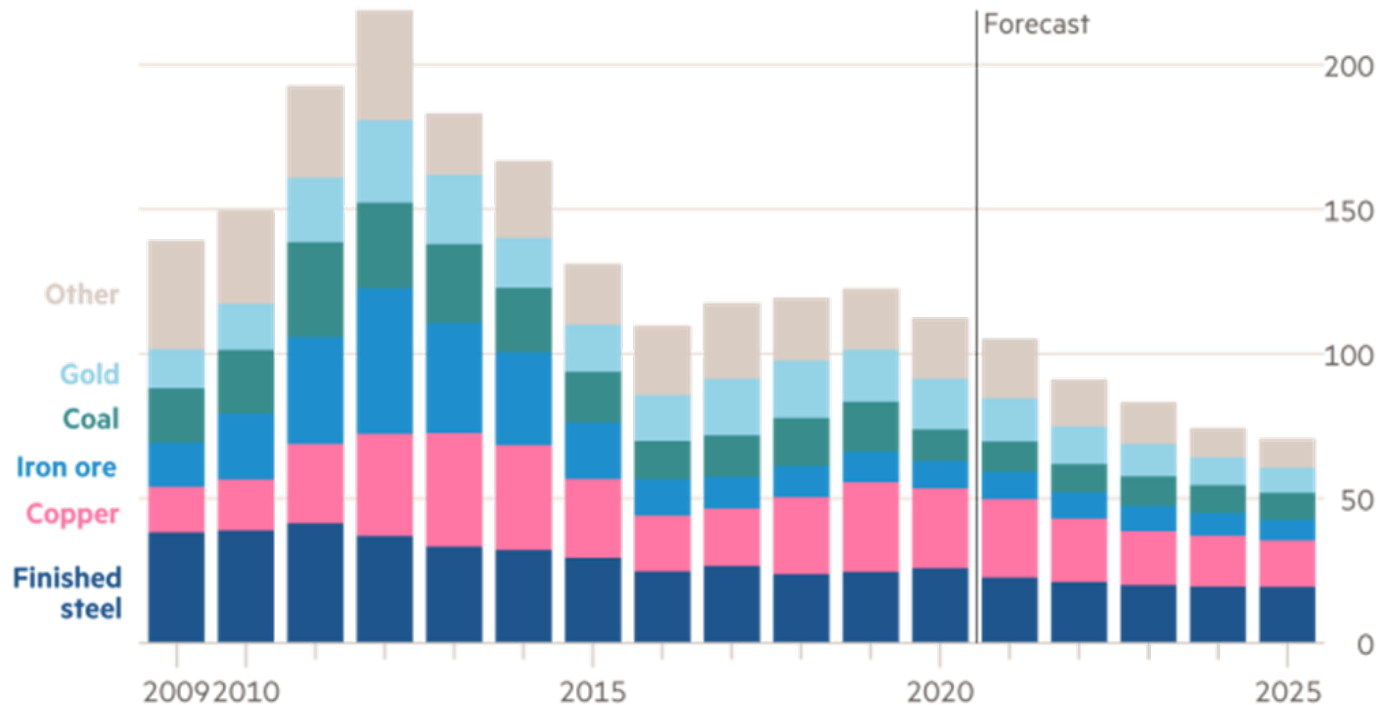
Consumption and production of natural gas



We've also Underinvested in Industrial Metals

Capital expenditure on copper sector set to fall

\$bn, mined commodities

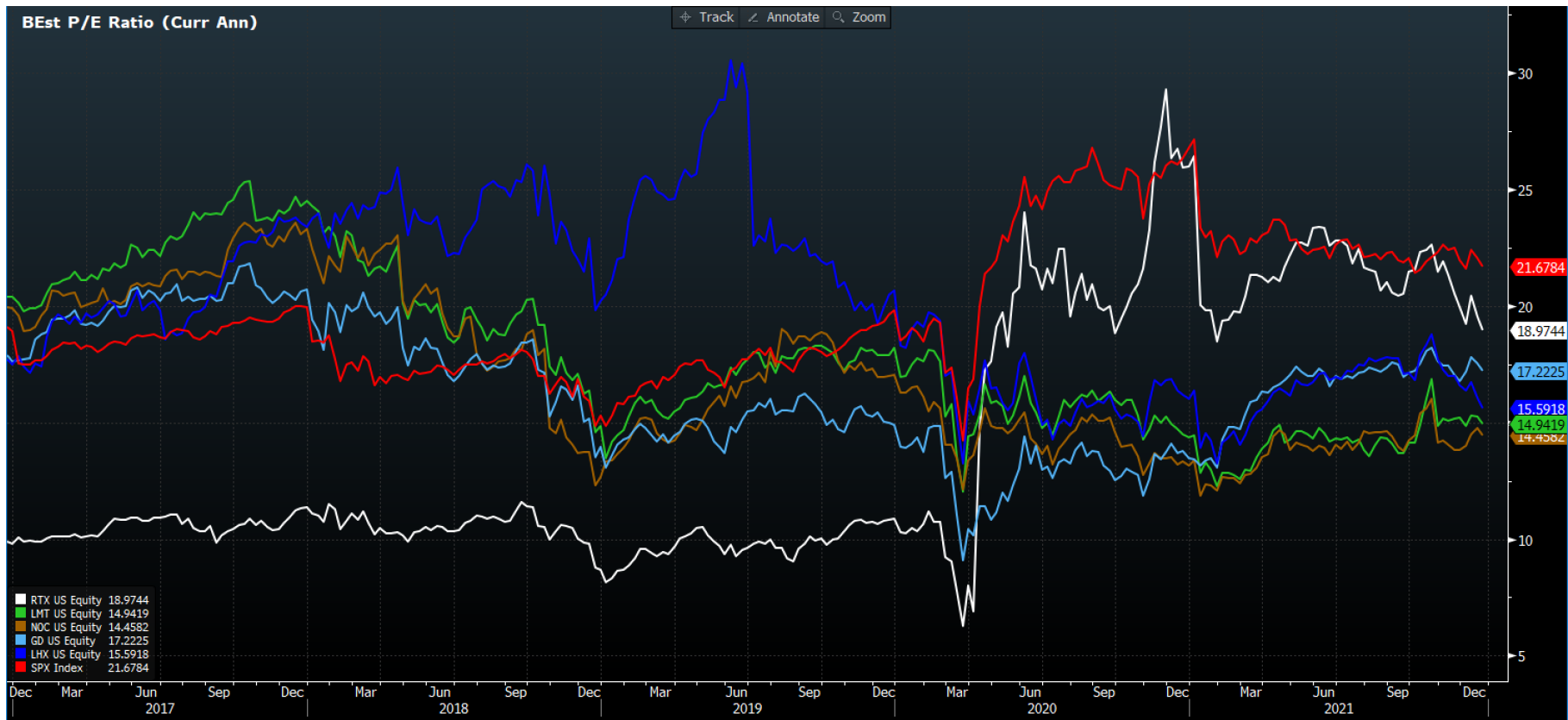


Source: Wood Mackenzie

© FT

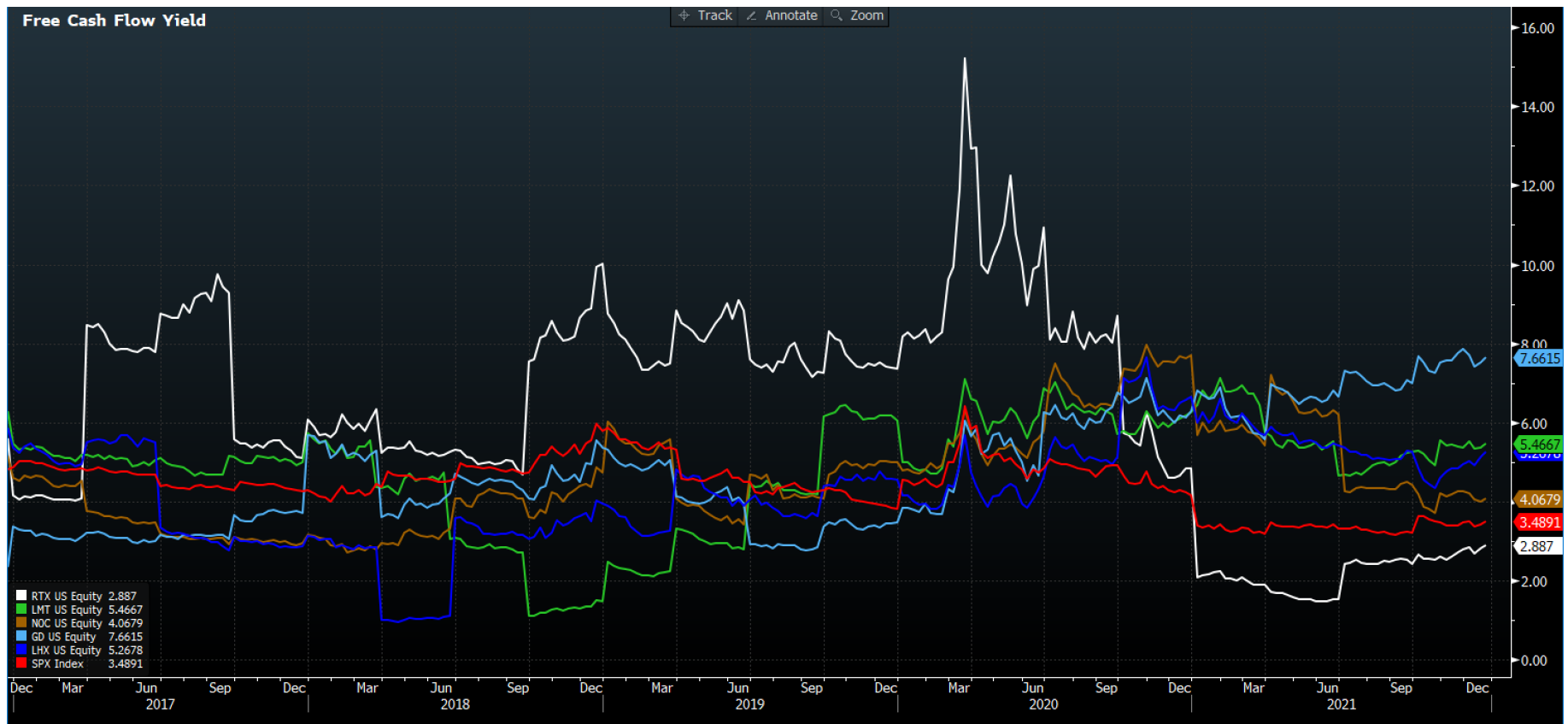
Defense Stock Valuations Don't Reflect Global Instability: Part 1

Forward Price to Earnings Ratios of Leading U.S. Defense Firms vs S&P 500 (Red)



Defense Stock Valuations Don't Reflect Global Instability: Part 2

Free Cash Flow Yields of Leading U.S. Defense Firms vs S&P 500 (Red)



Global Defense Spending to GDP is Low, but Rising

Defense Spending as Share GDP, by Country (2020)

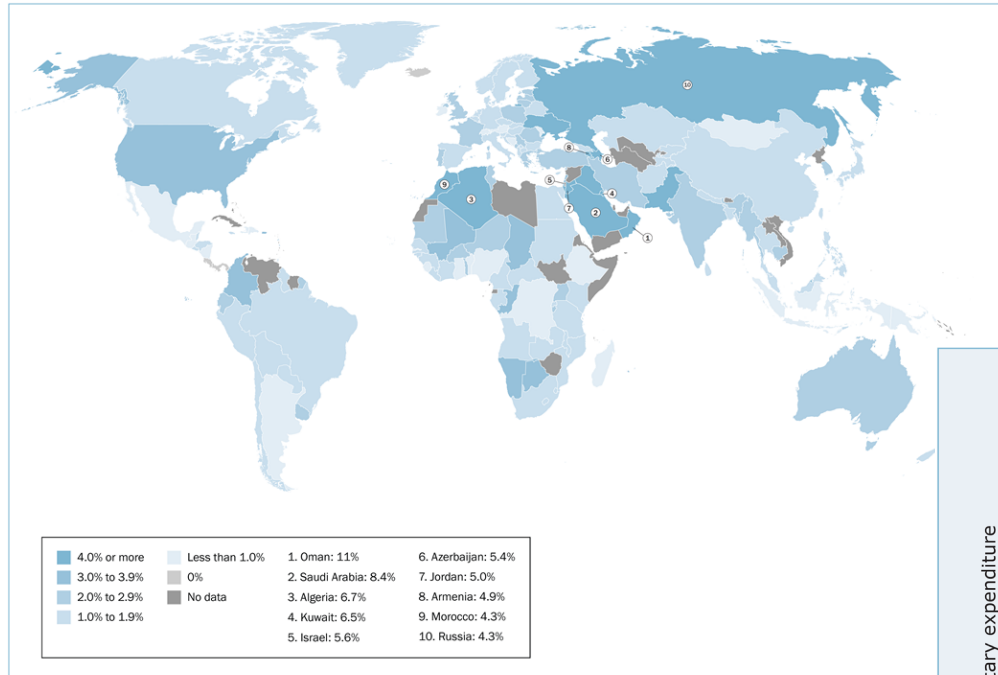


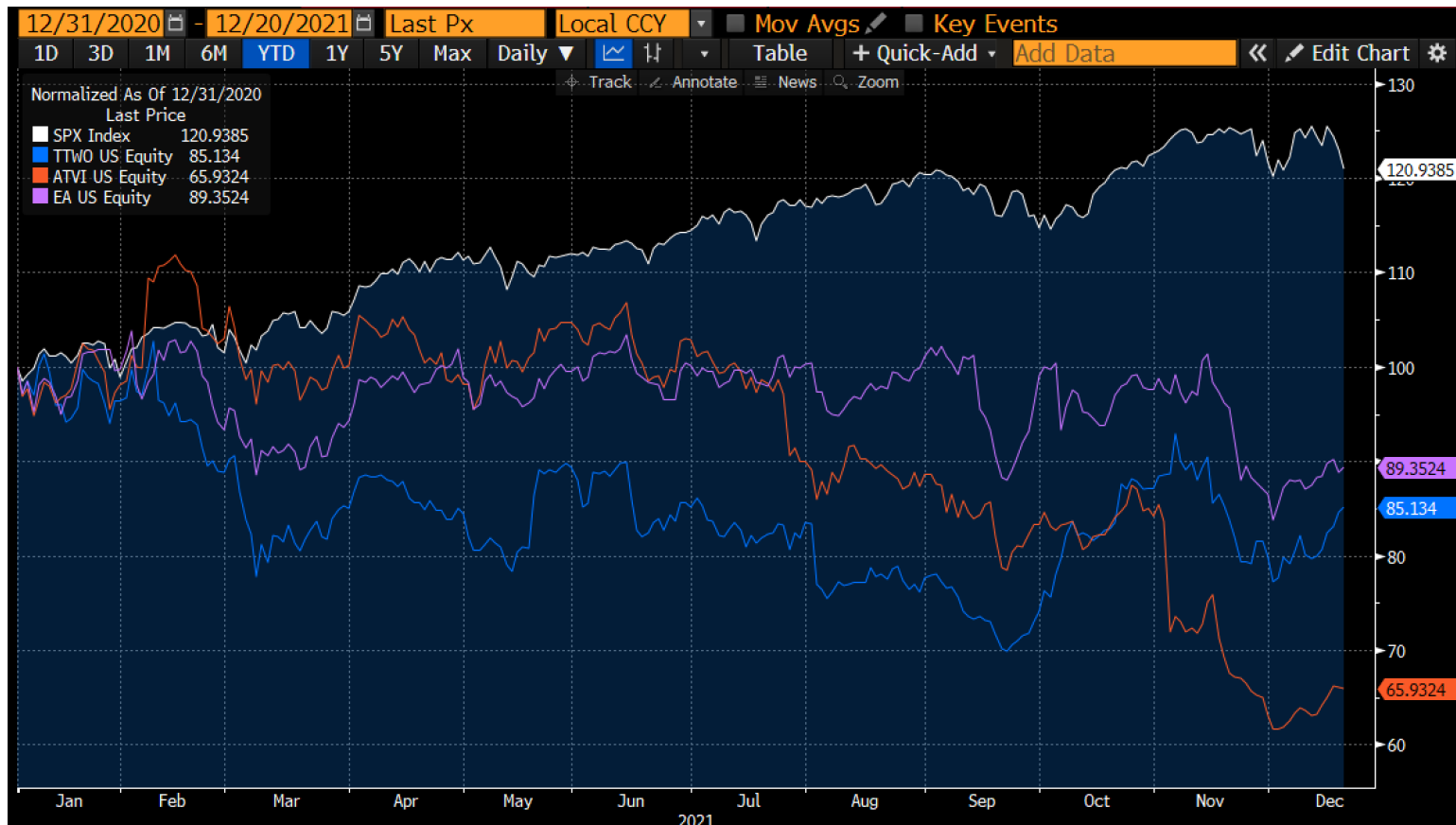
Figure 4. Military spending as a share of gross domestic product, by country, 2020
 Notes: The 10 countries with the highest military spending as a share of gross domestic product are listed.
 The boundaries used in this map do not imply any endorsement or acceptance by SIPRI.
 Source: SIPRI Military Expenditure Database, Apr. 2021.

Annual Defense Spending

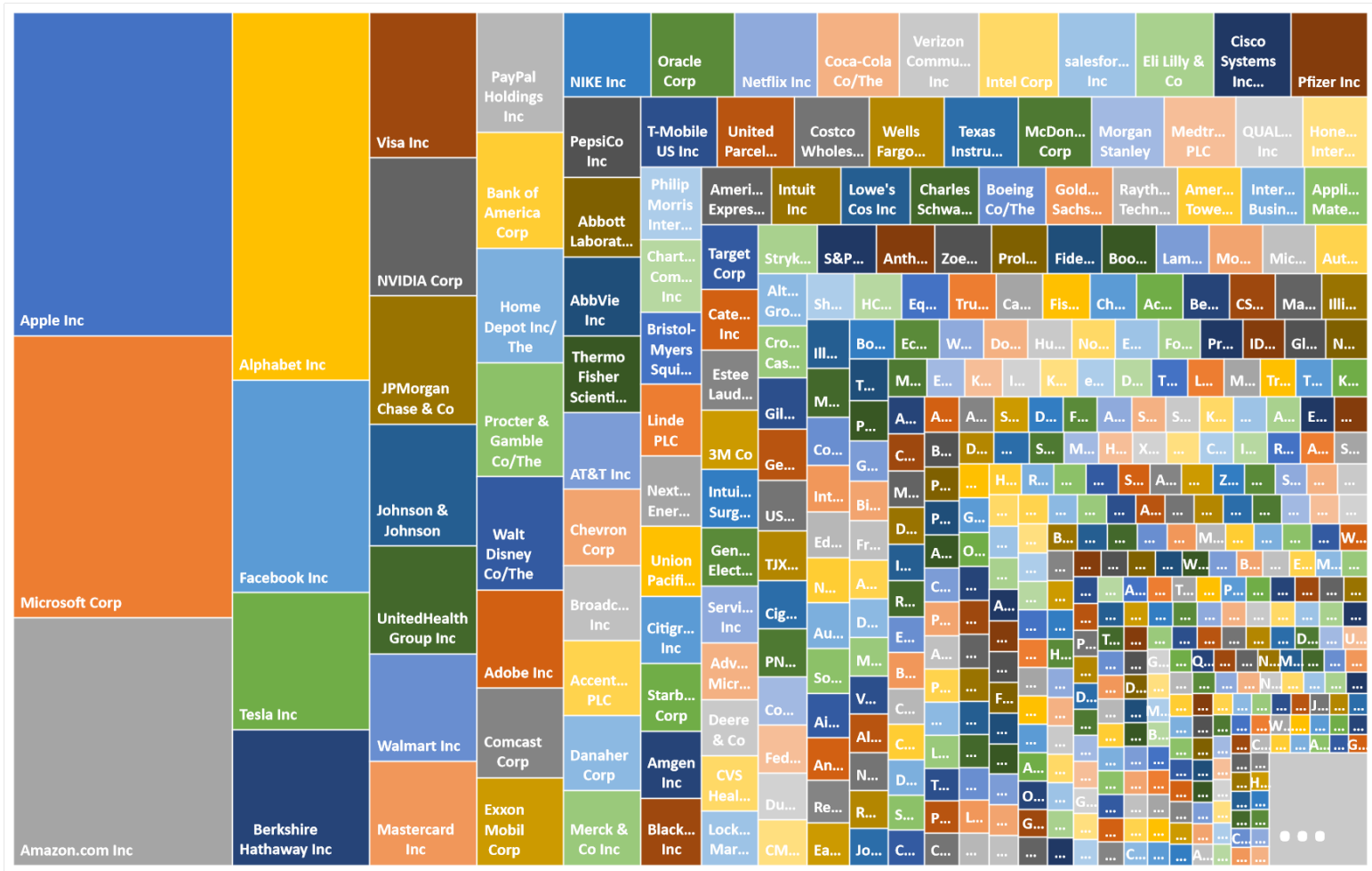


If Videogames are Central to the Metaverse, They Don't Trade Like it

YTD Performance of S&P 500 vs Take-Two Interactive Software, Activision Blizzard and Electronic Arts



**Plenty More Examples, but Main Point is:
If Tide is Going Out, Being Passively Long the S&P 5(00)
May Not Provide the Most Attractive Risk/Return Profile**



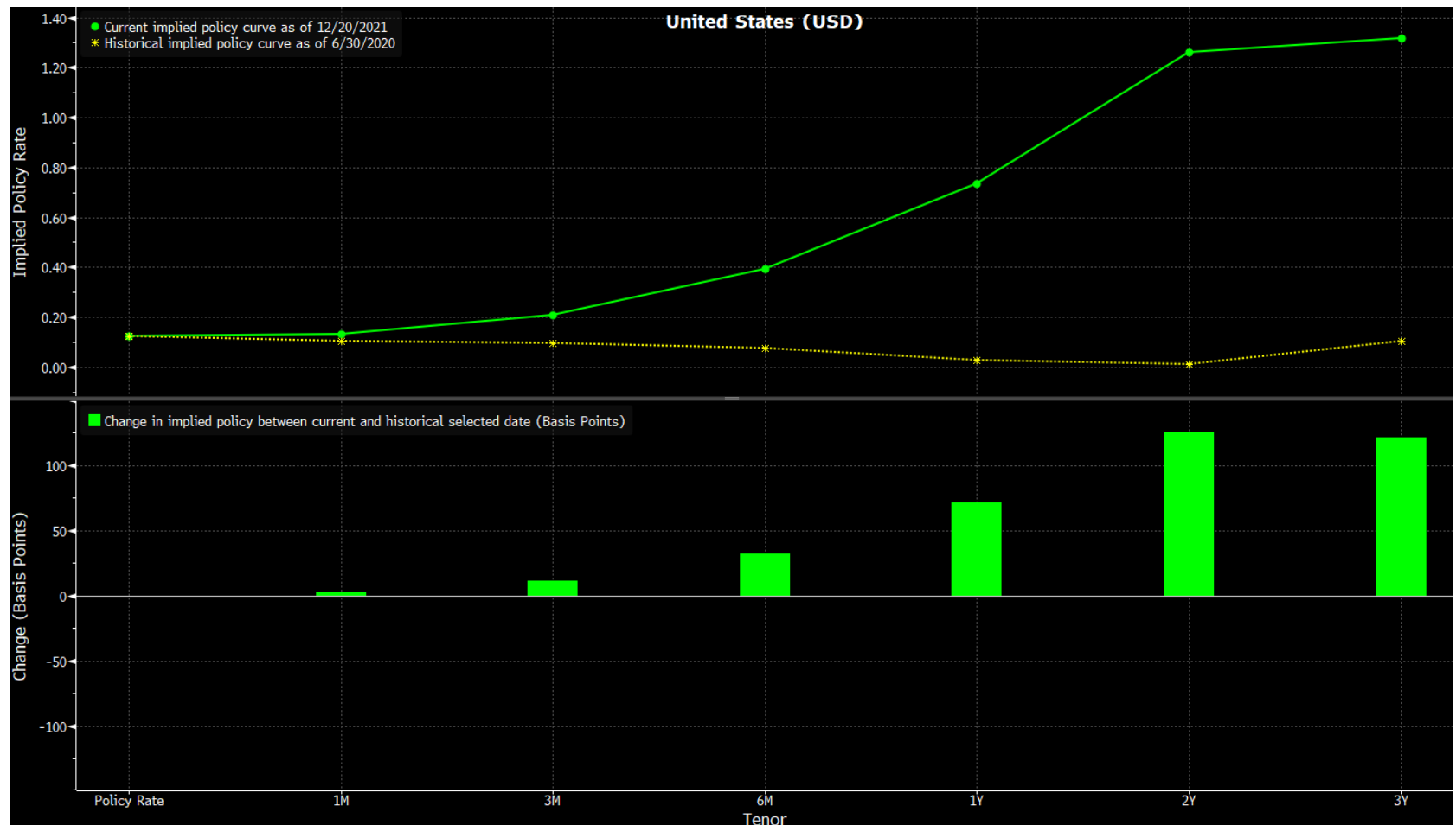
And the Extreme Froth in Long Duration Growth is Unlikely to Respond Well to a Fed Tightening Cycle

Goldman Sachs Non Profitable Tech Index vs ARK Innovation ETF (Last 3 Years)



A Lot has Changed in the Past 18 Months Since High-Risk Growth Went Vertical

Federal Reserve Implied Future Policy Rate Comparison Chart (Dec 2021 vs June 2020)

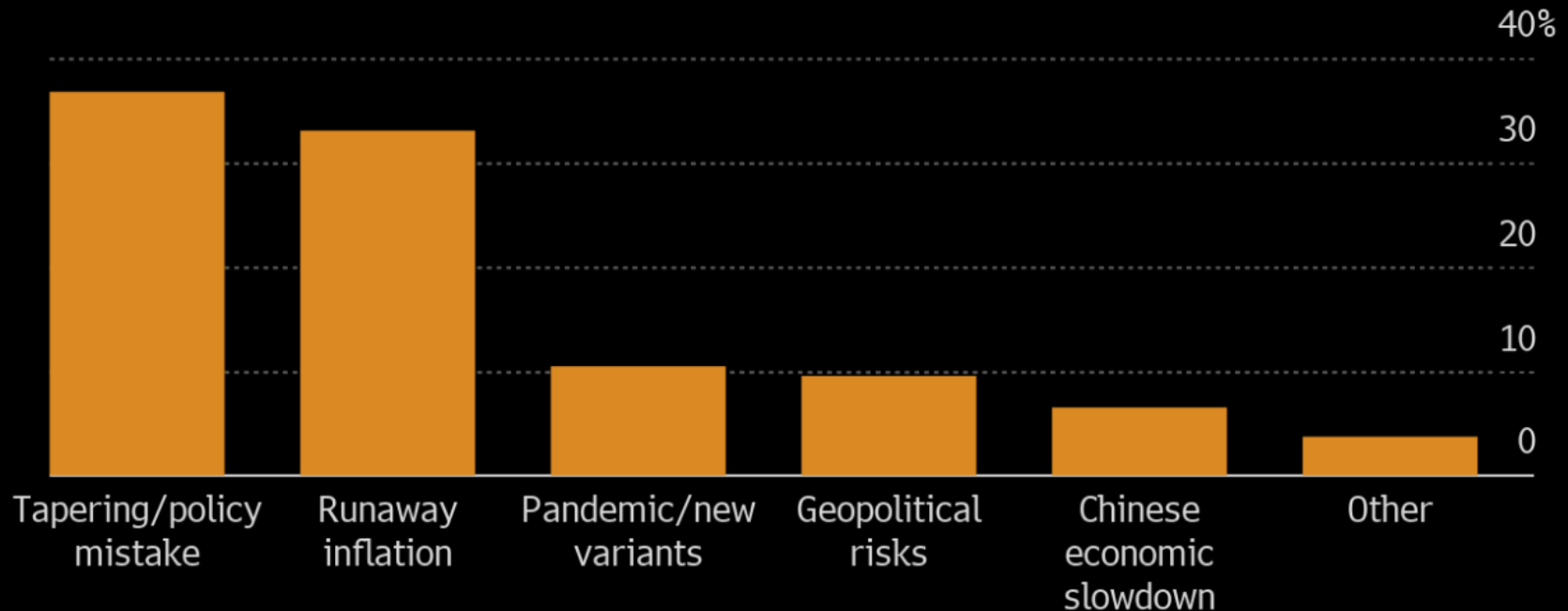


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20-Dec-2021 12:52:46

2022 Reminder: Just as the Best Returns Rarely are Consensus, The Biggest Risks Rarely are Most Expected

What is the biggest downside risk to your main scenario?



Source: Compiled by Bloomberg News

Note: 106 asset managers participated in the survey between Dec. 3 and Dec. 13

Bloomberg

If the Tide's Going Out, Figure Out Your Competitive Advantage

Behavioral

Take advantage of behavioral inefficiencies in markets stemming from ability to assess:

- overextrapolation
- sentiment
- crowding
- conformity

Approach works best for informed contrarians.

Analytical

Take advantage of analytical inefficiencies in markets stemming from differentiation in:

- analytical/valuation framework
- information weighting
- anticipating market's narrative
- Identifying and incorporating new themes and/or information

Approach works best for fundamentals-focused investors.

Informational

Competitive edge comes from ability to:

- legally gather, sort and analyze new data and information before others
- efficiently process vast quantities of data
- simplify complex data sets

Approach works best for organizations with significant research and/or quantitative resources and investors operating in markets where information is not widely distributed (e.g., VC, Private Equity).

Technical

Competitive edge comes from ability to:

- provide liquidity
- model correlations
- anticipate fund flows

Approach works best for institutional investors with significant capital resources and quantitative investors.

And Figure Out Your Investing Horizon

**Over the short-term, investing is about momentum.
It's like the beauty contest where you need to
guess the winner based on who you think everyone
else judges to be the most beautiful.**

**Over the long-term, fundamentals matter and
valuations matter.**

Reach Out to Discuss Specific Ideas

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