EXM Capital

Quick Thought (Tuesday, August 3rd, 2020)

EXM is now $200M+ AUM and 550+ clients strong, with 50,000+ subscribers. Feel free to spread the word

Since the start of the year, 25 companies have been in our Flagship portfolio the entire time. The average stock in this group is beating the market by an impressive +30% YTD, and 20 of 25 (~80%) have outperformed. Both a strong slugging percentage and batting average overall.

But let's do a retro on our biggest loser to see what we can learn.

Schwab is the biggest laggard, trailing the market by 31% this year.

What's our thesis? We believe that Schwab has a structural low-cost advantage within asset management, with a flywheel that strengthens that advantage as its client base grows. From our app:

"*Over time, the company will see increasing economies of scale (much like Amazon). As net earnings compound at double-digit rates for the foreseeable future, SCHW's stock returns should similarly compound at very attractive rates.*"

LONG-TERM THESIS

More customers

Better value proposition

More profit per customer

Ability to lower cost

More capital for new products

The "Amazon" of asset managers, Schwab has a flywheel enabling it to increase its value prop to consumers as it grows.

What did we get wrong? To quote a macro investor phrase: "lower for longer" interest rates. **Or in simple terms, as short-term rates fell to near zero, so did Schwab's profits on the cash in your Schwab account.**

When we bought the stock in early 2018, we were of the impression that this risk was immaterial. Was this a known risk? Yes. It's the first risk mentioned in the company's filings: *"Our business can be adversely affected by ... interest rates."* But then came COVID-19, which amplified the magnitude of the risk.

Yet even having lost over 30% on the stock, we feel great about how Schwab is positioned today. We think the company is now trading at a material discount to its long-term intrinsic value.

It remains the low-cost leader and has been making shrewd strategic chess moves (e.g., TD Ameritrade acquisition) to bolster its scale and product suite. Return on equity remains solid (~17%), and the valuation is undemanding (~18x forward P/E). Hence we're sticking with the position.

Schwab is a great example of how you can be right about the business quality, but lose money in the short term due to known unknowns. No one bats 100%.

Having losers is a natural part of investing. Nothing ventured, nothing gained.

Have a great weekend,
EXM Research

What you own

For EXM clients: (+) is a positive read-through, (-) negative, (~) neutral

(+) Apple (AAPL) up +13% to all-time highs after blowout Q2 results (iPhone sales +2% YoY, Services +15%, Wearables +17%) - despite store closures during the pandemic - plus the announcement of a 4-for-1 stock split.

(+) PayPal (PYPL) up +13% as the Venmo owner had its best quarterly earnings ever, with sales growing +25% as people shifted to digital payments.

(+) Amazon (AMZN) up +10% on +40% sales growth with profits doubling to $5.6B from last year despite spending $4B on COVID-related costs. They now control ~40% of US retail e-commerce and reach 82% of US households (!).

(+) Facebook (FB) up +9% on +10% ad revenue growth in Q2 (+ healthy margins) and guidance for a similar growth rate in Q3, proving the resilience of the ad biz even amid the pandemic.

(+) Google (GOOG) up +2% as it beat Q2 earnings expectations despite its first sales decline ever, driven by tightening ad budgets amid COVID-19.