4th Quarter Commentary

January 2020

From Our Clients to Us, and Back Again

Part I: *What I Might Write to a Client: Alternatives to today's valuation extremes and yield famine*

Part II: *Client Questions: When Will the Indexation Train Stop? When Will the Bubble End?*

Page 11: The Impossibility of Stability

Page 13: Why You Don't Need for the Bubble to Stop

Page 14: But, Anyway, How Bubbles Do Stop

Page 19: A Reminder About the Invalid (and Invalidated) Premise of Asset Allocation Models and their Return Projections

Part III:

Page 20: On to Final Matters: A Couple of Stocks

Every three months a small group of us sits together for 20 minutes or so, in preparation for *this.* Among them is one of our analysts, who is also a fund manager. Also one of our relationship managers. The one is deeply involved, every day, in company analysis and market statistics; it's all about determinable facts and valuation models. The other is deeply involved, every day, in what our clients see and hear about the financial markets, and what they believe or wish to know.

There are times when there's a very particular idea or investment I'd like to communicate, and that will dominate the direction of the quarterly review. But first, I ask the group, "What do you hear? What's on clients' minds? Any particular concerns?" This time, those will dominate the direction of this review. They must. Because, here is some of what came up right away:

> "A lot of clients want to know why _______ is down. They've heard our thesis before and nothing has changed. Are we (Horizon Kinetics) missing anything? We own a lot of it; are we stuck with it?"
>
> "They understand our indexation thesis, but what if that's just the status quo? What if it just keeps going on?"
>
> "Fatigue is setting in, waiting for the bubble to end. Clients are tired of waiting."

Well, how can you not respond to that? We all learn by degrees. But, even if we were instant learners, circumstances constantly change and more information develops, so any proposition must be re-examined or refined, even if the result is simply to confirm it. In any case, we're not the arbiters of reality; we could be wrong – in which case, better to check that out earlier rather than later.

In that spirit, you might not know that we don't just answer questions every three months during a 60-minute webinar. I often have occasion to respond to a client's question about a holding or review their portfolio, and that can happen any old time. Sometimes it is more narrowly focused, sometimes with a more overarching purpose. A couple of those have occurred in recent weeks. When the response is in writing, as opposed to a conversation, it is w*ay* shorter than these quarterly reviews – it's not only a matter of convention, but who wants a 15-page letter to a simple question like, "How are we doing?"

So, the first part of this review will consist of two client review letters. One is for what I'll call an unconstrained account, the other for an income-focused account. Neither is part of a formal strategy such as Core Value or Strategic Value. The purpose of the letters was to address the extreme valuation and

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concentration risks in the financial markets, and to contrast that with the functional, business- and valuation-based diversification structure of the account. The first letter predominantly addresses the equity markets. The other focuses on the bond market and the yield famine, and reviews the alternative yield and purchasing power protections that have been incorporated into that portfolio and which cannot be found within the universe of ETF-based investing.

Letter #1 To reiterate, this account is not part of a formalized strategy. This client's general goal was to achieve long-term returns comparable to or exceeding the historically expected stock market return of roughly 10%. More specifically, we were asked to *not* constrain the portfolio by adhering to one type of stock or another, such as large cap or small cap, or even only to stocks. We were to invest in whatever we felt would meet our own criteria for achieving the objective, whatever we felt was within our circle of competence within an individual account format. It should be understood that this sort of request is relatively unusual, but this person had, in a professional capacity, read much of our published research over an extended period of time and was unusually familiar with the breadth of our investment offerings. This account, therefore, more completely expresses our (investment) world view than is typically the case.

December 2019

Dear _______,

My appraisal goes thusly. I might be repeating some prior observations, but the conditions we've previously identified as extreme have only become more extreme.

I am very pleased with the structure of your account, probably more so than at any prior time, even including our portfolios on the eve of the Internet/Tech Bubble at year-end 1999. Back then, the market was not overvalued; rather, there were a very discrete two or three sectors that were trading at bubble valuations. They could be easily avoided. And the bond market was relatively normal, with interest rates being in the 6% range, so that certainly allowed a fair cost-of-money return.

In contrast, today the entire equity market – the S&P 500 Index and other major indexes like the Russell 1000 – is at a bubble level valuation, as is the entire bond market and almost any mainstream yield-oriented instrument such as REITs and utility stocks. There is nowhere within 'the market' to avoid this. It is therefore a far greater systemic danger than during the 1999 environment.

Moreover, the market is more concentrated than it has ever been. The enormous volumes of money that have persistently flowed into ETFs these past 10 years since the Financial Crisis have limited ETFs primarily to very-large-capitalization and mega-cap companies. The same phenomenon, by the way, applies to the bond market, sometimes with more extreme results.

As money comes in, the ETFs must buy, creating automatic bids, so to speak, for their major constituents. I recently counted up the top 100 names in the S&P 500, 20% of the total, and they accounted for 67% of the value of the index. The smallest companies in the S&P are clustered in

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the $4 billion range, yet their index weights are only 0.1% – even if this micro-contingent were, for the sake of argument, deeply undervalued or wellsprings of future growth, they could not have a meaningful impact on the index.

That 20% of the S&P 500 that essentially represents its recent and future return behavior comes in two flavors: those companies that are growing rapidly – the FAANG and related technology/information technology stocks; and the other non-technology stocks. The growth companies trade at 35x earnings and higher (or much higher), as if they are not subject to growth limitations or competition. The latter, like Coca-Cola, Procter & Gamble, McDonalds, trade at 25x earnings. They've done so in various periods in the past, too, except that was when they were growth companies. Yet, they have experienced either no sales growth or actual sales declines for the last several years; they are mature, trending to cyclical. In that sense, they might be more overvalued than the FAANG stocks. That is a simplified view of the market valuation profile.

In your account, since we gravitate toward companies that we assess as too cheap for the qualities we seek, we have accumulated, these last several years, companies in the very few industries that have experienced deep multi-year recessions (or even depressions) and from which they have yet to recover. Consequently, they've been deemphasized in, or even eliminated from, the major indexes.

It is not that we sought, by intent, to identify the economic sectors that were underrepresented in the S&P 500; it is merely that the only companies that intrigued us from a quality/valuation standpoint tended to not be in the indexes. The laws of supply and demand haven't been repealed. Money has steadily been withdrawn from stocks that don't meet the ETFs' statistical requirements for trading liquidity, price appreciation and price volatility. Those requirements are, it should be understood, geared toward trading and marketability/asset gathering needs, not future outcomes – so the statistically unattractive stocks have been 'made' to be cheap.

The result is that your account very much has come to represent a "completion index": *everything that the market isn't, and nothing that the market is.* The schedule below will demonstrate.

The first table of the exhibit identifies each holding individually, along with its weighting. Using the first category, Precious Metals, as an example – colored dark yellow – these are Sandstorm Gold, at 4.3%, and Wheaton Precious Metals with a 3.1% weight. These are asset-light businesses – they own royalty contracts, not earthmoving equipment– and remain profitable even when mining companies are not. Without the need to support any meaningful amount of property or equipment, they can direct their cash earnings into new royalty contracts and thereby expand even when mining companies cannot. In this sense, they even benefit when metals prices are low, since they can then buy on better terms. Therefore, the royalty companies can be thought of as permanent call options on higher precious metals prices, yet they are also growth stocks – which cannot be said of miners or gold bullion.

Unconstrained Account

Description	Market Value %	CATEGORY*
CASH	27.4%	Cash
SANDSTORM GOLD LTD	4.3%	Precious metals (asset-light, high ROE royalty model)
WHEATON PRECIOUS METALS CORP	3.1%	
BGC PARTNERS INC	5.9%	Counter-cyclical (exchanges/inter-dealer brokers/asset managers that can benefit from shift in interest rate and volatility environment)
ASSOCIATED CAP GROUP INC	3.4%	
ICAHN ENTERPRISES LPDEP UNIT	1.6%	
CME GROUP INC	1.6%	
CBOE GLOBAL MARKETS INC	1.3%	
SCIENCE APPLICATNS INTL	5.0%	Defense electronics (asset-light Defense sub-segment)
CHENIERE ENERGY INC	5.9%	Energy processing/export
CHENIERE ENERGY CONV 4.25% 3/15/45	2.6%	Energy processing/export (convertible notes)
TEXAS PACIFIC LAND TRUST	17.2%	Energy production (asset-light, high margin royalty model)
VIPER ENERGY PARTNERS LP	1.0%	Energy production (asset-light, high margin royalty model)
SUBSEA 7 SA ADR	2.0%	Energy (offshore oil and wind turbine services)
CIVEO CORP	1.8%	Mining (less-capital-intensive remote area housing/svcs.)
MESABI TR	1.4%	Mining (asset-light, high ROE royalty model)
BROOKFIELD ASSET MGMT	0.8%	Hard asset inflation beneficiary (alternative-assets mgr.)
CLARKSON PLC	2.4%	Marine shipping (incl. asset-light shipping broker model)
BRAEMAR SHIPPING SERVICES PLSHS	1.9%	
NAVIGATOR HOLDINGS LTD	1.0%	
FANNIE/FREDDIE MAC PREFERRED SHS	5.1%	Deep discount (~50%) legal obligations
GMO INTERNET INC	2.0%	Blockchain Disruption (cryptocurrency exchange and mining)
HIVE BLOCKCHAIN TECHNOLOGIES	0.0%	
GRAYSCALE BITCOIN TRUST BTC	0.8%	Cryptocurrency (fixed-issuance, non-debasable)
ROYCE MICRO-CAP TR INC	0.7%	Micro-cap stocks – Discount to NAV
Closed-End MLP Funds (4 funds)	1.7%	Income – Discount to NAV
VANECK VECTORS ETF TR PFD EX FI	0.9%	Income - Preferred (excluding Financials) ETF
Closed-End Bond Funds (4 funds)	1.3%	Income
Leveraged ETFs/ETNs (across 4 funds)	-5.0%	Short Dysfunctional NAV-Decaying ETF
Total	**100.0%**	

Source: Fiserv, Account Custodian

*The categories listed in the charts herein have been created and chosen by Horizon Kinetics.

Following these two royalty companies down to the next table, which aggregates the portfolio holdings by industry sector, they are identified – same dark-yellow coloring – as precious metals companies. Their aggregate weight in your portfolio is shown as 7.4%. And the S&P 500's weighting in the precious metals sector is also shown: 0.1%. That is the S&P 500 weighting in the world's largest goldmining company, Newmont Goldcorp, *which has a $34 billion market cap*!

Category	% Weight Account	% Weight S&P 500	S&P 500 Notes
Precious metals (asset-light, high ROE royalty model)	7.4%	0.1%	Newmont Goldcorp
Counter-cyclical (futures/options exchanges/ interdealer brokers/ alternative asset managers)	13.8%	0.3%	CME, CBOE
Defense electronics (asset-light Defense sub-segment)	5.0%	0.2%	L3 Harris Technologies
Energy processing/export (stock & convertible notes)	8.5%	0.0%	*None*
Energy production (asset-light, royalty model)	18.1%	4.3%	Of which, ExxonMobil & Chevron 2%
Oil service (offshore oil and wind turbine services)	2.0%		
Mining (less-capital-intensive remote area housing)	3.2%	0.1%	Freeport McMoRan
Land & real estate development	0.8%	0.1%	Weyerhauser (timberland)
Marine shipping (incl. asset-light shipping broker model)	5.3%	0.0%	*None*
Deep discount (~50%) legal obligations	5.1%		*None*
Blockchain Disruption and Cryptocurrency	2.8%		*None*
MLPs (closed-end fund format)	1.7%		*None*
Bonds (closed-end fund format)	3.0%		*None*
Preferreds (ETF format, excl. financials)	0.9%		*None*
Short Dysfunctional Decaying ETF	-5.0%		*None*
Sub-total	**72.6%**		
Sub-total excluding Texas Pacific Land Trust	**64.7%**		
Cash	**27.4%**		***None***

The balance of the 2nd table shows much the same pattern throughout:

- *Counter-cyclicals* benefit from market conditions with more volatility and wider transaction spreads, which have been suppressed in this artificially low interest rate environment. These provide an entirely different way to try to benefit from conditions that can initiate an otherwise injurious future equity market.
- *Marine shipping*, which is a major global industry, has a 5.3% representation in your account; the S&P 500 has no such company within it.
- *Hard-asset companies* which tend to be beneficiaries of an inflationary environment, such as via land development or infrastructure assets likes electricity grids and toll roads, have essentially zero weighting in the market.
- Even *Energy*, a not infrequent source of inflation shock (or simply cyclical recovery), is now at an all-time low weighting of 4.3% in the S&P 500. ExxonMobil, all by itself, used to be a higher weighting. Moreover, ExxonMobil and Chevron, which account for half of that sector, are not true cyclical beneficiaries, since they have large refinery operations: their oil production business will benefit from higher prices, but their refinery operations will suffer.
- And so forth.

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There are also two investments that are entirely different as to how they might behave in the face of systemic economic and financial markets risk, even relative to the securities above. They really can be called different asset classes, they bring additional forms and sources of return, and they don't exist in the indexation world:

- *Path-dependent ETF short-sale program, -5% weight.* We've discussed this previously. For structural reasons a variety of leveraged ETFs constantly lose net asset value over time, although they can be extremely volatile in the short term. But the ultimate outcome is quite determined, and the returns from this program are also independent of the systemic risks that can impact most other financial assets.
- *Bitcoin and Blockchain Disruptors, 2.8% weight.* Another topic we've discussed. Bitcoin is perhaps the ultimate non-correlated security, probably the most volatile. It is also perhaps the ultimate contingent insurance against a severe or crisis-level of currency/U.S. dollar risk, and very likely the highest-return-possibility asset one can own.

Essentially, the stock market has – through its reshaping by the indexation business model and ETFs' asset accumulation – lost substantially all of its sources of resilience in the event of some jarring change to the present economic environment, whether that might a credit crisis, interest rate spike, inflation surge, etc.

I'd describe your account as having an unusual degree of functional business diversification embedded within it, diversification not otherwise available in mainstream funds. Likewise, I'd say that it has a great deal of positive optionality inherent in these businesses and their valuations, and to a degree that simply can't exist in the stock market at it is today constituted. This year, through December 27th, the account returned ___%.

Let me know if any questions or comments,

Steve.

Letter #2 This account, also not part of a formalized strategy, was simply intended as a long-term conservative strategy. For this client, that meant predominantly bonds, with creative allowance for other income producing securities and also some non-income securities that might serve as possible hedges against conditions that would hurt a bond portfolio, such as rising inflation or interest rates. Depending on the pricing and availability of different instruments, the weightings between sectors of the account (e.g., cash, bonds, convertibles, etc.) have shifted markedly over time.

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January 2020

Dear _______,

I wanted to review the family income-focused accounts with you. They differ markedly enough in structure from any standard bond or income-allocated portfolio, that I thought it worthwhile to look at one of them in more detail. Very few of the holdings will even be found in an ETF. In a sense, it has to be that way, because there is simply no adequate yield available in index-based instruments. I'm very pleased with the portfolio structure, which has both a higher-than market yield, along with additional liquidity that doesn't exist in a fund or index, and along with pathways for purchasing power protection that likewise don't exist in bond funds.

With respect to the bond market narrowly – although this is central to the valuation excesses in all financial assets – one of the dominant economic vectors of the past three decades has been the unprecedented decline in interest rates. A large portion of global sovereign debt now has a negative yield. The 10-year U.S. Treasury does have a positive yield to maturity of 1.7%, but it nevertheless produces a loss after the impact of inflation.

The inflation rate, according to the Federal Reserve, has been less than 2% for the past 10 years, and its stated policy is to maintain it there. The M2 money supply, though, expanded 6.2% annually. M2 is a more transparent measure of monetary debasement than the highly engineered Consumer Price Index that the Federal Reserve publishes. And in the past 12 months, the rate of money creation has risen to 7%, and to 9% during the last 6 months. At a 6% currency debasement rate, the government is effectively guaranteeing you that you will lose over 4% of your real-world purchasing power every year, when you buy its 10-Year Notes. Before deducting taxes.

It's unfortunate that the average investor does not see the problem. There are two problems, really: not understanding what the return will be, and not understanding the risk. The first problem can be seen in one of the most popular bond ETFs in the country, the iShares 20+ Year Treasury Bond ETF (TLT). It returned 14.9% last year. An average investor likely considers TLT to be both a wonderfully profitable and low risk investment. But the average coupon is only 2.99%; therefore 80% of the return came from price appreciation. That could only happen because interest rates were lowered last year; there is an obvious limit to doing that.

Even if the government were to continue lowering rates until it could go no lower, the going-forward pre-tax yield to maturity is only 2.29%. And then, more than one-half of the positions in TLT, by value, trade at price that is 20% above face value. That appreciation will reverse, since the bonds must mature at face value.

The second problem is the way risk is described. The investment profession uses past price volatility statistics. They're on the TLT website: standard deviation, convexity and something known as effective duration (which is formulaically derived; it is *not* a maturity date). Obviously, the average investor is not conversant with those terms or how to use them. There is no explanation that *if long Treasury rates were to rise by a mere 2% points, from 2.29% to 4.29%, the ETF price would drop by nearly 30%.*

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So, the facts are that a bond ETF like TLT is guaranteed to:

1. With stable or declining interest rates, lose purchasing power every year; and
2. With a rise in interest rates, be vulnerable to truly severe price declines.

It seems to be common sense to seek alternatives to the certainty of a negative outcome. The proper objective in a bond portfolio should be to maintain or increase one's purchasing power, which is after the impact of taxes and inflation. That has always been the expectation historically, at least until this modern era of organized central bank interest rate suppression.

Your account, certainly, is organized quite differently than any index-based bond or income strategy. The accompanying schedule displays the various investments by type, along with their yield and their weights in the portfolio.

The basic profile is that the portfolio has a 4.2% yield, which is about twice as high as a 10-year Treasury, and quite a bit higher than a corporate bond index fund like the iShares U.S. Aggregate Bond ETF (AGG). However, the portfolio is much more strategically flexible than an all-bond portfolio, and offers different vectors for optionality and purchasing power protection that has been stripped out of conventional fixed-income ETFs:

- It has a cash position of about 21%. This is a valuable resource, available to make opportunistic purchases in the event of market disturbances.
- Bonds and bond funds are about a 27% weighting. Most of these are closed-end funds, which are generally at discounts to their NAV. Aside from their current yield, the eventual closing of those discounts, which happens from time to time, would add a measure of appreciation.
- Convertible bonds and convertible preferreds, which also offer appreciation potential, are another 5%.

Together, cash and fixed income securities comprise about 53% of the portfolio, with the bond portion yielding about 6%.

Equities amount to 44% of the portfolio, but are apportioned almost equally between income-stocks and non-income stocks.

- Income stocks are about 20% of the portfolio, and yield about 9.6%. We believe most of these businesses will benefit from some form or source of inflation or interest rate increases or economic activity, such that their market values and dividends can be expected to advance over time.

- Non-income stocks are about 24% of the portfolio. However, over two-thirds of this group, by weight, might well establish meaningful dividend payouts in the foreseeable future, which would markedly increase the portfolio yield. They are all, whether gold royalty or energy royalty companies, beneficiaries of some possible source of inflation shock.

Description	YTM or Curr. Yld.	% of Portfolio	Notes:
CASH	1.31	**21.3**	
CORPORATE BONDS			
NAVIGATOR HLDGS LTD SR 7.75% 02/10/21	6.24	4.5	Not in major bond indexes
CHEMOURS CO 6.625% 05/15/23	6.49	0.7	0.27% weight in SPDR High Yield Bond ETF
GULFPORT ENERGY 6.000% 10/15/24	18.75	0.8	0.10% weight in SPDR High Yield Bond ETF
IAMGOLD CORP 7.000% 04/15/25	6.15	1.2	Not in major bond indexes
	7.67	**7.2**	
CLOSED-END BOND FUNDS			
Taxable Closed-End Funds (2 funds)	8.96	6.5	
Municipal Bond Closed-End Funds (9 funds)	5.01	13.4	Tax-exempt, 0% to 10% discounts to NAV
	5.55	**19.9**	
CONVERTIBLE NOTES & PREFERREDS			
CHENIERE ENERGY CONV SR 4.250% 03/15/45	5.38	4.0	Equity value benefits from growth of US liquid natural gas exports
BUNGE LIMITED PREF PERP CONV	4.81	0.8	Equity value benefits from food commodity price inflation
	5.29	**4.8**	
DEEP-DISCOUNT PREFERRED STOCK			
FREDDIE MAC PFD SERIES K Z, R	0.00	2.0	Current prices approx. 60% of face value
FANNIE MAE PFD SERIES I, H, S	0.00	2.0	Current prices approx. 60% of face value
	0.00	**4.0**	
INCOME STOCKS			
BGC PARTNERS INC CL A	9.41	3.6	Interdealer broker: beneficiary of higher interest rates, market volatility
GDL FUND	4.26	0.4	Merger/arbitrage fund: beneficiary of higher interest rates
BOLSAS Y MERCADOS ESPANOLES	4.42	0.7	Securities exchante: asset-light, high margin croupier business model
MESABI TR CTF BEN INT	14.79	1.3	Royalty business model: beneficiary of higher iron ore prices, US steel production
NEWMARK GROUP INC CL A	3.28	1.3	Asset-light real estate service provider
BRAEMAR SHIPPING SERVICES PLC	7.35	1.4	Shipping broker: asset-light beneficiary of higher shipping activity and pricing
BROOKFIELD PPTY PARTNERS L P	6.65	1.9	Large-scale, diversified commercial real estate
BLACK STONE MINERALS L P COM UNIT	12.12	1.4	Oil/gas royalties
ICAHN ENTERPRISES LP	12.13	4.0	Activist value manager with hedges against stock market and credit deterioration
Pipeline MLP Closed-End Funds (5 funds)	14.76	3.5	Trade at discounts to NAV
	9.59	**19.5**	
NON-INCOME STOCKS			
BROOKFIELD ASSET MGMT INC	1.03	2.2	Inflation hedge: alternatives/hard assets investment maanger
SANDSTORM GOLD LTD	0.00	2.3	Royalty business model: asset-light, precious metals
WHEATON PRECIOUS METALS CORP	1.28	1.9	Royalty business model: asset-light, precious metals
GMO INTERNET INC	1.07	1.1	Exposure to cryptocurrency operating businesses: mining, currency exchange
	0.77	**7.5**	
CONTINGENT/FUTURE INCOME STOCKS			
CHENIERE ENERGY INC	0.00	1.8	Likelihood of dividend establishment, with elevated rate of increases
TEXAS PACIFIC LAND TRUST SUB SHARES	0.22	15.2	Likelihood of dividend establishment, with elevated rate of increases
	0.20	**17.0**	
PATH-DEPENDENT ETFS			
Leveraged ETN	**0.00**	**-2.5**	Non-correlated, reliable long-term cash flow generation
NON-INFLATIONARY CRYPTOCURRENCY			
GRAYSCALE BITCOIN TRUST BTC	**0.00**	**1.3**	Non-correlated, high-optionality currency-debasement hedge
	4.22	**100.0**	

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- *Path-dependent ETF short-sale program, -2.5% weight.* We've discussed this previously. For structural reasons a variety of leveraged ETFs constantly lose net asset value over time, although they can be extremely volatile in the short term. But the long-term outcome is pretty much determined, and those returns are independent of the systemic risks that can impact most other financial assets.
- *Bitcoin, 1.3% weight.* Another topic we've discussed. This is perhaps the ultimate non-correlated security, very probably the most volatile. It is also perhaps the ultimate contingent insurance against a severe or crisis-level of currency/U.S. dollar risk, and very likely the highest-return-possibility asset one can own.

The result is that, even though the choices for yield and exposure seem very limited within the bond and income markets as people understand them, your account very much has come to represent a "completion index": everything that the market isn't, and is nothing that the market is.

Please let me know if you'd like to discuss further or have any questions,

Steve

What do these two accounts show? That there really are alternatives to today's extreme valuation and concentration risks and to the yield famine. But first, you can't possibly learn that through a financial news network or brokerage firm's asset allocation software, since they embrace the passive investing framework, which deliberately turns a blind eye to valuation. It is a superb idea for certain purposes, and works fine if indexed assets are a small portion of the market. But having captured almost every new investment dollar, *passive has distorted the original thesis, perversely becoming a new and disruptive form of active investing.*

Using extremes for clarity, if any one of you listening now were the only ETF buyer in the country – I don't care how large your account is – you couldn't possibly affect clearing prices. You'd just be participating in the existing flow. That's obvious. At the other extreme, if, as in a dream fantasy one midnight dreary, your account were so large that you were responsible for 100% of new inflows into, say, the S&P 500, well then, you can see how you would be the one setting the prices. That really is what has been going on, particularly since active managers have been steadily losing assets, which means they are continuous forced sellers of their own holdings. It really is pretty extreme.

How do the alternatives to the extremes arise? Through the pleasing yin and yang that excesses in one sector of the market, the one that becomes flooded with new money, creates deficits in another – in the place from which that money came. That has created the opportunity to identify securities excluded from the indexation inflows, those with valuable attributes, yet which trade at much lower clearing prices – artificially low (or liquidity-driven) clearing prices, just as the index-centric securities trade at artificially high (liquidity-driven) clearing prices.

Now to the questions. First, the general ones:

> "They agree with our indexation thesis, but what if that's just the status quo? What if it just keeps going on?" And, "Fatigue is setting in, waiting for the bubble to end. Clients are tired of waiting."

I sense that there are a variety of separate concerns behind those singular questions. So, I'll provide a variety of responses, one or two of which I hope will hit the target. You'll see, as we go on, that I was quite motivated by them.

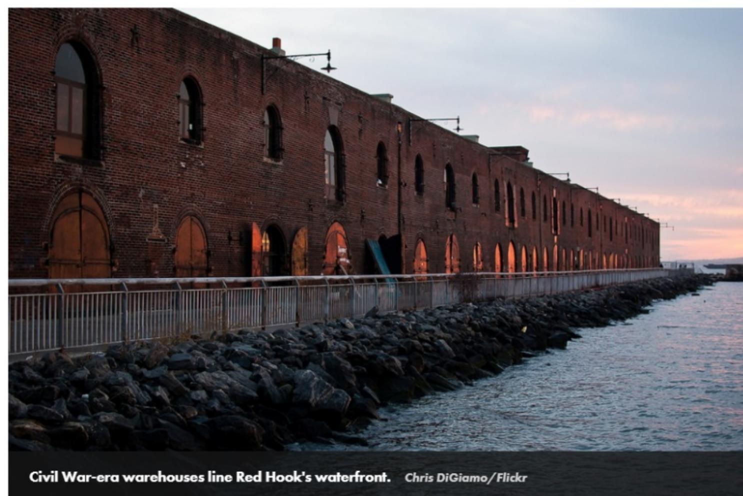
1. ***The Impossibility of Sustained Stability or Linearity***

One of the messages I take from my reading of history and behavioral economics and behavioral finance, is that stability can't persist in human populations. Stability or linearity, predictability, breeds changes around itself that eventually undermine it; stability breeds instability. One manifestation that's been observed by just about anyone who's old enough has to do with neighborhoods. Take the example of an abandoned neighborhood in and near metropolitan centers. It might once have been a dynamic and stable light industrial neighborhood serving a certain market. Until that industry gets displaced. The neighborhood gets abandoned, sits neglected, even dangerous for a very long time, generations even, and in that sense it again seems very stable. It is what it is.

But a supply shortage gradually develops in the housing stock in that metropolitan area, pricing out people who can no longer afford the rent. The lowest-income and most flexible people, say artists or students, find their way there. They found a solution, and can live there a very long time, even raise families, and it seems very stable. But a lone entrepreneurial spirit decides to buy some building that she can afford, improve it, and charge higher rents. That can go on for quite a while, and she can get quite a bit larger, going from one property to several. That seems very stable.

But, as the years pass and the neighborhood attracts a more diverse population and more retail businesses, it also attracts larger and better funded real estate developers. They can afford to pay more, and push up the clearing prices, and our original entrepreneur's expansion days might be over. It might or might not necessarily be bad for her, but the artists and students do have to move on again.

Get to know Red Hook, where availability is limited and prices are rising



Civil War-era warehouses line Red Hook's waterfront. *Chris DiGiamo/Flickr*

Take Red Hook in Brooklyn, a 38-acre peninsula that was the world's busiest freight port until the 1960s. It's where the movie *On the Waterfront* was based. The port was displaced because containerized shipping displaced traditional bulk shipping, and

the business and jobs went to New Jersey. By the 1970s, it was derelict, and a 1988 LIFE Magazine cover story labelled Red Hook one of the 10 worst neighborhoods in the U.S. and the crack capital of America. By the 1990s, middle class artists who were being forced out of Manhattan's Lower East Side, came to Red Hook for the incomparably low rents. In that former set of slums known as the Lower East Side, by the way, you're now looking at million dollar and multi-million-dollar apartments. One real estate website specializing in Red Hook put it more succinctly: *"Get to know Red Hook, where availability is limited and prices are rising."*

You can't get away from it.

A straight line in a marketplace is something that will be noticed and gamed by people who find a way to make use of its predictability, and thereby creates activity of a different sort. Our steady, artificially low interest rate regime, coupled with the mechanism of passive investing funds has resulted in a very stable, linear flow of funds into certain kinds of securities. *"The availability is limited and prices are rising."* People will do more and more of it and – here's the thing – they will not stop of their own accord. They simply don't. It is something external, an exogenous event, that ultimately changes the game for them.

So back to that question, which is very important, *"What if it keeps going?"* The answer is that it can't. It's true that it can go on for a long time. But when it stops, the damage is likely to be even more severe.

I can sense – because I'm like this – the impatience, once one knows the story, but knowing it, you start to get restless for it to finish. Think of the game Musical Chairs. To bend this game to our purpose, though, instead of there being only 1 chair short of the number of people dancing – and we're talking about the securities markets – there are only enough chairs for a modest proportion of the dancers. The music's playing and that's really great and you can stay at the party and have a lot of fun. But you don't know – you can't know – when the music stops. As soon as it stops, the dancers have run out of options.

2. *<u>But we don't need for the bubble to stop for our investments to perform however they will perform</u>*. They each, in our estimation, of course, have pathways of return independent of the S&P 500. Some, like the precious metals royalty companies have been constant producers of free cash flow. They've done well over the years even when gold prices or gold mining stocks have been down. They didn't require anything to stop.

   Part of the confusion here is that the S&P 500 once represented a much more functional totality of the market. Buy the S&P 500 and you really did encompass much of the entire set of business types and valuation attributes of stock market, including a reasonable exposure to smaller and emerging companies, cyclicals, and so forth. So, yes, if the S&P 500 were a bubble and you realized it and didn't want to participate, you might really have had to wait it out until it collapsed, until the time when you could again find an opportunity to assemble a portfolio of appropriately valued stocks. Today, what people think of as 'the market' encompasses only a small fraction of publicly traded companies. You don't need to wait for the S&P 500 at all.

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3. Maybe that question seeks a more specific answer or trigger event as to what will make the indexation-as-the-new-norm bubble stop.

   a. *Oxygen Depletion* One answer relates to that problem of linearity. Last year a published study found that the total value of indexed assets finally exceeded 50% of all investment assets. That is a critical borderline. It now means that passive products exceed in size the available pool of funds, or float, available to flow into it. But, really, the float is smaller than the 50% figure. The 50% figure was in comparison to all investment assets, not all managed assets. There are plenty of securities not held in funds or with investment advisors, and so they not readily available as float. Indexation is a lot bigger percentage of all managed assets.

      The float's even smaller after insider ownership. There's no inside ownership worth mentioning anymore at Apple or Microsoft, the figure is 16% at Amazon, 12% at Google and 14% at Facebook.

      We just don't know what will happen if passive investing runs out of new cash inflows. One reason we don't know is that this condition has never existed in the 20+ year history of ETF investing. But we are going to learn something about that in the coming years. You can picture how, as the assets in passive investing get ever larger – and, again, we're already way over 50% – and as the float or pool from which it can draw new cash shrinks, the depletion of that pool can suddenly accelerate to the point where it's not practicably available. As that event horizon is approached, we don't know what will happen to the prices of the leading index companies, to the tip of the spear.

   b. *When Giants Fall* Another answer relates to the dominant force within the stock market today. The Information Technology segment of the S&P 500 is now 24.0%. Let's pretend that Facebook, Google and Netflix were assigned to or moved to the Communications sector for purely objective reasons, and the same for Amazon being in Consumer Discretionary. But we're going to lump them together anyway. Altogether, that's 33% of the S&P 500. That should really set off warning bells. The S&P 500 can't absorb the impact of a decline among those companies. But it always happens. Here are some – but not all – of the ways. These are just two examples; there are plenty more.

      i. Growth limits and competitive displacement.

         1. Facebook and Google now dominate global digital advertising, with roughly a 75% market share. Digital media is about 44% of global advertising expenditures and is expanding at about a 10% rate. At current growth rates for Facebook and Google, they will only require about 2 years to approach 95% of global digital advertising. Here's the thing: the global advertising market as a whole only expands a few percent per year; and it's cyclical. What happens to Facebook and Google growth rates then? What happens to their valuations?

         2. *Competitive profit pressure*. Dell once disrupted incumbent, giant PC makers like IBM with a lower-cost, direct-to-consumer sales model and by being willing to sustain a lower margin. Dell is now trying to capture market share in cloud computing by underselling the competition. It's like PCs except bigger, with huge warehouses, thousands of servers, and backup generators. Over 70% of Amazon's operating income last quarter came from its cloud computing business, AWS.

The important point is that the largest, most profitable companies are attractive targets for a competitor who would like to carve out some of those already existing, paying customers for itself. No business is immune.

As forever as Amazon and Google seem, the paradox is that just about everyone on this call has personally witnessed this movie before. Here is a list of the 10 largest S&P 500 positions at year-end 1999, along with descriptions of what happened to just some of them. *Only one of them is still on the list.*

– America Online merged with Time Warner. It's virtually non-existent today.
– IBM was displaced by cloud computing disruptors.
– Lucent was displaced by the internet and advances in telecom. Its shares went to 55¢.
– Walmart remains under disruptive pressure from Amazon.
– GE has its own self-inflicted wounds, via GE Capital. It's now #63. Its share price is 80% lower. GE was memorialized as a Harvard Business School case study in applied management skill.

Ten Largest S&P 500 Positions in 1999

MSFT	Microsoft Corp.
GE	General Electric Co.
CSCO	Cisco Systems, Inc.
WMT	Walmart Inc.
XOM	Exxon Mobil Corp.
INTC	Intel Corp.
LU	Lucent Technologies
IBM	International Business Machines
C	Citigroup Inc.
AOL	America Online

One might think that this example is a fluke of that particular cycle, the Internet Bubble. Here's a more comprehensive example that goes back to 1980. It's in the form of a before and after list. The first list is of S&P 500 companies that became as large as a 3% or greater weighting, along with the years in which they achieved or maintained that status. Using the first company, IBM first achieved that distinction in 1980 and reached its zenith 6.4% weight in 1985. It was the Microsoft of its day. In fact, Microsoft was just a subcontractor. Unassailable.

S&P 500 Cos. that Were 3% or Greater Weights at Each Year-End

Year	Company	Market Value	% Index	Year	Company	Market Value	% Index
1985	Int'l Bus. Machines	$95,607	6.4%	2004	Genl Electric	$385,883	3.5%
1984	Int'l Bus. Machines	$75,338	6.2%	2018	Microsoft Corp	$779,674	3.4%
1983	Int'l Bus. Machines	$74,346	6.1%	2006	Exxon Mobil	$446,944	3.4%
1982	Int'l Bus. Machines	$57,794	5.7%	2001	Microsoft Corp	$356,806	3.4%
1981	American Tel & Tel	$47,750	5.5%	2011	Exxon Mobil	$406,272	3.4%
1982	American Tel & Tel	$52,989	5.2%	1998	Genl Electric	$334,237	3.4%
2008	Exxon Mobil	$406,067	5.0%	2014	Apple Inc	$647,361	3.4%
1999	Microsoft Corp	$604,078	4.9%	2018	Apple Inc	$748,539	3.3%
2019	Apple Inc.	$1,226,479	4.6%	2005	Genl Electric	$370,344	3.2%
2019	Microsoft Corp	$1,203,063	4.5%	2018	Amazon.com Inc	$727,114	3.2%
1986	Int'l Bus. Machines	$73,176	4.3%	2018	Alphabet Inc'A'	$726,559	3.2%
1980	Int'l Bus. Machines	$39,604	4.3%	1997	Genl Electric	$240,120	3.2%
1999	Genl Electric	$507,734	4.1%	2011	Apple Inc	$376,411	3.2%
2000	Genl Electric	$474,929	4.1%	1981	Exxon Corp	$27,071	3.1%
1987	Int'l Bus. Machines	$69,815	4.0%	1987	Exxon Corp	$54,372	3.1%
1981	Int'l Bus. Machines	$33,587	3.9%	2009	Exxon Mobil	$323,717	3.1%
2007	Exxon Mobil	$511,887	3.9%	2016	Apple Inc	$645,735	3.1%
1980	American Tel & Tel	$35,676	3.8%	2010	Exxon Mobil	$368,712	3.1%
2001	Genl Electric	$398,105	3.8%	2003	Genl Electric	$310,384	3.1%
1988	Int'l Bus. Machines	$72,163	3.8%	1988	Exxon Corp	$57,551	3.0%
1980	Exxon Corp	$34,856	3.8%	2015	Apple Inc	$586,859	3.0%
2012	Apple Inc	$500,608	3.7%	2005	Exxon Mobil	$349,512	3.0%
2017	Apple Inc	$868,880	3.6%	2002	Genl Electric	$242,308	3.0%
1998	Microsoft Corp	$345,808	3.5%	1999	Cisco Systems	$366,481	3.0%
2002	Microsoft Corp	$276,411	3.5%	1986	Exxon Corp	$50,638	3.0%

Source: S&P Dow Jones Indices

2

The second list reorders the first one in descending P/E order – that is, the highest-valuation companies first – and shows the performance of their shares over the next five and 10 years.

Subsequent Annualized Returns for the Prior-Listed Companies with the Highest P/E Ratios

Year	Company	Market Value	% Index	P/E	Next 5 Year Performance	Next 10 Year Performance
1999	Cisco Systems	$366,481	3.0%	220.88	-18.45%	-7.74%
1999	Microsoft Corp	$604,078	4.9%	72.90	-12.42%	-4.40%
1998	Microsoft Corp	$345,808	3.5%	67.65	-4.45%	-3.94%
1999	Genl Electric	$507,734	4.1%	46.05	-4.73%	-8.92%
2001	Microsoft Corp	$356,806	3.4%	41.67	0.82%	0.03%
2000	Genl Electric	$474,929	4.1%	36.00	-3.82%	-6.34%
1998	Genl Electric	$334,237	3.4%	35.02	-0.03%	-4.76%
2002	Microsoft Corp	$276,411	3.5%	34.61	10.03%	3.12%
1997	Genl Electric	$240,120	3.2%	28.79	1.49%	6.52%
2001	Genl Electric	$398,105	3.8%	27.32	1.16%	-4.68%
2004	Genl Electric	$385,883	3.5%	21.79	-12.92%	-0.17%
2005	Genl Electric	$370,344	3.2%	19.25	-8.79%	2.43%
2003	Genl Electric	$310,384	3.1%	19.21	-9.27%	2.43%
2009	Exxon Mobil	$323,717	3.1%	17.01	9.09%	3.54%
2002	Genl Electric	$242,308	3.0%	15.50	11.80%	1.89%
1986	Int'l Bus. Machines	$73,176	4.3%	15.36	-1.93%	5.80%
2014	Apple Inc	$647,361	3.4%	14.92	23.69%	
1985	Int'l Bus. Machines	$95,607	6.4%	14.57	-2.60%	-1.79%
1983	Int'l Bus. Machines	$74,346	6.1%	13.50	3.40%	-3.71%

Source: S&P Dow Jones Indices

Source: S&P Dow Jones Indices, Bloomberg, Horizon Kinetics Research

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From the second table, the majority of the 5- and 10-year annualized returns were negative after companies achieved their greatest index status. Of the positives, only three were positive to the degree of double-digit returns, and the rest were largely in the 2% to 3% range.

You might think that Microsoft is an exception, since it was on the list in in 1998 at 3.5%, and here it finished 2019 at 4.5%. It is, sort of, but you wouldn't call it exceptional. Over these 21 years, the shares appreciated at a 7.5% rate, about the same return as a long-maturity Treasury at that time.

And which three companies today have a 3% weight or greater? Apple, Microsoft and Google. I'm going to give Amazon honorary membership, for our purposes, even though it's only at 2.84%. There's no predictive power in simply referencing prior statistical results without qualitative context. But I believe we've laid out plenty of qualitatively contributory reasons why those uninspiring historical results exist. There are other factors as well, such as regulatory and political risk, which large enough companies tend to attract to themselves.

And this rise-and-fall dynamic, the displacement of what ultimately become bubble-valuation market darlings and must-owns, is part of the reason why the 20-year history of ETF investing, from year-end 1999 to year-end 2019, looks like this:

- SPDR S&P 500 ETF (SPY): 5.96%
- MSCI ACWI (All Country World Index): 4.52%

If going back to 1980 isn't long enough for you, here is a view of the stock market from 1929, but from a different angle. A view from the top, so to speak. Here is how an investor – a very long-lived investor – would have fared from one market peak to another. Let's say that upon the collapse of each peak, this investor did not do what most investors do, and which they have been statistically proven to do, which is that this investor did not sell. Not because of panic, nor because of fiscal need.

The second column shows how much the market appreciated up through the peak. The third column shows the depth of the decline. The final column is the interesting one: how many years until that investor broke even.

Date of Market Peak	Peak to Peak Run Up	Peak to Trough Decline	Peak to Break Even Time (Years)
8/30/1929	79.56%	-86.03%	25.10
7/31/1956	55.76%	-19.03%	2.17
12/29/1961	44.87%	-23.48%	1.67
1/31/1966	29.81%	-17.57%	1.24
12/29/1972	27.10%	-46.18%	7.59
11/28/1980	19.03%	-23.79%	2.09
8/31/1987	134.50%	-30.17%	1.92
8/31/2000	360.18%	-46.28%	6.75
10/31/2007	2.09%	-52.56%	5.41
12/31/2019	108.52%	???	

Source: Bloomberg, Horizon Kinetics Research. Price returns (excl. dividends), cumulative returns.

What do we see? There are a bunch of 2-year type of break-even periods. Not so bad. Then there are the 5-,

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6- and 7-year variety. That requires a bit of pause: over a half-decade to break even. We'll ignore the 27 years it took to break even after 1929. Surely, that wouldn't happen again.

What this is supposed to bring to mind is that however rewarding any bull market is, people think and talk about it as if that wonderful period stands alone. But it was preceded by some number of years of zero return, the result of getting from the prior peak to breakeven. That has to be accounted for, too.

One rejoinder might be: 'But I don't get in at the peak, I get in earlier.' Ok, let's test that proposition. Here are the returns for someone whose special method allowed them to get into each bull market exactly one year before it peaks. Unfortunately, this is a one-way faculty, so it can't tell them when to get out, but they do have this special advantage. Here are the results:

Date (Peak)	Peak to Peak Run Up	Annl'zd Change, 1 Year Prior to Peak to Next Peak
8/30/1929	42.02%	
7/31/1956	1.66%	3.13%
12/29/1961	7.08%	8.06%
1/31/1966	6.58%	9.65%
12/29/1972	3.53%	3.85%
11/28/1980	2.22%	3.65%
8/31/1987	13.44%	15.73%
8/31/2000	12.45%	13.64%
10/31/2007	0.29%	1.98%
12/31/2019	6.22%	6.68%

Source: Bloomberg, Horizon Kinetics Research. Price returns (excl. dividends), annualized returns.

Out of these 9 market cycles, from 1929 to today, even with the advantage of a final full year of each bull market, only two instances provided double-digit annual appreciation to the next peak. There are four instances in the 2% to 3% range of annualized return, a 7%, an 8% and a 9.6%. The median is 6.7%. Is that really the way you want to try to earn an adequate return on your retirement assets? It's hard to beat the flow when you're in the flow.

I don't know what more I can say in response to those questions. What I hope I answered was that:

- The bubble doesn't have to end for the portfolios to do just fine. Because 'the market', the one that is this bubble, comprises only a tiny proportion of all the publicly traded companies and excludes an important variety of business sectors.
- And indexation won't end. That's not what this discussion is about. If enough participants and constituents find that it's not working for them, though, then it will improve or evolve.
- But the bubble valuation element will end, by one mechanism or another. It could be via the entirely normal competitive displacement that occurs, which is internal. It could be via an exogenous risk, like the impact of higher interest rates on a corporate America that has record debt leverage. Could be anything. It could be that the fire runs out of oxygen, which in this case is cash inflows, which have to come from somewhere, just like oxygen. *But nothing never happens*, if you catch my meaning.
- *And, finally, it's important to remember that asset allocation index-based assertions about future expected returns are now provably false, invalidated on their face.* Observe:

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- This chart happens to come from Vanguard, but it's generic; it can be found anywhere. Any reputable index-oriented asset manager will indicate that the expected annual return from bonds will be about 5.3%. That information is used to help investors achieve their financial targets. They characterize this type of investment as the most conservative.

Income

An income-oriented investor seeks current income with minimal risk to principal, is comfortable with only modest long-term growth of principal, and has a short- to mid-range investment time horizon.

100% bonds

Historical Risk/Return (1926–2018)	
Average annual return	5.3%
Best year (1982)	32.6%
Worst year (1969)	–8.1%
Years with a loss	14 of 93

- But the broadest bond market ETF, AGG, has a yield to maturity below 2.2%. That's less than half of the allocation model's presumed future return.
- That logic, which does not recognize price or valuation at the time of purchase as relevant, carries through to the various balanced portfolio proposals. Here's another conservative one; it's 60% bonds and 40% stocks, and the asset allocation model proposes that, for planning purposes, the expected return is 7.7%. I think we might all agree that's an entirely reasonable goal.

Balanced

A balanced-oriented investor seeks to reduce potential volatility by including income-generating investments in his or her portfolio and accepting moderate growth of principal, is willing to tolerate short-term price fluctuations, and has a mid- to long-range investment time horizon.

40% stocks / 60% bonds

Historical Risk/Return (1926–2018)	
Average annual return	7.7%
Best year (1933)	27.9%
Worst year (1931)	–18.4%
Years with a loss	17 of 93

- It's just that if a 60% portion of the portfolio can only return 2.17% (that's the yield to maturity TLT, the 20+ Year Treasury ETF), then its impact on the entire portfolio can only be 1.3%. The balance of the 7.7% expected rate of return, which would be 6.4% per year, would have to be produced by the remaining 40% of the portfolio. Those are the stocks. In order for 40% of the portfolio to produce a 6.4% portfolio-level impact, the stocks would have to return 16.0%. Every year. For the duration, for however many decades, of your planning period.

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The Hypothetical Growth of $10,000 chart reflects a hypothetical $10,000 investment and assumes reinvestment of dividends and capital gains. Fund expenses, including management fees and other expenses were deducted.

Now, before anyone says, 'Hey, that's not possible' – which it's not – let's give the possibility some consideration. The iShares website presents an interactive graph of the return of the S&P 500 ETF (IVV). As you see, I picked the best possible starting point, the bottom of the market in March 2009, following one of the worst financial crises in American history. I picked the best possible ending point, today (January 27, 2020) basically, in the longest bull market in American history. And look, the annualized return was 17.9% over those 10.9 years. So, it's possible. Keep that up for another decade or two or three, and it's possible to earn that asset allocation modelled 7.7% in a conservative bond/stock portfolio. Don't let me be the naysayer.

On to Final Matters

There is a Core Value stock that we've purchased, one that wasn't in many of the accounts at year-end. While we're not prepared to identify the security, I can share some of its characteristics and describe its valuation. First, it's the leading company in its industry. Come to think of it, we own a number of companies that are the largest in their industries yet which are not in the indexes, a few of them being: Clarkson PLC, the shipping broker; Wheaton Precious Metals; and Cheniere Energy in natural gas liquefaction and export. You wouldn't think that industry leading companies would be excluded from broad-market indexes. This is just another facet of how narrow and unreflective of the economy the indexes have become.

Back to this particular company, it made a couple of strategic acquisitions in the last two years: one was of a competitor, which increased its market share; the other, with a vertical integration objective, improved the company's service offerings. Its customers are all large national- and international-class corporations. While the company has more debt than is typical for one of our holdings, interest coverage is about 3.5x, and net of capital expenditures it's about 2.3x. The shares trade at about 6x trailing free cash flow. To put

that in financial return terms, the inverse of 6x is 16.7%, which is the cash earnings yield received on the price paid to buy shares of this company. Also, these are cyclically depressed earnings.

Because the business doesn't require additional capital expenditures for near term organic growth, the valuation can readily be even lower. For instance, if the company's revenues were to rise by 10% this year, just due to some increased activity among its existing clients, some of which is already known or anticipated, then the free cash flow would rise by about 25%. In that case, the Price/Free Cash Flow multiple, based on today's share price, would only be 4.6x. One would hope, of course, that the valuation would merely stay at its already depressed level, in which case the shares would be 25% higher.

As well, much of this year's capital expenditures were related to two growth projects that will not require such spending in coming periods. If capital expenditures subsided by one-third, the free cash flow would be 60% higher.

Plus, at that first level of free cash flow above – with a 10% increase in revenues – the company could repurchase well over 10% of its debt just in 2020, and it's the management's stated intention to direct its free cash flow to debt reduction.

Debt reduction is a powerful source of return separate from the standard of acquiring additional customers or market share. If the year 2020 results, as suggested above (even with no reduction in capital expenditures), were to be the limit of the company's external growth – that is, no increases in sales thereafter – and if all it were to do is repay its debt each year with its free cash flow, then it would be debt-free in about 8 years. This would have two effects. The first and more minor effect, but not unimportant, would be that net income will rise by 6% per year due to the elimination of interest expense. That's about what the earnings growth on the S&P 500 has been over the decades. The more significant effect would be on the equity market value.

Debt reduction in a leveraged company is a phenomenon that has enriched many real estate and leveraged buyout devotees. The idea is that the enterprise value of a public entity, which is the sum of both its stock market value and its debt, is settled upon by the market. Let's say that the market determines that a certain company's enterprise value, in light of its level of operating income and degree of leverage, should be about $1 billion. Of that $1 billion, let's say that debt is $650 million and the market cap is $350 million.

What happens if the company uses its earnings one year to pay down $65 million of the debt, which is about 10% of it? Well, if there are no other changes, then the enterprise value is $65 million, or 6.5% lower. Which means that the company just got cheaper, as if it were being penalized for reducing its leverage and financial risk, and even though its earnings improved via reduced interest expense. What should happen is that the equity market value rises by a comparable $65 million, in which case the enterprise value remains constant. There's an academic term for this phenomenon, which describes what should happen in principle, and of course it also happens in practice.

Importantly, though, in this case the $65 million increase in equity market value occurs on a stock market cap of only $350 million, whereas the debt was $650 million. That would be a counterbalancing 19% increase in the stock market value of such a company for a 10% reduction in the debt. That can be a very

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powerful engine of share price return over a period of years, irrespective of any increase in revenues or other sources of earnings growth and irrespective of a higher valuation perhaps accruing to the stock.

As to the latter point, this company, as for many others we hold, serves an industry in which pricing and activity levels are dramatically below what they were several years ago. The levels of revenue and profitability it manifests today reflect that. In the event of a cyclical recovery, those levels can be higher by some whole-number multiple.

In any case, this is not a new holding, it's just that many clients instructed us to sell the shares near the end of the year for the tax loss credit, so I can share the name of the company with you. It is **Civeo**. In dollar/market value terms, Civeo is smaller than the model company used in the preceding exercise, but the proportions and percentages are pretty much the same, so you can think of it as comparable to Civeo. It is also the unnamed company in the question from the beginning of this hour: "A lot of clients want to know why _______ is down. They've heard our thesis before and nothing has changed."

It is true, nothing much has changed so far. For better or worse, that could probably be said about most of the stocks we own at some point during the time we've held them. Even the very successful ones. There have been periods measuring in years during the time we've held **Texas Pacific Land Trust** ("TPL") when nothing had changed. Lately, of course, there have been ongoing changes at TPL. It is probably common knowledge, now, but can't not be mentioned, that last week the Conversion Exploration Committee announced that it had arrived at its much awaited conclusion. The Committee unanimously recommended to the Trustees of TPL that the Trust convert to a Delaware C-corp. That recommendation was made with the input of Credit Suisse as outside financial advisor as well as outside legal counsel. It should not escape notice that the Trustees are, in fact, on the Committee, so I suppose they took part in formally notifying themselves.

The Committee also recommended that if such a conversion takes place, it should be structured so as to be a tax-free transaction to shareholders. Such changes require the customary regulatory filings and approvals, such as with and by the SEC and NYSE. No doubt, we'll be hearing more in the coming weeks, since the Committee chose to extend its term for one more month, through the end of February. It could as easily have made it two months or three.

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