
Weekly Market Flash

Of Sports and Stocks

May 22, 2020

In the long run, it's cash flow that matters. If you've been reading our commentaries for awhile you will have heard us say this many times over. This, the primacy of sustainable cash flow generation throughout the economic cycle's up and down phases, is the core principle of our investment philosophy.

Goodbye ESPN, Hello CNBC

What's true for the long run, though, has very little to do with the colorful carnival of emotions that is day-to-day speculative stock trading. An article in the Financial Times this week noted that E-Trade, Charles Schwab and Interactive Brokers – three of the largest US online brokerages – saw a record number of new accounts open up in the months of March and April, which represented at its peak almost three times the monthly average of the past two years. We're talking about 780,000 new accounts just for these three online platforms.

Where did all these new accounts come from? The article's headline says it all: "Frustrated sports punters turn to US stock market" (FT online edition of May 20, 2020). Stuck at home with no Final Four, no Major League Baseball or NHL playoffs to wager on, the hundreds of thousands of denizens of the sports betting complex have resettled in the S&P 500 and Nasdaq. It wasn't too hard, because the infrastructure was already in place. Here's a quick sketch of what we might call the equities-industrial complex.

The Punters

These folks opening up their new E-Trade accounts get their kicks from the thrill of the moment. Ten dollars says Kentucky's going to make that free throw! I've got fifty on Team USA making that corner kick! It's not hard to translate that adrenaline rush into the market headlines on any given day. Fauci's going to talk up that clinical trial for the vaccine! Powell's going to pledge more Fed firepower at the press conference! Most of the headlines don't hold up to deeper scrutiny, but that's not the point. These punters aren't in it for the long run, they're just hoping for a couple hundred bucks or so in a quick kill.

The Pros

Sports betting complexes make most of their money off the punters, but there is also a legion of professionals – analysts, former players, statistical nerds – who approach their task with diligence and data-driven strategic thinking. These people are well-versed in the arcana of RBI/base-stealing ratios, average yards per carry in the 4th quarter, field goals made from 45 yards-plus and the like.

In the securities world these pros are what we know as "hedge funds." At the end of the day their dense lines of code running real-time algorithms are doing the same thing as the punters – betting on outcomes – but they are doing it methodically and with enormous sums of money that – on certain days when the algos all move in the same direction – can dominate the market's direction. Although on average the track record of these pros is not much different from the hit-or-miss luck of the punters, they do have a very persuasive marketing machine capable of convincing many institutional investors to shell out large sums in fees for their purported expertise.

The House

Don't bet against the house, as anyone who has made a career in Vegas will tell you. That same advice has been handed down through generations of stock market mavens and is probably more germane than ever in our present world: Don't fight the Fed. The ultimate draw in the equity markets of the 21st century is the "Fed put" invented by Alan Greenspan and carefully tended to by each of his successors as Fed chair. Whether the Fed's formal mandate of economic price stability and maximal employment is best achieved by direct intervention in securities markets is debatable. What is no longer up for debate is that this is how the system works, and will continue to work for as long as the Fed has more powder in its arsenal.

The Supporting Cast

Sports is a huge business, and much of its institutional infrastructure is set up around encouraging the punters to part with their money. This tendency has intensified with the rise of online interactive platforms, supported by the creation of continuous content aiming to bring actionable drama to as many events as possible, from fantasy drafts to the fate of that potential game-winning field goal.

Financial news outlets like CNBC have long been set up in a similar fashion: it's not accidental that they run segments like the "Halftime Report" in the middle of the trading day to essentially make themselves indistinguishable from ESPN programming fare. But other institutions outside the financial bubble have caught on and seem to be vying to get into the game. For example, a regular feature of the news cycle since the onset of the coronavirus pandemic has been news releases – sometimes official, sometimes leaked – about the progress of a vaccine or therapy drug. Because so much of our economic health depends on finding curative remedies and making them publicly available, these headlines can carry a great deal of market-moving power.

Drug development is a time-consuming and methodical process fraught with uncertainty and subject to intensely restrictive, preventative quality measures. But many in the medical community, perhaps meaning well, have taken to playing into the market-moving game by issuing promising-sounding headline teases, often coinciding with that window of 3-4 p.m. when share trading is at its most frenetic. In reality we are still a very long way from possessing a proven vaccine for Covid-19 with a viable manufacturing and distribution platform for reaching billions of individuals around the world. But the temptation to gin up animal spirits with snippets of happy talk seems too tempting for many to resist.

As we said in the beginning of this commentary, what matters in the long run is cash flow. It takes discipline to remember that in the face of all the bright and shiny short-term distractions that have become increasingly institutionalized in the infrastructure of the modern securities market. But we believe it is no less true than ever, and we will leave the headline-chasing market punts to others.

We wish you a safe and happy holiday weekend.

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