

CSC STRATEGY LETTER NUMBER 54

Yeah, Whatever



2024 got started in a similar fashion to which 2023 ended: eyes were tightly focused on the proverbial briefcase of Federal Reserve Chair Jay Powell as to interest rate policy...and the conclusion for now is that interest rate cuts in 2024 remain largely on the table. The U.S. economy managed another “What? Me worry?” positive quarter. Large-Cap technology stocks led capitalization-weighted indices up double digits, a nice annual result in 3 months. Value-oriented equities were mostly ignored until March, when risk enthusiasm broadened out... slightly. And anyone with a decent AI machine was told to buy nearly everything. We chugged along.

“Yeah, Whatever” shall be the annoying theme for the next few hundred words due to a recent and random listening of Liam Lynch’s 2002 important hit, “The United States of Whatever,” whose cultural significance is endlessly supported by [this essay](#).

The reference is the wonderful way in which the history of deftly articulated bearish visions of the future are so easily swept away through higher prices. It’s a long history — take a re-glance at where the Dow Jones Industrial Average was in 1927. Plenty of unpleasant things have happened in the world since, and yes it is important to understand your inherent or implicit leverage issues as well as where your risk tolerance resides in terms of age or contractual commitments, but there is something pleasing about how humanity manages to pull rabbits out of the hat that seem to drag us forward to another millennial lifetime. Unless of course we all boil to death in 2030.

A partial list of whatever happened to that:

- A serious credit contraction as the banking world licks its wounds from a decade of commercial real estate lending at 2% and interest rate speculation and only 3 banks fail? Whatever.
- The global credit markets freeze and digest the process of having enabled the highest prices paid at the highest leverage ratios since the debt covenant was invented? Whatever.
- A full blown liquidity crisis as the Fed tightened monetary policy? Whatever.
- Ukraine? The Middle East? Whatever
- The formerly best indicator of a recession - an inverted US yield curve - stays inverted for well over a year, the longest stretch on record, and the economy chugs along? Whatever.
- Disinflation? Inflation? Whatever.
- Every historical indicator of US equity valuation screaming low future returns? Whatever.
- Not just Bitcoin is rallying, but dog memes again? Whatever.
- A Biden/Trump rematch? The Ultimate United States of Whatever.

While I have not yet tired of the song and can perform it with event appropriate lyrics at your next corporate get together, I think we can move on in this writing. Most of the world will wake up tomorrow and perform some basic set of utility functions remarkably similar to that which filled today. In the words of Herbert Stein, if things cannot go on forever, they won't. He then passed without giving us a date. There has been a mostly unbroken trend in credit extension, large cap growth and private assets since 2011. That is a long time and a lot of money. There are any number of things upon which we will look back toward and see how obvious it was that things changed. What we know about its timing is little. What we do know is that one group is a lot more expensive, crowded and levered than the other.

Trend persistence is not just an academic financial term. A preponderance of early human settlers, 10,000 years ago, did not fall prey to wanderlust when the valley in which they inhabited had enough food, water, and shelter materials. Johnny, the guy who had that gleam in his eye and took off for somewhere else? Never heard from him again. Whatever.

And that trade worked until the season the rain changed, the food ran out, and there was dying amongst those who did not bank some of the good fortune. Here we are a few thousand years later and tossing around Buffett and Graham quotes. Slowly wrecking a previously fine career built on value investing doesn't exactly have the same practical moral clarity as having your bones picked over by a pack of ravenous dire wolves, but certain common sensations prevail. Like clouds on AI steroids, perception can change rapidly in financial markets in a step-function manner. We await their arrival.

Among lots of other things, Benjamin Graham said that "the intelligent investor is a realist who sells to optimists and buys from pessimists." Please re-read our last [strategy letter](#) which was a general "how we do what we do and why" refresher and just assume for the purposes of this letter that we try to be realistic about things, particularly with respect to our ability to prognosticate about the future. We simply worry about being very stupid with other people's money, a trait which doesn't seem to be universally shared.

So whining about not owning NVIDIA aside, there are a lot of very investable things in public markets whose valuation suggests realism about the general baseline of the past and some sense of the future. Why do their securities prices seem to sit there? Because they might be smaller

and/or illiquid? Because they have not figured out how to include a reference to AI in the 2nd paragraph of their recent earnings release? Because they are an older, more stable, and likely "boring" companies that can easily be bucketed in an idea dinner as being "highly disruptable?"

Let's say some of this about all that. Artificial intelligence/machine learning remains a tribute to "our" inhabitancy of this planet, and while it truly may represent some step function quantum leap in global wealth creation and humanity improvement, it could also be just a tool for the rest of us and as an investment theme no more net profitable to investors than say - railroads, cotton mills, the early automobile industry, or most space-related companies without an X in them. Other than the beauty of an early speculation, and the marvel of how a trillion dollars of capital spend can be so easily mustered and directed at a precious few, we are finding it difficult to see how incorporating AI into an industrial product set makes said products more profitable. If everyone has it, all products are better, the user is better, then prices and margins remain the same like some giant hedonic adjustment of life?

And yes, machine learning means things should always be getting better in theory, and clearly there are areas in which time commitment can be improved to higher and better uses. And there will be a lot of end usage based upon simple availability that is just impossible to see on this side of the wall. But today, isn't A LOT of what we are seeing all day in financial markets is...just the latest thing? FOMO? And the latest hunt for the shiniest object versus the utility of merely a very good business at a very reasonable price delivering perfectly decent return expectations?

Models are important and imperfect; harnessing them to make your life, job, and process easier are what any continuously improving sentient being is attempting to do. What is non-model and arguably value-adding is focusing on what aren't in models, what is difficult to model, what very few are modeling, and what is inherently qualitative. That is where we try to spend a lot of time - incentives, management background, competitive analysis, non-index securities, and the presently unloved. We are always trying to use technology to make better decisions, not compete on technology for basis points.

We also spend a lot of time "inverting" something that seems too cheap to weigh the probability that this is a secular problem caused by technological change. There are trillion dollar companies with sovereign like wealth

looking to take our gross margin. There are college dropouts with access to the “American dream of venture capital funding” looking to blow up their elders. Cyclical vs. secular almost defines the definition of successful value investing vs. plodding into one value trap after another. We shall see in our adventures in broadcasting and media content.

But that is not all folks. Agriculture is a good example of an industry that can be helped by more data and machine learning, and yet Wegovy aside, eating does not seem to be globally at risk of being disrupted. Good old fashioned weather, insect trends, and resolvable supply chain and working capital issues seem like buyable short term issues. We have two new investments there. New management teams or Board change in fundamentally fine businesses that have been detoured by poor capital allocation decisions seem to be fertile areas of investment. And other ideas.

Returning to some more factual, though boring ground, we culled a few choice repeatable things for this edition. From the Financial Times:

“The Russell 2000 index has risen 24 per cent since the beginning of 2020, lagging behind the S&P 500’s more than 60 per cent gain over the same period...fourth-quarter earnings for Russell 2000 companies, about 30 per cent of which are unprofitable, fell 17.6 per cent year on year, according to LSEG data. Earnings for S&P companies, in contrast, rose by about 4 per cent, although a large portion of the gain was driven by the so-called Magnificent Seven tech stocks...the only other time you’ve seen relative multiples this cheap was during 1999 and 2000, and that ended up being a great decade for small-caps.”

To wit, we recently made a detailed, weeklong, and under NDA presentation to what will ONE DAY be a wonderful client, on a specific investment that would be delivered via SPV. We did a very spiffy chart that analyzed the competitive landscape by Return on Capital/Valuation. Okay, what we were looking at seemed stupidly cheap. Why? And then we threw in the third variable - size. Voila.

To reiterate, we have decades of relationships and research in smaller companies. We are irregularly getting invites to buy — founders stock, PE overhangs, and just large and bored stock positions — that often come with actual or likely Board representation. Like the opportunity noted above. This is a direct result of paying attention in an area where few are paying attention. This is not a whole source of professional being, but it could be and we are seeing some interesting things in which to make material investments on top of our core strategy, which is concentrated in and of itself. Operators are still standing by.

Said one more time, the future is uncertain. There is impressive historical data to suggest that when asset flows and mental commitment are lacking in a sector or market, subsequent returns tend to be favorable. This is arguably the least interested educated humanity has been in public, value, and smaller cap stocks...since...a long time. There is some math that is different, but it “smells” like late 1999. Things seemed oddly hopeless at the time, and then...things changed. Trust me, you won’t hear the dog whistle signaling it’s time.

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