

## Investing Amid the Epidemiological Forces Reshaping Society

*This article is excerpted from a letter by MOI Global instructor Glenn Surowiec, founder of GDS Investments, based in West Chester, Pennsylvania.*

“Be civil to all; sociable to many; familiar with few; friend to one; enemy to none.”  
–Benjamin Franklin

As I write this regular update in this most irregular time, I can see on the horizon my 50th birthday. I find myself more eager than ever to discover life over that next hill. Perhaps that yearning for the future to “hurry up and arrive” is driven in no small part by the transformative forces now at work in America.

The epidemiological forces which are working on us will significantly reshape our society, sometimes in manners which were already underway and are now being accelerated. In this season of extreme volatility, and as we consider how best to position clients for that transformation, we reflect on another historically seismic pandemic, The Black Death in the Middle Ages.

Readers will recall the incalculably huge death rate from that epoch-defining pestilence. The plague culled horrifically large portions of the populations of North Africa, Western Asia, and Europe. Though the mortality rate of Coronavirus is not (and, God-willing, never can be) anywhere near the carnage which the world experienced in the Middle Ages, we can learn 21st Century lessons from the effects of The Black Death.

The plague swept through medieval society and left fields fallow and towns devoid of human life. With no defense, entire communities succumbed within days of arrival of the disease. News of the virus in a nearby village most certainly meant that, before the next Sabbath day, you would also be gone.

The disease eviscerated local labor forces and radically impacted the social order. The Black Death challenged the previous certainty that appeals to the Almighty would yield relief from personal and communal suffering. That pandemic remains part of our collective consciousness nearly a millennium later and the wholesale changes which it wrought shaped the social order for centuries.

This COVID-19 pandemic remains in its early stage. We can already see, though, some of the broad effects it will have on our own social and economic structures. Those effects include massive disruption to the American workforce and industries altogether, and the impacts of colossal governmental intervention which is intended to prevent a collapse of the American economy.

In much the same way as survivors experienced dramatically altered work conditions in the wake of The Black Death, employees returning to reopening companies in 2020 are finding a radically changed landscape. Those employees will likely operate in more remote and “flex” environments which, of course, will impact the commercial real estate, airline, and hospitality industries. Other changes will include a turn toward automation as companies re-examine cost structures and consumers look for ways to deliver and accept services without the need for human-to-human interaction.

On that point, we see here another transformative impact of the COVID-19 pandemic . . . the acceleration of disruptions of industries which were underway before March. Already, we were seeing shifts to remote work, store closures, and business consolidations. Without the pandemic, those trends would have continued for several years. Consumer responses to the quarantine, or personal choices

around the Coronavirus, though, are packing into months changes which might've otherwise taken years to run their course.

Perhaps the largest effect of the COVID-19 pandemic, though, will be the collapse of long-held certainties. We see here another similarity to The Black Death. That disease caused a breakdown in the certainty which most people placed in their religious faith. Today, the breakdown we see is in the myth of our own individual invulnerability.

Nearly eighty years have passed since Americans were challenged as seriously, and on such a large scale, as we are today. We are steeped in the national mythology and epic lore of how our founders overcame all odds to create this country and how our grandparents rose to rid the world of Nazi and imperial aggression. Perhaps because of that passage of time and the acts of those generations, many of us were raised to accept as an Article of Faith the proposition that, individually and collectively, we are able to solve any problem and overcome any difficulty. Now, the veneer of invulnerability is stripped away and, like those who survived the plague, we find ourselves questioning our own long-held certainties.

That uncertainty will continue until ongoing efforts to develop a vaccine prove successful. The Coronavirus will surely spread and many more individuals will become sick. We think a lot, therefore, about how to best secure the GDS Investments portfolio in the throes of such insecurity.

One lesson we take to heart is the need to identify equity positions which will not only survive in this environment but will, also, thrive. We seek companies with deep and wide economic moats.

Like their defensive physical counterparts around Medieval castles, economic moats are competitive advantages which allow companies to protect their market share and financial strength. As stated by none other than Warren Buffett, "we think in terms of that moat and the ability to keep its width and its impossibility of being crossed as the primary criterion of a great business." In uncertain times, holding well defended companies is especially prudent. Below, we highlight some of those positions in the GDS Investments portfolio.

## Twitter

More and more, Twitter, Inc. (NYSE: TWTR) is an indispensable thread in the world's business, political, and cultural fabric. Leaders of all stripes are active on the platform and it is becoming a learning network where people are able to quickly familiarize themselves with various subjects.

The company also occupies an enviable financial position. First Quarter Operating Results showed that Monetizable Daily Active Usage grew 24% year-over-year. Notwithstanding the fact that the company's advertising revenue fell 27% during the last several weeks of March, First Quarter Revenue rose 3%. Furthermore, though Twitter incurred \$815M expenses in Q1, \$200M of that was in R&D (up from \$146M in R&D in Q1 2019). Finally, Twitter ended the First Quarter with \$7.7B in cash and will use \$2B of that to finance a share buyback.

As strong as Twitter is, the company is taking steps to widen and deepen its economic moat while increasing accountability to shareholders. In early-March, the company, Elliot Management Corporation (which earlier called for co-Founder and CEO Jack Dorsey to be removed), and leading technology sector investor Silver Lake (which already has a track record of successful investments in Skype (NASDAQ: MSFT) and Dell Technologies, Inc. (NYSE: DELL)) announced an exciting plan. Silver Lake will invest \$1B in Twitter through the purchase of convertible bonds and each of Elliot Management and Silver Lake will appoint a new member to Twitter's Board of Directors.

The Board of Directors will now form an independent five-person Management Structure Committee

which will enhance the Board's regular evaluation of company leadership. That committee will also evaluate the company's CEO succession plan and share the results publicly. For the foreseeable future, Mr. Dorsey will remain in his position but his performance will now be evaluated on the basis of his ability to continuously improve operating results while producing shareholder value.

### **Zillow**

We began our position in Zillow Group, Inc. (NASDAQ: Z) in 2019 at approximately \$30 per share. With the company's stock now trading at more than \$60 per share, we remain excited about the ways Zillow is disrupting the real estate industry (and, in particular, the 149% increase in revenues (to \$1.13B) in the latest quarter).

Zillow continues to open new pathways for consumers to buy and sell homes. With open-houses and showings halted due to the pandemic, more people than ever are turning to virtual tours. In late-March, the company reported a four-fold increase in those tours.

With its user-friendly and frictionless home sales platform, Zillow has enormous potential for growth in an environment with few real competitors. In Zillow, sellers and buyers find solutions for any number of transaction structures including the use (or elimination) of brokers and the ability to avoid processes altogether by selling directly to the company.

In Zillow, we find a great example of the pandemic compressing three years of disruption into a mere few weeks. That, and the great aspects of the company generally, make it a key part of the GDS Investments portfolio.

### **Qualcomm**

Speaking of examples, there is no better illustration of a competitive moat than the technological lead which long-term GDS Investments position QUALCOMM, Inc. (NASDAQ: QCOM) holds in the development of 5G. On a recent earnings call, management confirmed its expectation that the company would produce approximately 200 million 5G chip sets in 2020. Even more impressive is that the company expects to produce as many as 450 million 5G chip sets in 2021. Like other technology companies, Qualcomm invests heavily in R&D to preserve its leadership position. The company goes even further to maintain its economic moat by also allocating capital to expand into emerging markets and to fund share repurchases.

### **Alphabet**

Staying with technology holdings, this year we began a position in Alphabet Inc. (NASDAQ: GOOG). Though significant R&D investments are a hallmark for technology companies, we were intrigued by the fact that, in 2019, Alphabet spent \$26B in the R&D space, second only to Amazon.com, Inc. (NASDAQ: AMZN). In the first quarter of 2020, Alphabet's total revenue grew 13% while operating profit increased by more than 21%. In that same timeframe, the company completed a 6.5M share repurchase. Later, as people searched for entertainment options during Covid-19 stay-at-home mandates, advertising revenues on YouTube increased by approximately 33%.

Alphabet dominates in the development and implementation of search algorithms and the manner in which it collects and deploys user-related information for advertising purposes. Quite simply, no other company has a stronger competitive advantage in the Internet-user space.

### **Roku**

Another new position is Roku, Inc. (NASDAQ: ROKU). With accelerating disruptions to conventional

television viewership and more than 10% of users expected to be “cord-cutters” by the end of 2020, Roku offers a plug-in device which works with any hardware. Roku truly is the Windows or Android of television . . . a tool which works with any hardware.

That level of adaptability is one reason why Roku is installed on one in three smart television sets and is used by approximately 36M viewers. Those viewers watched more than 13M hours of streamed content during Q1 and Roku collected an impressive amount of data from all of them. Roku uses that data to enhance the company’s advertising revenue to increasingly strengthen the company’s position in the post-traditional television environment.

### **Square**

In early 2020, we initiated a position in payment processing company Square, Inc. (NYSE: SQ). Following a significant run-up in value, we recently liquidated that position. Though GDS Investments does not typically hold positions for such a brief period of time, by mid-year we concluded that investor optimism about the company was already a factor in the share price and felt that the portfolio could better take advantage of other opportunities.

### **Berkshire**

One such opportunity is Berkshire Hathaway, Inc. Class B (NYSE: BRK.B). With shares trading at just 1.1x book value we started a new position in the company at a deeply discounted price of \$180 per share (down from a 52-week high of approximately \$230 per share). Berkshire Hathaway enjoys an unparalleled track record over several decades of being able to deploy cash in ways that other companies simply cannot match.

Berkshire Hathaway recently purchased midstream energy assets from Dominion Energy Inc. (D:NYSE) and now controls approximately 18% of all interstate natural gas transmission. This is a fantastic example of Warren Buffett investing in an out-of-favor industry on attractive terms without taking on much economic risk. The company also holds a stake in Apple, Inc. (NASDAQ: AAPL) which is valued at close to \$100B.

Our research confirms that, when purchased at 1.4x book value, Berkshire Hathaway produces annual returns of approximately 15%. GDS Investments began its position at 1.1x book value and expects at least as good results. With \$137B in cash-on-hand, Berkshire Hathaway is a super-safe and inexpensive position with enormous balance sheet optionality.

### **China**

Finally, we continue to hold a basket of Chinese companies which give us good exposure to the world’s second largest economy. Though tensions between America and China run high, we remain confident that companies such as BYD (OTCMKTS: BYDDF) and Alibaba Group Holding Limited (NYSE: BABA) are well-positioned for growth from which American investors can benefit. In that regard, recall our 2019 Year-End reference to Alibaba’s fintech arm, Ant Financial Services Group. That company may soon be listed on the Hong Kong and Shanghai exchanges with a target valuation of \$200B.

History teaches that profound and tumultuous events can lead us to rethink long-held certainties. Smart investors should look to companies with the structural and financial ability to withstand uncertainty. Each of the positions we discuss here, and others in the GDS Investments portfolio, are examples of such companies. We intend to benefit from their strength until, at long last, it is prudent to lower the drawbridge and venture again beyond the castle walls.