QUO VADIS CAPITAL
Private Wealth Management

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The Market Does Not Care About the Election

Covid numbers & stimulus dynamic matter much more, in our opinion. Over the next few weeks, we expect to be inundated with articles on discussing each candidate's respective platform and the potential ramification for stock prices. However, the reality is that not much will change, regardless of who wins, at least in the foreseeable future. Both candidates will continue the Fed's stimulative policies with trillion dollar packages likely, and neither will make coronavirus go away. Get ready for a few weeks of handwringing and anxiety which will eventually cumulate in the unsatisfying sensation of being exhausted from running in place.

Let Go of the Idea that Stock Prices Normally Reflect Fundamentals

Momentum and sentiment can be much more powerful over the near-term. In previous newsletters we have tried to explain the divergence some have noted between the stock market and the "real" economy. Our big picture view continues to be that stock prices exhibit at best a "weak tether" to corporate fundamentals. Prices are not set by a secretive group carefully forecasting future results, calibrated using the latest data and tweaked for complex risk factors. Instead equity prices are the result of a messy confluence of competing influences many of which have little to do with underlying business' future earnings and cash flow. Turning back to the election, can this event really change the long-term outlook for companies for is it just one of many factors contributing to near-term fluctuations in prices? If stock prices are detached from fundamentals does it even matter? Our view is that there are important differences in the economic policies of each candidate but changes are too far into the future and details are too uncertain for traders to focus on these items at the moment.

Covid-Driven Secular Change

Sticky or Slippery? In our conversations with other professional investors and money managers, a topic everyone is focused on is evaluating which Covid-related changes are sticking around and which ones are temporary. Almost no one thinks things are going back exactly to the way they were pre-coronavirus. However, a decent percentage believe that consumers will stay scared and will not soon feel comfortable eating in restaurants, watching movies (inside) theaters, traveling on cruise ships or in airplanes, etc. This group believes Covid19 has permanently changed consumer behavior and by extension invalidated certain business models. We are not in this camp. Instead, we believe that when the media environment shifts away from daily triggering of corona-fear and social strife that most pre-Covid behaviors will return. It may take time, and it will certainly take a widespread effective vaccine, but we are willing to wait.

How we deal with Uncertainty

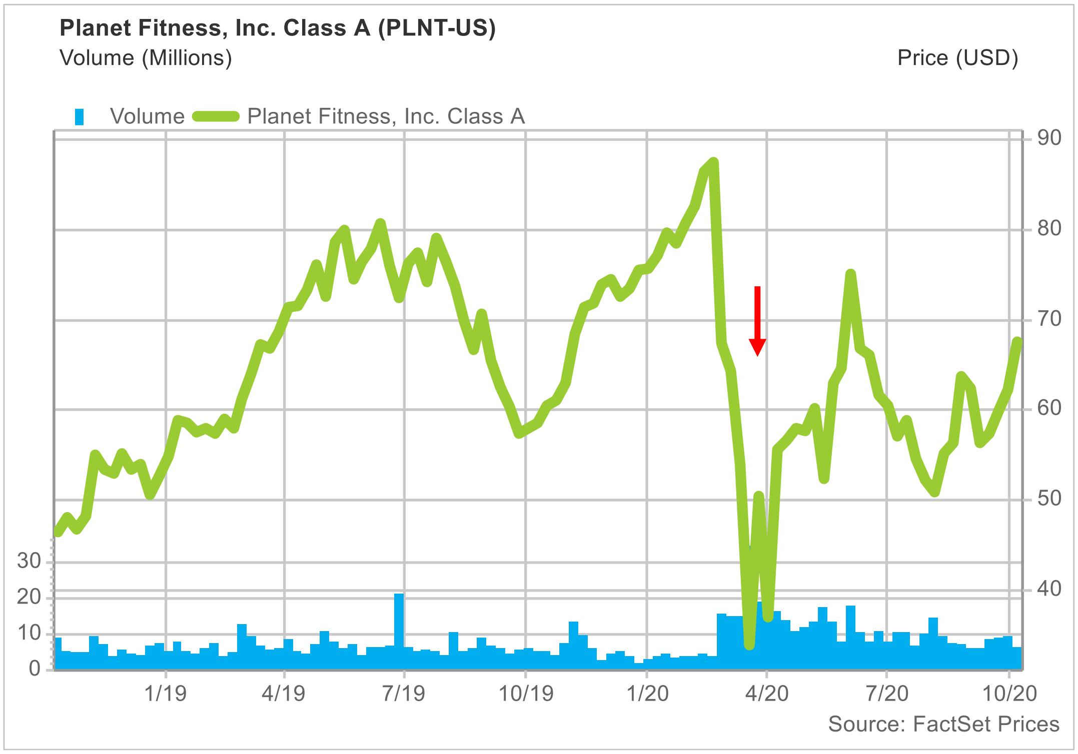
Concentration, not diversification. A central challenge to investing (whether in stocks or other asset classes) is that the future is uncertain and unknowable. The conventional response to this problem has been to advise investors diversify their investments as a strategy to deal with the unquantifiable risk of the unknown. Unfortunately, a side of effect of diversification is the dilution of investment gains in the best performing assets or stocks. We have a different approach. We believe risk can be diminished (not avoided altogether) without the negative effect of dilution. Our approach has two components. First, we focus on very high-quality companies. Investing in a small number of the *best management teams* and the *strongest business models* effectively turns over the challenge of adapting to the future to proven creator of value. Second, we do the work, and know what we own and why we own it. This permits us to focus on the long-term and to resist the temptation to let short-term market price moves challenge our conviction.

Discussion of new investment, Planet Fitness (PLNT)

Gyms were not for Germaphobes, even before Covid. Within our portfolio, we are owners of some companies that were hurt by the Covid-related loss of sales as well as other businesses that either benefited or were unaffected by the virus. However, since Covid has hit, we have focused on adding investments in the former category, where stock prices are generally lower, rather than chasing the names benefiting from the virus whose stock prices have soared. We wrote about Las Vegas Sands (LVS) as a recovery name we added to our book in our May Newsletter. So far, the stock has not performed, but our view on its opportunity is unchanged. In the last month we added another recovery idea, Planet Fitness (PLNT). To make room for PLNT, we exited our position in Harley Davidson (HOG). In contrast to selling winners that might be fully-valued or overvalued on a near-term basis, we believe in selling stocks that have not worked. HOG has been a loser for us. We do continue to like the company for its very high margins, cash flows, returns on capital, its brand and market dominance (nearly half of motorcycles sold in the U.S.) but the thesis we had that HOG could introduce electric motorcycles and shift its demographic to younger consumers from baby boomers (who frankly should be hanging up their motorcycle keys for their own safety) is taking too long to play out. We still like HOG and think it could also be an acquisition target (why wouldn't Tesla (TSLA) buy them?) but we think we have a better opportunity elsewhere. So we sold.

Instead, we have added position in shares of Planet Fitness (PLNT). PLNT is primarily a franchisor of gyms with a friendly branding and unintimidating environment attracting a customer at the value end of the spectrum. PLNT's members are novices to working out and approximately 40% have never been a member at another gym. Prior to Covid, the company had an extremely strong financial model (due to its franchise fee income) and reported 41% profit (EBITDA) margins last year. The stock had been a star and was trading for nearly $90 per share prior to the Covid shock. Of course, when gyms were mandated to be closed, revenues and earnings tanked, and the stock crashed. It has since somewhat recovered, and we were buyers recently. Our view is that over the long-term, in a post vaccine world, customers will come back to the gym and the company's economic model and growth opportunity are intact. A lot of competition has been reduced by the pandemic as other gym operators have filed Chapter 11. Consumers are also showing an increased interest in health, which we believe will be sustained. In the short-term, the company recently restarted national marketing. PLNT spends 8% of membership fee income on advertising, which last year amounted to $220 million dollars. This is significant. We believe restarted advertising could drive new membership in a time when many investors are worried that fear will keep people away from the gym. In summary, while PLNT shares are not “cheap” we believe the Corona-Crisis has presented an opportunity to invest in this high-quality growth company that will see competitive and psychographic tailwinds in a post-vaccine environment.

Figure 1. Muscle strain: Shares of PLNT have been long-term winners but dropped 50% during the Corona-panic.



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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.

Hoping to get back to the U.S. in early December. Covid has upended my normal schedule with involved returning to the U.S. approximately every over month to attend trade shows, conferences, participate in company-sponsored analyst events or meet with clients. This has been off the table since March when I was luckily on the last regular flight back to Paris before Trump issued his edict prohibiting travel between the U.S. and Europe. (The other Americans on the flight had to disembark and immediate get in line to fly back to avoid potentially being stranded.) It is currently possible to fly between the U.S. and Europe but only if you have the legal right to be in both places. (I am a U.S. citizen and a French resident.) I've booked flights provisionally with the hope of coming back to visit retail stores and take care of various items. As you might imagine, the seat maps show the flights are nearly empty, so the good news is that with no other passengers, the chance of catching Covid on the plane is low. I'm looking forward to eating out back in NYC but in the meantime, here's a shot of street side dining in Paris.

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The analyst who is the author of this report has a long position in shares of Las Vegas Sands (LVS), and Planet Fitness (PLNT). 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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