

DAN FERRIS

VALUEX VAIL

JUNE 22, 2017

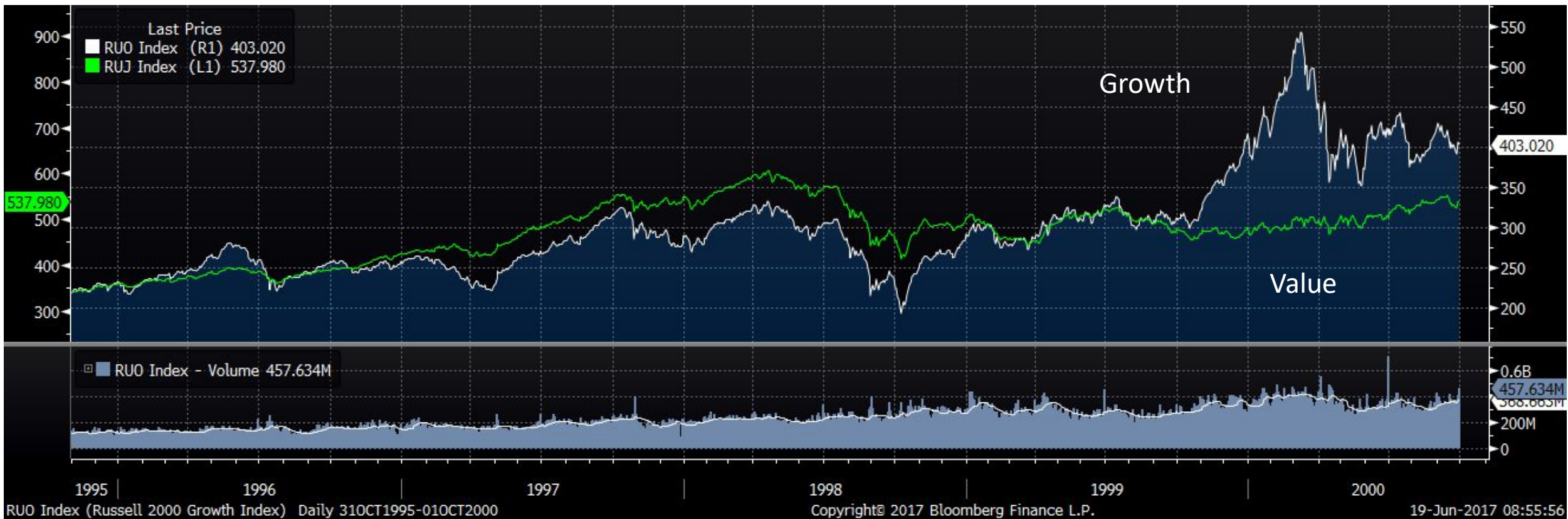
# Mania Immersion Therapy

# Value vs. Growth

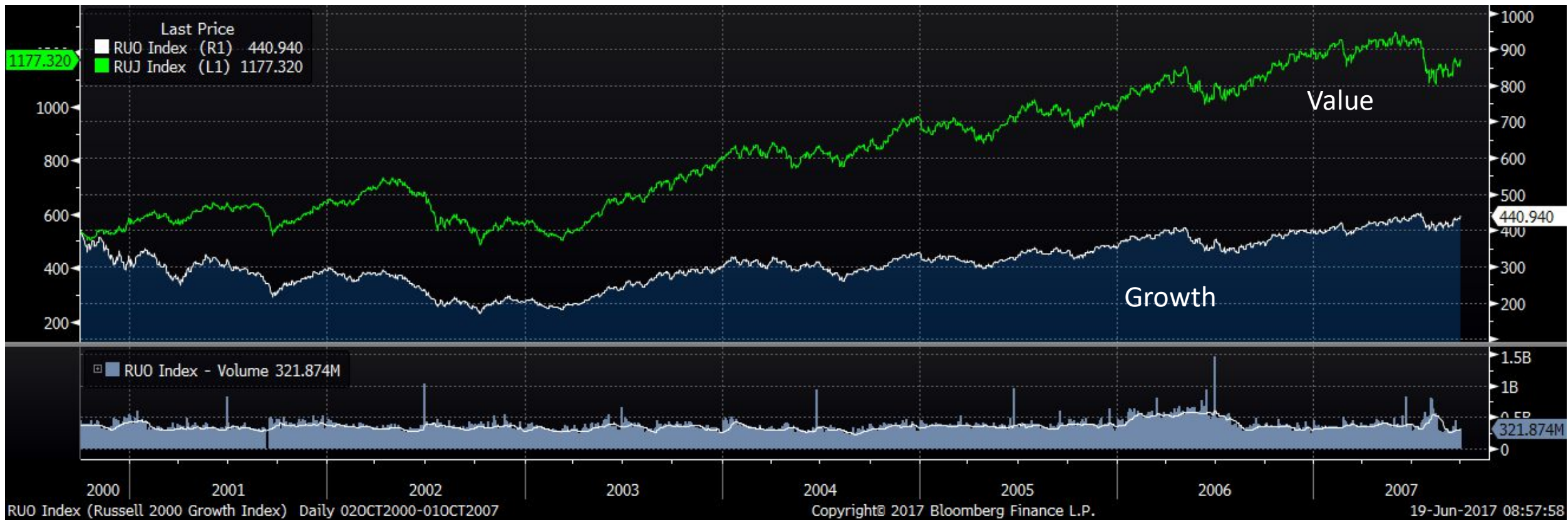
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WE'VE HAD A TOUGH TIME THE LAST EIGHT YEARS

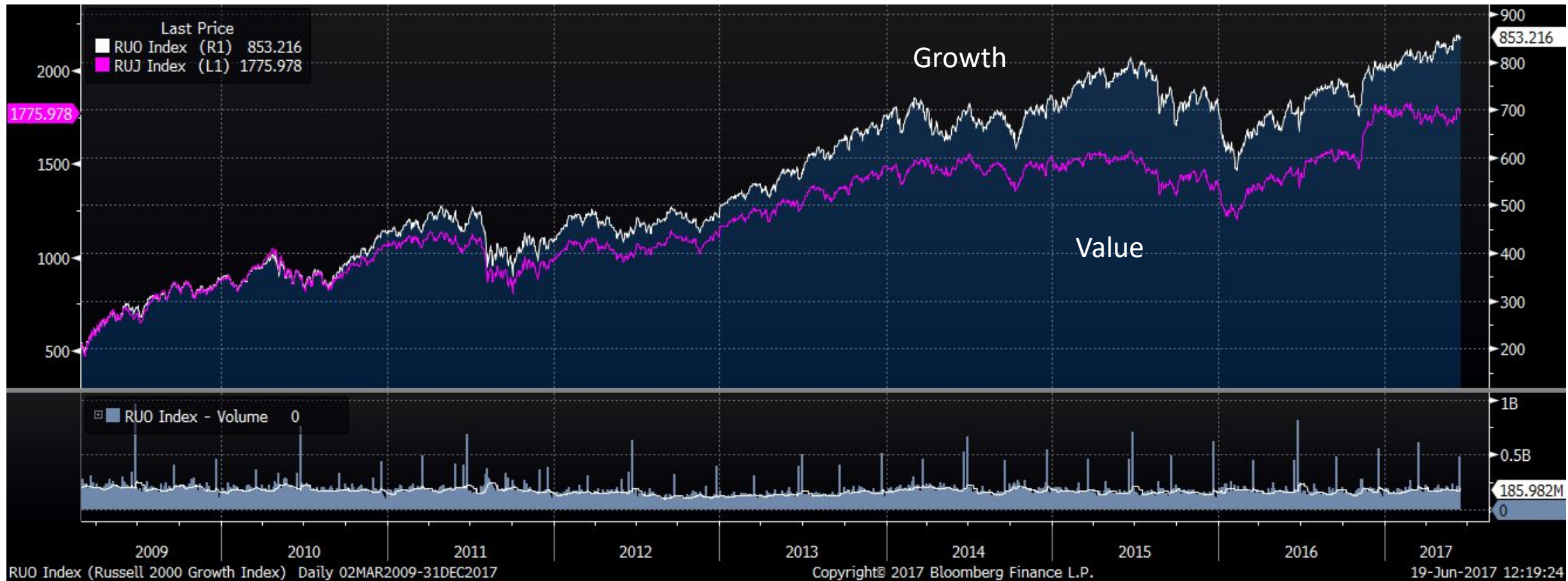




# Growth v. Value 1996-2000



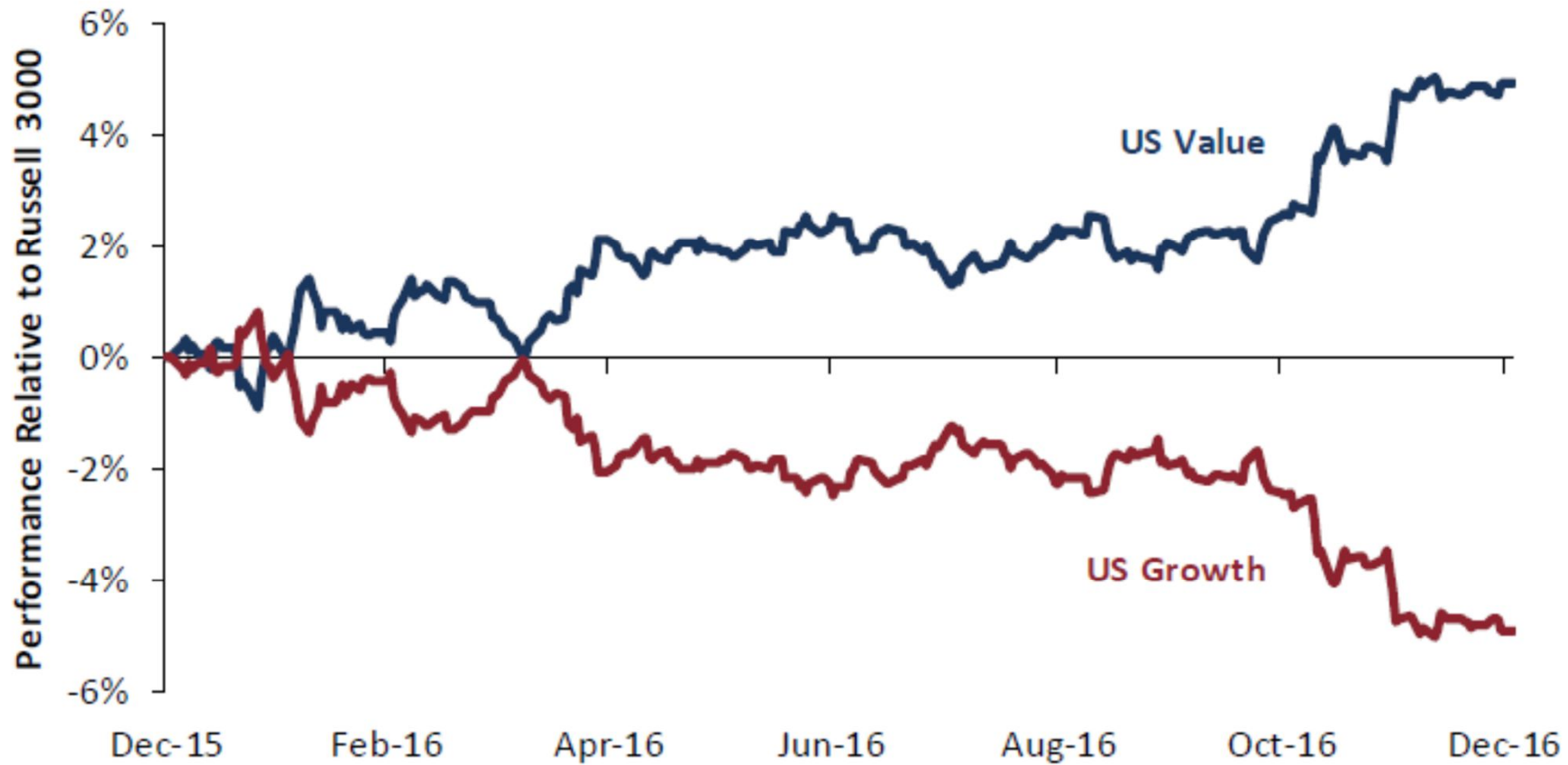
# Growth v. Value 2000-2007



# Growth v. Value 2009-2017



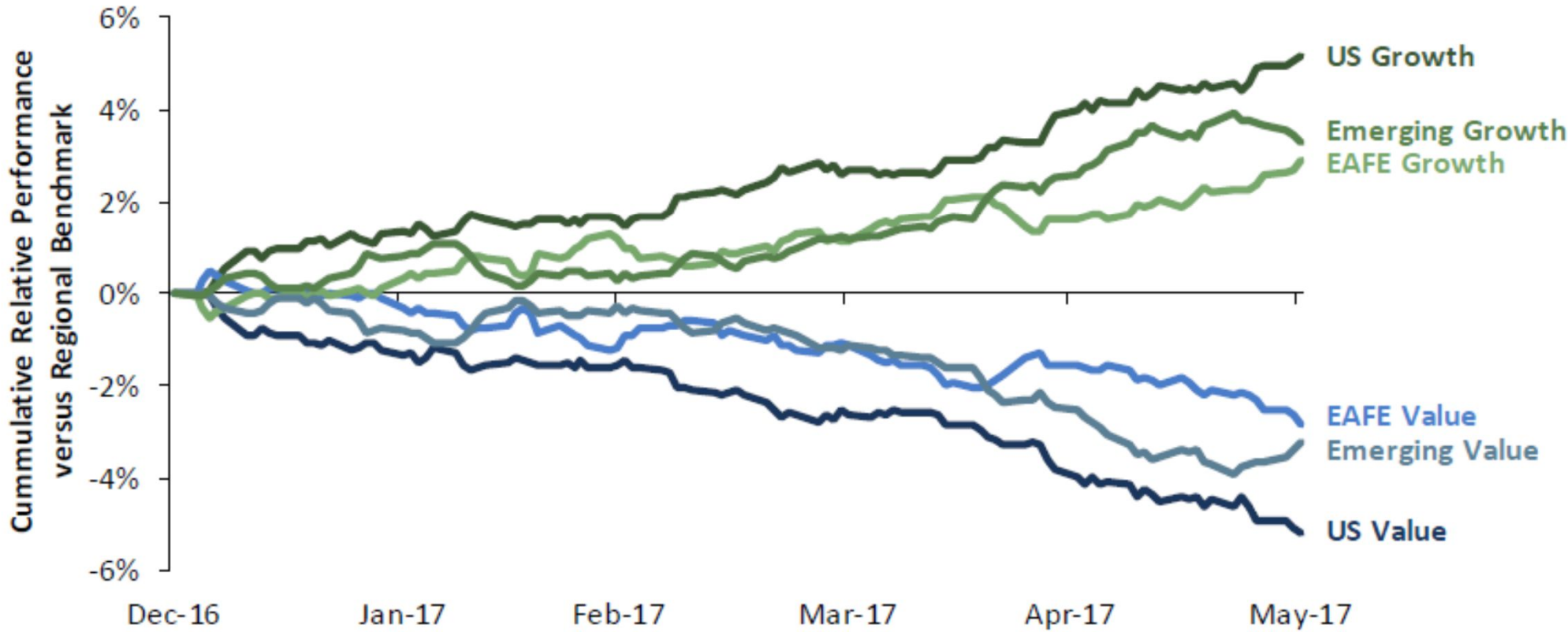
### Exhibit 1 – 2016 Marked Value's Strongest Year in a Decade



Source: GMO

US Value and US Growth represented by the Russell 3000 Value and Russell 3000 Growth indexes, respectively.

Exhibit 2 – Styles Reversed Early in 2017 with Growth Outperforming Globally



Source: GMO

Indexes include Russell 3000 Value, Russell 3000 Growth, MSCI EAFE Value, MSCI EAFE Growth, MSCI Emerging Value, and MSCI Emerging Growth.

# A story about career risk

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TIME TO ROLL THE DICE AGAIN





**amazon**

**facebook**

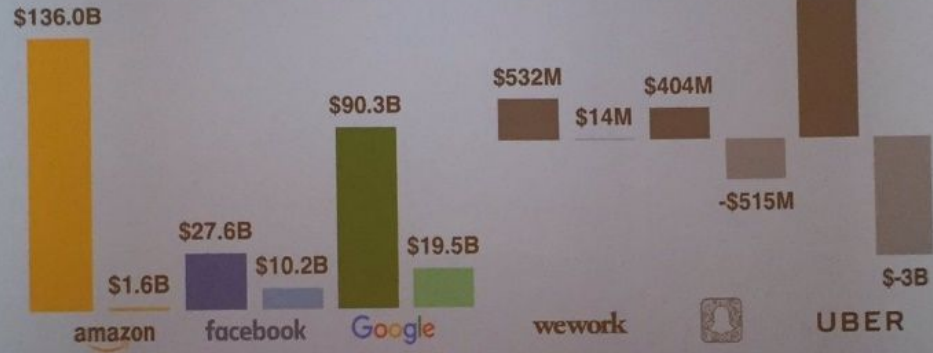
**Google**

**?**

# LOSS IS THE NEW BLACK

2016 Revenue vs. Net Income

■ Annual Revenue ■ Annual Net Income



Source: SEC Filings and Company Announcements





# EXTREME VALUE

## The Mania Has Arrived Returned

***U.S. Equities Are at Their Riskiest Levels Since the Dot-Com Bubble***

I've warned you many times about big risks looming on the horizon...

In March 2008, I recommended selling short Lehman Brothers and avoiding leveraged companies, banks, and homebuilders. I said, "The financial crisis isn't half over yet, and you need to know just how big it really is." And I warned that "housing prices have a long way to fall."

We closed the Lehman short five months later with an 82% profit. Even that large gain was premature as it turns out, since ***Lehman went bankrupt a few days later. Homebuilding stocks imploded, as did most bank and other financial stocks.***

### IN THIS MONTH'S ISSUE:

- From 'Get Big Fast' to 'Loss Is the New Black'
- When Things Get Manic, Smart Investors Keep Their Distance
- Stocks Are Near Dot-Com Bubble Peak

# Seven Traits of Manias

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1. Something New
2. A Credit Boom
3. An M&A Boom
4. A Reasonable Fundamental Taken to Unreasonable Extremes
5. A Risky Scheme Sold As a Safe Investment
6. “This Time is Different”
7. Financial Shenanigans

TRAIT NO. 1

Something  
New

# Most manias include tech booms

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--1920s: Radio, Automobiles, Electrification

- Radio Corporation of America, RCA

- 1921: \$1.50

- 1929: \$549.00

- 1932: \$2.50

--1926-1929: DuPont, Maytag, GE, Westinghouse, Chrysler and GM all rose 200% or more

--1960s: electronics for aerospace and defense; “tron” and “onics”: Powertron Ultrasonics

--1990s: internet, telecom, personal computers

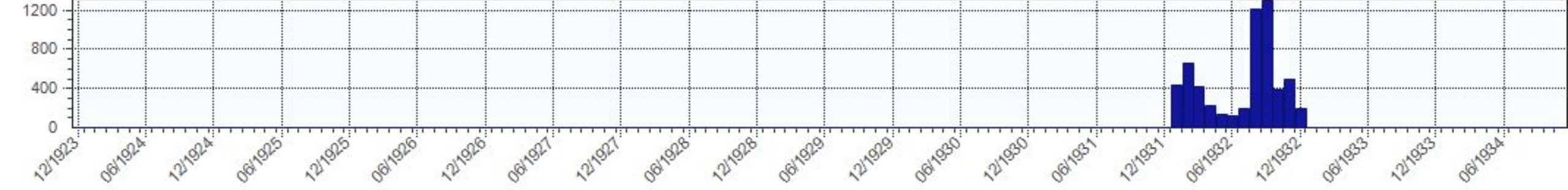
--post-2008: iPhone, Social media, Amazon.com 2.0, EVs, Solar power



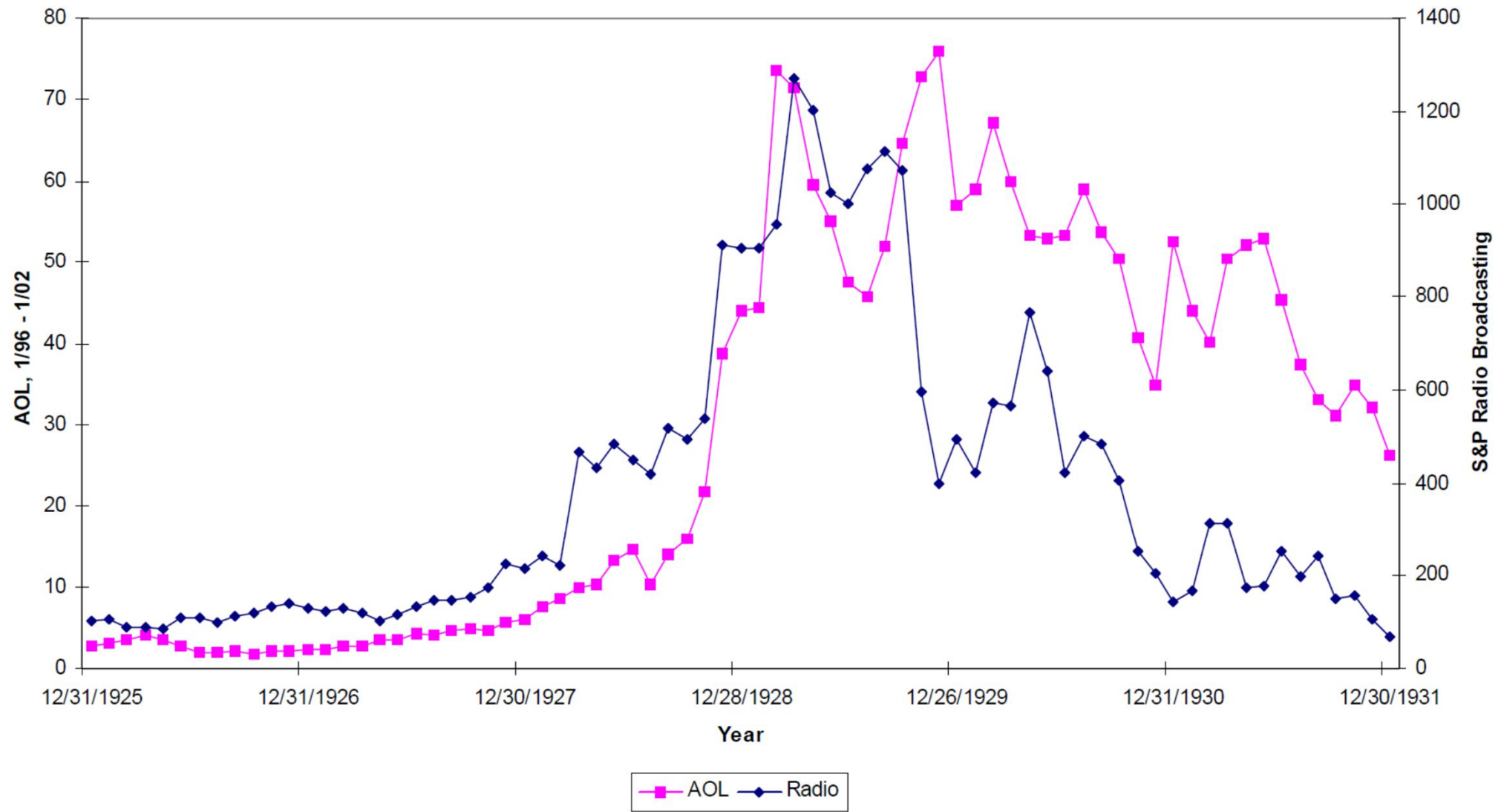
# RCA Corp. (RCA2)



## Volume



RCA2 Volume



TRAIT NO. 2

# A Credit Boom

# 1920s

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“Credit fueled a real estate boom in 1925, a Wall Street boom in 1928-9, and a consumer durables spending spree spanning the second half of the 1920s.”

“The Great Depression as a credit boom gone wrong”  
by Barry Eichengreen and Kris Mitchener  
BIS Working Papers No. 137, September 2003

# 1920s

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1919: GMAC founded in New York, then Detroit, Chicago, San Francisco, Toronto

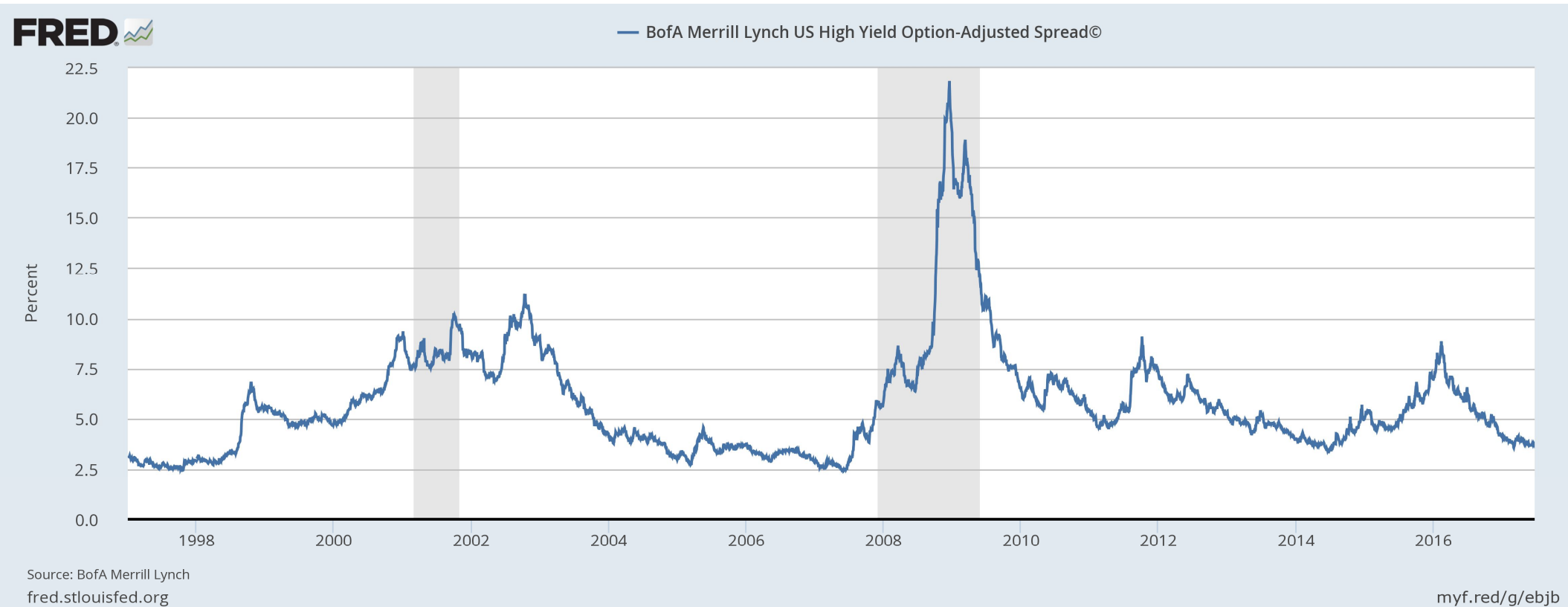
1924: GMAC financed 4 millionth vehicle

1925: 1,500 finance companies in the U.S.

1927: Nearly 2/3 of all new cars bought on credit

*The old conservative ways are lost in the manias...*

# Today



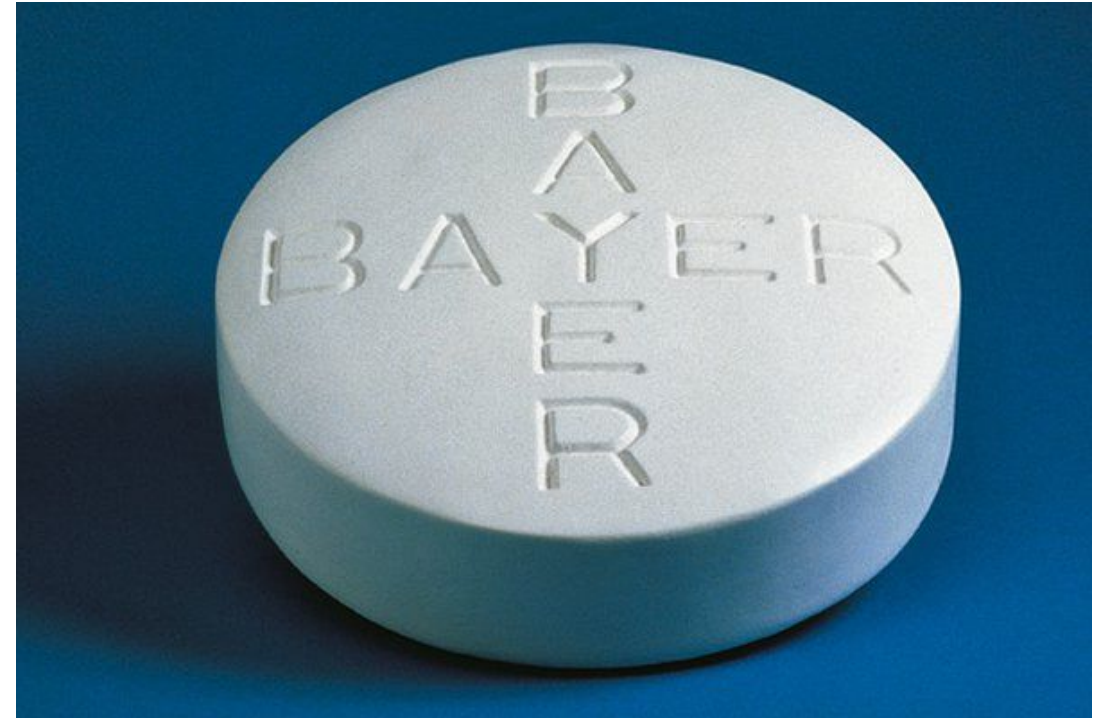


TRAIT NO. 3

# Mega M&A

# \$130 Billion all stock merger

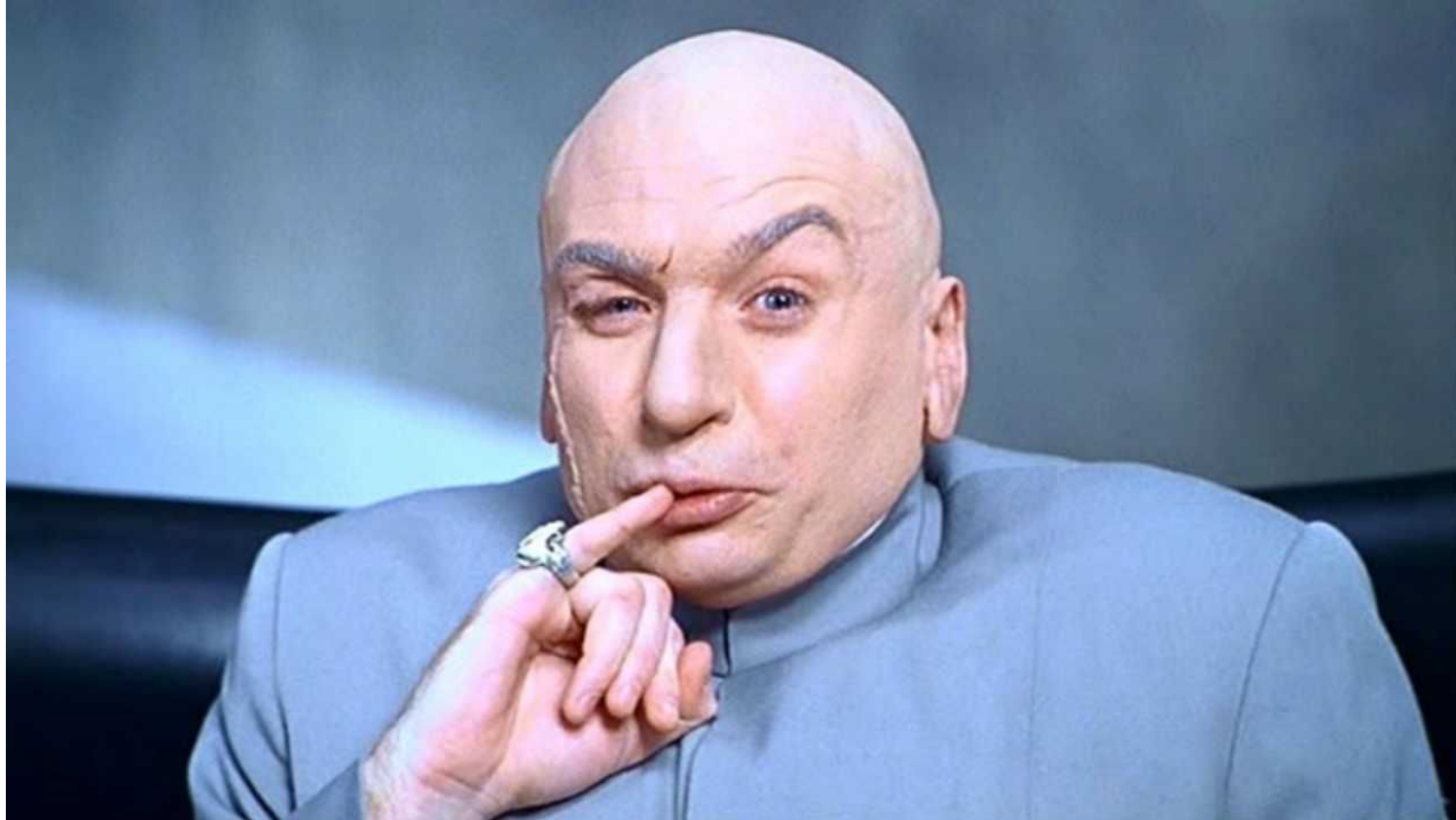




\$66 Billion all cash

“100 billion dollars!”

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TRAIT NO. 4

A reasonable  
fundamental  
taken to  
unreasonable  
extremes

# Reasonable vs unreasonable

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1920s: “anybody can invest in stocks” = “everybody ought to be rich”

1960s: “mutual funds are sound investments” = “Anything done in a mutual fund is good”

1980s: “portfolio insurance” = “sell when everybody does”

1990s: “the internet will change everything” = “therefore tech stocks will go up forever”

2000s: “housing prices have always gone up” = “house prices will never go down”

Today: “Volatility is painful” = “Sell Volatility”



TRAIT NO. 5

A risky  
scheme sold  
as a safe  
investment

# Too much of a good thing

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1920s: investment trust

1960s: mutual funds

1990s: hedge funds

2000s: mortgage-related securities, CDOs, CDOs<sup>2</sup>

Today: ETFs

**The VIX Index Is A Measure of Forward Volatility of the S&P 500<sup>®</sup> and Your ETN Is Not Linked to the Options Used to Calculate the VIX Index, to the Actual Volatility of the S&P 500<sup>®</sup> or the Equity Securities Included in the S&P 500<sup>®</sup>, Nor Will the Return on Your ETN Be a Participation in the Actual Volatility of the S&P 500<sup>®</sup>**

The VIX Index measures the 30-day forward volatility of the S&P 500<sup>®</sup> as calculated based on the prices of certain put and call options on the S&P 500<sup>®</sup>. The actual volatility of the S&P 500<sup>®</sup> may not conform to a level predicted by the VIX Index or to the prices of the put and call options included in the calculation of the VIX Index. The value of your ETNs is based on the value of the relevant futures on the VIX Index included in the Index underlying your ETNs. Your ETNs are not linked to the realized volatility of the S&P 500<sup>®</sup> and will not reflect the return you would realize if you owned the equity securities underlying the S&P 500<sup>®</sup> or if you traded the put and call options used to calculate the level of the VIX Index.

dependent upon the level of the related VIX Index price relative to the unwind price of the relevant VIX Index futures contract at the time of hypothetical sale of the contract. The contracts included in the Indices have not historically exhibited consistent periods of backwardation, and backwardation will most likely not exist at many, if not most times. Moreover, many of the contracts included in the Indices have historically traded in “contango” markets. Contango markets are those in which the prices of contracts are higher in the distant delivery months than in the nearer delivery months. VIX futures have frequently exhibited very high contango in the past, resulting in a significant cost to “roll” the futures. The existence of contango in the futures markets could result in negative “roll yields”, which could adversely affect the value of the Index underlying your ETNs and, accordingly, decrease the payment you receive at maturity or upon redemption.

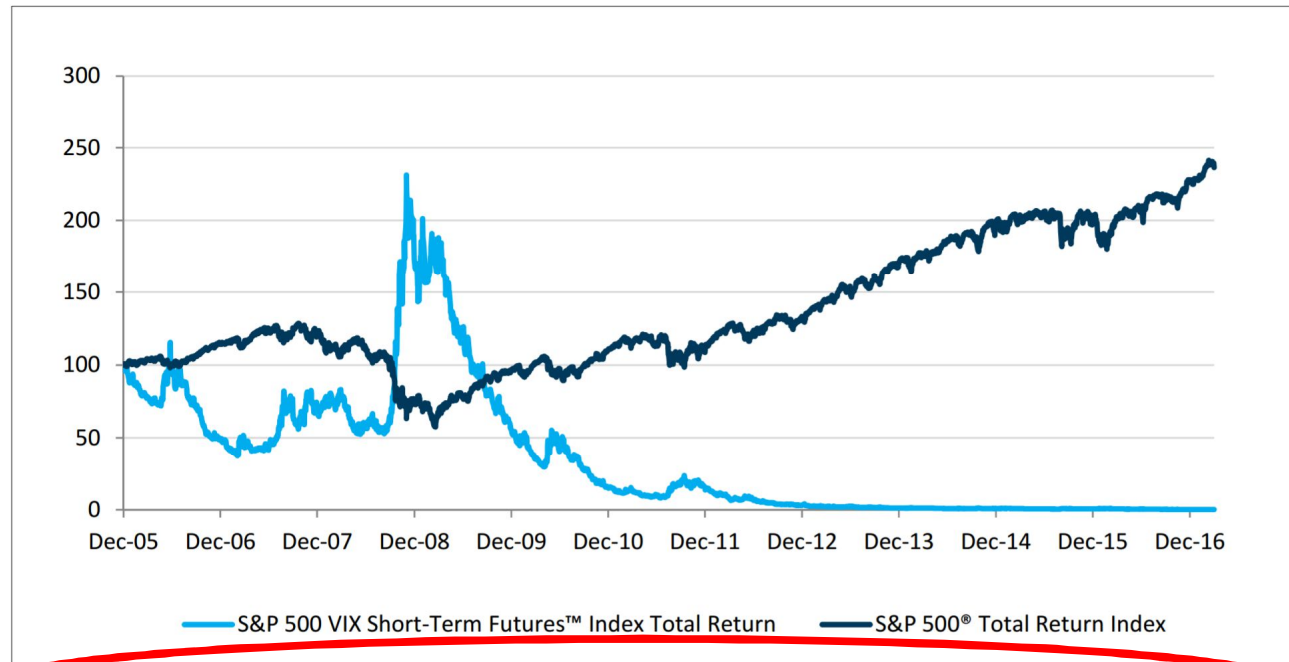
**The Level of the VIX Index Has Historically Reverted to a Long-Term Mean Level and**

changes to its indices and related matters to be potentially market moving and material.

principal amount of such ETFS.

Therefore, all Index Committee discussions are confidential.

### S&P 500 VIX Short-Term Futures™ Index Total Return Historical Performance December 20, 2005 – March 21, 2017



**PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS**

PS-24

27114802v2

Below B	0.00%
Others	0.00%

**Top 10 Holdings (66.68% of Total Assets)**

[Get Quotes for Top Holdings](#)

Company	Symbol	% Assets
Exxon Mobil Corp	XOM	24.30%
Chevron Corp	CVX	14.26%
Schlumberger Ltd	SLB	7.06%
ConocoPhillips	COP	4.02%
EOG Resources Inc	EOG	3.79%
Occidental Petroleum Corp	OXY	3.28%
Halliburton Co	HAL	2.85%
Kinder Morgan Inc P	KMI	2.62%
Phillips 66	PSX	2.44%
Pioneer Natural Resources Co	PXD	2.06%

composed of U.S. equities in the energy sector. The fund generally invests at least 90% of its assets in securities of the underlying index and in depository receipts representing securities of the underlying index. The underlying index measures the performance of the oil and gas sector of the U.S. equity market. The fund is non-diversified.



[Yahoo Small Business](#)



B	0.00%
Below B	0.00%
Others	0.00%

**Top 10 Holdings (45.72% of Total Assets)**

[Get Quotes for Top Holdings](#)

Company	Symbol	% Assets
Masco Corp	<a href="#">MAS</a>	4.88%
Fortune Brands Home & Security Inc	<a href="#">FBHS</a>	4.67%
Whirlpool Corp	<a href="#">WHR</a>	4.64%
The Home Depot Inc	<a href="#">HD</a>	4.64%
Mohawk Industries Inc	<a href="#">MHK</a>	4.61%
Tempur Sealy International Inc	<a href="#">TPX</a>	4.54%
Toll Brothers Inc	<a href="#">TOL</a>	4.52%
Johnson Controls International PLC	<a href="#">JCI</a>	4.50%
Owens-Corning Inc	<a href="#">OC</a>	4.40%
D.R. Horton Inc	<a href="#">DHI</a>	4.32%

The investment seeks to provide investment results that, before fees and expenses, correspond generally to the total return performance of an index derived from the homebuilding segment of a U.S. total market composite index. In seeking to track the performance of the S&P Homebuilders Select Industry Index (the "index"), the fund employs a sampling strategy. It generally invests substantially all, but at least 80%, of its total assets in the securities comprising the index. The index represents the homebuilders segment of the S&P Total Market Index ("S&P TMI"). The fund is non-diversified.

[Yahoo Small Business](#)

2017 ALFA ROMEO GIULIA  
Best-in-Class 0-60 MPH in 5.1 seconds<sup>1</sup>



Alfa Romeo  
VEHICLE DETAILS >  
VIEW GALLERY >

BUSINESS NEWS | Tue Jun 20, 2017 | 4:23pm EDT

# More quadruple-leveraged ETFs proposed despite SEC review



By Trevor Hunnicutt and John McCrank | NEW YORK

Intercontinental Exchange Inc's (ICE.N) NYSE Arca exchange is asking the U.S. Securities and Exchange Commission for permission to list a new set of exchange-traded funds that aim to quadruple the performance of the market, a filing this week showed.

The exchange would list two "ProShares QuadPro" ETFs that would aim to deliver four times the return of an index of S&P 500 .SPX or Russell 2000 futures over a single day. A fund whose index declines 5 percent might fall by 20 percent.

Another two QuadPro funds would target four times the inverse of those benchmarks. That means a fund could gain 8 percent on a day the index it tracks falls by 2 percent.

The filing of the quadruple-leveraged ETFs comes amid ambivalence on the part of the

2017 ALFA ROMEO GIULIA  
Available Alfa Q4 All-Wheel Drive helps provide all-season traction and control



Alfa Romeo  
VEHICLE DETAILS >  
VIEW GALLERY >

## TRENDING STORIES

- 1 Senate Republicans unveil Obamacare replacement bill, fate uncertain



TRAIT NO. 6

“This Time is  
Different”



Stocks have reached what looks like  
a permanently high plateau.

— *Irving Fisher* —

AZ QUOTES

# Why Stock Market Valuations Have Reached A Permanently High Plateau

Jun. 19, 2017 4:50 AM ET | 76 comments | Includes: CRF, DDM, DIA, DOG, DXD, EEH, EPS, EQL, FEX, FWDD, HU..



**Heath White**

Long only, value, growth at reasonable price, medium-term horizon

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## Summary

- Stock market valuation is very high by historical measures. Is this scary?
- Market valuations are structurally higher for good reasons: bond valuations are structurally higher, and the market is less risky than it used to be. (Doubt me? Read on).

Disclosure

**UNCOVER HIDDEN RISKS.**  
And help manage them with Fixed Income.

**SEE THE RISKS**

Disclosure

**UNCOVER HIDDEN RISKS.**  
And help manage them with Fixed Income.

**SEE THE RISKS**

# Warren Buffett

The ratio of the total U.S. market cap of equities to gross national product (today known as gross domestic product, or "GDP") was "probably the best single measure of where valuations stand at any given moment."

~*Fortune*, December 10, 2001

"Everything in valuation gets back to interest rates."

~BRKA shareholder meeting May 6, 2017

# Jeremy Grantham

“I used to call profit margins the most dependably mean-reverting series in finance.”

*"We value investors have bored momentum investors for decades by trotting out the axiom that the four most dangerous words are, 'This time is different.' For 2017 I would like, however, to add to this warning: Conversely, it can be very dangerous indeed to assume that things are never different."*

~This Time Seems Very Very Different, [www.gmo.com](http://www.gmo.com)

TRAIT NO. 7

# Financial Shenanigans

# Manias Breed Scandals

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1920s/30s: Richard Whitney, Ivar Kreuger

1960s: Gerald Tsai

1990s: Bernie Ebbers, Skilling/Fastow, Dennis Kozlowski

2008: Bernie Madoff

2017: Non-GAAP results...?



# Non-GAAP reporting

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**Marty Fridson:** “The purpose of financial reporting is to obtain cheap financing.”

**Jack Ciesielski:** “...a company’s use of non-GAAP metrics may raise potentially troubling questions about management’s motivation, with governance implications.”

- “non-IFRS earnings, adjusted earnings, recurring earnings, street earnings, earnings ex items, core earnings, cash earnings, and pro forma earnings.”
- “Of the non-REIT companies in the S&P 500 Index, **70% disclosed adjusted (non-GAAP) earnings in 2014 versus fewer than 50% in 2009**. As shown in Table 1 and Table 2, the dollar amount and number of adjustments to derive non-GAAP earnings have similarly increased. In 2014, the companies in the S&P 500 disclosing non-GAAP earnings made a total of 1,332 adjustments totaling \$132.1 billion. Comparing the subset of S&P 500 companies that existed in both **2014 and 2009** shows that **non-GAAP adjustments increased by 57% in number of adjustments and 109% in total dollar volume.**”

*~Accounting’s Tower of Babel, Jack Ciesielski and Elaine Henry, CFA Journal 2Q 2017*

# Seven Traits of Manias

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# SHORT EAT

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SELL SHORT BRINKER INTERNATIONAL (NYSE: EAT)

# Brinker International (NYSE: EAT)

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- \$1.9B market cap, \$3.3B sales (97% restaurant sales; 3% franchise rev)
- Chili's Tex-Mex restaurants (85% rev; 88% op inc)
- Maggiano's Little Italy
- 1,660 locations in 30 countries
- 60% corporate-owned, 40% franchised
- Founded Dallas, 1975

<b>Chilli's</b>	Maggiano's	Longhorn	Olive Garden	Outback	Carabba's	<b>Ruby Tuesday</b>	BJ's	<b>RRGB</b>	Applebee's	BWLD	TXRH
<b>1975</b>	1991	1981	1982	1988	1986	<b>1972</b>	1978	<b>1969</b>	1980	1982	1993

# An old brand getting tired

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- **SELL SHORT Brinker International (NYSE: EAT)**
- Chili's Grill & Bar = 85% rev; 88% op inc
- 40-year-old restaurant brand, 1,660 locations in 30 countries
- ***8 straight quarters of declining comp sales***
- Bad mgmt. moves, responding inappropriately to incentives
- Levered up to buy shares, record debt levels
- Warning: store closings ahead

# SELECT RESTAURANT SAME-STORE SALES

Quarter	Chili's	Maggiano's	LongHorn	Olive Garden	Outback	Carrabba's	Ruby Tuesday	BJ's	Red Robin	Applebee's	Buffalo Wild Wings	Texas Roadhouse
3Q15	1.9	0.1	5.4	2.2	5	1.9	1.1	3.2	3.1	3.6	7	8.9
4Q15	-0.8	-0.1	5.2	3.4	4	0.9	-1.7	0.5	2.9	2	4.2	8.2
1Q16	-1.6	-1.7	4.4	2.7	0.1	-2	0.6	2.3	3.5	0.4	3.9	6.9
2Q16	-2.8	-1.8	2.6	1	-2.2	-4	0.8	0.7	2.1	7.7	1.9	4.5
3Q16	-4.1	0.2	5.2	6.8	-1.3	-2	-3.1	0.6	-2.6	-4	-1.7	4.6
4Q16	-1.8	-1.7	1.1	1.6	-2.5	-4.8	-3.7	-0.2	-3.2	-4.4	-2.1	4.5
1Q17	-1.4	-0.6	0.6	2	-0.7	-2.1	-2.7	-3.4	-3.6	-5.1	-1.8	3.4
2Q17	-3.3	-0.8	0.1	2.6	-4.8	-2.3	-4.1	-1.3	-4.3	-13.5	-4	1.2
3Q17*	-2.3	-1.6	0.2	1.4	1.4	-3.8	-4	-1.3	-1.2	-8.6	0.5	3.1

Year-over-year change, last nine quarters.

\*Third-quarter fiscal year ended March 31, 2017.

“Unfortunately, in December, the lower category really started to get soft. **We believe that’s largely driven by the shift in holiday retail traffic to online, which is starting to impact how holiday shopping patterns play out.** And based on this year’s activity, some of the assumptions we’ve made regarding how to market during this time of year will have to be reevaluated.”

~Brinker Int’l (EAT) CEO Wyman Roberts Q2 cc



# CHILI'S

## SAME-STORE SALES BREAKDOWN

Quarter	Traffic Change (YoY)	Mix-Shift Change (YoY)	Pricing Impact Change (YoY)	Same Store Sales Change (YoY)*
1Q15	0.1%	0.7%	1.8%	2.6%
2Q15	2.1%	0.5%	1.4%	4.0%
3Q15	-0.4%	1.5%	0.8%	1.9%
4Q15	0.7%	-1.8%	1.7%	-0.8%
1Q16	-1.4%	-1.6%	1.4%	-1.6%
2Q16	-4.0%	0.4%	0.8%	-2.8%
3Q16	-4.9%	-0.3%	1.1%	-4.1%
4Q16	-4.1%	1.3%	1.0%	-1.8%
1Q17	-4.1%	1.5%	1.2%	-1.4%
2Q17	-6.5%	1.4%	1.8%	-3.3%
3Q17	-6.2%	1.0%	2.9%	-2.3%

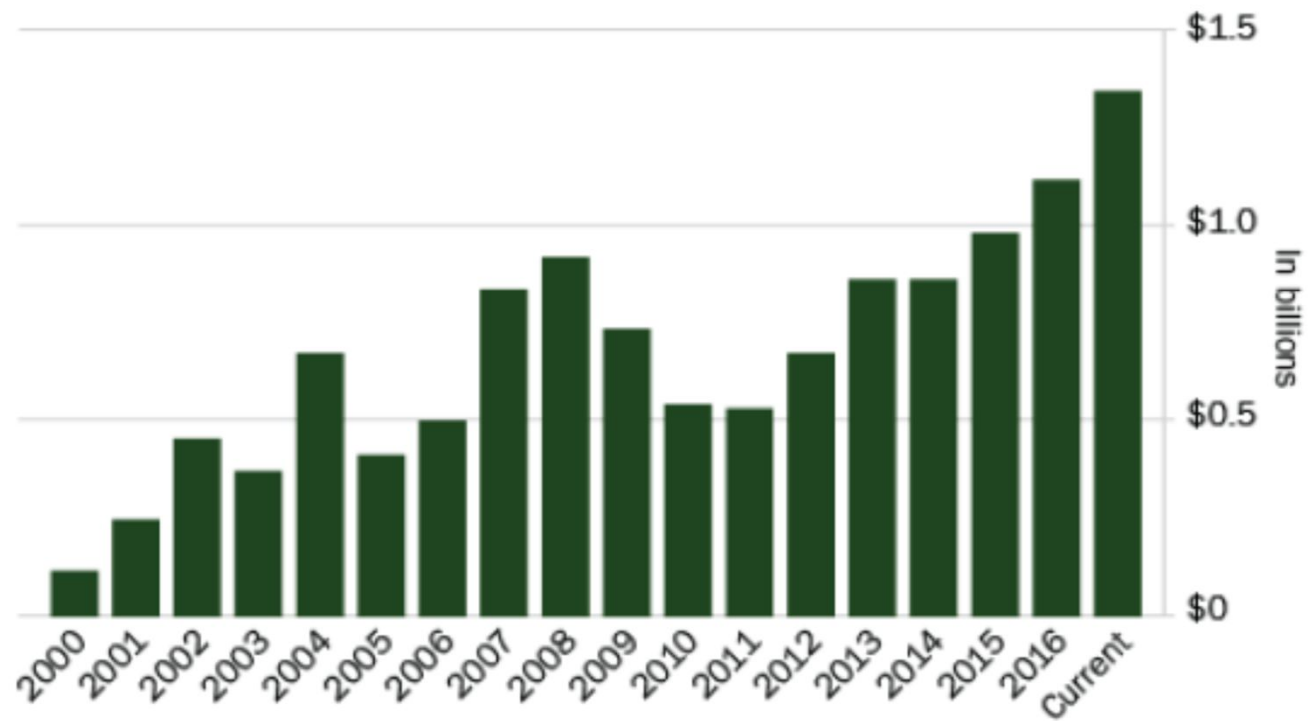
\* Traffic Change + Mix-Shift Change + Pricing-Impact Change = Same-Store Sales Change.

# OPERATING-MARGIN ANALYSIS

## LAST SIX QUARTERS (LAST-12-MONTHS BASIS)

LTM Op. Margin	EAT	BLMN	DRI	PNRA	CMG	TXRH
F2Q16	10.4%	5.3%	7.8%	9.0%	17.0%	8.0%
F3Q16	9.8%	5.1%	8.4%	9.1%	12.2%	8.0%
F4Q16	9.7%	4.0%	9.0%	8.7%	8.2%	8.7%
F1Q17	9.3%	3.8%	9.3%	8.7%	2.8%	8.9%
F2Q17	8.9%	3.0%	9.8%	8.6%	0.9%	8.6%
F3Q17	8.5%	2.6%	9.9%	9.0%	3.7%	8.2%

## BRINKER INTERNATIONAL'S DEBT: ALL-TIME HIGHS

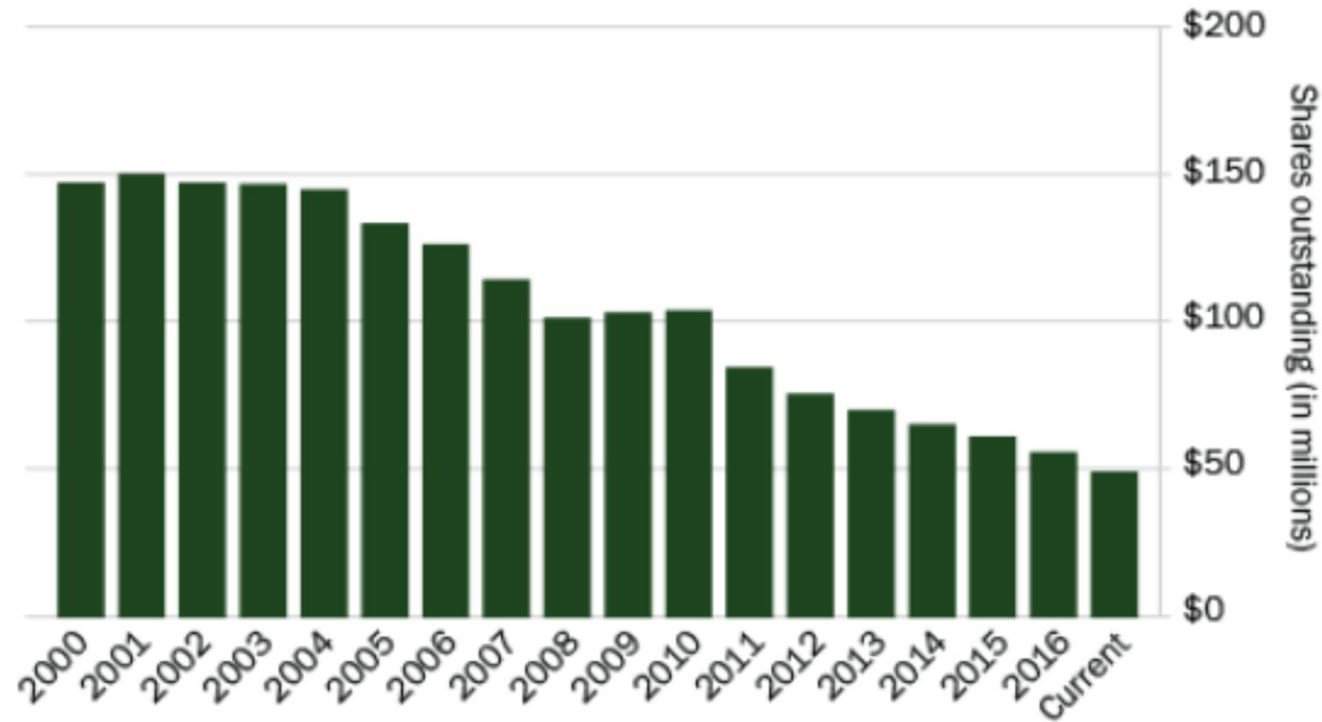


Based on the company's fiscal year.

[www.stansberryresearch.com](http://www.stansberryresearch.com)

Source: Bloomberg; Extreme Value

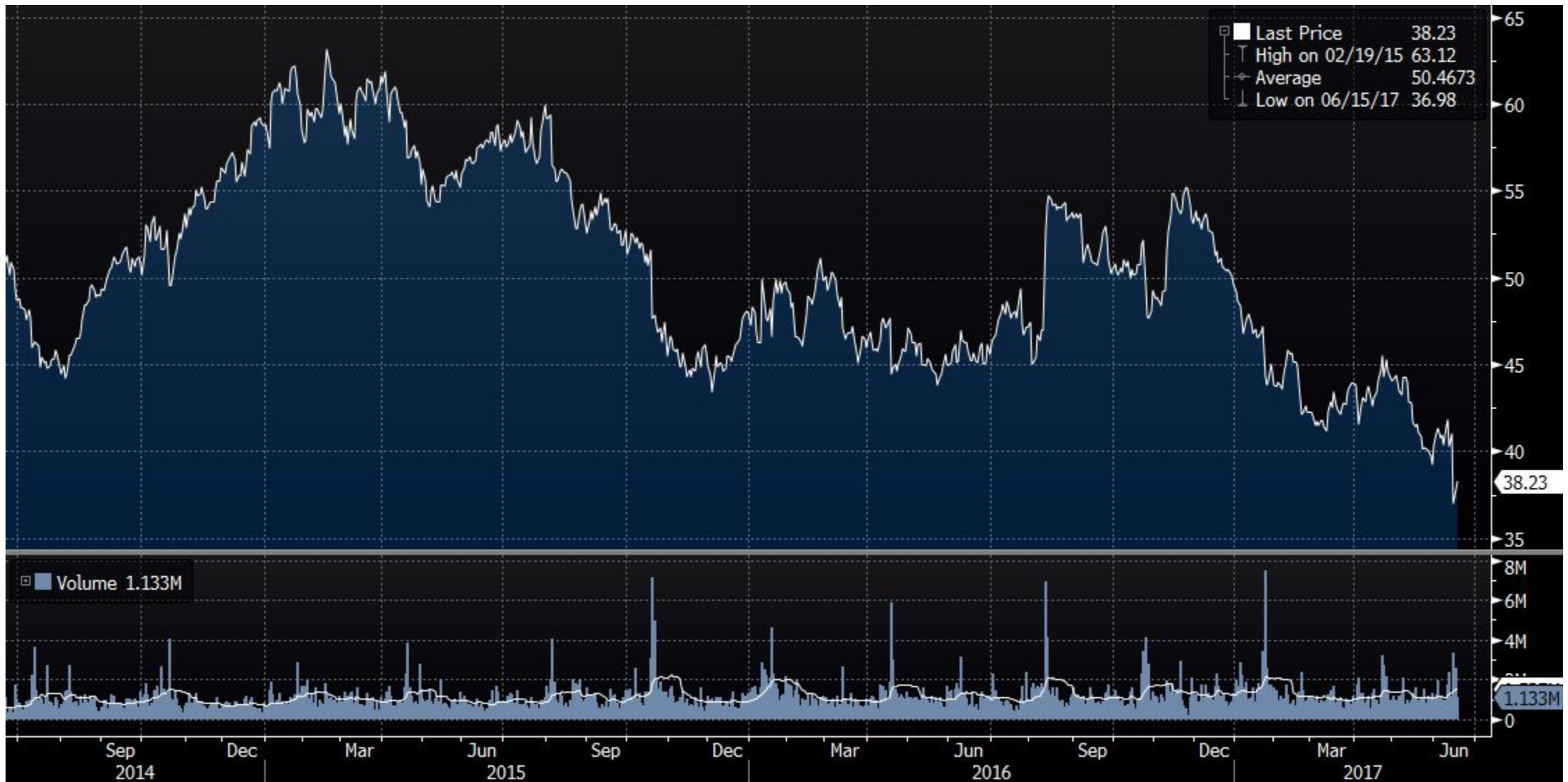
# BUYBACK MANIA: BRINKER SHARES OUTSTANDING



Based on the company's fiscal year.

[www.stansberryresearch.com](http://www.stansberryresearch.com)

Source: Bloomberg; Extreme Value



EAT US Equity (Brinker International Inc) Daily 20JUN2014-19JUN2017

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