the Connection

A Quarterly Review 2nd Quarter 2023

MARKET HEAVYWEIGHTS

Big Cap Tech is back. We all know it, but does everyone have a good answer for the why? We are going to explain the reasons why we think everyone should own a few of these. We are also going to compare other industries against the technology revolution to give people an idea of what we are thinking when we own some of these stocks.

The year so far has been about the latest buzzword; Artificial Intelligence. “A.I.” is not a reason to invest. We have all seen this fad before – Companies put a phrase in their earnings call; “The Internet” in 1999, “Novel Treatment” in 2010, “Cloud Computing” in 2015 or “Crypto” in 2020 – result; automatic stock move upwards. This latest iteration of “phrase to move my Stock” is neither novel nor helpful. This latest buzzword is not the sustainable investment impetus to keep the market moving. We don’t have working Artificial Intelligence yet – we have very advanced data sorting and compiling that can respond with a very detailed answer, but the decision making behind it is not aware, it’s algorithmic. Whether we ever actually create Artificial Intelligence is a white paper that is most likely being written by professors at Cal Tech or MIT right now.

Behind the “A.I.” is meaningful. While the phrase is catchy, technology has very tangible impacts. The broader economy is getting smarter and more efficient. The tech boom in stocks is translating into real results. Satya Nadella, the CEO of Microsoft, recently stated in a filing that they expect revenue to reach $500 billion by 2030. That is an increase of about 150% from today. I am surprised Microsoft isn’t trading up above Apple with news like that. We have written before, for Microsoft to double earnings every 5 years, they probably need to grow revenue around 5% a year with their margins. If they sniff $500bn in revenue, they will most likely have operating earnings of close to $250bn. That puts their Forward Price Earnings ratio at 12x on 2030 numbers. That isn’t expensive.

More importantly Microsoft will triple their expenses and partnerships to support that growth. Meaning there will be another $150bn going into companies like Nvidia, Corning, Honeywell, AMD, Intel etc. directly through Microsoft spending. Microsoft won’t grow like this in a vacuum either. If Microsoft is growing even close to the rate, they are targeting for the next 7 years, you can bet that Google, Amazon and Apple are all going to be growing too. That revenue growth won’t just feed a tech spend cycle, it will feed into Consumer companies, healthcare companies, and things we haven’t thought of yet.

Contrast that type of growth and ambition with an Airline or an Oil producer – There is a reason growth is expensive and cash flow is cheap. Exxon Mobile is cheap because there is no viable path for Exxon to outgrow the basic demand for energy. Exxon Mobile is always going to have a large share of a limited market – demand for energy. Potential often gets priced more heavily than actual. With Treasury rates above 5%, investors are telling the market that we either want massive growth potential, or guaranteed money. That is leaving traditional GDP growth (1-3%) companies like Target or United Airlines to bounce around cheaper multiples and prices than the high-flyers.

Client allocation is dictated by need. The amount allocated to future stocks versus today stocks is based on how long clients need to invest against inflation. Positive returns this year came primarily from hopeful future companies, not companies generating strong cashflow today. As an investor with a time frame longer than 5 years – the most pertinent question we should all be asking ourselves isn’t whether Nvidia or Taiwan Semi-conductor is over-priced. The real question is, Can I afford not to own these companies? The market is telling us, resoundingly, regardless of price, you need to have a large portion of your investments in companies that have the potential to change the world over the next 10 years. Investor preference and cash flow needs dictate how you invest around these high potential companies.

Traditionally, equity investment was used to fight inflation through dividends. The dividend payment was expected to grow faster than the rate of inflation. The dogma in 2022 was that 5% interest rates would compete for investment and create downward pressure for long duration assets. Markets were wrong about discounting long duration companies like Netflix or Nvidia. Investors instead are choosing high-growth future businesses to combat inflation over the next ten years, and short duration treasuries are competing for investment dollars with short duration higher yielding equities like oil companies and banks.

GenCap Portfolio Mgmt

There has only been one other time in recent history that has looked like this. It was a scary period, of which there are enough differences that we are not concerned about history repeating itself. It was in the mid to late 70's, when the only companies that had positive returns were the Nifty 50, of which IBM was the centerpiece. The main lesson learned from that period; if you didn't own IBM, General Electric or Xerox in the 70's you probably lost money.

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

National 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

Vivalon
www.vivalon.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

UCSF Foundation – Sarcoma Research
www.giving.ucsf.edu

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