

## J. Michael Locke

### Musings

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#### #124: Musing May 1, 2021

With expansive federal government stimulus and vaccination progress, the economy is beginning to rock. GDP grew at a 6.4% annual rate in the first three months of 2021. Large technology companies are one of the drivers of growth. We are in the middle of earnings announcements for publicly-traded companies with large tech posting stunning results: Tesla revenue up 74%, Microsoft sales up 19%, Google sales up 34%, Apple profit more than doubled and Facebook advertising revenue grew 46%. These huge companies growing at these rates is pretty incredible. According to the Microsoft CEO *"Over a year into the pandemic, digital adoption curves aren't slowing down. They're accelerating."* Tech isn't the only hot area, so is chicken. McDonalds posted US same-store sales up 13.6% compared to flat last year. *"Chicken-focused menu items, like the Spicy Chicken McNuggets and Crispy Chicken Sandwich, helped fuel sales this quarter"* according to CNBC.

The federal reserve left interest rates at their historically low levels mostly due to labor market softness. Fed Chair Jerome Powell said *"For the economy as a whole, payroll employment is 8.4 million below its pre-pandemic level. The unemployment rate remained elevated at 6% in March, and this figure understates the shortfall in employment, particularly as participation in the labor market remains notably below pre-pandemic levels. The economic downturn has not fallen fully on all Americans, and those least able to shoulder the burden has been the hardest hit."* My anecdotal experience is inconsistent with this view and it appears to me the labor market is getting tight. Friends running factories complaining about the difficulty in getting people hired to keep up with demand; McDonald's lobby closed in Arkansas with sign indicating it is because they can find enough staff to open; and our pier installer in Wisconsin ends our business relationship because he can't get enough people to work our lake. Part of the issue is the enhanced federal unemployment insurance benefit which makes the "breakeven" on going to work versus staying at home around \$50k a year depending on state. Another is the material decline in labor participation by women with children due to schools not operating normally. A final contributor is the embracement of a YOLO mentality by many workers in light of pandemic (thanks Ellie Locke) [technology/welcome-to-the-yolo-economy](#). Labor shortages are not just about entry level jobs. I have received data points on law firms struggling to staff their associate classes and accounting firms who can't get tax managers.

We need to do a better job tapping into experienced women in our labor market. Kudos to LinkedIn as according to Fortune *"LinkedIn will add stay-at-home mom' and other job titles to enable parents and caretakers to describe their gaps in employment more accurately."* I have had great experience with the hiring of moms "returning to work" after raising kids. They have dealt with real issues and aren't going to complain about stupid stuff like many millennials. Some companies creating "returnships" to tap into this talented labor pool. An investment firm I work with -- OCA ventures -- has invested in a business focused on this talent pool <https://themomproject.com/>

While stocks have been on a nonstop march upward, they may still be an alright buy. Stocks should trade based on a multiple of their forward earnings (shortcut for the discounted value of their future

cash flows). The market forward P/E multiple is 22x. If you look at that in relation to inflation rates which drive bond yields, it is not out of historical norms (from Factset and Mid Continent Capital):

1964-Present			
Inflation	Average P/E	Max P/E	Min P/E
0-1%	16.9	23.1	10.6
1-2%	18.6	29.8	9.8
2-3%	19.0	29.6	11.8
3-4%	17.5	28.9	9.9
4-5%	15.3	23.4	8.5
5-6%	14.6	18.0	7.3
6-7%	10.9	15.5	7.3
>7%	9.2	15.1	7.0

On the private company value side, I think it is important to look at how much money was invested to judge the success on how much a company is worth. MOIC or multiple of invested capital is the metric for me. WeWork is being purchased by a SPAC at an enterprise value of \$9 bn. As a reminder, enterprise value is the value of the business regardless of capitalization so it is equity plus debt (this is why you look at enterprise value as a multiple of ebitda so you don't factor in debt/equity mix vs equity value where you look at multiple of net income). Most of the discussion has been about how WeWork's \$9bn value was down from when they raised money at a \$47bn valuation. But how about the fact that they raised \$20.6 bn in debt and equity according to Crunchbase. So the management of WeWork has taken \$20 bn in other people's capital and turned it into a business worth \$9 bn. No thanks! They haven't created \$9bn in value; they have destroyed \$11bn in value.

Anyone running a "consumer comes to me" business should rethink their model and take their service to the consumer. Restaurant delivery is the obvious one but think about things like churches. I visited our daughter at TCU who "goes to church" by walking to college coffee shop where a church takes over and delivers a contemporary service with great music. Heard from a friend whose barber was coming to his garage. Will the doctor house call come back with a nurse practitioner coming out of the local Walgreens like the geek squad coming out of Best Buy? Humana just bought a big home-care provider.

Speaking of Best Buy, I have written about how value is created "inverse to the organization chart" with those interacting with consumers being the key more than the person at the top. Hubert Joly has done a great job as CEO rebuilding Best Buy. He recently wrote a book and here is an excerpt: *"Wearing my khaki pants and Best Buy's uniformed blue polo shirt with a 'CEO in Training' tag, I spent my first day meeting the staff, listening, asking questions, walking the store and visiting every department. After my shift, I had dinner with the store management team at a local pizzeria. They knew a lot about what was really going on at Best Buy. A lot! During that dinner, for example, one employee pointed out that the bestbuy.com website's search engine was a problem. She demonstrated just how bad by typing 'Cinderella' in the search bar. Inexplicably, the search engine spat out a list of Nikon cameras. I couldn't believe it. Over dessert, I found out that employees were also unhappy about a reduction in worker discounts—a perk they valued since many loved electronics."* That is leadership!

I previously wrote a musing on the "power of positivity" and the growing field of positive psychology. My experience is people do not follow someone who is negative. This is especially important in a growing, entrepreneurial company. Now some are trying to measure your "positive intelligence" and literally give you a score. According to some research, those with a higher "positive intelligence" live

longer, sell more and are better team members. Get your score:

<https://www.positiveintelligence.com/pq-score/>

The new Apple operating software rolled out with the new privacy controls. I encourage all to “opt out” of cross-site tracking and don’t let Facebook et al. follow you as you surf the web. Your data should be your property and not for others to get rich selling it so you get customized ads. The ad-based business model drives all activity to center around engagement. To quote an ex-Google employee who testified to Congress this week: *"Their business model is to create a society that is addicted, outraged, polarized, performative and disinformed. That's just the fundamentals of how it works."* That drives engagement and engagement drives advertising sales.

Great quote I heard - - “Everything someone says before *but* is bullshit.”

The migration south accelerated with Covid. It was augmented by a move out of big cities to suburbs. Census results showed the longer term “move south” dynamic with Texas and Florida gaining seats while Illinois, New York and others lost seats. [pandemic-supercharged-changes-in-where-americans-live](#) . New WSJ index on hot home markets gave top spot to Coeur D’Alene, Idaho followed by Austin, Springfield OH and Billings, Montana.

Let’s wish positive things for India and other countries being ravaged by Covid right now.

Jml