September 2023

"We are going to need a bigger Moat!"

Dear Investor,

Over the years we have heard other professional investors proclaim that they predominantly focus on finding companies with large moats. Many ascribe the moat philosophy to famed value investor Warren Buffett. With all due respect to Mr. Buffett and his legion of disciples, we are not sure that strategy neceassily works for growth investing. The huge concentration of investors in a small handful of mega cap growth companies this year appears to be a cocktail of momentum, FOMO, performance chasing and, we suspect, a belief by some that the market has sussed out the small handful of long-term winners in AI and other sexy secular growth trends with large moats. Our decades of experience investing in innovative companies causes us to challenge the concept of moats.

Although we note that a company's market cap is only one measurement of success, we submit that this metric demostrates how investors are essentially voting with their checkbooks.

Today the market is dominated by a few mega cap technology companies with the top 10 companies represeting over 30% of the S&P. The top 10 names by market cap are as follows:

2023	Weight
AAPL	7.10%
MSFT	6.50%
AMZN	3.22%
NVDA	3.09%
GOOGL	2.09%
GOOG	1.81%
TSLA	1.74%
BRK.B	1.72%
META	1.71%
UNH	1.24%

*Source: Yahoo Finance, Bloomberg,*Investopedia.com Aug 25, 2023

So there are actually only 9 companies representing the largest 10 market capitalizations in the S&P (Google represented twice) and approximately 21% of the market cap of BRK.B can by ascribed to the value of its holdings of APPL (~$166B) and AMZN (~$1.4B). Would one suggest the trade may be a little overcrowded?

Hardly a day goes by without a sell side analyst, cable news commentator or portfolio manager celebrating several of these companies as long term dominant franchises. We agree that the above list are all stellar companies with strong franchises, innovative products and services, and very healthy balance sheets. However, we know that none of these companies has a monoply on creativty and innovation, nor do they employ every entrepreuer who is building the next awesome

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company. To be honest, that next crazy brilliant entrepreneur would not likely ever wear an employee badge from a large bureacratic company.

Perhaps, the market is becoming a little too exuberant over the prospects of long term domination. History would suggest taking the under on that bet of future domination.

A look at the top 10 market caps in 2000 looks a little different from today.

2000	Weight
GE	4.10%
XOM	2.60%
PFE	2.50%
CITI	2.50%
CSCO	2.40%
WMT	2.00%
MSFT	2.00%
AIG	2.00%
MRK	1.90%
INTC	1.70%

Source: Yahoo Finance, public.tableau.com Published September 26, 2021

A short 23 years ago, GE was the king of kings and the top stock in the market; today its market cap of ~$122 billion represents approximately 3.5% of APPL's market cap. Note that MSFT is the only top 10 company from 2000 that remains in the top 10 today. We are pleased the company hired a genius from Sun Microsysems to help figure things out. The once dominant semiconductor company Intel today has a market cap of approximately $154 billion representing about 1.8% of rival NVDA.

1990's Top 10 and 1980's Top 10 are also telling:

1990	Weight		1980	Weight
IBM	3.00%		IBM	4.30%
XOM	2.90%		T	3.90%
GE	2.30%		EXXON	3.80%
PM	2.00%		Std Oil of IN	2.50%
SHEL	1.90%		SLB	2.40%
BMY	1.60%		SHEL	1.90%
MRK	1.60%		Mobil Oil	1.90%
WMT	1.60%		Std Oil of CA	1.80%
T	1.50%		ARC	1.60%
KO	1.40%		GE	1.50%

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IBM is the only technology company that made the list in either year and 4 of the companies from 1980 have merged into other companies. 7 of the 10 in 1980 were energy companies while today there are no energy names in the top 10 yet we have TSLA with an $800 billion market cap. Irony aside, it should not be lost on investors that the 7th largest market cap company in the world started only 20 years ago. Who knows what company being started this year will eventually replace one of the elite mega caps that is crushing the market this year?

We humbly submit that now is the time for thoughtful investors to position for outsized returns over the next few years by calmly embracing under-utilized investment tools….contrarian thinking, logic and duration of time. Might it make sense to look at small and mid cap stocks that are also levered to similar secular growth themes as the mega caps, and have the added benefit of stock prices that are 60-80% off from peak valuations. The prospect of a $10 billion company going to $20 billion seems an easier feat than a $2.86 trillion company growing into a $5.72 trillion company. It certainly takes a fraction of incremental investment dollars for a smaller cap company to double. Moreover, in our view moats are less defensive than many surmise. That shiny object today will look museum ready in a minute. We do not know many investors listening to their Sony Walkmans, cordless phone in hand, awaiting a newly published sell side research report to come across the fax machine. The shelf lives of those once awesome products were all devoured by the jaws of innovation (pun intended).

We are so grateful for the support and confidence of our clients, and view our responsibility as a steward of capital as a privilege. We look forward to connecting with you soon.

Respectfully,

Frank

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