Breaking Big Tech

October 15, 2020
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You are probably aware that we do a great deal of reading, writing and watching at Smead Capital Management/the Smead Value Fund. 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. What they couldn't "cut-to-kill," they acquired.

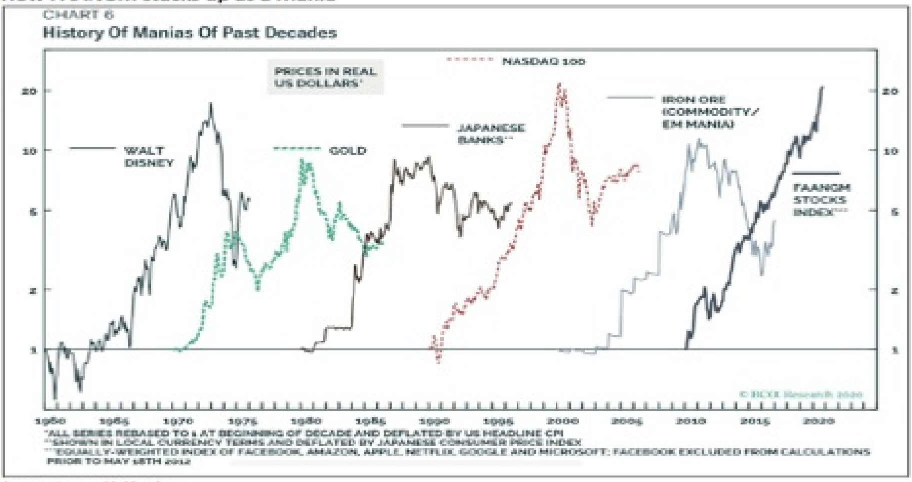
2. The Sherman Antitrust Act of 1890 had nothing to do with end customer prices. Sherman recognized that, "The popular mind is agitated with problems that may disturb the social order," he wrote, "and among them all, none is more threatening than the concentration of capital into vast combinations."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

Source: Goldman Sachs research September 2020, p 33

Long-time clients also notice that we have never owned tobacco, alcohol and gaming companies. We decided a long time ago that we would make all the money we could outside of businesses which ruin the lives of their best customers. How are these "vast combination" companies (AMZN, GOOGL, AAPL, MSFT, FB, etc.) "disturbing the social order?"

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?

How FAANGM stacks up as a Mania



Source: Jeroen Blokland

Source: Cypress Capital Sept 9, 2020

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.

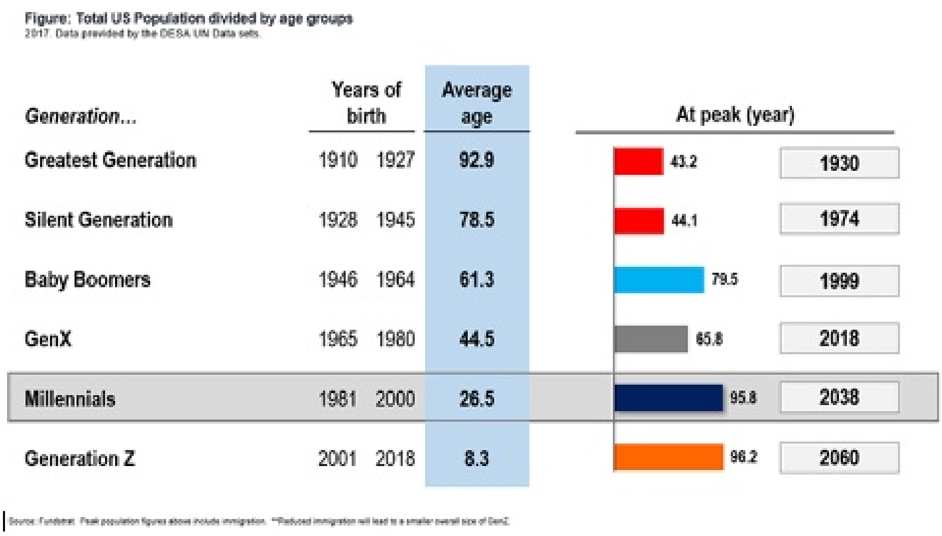


Figure: Total US Population divided by age groups
2017. Data provided by the DESA UN Data sets.

Generation...	Years of birth		Average age	At peak	(year)
Greatest Generation	1910	1927	92.9	43.2	1930
Silent Generation	1928	1945	78.5	44.1	1974
Baby Boomers	1946	1964	61.3	79.5	1999
GenX	1965	1980	44.5	65.8	2018
Millennials	1981	2000	26.5	95.8	2038
Generation Z	2001	2018	8.3	96.2	2060

Source: Fundstrat. Peak population figures above include immigration. **Reduced immigration will lead to a smaller overall size of GenZ.

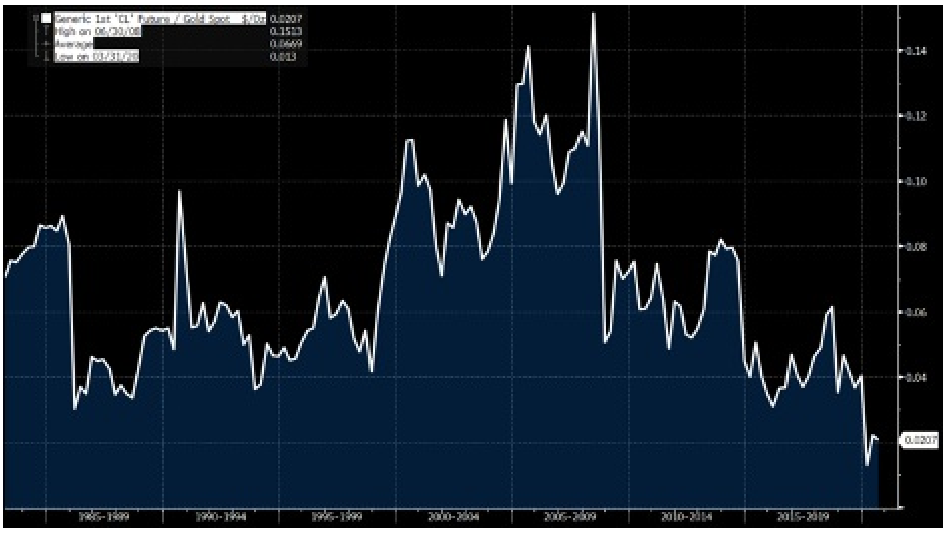
Source: Fundstrat

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).

Source: Bloomberg.

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:



Source: Bloomberg.

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.

Source: Bloomberg

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.

Source: Bespoke Sept 22, 2020

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.

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