The Long Run

INVESTMENT LETTER
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"In the light of temptation
Beyond conversation and all expectation
Pausing a moment or two just to mention...
Impatience"
—Elvis Costello

When the pandemic began, we counseled patience. In our spring *Long Run* of 2020, we wrote, "We cannot let immediate fear — or the constant drumbeat of bad news during this acute period of crisis — push us into poor decisions or drive us away from the fundamental disciplines that secure our financial foundations." Today, we are concerned that investor impatience has led many down dark alleys of short-termism and speculative excess.

In March of 2021, the Organization for Economic Cooperation estimated that the U.S. economy would accelerate twice as fast as expected in 2021 as the passage of President Biden's $1.9 trillion stimulus plan, combined with a rapid vaccine rollout, would ignite a powerful recovery from the pandemic and help lift global growth. This sparked enormous excitement among investors of all stripes and led to strong upward revisions in earnings expectations and global GDP estimates. The CDC's lifting of some mask mandates in May, and President Biden's announcement that more open Fourth of July celebrations would begin a "summer of freedom" only increased expectations for a strong and immediate economic reopening — and a return to relative normalcy — by the fall.[1]

Reality has not lived up to these expectations. Not unlike an old tractor coming out of the barn in early spring, it takes time and effort to get the global economy restarted after such a long period of hibernation, and there are more factors and complications than one might expect. Just as it seemed that we were coming into the light this summer, vaccine hesitancy and the hyper-contagious COVID-19 Delta variant exacerbated supply chain issues, slowed re-employment, and scuttled reopening plans across a wide swath of businesses. Whether it is the current shortage of chip supplies for cars, the lack of workers to unload containers at ports, or the scarcity of energy resources in China to run manufacturing plants, significant supply chain issues remain with us today, and it is going to take some time for the global economy to normalize.

In periods like these, higher-risk investments that promise extraordinary returns and/or trades that ride on shorter-term market moves tend to grab investor attention. Too often, when the merits of fundamentally sound investments in strong, well-anchored, long-term growth opportunities are not immediately reinforced by consistent earnings reads, investors tend to stray.

In a recent article titled "Lifestyles of the Rich and Gullible: Theranos and Ozy Edition," the *New York Times* chronicled how celebrities, venture capitalists, and billionaires poured enormous sums of money into a wide range of Silicon Valley "unicorns" with little due diligence — just for the chance of being a part of the start-up boom — only to lose enormous sums of money chasing flimsy claims.[2] These failures of the wealthy are celebrated widely by those on Main Street who were not invited (or legally eligible) to invest. But are everyday investors really that distanced from the same kind of trouble? Considering the investment environment today, the authors note, "To those watching from the sidelines, it all looks so obvious. But beneath the know-it-all tweets, there is a creeping sense that the psychological distance between the masses of 401(k) investors and the billionaire marks may not be that far."

Wall Street firms have noticed a captive audience of investors, pinned at home and hungry to participate in trades or opportunities that might win them large returns in short periods of time. The lottery-like successes of meme stocks like AMC, Hertz, and GameStop that beat hedge funds at their own games only added fuel to the fire in the last year. *The Economist* reports that in 2019, around 59 million Americans had accounts with one of seven of the largest brokerage firms. This number has surged to 95 million as 17 million new accounts were opened in 2020 alone, with an additional 20 million set up so far this year. Now, for the first time in more than a decade, retail investors represent a larger part of trading volumes than banks, quantitative funds, or institutional investors.

Financial institutions have not been shy about offering shiny new investment opportunities to attract the attention of these new investors, either. In fact, there were more companies taken public through IPOs in 2020 than the previous record high set during the Internet boom. The surge in 2020 IPO activity was fueled by a boom in offerings from special purpose acquisition companies (SPACs). Through these "blank check" companies, private equity, venture, hedge fund, and other professional investors raise capital from the public — in many cases before they even know what they are going to acquire on behalf of their investors. These trends have only accelerated. In 2020, there were 480 IPOs. In 2021, there have been more than 800 IPOs to date. And — in what should come as no surprise to our readers — performance of IPOs this year has been poor. According to a September article from *BusinessInsider.com*, the Renaissance IPO ETF that tracks recent IPOs has lost 12% since mid-February, while the collective value of the 137 SPAC deals that closed by mid-February has plunged by 25%, totaling $75 billion in lost value.[3]

As the narrative shifts from conversations about binary "boom" or "bust" scenarios — and short-term calls on reopening trades versus at-home trades — to a more grounded discussion around actual global growth rates and realistic earnings expectations across industries, this speculative excess in the markets should work itself out. It is now clear that global GDP growth this year, and next, will be slower than most analysts had expected, but we have a better view of how the current economy is working and responding to challenges. Inflation readings have spiked, with pinched supply chains lifting prices. This may well be a key factor in the pace and intensity of any recovery, but we are not convinced that inflation readings to date have been broad enough to signal that the price increases are a byproduct of current monetary policy. In the most recent Consumer Price Index report, for example, all but 11 basis points between the 5.39% reading and the Federal Reserve's inflation target of 2.5% is explained by rising prices in just two categories: gasoline and motor vehicles. Supply chain issues are solvable in the intermediate term, and we doubt that we will be talking about them with any regularity in a year's time.

Powerful tailwinds support the potential for significant earnings growth in many industries, and consumer wallets remain flush. Many innovations that drove new efficiencies and broadened market opportunities through the pandemic are poised for continued growth ahead. These realities support earnings growth in many profitable companies over the next five to ten years. Underneath the speculative froth on the surface, we have been watching surprisingly orderly price corrections in many segments of the market and are finding attractive long-term growth opportunities trading at reasonable prices. Patient investors are beginning to see how and where the earnings rubber meets the road in our new economic reality, and can now make more informed decisions about where to commit capital. Unfortunately, those who chased after unfounded promises in this time of speculative fervor are just beginning to learn that they may have been sold a bill of goods. RM

[1] Liz Alderman, https://www.nytimes.com/2021/03/09/business/oecd-doubles-us-growth-forecast.html

[2] Erin Griffith, https://www.nytimes.com/2021/10/09/business/ozy-theranos-startup-lawsuits.html

[3] Ethan Wu, https://markets.businessinsider.com/news/stocks/spac-blank-check-deals-lost-value-ipo-etf-market-2021-09

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