Building conviction #neversell

I've had three connected thoughts sort of floating around my head recently.

- I've talked about how obsessed I've been with Peloton (the app) recently, and that got me interested in revisiting the stock. As part of that, I reread Implied Expectation's (excellent) Peloton write up. This line (you won't share the confidence unless you own a Peloton bike) really jumped out at me; both because it made me wish I had been using a Peloton back then and because it discussed how using the company's product really helped build conviction in the product / differentiation.
- I went on the acquirer's multiple podcast. One thing I said on there kept popping up in my mind; towards the middle of the pod, I talked about some microcap stocks that I had invested in and sold way too soon. XPEL is the headliner here (my cost basis in it was ~$1/share, I sold it around $1.25, and it's approaching $60/share today), but I also had nice sized positions (~5% of the portfolio) in INFU, PDEX, and a few others that I sold way, way too soon (all of them have 5x'd since I sold 2-3 years ago). Fudge me.
    - PS- feedback for that podcast has been good, for which I am grateful. If you watch the YouTube, you can see I was outside when I taped the pod (I even wore a floral shirt to celebrate!). It was a little noisy and my audio was a little funky; I think that combo put me in a weird headspace and I was worried that I was talking so fast and jumping around so much people would think I had drank 10

cups of coffee (or done something stronger) before hoping on. So, again, appreciate the positive feedback!

- In the post on my vision for YAVB in 2021, I included the line: "my own personal goal for my portfolio is to find one big new "compounder" type idea a year that is significantly mispriced that I can put a significant piece of my portfolio into (>10%). Examples of that include cable sector in 2017 and IAC in 2017 and again over the summer. For 2021, my goal remains the same: find one of those. If and when I do, I'll post it exclusively to the premium site."

That's a lot of links and a lot of tickers. So why have those been floating around in my mind?

Because all of them relate to the thing that I increasingly think is the most important in investing: building conviction in your thesis / ideas.

Consider those missed microcaps I held. Obviously my thesis on them was right. But guess what? Tough cookies. I sold them before their big runs. Maybe I sold them because they started to look expensive. Maybe I sold them because I thought the thesis was broken. Maybe I thought I saw better opportunities elsewhere. Maybe I just got a little bored with them.

Whatever the reason, I sold them even though my thesis was right. I sold them because I wasn't convicted enough. I hadn't done enough work on them to build the conviction that these were huge winners, or that their long term potential far outweighed some momentary "expensiveness".

Or consider a company I passed on: Games Workshop. I saw the thesis clearly. The company had global IP that had a bunch of optionality and really resonated with fans. Yet I passed because it looked a little expensive on trailing numbers.

I saw the thesis..... but I didn't have the conviction to invest because the company seemed expensive. I didn't have conviction in the company's future, so I was relying on trailing financials / cheapness as a crutch to protect me. Without that crutch there, I couldn't pull the trigger and passed.

The stock is up ~3.5x since then.

That's why the Peloton quote stuck out to me so much. Implied Expectation did all the work on Peloton the company and bought / used the product. His love of the product helped him develop the conviction to stick with his thesis. It didn't matter that the company might look expensive on a trailing basis. He saw a company with great unit economics and a product that looked like a commodity to the average analyst but had some type of "magic" that only a user would see. With what he saw about the company's competitive position and future as it scaled, the company was a steal even though it was expensive on a trailing basis.

I'm sure the comparison has been made before, but in a lot of ways Peloton reminds me of the iPhone a few years after it launched. Everyone thought they'd be besieged by competitors undercutting them on price, but Apple's tight integration and ease of use for a consumer was some type of magic that competitors simply couldn't recreate. Everyone shot for Apple / the iPhone, but consumers were willing to pay a huge premium for the iPhone even though it "technically" did the exact same thing that their much cheaper competitors did (Stratechery had a great piece on this back in 2013). If you understood that, you could ride one of the greatest stocks in history over the past ~15 years (you could probably throw the magic of driving a Tesla in here too, though I think there were a lot of other dynamics going on with that stock).

That's also why my goal is to find one big compounder swing every year. If you forced me to, could I find 10 different stocks that I thought were quality stocks trading cheap enough that I could park my portfolio in? Sure, not a problem. But I'd never be able to build the conviction in them to hold them for the long term. The moment they started to get expensive I'd sell them. Or after a few months I'd get bored and research something more exciting and swap into that stock.

The reason I can only find one really big swing a year is because most of the rest of the year is spent doing the research to find that swing and then doing the work to build the conviction to make the swing (and then hold on to it once I've done it). (Yes, maybe in the right environment I could find two or three of these, but honestly all you need is one!)

It's a skill I'm still developing and working on. I'm sure I'll be saying the same thing twenty years from now. But my goal continues to be to find one of these big swings a year and have the conviction to hold on to it. As I get older and (hopefully!) wiser, I'm trying to trust my judgement more and swing harder (and hold longer) when I've done the work and am convinced I'm really right on a swing. I'm also trying to get better at sizing the swings based on downsides; I've made a lot of mistakes over the years, but I think one of the major ones has not been swinging at things with limited downsides.

IAC stub trading at a negative enterprise value with net cash at the holdco, a great management team, and some stakes in publicly traded companies you really like / think are undervalued? That's the type of thing you can put a ton of your portfolio into. A CVR with one of the best checks you've ever seen and 4x upside? Can't put more than a small percentage of your portfolio into it because there's a decent chance it ends in tears (or parody?) and goes to zero (or at least that's how I felt; some people had done more work and had more conviction to get bigger than that). To be fair, comparing IAC to a CVR is completely apples to oranges; I just couldn't think of something that highlighted the downsides and size of swings you can make better than a negative enterprise value, cash rich IAC with stakes in two publicly traded stubs and a CVR that could go to zero.

Just to drive home how hard I'm still working on this skill, consider IAC in 2020. All last year I was talking about how bulled up on ANGI and particularly IAC I was (sorry, the IAC post is a premium / paywalled post). I had a good sized positions in both of them. When Facebook attacked ANGI and the stock briefly dropped, I wrote up how good of a buying opportunity it was. But I didn't size it even bigger. I had mammoth conviction in IAC, and while I had a big position (>10%) in it I didn't have a life / portfolio changing amount in it. The stock's up 33% in the past month. A nice outcome for me, but one that should have been better given my conviction. Given IAC's lack of leverage, fantastic management team, and diversification of assets, it's near inexcusable that I wasn't swinging harder when I saw the pitch so clearly.

I undersized IAC in 2017, and then when I had the exact same opportunity in 2020, I undersized it again.

Beyond frustrating.

Hopefully when IAC gets ridiculously cheap again in 2023, I'll be ready to really swing.

Four other things while I'm here.

1. Lots of people like to use #neversell. The conviction I'm talking about here is what they are short handing (I think); when you're convinced you have a winner, you don't sell it because it's expensive or because it's a big piece of your portfolio (either because it started that way or has grown into it). If you think Jeff Bezos is the best manager and capital allocator you've ever seen, you don't sell the company because it looks expensive for an online retailer. You hold on because he'll build AWS and the stock's gonna go up another 20x. If you think Elon is the best entrepreneur in history, you don't sell because he's committed some light securities fraud; you HODL because he's literally going to Mars.
    - I think the AWS example is why the current era plays so well for #neversell. Zero cost of capital plus the infinite scale provided by the internet means that the opportunity set for companies is really only limited by what their managers can dream up and successfully execute. A retailer can become the world's biggest computing company or a DVD rental service can take over Hollywood inside of fifteen years. It just takes the right manager with the right vision and an ability to execute.
2. There are two things that are really easy to build conviction around: a product that you can touch and love as a consumer (like an iPhone or Disney), or the genius

of a manager (like Buffett / Berkshire). I wonder if that's why most of the "huge winners" we hear about people holding come from one of those two things. You can build the conviction to hold them either because you love the product or you worship the manager. Think Berkshire's expensive in 1980? Who cares; Buffett's a genius and he'll make it work. HODL. Monster Energy is trading at 50x earnings in 2011? Who cares about this year's earnings; in 10 years, the energy drink market will be 10x bigger and Monster will be the best brand. Amazon's on death's door? Steve will figure something out. In contrast, Fastenal is (famously) a super boring company that doubles as one of the best performing stocks of the best several decades.... yet I never hear about anyone who rode that stock to a multi-generational fortune. Perhaps that's because you get rich slowly, not FAST, but I wonder if that's because FAST is/was a boring business run by a sleepy management team. Without a management team to believe in or a product that they could build love around, investors simply didn't have the conviction to hold the stock for the long term and really let their winner run (I'm sure there's one or two people I'm missing who held Fastenal for a long time and made a fortune, and good for them! But Fastenal and Monster Energy have roughly the same EV; I would bet serious money that multiples more people made fortunes on the later than the former)

3. There is, of course, a downside to this type of conviction: riding conviction in the wrong horse. Perhaps I'm talking limited sample size or selective memory when I discuss the microcap riches I sold too early or the investors who made a fortune holding stocks for a long time. For every investor who made a fortune in Apple, there's an investor who was convinced Blackberry was going to rule the world forever and lost their shirts. For every manager-genius success story like Buffett/Berkshire, there's someone who emulated

Berkshire only to disappoint shareholders. For every XPEL I didn't hold, there's a microcap that I sold right before the bottom fell out.

    - So yes, it's possible this whole post (and much of my investing style!) is based on small sample size. I don't believe it, but it is possible.
    - I do think there is something to say that #neversell is cyclical. The mindset makes sense for companies with historically great businesses or with out of this world managers, but I do think it's gotten a little perverted to mean hold on to basically any tech company or company whose product you like and whose stock is going up; I think the tide on #neverselling second/third rate tech companies will go out pretty viciously at some point.

4. Last thing- just a small anecdote. When I was first buying IAC a few years ago, it was a big position for Greenlight. Right around when I finished sizing IAC up, they announced in their Q2'17 shareholder letter that they sold it. I remember getting a bunch of texts from friends who knew it was a big position size for me asking things like "why did Greenlight sell it" and "are you going to trim". My answers were "I guess they had a big win and wanted to lock it in, but I have no idea why they'd sell here" and "heck no". I know Einhorn's rep has taken a big hit recently, but I had / have a lot of respect for him. When I was in college, I remember reading his book and having him as one of my investing.... not heroes, but role models? But him selling had no impact on my thesis on IAC. I was absolutely convicted it was undervalued and that the management team was really good (over time, I've come to believe that it was even more undervalued at the time, and my respect for the management team has grown exponentially). That's the type of conviction I want to build when I make a big swing. The conviction that even

when someone you really respect says "this is overvalued" or sells out of a position, you can look at your thesis and the stock price and wonder more "what the hell are they thinking" than worry about having to sell or trim you position.