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OBSERVATIONS ON THE MARKET

By Greg Denewiler, CFA

Last month, WeWork was the hot story. You may remember they are the company that loses almost as much money as they have in revenue, which is currently $1.8 billion - for a company that rents office space. They were preparing to become a publicly traded company, allowing the public to share in the CEO's vision. The expected value of the company was reported to have reached $47 billion. His vision, according to the Wall Street Journal, was to become a trillionaire, live forever, and serve as the first president of the world. Apparently, smoking pot on your private jet let's you dream big. The private investors who have already invested in WeWork, loved the ambitious Mr. Neumann, and were excited to cash in. However, the public was less thrilled, and they started to ask a simple question; how are we going to get paid? That answer was not forth coming, so the company has since pulled its plan to go public. You may be wandering how does this affect me?

Merrill Lynch stated recently that the U.S. now generates approximately 94% of global government interest. This means that if you invest in anything other than U.S. Treasury's, you earn nothing. At what point will investors ask; we need to get paid? Eventually, the cash needs to show up, or why invest? The story may sound good, but it should never be so alluring that you drop your demand to earn a return. Markets are near all-time highs again, and interest rates near all-time lows. Below is a chart of the 10-year German bond. The 10-year interest rate is negative. In an environment where returns are very low, you are forced to make a choice. It seems that the best option is to except a lower return for a shorter term rather than investing for 10 years or longer trying to generate a small yield. If you believe that investors will someday again expect to earn a positive return, don't invest long-term. The risk is very high.

The stock market is always looking for the next guru who promises to disrupt the world. A few do, but most do not. Study after study shows acquisitions usually come at the cost of current shareholders, while the CEO promises efficiencies and cost savings and earns a big bonus. The synergies never seem to show up like they are were promised. The story that doesn't get much attention is the company that doesn't have a sexy story, but instead just focuses on trying to slowly compound their profits, while paying some of them to you. We are in a very challenging investing environment. These are the times when it is imperative to know your strategy and ignore the stories.

This does not mean or imply that investing in growth companies is a long-term formula for disaster. Growth investing works just like value investing does. However, when investors stop investing for 30 years with the certainty of no return, the seas are probably going to get choppy. That is when everyone starts asking; what happened to the cash flow? You want to be able to answer that question now. As a famous investor once said, "when the tide goes out, you find out who has been swimming naked." How long do you wait for opportunities? However long it takes.