YOU CAN'T TEACH AN OLD DOG NEW TRICKS

The baby boomer generation has now seen 4 bubbles, each time refusing to learn the lessons from the last. In the past, a generation would buy into at most one bubble in their lifetime, as goes the saying "fool me once, shame on you, fool me twice, shame on me". After having witnessed the Japan bubble of the late eighties and early nineties, you might expect our leaders to recognise a bubble as it is forming. Not even a decade later, the Dot Com bubble killed the optimism many people had for the new millennium. Unbelievably, another bubble was just around the corner. People wanted to believe that home values would continue to rise simply because that's what happened in the past, because they wanted to see growth that just wasn't there. Which brings us to the so-called Everything Bubble of 2020-2021. The inflated asset values didn't seem strange to anybody, because everybody was in on it, from holding bitcoin to selling secondhand cars. People got to stay at home and the government sent out checks, so no one complained. Jerome Powell insisting that inflation was "transitory" is emblematic of the dogmatism at the leadership level. When questioned on policy, they simply echo that their policies are backed by *Modern Monetary Theory* as though it were a universal truth. Powell (the only Trump appointee to remain in office under the Biden-Harris regime) did not change his stance until it was already too late, and the economy was already headed straight for inflation.

HIGH TIDE

As of mid-January, there are clear signs of an economic recession. Job cuts, such as the ones announced by Salesforce and Goldman Sachs, or even the hiring freezes at Apple show that the economy has slowed down significantly. Money is being pulled out of the stock market, property and any pretty much any other risk asset you can think of, to be put into assets further down the risk curve. Treasuries and corporate debt now have a much higher risk-adjusted rate of return than equities, and several large shareholders of growth stocks have written open letters to the executive management of these companies recommending that they change strategy from growing the top line, to initiating share buyback programs and issuing dividends. Clearly, investor focus has shifted from long term to near term.

LOW TIDE

During the propped-up, frothy economy of the twenty month stretch between march of 2020 and December of 2021, private companies were able to raise an enormous amount of money. Mammoth funds like SoftBank and Tiger Global rushed into the technology start-up space handing out money to companies with no clear line of sight to positive cash flows. Klarna raised a round of funding at $45 Billion, which crashed down to under $7 billion by July of last year.

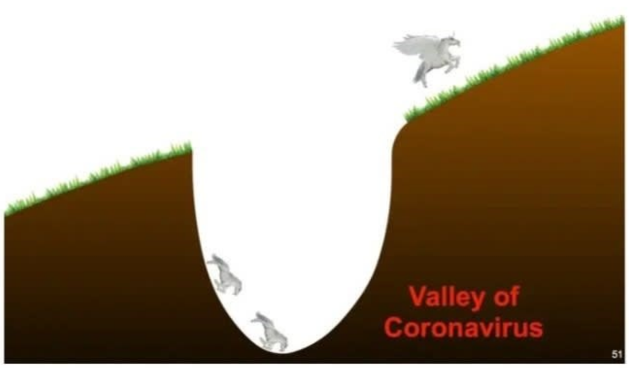
An interesting trend I found when researching the history of leveraged buyouts, is the time at which they happened. The famous case of RJR Nabisco happened in 1988, right before the crash of ’89. The flurry of private equity takeovers around 2006 preceded the 2008 financial crisis. In 2022 we saw Zendesk purchased for $10.2 billion by PE firms, which I think is a sign of things to come in 2023. Private equity may have to save these companies, as they are not equipped to convert growth businesses into positive cash flow generators. In the public markets, activist investors may also have an outsized role to play in getting companies veering off-course back on track.

LOOKING AHEAD

The big winner of 2022 was the Ken Griffin-led Citadel, which raked in over $54 billion in revenue over twelve months. The ensemble of hedge funds that employ algorithmic trading strategies came out ahead, and as computer hardware and algorithmic techniques improve, 2023 is likely to be a great year for these funds. On the flip side, I think Blackrock and companies like it will have a difficult year. Larry Fink, Blackrock CEO speaks out of all sides of his mouth, one minute endorsing ESG and the next endorsing defense companies. Blackrock is a huge supporter of ESG, given it makes so much money managing ESG ETFs, which despite claiming to be 'green', includes companies such as Exxon Mobil.
For the financial sector, my hope for 2023 is that the general public can regain some trust in financial industry, which took a hit this year with the ongoing FTX scandal. 2023 will certainly be an important year for regulators, who can go down one of two paths; revive the economy by reducing regulations (as was done in Germany with the LNG terminal which bypassed environmental laws), or pile on more regulations and EU court decisions against crypto and the American tech companies.

IT'S ALL WATER UNDER THE BRIDGE NOW

Recessions are necessary evils. They can be seen as a filter, only allowing through companies strong enough to endure the reduced economic activity. Milton Friedman said that the free market is a system of profits and losses, "and losses were at least as important in weeding out failures, as profits in fostering successes".
Historically, economic downturns have been periods of great technological innovation. Despite being in the shadow of the Great Depression, the 1930s were a time of incredible innovation. It was the time when the movies industry, the aviation industry, household appliances and secondary oil recovery all became mass market. Tesla was founded during the crash of 2008. Now is an exciting time to be an innovator, founder, investor or simply someone with strong convictions. Ray Dalio urges people to have universal principles and make them the basis of all decision making. His investment vehicle, Bridgewater Associates aced the past few years, while the market beta was negative in real dollars (euros). The same goes for Buffet and Munger, leading Berkshire Hathaway, deviating from the rest of their generation by ignoring the hype around new trends.
The takeaway is that the two extremes of the economy, namely startups and long-term funds, have good prospects, while everything in the middle will struggle to keep up. Those who were simply riding high on good times like Ark Invest and SoftBank will hopefully be the grounds for lessons learned in the future.



Slides from a presentation by Masayoshi Son, the founder, and CEO of SoftBank Group, which operated the two largest funds ever, Vision Fund 1 and Vision Fund 2, totaling $150 Billion put together. In 2022, the fund lost $60 Billion.