Foregone Conclusions Become Well Known Facts
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We’ve heard Warren Buffett continue to repeat an important phrase, “what the wise man does in the beginning, the fool does in the end.” This begs the question, when does a foregone conclusion become what we call “a well-known fact”? We thought today’s bifurcated stock market makes for a good time to analyze some crowded historical opinions in the U.S. stock market and compare them to those held today. We will do this while most market participants attempt to predict when the next major stock market decline is coming.

A foregone conclusion is a result predicted with certainty. We define a well-known fact as a body of economic information which has been widely disseminated and has been acted upon by almost everyone who could care to act. In effect, the wise man figures out the foregone conclusion earlier than other investors, but the fool piles into the foregone conclusion once it becomes a well-known fact.

We screen companies via media coverage, heavy index and mutual fund ownership, research analyst unanimity, insider trading and add our own “feel” that comes from a combined 70 years of investment industry experience among our three portfolio managers.

Historical Foregone Conclusions Becoming Well Known Facts

After the end of World War II, the U.S. put a cap on long-term interest rates to give taxpayers time to pay back the debt incurred fighting war on two international fronts. The economy grew in the 1950s and 1960s as we witnessed a baby boom. It was a foregone conclusion that rates would rise after the controls came off. Wise investors avoided long-term bond investments, while stock market investors continued to buy because of leftover fears from the Great Depression. By 1981, five-year Treasury bonds were paying 15%.

Along the way in 1973, President Nixon put wage and price controls on the economy because it was a foregone conclusion that high levels of inflation were damaging economic growth. At that time, wise investors bought investments which would benefit from cost-push and demand-pull inflation. By 1980, we’d had double-digit inflation and almost everyone had their investments organized around un-ending high inflation levels, which were peaking around 11%. It was a “well known fact” in 1981 that high inflation and high interest rates were something we had to live with continually. Wise investors bought
stocks which were depressed by those high interest rates and by how difficult it was to succeed in business as owners, while customers wrestled with exorbitant borrowing costs.

In 1981, it was a foregone conclusion that foreign automobile manufacturers were going to take away huge market share from U.S. automakers and it became a well-known fact. Ford’s stock bottomed around $1.13 in 1981 and peaked above $22 per share in late 1994. Counting dividends, it was a 28-fold gain in 13 years. Ford and other U.S. manufacturers did see their market share shrink immensely! Many times, the most damaging “well-known facts” come true.

Netscape went public in 1994 and it was a foregone conclusion that technology and the internet were going to change our lives. Wise people bought major blue chip tech stocks in 1994. By the end of 1999, the fact that the internet was going to change our lives became a well-known fact. Fools lost a great deal of money from early 2000 to early 2003.

Possible Current Foregone Conclusions

1. Amazon and other internet-based organizations will destroy the physical retailing of apparel, groceries and pharmaceutical products (and make money in the process) once they drive most of their major competitors out of business.
2. Facebook (FB), Amazon (AMZN), Apple (AAPL), Netflix (NFLX) and Google (GOOGL) (FAANG) are going to kill the television and cable industry by drawing away everyone under 40 years old.
3. Young married folks will want to stay in the big cities of America even after they have children (in other words, married folks won’t repeat the behaviors of their parents).
4. Electric and autonomous cars will kill the auto industry, auto parts stores, auto advertising and the auto insurance industry.
5. Anemic U.S. economic GDP growth will stay around 1.5 to 2.0% and interest rates and inflation will stay low for much longer than anyone can expect.

Are any of these possible foregone conclusions already well-known facts?

If the media coverage of these so called “disruptor” companies is any indication, we are getting close to well-known facts. Jeff Bezos, Reed Hastings, Larry Page, Mark Zuckerberg and Tim Cook are treated and covered like small “g” gods. The FAANG stocks are heavily owned by the S&P 500 Index and by large cap growth/core mutual funds. Analysts are very bullish—as represented by the snapshot from August 11th of 2017 on Amazon:

Insiders in these companies are, for the most part, dumping billions of dollars of shares and are getting rewarded with massive equity compensation. This equity compensation dilutes existing shareholders.
the same way it did for Microsoft (MSFT), Intel (INTC) and Cisco (CSCO) shareholders back in the late 1990s. Intel and Cisco have never exceeded the early 2000 all-time high stock price level. Could we see a repeat in the next few years?

From a feel standpoint, we can tell you how crazy of a boom-town Seattle is. This is happening because of all the people being brought here by Amazon, Google and Facebook. For two years in a row, Seattle is the largest employer of cranes to build large commercial real estate projects of any city in the U.S. Having a software engineering degree is an almost immediate ticket to prosperity in this and many other cities across America.

Therefore, on most of these foregone conclusion subjects, we fall in the camp of investors who believe that nobody is really in a position of being an early wise person. Since we believe this to be true, we are forced to avoid the securities made popular by these potential well-known facts and search among deeply out-of-favor stocks which have been abused by the certainty among professional and amateur investors alike.

We are avoiding FAANG stocks and looking forward, in some cases, to the day when their businesses stumble. Lower prices could get us interested, like they did with eBay (EBAY) when the stock stumbled in 2008. We are expecting that shrunken market share in retail, like what happened in the auto business in 1981, could benefit surviving companies like Target (TGT) and Nordstrom (JWN). We think that producers of worthy content for TV like Tegna (TGNA), Disney (DIS) and Comcast (CMCSK) will transfer use of their scarce content easily to other distribution methods.

We have explained in detail that it is a foregone conclusion that we need to build millions of homes in the U.S. to satisfy demand coming from aging millennial buyers as they form families over the next decade. Since home building is historically a cyclical business, investors have been slow to make this a well-known fact. A secular move in a normally cyclical industry can be quite pleasing under the right circumstances. Remember, Ford’s business was very cyclical and deeply out-of-favor in 1981.

Lastly, we believe it is a foregone conclusion that the largest adult population group is about to have millions of babies and buy houses the next ten years. Staying in the most populated cities with a young family is unlikely to be very attractive when critical mass is reached. As 30 to 45-year-old Americans borrow money for homes and cars, they will demand loans for the first time in aggregate and could drive expanded GDP growth—resulting in significantly higher interest rates. We recommend avoiding bond investments while enjoying better bank activity levels and spreads through ownership of Bank of America (BAC) and JPMorgan (JPM).

Warm regards,
William Smead

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