Breaking Big Tech

You are probably aware that we do a great deal of reading, writing and watching at Smead Capital Management. We recently read Peter Doran’s book, *Breaking Rockefeller*, which is a fabulous economic history of the world from 1840-1920 and focuses on how the monopoly created by John D. Rockefeller was broken from 1890-1910. We also watched a documentary called, “The Social Dilemma,” which explains, through the eyes of some of the social media creators, how incredibly damaging the monopolies, created by internet technology, are to society.

Here is what we learned:

1. John D. Rockefeller knew Standard Oil was a monopoly and did everything he could to cut prices to kill the competition. He called this “cut-to-kill.” He would then buy out his crippled competitors.

   Jeff Bezos, Mark Zuckerberg, Larry Page and Tim Cook all know that they have a monopoly via the addiction/control they have over their “users.” Amazon, Facebook and Google gave away the primary product, ensuring that nobody could compete on price. They “cut-to-kill” right from the beginning. They couldn’t “cut-to-kill,” they acquired.

2. The Sherman Antitrust Act of 1890 had nothing to do with end customer prices. Sherman recognized that, “The popular mind is agitated with problems that may disturb the social order,” he wrote, “and among them all, none is more threatening than the concentration of capital into vast combinations.”

3. In the documentary, “The Social Dilemma,” the people who were creating the addictions to the “free” product, were then using the scale of info to addict and manipulate the “user!” Their customers are the advertisers who want to have users manipulated into purchases or votes or associations. It is truly a bunch of frogs in the not-yet-boiling water.

4. Standard Oil was broken up before the automobile and airplane exploded the importance of refined oil products.

5. COVID-19 has put the addicted “users” in a state of near-complete dependence on today’s “vast combinations.” How do we put this genie back into the bottle and how do we deal with a stock market completely addicted to their success and the S&P 500 Index investors who are tied to their hip? After all, the “vast combinations” have two billion frogs already addicted.

Suicides among 10-18-year old kids have soared with email/social media addiction. Friendships are broken over politics. Civil discourse has disappeared. Violent protests are off the charts. Homicides in major cities have skyrocketed. Folks are siloed into like-minded groups and all this is being exacerbated by the COVID-19 quarantine. People are ignoring their loved ones to satisfy the addiction to the phone or online shopping or social media or to YouTube videos. What have we done?
You must love us capitalists. We are not only frogs in boiling water as addicted "users," but we are enjoying free delivery, free social media and free search at the expense of societal disturbance. On top of this, the wealthy are getting rich from owning these “vast combinations.” It is enough for you to want to take a rocket into outer space (they are)!

Since we can’t sell our soul to make money from these businesses, where can we find opportunities in the post-COVID-19 world? The answer is to look for favorable supply and demand circumstances over the next three to five years with companies which meet our eight criteria for common stock selection. We believe those favorable supply and demand circumstances come in pharma, energy, real estate and mobility.

We have lots of over 60 folks and will keep healthcare costs down by Amgen (AMGN), Merck (MRK) and Pfizer (PFE) providing them medicines which extend their life and their health.

We intend to satisfy 30-40 years of oil and gas needs by owning Chevron (CVX) and Continental Resources (CLR). Even if electric cars dominate in 20 years, the stock market is seriously undervaluing the oil in the ground (see below).
There are huge proven reserves behind each share of these major oil producers and there are numerous unproven reserves in the property owned by each company. On top of these looking attractive at $40 per barrel of oil, the price of oil is historically cheap in relation to gold:

We will build houses for 90 million millennials with NVR (NVR), Lennar (LEN) and D.R. Horton (DHI). American households are in the best financial shape they have been in 40 years, as represented by the Federal Reserve Board’s Household Debt Service Ratio. These stocks will correct along the way, but we believe we are in the fourth inning of a nine-inning home building era.

We expect continued intra-country migration and household formation. Therefore, we like the mobility that Credit Acceptance Corp. (CACC) gives to auto buyers with damaged credit scores. We also like moving them with Amerco (UHAL) vehicles and storing their extra junk in the meantime.

We believe that when the hammer comes down on these “vast combinations,” investors will suffer permanent capital damage. When Rockefeller’s Standard Oil got broken up in 1910, the oil business had its best days ahead of it. The shares of the individual companies were cheap and did well. Amazon Web Services funds the “cut-to-kill” in the Amazon e-commerce business. The high price-to-earnings (P/E) multiples on the common shares could get obliterated when the two get separated and the company gets taxed like everyone else.
Since COVID-19 is likely a pinnacle of dependence for “users” of these “vast combinations,” growth stocks are likely a disaster waiting to happen. Companies which provide necessities to the enormous millennial population are due to succeed on a relative basis. History would argue that when this changeover occurs, labor and physical assets will be the winners. History also argues that when labor and physical assets win, society becomes less disturbed. Value has beaten growth by over 3% per year for 94 years (Ibbotson) and is the most depressed it has been in 57 years. We look forward to the next five years as we believe the remedies will play out and are very grateful for our faithful end owners.

The recent growth in the stock market has helped to produce short-term returns for some asset classes that are not typical and may not continue in the future. Margin of safety is the difference between the intrinsic value of a stock and its market price. The price-earnings ratio (P/E Ratio or P/E Multiple) measures a company’s current share price relative to its per-share earnings. Alpha is a measure of performance on a risk-adjusted basis. Beta is a measure of the volatility of a security or a portfolio in comparison to the market. FAANG is an acronym for the market’s five most popular and best-performing tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet’s Google. Growth investing is focused on the growth of an investor’s capital. Leverage is using borrowed money to increase the potential return of an investment. Momentum is the rate of acceleration of a security’s price or volume. The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. Profit margin is calculated by dividing net profits by net sales. Quality is assessed based on soft (e.g. management credibility) and hard criteria (e.g. balance sheet stability). Value is an investment tactic where stocks are selected which appear to trade for less than their intrinsic values. The dividend yield is the ratio of a company’s annual dividend compared to its share price.

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