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Throwing Caution

Dear fellow investors,

As we begin 2021, the investing public is tied up in a “frenzy,” to quote Charlie Munger from a recent interview. This “frenzy” can be captured a couple ways. Whether by the investment banking activities that usually coincide with poor market returns going forward (stock market failure), or by the sell-side research analysts playing hopscotch to raise their price targets over their competition in the most exciting stocks. Rather than look at Wall Street, who can often exact nefarious schemes and ideas on investors, we think it would be best to look at market participants to understand where we sit.

I was travelling from Las Vegas back to Phoenix with my family from a vacation recently. As I pulled out of the hotel that we stayed at on the Vegas strip, “Caution” by The Killers began playing over my SiriusXM radio station. For the baby boomers in the room, The Killers were one of the most popular bands in the 2000’s (for older millennials particularly). The band was formed in 2001 in Las Vegas and is closely associated with the city. With the Consumer Electronics Show not going on this week in Las Vegas, I thought there would be no better song to take us into the mindset of investors right now.

*Let me introduce you to the featherweight queen
She got Hollywood eyes
But you can't shoot what she's seen
Her momma was a dancer
And that's all that she knew
'Cause when you live in the desert
It's what pretty girls do*

When investors look at the speculative activities of the last six months, they will find “featherweight” kings and

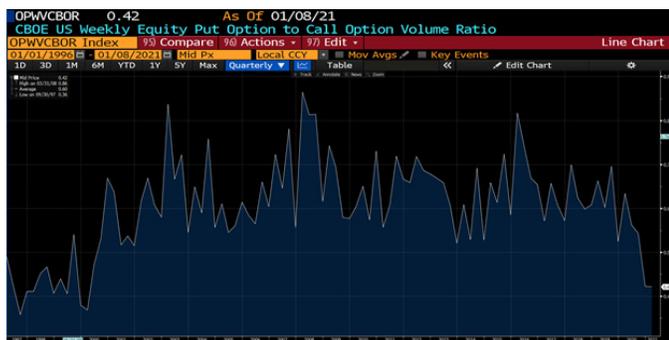
queens that have “Hollywood eyes.” These are retail investors, not billionaires, taking their vision of the future into their stock market wagers. It’s exactly as David Dreman explained in his analogy of the [red wing](#) of a casino where there are small chip stacks with few green and black chips. They incorrectly believe the market is there to instruct you, rather than serve you, as Warren Buffett would say. Thus, they are playing table games that are in the house’s favor (read Wall Street).

Millennials have fallen completely in love with the stock market like their “momma” did 20 years ago. This was the last time that the IPO market was this exciting and speculation was this high. Does this mean boomers aren’t involved? No, they are passively ready for trouble as well. To quote the wisdom of Ralph Wanger, “Usually the market pays what you call an entertainment tax, a premium, for stocks with an exciting story. So boring stocks sell at a discount. Buy enough of them and you can cover your losses in high tech.” We hope that investors will be able to cover their losses in the S&P 500 Index. The entertainment tax is heightened today because of the pandemic giving everyone few entertainment options other than the stock market channels, while they work from home. Being based in Phoenix, we “live in the desert” and know this is what all speculative bull markets do.

*I'm throwing caution
What's it gonna be?
Tonight, the winds of change are blowing wild and free
If I don't get out
Out of this town
I just might be the one who finally burns it down
I'm throwing caution
I'm throwing caution*

Call buying relative to put buying is at a 20-year high as noted by the chart below. Investors have never been this enthused to speculate in options at any point since 2000. This is Munger’s “frenzy.” They aren’t avoiding caution. As the song says, they’re “throwing caution.” They believe “the winds of change are blowing wild and free.” Individual and institutional investors are telling us stories of what the future will hold and what the market has capitalized. As Marty Whitman would remind us, they’re way too interested in the “going concern” and not interested enough in the balance sheet of these situations. Predicting earnings in the future is tough. Looking at the capital structure of a business is more predictable.

Millennials are the generation that typifies this “frenzy.” Boomers have seen this before. They’re not resting on their laurels. They’ve thrown them out with the idea of caution. However, my generation (millennials) has never participated in a phenomenon like this in stock markets. Only the oldest of my group were lucky enough to speculate in the 2007 housing debacle. In fact, most didn’t begin participating until last spring in the stock market. This group is so virtuous, they waited for 10 years to figure out that we had a bull market on our hands! However, they “just might be the one who finally burns it down.”



*Never had a diamond on the sole of her shoes
Just blacktop white trash
Straight out of the news
Doesn't like birthdays
They remind her of why
She can go straight from zero
To the Fourth of July*

The “blacktop white trash” in online chat boards pumping stocks are “straight out of the news” as major broadcasting outlets produce content of the rise of Robinhood and the popularity of stocks like Tesla. Today, the “blacktop white trash” uses Reddit and Twitter. Our “momma” used Prodigy and AOL chat rooms. These speculative episodes don’t “like birthdays.” “They remind” investors “of why.” It’s why 1972 caused a generation of investors to give up on stocks. It’s why 2000 crushed the hopes and dreams of baby boomers and made them all cautious value investors by 2003. These investors are fickle. At the end of March 2020, they went “...straight from zero” and ran stocks right up through “the Fourth of July.”

As though this song doesn’t provide enough fiction for life already, the song was published on March 12, 2020, right as millennials got going. The song comes from the album titled “Imploding the Mirage.” Passive investors and speculators may want to hope the parallels only go so far. 🐦

Warm regards,

Cole Smead, CFA

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