

The Collectibles

It is 1883, Kansas City. You are at a livestock auction and couldn't be further from Wall Street. The auctioneer chants over the din of the crowd. The air is thick with dust; the fear of missing out; pure, blood pumping desire; and, the palpable buzz of adrenaline. You can literally see the price action moving through the crowd. A tilt of a cowboy hat, two fingers waved casually. They telegraph intent, while trying to feign only modest interest at the price. A bidder, with an entourage, from back East is intent on buying a particular show horse that has been sold for ever higher prices in the year or two leading up to this auction. He smiles broadly when the gavel falls and he has acquired a most desirable and rare show horse, one which will, no doubt he reasons, be sold for a handsome price in the future. He is a trader, a collector of fine horses, who wants to acquire things which will be much desired by others. Another buyer is there simply to add a few dozen head to his growing herd. Ranching after all is what puts milk in his bowl and food on his table. It is how he builds wealth over time. He is a rancher, a businessman, an investor.



With a wish, you are cast back into 2025. The flickering screens of traders reveal that seemingly all the dollars in motion are being squeezed into a handful of very famous stocks. Whether they are the proper Magnificent Seven or near-there-to, the striking thing is that they all have been moving in near lockstep and far away from the price action of the rest of the broad market. Mind you, when stocks valued a \$4T move a percent or two, that is quite a move in dollar terms. Further, when they trade at 40+ times book and 500X earnings, you have a decidedly different kind of market. While markets have always placed a premium on the familiar, this is a market that has morphed into a 'brand name' market. Investors feel as though they know something of these companies owing almost exclusively to their ubiquitous presence of the companies' products and brands in our lives and the frequency with which they are discussed in thematic investing discussions around AI or chips or social media or 'technology,' which in its own right is almost always applied to things simply oriented around computers whether they actually sell anything related to technology or not. This concentration is not at all common in US equity markets. And, quite frankly, it is quite likely being exaggerated by the widespread adoption of certain investment products in recent years, as well as some fairly interesting investor behaviors in this cycle. Rest assured, dear reader, you are not in Kansas anymore.

The news cycle is turning stocks almost as never before or, at least, as never in a long while. Against that backdrop, investors may be seeking the safety of familiarity. Having democratized investing and financial information many years ago, you now have a broad cross section of investors who move with the news cycle. Like fans at a race, they put their money on their favorites. While they may not know about the build of the engine or suspension or the name of the driver, they saw them win an earlier heat and put their money down. If they are among friends, they are likely influenced by the buzz, as well. Curiously, if a prospective team owner were to be in the stands, one would guess that he would not buy the team in the same manner that the fans cast their bets. This is not at all to suggest that the bettor or fan won't win. After all, the bettor on the race is making his decision about the race in a not entirely irrational manner. Investing, however, is somewhat different over the long term. A simple, short-term pattern of higher prices does not imply that future prices will be higher. A stock moving ahead does not make it a clear favorite to win the race. Leon Cooperman has said that he can put any price he wants on a stock, but it does not make it worth it. Yet, in this environment, it seems that price action is, in fact, the preeminent motivator to attract more investor dollars. It is as though investors have, in fact, come to believe that a rising price is the best, most rational predictor of future prices. It is fair to ask what else in life is purchased principally on that basis. Yes, it does feel like a transition has taken place.

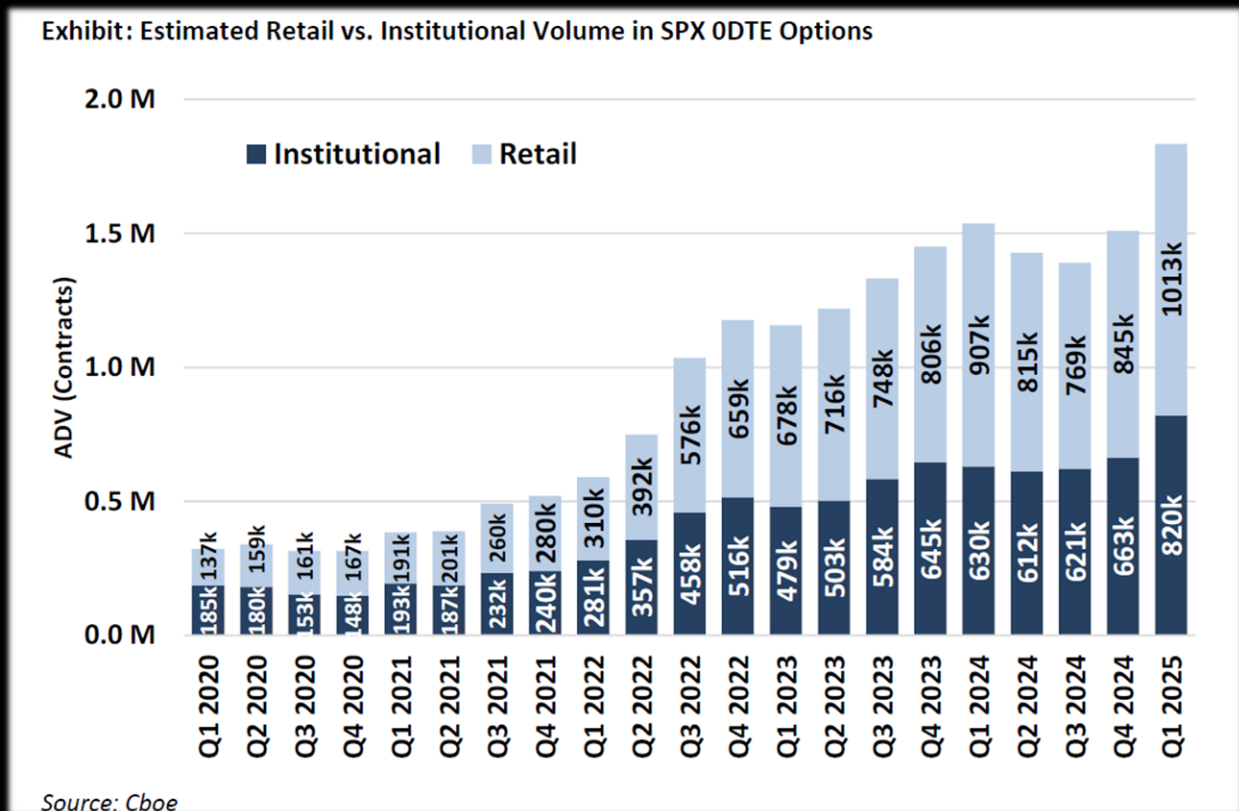
The question sometimes arises, "Who is driving this action?" Is it the institutional or retail buyer? To which I most often respond, yes. It is a rare professional trader or investor who will not ride the crest of a wave created by retail. Imagine a stock gaining momentum driven by



retail Reddit boards. If the moves are significant, there is no reason why a professional momentum investor would not ride the crest of that wave. In an era where mega cap stocks have attracted incredible flows of capital, it is worth recognizing that we are also simultaneously pointing trillions of investor dollars at ETFs through 401Ks and other vehicles. The overwhelming majority of ETF dollars are passively allocated according to market cap. They are capitalization-weighted, meaning that every new dollar into an ETF is allocated in such a way that the largest companies receive most of the investment. Given that ETFs are most

often passive and cap weighted, there is proportionally less money placed on individual stocks via professional managers than in most cycles. The net result is, of course, that more than 30% of your investor dollars into passive ETFs are going into a very small number of the mega cap

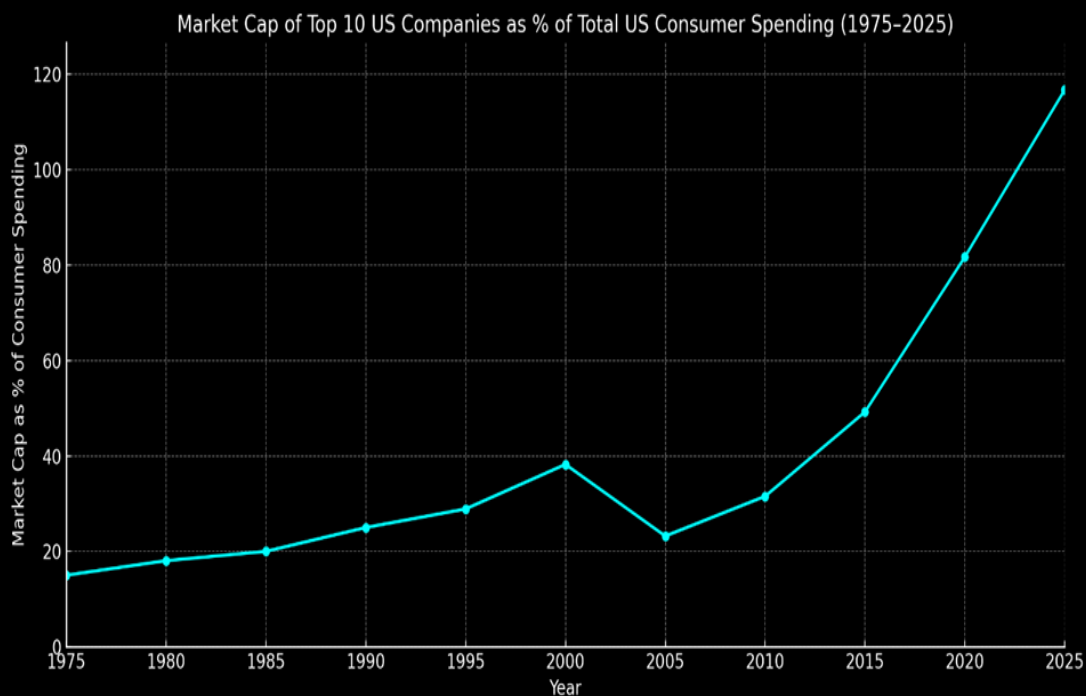
stocks. Thus, reinforcing their market dominance. Now, if we were to extend the dynamic to the options market where smaller investments can more easily influence price action, you can reasonably infer and, on some days, easily conclude that the options tail may be wagging the stock tail. The chart below shows the tremendous seven-fold increase in retail investor use of zero day to expiry options since 2020.



Imagine a company that has become the darling of retail and Reddit. The company is subject to a very attractive thematic story that follows along the lines of ‘this company will revolutionize; no one can compete with; these assets are scarce and getting scarcer.’ The stock begins to gain momentum and multiples expand as the price rises in anticipation of its continued rise to greatness. As it does so, a few things happen. Of course, there are direct buyers. As the momentum increases, it attracts the attention of the financial media and blogs. The multiple rises as the price increases. Some savvy investors discover that they can leverage their exposure through options while others employ margin. The stock has gotten rolling. An enterprising investment company decides to offer leveraged ETFs on the single stock name which offer 2 or 3X returns on stock performance. This also requires options volume. The institutional investment community begins to ‘participate’ in the trade. Multiples continue to increase. Meanwhile, some investors are buying calls which should allow them to participate on gains in the stock without having to put up so much capital. The options dealers will hedge

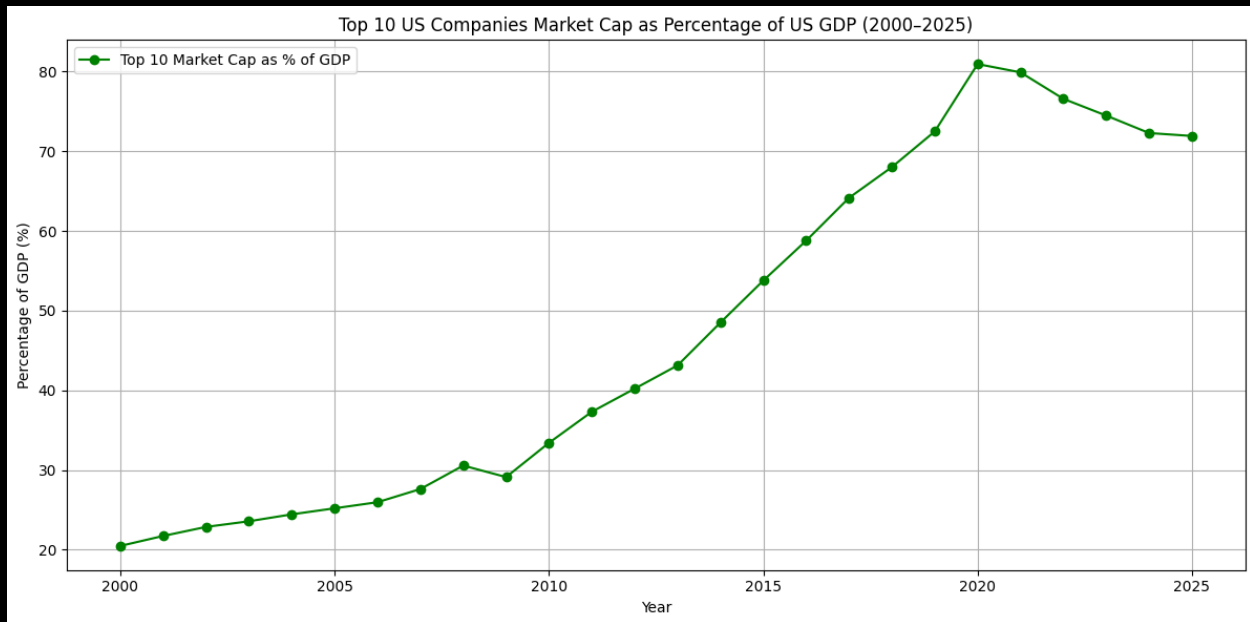
their exposure at some point and to some degree by possibly buying the underlying stock, as well.

With a recent experience of having bought a stock and watched it increase, investors can be forgiven for thinking that they have arrived at a working strategy and simply acquiescing and riding the wave. There could, of course, also be reward in hours of arduous research to find enterprises of value over the long term. The typical investor, having bought the most popular, widely-hyped stock on Wall Street and seen it go up, will assume that he or she has some fundamental or even innate ability to discern good investments. This skill, they presume, should help them in the future. All of which leads us back to - *the collectibles*. This new investor is exhibiting characteristics very similar to those on display at auctions. Be they art auctions, auto auctions or otherwise, the buyers arrive with the idea that they will be competing for a chance to own something whose sole value lies in the prospect that the price will be driven higher solely by the popularity and desirability of their holding. As in auctions of collectibles, a great majority of the action and the money is now concentrated in just a few names.

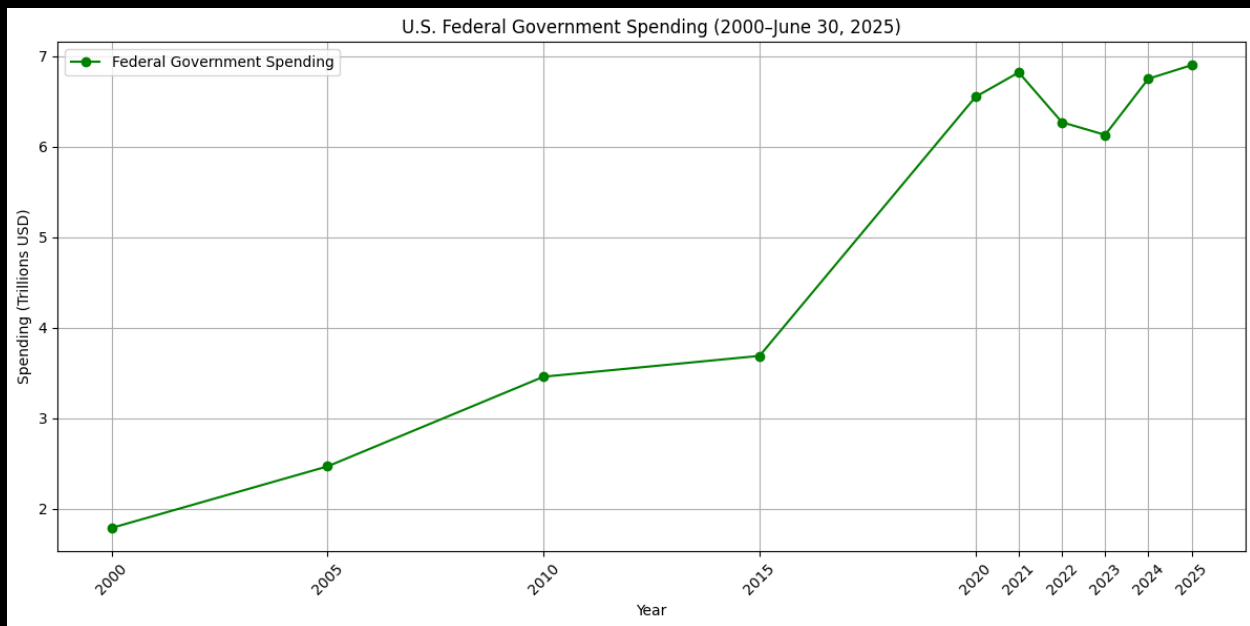


The chart above casts the combined market cap of the ten largest US companies against aggregate US consumer spending over the last fifty years. It could be thought of this way: if ten dollars out of every hundred dollars spent by every consumer in the US were siphoned off to buy stock in just the top ten companies, it would take the whole of America more than ten years

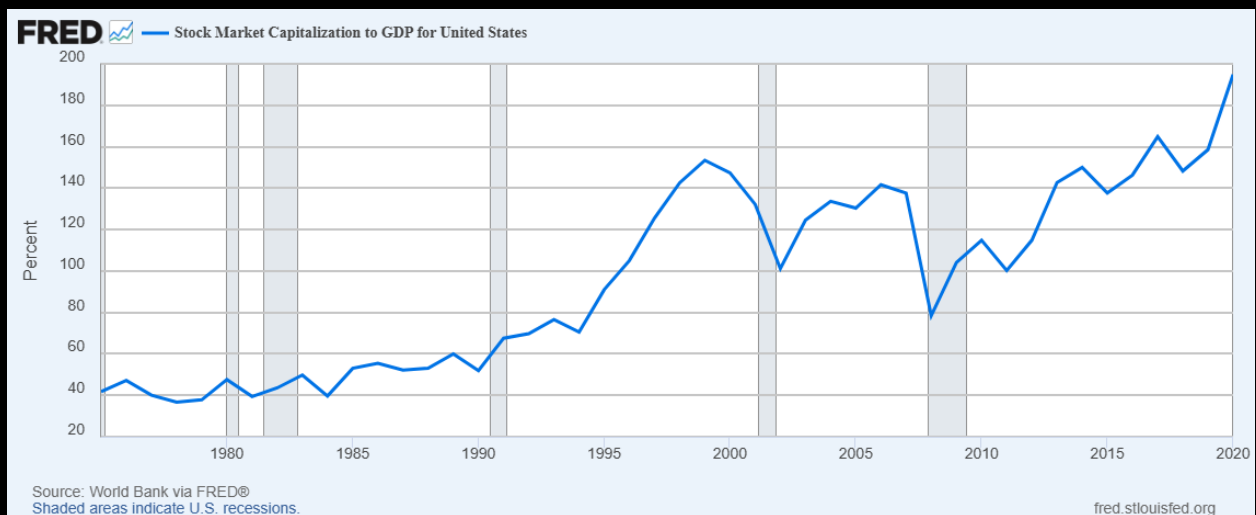
to acquire just these ten companies. For those who say that it would be better to compare those ten largest with the overall market or GDP or some such, let it be noted, that the trend versus capital investment and corporate spending was very similar and, interestingly, even more overwhelming in the magnitude of change over time. The overall market cap to GDP is often referred to as the Buffett indicator. For the record, it is at all times high. Consumer spending in aggregate is conceptually very easy to grasp as a somewhat purer measure of US economic activity and is conceptually very easy to understand. But, to complete the exercise, here is the graph of the combined market cap of the ten largest companies against overall US GDP, as well. You will want to put down your drink.



One can interpolate that a major reason for the softening after the 2020 high was due to government spending which spiked during Covid and, low and behold, did not go back down and stay down as evidenced below.



And, for those of you still wanting a review of the Market Cap to GDP or the Buffett indicator, here is a look at it.



Further evidence of an investor psyche having taken hold that mimics a collectibles auction is not hard to find. As I write, we are hearing about crypto hitting all-time highs. Crypto, which is hard to fake and of limited production, is deemed to have organic value due to its precious scarcity. Some narratives about the use of it as a medium of exchange and relating to its security are tossed in to support the investment thesis. Some very large institutions have money in it now, which also seems to buy credibility. John Kenneth Galbraith was not the first

to realize that decisions are not manifestly correct because those with deep pockets make them. Crypto may earn its place in this era as the most symbolic of this rush to herald the immense value of a few precious, collectible things. Curiously, a quick AI search asking how many types of crypto there were put the number around 9,000, with further research indicating many more. Yet, interestingly, only five cryptos comprise more than 80% of all the assets in crypto. Some said during the early days of crypto that the reason that it would be so valuable was that there was a cap on the number of coins that could ever be created. Yet, this can no longer be the case. With 9,000 crypto currencies in existence, it is clear, among enthusiasts, that there are many currencies that are limited in number and, perhaps, even technically superior to the predominant coin, bitcoin, in many ways now. So, to what do we owe the value of bitcoin? The idea that transactions are secure and such is interesting, but could be done using blockchain without or without any specific coin or one could utilize the, long popular, banking system to transact dollars at real-time dollar prices. So, popularity, acceptance, as well as early adoption, are among the reasons for bitcoin's unique success among cryptos. Why else would so many, similar coins be so worthless – like much artwork or many old cars. Sort of like the collectibles market, no?

Meanwhile, other crypto providers have seized on bitcoin's vulnerability as a means of exchange (due to its unstable value) and created stable coins which are backed with dollars (actually treasuries) which will allow one the modern miracle of sending money electronically. You can do that? It reminds me of the news of an incredible new boat technology that was hyped during the sustainability and warming craze. It ran, astonishingly, solely on the power of the wind. Imagine Christopher Columbus' astonishment. Thinking that I had overlooked the genius of sending money electronically using stable coins, I listened to a podcast featuring a Nobel Laureate in economics who was similarly confused by this solution to a non-problem. Then, I happened across something where Jamie Dimon from Chase said, effectively, that his bank will work with dollar stable coins, but why? You can transact in real-time with dollars via the banking system. Color me perplexed. There will be applicability to blockchain (seems a fine way to contract for services internationally or eliminate notarization, for example), but it is far from certain that bitcoin or one of the other coins needs to be the means. So, is there a case for investor interest in bitcoin? I have ceased thinking about it in the same way that I have stopped

caring that a Cabbage Patch doll went for \$200,000 in 2014. Interestingly and coincidentally, the number of unique models of Beanie Babies (9,000) is very close to the number of cryptos that AI told me there were. Yet, of the millions produced, only a few have any real value today. While one once sold for \$500,000 once, most are about \$10. The reason for such a high price paid for that rare collectible Beanie Baby was its rarity – only so many made; its authenticity; its desirability. The Beanie Baby craze peaked in 1999, coincidentally, just as the NASDAQ was about to begin to buckle in 2000. Obviously, most of the 9,000+ crypto tokens have very little value either at this point. Interesting, but completely unrelated facts, right?

I have no particular position to evangelize about crypto. If you have chosen to own it, fine. If you want to own Hummel figurine or Longenberger baskets. That is fine, as well. I simply present the case of crypto as illustrative of a behavior that I am more and more inclined to believe is being broadly applied to the US equity markets, the collector psyche. Consider again the example of a user of a particular technology who is quite fond of the product. They become a devotee of all the company's offerings. They just 'like' it. They buy the stock. The stock rises. They are a fan. They are a user. If, for a time, many investors orient around the very popular stock, this will seem to represent a very workable, defensible strategy. This *strategy* may work for a time. The company could actually be a good company, but the rationale or the discipline applied to make the decision was arguably less good. Yet, the ongoing consolidation into ever, fewer astoundingly large companies may well have resulted in a higher stock price and, thus, affirmed their *strategy* of buying the stock of a company whose product they liked and which was wildly popular. In a society that repeatedly watches the same actors in all our movies every day, we are conditioned to value the familiar. Psychology even has a name for it – the mere exposure effect. Simply being exposed to something makes you more likely to feel comfortable with it (i.e., you hear the company name on CNBC a few times). So, in a virtuous spiral wherein large, popular tech companies dominate the cap weighted indices and a lot of individual stock investing is taking place in heavily hyped, story stocks that have tremendous brand popularity, it does feel a lot like collecting.

What if, however, there were ways to leverage these collectibles to produce income or revenue? Imagine a Beanie Baby that spit out nickels or a collectible tractor that could provide food as you plowed your garden. What if those few head of cattle in the Kansas City auction actually provide milk? Ironically, that



opportunity is embedded in the same market. The distinction being that one needs to actively seek to identify productive, truly valuable assets rather than chase price momentum and popularity. Fortunately, the equity market is an auction of many, many companies. To be sure, one could focus on popular, familiar stocks that can potentially rise dramatically in bursts. One could also seek to identify companies, popular or not, which earn high rates of return, perhaps, returns funds to shareholders and hold the promise of continuing to do so over a long-term horizon. A near equivalency would be the difference between land speculators and commercial real estate investors. One might buy an acre near a location where an exit was to possibly be built while another buys a small, fully-leased shopping center. The speculator can make very good money and, thereafter, immediately try to do again to repeat the success. The shopping center owner will use the rents to buy other shopping centers over time, perhaps. Who might you think would have the best long-term outcome? What if I told you that the two investors are soon to retire and will have to eat off the proceeds of their investments?

The fundamental reason to own stocks in the long run and the driver of stock value over the longer term is simply earnings. How much cash can this company make over time and eventually make available to me in some way? When thought about that way, it makes wanting to invest in something the investor saw as possibly the next great technology from a favorite stock on Reddit or plowing more money into the most popular gargantuan tech monopoly which pays no dividend and is facing a platform revolution seem less interesting. To be fair, it is absolutely allowable for an investor to have some companies about which they *just have a good feeling*. In fact, it is as likely as not that a rigorous, fundamental analysis will overlap with popularity/familiarity relatively often. There will inevitably be occasions where liking something, having a good feeling and having a solid fundamental case for investment will intersect. When a market is seemingly, increasingly being driven by collector behavior, however, one has to ask, “What ever happened to Beanie Babies?” “Cabbage Patch dolls?” An Atari 2600 game console once sold for \$20,000. At launch in 1977, they cost \$200, which if it had been put in something bearing the inflation rate of return would be worth about \$1,000 today. They can now commonly be had for between \$50 and \$200.

If you sit quietly, you can almost hear an old cowboy saying, “That is all very interesting, dear, but I am just here to add to the herd.”

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