SMEAD capital management

Missive

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DXYZ: An Old Form of Ignorance

Many investors are bullish, or not fearful, of the future of stock returns. At Smead Capital Management, we continue to explain to our investors how poor the outcomes will be. Some ask when this view will change. To quote Keynes, "When the facts change, I change my mind. What do you do, sir?" The facts are not changing. Instead, we continue to find mountain evidence of the danger present. In this piece, we will explain an analogous instance from the past.

A *Bloomberg* article last week pointed out that a closed-end ETF had surged in value since its initial offering and had begun to burn investors. "Destiny Tech100 Inc., which trades on the New York Stock Exchange as DXYZ, spiraled as much as 45%, trimming gains from its debut last month to about 700%. The fund's shares are incredibly volatile, reminiscent of 2021's meme stock mania, as trading had to be halted at least four times in the opening 30 minutes of Tuesday's session."

DXYZ owns a portfolio of venture investments with the largest holding being SpaceX. The promoters of this closed-end investment product tout many things on their site about the originality of what they are doing for investors compared to past private market products:

> *At Forge, we focused on building the infrastructure for trading in the private markets, working under the assumption that someone would inevitably make a product like this. But five years ticked by, and no one stepped up...So, why did it take so long for something like this to exist? Simply put, no one else was willing to take the hard road — until we did.*

While this sounds like ingenuity and creativity, students of history will learn that it isn't. It's a sign of the times as products like this come up in other exciting eras of the stock market. The question for investors is whether now is the time.

In Janet Lowe's book about Charlie Munger, *Damn Right*, you can read of a product identical to this. During the Go-Go 1960s, products like these were available. Charlie Munger and his partner Al Guerin took control of a product called the Fund of Letters. It was a "venture capital that its founders had formed in a highly touted initial public offering allowing liberal sales commissions to stockbrokers. When it was first organized, the fund raised $60 million..." Lowe goes on to say, "As typically is the case with the closed-end fund, the Fund of Letters soon traded well below its net asset value. Moreover, when the market went into a prolonged decline, the Fund tanked with it."

Since markets are made to serve you and to take advantage of the future, not instruct you:

> *...Guerin and Munger bought control of the troubled Fund of Letters, they changed almost everything about it. They renamed it the New America Fund, reorganized the board, and redirected the investment style to a value approach. They quickly liquidated assets chosen by former managers."*

Why were they able to do this in 1972? Venture investments soured after 1969. It was the point that the bear of the VC markets began, much like what transpired in other years such as 1987, 1999 and 2021.

Charlie Munger was no slouch as we all know. He could acquire the fund at a large discount to the value of what he paid. He then could sell the underlying venture investments for more than he paid. He then went on to make investments inside the closed-end fund after 1972. They went on to own all of the Daily Journal Corporation (DJCO), Capital Cities (now Disney) and eventually Blue Chip Stamps (which is now part of Berkshire Hathaway).

Since Munger is no longer alive, we will speak for what he stood for. DXYZ is just another form of gambling today like betting on sports on your mobile phone. Many people place bets just to entertain themselves. As they say on the DXYZ's website, "Everything is more entertaining when you have a stake."

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For the investors of Smead Capital Management, we would advise this is a sign of the times. It is unlikely we will be able to take advantage of DXYZ when these types of investments in the market "goes into a prolonged decline." Our best way to make money is to avoid and recognize the damage this thinking is doing to market operators.

To add some levity to this note, I took notice when Cathy Woods' firm, Ark Invest, commented that they thought DXYZ was crazy for investors as they were paying far more to own these venture stakes in companies like SpaceX via DXYZ. While they are correct in what they are saying, it shows you how euphoric the psychology in this stock market is. In other words, when growth people start talking about valuations being insane, you know how ugly things could get. We believe Munger would say it's an old form of ignorance.

Fear stock market failure,

Cole Smead, CFA
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