Global Matters Weekly

13 February 2023

Love Actually? Disappointment, actually

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A few weeks ago, during the Christmas period, I treated myself to the ideal night in. I was sat on my comfy sofa, blanket on my legs, my girlfriend by my side, hot chocolate in one hand, and TV remote in the other. The lights from the Christmas tree were too bright to enjoy a proper televised experience, but that didn't bother me. What did bother me was the exhausting job of selecting a movie to watch on Netflix, especially for a rom-com junkie like me who's probably seen 99% of the platform's genre. Then it struck me: I hadn't watched Love Actually, supposedly the masterpiece of Christmas movies and a true showcase of top-tier British actors. And what a disappointment that was, to see such a great cast interpret (in my opinion) a poorly-written story. It could have been a new holiday tradition, but now I don't think I'll watch it again.

What does this have to do with investments, you may ask? Well, this was just another example of Tom Magliozzi's formula: happiness equals reality minus expectations. I had massive expectations, but the reality was only mediocre, though if I'd have watched it without any expectation at all, I might have liked it. This is precisely the risk that highly valued growth stocks face constantly.

Adidas, the second largest sportswear manufacturer in the world, lost more than 12% overnight as they warned shareholders of a potential major impact on their profits after ending their partnership with Kanye West following his anti-Semitic comments, and that they would take a €500m hit to profits if the entire stock of Yeezy sneakers got written off. At the time of writing, Lyft (the fast-growing Californian ride-sharing platform) is heading for its biggest single-day decline ever (about -35%), after forecasting dramatically lower profits than expected, and saying they will cut prices in an attempt to attract and keep customers. Electronic Arts, one of the longest standing American video game companies (who remembers "E-A-Sports, it's in the game!" when playing FIFA 98?) plummeted around 10%, as it announced to investors that they were killing the mobile versions of two popular games, laying some employees off, and announcing disappointing earnings forecasts. Intel tumbled more than 8% after the semiconductor giant reported Q4 results that missed expectations and indicated further weakness in their cloud computing, data centre, and AI-related revenues. Nintendo's stock price dropped more than 7% after they cut their full-year earnings and revenue outlook on weaker demand for their aging Switch console, expected to be lower than initially targeted by one million units. Netflix, the largest online streaming platform with more than 220 million subscribers worldwide, lost more than 50% in April last year after showing that this number had shrunk for the first time in more than 10 years.

What all these companies have in common is undeniable quality, strong market position, and leadership within their sectors. Few people out there would question whether these are great companies, but at times great companies might not be great investments. Assuming that a good investment is one where you pay a little for something that is worth a lot, the issue with great companies is that everyone recognises their worth, uniqueness and leadership, and many are willing to pay up for quality, sometimes too much. When a stock is priced for perfection, or for eternal double-digit growth, markets are extremely susceptible to any obstacle (or a reality check) that might come along the way. Whilst we believe that it's only fair to pay up for those rare gems, the fast growers, the disruptors and the dominants, a certain valuation discipline is always necessary. This discipline encourages investors to be realistic about their assumptions, investment thesis, and expectations and disappointments become less common.

I certainly wasn't very disciplined when I decided to watch Love Actually, my expectations were excessive, and the movie underperformed the benchmark (which is Home Alone!)

Sources:
Bloomberg Finance L.P. for all stock-level information

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