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OBSERVATIONS ON THE MARKET

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Sooner or later, it hits you. Life is not fair. The world of investing is no different. Compare two companies that seem to have similar measures of profitability, financial leverage, and growth characteristics, yet one company's stock dramatically outperforms the other. Worse, the market rewards one company for executing a highly risky business plan, while seeming to penalize another company that generates lots of cash but doesn't seem to be innovative enough. Sometimes it feels like it is all about luck. The following illustration is not a recommendation to buy or sell, it is merely an observation on how investors value companies.

There is no doubt that Tesla has led the electric car revolution, and Elon Musk is a very smart guy. However, when you examine the company, there is no magic here. The first problem with Tesla is that Elon Musk has yet to ever deliver any of his predictions when he said would. In a world where the slightest revenue or earnings miss can lead to a nasty decline in a company's stock price, investors continue to give Musk a pass. What do you do when you are having trouble producing your first mass market car, you bring out another model and add a truck line on top of that. Never mind they are currently losing billions, and they have accumulated $12 billion in debt. Their current loses even with the help of $360 million in zero emissions tax credit sales last year, and $163 million in tax credits from the state of Nevada for building a battery factory in the state. Then you get to add the tax credits for buying their cars. One wonders why they only pay 3% on their debt? The company is valued the same as Ford and General Motors who are much larger companies. It is not like Mercedes Benz, BMW, and every other car company isn't working to build an electric car. Everyone else builds millions of cars verses Tesla who builds thousands. Then we have IBM.

IBM has been a market leader for most of their history. They are currently in the process of reinventing themselves again. IBM generates about $13 billion in free cash annually. They are now showing some growth in revenue, mostly due to their cloud-based businesses that are growing at 20%. The stock only trades at about 10 times what they earn, however, last week the stock declined 10% after their profit margins were 1% lower than expected. If the same standard was applied to Tesla, it would currently be trading at $25 per share, not $290. When Tesla disappoints the stock usually goes up because the vision just keeps getting bigger. So, what do you do when the game of investing doesn't seem fair?

It seems that the time horizon for investing has been reduced to hours. With the advent of instantaneous news, information is coming at us continuously. As we have seen in the last few months, investors can change their minds about the same subject in a matter of hours. The contrary approach may be to start thinking in terms of years. Again, looking at IBM, if they grow their dividend by 5% per year for the next 10 years, and the stock is then paying a 4% dividend yield at the end of year 10, you will double your money. Can they grow the dividend over the next ten years? It helps that they already earn more than what the dividend would be in ten years growing at a 5% annual rate. It seems like a good speculation that IBM can maintain their current business and is a better 10-year risk than Tesla, who must overcome a multitude of challenges. Not to mention hoping their competitors also can't compete. Extending the time horizon can simplify the process, however, it is not easy to do. In the world of unfairness, Zimbabwe may top the list.

Zimbabwe is a country that is a financial mess. If you have $20, you are a Zimbabwean millionaire. In 2008, from August to October the Zimbabwean stock market went up 500 times. That means $100 became $50,000. By the end of the year, the stock market had declined by 99.8% and the market permanently closed. Before you shrug it off as some third world country that really doesn't matter, a version of the same thing happened here a few months ago with a fund whose value was based on the volatility of the stock market.

The VelocityShares Daily Inverse VIX ETN was at $115 with almost $2 billion of assets on a Friday in February, the fund closed on Monday at $4.22. It ceased to exist a few weeks later. What a surprise to shareholders who are probably convinced that that wasn't fair. If shareholders would have looked inside the fund for something that produced cash flow, they wouldn't have even purchased this fund. Its value was based totally on how much something else moved, and it obviously moved the wrong way. (I own shares in IBM)