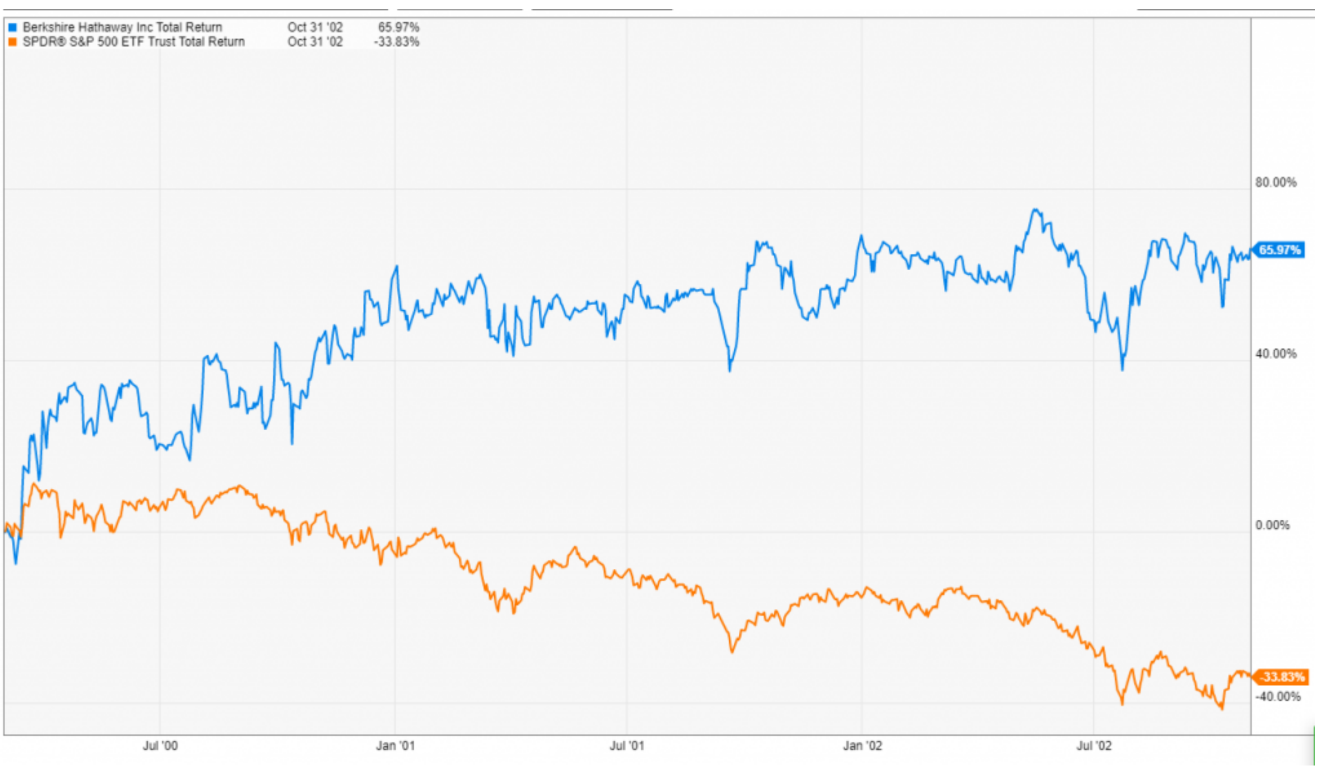
My State of The Markets 2021: Speculative Excess and Opportunity Everywhere

In 2000, the tech bubble collapsed. The next 2.5 years were a disaster for stocks in general; the S&P 500 shed about half its value and the Nasdaq dropped even more. But it was a super fertile time for value investors; sectors that had been left for dead saw huge increases as speculative money dried up. Berkshire Hathaway (BRK) went up 65% while the indices were collapsing (see below). A lot of now very famous value investors built up near unassailable track records buying value stocks and riding that value wave in the same time period (seriously; several of them outperformed so hard in the 2000-2005 time frame that they're still beating the market today (~20 years later) despite persistent underperformance in the fifteen years since!).



Why do I mention this "stock collapse / value outperform" combo? It's not because I think the overall market is set to collapse or anything; I highlight it because I see several signs of speculative excess in the markets (SPACs, EV companies, and cruise lines / hard reopening plays being a few I mentioned in my 2021 predictions), and I suspect we could see something similar to the 2000-2002 time frame in the near future: the overall market averages wobble as some of the more speculative sectors collapse / some of the frothier valuations come back to reality a bit, but more value oriented stocks significantly outperform. Note that I'm using value here in a more "companies priced at a reasonable multiple with decent prospects" sense than its traditionally "buy a tire fire of a company for less than its working capital" sense; I am no expert but I would very much call Facebook and Google "value" stocks today and think they will very much fit into this eventual trend (outperforming while more speculative / growthier peers with much more outlandish valuations underperform); I would guess Berkshire outperforms the market as well (though to nothing like the extent it did in the 2000 time frame!). There are plenty of others companies that would fit here, but the basic point I'm trying to make is that companies with solid growth and competitive positions trade at a huge valuation discount to companies with higher growth (but often worse competitive positions); I think that normalizes over the medium terms and those lower growth companies significantly outperform.

I'd also note that the speculative excess of the current environment has created perhaps the richest environment for event driven investing in history. While BMYRT was (unfortunately) a failure, there are plenty of pockets of the market where speculative excess has created incredible opportunities. For example, I think we're in a SPAC bubble currently, but the insane implied volatility around PSTH has created some really interesting opportunities in their options. Or consider companies that own equity investments in things that get SPAC'd; for example, over the summer, I did a premium write up (that I subsequently posted publicly) on Worthington (WOR). Worthington had made a small equity investment into Nikola (NKLA) a few years back, and when Nikola exploded on the stock market Worthington's investment was suddenly worth more than half their market cap. Worthington's stock, however, barely budged. That combo couldn't be right; either Nikola's stock would collapse, or Worthington would eventually sell their shares and buyback their own stock at a mammoth discount (both turned out to be somewhat true! See chart below). Either way, the market was clearly mispricing Worthington based on the value of their Nikola shares.

Those are just two SPAC-related highlights, but I'm seeing plenty of other examples of really fertile event-driven opportunities. For example, I'm seeing lots of opportunities in bidding wars (like Alaska (ALSK)) or "bumpitrage" (like Great Canadian). I suspect the reason is that the combination of zero interest rates plus a near term economic environment that is a disaster for ~80% of companies (and a bonanza for the other ~20%) and huge variability around the speed and pace of a rebound means that bidders and sellers can have wildly divergent views on values. Consider the case of Great Canadian: they're currently earning effectively zero as all of their casinos are shut down. Anyone buying them needs to take a view on when they reopen and how much of business returns when they reopen. If management think that they don't reopen until 2023 and they get 85% of business when they reopen, and you believe they'll reopen in 2022 and get 95% of business when they reopen, then management will happily sell to you.... but I might believe that they'll reopen in 2021 and get 105% of business when they do (because people are just so excited to gamble!), and if that's the case I'll see the deal they have to sell to you and think it's wildly undervalued and easily be able to come in with a mammoth topping bid justified by my assumptions.

Anyway, long winded way of saying :

1. There is a lot of speculative excess out there
2. Despite that, there's still plenty of value to be found
3. The back half of 2020 was probably the richest environment in history for event driven investing, and I think the combinations of points one and two will keep the environment very rich for 2021.

So that's my overall / market outlook for 2021. Pretty vague, I know. But I wanted to put some thoughts down because it's what I'm seeing and also because I'm just incredibly excited for 2021. It's honestly the perfect environment for the type of research / writing / investing I like to do; I'm not sure I've ever had as much fun researching stocks / companies /

events as I have in the past few months. It's actually been a little bit of an issue; I think my wife got a little annoyed with me because I was trying to squeeze in so much work around Christmas / working on Christmas Eve / Christmas Day / New Years Eve (I think she appreciated the late night whiskey driven day off on New Years!).

If you're an avid reader of the blog, you've probably noticed that enthusiasm: quantity of posts has been way up in the past few months, and that's a function of my excitement about the opportunity set. Over the rest of the week, I'm going to discuss that excitement a little more and indulge in a little navel-gazing on my vision for Yet Another Value Blog and all its spin offs (the podcast; the premium service) in 2021. (update: those navel-gazings are here; here's the podcast and here's the blog/premium service)