*August 2020*

# OCCASIO PARTNERS LLC

San Francisco, CA

## No Textbooks Needed:

*"Although the valuation might appear stretched when evaluated against historical norms, we view Penn as a 'story stock' at this point and thus find valuation less important to our overall investment thesis."* -Goldman Sachs research note, 8/11

And that ridiculous piece of "research" is without a doubt the best way to summarize the current market environment we find ourselves in. That's not to be considered a negative, more just an observation. In August, we saw both the S&P-500 and Nasdaq-100 hit all-time highs. All this amongst an on-going pandemic, 10%+ unemployment, large swaths of the country remaining shut down for retail and other non-essential business. And with a S&P-500 earnings multiple of nearly 22x, which historically, is on the high side.

Market participants have suspended (or ignored) reality and started to embrace "concept" stocks in an attempt to explain away valuations and the macro backdrop. And that is fine; it is a speculative market that has been for years and will be for many more. As long as you know what type of pool you are wading into, there is nothing wrong with enjoying a nice swim.

And maybe the current extraordinary action is trying to tell us something? Perhaps the all-clear signal in the stock market is a pre-cursor to the economy and a rational, expediated election that is void of controversy. Is the fact that Tesla continues to make all-time highs despite selling 1/20th of the cars GM sells pointing in the direction of a proven vaccine for Covid being ready by year's end and allowing us to all get back to some semblance of a normal life?

Or maybe this is just a reckless market fueled by unprecedented Fed liquidity and further bolstered by bored day-traders stuck at home with easily accessible Robinhood accounts that add fuel to the institutional fire. The answer, as always, lies somewhere in the middle. Obviously, tech has taken the mantle and been the clear leader this year. Which does make sense when you think of the ramifications of the work from home movement that has commenced in 2020 and will likely continue to grow in popularity in the coming years – especially if we can't get better control of Covid.

The main criticism of the markets these days, aside from the valuation perspective is the narrowness of the leaders, or the breadth to use a more technical term. We have seen most of the heavy lifting done by the tech behemoths (4 stocks now make up 25% of the SPX-500), all whose market caps are near, or over a trillion dollars (or $2 trillion for Apple). Being disregarded however are the "real" economy stocks such as the airlines, banks, and to a lesser extent the industrials and transportation stocks (ex Fed Ex and UPS for obvious reasons)

Many point to the Fed's actions as the primary catalyst for the rise in equities. But what gets overlooked at times is the effect that low interest rates have on the valuation of equities. Let's assume that benchmark rates remain below 1% - which they have for quite some time now, that treasuries yield less than 1% while the traditional equity premium yield should be 4%, and an inverse ratio is 100/4 or 25, meaning the SP-500 P/E should be closer to 25 not the traditional 16. So, using that albeit generous math model, one would conclude that stocks have a way to go seeing that the current forward P/E is only around 22. Another conclusion is that a rise in rates is the biggest bogey facing *stocks* right now for a variety of reasons.


***Everyone loves to overuse the word bubble. But it is starting to become a bit more justified when looking at soaring P/E's amongst a contracting economy and uncertain health and political future.***

That does not seem like much of a threat these days and hasn't for a while. But we should note a few events that transpired in August that at the minimum should raise a few eyebrows. First, we saw some of the hottest CPI and PPI numbers in nearly 30 years this month. The Fed is hell bent on getting inflation above their mythical 2% level – they have made that crystal clear (more below). But it seems to us if you replaced the word inflation with living costs it wouldn't sound quite as sanguine – especially during a pandemic/economic contraction.

Second, the treasury held two significant auctions this month for both 30-year and 20-year bonds. The 30-year auction was deemed the weakest in over 10-years. The 20-year was better, but not by much. It's hardly a reason to panic, but let's all realize that the world and equity markets are addicted to and reliant on low rates now. That is the deal we all made (or was made for us?). Any change in those parameters via inflation or lack of demand is going to cause a disruption that won't be quiet or peaceful.

**Looking Forward and other Market Commentary:** Now that summer is essentially over, the big vacation plans are now a lasting memory, and the kids are back in school, it's time to re-focus our brains on the markets. Oh wait… this is 2020 and none of the above are even applicable. But let's pretend things are semi-normal and prepare accordingly. For starters, the volume across all markets, which was painfully light in August should return to more normalized levels. Second, the looming election is getting closer and closer and will be THE focus for the markets until it is decided – even more so than Covid - barring a large directional change in the number of reported cases.

As for the election, the best case for the markets, and the country, would be a decisive win by one of the candidates and a controversy-free election day. Seems unlikely at this junction, and the odds of this becoming a highly dysfunctional event seem to be rising given all the rhetoric. Let us all hope this isn't the case. If one were to strictly handicap the election as a market event, and leave personal political beliefs aside, then the re-election of President Trump would be the most sanguine outcome for asset prices. The simple fact is financial markets love the President and his pro-growth/less regulatory agenda. Conversely, they are wary of a Biden presidency due to his threats to raise taxes and the association his party has with very anti-market members, namely Elizabeth Warren, Bernie Sanders, and Alexandria Ocasio-Cortez- fair or not, it's an issue.

There are some who believe a Biden win will restore some sense of calm to the country and provide a more stable political environment that will ultimately be a long-term positive for stocks. There are others who feel he is too liberal and tolerant of social disobedience and his election would only bolster their insubordination.

Aside from politics, September we will see another slew of central bank meeting, highlighted by our Fed, which will meet on the 16th. Also, ones to watch will be the ECB on the 10th and the BOJ on the 17th. Obviously, with the massive liquidity provided by the above entities this year, any change in verbiage will be highly scrutinized. There is no chance of any change in rates in September however, nor for the foreseeable future. That should not come as a surprise to anyone.

We find it very interesting that this market, and particularly retail and non-discretionary stocks have not reacted more negatively to the fact that congress still has not passed a second stimulus bill to further unemployment benefits, extend some PPP loans, and possibly send out another round of stimulus checks. For a while market strategist were keen on the rally continuing due to the coming additional stimulus. That was nearly a month ago.

And by the sound of it, the two parties are barely even speaking and not at all close to an agreeable package. Which should come as a surprise to no one but does raise yet another concern about the current market environment.

Corporate earnings will effectively take the month off as we gear up for another season of reports starting in mid-October. There will be a few scattered reports to check on including Slack, Crowdstrike, Five Below, Smartsheet, Zuora, Sina, Pager Duty, Cloudera, Ambarella, and Mongo DB.

One of the stocks we have been long off-and-on for years now, Trade Desk, reported their quarter on the 6th of August. They were as strong as expected given the run-up into the report – beating estimates by $0.72 while coming in $6.4 million higher on revenue estimates. They also guided Q3 revenue for +8-10%. Trade Desk now sells at 30x sales, which in a normal world would be considered nearly insane, but these days it's just another tech stock.

The stock price has been stuck in a trading range for all of August, between $460-$515. The reaction to their report was muted and it has been unable to breakout over the $550 mark so far. We are flat the name right now but would love to get back involved on any significant pullback. However, those seem to be few and far between these days.

Facebook had quite a month, as most tech stocks did. But we came across an interesting piece of research that seemed to be ignored.

*Facebook on Wednesday acknowledged that Apple's upcoming iOS 14 could lead to a more than 50% drop in its Audience Network advertising business. Facebook had previously warned that iOS 14 could impact its advertising business, but the company's blog post on Wednesday outlined just how specifically that impact could be. The Facebook Audience Network allows mobile software developers to provide in-app advertisements targeted to users based on Facebook's data. A change in iOS 14 lets users opt out of data collection used for such ads. Facebook says more than 1 billion people see at least one Audience Network ad every month, although many of those are probably using Android phones and will not be affected by the change.* ***Facebook derives nearly all of its revenue from advertising****, but it's not known what percentage is attributable to the Audience Network versus ads on Facebook and other properties*

When all your revenue is sourced from one area, and that area takes a significant change in procedure from the most powerful company in the world, we see it as a "big deal," although apparently, the market does not though. Just another example of the environment we are in right now.

Remember last month when we touched on the fact that a vaccine may actually be a *negative* for the markets? And how that seemed counterintuitive? Well, Goldman Sachs agrees with us as they issued this warning in August via the *Wall Street Journal*

*Goldman Sachs out warning that a vaccine could drive a major shift in equity allocations away from growth while driving yields higher. They think the combination of a vaccine plus the election around November could cause significant volatility into year-end.*

It would be a drastic understatement to say the equity markets, but not the bond markets, are counting on, if not demanding a vaccine of some sort that will help the economy and society return to a level of normalcy and justify the V-shaped bounce in the stock market that has not (yet?) been reflected in the economy.

The current divergence between equities and the "real world" has never been as dramatic as it stands at the end of this month. It is almost as if the stock market is just a virtual simulation void of any traditional inputs. A video game if you will. The hope is that the market is a leading indicator and is sending a strong signal that the economy will come roaring back at a much faster pace than even the most ardent bull could have imagined.

Some of the recent evidence from the economy does indeed point us in that direction. Unemployment, durable goods, PMI's, and retail sales have all shown marked improvements lately and that has helped spurn the equity move. However, as always, the bond market continues to ignore all data and remain in a ultra-low rate environment - largely fueled by central bank policy.

There are now calls that we are in a stock bubble, which is an incredible statement considering we are in the midst of a pandemic. Some are pointing to the influx of Robinhood traders as the catalysts bolstered by the ability to now purchase partial shares and commission-free trades. Others believe passive investing, especially in ETF's have made this a "mindless" market that is run by machines and void of any human rationale - especially fear or valuation levels.

It is what can help explain the moves we saw this month in Tesla, Facebook, Salesforce, Apple, and to a lesser extent Netflix. Tech-filled ETF's are receiving the vast majority of money-market funds and even the recipient of a lot of the stimulus money that the government has doled out.

This year is one like no other, we all know that and are living through it, but maybe nothing encapsulates it more than the news of Salesforce replacing Exxon in the Dow Jones Average beginning on August 31st. It was only 10 years ago that Exxon stood as the biggest company in the world based on market cap and has been in the Dow since 1928. This month it got replaced by a cloud company that has only been public since 2004. We aren't here to say it's a bad thing, it does makes sense on a modern-world level. But let's not skip over the fact that Salesforce trades at a forward PE of 74 and 10.4x sales. It would be curious to get Charles Dow's take on that or Benjamin Graham's for that matter.

Lastly on Salesforce. Despite being added to the Dow Jones and posting record profits in Q2 this month, they also announced 1000 coming job cuts for US employees – including 165 here in San Francisco. If that doesn't sum up 2020 any better than that?

Chairman Powell gave a (virtual) speech on August 27th titled "*Monetary Policy Framework Review*", despite the dreary name many were calling it the most important one of his tenure at the fed. Turns out it wasn't. In his speech Mr., Powell explained that the Phillips Curve has not been driving inflation like it had in the past and re-emphasized the Fed's desire to get inflation past the mythical 2% level they so desire. Inflation is now only 1.4% according to the fed. But we all know how nonsensical that is in the real world we dwell in.

The Fed will now do away with the Phillips Curve and switch to a policy known as Average Inflation Targeting (AIT) - This would potentially mark a mirror image of the early 1980s when then-Fed Chairman Paul Volker aggressively raised interest rates to stamp out the inflation that crippled the U.S. economy. Since Mr. Volker's assault on pricing pressures, the United States has been in a downward trend. A move by the Fed to AIT would be the most aggressive action to try and arrest this decline.

The Fed's obsession with raising inflation seems a bit odd and ill-timed in our opinion. But they may well be on their way when you consider that both the CPI and PPI numbers this month came in as hot as we have seen in years. But we would like to ask the Fed just one simple question:

"What if you replace the word **inflation** with *cost of living*?"

Let's say you went on national TV and told the American people during a pandemic no less that it was your stated goal to increase everyone's cost of living. In fact, you were altering your policy to do just that. How do you think that would resonate with folks at home staring at their health insurance, mortgage, kids' schooling, and simple grocery bills?

Our guess is it would not go over too well - at all. Yet, that is essentially what is going on. Yes, we understand that inflation in wages is part of the goal but would strongly argue there are much better chance of the cost of goods going up before any employers jump to hand out raises.

Maybe we are missing something here or didn't study economics enough in college. But it seems to us the Fed is continuing down a dangerous path that they somehow have the confidence they can control magically. Despite the fact that they possess a recently expanded balance sheet of nearly $7 trillion dollars with rates at multi, multi, multi-year lows!

The reaction to Mr., Powell's speech was severe for the bond market as we saw yields on the 10-year pop up to 0.74% – which was an 7-week high and also saw gold and bitcoin slammed by over 3% each.

*"They have created a real speculative environment, I am uncomfortable at the present time, not because of the virus, because I'm focused on something the market isn't focused on. And that is the amount of debt that's being created. Who pays for the party when the party is over?" Low interest rates "are indicative of a problem economy. We have had artificial support for the economy since 2008. I don't look at that as being a positive."*
Hedge Fund Pioneer Leon Cooperman, Bloomberg TV 8/16

Probably the best news we got all month, at least for society, was the news out of Abbot Labs. On August 27th, they announced a 15-minute Covid test with 98% accuracy and the ability to produce 50 million kits per month - all for $5 each. If indeed this is as good as it sounds, which is asking a lot, then this is *really good* news for the travel, leisure, and entertainment industry. Let's see if they can actually produce this before we get too confident, but it's certainly an exciting development.

It was not a great month for holders of precious metals or Bitcoin. After a stunning run in July, the sector saw a sharp decline. Some would point to profit taking as the motive, while others sense an improvement in the hope of vaccines or that better testing (Abbott) will allow the Fed to reduce their support and hence damage the allure of metals and Bitcoin.

However, as the quote below eloquently lays out, it is not going to be that easy to turn off the spigot despite what happens in the medical world and even the economy.

*A long-term trend of investor demand for stores of value has only just begun, with policy doors now open that **won't be easily closed again**. That's a huge mark in favor of gold and Bitcoin. It's just that we now know the eventual policy response will be to print enough money into the system until real yields are once again negative, only reinforcing the long-term underlying demand for those perceived stores of value at the expense of fiat currencies.* Mark Cudmore, macro strategist at Bloomberg Markets

Also, this month Fidelity announced a Bitcoin fund for accredited investors. We take this as just another example of main street finance adapting to the cryptocurrency world. Expect to see more announcements like this in the coming months.

We may be at a juncture when current Fed policy is the "new normal". Perhaps we have gone over the cliff in policy terms and now there is no going back to the "old days" of fiscal responsibility and traditional fed record. If that is remotely possible, and it certainly is, then the future for the metals and cryptocurrency world remains very bright – despite an admittedly dark August.

Finally, it is incredulous to us how sometimes the markets behave when we go for a walk around our fair city of San Francisco and see the massive destruction Covid has caused. It is estimated that 1,200 small businesses here, mostly tourist and service related won't open again. Much of the city, especially here downtown, remains boarded up and continues to look like it is preparing for a hurricane – that may have sadly already come and gone.

Restaurants, which usually need 80% capacity to survive on their thin margins are forced to serve outdoors only, usually in a cold typical summer fog, in hopes of hanging on until either they are allowed to re-open at a lesser capacity or until their PPP or EIDL loans run out – which by all accounts is very soon or has already transpired.

*SF Eater*, once a popular site to hear about exciting new places opening or new chefs taking over current establishments, has now become an obituary section to identify what corpses are the latest victims to shut their doors permanently.

Fisherman's Wharf, usually booming with tourists scooping up cheap trinkets and waiting in long lines to see Alcatraz at this time of year now looks like the set of a zombie apocalypse movie.  All this without much hope of change anytime soon seeing as travel is still light and kids are "back" in school.

This great city is strewn with trash and has seemingly been infiltrated with even more homeless than before the pandemic.  Crime is on the rise, both petty and violent, and this month our mayor decided to defund our proud police department $140 million dollars – despite the pandemic and severe economic contraction.

The rumor is you can't even find a rental truck to move if you wanted to.  The trucks are sold out weeks in advance.  Landlords are doing the unthinkable here and slashing rents, usually to those who came in only recently and are paying $3,000+/month for a small one-bedroom.

And as if because things weren't bleak enough, the Bay Area has been suffering through some of the worst fires in 90 years, fires that have  has painted our skies a sickening brown and made the air quality so bad that wearing a mask now serves two purposes.

It is easy to get down on this once proud city that attracted some of the best talent across a large swath for decades.  It's still a beautiful city, despite its current "makeover" and we still love the downtown vibe despite it being less populated. The bridges, the sound of a foghorn in mid-August, and the hope that one day we will be dining again with all those interesting cuisines this place has to offer keeps us hopeful for a better 2021 and beyond.

We are not going anywhere and think those bailing now are selling at the lows, to use stock market jargon. San Francisco just has too much natural beauty, cultural diversity, a richness of tech history, and a plenty of bars (when opened) to celebrate bonding with friends or drowning away a bad day.

San Francisco will be back. It may take a bit, and it will almost certainly come back in a different form.  But make no mistake; this city is not going by the wayside.

All those rental trucks you can't find will be doing U-turns a lot sooner than people think