Market Commentary: Tesla – Opportunity or Bubble?

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My son's friends are all in. They have more than doubled their money. My son told me if he had the coin, he too, would be all in. We are talking about buying Tesla stock. My son is 12.[1]

The last time I remember this much chatter was when Bitcoin touched $20,000[2]. (Measuring in $s almost seems old-fashioned, but it's also too complicated to convert to gold, an even older but somehow more exciting-at-the-moment currency). The time prior was right before the dot-com bust.

Tesla is a hot name for good reason. They are changing the world and hopefully for the better. They are a super-disruptor.

In order to lead the revolution to the all-electric vehicle ("EV") they had to materially upgrade battery technology so they could increase the distance their cars can go on one charge. As a result, they are not only a leader in EV but also in green energy storage (i.e., batteries). They would like to get rid of drivers and allow them to just play games while their cars move around on their own. When speaking about future innovations in a recent Exploration, we prominently displayed a self-driving Tesla truck. Need I say more?

The global automotive industry is gigantic. Despite their current brand, General Motors was a tremendous innovator back in the day and held the mantle as the most valuable US company for large portions of time[3]. As much as Tesla lovers may cringe, Tesla is following in their footsteps by creating material innovations within the space. Along the way, Tesla has created an enviable brand by marrying a tech savvy approach to the generally stalwart car industry[4].

Along said path, in order to work around the limitations in distance traveled on a single battery charge, they had to materially advance battery technology. Energy represents another significant opportunity for Tesla. There are applications for energy storage beyond cars - think houses with solar panels (which they are in the business of as well), industrial green energy and any other energy- related arena. Historically, energy and auto/truck manufacturing have been two of the largest components of US markets.

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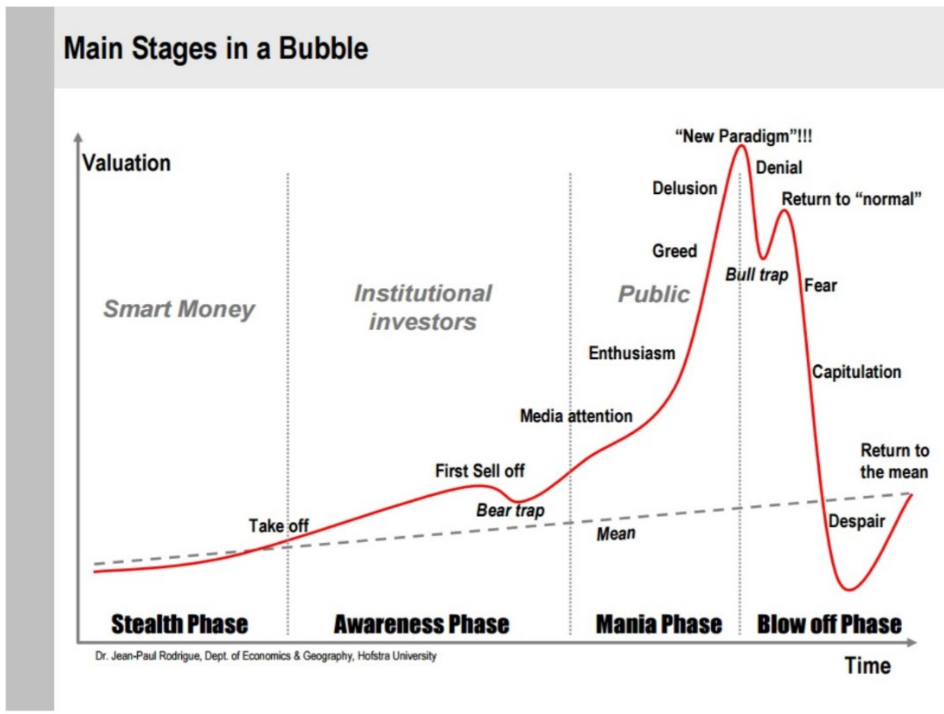
[1] After writing this my nephews (13 and 10) came over. Unprompted, they both spoke about investing in Tesla. One of them surmised the firm would be bankrupt in 50 years so he was planning to get out in 20 - prudent!
[2] Currently trading $10,587 close to three years later.
[3] https://archive.fortune.com/magazines/fortune/fortune500_archive/full/1975/
[4] Evidently electric vehicles were created at the pioneering of the car but for various reasons lost out to the Fords of the world: https://en.wikipedia.org/wiki/Electric_vehicle

If a company is so inspiring, so exciting, does it need to be tethered to a valuation? After all, Tesla is a clear innovator and is currently leading in the production of electric vehicles and batteries – two massive sectors with tremendous perceived upside.

Based on the valuations (see right chart [5]), Tesla has to more than execute perfectly. While one may argue that price to earnings (P/E) is relatively meaningless given that Tesla should probably be operating at a loss given expectations of dramatic growth and future scale, the price to sales (P/S) and price to book (P/B) relative to the market is exorbitant. It points to extremely high market expectations.



Furthermore, while Tesla leads in EV and battery technology, they have not invented either. There are many deep-pocketed competitors with their own IP, expertise and so on. Given the attention Tesla is receiving, not to mention their enviable market cap, you better believe that their competitors will duplicate certain innovations and look to leapfrog elsewhere.

It is worth stating that historically, beginning in the 1930s, the largest 10 companies, have averaged around 24% of US market cap generally at the start of each decade (meaning we are not in an atypical market with regard to size of market leaders) and have ***lagged*** the general market by an average of 1.5% annually in the subsequent decade for every decade since![6] We can all speculate on the reasons for this but the real takeaway is that there are times historically when companies seem like they can do no wrong, resulting in outsized attention and market valuation. Between the competitiveness of the world, the fact that the world does have a finite size (resulting in limits in ultimate purchases) and simple human nature, it is hard for an entity to maintain exorbitant levels of growth.

As an aside, and speaking of growth and valuations, ultimately companies *do* need to be tied to valuation. [7] Currently, value investments are being assigned a very low value relative to growth investments. There is logic in assigning a premium to growth companies and furthermore, this premium will adjust through time based on interest rates,

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[5] P/E = Price divided by Earnings; P/S = Price divided by Sales (Revenue); P/B = Price divided by Book value – these are all ratios the financial industry uses to standardize the comparison of companies.
[6] Rational Reminder podcast episode #113 - these guys do their homework.
[7] https://www.longtermtrends.net/growth-stocks-vs-value-stocks/

market reaction and so forth - though generally it comes back to some level of equilibrium. Tesla is currently a high-flier in a market that is pricing historically high premiums to growth companies.

In short, while Tesla may indeed be an amazing company worthy of the much attention it is currently receiving, beware of its lofty valuation. It is definitely acting like a bubble stock, but as is the case in markets, it is always easy to tell after-the-fact. That's why diversification is such an important aspect of portfolio construction.

Occasionally I come across an article that is worthwhile sharing. I do not use Siri or any of the voice systems out there, but one time while driving I commented to my wife that we needed gas and Waze supplied me a gas station list about one minute later. While extremely convenient, I did not know Waze was listening (I now tend to keep my car conversations incredibly boring but my gut is Waze continues to listen in).

For those already concerned about internet privacy I would recommend you skip this link to avoid salt in the wound. For all others, Our Post-Privacy World is a scary but important read. Some highlights:

- The author requested from Google all data it had collected on him. He received the equivalent of 14 million pages documenting his online self (or 214 hours of film for those non-readers).
- He quotes Michal Kosinski, a computational psychologist at Stanford University's Graduate School of Business, as believing that:
    - It takes Facebook 10 likes to know you better than a work colleague
    - 150 likes to know you better than friends and family
    - 300 to know you better than your spouse[8]

Note of pride: I am not on Facebook.

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[8] I would not be surprised if 'your spouse' was replaced with 'you' – yes, Facebook knowing you better than yourself, a concept Yuval Harari warns about generally when it comes to humans vs. technology