



William Smead
Chief Executive Officer
Chief Investment Officer

If I Fell, Again

Dear fellow investors,

Investors have called their five-year love affair with technology stocks into question over the last 35 days. For this reason, we at Smead Capital Management are calling in John Lennon and Paul McCartney's beautiful ballad "If I Fell" to help answer the following questions. Should investors continue to fall in love with these glamour growth titans? How have past love affairs with tech ended? Where might the bottom be over the next five years if history is any guide? Lastly, how will agnostic index and ETF investors react if the stocks which made their wealth grow the last five years become a source of financial heartache?

*If I fell in love with you
Would you promise to be true
And help me understand
'Cause I've been in love before
And I found that love was more
Than just holding hands¹*

In the fall of 2018, technology companies grew to 30% of the S&P 500 Index, when Amazon (AMZN) and Netflix (NFLX) were included. This tied the peak reached at the end of 1999. To say that investors "fell in love" with these stocks would be a severe understatement. Will they "promise to be true" and help investors reach their financial goals? Have these companies helped investors "understand" why they may reward them in the future?

These are important questions to answer, "cause investors have been in love with tech before" and they found on the downside that "love was more" than "just holding hands." Today their hands are held by Vanguard,

State Street, Charles Schwab and BlackRock, the largest owners of tech-concentrated vehicles. The growth versus value chart below shows the "love before" and how that played out:

US Value underperformance vs Growth same extreme as 1999...

In the US, the underperformance of Value (measured as Value Index/S&P 500 price ratio) has retraced back to the extreme low seen in 1999.

- The question we need to answer (later in report)—is Value broken? We do not think so and hence, this retracement is significant.

Figure: S&P 500 Growth and Value relative price performance (vs S&P 500) past 25 years
Price ratio: Style / S&P 500. Since 1995



Source: Fundstrat August 29, 2018

It took four years to create a historical extreme in early 2000 and two years to completely crush those who had their hands held on the way down. Doesn't building the peak in 10 years mean "the pain" will be handed out for five or six years this time?

*If I give my heart to you
I must be sure
From the very start
That you would love me more than her
If I trust in you oh please
Don't run and hide
If I love you too oh please*

*Don't hurt my pride like her
'Cause I couldn't stand the pain
And I would be sad if our new love was in vain*

On November 1, 2018, Tim Cook, the CEO of Apple (AAPL), joined the other FAANG companies by announcing they will “run and hide” about phone sales. Phone sales have been the bread and butter of the massive gain in Apple’s stock the last ten years. This is mild “hiding” compare to Facebook (FB), Amazon (AMZN), Netflix (NFLX) and Alphabet (GOOGL). They hide on privacy, disclosure, accounting, anti-trust issues, and in many cases have used “free” giveaways (free social media, free delivery, free search) to distort our economy and amass the most power this side of Standard Oil/John D. Rockefeller in 1900.

If this market route turns into a debacle like 2000-2003 it will “hurt investor pride like her.” We believe investors in tech-heavy funds, ETFs and indexes won’t be able to “stand the pain” and will flee in a multi-year negative-tech feedback loop. Their “love” will have been “in vain.”

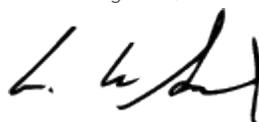
*So I hope you see that I
Would love to love you
And that she will cry
When she learns we are two
'Cause I couldn't stand the pain
And I would be sad if our new love was in vain
So I hope you see that I*

*Would love to love you
And that she will cry
When she learns we are two
If I fell in love with you*

Once the privacy, disclosure, accounting and anti-trust issues are fully priced into these stocks, we “would love to love” some parts of these businesses. Things were similar in 1999. Our investors expect us to stick to our discipline and only buy these great tech businesses when they are deeply out of favor. Look at how analysts on Wall Street have fallen all over each other to raise their price targets when nobody was left to add their buy recommendation.

The stock market always does what it must do to frustrate the most people. Investors could very well “love to love” the FAANG glamour stocks most of the way down, sucking every possible dollar into these crowded and popular trades. It would be sad if this “new (tech) love was in vain” and we believe investors “will cry” if they learn that 2018 and 1999 “are two.” We don’t expect many investors to agree with us, because when it comes to glamour tech, the stock market is “in love with you.” 

Warm regards,



William Smead

¹Lyrics source: The Beatles “If I Fell”

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