

## Introduction:

We hope everyone had a wonderful Thanksgiving and this year reminded you a little bit more of a “normal” holiday. The morning air is crisper, our kids are back in school, and everybody seems to be ordering pumpkin spice lattes at Starbucks again.

As we finish off 2021 and look forward to 2022, there is a constant tug of war between the optimists (rising demand, strong corporate profits, low interest rates, etc) and the naysayers (COVID, valuations, inflation, government bickering, etc).

It reminds us of a quote from former Secretary of Defense (1975 to 1977 and again from 2001 to 2006) Donald Rumsfeld. We think his 2002 quote is apropos to today’s stock market. Right before the Iraqi War, Rumsfeld said, “There are known knowns — there are things we know we know. We also know there are known unknowns — that is to say, we know there are some things we do not know. But there are also unknown unknowns, the ones we don’t know we don’t know.” Isn’t that amusingly opaque?

## Selling Fear:

Today, most financial commentary involves the negatives, like inflation worries, Fed tightening and significantly higher government stimulus and spending. Naturally, many are wondering where do we go from here. Will the Fed end its latest QE (quantitative easing) and taper quicker than expected? Will interest rates spike in response or will they rise in a steady and measured way? Will inflation continue to tick higher, or will it simply be “transitory”, as the Fed says? Will small businesses lift wages and go on a hiring spree? Are supply chain hiccups temporary or will delays become the “new normal”? Will the Omicron COVID strain cause another lockdown or are we better equipped to handle this variant? We wish we had the answers to these questions, but we are not Nostradamus, expert forecasters, or even macro economists.

Don’t get us wrong, we believe Fed tapering, interest rates and inflation absolutely matter. However, as fundamental analysts, we believe that economic growth and corporate earnings are equally as important. For us, the ability to generate free cash flow remains the critical component and driver of future equity market performance.

We don’t want to imply that everything is rosy and that there is nothing to concern ourselves with. There are issues, but there seems to be a disconnect between the fundamentals and current sentiment. We see a positive environment and outlook, despite certain media naysayers. We continue to hold a constructive view and expect this expansion to continue; fueled by steady consumer spending, an improving labor market and slowing inflationary pressures. Growth continues to nicely expand, technology gains drive productivity, and our FINTECH companies continue to produce impressive results.

## Timing:

Investors and traders are quite different, especially as it relates to timing. Traders can be very short-term focused, making trades dozens or hundreds of times a day, especially now that trading is essentially “free”. However, some investors prefer to own growing companies, over a full cycle or several years, trying to take advantage of long-term secular trends.

Over 20 years ago, when the Dow was only at 10,000, James Glassman and Kevin Hassett published a book titled *Dow 36,000*. In 1999, the technology market was euphoric, experiencing what Fed Chairman Alan Greenspan later called an “irrational exuberance.” Investors were convinced the stock market could only go higher. This book couldn’t have been timed worse, as the tech bubble burst, shortly after its publication in 2000. Two decades later, Glassman and Hassett were proved correct, as the Dow eclipsed 36,000 in November of 2021. Both Glassman and Hassett were trained economists and were well-versed in analyzing the stock market. However, their book was emotionally driven and was somewhat detached from current fundamentals.

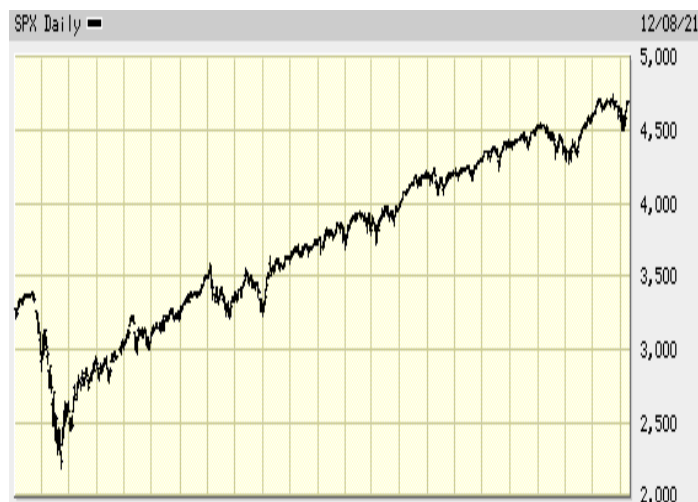
There are other notable errors from credible economic experts, making historically bad timing predictions. For example, in 1929 one of the world’s top economists was Irving Fisher (no relation). He boldly declared stocks could only go up, right as the Roaring ‘20’s were coming to an end. Two weeks after Fisher’s prediction, the Great Depression began.

History proves that the stock market experiences an average intra-year correction of (14%), leading to angst and worries. It seems the market has a real “white-knuckle” panic every few years, from September 11<sup>th</sup>, 2001, to the Financial Crisis in 2008 and then COVID in 2020. The Fed has pumped massive amounts of money into our financial system in response to these crises, that were supposed to be a “once-in-a-century” event, but now seem to occur every five to ten years. The lesson, in our opinion, is that the best course of action is to remove emotions from the investment equation and purchase long-term secular growing businesses that have wonderful [characteristics \(like we show here\)](#).

As this Carl Richards image depicts, we focus our attention on long-term, secular growth drivers, not the volatile or daily movements of a share price. This means we might be “wrong” on any given trading day, but the goal is to be “right” over the long-term.

As you read 2022 forecasts, we suggest that these bold predictions be taken with a “grain of salt”. Anything with exact price targets, specific timelines, or short-term predictions are done to be flashy but are unlikely to be anything close to accurate. Instead of bothering with these attention-grabbing headlines, we will keep our focus on the underlying business fundamentals of our FINTECH companies.

#### The Market:



The equity markets continue to grind higher, with surprisingly low volatility. The S&P 500 (our best representation of the US stock market) recently reached a new high for the 67<sup>th</sup> time this year, which is approaching the all-time record of 77 set in 1995. In fact, the S&P 500 has hit all-time highs in every month this year.

Results in the 3<sup>rd</sup> quarter of 2021 were exceptional, as over 81% of companies beat EPS expectations, by an average of over +9%. Earnings grew +43% year-over-year reaching a new, all-time high; eclipsing the previous record set last quarter. Last quarter, S&P 500 companies re-purchased \$234 billion of their own stock and are on

pace to eclipse the quarterly record of \$223 billion set in the 4<sup>th</sup> quarter of 2018. This is significantly higher than the paltry \$89 billion bought back during the 2<sup>nd</sup> quarter of 2020, as the uncertainty gripped the market. Two of our long-term holdings both announced sizeable buybacks recently, with Visa announcing its intention to re-purchase \$12 billion and Mastercard stating a goal of buying back \$8 billion. Dividends distributed also set a record in the 3<sup>rd</sup> quarter and 2021 might be the first year that dividends exceed \$500 billion.

The Atlanta Fed is predicting that 4<sup>th</sup> quarter GDP growth will be an impressive +8.5% and the US is enjoying the best nominal profit boom since the 1950s. The Fed just lifted its GDP forecast for next year to +4.0%. With these positive results and encouraging forecasts, it makes sense (at least to us) to see daily records in the markets. Despite the excellent results, nobody seems terribly pleased with the economy. All we hear about are problems, issues, worries and the latest crisis. Where is the glass half-full crowd, discussing record revenues, soaring profits, rising wages, abundant job opportunities, and surging consumer demand?

#### Now That's a Rebound!

According to the NBER or the National Bureau of Economic Research, last year's pandemic-induced decline was the shortest recession on record, spanning only from March to April of 2020. It was the deepest recession since the Great Depression and 2<sup>nd</sup> quarter 2020 output declines were 3x larger than the next largest drop in post-war American history.

NBER defines a recession as "a significant decline in economic activity that is spread across the economy and lasts more than a few months". Others define it as "a period of temporary economic decline, during which trade and industrial activity are reduced; generally identified by a fall in GDP in two successive quarters". Either way a recession is defined, the decline in the 1<sup>st</sup> quarter of 2020 was sharp and sudden. However, so too was the rebound and subsequent rally. From the depths of the late-March 2020 decline, the S&P 500 climbed +68% to the end of the last year and then officially doubled (off its low) by mid-August of 2021.

If we examine the last four downturns (before the COVID-19 decline), it took an average of six quarters for US GDP to regain its prior peak. However, it took over four years (fifteen quarters) for employment to eclipse its previous high. Our recent recoveries tend to be production, or efficiency gain driven, not labor driven. Even with six million fewer workers, the US economy is producing more output than it has in the past.

During the early part of 2020, as the pandemic was unfolding, the 10-year US Treasuries hit a low of 0.54%. Now, the S&P 500 is sitting at an all-time high and the 10-year Treasury is back to 1.40%. Others might fret about rising interest rates, but we view it positively. Why? Rising yields tell us that we are likely returning to a more normalized environment. We viewed higher rates as a positive, as it told us that the economy was looking promising and improving.

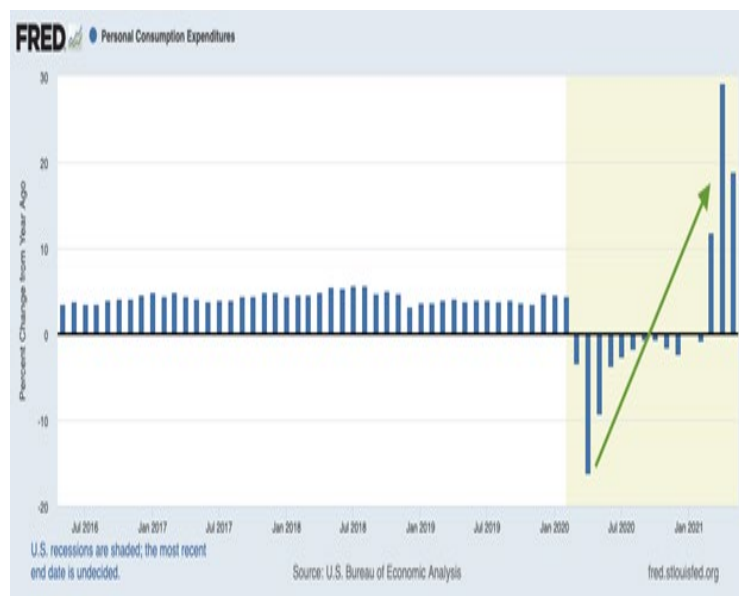
### Don't Bet Against the US Consumer:

Following Global Financial Crisis, US consumers were in bad shape. Housing prices dramatically declined, many were unemployed and overall household wealth declined. For years, US households got their "financial house" in order, paid down their debts and strengthened their balance sheets. After a decade of repair, the environment and outlook in late-2019 and early-2020 was excellent. This is why, when the pandemic hit in early 2020, the recession was so short-lived.

Today's US consumers are well-positioned to thrive. Personal savings are at an all-time high of \$2 trillion, household debt is manageable, housing prices are strong, and wages are rising. If you add in \$6 trillion of stimulus money, of which a quarter hasn't been spent, we wonder why so many are surprised by the market's strength.

Look at this US Bureau of Economic Analysis and Federal Reserve of St. Louis chart on (PCE) personal consumption expenditures. This snapback is just one reason we continue to believe that the US consumer will lead the global economy forward.

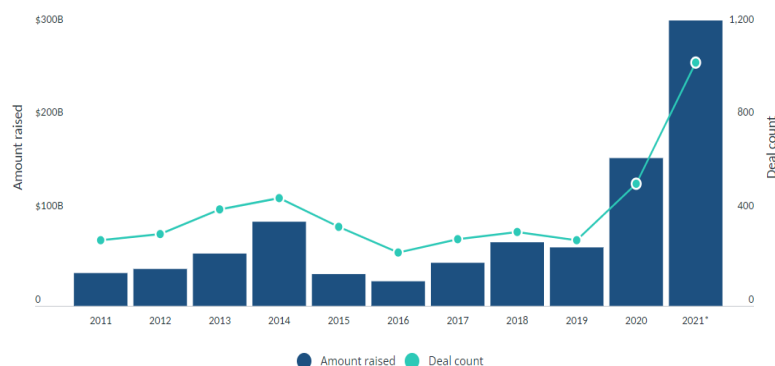
The US consumer is the primary driver of global spending and has a record \$142 trillion of net worth. Americans account for a quarter of worldwide spending (versus China at 11%) and this continues to drive corporate earnings higher. Forecasters believe that US consumer spending will climb +10% this year, even after adjusting for higher-than-normal inflationary pressures. If this occurs, US consumer spending growth will be the strongest since 1946.



### No Profits? No Problem!

Over the last 3 years, global stock markets have been quite strong. The S&P 500 was up over 31% in 2019, then 18% in 2020 and another 25% so far this year. However, this pales in comparison to some of the strength we've witnessed in the private markets, especially in our FINTECH niche.

US public listing activity



Source: PitchBook data  
\* As of Dec. 13

The number of new listings or IPOs will be a tough act to follow. More than 1,000 companies tapped US public markets in 2021, raising a grand total of \$306 billion –more than the previous three years combined, (according to PitchBook).

According to the PitchBook IPO Index, shares of new public companies performed well starting in mid-2020. During the uncertainty of the pandemic, many of these younger companies widened their advantage over the overall market.

However, the 2021 IPO class has been fairly disappointing. A recent WSJ study found that the majority of 2021 IPOs are now underwater (i.e., trading below initial list price). IPOs began to underperform the broader market in the 1<sup>st</sup> quarter of 2021, and it continued with heightened inflation worries. Indian FINTECH firm Paytm had its much-publicized IPO in November and lost more than (27%) on its first day of trading. In its last capital raise before Paytm's IPO (Series G round), Softbank and Alibaba valued the company at \$16 billion, only to see it fall on its public listing debut. In 2019 to 2020, roughly 70% of IPOs were ended the year of their debut higher.

Despite lackluster performance, the 3rd quarter market (in terms of new IPOs) was the strongest in 20 years, +18% higher than the previous 3rd quarter high back in 2007. With strong equity gains, one might wonder why these IPOs have been weak? We believe that the public market is the great equalizer, that tends to shine a light on financials and free cash flow. Crunchbase's database has found that the vast majority of newly listed IPOs are unprofitable, eclipsing the prior peak of 81% back in 2000.

When a company is private, it can be opaque and keep its financials out of the general public's view. To raise money, management teams simply need to articulate a "good story" and forecast aggressive growth rates. Once a company is public, it is required to be transparent and meet those new growth targets. Sometimes going public can be great for a company, but other times it can just be a way for early shareholders to liquify and cash out. In our opinion, Wall Street seems to be rewarding growth, not necessarily profitability. We believe this will begin to change, especially if the market experiences more volatility.



#### Valuation:

Investors are constantly searching for the best way to value the equity markets. Valuation metrics can help investors determine when stocks are cheap and potentially attractive for purchasing, or when they are expensive and potentially sold or shorted.

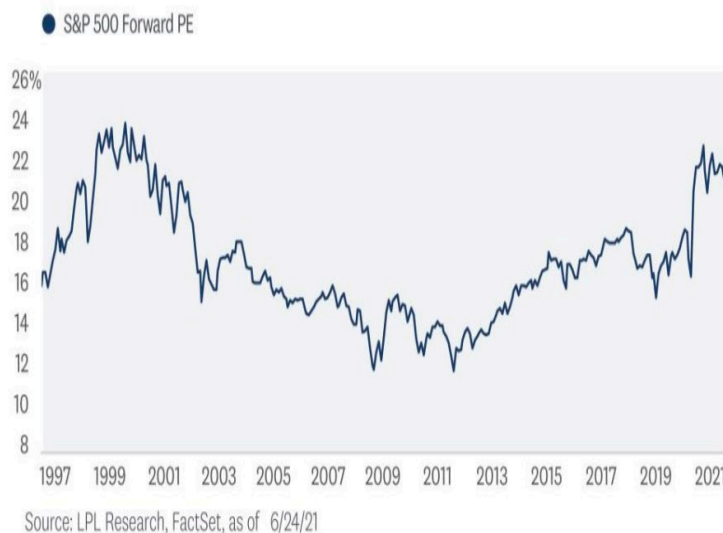
However, we believe that valuations are not an investment strategy, and they are only one component of a solid investment process and philosophy. There are dozens of important metrics to monitor. On the macro front, it is important to understand interest rates, inflation, geopolitical issues, technological innovation, government stimulus, etc. Then, on the individual business side of the equation, an analyst must understand how a company is positioned inside of its industry. Is it gaining or losing market share? Are margins expanding or declining? Is the balance sheet strong or has management taken risks with debt levels or acquisitions?

There are pockets of market that are expensive and overvalued, but we do not look at any one valuation metric “in a vacuum”. We analyze individual companies and project their free cash flow two to three years forward. We assess the probability for a company maintaining its positioning and whether it can sustain those margins. We require our management teams to be excellent stewards of “our” capital on their balance sheets and prudently budget for future growth.

As we look forward, the S&P 500 is currently trading at a forward earnings P/E multiple of roughly 21x. This is above the 5-year forward average of 18x, but it does not scream significant overvaluation. The US recovery is strong, and it is only a calendar-year old. With a GDP in the mid-to-high single digits, the US is experiencing significantly higher growth than any other advanced economies in Europe, Japan, or the UK.

We are fundamental analysts, that believe that a stock’s price today is greatly influenced by what investors are willing to pay for future free cash flows. When stocks trade at a very low valuation, we have found this is typically justified (sentiment, disappointment, etc). In our opinion, successful investing has more to do with identifying superior companies and attempting to predict how this will unfold looking forward, than market timing or sector rotating.

We estimate that the global recovery is just underway, and the expansion is durable. As we look forward, we argue that stock prices will reflect that optimistic environment. Considering interest rates remain at historically low levels, we are comfortable that the overall market is slightly above its historical average. If we are calculating what is the value of future free cash flows, we must consider low interest rates and calculate their worth in today’s dollars.



#### The Fed:

On November 22nd, President Biden re-nominated Jay Powell for another 4-year term as the Fed's Chairman. This was not a simple formality, as some Democrats were opposed to Powell (nominated by President Trump) and the fact that he is a registered Republican. Also of note, President Biden proposed Lael Brainard as the Fed's next Vice Chair, which potentially sets her up to become the next Fed leader (depending on who controls the White House in 2024). The Fed Vice Chair position provides a clearer path for Brainard to become either the Federal Reserve Chair or the Treasury Secretary. The White House went with the safe choice (Powell) that provides the market with leadership continuity and we expect both to receive Congressional approval next month.

Will the Fed continue to migrate its mission away from inflation targets and full-employment goals? Will this administration prioritize climate change, push a Community Reinvestment Act (CRA) modernization effort, crypto regulations or strengthen the bank stress tests? We are skeptical that many of these progressive changes will get past the Fed's original Congressionally mandated mission.

Fed Chairman Powell recently said that "the Fed will remain patient as long as inflation allows, but it will position itself to respond if price pressures surprise, especially in-light of current unique labor market dynamics." It seems that the Fed has multiple masters, from their traditional ones (inflation and the job market) to some new ones (the US Treasury, as well as the stock and bond market).

President Biden still has 3 vacancies on the seven-member Federal Reserve Board to fill by February of 2022. Why are there still so many openings? Well, two members (Dallas Fed President Kaplan and Boston Fed Rosengren) recently "retired" following news about equity trades they did, just as the Fed was contemplating market moving issues in 2020.

Following this scandal, the Fed has instituted rules that ban policy makers and other senior Fed officials from buying individual stocks and bonds. These new rules will help guard against even the appearance of any conflict of interest. How could the Fed not have ethical and trading rules in place to prevent this from occurring? In our opinion, this was a very disappointing error for such an independent entity to allow.

#### Inflation:

Few words strike more fear into investors' hearts than inflation. It can eat away at one's purchasing power and the value of their assets. After years of being in hibernation, consumer prices surged +6.2% in October, the highest rate of inflation in 31 years. Then, in November, the Bureau of Labor Statistics and the Department of Labor stated that CPI (consumer price index) was +6.8% year-over-year, the highest since Chairman Volker's Fed in 1982. As Lisa Beilfuss said in Barrons, this "surge in consumer prices stunned economists, rattled investors, and likely horrified policy makers."

Larry Summers was a former US Treasury Secretary and now he teaches Economic Policy at Harvard University. He recently had some worrisome comments about inflation too. He insinuated that economic policymakers were being too complacent thinking that inflation can be easily managed. He said that "the Fed used to remove

the punchbowl before the party got good. Now, the Fed's doctrine is that it will only remove the punchbowl after it sees some people staggering around drunk."

The Fed is committed to supporting our recovery and getting the economy closer to that elusive "full employment" mandate. It obviously wants to prevent our economy from overheating, but we do not believe that we are there yet. With interest rates near zero and governments spending trillions, it was inevitable to see some inflation.

In terms of inflation, increases are running at roughly twice to three times the Fed's 2% target. As you can see in this chart, US, UK, and Eurozone inflation are all experiencing significantly higher inflation levels than the 2% objective. Rising prices, low inventories and a lingering labor shortage aren't helping.

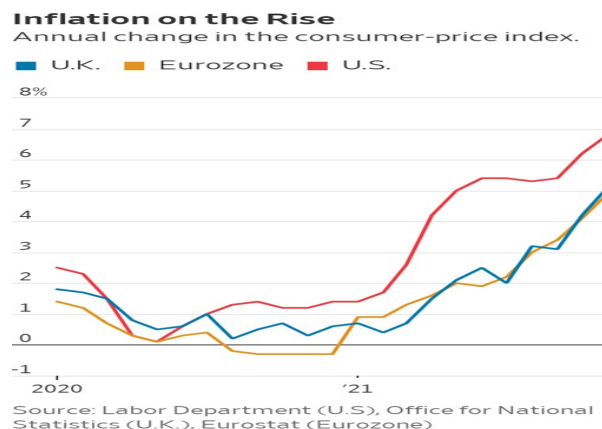
The job market has been perplexing experts, as participation is only modestly improving, despite record job openings. The labor-force participation rate remains stalled at 62% and the end of extraordinary jobless benefits, the re-opening schools, and our growing economy has done little to attract people back into the workplace. Why has the US struggled to get people working again? We don't know, but Bank of America believes there are 1.2 million that are simply out of the workforce. Are more people choosing to retire? Are family-care needs to blame? Are more people starting their own business, instead of working in a corporate environment? Is there a pent-up, general dissatisfaction with one's current job?

It seems like much of this inflation is from transportation bottlenecks and supply shortages, so we wonder how much lifting interest rates will alleviate that concern. It currently takes roughly 80 days to transport goods across the Pacific Ocean, which is twice as long as it was pre-pandemic. Also, once cargo ships make it to our major ports, they can get delayed there for weeks. Fed expectations are that inflation will not become a persistent problem if productivity gains rescue consumers and businesses from higher prices. Can companies incorporate new technologies and efficiencies to succeed during a period of rising input costs, wages, and labor shortages? Productivity growth has slowed to under 2% and does not seem to be acting as an inflation shock absorber. Containing surging prices requires tighter financial conditions, but that does not seem entirely priced into today's markets.

Strong demand comes with its own set of risks and challenges. If consumer goods and prices rise too quickly, it has the potential to choke off an economic recovery. It also impacts supply chains and how businesses operate, in terms of labor and input costs. Inflation will become a major problem if prices continue to rise, supply chains get tangled, and investors lose trust in traditional fiat currencies.

#### Another Taper Tantrum?

The last time the Fed tapered its QE purchases, the market had a bit of a "taper tantrum". Back in the summer of 2013, the Fed began to discuss the option of removing some of its bond purchases. Typically, when one thinks





of reducing Fed purchases, it has a negative connotation. The worry is that once the Fed pulls back its involvement, the market will collapse or fall.

QE tapering and Fed interest rate changes are not perfect correlations to equity returns. In fact, if the Fed tapers and end its bond purchases, we would view it as a positive, since it likely means we are closer to a more “normalized”, post-COVID environment. While there was significant volatility and short-term selling during the “taper tantrum”, the downward pressure on the markets was only temporary. While the end of QE did not occur until the fall of 2014 (over a year later), the S&P 500 gained over +20%. Then, another 12 months later, the Fed started to increase interest rates in December 2015. Despite higher interest rates, the equity market climbed +12% higher in 2016, +22% in 2017 and +31% in 2019.

Since June of 2020, the Fed enacted emergency policies and has been buying \$120 billion in monthly assets (\$80 billion in Treasury bonds and \$40 billion in mortgage-backed securities). The Fed once again telegraphed and told the markets that it plans to taper its pandemic-era bond purchases. This 2021 taper will proceed at about twice the pace of 2014, but the market seems much more comfortable with today’s rationale.

Instead of winding down its QE, the Bank of Canada simply halted its bond-purchasing program and said inflation had been “stronger and more persistent than expected.” The Bank of England, the Reserve Bank of Australia, and the Reserve Bank of New Zealand have already begun to hike short-term rates to slow down inflation. So, the natural question is whether or not the Fed has waited too long to act.

Just a few months ago, back in September, most members of the Fed’s FOMC (Federal Open Market Committee - that votes on rates) did not expect any interest rate increases in 2022. Now, the market is expecting three rate hikes next year and there is a nearly 50% chance of a rate hike coming at the March meeting. Can Chairman Powell “thread the needle” and properly handle this delicate balance between economic recovery and inflation? Accelerating inflation has quickly changed the Fed from its accommodative stance, to one that is clearly more hawkish.

When it comes to inflation, the term “transitory” has been replaced by “persistent” and “entrenched”. By doubling the taper and pace of its bond-buying program, we believe it actually signals a stronger underlying economy. The Fed has always said that its programs were designed based upon the forward outlook and what was necessary. We think that a more restrictive monetary policy is justified based on inflationary pressures and a healthy outlook. Chairman Powell continues to get attacked in the media, but we argue he has a solid job of maintaining some semblance of calm, during a very stressful and uncertain time period. For us, if the Fed no longer feels compelled to remain accommodative, it must see an improving and positive environment.

#### **Our Version of FINTECH:**

The phrase “I know it when I see it” gained popularity once US Supreme Court’s Justice Potter Stewart, in the landmark case *Jacobellis versus Ohio*, described his test for obscenity. Justice Stewart was attempting to define the undefinable, or what the law might describe as pornographic. Why are we mentioning pornography in our

newsletters? Well, pornography is something that is subjective or lacks a clear definition. This reminds us of how everybody seems to have a different definition of FINTECH.



We define FINTECH as “anything utilizing technology to improve an established process”, but once again...everybody seems to have their own specific definition of the emerging FINTECH category.

For us, we tend to shy away from opaque balance sheets (bottom right corner of slide) and tend to prefer the payments industry, which we consider the quintessential FINTECH business (black boxed, upper right corner). Many companies in this space earn predictable, sustainable, recurring revenue, as well as fantastic free cash flow. Not all, but many of our merchant acquirers, payment processors, payment networks and payment gateways have these characteristics. These are the entities that authorize, clear, and settle a card transaction, but do not take the credit risk of providing unsecured lines of credit to consumers.

Justice Stewart, in that famous Supreme Court case, later said, “I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [“hard-core pornography”], and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.”

#### FINTECH Examples:

This confusion around what is and what isn’t FINTECH reminds us of one of our earliest investments (Chicago Mercantile Exchange), as well as our latest private company investment (Source Digital). The CME started in 1898 as the Chicago Egg & Butter Board and traders exchanged contracts via an open outcry environment. Now, with CME’s Globex technology platform, roughly 90% of total trades are done electronically, not “in the pits”. This is a great example of “utilizing technology to improve an established process”, yet most investors would consider CME a traditional financial stock, like a bank or insurance company.

Source Digital (privately held, based in Pennsylvania) is another example of a company we consider to be a FINTECH position, that others might not. Simple videos (on TV or on your iPad) have not materially changed in decades. Source Digital uses its patented technology to drive audience engagement, contextual commerce and bring a “Googling Mindset” to videos. Their technology dramatically improves “an established process” (traditional, low ROI advertising) by enabling frictionless participation across any device or screen, in real-time. If you want to better understand Source Digital, [click on this link \(investor presentation\)](#).

#### Another (albeit Questionable) FINTECH Example:

For 15-years, Seattle-based Zillow (ticker Z) published online real estate listings and home price estimates, called Zestimates. Instead of focusing on a core niche (that it essentially created and developed) Zillow decided to take an aggressive and risky approach to their FINTECH business.

Zillow created an iBuying Service called Zillow Offers, using algorithms and machine-learning to help it purchase nearly 20,000 homes. Zillow's thesis was to use its proprietary pricing algorithm to buy homes, make light repairs, and then put them back on the market for a profit. With real estate prices reaching levels last seen in 2007 and 2008, management clearly thought it was "ahead of the curve". It boldly stated at an analyst meeting last summer that it was planning on purchasing 5,000 per month by 2024. To enable this aggressive plan, Zillow borrowed more than \$1 billion through two bond offerings and set-up \$500 million credit facilities with Credit Suisse, Goldman Sachs, and Citigroup. How did this audacious move turn out?

Well, Zillow recently pulled the plug on their home-flipping operation; it took a 3rd quarter write-down of \$304 million with an additional loss in the 4th quarter of another \$250 million and reduced its workforce by 25%. Zillow's CEO and Co-Founder is Rich Barton and he said, "We've determined the unpredictability in forecasting home prices far exceeds what we anticipated and continuing to scale Zillow Offers would result in too much earnings and balance-sheet volatility. We went into the business as a big swing on the bet that we could accurately predict the price of a home six months into the future, and what happened was... COVID happened."

Did Covid really cause the miss for Zillow? Did it get too enamored with FINTECH buzzwords like machine learning and complex pricing algorithms? Was it simply hubris that allowed Zillow to put enormous amounts of capital at risk on unproven models? Either way, Zillow is just another example of a company that took too big a bet (i.e., risk), at exactly the wrong time.

#### Holiday Shopping:

Pictures like this Black Friday frenzy, with consumers fighting over cheap TV's, seem to be a thing of the past. Plus, can't shoppers just buy it online for the same price and avoid the hassle?

With Thanksgiving in the rear-view mirror, retailers are focused on lifting sales and turning a profit versus a challenging 2019 and 2020. With worries about supply chain constraints and shipping delays, many consumers began their holiday shopping earlier in November, as opposed to just starting on Black Friday, Small Business Saturday, or Cyber Monday.

Since 2012, Adobe Analytics has analyzed more than 1 trillion retail traffic visits for 100 million SKUs across 18 distinct categories. Adobe forecasts provide a solid guestimate of holiday spending, primarily in eCommerce. For the first time since Adobe has been tracking sales, 2021 is projecting a slight decrease versus prior years. While this could distress retailers (or even our payment names), we believe a deeper analysis of the numbers is warranted.

While US consumer spending was flat on Black Friday and down (4.3%) on Saturday, holiday shopping for the entire month of November is estimated to be up +13.6%. In November a year ago, there were 8 days that topped \$3 billion in sales. This year, 21 days have exceeded that level. ACI Worldwide is also projecting a busy holiday shopping season, with eCommerce transactions rising +23% year-over-year. It also estimates that global eCommerce transactions for the whole holiday season (October through December 2021) is expected to

increase +14% year-over-year. Mastercard released their Spending Trends report from November 22<sup>nd</sup> through November 28<sup>th</sup>, which covers all US retail sales (including eCommerce). It too projects that this year will result in spending growth of double-digits versus last year.

It seems that holiday spending has been smoothed out, over a longer period, as opposed to concentrating shopping to 1 or 2 specific days. The Philadelphia Credit Union found that 70% of respondents said that their holiday shopping was affected by the global supply chain disruptions. This certainly supports additional data that shows gift card purchases of are dramatically higher this year, as consumers are having difficulty finding what they want and getting it delivered in time for holiday gift-giving.

Were people worried about out-of-stock items? Maybe consumers took some of the supply-chain worries seriously? We are confident that consumers, especially here in the US, will spend this holiday. While we never can predict what will be the “hot” gift of 2021 (remember Beanie Babies and Talking Elmo?), we are very confident that US consumers will choose and prefer to pay for their gifts with a card, not a paper check or cash.

#### Silly Sounding Acronyms:

A big trend in payments is **BNPL** or buy now, pay later. What is the BNPL phenomenon sweeping the payment sector? Well, many claim that it is just a modern term for an installment loan. Instead of spending \$100 on a sweater at the Gap, BNPL users make four weekly and equal \$25 payments. Some merchants appreciate the additional traffic and lift in AOV (average order value) from BNPL transactions, but it comes with a higher acceptance cost.

The largest player in this emerging industry is privately held, Swedish-based Klarna, which we own in the Manole Fintech Fund. The 2<sup>nd</sup> and 3<sup>rd</sup> largest players are Affirm (ticker AFRM) and Australian-based Afterpay. The 4<sup>th</sup> largest player in the BNPL industry is PayPal, with its “Pay in 4” product, which was only launched in August of 2020. On August 1<sup>st</sup>, 2021, Square purchased Afterpay for a \$29 billion and kickstarted a BNPL payment sensation.

Accenture estimates that BNPL will account for 6% of total US eCommerce sales in 2021 and that it will more than double by 2023. During the 1<sup>st</sup> half of 2021, BNPL volumes more than quadrupled (up +450%) and growth should be high during the holiday shopping season. On Black Friday, PayPal stated that it experienced a +400% year-over-year growth in BNPL volumes with 1 million out of the 9 million BNPL customers using “Pay in 4” product for the first-time last month.

We hate to simplify things too much, but Americans continue to predominantly use plastic (debit and credit) for spending. In the US, people spent \$6.7 trillion through their credit and debit cards in 2019, up 88% versus 2009. Globally, credit card penetration is still under 20%. We are certainly aware of BNPL’s growth, but we do not believe it means that traditional payment networks (like Visa or Mastercard), are seeing their moat shrink. BNPL is today’s “hot” new product, but we anxiously await to see delinquency rates and what potential chargebacks look like, throughout a full credit cycle. That will truly determine if BNPL is revolutionary or just a “flash in the pan”.

## Conclusion:

70 years ago, Fed Chairman William McChesney Martin described the Fed as “the chaperone who has ordered the punch bowl removed just when the party was really warming up.”

Chairman Powell is confident that the Fed is ready and willing to act as a global backstop, in the event another crisis. The Fed will taper, but it will still “keep the bubbly flowin’” at this party. It has succeeded in convincing the market that inflation is temporary, tapering doesn’t mean tightening and “free” money isn’t going away anytime soon. Banks and governments are hooked on QE and there seems to be no way of weaning this addict off its preferred drug – cheap capital.

There is still much we do not know about the latest COVID strain, Omicron. Will our vaccines prove to be resilient against this? We certainly hope that we will not be forced back into strict social distancing or another wave of lockdown measures. There are always unknowns, and this Omicron variant is just the latest worry. There is always a push and pull of positive and negative factors weighing on the equity market. As we look forward, we do not see anything that derails our belief and confidence that the economic surge (on the other side of this global pandemic) will remain robust. We think our foundation is solid and that tailwinds are strong enough to overcome this latest headwind - Omicron. If our vaccines and boosters prove capable of handling Omicron, does that mean that COVID is officially over? Unfortunately, the answer to that question is no. Paraphrasing Winston Churchill...it may not be the end. It may not be the beginning of the end. But it could be the end of the beginning.

We promise not to get complacent or too comfortable with this steadily rising market. Our goal is to prepare for volatility, instead of trying to time the market. We remain focused on the market’s risks and refuse to stray from our investment discipline. We will not aggressively add leverage, nor we will assume that the current environment is permanent. Today’s “good times” will eventually come to an end, but we do not see that occurring for a while (famous last words, right?).

Vaccines and treatment therapies have proven to be excellent; consumers remain resilient, company balance sheets have never been better and central banks are willing and able to adjust policies as necessary. The economy is far from perfect, but we see strong demand, a wide-open jobs market and companies generating record earnings and profits. We believe and expect our FINTECH companies will continue to outgrow the overall market. We expect 2022 will be another good year, and we hope the same for you and your family.

We look forward to speaking with you soon!



**Warren Fisher, CFA**

CEO of Manole Capital Management



#### Cliff Clavin Fun Facts:

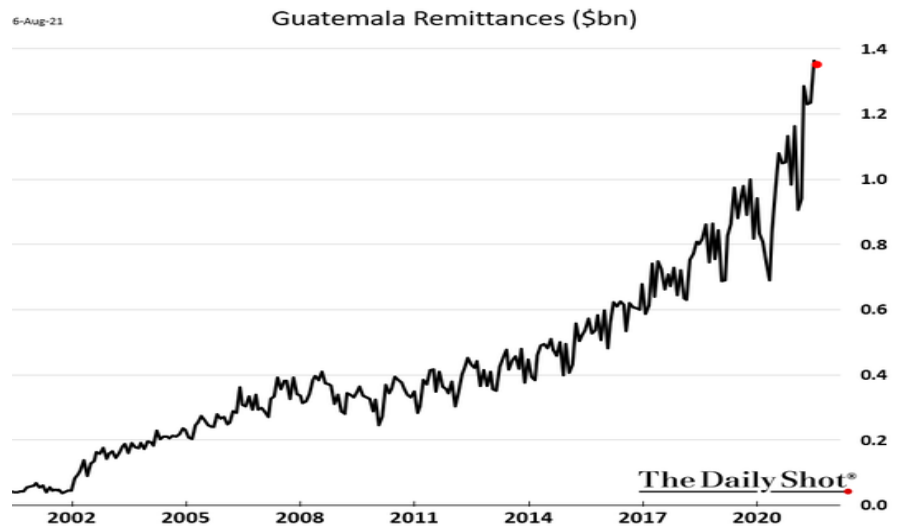
In the 1980's, one of our favorite TV shows was Cheers. The know-it-all postal worker was named Cliff Clavin, played by John Ratzenberger. This segment of our quarterly newsletter highlights some useless information that Cliff would be proud of.

The Wharton business school at the University of Pennsylvania has started an executive education program in blockchain. Keeping with the theme, it also has decided to accept tuition payments in Bitcoin and Ethereum. Penn is now the 2nd American college to accept crypto for tuition payments and it also accepts payment via PayPal and through major credit cards like Visa and Mastercard.

The S&P 500 has never experienced a negative November to December time-period when it was up +18% year-to-date through October.

Over the last several years, the media has covered the number of illegal immigrants coming into the US. President Trump tried to "build a wall" to keep illegal immigrants out of the country. President Biden has also received plenty of media attention regarding his handling of the same issue. Governments in the Northern Triangle countries (El Salvador, Guatemala, and Honduras) seem to have little incentive to curtail illegal migration into the US. Why?

Well, the remittances market is a key component to their finances. Remittances provide significant currency and dollars into these nations' struggling economies. For example, Guatemala's coffee exports generate worth \$650 million per year and banana exports are another \$940 million per year. Remittances or migrant labor "exports" now deliver \$1.35 billion per month or over \$11 billion in 2020. For perspective, this is over 7x what is generated from coffee and banana exports and nearly 15% of their entire GDP (Source EIA).



## DISCLAIMER:

Firm: Manole Capital Management LLC is a registered investment adviser. The firm is defined to include all accounts managed by Manole Capital Management LLC. In general: This disclaimer applies to this document and the verbal or written comments of any person representing it. The information presented is available for client or potential client use only. This summary, which has been furnished on a confidential basis to the recipient, does not constitute an offer of any securities or investment advisory services, which may be made only by means of a private placement memorandum or similar materials which contain a description of material terms and risks. This summary is intended exclusively for the use of the person it has been delivered to by Warren Fisher and it is not to be reproduced or redistributed to any other person without the prior consent of Warren Fisher. Past Performance: Past performance generally is not, and should not be construed as, an indication of future results. The information provided should not be relied upon as the basis for making any investment decisions or for selecting The Firm. Past portfolio characteristics are not necessarily indicative of future portfolio characteristics and can be changed. Past strategy allocations are not necessarily indicative of future allocations. Strategy allocations are based on the capital used for the strategy mentioned. This document may contain forward-looking statements and projections that are based on current beliefs and assumptions and on information currently available. Risk of Loss: An investment involves a high degree of risk, including the possibility of a total loss thereof. Any investment or strategy managed by The Firm is speculative in nature and there can be no assurance that the investment objective(s) will be achieved. Investors must be prepared to bear the risk of a total loss of their investment. Distribution: Manole Capital expressly prohibits any reproduction, in hard copy, electronic or any other form, or any re-distribution of this presentation to any third party without the prior written consent of Manole. This presentation is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use is contrary to local law or regulation. Additional information: Prospective investors are urged to carefully read the applicable memorandums in its entirety. All information is believed to be reasonable, but involve risks, uncertainties and assumptions and prospective investors may not put undue reliance on any of these statements. Information provided herein is presented as of December 2015 (unless otherwise noted) and is derived from sources Warren Fisher considers reliable, but it cannot guarantee its complete accuracy. Any information may be changed or updated without notice to the recipient. Tax, legal or accounting advice: This presentation is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. Any statements of the US federal tax consequences contained in this presentation were not intended to be used and cannot be used to avoid penalties under the US Internal Revenue Code or to promote, market or recommend to another party any tax related matters addressed herein.