Highlights from Invaluable Insights 2021

PORTFOLIO MANAGER
Viewpoints

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Daniel J. O'Keefe, lead portfolio manager of the Artisan Partners Global Value Team, recently sat down with a panel of legendary value investors to discuss the current environment and offer perspectives on a post-pandemic world. The conversation ranged from fiscal and monetary action to shifts in consumer spending patterns and the prospects for commercial airlines. The panelists turned introspective as well, offering thoughts on what behaviors can help lead to longevity in the business and deliver alpha over time. We've shared Dan's insights here.

On the markets' recovery…

We've likely had the largest and swiftest injection of money from both monetary policy and the fiscal side. Usually in a crisis, it can take a year before the government reacts. Certainly in the financial crisis of 2007-2008, it took a long time before there was huge fiscal and monetary intervention. I would guess it happened faster this time because authorities have become accustomed to injecting money in the economy over the last 10 years. This is certainly true in the US, where we injected close to what we spent on World War II over three years, in 2020 dollars, into the economy during the pandemic, so don't underestimate that. That is absolutely unprecedented and massive—and I think more than anything else—speaks to the very quick recovery in the equity markets.

On broad fiscal and monetary support…

Now we have a Democratic Senate, and every American is going to get a $2,000 check. What are they going to do? They're going to spend it. It was a luxury for precision. The second time, you should have learned a lot. You've had six or seven months to learn to be more efficient and effective with what we have. And I think that's what is missing. Let's remember, a good chunk of the country is doing as well or better than they ever have, so why are we showering money on people who don't need it? [In discussing the lack of precision so far…] It doesn't really make any sense. Send the money in meaningful amounts to where it's really needed.

On consumption spending…

I think one of the most important ways to understand the potential for the economy to take off and the latent power of the consumer to spend is to look at the banking system. We've gone through this tremendous economic dislocation and had a period of extremely high unemployment, and we still have high unemployment, but not as high as it was in March or April. But if you look at banks, loans have not gone bad yet. I own Citigroup and it's taken enormous provisions, but it hasn't written off any loans in any meaningful ways, and American Express is the same way.

Typically, in a crisis, you see loan losses go up, which is just another way of demonstrating the pain the consumer has suffered. In a crisis, that reflects consumers' basically stepping backwards. Then, in order for the economy to go forward, those same consumers have to sort of rebuild before they can go forward again from the prior peak.

We haven't seen a step down. We've seen loans retain their quality even though banks have provided for them—which is another way of saying consumers have not really gone backward in a significant way in terms of their potential to spend. Once the coast is clear, I think you're going to see just an incredible amount of money being pushed into discretionary areas—particularly travel, vacations, those types of things—because there hasn't been with a large portion of the population the type of retrenchment you normally see.

On investing in Chinese stocks…

You look at the FTC's action against Facebook and Google, and you can read hundreds of pages of Congressional committee conclusions. You can compare it against legal precedent, and you can compare it against the law. With China going after Alibaba—into which they're currently pursuing antitrust investigations—it's a one-page press release with a few bullet points. There's no rule of law behind it, and you have no idea. They're going to do whatever they want. They can't do that in the US.

I've always been leery of Chinese stocks because it's a totalitarian dictatorship. If you invest in Alibaba or Baidu, you don't actually own the company. You own this bizarre variable interest entity structure, which doesn't give you any real rights, so anybody who owns that should be cautious.

On airline stocks…

Southwest is in a better position than most of the other airlines in the US to recover because it's a purely domestic business. It's less reliant on business travelers and has virtually no international exposure. It's all domestic and mostly leisure, and it has a very strong balance sheet. It went in with the strongest balance sheet [among the major carriers]. It went in [to the pandemic] with a net cash balance sheet, and it continues to be in a very strong position.

You're actually seeing Southwest start to play a little bit of offense, adding some new routes, so that it's in a structurally better position to grow as demand comes back. I think the business will do very well. It's recovered a lot from the bottom, and for this stock to do really well from here, there does need to be a surge of travel such that we see even higher than normal travel rates. We need to get back to 2019 very quickly and above it. I think it's possible, given the pent-up demand, that we see an extraordinary surge, which would make the valuation attractive. If we don't see that, then the valuation is decent but not great.

On missed opportunities…

We have errors of commission and we have errors of omission, and the errors of omission are virtually infinite. You learn in your money management career relatively early to not go too far down that route at all, because it can literally drive you insane.

The biggest mistake I've made over the last probably year or 10 years is just not having bought enough of these very strongly growing technology companies. We looked at Amazon earlier this year and passed on it. I think it's done very well from March on and certainly done very well from three years ago. That's probably the biggest single mistake, as a value investor, is just not having recognized [that opportunity]. Even though I've owned Google and Facebook as some of my biggest positions, it hasn't been enough given the shift in the economy and the value creation and destruction that creation has caused in other parts of the economy. That's my biggest mistake.

On essential characteristics of a great value investor…

You have to be extremely stubborn on the one hand, and you need to be extremely flexible on the other hand. You need to be able to go into a situation and say, "OK, the stock is price is going down. I don't care. I see value here where others don't." That's where the stubbornness comes in. On the other hand, you have to be extremely flexible when new information comes in and you're wrong. You need to say, "OK. I was wrong. I'm done. I'm moving on." Those two characteristics reside very uncomfortably inside all of us individuals, and that's what we have to deal with.

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