the Connection

A Quarterly Review

1st Quarter 2021

KEEPING IT SIMPLE

The most talked about investment theme this year has been value vs. growth. The discussions have been focused on high valuations, inflationary factors, and future interest rate increases. Frankly, we have not heard much to change our opinion from our long-standing view….companies that have potential to exceed their revenue expectations are the place to invest. It does not matter how they are labeled.

We have heard that growth is in trouble. We have heard that the reopening trade is the only trade. Value companies should overtake growth companies in the equity market etc. We do not understand what all these people are talking about. We know what they think, but we do not really know why. There was an investor on CNBC that implied companies like Microsoft and Apple were out of favor for "quality" companies like Coca-Cola and Proctor & Gamble. We have also heard the value discussion for airlines, hotels, and autos. We are going to try to dispel some myths, and then categorize companies so that it is easier to understand.

There is going to be short term inflation. Pent up demand, government aid, and a rush to reopen is going to cause problems with pricing – short term. We are also coming out of a significant pricing depression, so that will make inflation seem higher. Oil is back, travel is back, restaurants are back, retail is back. Service industries are having difficulty luring people back to work, meaning wages are going up. All of this will cause mild inflation in the short term.

Beyond short term, competition and technology improvements will continue to drive prices downward. Housing and Healthcare are two unique inflationary problems the U.S. faces in the coming decade. Everything else is going to get cheaper over time because countries and companies will continue to compete for your dollar and develop new technologies that make goods cheaper. We are living in a deflationary environment for goods, while services are probably in an inflationary environment. We see this as a balance. Tie this in with a tax increase on corporations and ultra-high wage earners and we do not project runaway inflation.

Growth companies are classified generally as companies growing revenue significantly faster than an average company in an index. Typically, revenue growth greater than 6%. There is no rule that says a growth company is in any better or worse shape financially than a value company. There is a big (important) difference between a company that is able to grow revenue and fund new ventures using cash reserves (e.g., Apple) versus a company growing rapidly that still needs to access cash in the open market (e.g., Tesla, Netflix).

Big tech and other cash generating companies do not really care where interest rates are going. They can reinvest at higher rates in a better economy just as well as other investors. Cash-burn companies are the danger in the growth sector. They will have to pay more to borrow, or they will be forced to release shares at a lower valuation to evolve into self-funding companies. These companies must balance increased capital costs with the potential return on internal investment. They need to find the profitable medium between investment in growth and generating income. Companies like Tesla, Netflix, Crispr – these companies can still succeed in a rising interest rate environment, it is just that much harder.

Value companies are classified as slower growth, or more economically sensitive companies with a significant market share of their sector. They have a lower valuation (p/e) generally and are thought to have a more difficult time unlocking new markets and generating new revenue. Value is not synonymous with quality. What value really suggests is that a company is in a difficult transition; or is itself difficult to understand. Prime example, Nvidia in 2013, trading at 10x forward earnings. Well look at that company now. Investors did not understand the available opportunities for Nvidia, thus is was cheap thus is was "value". That is different than a value investment like American Airlines. American Airlines has real problems. They went a year without revenue, a year without reinvesting, and competing and while the current price appears cheap, that does not suggest value to us, it suggests impairment. Investors can make a lot of money investing in impaired companies, but it is dangerous.

GenCap Portfolio Mgmt

We think the market is acting normal. There should be market skeptics. No investor knows for certain what is going to happen. This market is the same as the market two years ago, or ten years ago. If investors do their homework, have patience, and invest in companies that have better growth or better profitability than expected, rewards will come. It will not matter if the company is growth or value – pro-cyclical or staple. What will matter is what always matters. Can our investments exceed expectations? We think our companies will, and we look forward to monitoring our investments in the coming year.

THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today.

All Local Food Banks
www.sfmfoodbank.org
www.shfb.org
www.foodbankccs.org
www.refb.org

Bloom Marin
www.bloom.org

Maya's Music Therapy
www.mayasmusic.org

Frien*ds of the Urban Forest*
www.fuf.net

Guide Dogs for *the Blind*
www.guidedogs.com

Doctors without Borders
www.doctorswithoutborders.org

The Nature *Conservancy*
www.nature.org

Nationa*l Kidney Foundation*
www.kidney.org

Guide Dogs of America
www.guidedogsofamerica.com

Golden Gate National Parks Conservancy
www.parkconservancy.org

Fine Arts Museums of San Francisco
www.famsf.org

Canine Companions for Independence
www.cci.org

Alzheimer's Association
www.alz.org

The Foundation for Rotary International
www.therotaryfoundation.org

Wildcare
www.wildcarebayarea.org

Homeward Bound of Marin
www.hbofm.org

Whistlestop
www.whistlestop.org

FINCA
www.finca.org

Sonoma Land Trust
www.sonomalandtrust.org

Friends of the Earth
www.foe.org

The American Friends Service Committee
www.afsc.org

Amnesty International
www.amnestyusa.org

Eastside College Prep
www.eastside.org

Northern Sierra Partnership
www.nothernsierrapartnership.org

American Bird Conservancy
www.abcbirds.org

The Cornell Lab of Ornithology
www.birds.cornell.edu

Mono Lake Committee
www.monolake.org

California Trout
www.caltrout.org

Tahoe Rim Trail
www.tahoerimtrail.org

Ocean Conservancy
www.oceanconservancy.org

Global Fund for Women
www.globalfundforwomen.org

Marin Agricultural Land Trust
www.malt.org

Walk to End Alzheimer's – San Francisco, CA
www.act.alz.org/sanfrancisco2019

If you would like to go paperless, please contact Barbara 415-797-6003 or bcorley@gencappm.com