April 2020

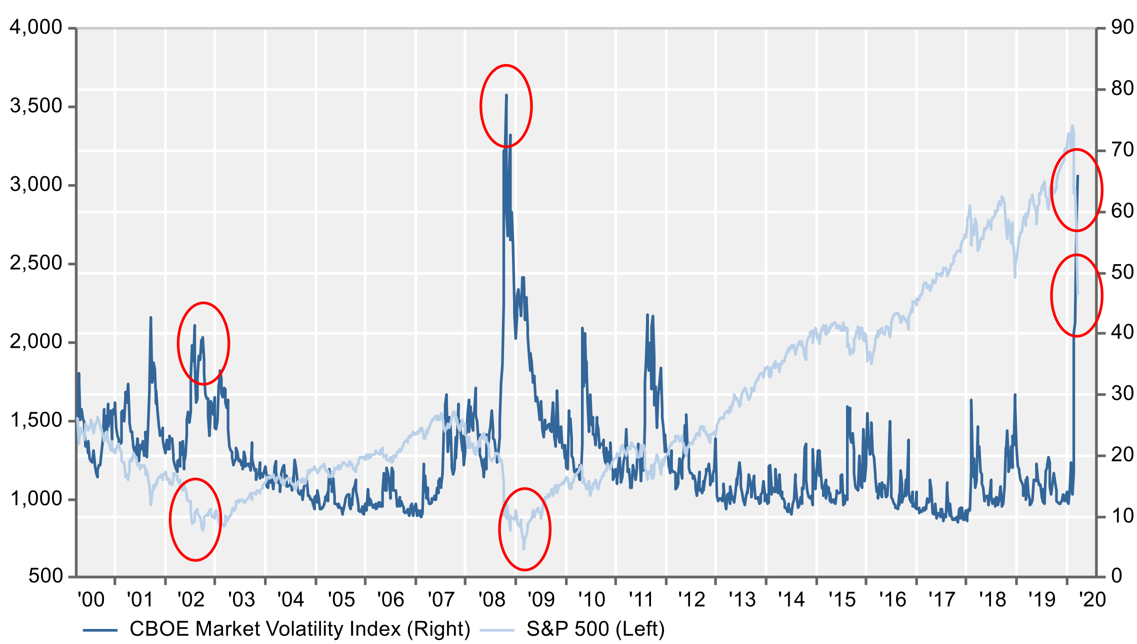
Look Forward, Not Backward

Summary: Was last week's mid-week 20% rebound real? Unemployment is exploding. 100 Million Americans are entombed in their homes. Businesses are shuttered. A pandemic threatens widespread death and suffering if some forecasts are to be believed. The stock market staged a dramatic three-day jump. We are saddened by the job losses, business foreclosures, stress, and tragedy but remain optimistic from a clinical investment standpoint.

Telescoping to Two Inches

The market discounts the future. And by "the future" we don't mean what is happening tomorrow or next week. Generally, the market is looking at the *visible investment horizon*, which we would define as the next nine to eighteen months. However, occasionally, when something unexpected occurs, investors can lose confidence in their outlooks, causing the market's focus to telescope to what is immediately in front of us. This is how we interpret what just happened. Stock prices were riding high fresh off the resolution of uncertainty of trade disputes (remember those?) and investors were totally unprepared for coronavirus to essentially shut down large swaths of the U.S. and global economies. Factor in fear related to coronavirus' threat to personal health and the amplification of trading moves due to computer-driven trading strategies and, voilà, you get a 30% rout of stock prices. We were not smart enough to anticipate that coronavirus would cause everything to tank. (We're still struggling with our perception that the worst-case scenarios we read are based on very bad math*, but don't worry we are

Figure 1. 20-Year History of volatility index (VIX) vs. the S&P500. Be greedy when others are fearful.

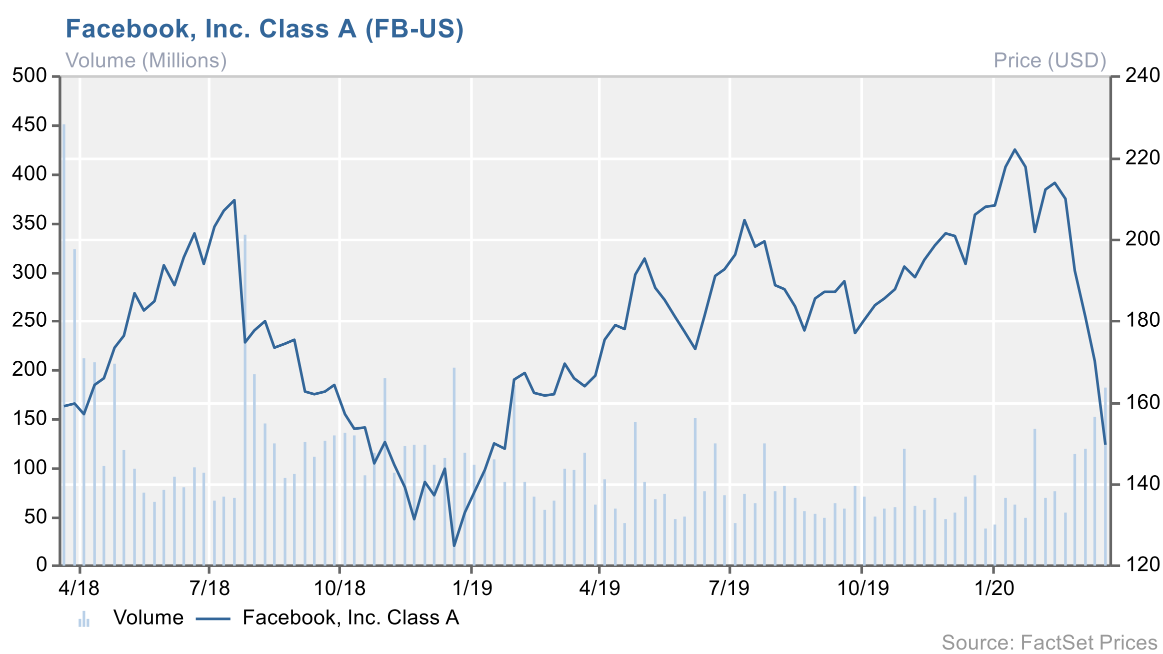


*contact us for something we wrote on this topic but decided against publishing social distancing nonetheless.) We also weren't smart enough to trade on the possibility that last week's $2 Trillion rescue package would be the trigger that possibly shifted the market's focus back to the future from the present. However, we are not surprised that investors may have started to look-past the current situation, as bad as it is on multiple fronts, and instead are beginning to anticipate recovery. Check out the chart in figure 1. It plots volatility (the VIX) which is a proxy for fear and uncertainty, against the S&P500. While the peaks don't line up perfectly, generally it can be said that spikes volatility have correlated with attractive times to buy equities.

Selection from our Model Portfolio: Facebook (FB)

Forget near-term advertising revenue, the Corona-crisis is a huge positive for the largest social network in the world, in our opinion. We'd even go far as to say that *Covid-19 is the event that will finally get Facebook past the Cambridge Analytica privacy scandals*. It says something that the media is so bought into its negative narrative on Facebook that news reports last week chose to focus on Facebook's disclosure that near-term advertising revenue would be lower, rather than on the massive increase in engagement that FB is experiencing across its platforms. A few of the details: messaging volumes are up 50% month-over-month in some countries. Overall use in Italy is up 70% with group calling up more than 1,000%. Volumes are spiking to record levels. These stats essentially prove, in our opinion, that Facebook is *the* medium that people use to connect. The crisis has cemented Facebook's role in this regard, reinforced its stated reason to exist and more importantly, actually made it very helpful to communities. If there is anything that can get people to forget their concerns over privacy (if they cared in the first place, which is doubtful), this is it.

Figure 2. Two-year chart for FB. This is the second-best time to buy it in the last two years even though the Corona-crisis has made the network more valuable, not less valuable, in our opinion.



Recall what we said above about the market discounting the future. FB's value is not determined by ad revenue *this quarter* but instead on its long-term ability to monetize usage and engagement. Accordingly, we see the surge in traffic across the Facebook, Instagram and WhatsApp platforms as much more significant to FB's worth than the near-term negative impact of a weaker economy and lower advertising revenues. FB shares have fallen more than 25% from a 52-week high. (See figure 2.) At current levels, the stock is trading at a P/E of 25x and EV/EBITDA of 9x. The company had $55B in cash on its balance sheet and no long-term debt at year end. We won't say the shares are "cheap" but considering the company's unique position as the glue that connects us all, and its opportunity to monetize this over time, we see this as an attractive level to own or buy the shares.

We fled Paris for our bunker in the French countryside. I was on a flight returning to Europe (where I live) from a business trip to New York on the night two weeks ago that Trump announced travel restrictions were going into effect. Some unfortunate Americans on the plane with me had to turn around immediately and get on standby for return flights back to the U.S. So much for *la grande tour*. Subsequently, we later learned that Macron was planning a quarantine in France. This prompted us to leave the next morning, taking an eight hour drive with the four of us in the family, one friend (teenage girls behave better in packs) and a cat stuffed into our Mini. We're much more comfortable in a tiny village in a house with a garden than we would have been in our Paris apartment. Also, great mountain biking abounds. Anyway, we're stuck here until this thing is over.

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Yours,

John Zolidis
President & Founder
Quo Vadis Capital, Inc.
John.zolidis@quovadiscapital.com
www.quovadiscapital.com

Mr. Zolidis started his career in finance in 1996 following degree studies in Philosophy at Kenyon College and the University of Oxford. He has followed U.S. consumer companies as a senior analyst since 1999, mostly on the sell-side, writing research for institutional investor clients. He also managed money in a buy-side role at a long-short equity fund over 2013-2014. He was named in the Wall Street Journal's Best on the Street list in 2005. Mr. Zolidis founded Quo Vadis Capital, Inc., a Registered Investment Advisor (RIA) and research consultancy, in 2017 and works from New York and Paris, France.

View from the ruins of an outbuilding of an XI-XV century fortress complex near our bunker in France. These guys were experts in social distancing. Check out this link for more info on site of the Chateau d'Allegre. It's in French but there is some cool drone footage. Translation is not necessary.

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The analyst who is the author of this report has a long position in shares of Facebook (FB). Quo Vadis prohibits analysts from trading in a way that is inconsistent with opinions expressed in reports [subject to exceptions for unanticipated significant changes in the personal financial circumstances of the analyst].

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