THOUGHTS FROM THE FRONTLINE

Buy Businesses, Not Stocks

By John Mauldin | August 21, 2021

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I write this letter on my way home from Steamboat Springs, Colorado, where I spoke to the fascinating "GoBundance" group of mostly young, successful, enthusiastic entrepreneurs. Before that I was in Grand Lake Stream, Maine, for the Camp Kotok economics/fishing retreat. I'll have some details for you later. Today we will look back a few months to a Strategic Investment Conference presentation that truly affirms my optimistic outlook for both business and humanity.

You've probably heard of Ron Baron, founder of Baron Funds which has grown to a stable of not just mutual funds but a variety of private investments and Ron's own capital—something like $50 billion in total. Ron is a legendary investment genius and we were thrilled to have him on the SIC virtual stage, where my good friend David Bahnsen ably interviewed him.

Below I'll give you some extensive quotes from that session's transcript, interspersed with comments from me. The GoBundance event reminded me of Ron's enthusiasm for fast-growing businesses. While there may only be a few Ron Baron's, the US has hundreds of thousands if not millions of entrepreneurs trying to build such businesses. The common thread is they all take risks.

Comments in brackets […] are mine. Let's jump in…

Holding Forever

David began by asking Ron what differentiates his philosophy from other managers.

> Well, what we try to do is find businesses that we think have a chance to grow a lot. There's something about the businesses that gives them a competitive advantage, that makes it very difficult for other people to do the same thing. We try to invest in exceptional people and then we differentiate ourselves by investing in those businesses for the long term. So, everyone could look at a growth opportunity, but very few people are able to understand or care about a business culture or what its competitive advantages are, and very few, even fewer can invest for the long term. And the reason for that is that it's not so easy to find a Charles Schwab and to invest in it in 1992 and have a cost of 60 or 70 cents a share, and it's now $70… and we still think it's going to 100.
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> Or to find a Robert Half that we invested in 1990 at less than a dollar a share, and it's $60 or $70 right now. Or find an Elon Musk in Tesla and invest in it for four or five years, when the stock went up and down dramatically. We invested $380 million. Market cap then was 35 billion. So we invested $385 million, which at the time we had $21 billion of assets under management, so it was 1.5% of our assets. And people would say, "Why are you investing in that crazy man? Why are you investing in that company, it's so volatile?" And what happened is that business over the next... we invested between 2014 and 2016, we bought and since it's split five for one.
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> So our cost for eight million shares was about $43, $44 a share, and the stock would go up and down like a yo-yo. But the business grew 10 times from 2014 when we bought it, 2014–2016 over those two years and grew 10 times as of last year in business and in revenues. But the stock price almost was unchanged, then all of a sudden it went up 20 times. Now it's up 15 times. Now it's about 650, 620, 630. I think it's going… but it's down from 900, but we never... the only stock we've sold is for our clients. We've sold 20% of our shares at an average price of 650. But the reason we sold was not because we were pessimistic about the prospects for the business, it had just become too large of a position of the portfolio for the clients who were holding it in our funds. You can see how that can happen [when a stock more than doubles]. But for myself, I own a million shares, 1,150,000 actually, that I bought after all of our clients bought. I have not sold a share personally, and I don't expect to for 10 more years. So how can someone be willing to hold a stock that he thinks in the short term or she thinks in the short term could go from 900 to 600 and not worry about getting fired? And I don't worry about getting fired because I'm not going to fire myself until clients do.
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> So, we think that in the case of Tesla, we're going to make another triple in the next 10 years, not 20 times, a triple, maybe four times. SpaceX is the one I'm really excited about now that we invested in, started about two or three years ago, started with a market cap of about $35 billion. It's now $75 billion. I think that we're going to make 30 times in the next 10 years. So that's a $70 billion market cap presently, and I think has a chance to be $2 trillion. It's certainly going to be $1 trillion. So, 15 to 30 times to 40 times, I don't think I'm going to ever sell that stock in my lifetime.

This is so important. Ron doesn't look for stocks to sell higher. He looks for solid businesses that will grow. The stock price will take care of itself if they do.

You may notice he talks about owning SpaceX, which hasn't even gone public. The owners are Elon Musk and an assortment of wealthy individuals and institutions. Having access to those kinds of opportunities is a big advantage now, one (sadly) not available to small investors.

JM: Certain kinds of funds, which you might think hold only publicly traded stocks, also allocate small slices to private companies they think will grow exponentially and eventually go public. Curiously, I find myself investing alongside them sometimes. You really do want to find visionary managers…

Perpetual Inflation

David asked Ron how macro factors fit into his bottom-up style. That led to some surprising comments about taxes and inflation, a theme that is certainly very front and center in relevance today.

> I don't worry about, well, prices or inflation or who's going to become the president or the programs they're going to try to increase or pass if they become elected. That's not of concern. The big idea that I have, though, is about inflation, and I've always had it. And I've always said that the big programs that government follows have one purpose, and that's to devalue your currency, to make your money worth less every single year. So, people tell you that there's no inflation, and that's not the case at all. The value your money has falls about 3% or 4% a year, every single year [JM: Ron uses real-world buying power, not government-created indexes which mask the reality. Good on him for being candid and honest]. And it falls in half every 17 years... And half again in 17 years— half that falls in half again.
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> So my dad, in 1948, we buy our first house, and it's $5,000. And before that, we were living in a garage apartment in Bradley Beach, New Jersey, just outside of Asbury Park. And the apartment's too small to get the refrigerator in the kitchen, had to be outside in the porch. 1948, we buy a house. It was $5,000, I'm five years old, and he sells it in 1955 for $10,000. I went to visit that house, I don't know, two years ago, three years ago, $350,000. 1122 Grismer Avenue, $350,000… and that's not because he was such a brilliant investor in houses. It's just because the value of your money falls 3% or 4% a year. And in real estate, it probably increases an average of 4% or 5% a year. And 1955, that's 65 years ago. So there's a bunch of doubles in there that you get.

> But go look up what... when I worked in the patent office, at first, out of college, I didn't get into medical school. I wanted to be a doctor… at least, my parents told me I wanted to be a doctor… and I didn't get in because I was messing around with my fraternity. And then in 1966, I got a job in the United States Patent Office and my salary was $7,729. I first had a scholarship at Georgetown Medical School, PhD, and they were paying me $1,600 a year. $1,600 a year. And so, I had to work as a bartender, a waiter, to make extra spending money. But then in 1966, I got a job in the patent office as an examiner, I'm making $7,729 a year.
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> And I thought this was the greatest. I couldn't imagine being more successful than that. But that job now is a $70,000 [plus benefits and a lot more] a year job. And my apartment then was $80 or $100 a month living in a basement. And now, I don't know what it would be... a couple thousand I guess, $1,500. But everything is devalued. So I always think about in terms of the money falling in value and trying to protect ourselves against that. And that's what I was talking before about investing in an index fund and you make 7% or 8% a year, and you double your money every 10 years from what you started with…
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> In Baron Partners Fund… if you invested in an index when I started it in 1992, and invested $1,000 in the index, it'd be worth $20,000. If you invested $1,000 with us, it'd be worth $80,000. So $80,000, and that's the difference between 500 basis points [5% a year]. That's the difference in earning 16.5% a year instead of 11% a year. So, always thinking about being long-term, the only perspective I have is that we have a really neat country, unbelievably fortunate to be born here and to live here, the rule of law, they encourage capital formation. You go through wars, and you go through pandemics, and you go through financial panics and... but the country just keeps chugging along and growing. And there's always programs, and sometimes Republicans get in and they cut taxes, and they cut spending. And if that doesn't work, then the Democrats get in, and they increase taxes and they increase spending. And if that doesn't work, then they go back and forth so it swings back and forth.
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> Sometimes you get someone in the middle like a Clinton, but other than that, you swing back and forth. So I just assume that whatever they try will work for a while. And then when it doesn't work anymore, the public fires him, and then they get new people to come in and run the country. And then that works for a while and then they fire them, and they get the other guys.

This passage highlights Ron's patience. He doesn't bother himself with politics because he trusts whoever is in charge will be gone in a few years, for better or worse. Inflation won't be gone, so that's a far bigger concern to him.

Better than the Market

Ron went on to describe how the same inflation that harms families and investors actually *helps* politicians and government… which is why we keep getting more of it.

> One idea that you should be keeping in mind is that in 1945, right after World War II, the soldiers were returning home, our soldiers, and people were afraid we were going to go back into the Depression again because they wouldn't find a job. And so, they have extremely stimulative fiscal and monetary policies in 1945, but debt then was 110% of GDP. 110%.
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> And then they kept the rate of interest below the rate of inflation for the next 30 years, for the most part. And in 1960, debt had fallen from 110% to 45% of GDP. So you make the economy grow faster. The late '70s, you had a lot of inflation. In 1960, debt had fallen to 45% of GDP. And in 1975, it was 22% or 23% of GDP. There's not a penny [of that debt] that's ever been repaid. On the other hand, the way the government continuously defaults on the obligations they have for indebtedness, is they make sure that inflation is higher than the rate of interest, and that makes the value of your currency fall. That's what I was describing before, that 17-year cycle about making your money worth less. So that's a big idea that the debt will get to be a smaller percentage of the economy if the economy grows faster than the rate of interest.
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> Every single democracy for 2,000 years, 3,000 years, has done the same thing. They have always devalued your currency. The Romans did it, they took silver out. The Greeks did it, they cut the value of your money in half. The Israelis did it. Everyone does it. And they say, "We're just not doing it." So, we're saying we're taking your money and making it worth less. We're just doing it by creating inflation. And if you think that the government, when they're buying $120 billion a month of indebtedness, why is there so much money around? Because the government has put all this money out there. They want to make sure we don't have a financial crisis. They want to make sure we don't have a financial crash. So they put the money out there and they've learned. Though in 1932, they actually tried for a while to make money more sound, tie it to the value of gold, but gold was one of the factors that potentially could have caused the Depression. And what they did with gold, is that people didn't trust the banks… so taking money out of the banks and buying gold. So instead of expansionary policy, gold is a contractionary policy…
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> But the bottom line is there's going to be inflation. You're going to make money worth less. Stocks are a hedge against that. Stocks on average increase 7% or 8% a year. Real estate is 4% or 5% a year. Gold is 2% or 3% a year. So we just think about historically stocks are a great thing to buy. And the reason we've outperformed is that we buy businesses that instead of growing 7% or 8% a year ago, 15% a year. And over the long term, if you stay with it and they keep growing at that rate, you'll do way better than the market.

That's a great way to close. You can buy generic "stocks" (index funds) and, if you can patiently sit through occasional bear markets, keep up with inflation and get a little growth as the economy expands. **But the real potential is in buying *businesses* whose growth leapfrogs ahead of everything else.**

That's what I [JM] try to do. This week I saw a reader comment alleging I had never recommended reentering the market after leaving it in 2007. That's not quite right. It's true I have never said to blindly plunge into index funds, but this isn't an either/or thing. I have a lot of stock exposure but it's targeted in companies I expect to outperform. Many are private—smaller versions of Ron's SpaceX play—and I consider the illiquidity an advantage. It limits the temptation to sell too soon.

Most investors can't do what Ron Baron does because they don't have Ron Baron's patience. Try to develop it. You'll be glad you did.

By the way, David asked Ron what his biggest mistake was. He mentioned a few companies that didn't do well, but…

> …A much bigger error than that was sitting next to Bezos for an entire year in that corner all-glass conference room and hearing his crazy laugh, and not investing in Amazon. Trying instead to sell him my junky stock in Sotheby's, and ignoring the fact that here's this guy changing the world and I wasn't investing in him, how crazy is that?

If you have our SIC Virtual Pass you can view video or read the full transcript of the full Ron Baron interview. Others can still get a pass here, with access to not just Ron Baron but tons of other valuable material.

Ron is still active, engaged, and enthusiastic at 78. I hope I can be like him. I think this quote will be a good way to close:

> I hate being called a legend as opposed to an all-star. I like being an all-star, legend sounds like Babe Ruth. So, I'd rather be right now.

A Room Full of All-Stars and COVID Depression

Just a personal note I hope helps some of you going through the same thing.

For the last 7–8 months, maybe longer, I haven't been on my personal game in the way I want. I feel like I'm swimming through peanut butter. The spirit (mind) is willing and active but the flesh, or at least my follow-through, is weak. I procrastinate more than normal. I see exciting opportunities around me, but lack the energy to finish what I need to do. I've talked with doctors and friends about this. It was really getting to me.

Then I went to Camp Kotok and serendipitously agreed to speak for my old friend Chris Ryan, who now runs a conference for a group of young entrepreneurs called GoBundance. Their enthusiasm was tangible. Clearly not my crowd, as less than 10% of them had ever heard of me. Yet after my speech, they arranged a 90-minute special off-the-record session the next morning. Not a person left the meeting. Their engagement was energizing. I gave them a whole new way to think about the economy and investing. For two days, people kept coming up to me and talking and asking questions.

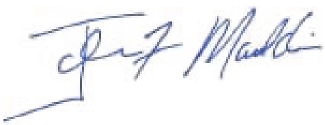
I was clear about the problems we face, but also stressed how entrepreneurs use problems as stepping stones. I told him how wonderful the future would be, even as we have to go through The Great Reset. For those who prepare, The Great Reset will be the mother of all great opportunities.

At the end of the third day, I realized it had been 20 months since my last in-person speech other than a Zoom call. Zoom is just not the same. Camp Kotok and the conference reminded me I draw energy from speaking and being with people. My doctor, Mike Roizen, says a kind of "COVID depression" (Google it) is a growing problem. Sitting in our homes without in-person interaction puts us "off our feed."

Reading and writing have always energized me, but I need interaction with crowds and people just as much. That's just a personal thing for me. You probably have your own psychological needs that keep you going. Figure out what they are and then pursue them.

And with that confession, it is time to hit the send button. Have a great week and let's go build something!

Your going to be more disciplined analyst,



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