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## Antitrust: The Truth Will Set You Free

Dear fellow investors,

Anyone who owns U.S. large cap stocks must understand what can happen from the actions of the government to enforce the laws on the books for antitrust. Contrary to popular opinion, these laws are not set up to primarily protect consumers from being gouged on price by someone with a monopoly. They are, in the words of Congressman John Sherman, designed to stop our nation from “social disturbance” arising from the “concentration of capital in the hands of vast combinations.” In other words, it was designed to limit the power of for-profit companies to receive a disproportionately large share of the success in our society.

What are the actual antitrust laws?

*Congress passed the first antitrust law, the Sherman Act, in 1890 as a “comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade.” In 1914, Congress passed two additional antitrust laws: the Federal Trade Commission Act, which created the FTC, and the Clayton Act. With some revisions, these are the three core federal antitrust laws still in effect today.<sup>1</sup>*

To understand this, all you need to do is watch the documentary, “The Social Dilemma.” In it, former employees of Facebook and Google explain the societal damage being wrought on us by the manipulation of their sites to benefit their advertisers at the expense of their “users.” Here is a short list of the consequences disturbing the social order of America:

- 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.

These liabilities for our society are a function of the fact that the primary product originally offered by these companies was given away for free. Amazon gave away delivery, Google gave away search, Facebook gave away social media and Apple gave away app downloads by pre-loading them in the devices. In effect, the “cut-to-kill” strategy on prices and the stifling of competition was put in place right from the beginning.

The following is an overview of the three core federal antitrust laws:

*The Sherman Act outlaws “every contract, combination, or conspiracy in restraint of trade,” and any “monopolization, attempted monopolization, or conspiracy or combination to monopolize.” Long ago, the Supreme Court decided that the Sherman Act does not prohibit every restraint of trade, only those that are unreasonable.<sup>1</sup>*

The fact that Amazon stumbled upon Amazon Web Services (AWS) by renting out their massive technology capacity in no way defends them from losing money in e-commerce to drive out competitors. We would love to see what price-to-earnings ratio (P/E) would be attached to AWS and to Amazon e-commerce as two companies. "Cut-to-kill" has been profitless for most Amazon e-commerce.

*The Federal Trade Commission Act bans "unfair methods of competition" and "unfair or deceptive acts or practices." The Supreme Court has said that all violations of the Sherman Act also violate the FTC Act. Thus, although the FTC does not technically enforce the Sherman Act, it can bring cases under the FTC Act against the same kinds of activities that violate the Sherman Act. The FTC Act also reaches other practices that harm competition, but that may not fit neatly into categories of conduct formally prohibited by the Sherman Act. Only the FTC brings cases under the FTC Act.<sup>1</sup>*

The Federal Trade Commission and the U.S. Justice Department have all the authority they need and appear likely to be turned loose for the American public soon.

*The Clayton Act addresses specific practices that the Sherman Act does not clearly prohibit, such as mergers and interlocking directorates (that is, the same person making business decisions for competing companies). Section 7 of the Clayton Act prohibits mergers and acquisitions where the effect "may be substantially to lessen competition, or to tend to create a monopoly."<sup>1</sup>*

Facebook acquired Instagram and WhatsApp to eliminate competition and continue its control over "users." They recognized that baby boomers took over Facebook and that millennials would move to Instagram. Google bought YouTube so they could monopolize news and information. This effectively "cut-to-kill" the newspaper and local news stations. Google and Facebook have made no effort to level the playing field by compensating the creators of content to perpetuate their usefulness in our society.

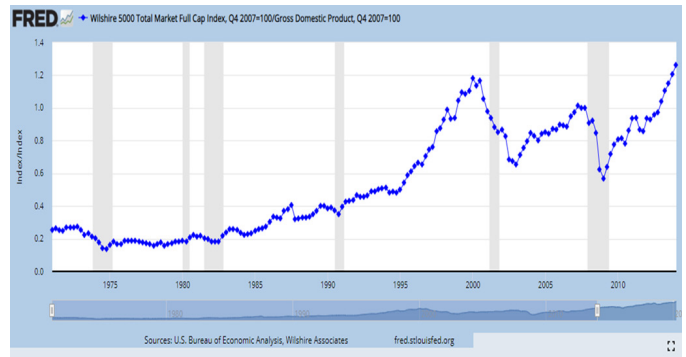
What does the government acting on these antitrust laws mean for U.S. common stocks going forward?

First, the S&P 500 Index is "all twisted up in the game!" It is estimated that 65% of large cap common stock ownership in the U.S. is tied closely with the S&P 500 Index and growth strategies which are dominated by technology stocks and confidence connected to these monopolies. To quote Sherman, "The capital is concentrated in the hands of vast combinations."



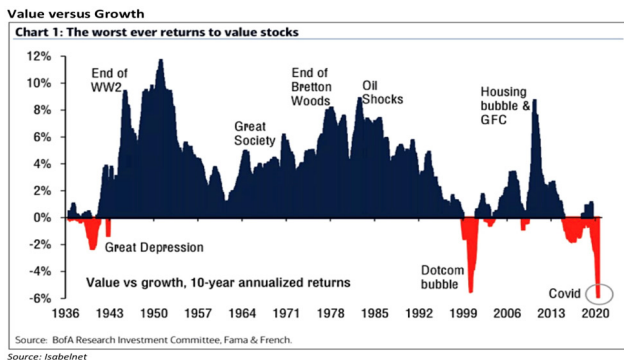
Source: Compustat, Goldman Sachs Global Investment Research. As of August 31, 2020. Global Investment Research  
Source: Goldman Sachs research September 2020, p 33

Confidence in the S&P 500 comes within the backdrop of common stocks trading at record levels in relation to U.S. gross domestic product (Warren Buffett's favorite market predictor).



Value investing disciplines are restricted, for the most part, from owning the most popular common stocks in a euphoric time period like this. Therefore, these disciplines are the most out of favor in 94 years, relative to the growth category dominated by the "vast combinations."





There is very little capital currently available to value stock buyers. Anything which would change this dynamic could cause an incredible shift in performance. Below is a chart of the Russell 1000 Value Index (RLV) versus the full range of indexes pumped up by the last technology financial euphoria episode from March 9, 2000 to October 7, 2002.



Source: Bloomberg.

Woe to those who stayed too long at the technology party back then. Value beat the S&P 500 by 24%, Growth by 43%, the NASDAQ Composite by 59.5% and the NASDAQ 100 Index by 64%. Before the mania broke in 2000, we had sold anything resembling technology because we didn't want to be in Palm Beach if a hurricane was going to hit Miami! This time we are being punished for tacking away from some of our long-term winners to defend our portfolio against the end of this euphoria episode. It has only cost us short-term alpha, just like it cost us from mid-1998 to March 9, 2000.

Could we see a replay?

Antitrust actions seem inevitable to us and so does ultimately getting past the COVID-19 Pandemic. Value investment disciplines like ours were born for times like this and it is at the core of why value outperforms growth over long-term time periods. 🐦

Warm regards,

William Smead

<sup>1</sup>Source: Federal Trade Commission (<https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws>)

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