

[Transcript] All-In with Chamath, Jason, Sacks & Friedberg / E114: Markets update: whipsaw macro picture, big tech, startup mass extinction event, VC reckoning

All right, everybody. Welcome to the All In Podcast. We're back. Thanks to Freeberg and Saks for moderating the show into the lowest ratings in its history.

Hold on, hold on. Please give the keyboard warriors that are their bot armies some respite here. They tried their best. They just did their best. It's okay.

I think the ratings of the last episode must be a result of Google downranking us as a result of our honesty about not wanting to get more boosters. Saks, you're on the Brigadoon track.

It caused somebody at Google some lower level functionary to push a button. Push a button.

To a shadow band. I mean, visibility filter us. It's everything except the moderation skills of the two days. The reaction I got from our COVID vaccine discussion was, hey, pretty fair and balanced. Like, not in a, in a joking way, but like actually like, yeah, the warning on YouTube was pretty benign actually. Yeah. It's like, if you want COVID information, click here. Thank you.

Okay. Let's talk about the market data. The Fed raised 25 basis points. The market obviously has ripped since then. The jobs data this morning was crazy. We added 517,000 jobs, more than 2x December, and well above the estimates of 188,000 jobs. The Fed, I think, is starting to realize they can, obviously, impact inflation and slowdown speculative assets, but they're having a very hard time with the labor market. Obviously, labor participation actually is growing. We've talked about that many times here. It's bumped up to 62.4%. We all know it peaked at like maybe 69% during the 2000 time period. Wage growth though, continuing to slow. So that is some good news there. And obviously, risk on assets are ripping the last couple of days.

Tramod, what's your take on where we are with the market and the Fed's action, which people are starting to believe will be another 25 basis point hike and then maybe staying high for the rest of the year? Did you hear their comments? You think dovish, what's your take on the market? I watched Powell's speech and it was really amazing because in December, he was extremely hawkish and he was basically like, listen, we're going to keep rates higher than you like and longer than you want.

And that was pretty clear and the markets reacted. And then not but 35, 40 days later, he essentially said we have two 25 basis point hikes left to go and he's going to try to stick the landing essentially. And even though the rest of the language in his entire speech and the press conference, if you read it in the absence of his body language, so if you just read the transcript, would seem very hawkish as well. But the reality was he basically capitulated and then the market essentially said, okay, we're at the end of this thing. And we've talked about this before, but markets tend to bottom six to nine months before it's clear that you could have done this.

And so we're a little bit off to the races in the short term. It's compounded by a couple of other factors. One is that at the end of last year, so many people were tax loss harvesting, which means if you had some gains somewhere else, you sold some things that were losing money so that you could net the two together. You saw a lot of stocks. Tesla was probably the poster child for this trade all the way down to like \$108 a share. And it's effectively doubled in the last 30 days. Right. So everybody tax loss harvested, everybody de-grossed, nobody was really owning anything. And then when Powell basically said we're mostly done, there's been so much systematic buying right now that nobody's really well positioned. To me, this is very similar and eerily reminiscent of the end of 2018 and beginning of 2019. And if you guys remember, at the end of 2018, October, November, December, the markets just fell. And part of it was Powell's going to raise rates, inflation's getting out of control, et cetera, et cetera. And then we got all this data that said

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China may be entering a real period of malaise and Powell capitulated, again, trying to stick the landing. And long story short, he didn't. That was a head fake and the markets just ripped higher. Then we went into the COVID pandemic and all of that stuff happened. So I think we're about to replay a little bit of that, at least in the next 30 to 90 days. The paint trade is to go up. So that's probably where we're going. Here's the Fed Fund Rates chart from 2000 and into the 2008 recession. And you see just to Trumot's point in 2019, that little step up to 2%. And then this dramatic step up that we've been on up to 4.5 or so. Saks, is this where the Fed pauses? Do you think they cut? And what overall effect is this going to have on venture capital on the startup market, which is super important to us? I think we're in the whipsaw economy here. Just a month ago, sentiment was incredibly negative. On the show, we were predicting for the year that we were looking at the Fed Fund's rate going from 4.5% to say 5.5%, 250 point increases. The belief was that we were going to have a recession later this year. I think that was pretty much consensus. And now three weeks later, you had a situation in which we got a couple of really good inflation reports. So all of a sudden, the consensus changed to, we're not going to need to raise rates to 5.5%. Maybe we only get one or two more quarter point rates. And the market just ripped on the belief that inflation was in the rearview mirror, the problem had been licked, and now we can just move forward. And the Fed seemed to confirm that just yesterday with a quarter point rate increase. And now today, we have this wild jobs report with over half a million new jobs. The expectation was only 100,000. And so now all of a sudden, people are wondering, wait a second, does this mean that labor costs are going to go back up, that the economy is overheating, and now the Fed is going to have to raise more? So I would say literally from week to week, we're being whipsawed between expectations of whether inflation has been conquered or not, whether the economy is going to have a recession or not. And I think probably where we're sitting at this moment is you'd have to say that the risk of inflation returning are slightly higher, but the risk of a recession are slightly lower because with this kind of jobs report, better chance of having a soft landing here. It's very hard, in other words, sacks, to have a recession if people are employed. If people are employed, and we have 50-year- Especially when you're down to 3.4%. Yeah, exactly. So... 50-year low. Right. So I just think that we're in a highly volatile economy, and it's very hard to predict the future. I'd say that relative to where we were a month ago, you'd have to say that the odds of us having a soft landing this year are quite a bit better than they were just a few weeks ago. All right, Friedberg, when we look at this employment picture, it does seem people are going back to work. Seems maybe indicative of people blew through their savings. We talked about this. You've been harping on and on previous episodes about people doing personal debt. Buy now, pay later. Is a possible visa here that people yo-load for so long, post-pandemic, Coachella, vacations, et cetera, that maybe they whip through their savings? It seems like we've burned off a trillion in savings or something like that, and the debt's going up. So now people maybe need to go back to work, and they're finally capitulating and taking jobs. Do you think that's what's actually happening here? I don't know if I would classify that. I mean, there's obviously a lot of this stuff is on the

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margin. The one challenge, Larry Summers has been harping on since last spring, all the way through the summer and the fall. And in multiple interviews and publications, he's done. He's the ex-US Treasury Secretary, obviously brilliant economist. The US needs to have a 5% to 6% jobless rate for five years in order for us to really get to the inflation rate target of 2% to 3% or below 2%. And so the economists and the macro guys that are tracking their jobs report today are, I think the indication is we're not there yet, and that the implication of a tight job market is wages go up, and wages go up, inflation goes up, because companies need to charge more because they have to pay more to get talent. And this obviously continues to support the escalatory spiral that drives inflation. So that's the downside to the jobs report today that I think a lot of folks are watching.

The Fed mentioned over and over again deflation. So any impact there?

Shamath, you think we're going to see prices start to crater?

And what impact would that have on the market?

I think sacks is right. I think the marginal risk here is for this whip-sign.

So we have a period now, which is disinflationary. But the problem is if the stock market keeps going up, and all of a sudden we have less restrictive monetary conditions, then we're going to be back at the same place we were before, which is money sloshing around into all kinds of risky assets or more money. There's still an enormous amount of money sitting on the sidelines that has to come into the market now if this thing keeps going higher.

So we're in a delicate moment. And if we reignite inflation, because all of a sudden more companies have more liquidity that they can tap, more money they can raise, more money as a result that they can spend, because we don't have this first inflationary cycle under control, there could be a risk that we reignite inflation. And so then they have to capitulate. The Fed has to capitulate again and start another hiking cycle.

So I think it's a complicated moment. I think all of the smart money in Wall Street that I talked to up until this point, they forecasted like this period would be choppy. And the second half of the year would be really robust. And like you need it to be super long and things were going to be incredible. And when I talked to them this week, they're like, oh, God, we weren't positioned for this. We had no risk going into this. We're going to be forest buyers.

There's a bunch of companies that are whispering that they want to go public now.

Oh, really? The big banks have been calling around trying to book build quietly for some IPOs. And so if they try to kind of crack this capital markets open, I think there's, again, the marginal risk will be that we do whipsaw as access.

When you say book build, you mean trying to see if you'll get some early takers to buy equity in an IPO, perhaps even in a company like Stripe that's been sitting on the sideline?

So not Stripe, they're in a complicated moment. But when they called to book build, they basically say, hey, listen, XYZ company, quiet filed, look at the S1, what do you think, where's the price, blah, blah, blah. And they're trying to get an indication of whether you'd want to be in the IPO book. So I think that there's a lot of those testing the waters that are now starting again. Would there be an appetite in your mind for an IPO in the second quarter of like a Stripe type company putting, you know, I don't know what the other candidates are, the lead candidates, but Stripe is the one people talk about most.

The thing that we have to think about is like, most of the market are not people, right? Most

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of the market are computers and algorithms and ETFs. It's an extremely formulaic buying model. Do you have components of an index? Those represent certain percentages. You have to own those percentages to be relevant as that index. And so it's this reinforced buying loop, as well as a reinforced selling loop, right? So when things start moving, those folks have to just systematically move money in. All the humans know that. So the humans tend

to front-run all the computers. And they basically are the ones that sell into these guys. And then that's what inflates these prices. Similarly, on the way down, humans try to front-run it by being short into that stuff. So we could see the capital markets open. Even if we don't, it's actually the worst scenario because now you have all this money going into a fewer number of names. That explains Facebook has doubled in 30, 60 days. Tesla has doubled in 30, 60 days. A lot of the tech stocks, like high beta stocks that we are all helping to build, those companies have just absolutely ripped 60 to 100%. These are not healthy and normal moves. And so the question is, what happens if inflation somehow all of a sudden pokes itself back up? Right now, it doesn't look like it is. And Paolo was clear, and it's true. We're in a deflation cycle. He said deflation 11 times during his, and he's very clear about his use of language. That's why the market rips. I mean, basically, that was all part of a narrative where inflation's on its way out. We've licked that problem. And that's what the market was pricing in. And I think now the question is, in light of today's jobs report, is that actually true or not?

Disinflation, not deflation. So I think one way to look at this is, Jake,

how you showed the chart of the Fed funds rate. Another chart is the yield curve.

Can we just pull up the yield curve for a second? This is the yield on U.S. treasuries, on RT bills. And one way to look at this is as a prediction market of where the market thinks interest rates are going. Because the Fed sets the rate for the Fed's funds rate, which is the overnight rate of lending to banks. But they do not set the rate of three months, six months, bonds, 10-year bonds, and so on. The market does, because the market trades those bonds, and it imputes a yield that the market requires to want to hold those bonds.

So what's interesting is that if you view the yield curve, again, as a prediction market, it tells you at any given time what the collective wisdom is of the market. Now, this thing is fluctuating all the time, so that collective wisdom is changing. But where things are today, it's pretty interesting. What the market is saying is that within the next six months, the rate peaks at 4.75%. So, Nick, if you just want to hold the mouse on the six-month dot, you'll see it's 4.76%. So, basically, the market is predicting we get maybe one more quarter point, roughly, not much. And then, if you go to the two-year, it's at 4.09%. So, a little over 4%. So, what the market is actually predicting is that over the next two years, we're actually going to get a 50-basis point decrease from the Fed.

And then, if you go to, say, the five-year or the 10-year, we're at 3.5%. So, the market's basically saying that long-term rates are going to stabilize at 3.5%. We're not going back to the abnormal zero-interest rate policy or ZERP that they have for 10 years. 3.5% will be the long-term stable cost of money. But you can see that the market, the prediction market, thinks that the Fed has done enough to combat inflation, because the Fed funds right now basically is where the bond market thinks it should be. And, in fact, the bond market thinks it's coming down over the next two years. But coming down to what would be 3.5% in a world that we've lived in for largely over

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the 14 years of this bull run, the majority of that was at close to zero or zero. Right. And that's why we're never going back to the bubble of 2021 where SaaS companies were trading at 100 times ARR. We're going to go back to an environment like a more normal one where valuations are more

like the 2017 valuation, something like that. By the way, it's 3.5% is not a bad...

It's still a great deal. Still a great deal if you got your mortgage at that.

If you listen to Buffett, Buffett's teacher, this guy, Ben Graham, in Ben Graham's book, the way that he would look at a stock and obviously look, things have changed. But the way that he would look at a stock is he would look at that risk-free rate. He would double it.

And then the inverse of that is the maximum price-to-earnings ratio that he would pay for a stock.

Right. That's the trade-off is if you can get more than two times the risk-free rate,

then it's worth owning a company. What that means is that if you take 3.5% as a terminal rate,

the right PE is around 14 for the S&P 500. Right now, the S&P 500 trades at 22 times PE,

which would mean that we are 50% overvalued. Now that, again, that's a Benjamin Graham model.

And I think the world has pretty cleanly moved away from it. But there's probably some rooting in that intellectual framework that's still valuable. And to your point, David,

it just reinforces that, man, we need to start to learn a new regime here because

when rates are not zero, there is just a lot of excess that you can't support

because the alternative trade-offs for investors are plentiful. And plowing money into a money-losing startup becomes less attractive. And to just give people some background,

that's the intelligent investor was that book, I believe. And he was talking about value investing,

which is, hey, what's the earning per share? What's the ratio? What's the PE? And that's

something that growth and momentum investing has been the opposite of. And this could be,

I think you wrote a blog post about this, Chumat, sort of the regime change. If you look at the

Googles, the Facebooks, the Apple's, Amazon's is a little bit of an exception here. Those companies printed money. They had profits. They built up large cash reserves. If we look at the next

cohort of companies, Airbnb's, Coinbase's, Uber's, et cetera, they focused on the top-line growth,

much like the Amazon, which was a very obscure approach, correct, Chumat, in the history of this.

Nick, do you want to just throw up this chart? We did a little analysis over here,

and it was just basically looking back 60 years of company formation. We looked at all of the

hundred most valuable public company startups, and we indexed that to the 10-year interest rate.

So what are we looking at here, Chumat, with this chart? So basically, we went back

from 1960 onwards, so basically, you know, 63 years. And what this shows you is

the hundred most valuable public technology companies. Then the size of the circle here

is their market cap. And then it's overlaid on top of the 10-year interest rate,

as well as gray bars for recessions. So what is this graphic meant to illustrate? Well,

it just was for us to study, is there a correlation between the value of companies

and what the interest rates were or what the economy was doing at the time? And to your point,

Jason, the trend is pretty starkly made on this chart, which is that if you are a company that

was founded in a period of austerity, you had the ability in general to build a much larger company than that which was founded in a period of wealth and excess. So when you look at when rates were

sort of approaching zero or were zero, there was a lot of really successful companies,

they're listed here in the light gray on the right, but none of those things really represent

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the success that these other companies had. That's the first interesting takeaway. The second interesting takeaway, though, from this has nothing to do with rates per se, but it is that when rates intersect with the emergence of huge technology trends, so in the case of the 1970s, it was the PC revolution. In the case of the late 1990s, it was the internet revolution. Those two things which required enormous progress in both physical infrastructure, so atoms as well as software infrastructure, bits when you put those two things together, those also created big companies. So if you add that all up, the point is that whenever you see huge tectonic shifts in technology combined with periods of austerity, that's when the gargantuan dollars are made. So in the 1970s, companies like Microsoft and Apple from the get-go had to be profitable. In the absence of one very important round of financing that Amazon was able to close, the next big wad of companies were founded again in rising rates where they just had to get profitable or find a way to be positive free cash flow or have positive working capital faster than anybody else. So these are really interesting trends that I think just say that as rates creep back up, and if we can intersect that with some improvements in technology over the next five to 10 years that we've all talked about, it could be a real boon for startups and startup investing.

It would mean people are a little more resilient, a little more hardcore to use a term.

Freeberg, where are your thoughts on this analysis by Social Capital?

It's interesting. I mean, I think there's probably two ways you could interpret this.

One is in an era of excess capital, all the capital gets competed away, and so you pay more salaries, it's harder to get high quality talent, you make a lower margin, et cetera, et cetera. It's much more kind of competitive on the ground. And then another one is just obviously kind of like evolutionary fitness, when there's less capital, investors are more selective.

I think what might make this era a little bit different than the past is just the amount of termed dry powder sitting on the sidelines right now. So the total VC capital raised last year, I think was a record high. That means there's a lot more cash that needs to kind of be deployed in the next 12 to 36 months than has ever been deployed in the history of venture, if that holds true. So that may be kind of a counterbalancing effect here, where it may take three years before that effect plays out, where there's more of a dearth of capital.

It's certainly the case that institutional investors, endowments, pension funds, traditional family office LPs, and venture funds are making far fewer commitments this year to new funds, as I think we all know. And that tightening will play out in the venture funds that'll get raised for this vintage, the next vintage, and so on. And so maybe that kind of evolutionary fitness concept starts to play out later. And sizing. And sizing. And sizing. I think there's also this like, you know, we talked about this on our text stream, but the venture business of the last 15 years, everyone since 2008, everyone's been trained. And all the younger people that have come up and are now partners and running the firms on an environment of momentum investing, rather than fundamental investing. And so there is also a question of how fit the investors are for a market space where valuations are flat, or descending, or the decision whether or not to invest is no longer driven by who else is investing and how much is the company growing and how much

is their valuation going up. But it's much more about kind of the fundamental performance

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of the business. Does this match what you're seeing on the ground, Saks? Are people being more dogmatic, pragmatic? Are the capital allocators really sharpening the knives and looking at these businesses a different way? Is it actually hit the streets?

Yes, there's a record amount of money venture capital has raised over the last, you know, a couple of years, but it's going to be deployed much more slowly and carefully over the next, say, three or four years than it was over the previous few years. So divide that amount of money by three or four, because the pace of deployment is going to go way down.

And so, yeah, I think people are going to be more careful and take longer to make decisions. I think it's going to be much, much harder for new funds to get started, all of the hype around solo capitalists and all these seed funds and micro VCs and all this kind of stuff. I think a lot of that's going to get washed away. I think in hindsight, a lot of that was a product of the bubble. And yeah, I think you're going to be in for a period of some retrenchment in VC. And I think that's good. I mean, I think to the point of Chimás's study, that the counterintuitive finding in his study was that great companies are created during times when we're not in a bubble and capital is sloshing around everywhere, but when you're in an environment of moderate capital availability. And I think the point is that we all have to be under some stress. That's what evolution requires is if an ecosystem or an organism is not under stress, they have no pressure to evolve and become fitter and compete. And I think that's what makes our industry and our ecosystem very adaptive over time is that it's constantly, it does face survival pressures, but over the last several years, all the survival pressures were taken away because anybody could raise money. There was always another bridge available. There was always some extension and there was no reckoning. Some convertible note to be done. There was no reckoning. A lot of these companies just seem to get another 12 months of runway. Another 12 months of runway. Founders learned so many bad habits during that period of time and so much entitlement and excess built up in the system during that time. And I think now we're seeing that a lot of that is working its way out. I mean, just look at the Facebook results the other day. Let's talk about Facebook as an example because here you have a company where the stock over the past year had been pounded.

It was like down over 50%. And the market did not like its answers around the capital investments it was making. And then Brad Gerstner, our friend, wrote that letter encouraging them to get much more efficient. And then they did that and they basically started doing some riffs and basically just getting much more efficient in what they're doing and specifically taking out layers and layers of middle management. I mean, that was really the big thing. So they kind of took a page out of Elon's book in terms of what Elon had done on Twitter. I mean, not nearly to that extent because I don't think they needed to, but they targeted this idea of we have too many layers in the company, too many mid-level managers. And the stock rip just was it like up 20%, 25% yesterday? And they're up to, I actually bought it based the day they had the layoffs, I put in a buy order and it was closed at \$94 and now it's at \$193. And FedEx of all places is laying off 10% of its officers and directors. So the idea now is, hey, in the senior ranks, what is the inefficiency there? How do we get more doers, more people who actually are building or operating the companies to take the reins and get rid of this, as you're saying, middle management, this waste that companies have? Yeah. Let me tell you specifically the problem that builds up in these companies is that everybody wants to be a manager. And so you can't just come

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at this problem by saying, we're going to increase the number of reports that each manager has from 5 to 10. That doesn't work because let me tell you what happens is that every individual contributor who's a star thinks that their career advancement requires them to manage a team. So what happens is you take that star IC and then you create a team around them. So that person then hires five people to manage. And those five people are not stored. Yeah, they stop working, they just start managing. Well, maybe you get like 20% more production out of that six-person unit than you would have just out of the star. But you're spending five times more money. So it makes no sense. And the problem is it cascades. So that IC becomes a manager, they hire five people. Then those five people, one of them is a star and says, well, I want to be a manager. And all the organizational pressure is to keep building more and more teams and more and more layers. Here's the quote from Mark Zuckerberg to illustrate your point from a recent All Hands meeting. I don't think you want a management structure that's just managers managing, managers managing, managers managing, managers managing the people who are doing the work. Yes, it's the problem of infinite delegation. Every star builds a team around them to delegate the work, but then they hire a team to delegate the work to. And pretty soon, the most junior interns in the company are doing all the work and all the best people are just managing. So it's actually a huge problem. And I think that I'd say that a lot of CEOs don't quite understand the problem because they think that all they have to do is increase the number of reports that managers have. It's not. You also have to reduce the number of layers in the company. And just the ultimate example of this, just to put a point on it, was at Twitter, what we saw is that when Elon went in to basically do a riff at Twitter, the first question he asked in the engineering department is, who's checked in code? And they looked at the code repository, and about 50% of the engineering department had not checked in code in months. And you want to know the reason for that is because the engineers were told that if you want to be a manager in this company, you don't code. Managers don't code. Only ICs code. And no one ambitious wants to be an IC, they all want to get promoted. So it all gets explained.

To explain what an IC is?

Just individual contributor. So the whole thing turned upside down because of this idea that, again, ambitious people want to be managers and managers don't do the real work. Yeah, it's a cowboy so you don't know how to ride horses. It's a dangerous precedent to set. What are your takeaways, Chamath, from what happened at Facebook when you look at it and the pressure that was put on, the ripping of the stock, even though they're down 2% year-over-year in terms of advertising revenue?

There's a guy on my team sent me this chart. He did a pretty detailed technical analysis of Facebook. Nick, can you please put that image up there? So basically, this shows the... This is really technical.

This is the first time Facebook mentioned the word metaverse in Q2 of 21. On the earnings call, they mentioned it 20 times and the gray line here is the stock price. So as they kept mentioning it, the stock price just reacted as it did. But Q4 of 22 was the first time that the word efficiency exceeded the word metaverse and you saw the stock price rip up. So what's happened at Facebook is really interesting because I think it transitioned to what's generally called an X growth company, which means that people are now looking at a business that has essentially gotten to its peak size and now what they're looking at is its ability to generate cash flow. The cash flow

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generation or cash flow yield of the business was like 3.5%. But they're making enormous cuts, both in capex as well as headcount over time. They're getting their expenses under control and all of that should drive up their free cash flow yield. And so I think why people got very excited is there are very few X growth stocks that you can own that can just compound and crunch ginormous amounts of money. And these guys are in an incredible position to do it, more than \$100 plus billion of revenue. And if you get these costs under control and get efficient, get the employee base down to \$30,000 or \$40,000 over time, this is a thing that just spits out just ginormous amounts of cash. Back to value investing and Warren Buffett, that means the earnings per share go way up. Yeah, like the Facebook PE is quite modest actually. Now, I actually put back in Stockbase Comp and its PE is about \$11,000.

It's still reasonable. If you go back to the Ben Graham analysis, this is a company that perfectly meets that criteria of like, you can buy it at a PE that's basically two times the risk-free rate. And so I think it's an incredible stock now that you can own. Because if they keep grinding out all of these kind of free cash flow gains, man, they'll just have enormous amounts of money. They already announced a \$40 billion buyback. The thing to keep in mind is Apple had a moment like this. And when Apple went X growth, they did the brilliant thing, which is they said, we're going to borrow heavily and we're going to return cash. I may have posted this in the group chat to you guys. By 2025, Apple will have exceeded \$1 trillion of cash distributions. I mean, that is just nuts. Is that include buybacks in cash distributions?

Buybacks in dividends. And so Facebook now, you can credibly see a path where Facebook could chunk

out hundreds of billions of dollars of total shareholder value returned over the next four or five years. And so for value investors, it's somewhat of a kind of a no-brainer. I mean, nothing's a no-brainer, but really, really attractive value fundamentals right now.

I mean, you did see Warren Buffett buying Apple. I think it's his largest position. You're going to see him probably do the same with Facebook. There was an interesting mass extinction event tweet that went on that's related to all of this. Tom Leverio, a GP, a general partner at IVP, which is a venture firm, tweeted the following thread. There is a mass extinction event coming for early and mid-stage companies late 23 and 24. It'll make the 2008 financial crisis look quaint for startups below. I explain when, how, and why. And we'll start off with some detailed advice. Basically, four in five early-stage startups, he claims, have less than 12 months of runway according to a Q4 survey of 450 founders by January Ventures. He sees late 23, 24 when this will all come home to Roost. Mark Seuster from Upfront Ventures, friend of the pod, replied with the following, precisely our internal analysis, 5,000 seed, 2.5 million raised or above, A and B companies, those are three different categories, funded in the last four years. We estimate 50% will go out of business. Lost ratios in the last seven years have been artificially low due to excess capital, as we just discussed previously, with the never-ending bridge. We've talked about this before. If you look back over 40 years of venture capital, the average top-quartile fund distributes 1.6 or 1.7x the capital they raise. Even though now we've gone through a period where people have shown these unbelievable markups, TBPI is the total value of paying capital, distributions have not really budged that much. Distributions are still modest. They're below 2x. We have to go through what's called mean reversion. We have to go back to the historic statistical average, which means that

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a 50% to 60% mortality rate seems pretty reasonable. By the way, in the dot-com bubble, that's what we went through. In 2001 to 2005, we had a 50% mortality rate.

At the seed stage, you kind of expect 70% to go out. Series A, maybe a little bit less.

Freeberg, what are you seeing on the streets? You're investing in startups.

Yeah, look, I think that there's-

Is there an opportunity, by the way, also in here? What are you seeing? Is there an opportunity in this cohort of companies which seem to be upside down and or in a tsunami right now?

This cohort of companies, I think, generally is overburdened with feature orientation and short-termism, more than you would see in an era of reduced capital rather than excess capital.

What I mean by that is a lot of companies built a business or built a product that allowed them to show traction in the market faster. Typically, those products that are easier paths to market end up being features. They don't end up being platforms. It's very hard to become a big business or to become a scaling business or to differentiate in a competitive market.

That's a very general statement. But I think when you miss out on the platform play, you start betting as an investor on a lot of the derivative plays that look like the real big company, look like the platform. I mean, think about how many companies try to look like some iteration of Stripe or try to look like some iteration of Uber or try to look like some iteration of name your big behemoth. As a result, you get all these feature-ish platform plays that have maybe a niche or some narrow market opportunity. They got funded. Those businesses obviously aren't going to have the same valuation multiples of the winners in the market. Now, and they burnt a lot of money to demonstrate growth because so much of investing over the last 15 years has been momentum investing. They try to grow, then they try to get a higher valuation, investors plow more money in. Now, the problem is that so many of these series, BCD and E-companies have a true market value. They're not a valueless company, but the true market value of them is probably less than the total preference stack of the capital that's gone in. I'll just describe it. When investors invest, they have preferred stock.

So they have a right to get their money back. So let's say a 1x liquidation preference, they invest \$100 million. The company is worth 300. So they own 25% of the company after they invest, but they have a right to that \$100 million first before common shareholders get paid.

The problem now is that a lot of those companies may be worth less than the 100.

They're not worth 400 anymore, they're worth 100. And you can see this play out in the public markets with that data set I shared with you guys a few weeks ago. Over two-thirds of companies now

that have gone public since 2020 are worth less than the capital that they have raised as in the venture market. So if they were still private, they would be worth less than their preference stack. And that's where these companies start to unravel. Because now the investors have

to totally recap the company. The founders don't want to have all of their common wiped out. Now they own nothing. And there ends up being a very ugly scenario that happens with the board at that point on how do we wind this thing down? How do we recap it? What's going to happen? And that's usually where everyone starts to run for the hills. The founders, one or more of the founders, leave and so on.

I have a question for you. So you mentioned this earlier, which I think was a really important

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point, but we didn't really touch it. Do you think there's going to be a reckoning inside of venture firms about recalibrating general partners?

100%. I mean, look. And why? Sorry, just explain why.

Yeah. So I think what's happened is over the last 15 years, to become a successful venture investor, you've gotten into the hot deals. The deals were and hot deals, the valuations are typically climbing up. And when the valuations climb up, that's an indicator that the company is doing well and you should invest. That's been the model for operating in the last 15 years.

But the truth is that maybe just because the valuations have gone up and more money has gone in, doesn't necessarily mean that that's a great business or, as Chimac points out, that you ultimately get a positive net return on that investment down the road.

And that window is now closed. So the investors that have been trained, this is such a generalization and I hate saying it because we have so many good, smart friends at work in venture.

But generally speaking, there are a lot of folks who have come up who have been trained on this momentum investing model. And it's like day trading, the stocks are going up, let's all put money into the stock going up. Instead of having a more fundamental approach to is there real cash generation potential and scalability and platformability of this company. And as a result, you're going to have to see, I think the junior partners that have come up and done well in this market. Can I have a point? Well, they've done well on paper, but they haven't done well on distribution. So maybe that, Chimac, becomes the way you decide who's a good venture capitalist. Which of these companies actually returned capital at a peak market?

Well, I think Friedberg is really onto something and he mentioned this before. So

I got curious about this and I went into pitch book and my team and I looked at all of the people, the humans in our business, that have generated more than a billion dollars in distributions on a given deal. And there's 20 that have done that in our industry. There's people that have made hundreds of millions of dollars once or twice, but there's 20 people that have made more than a billion dollars more than once. And if you look, not a single one came up through the ranks as a pure engineer or product manager. Everybody, 201 is extremely commercial in their background and their operating experience. Very few percentages of them were actually founders. A huge percentage of them were trained in banks and other places. So non-traditional roles for what this current crop of GPs look like, because we went through a phase where if you were a VP of product or a VP of design or VP of engineering at a well-known startup, that was the most obvious onboarding into a venture firm. But if you just look back at the data, that cohort of people has actually never made money. Again, according to pitch book.

That's fascinating. And that's a really fascinating counterintuitive takeaway, which is that, and by the way, what's so interesting about that is Pat Grady, I think, had a tweet.

And it just sums it up so cleanly because he just hired somebody from Co2.

And the tweet was something through the effect of this guy is the most commercial guy we've ever seen, something like that. And I thought that was so interesting because that is exactly what our heuristical analysis of this data was as well. Commercial people in venture are the ones that make the money. So you look at a Fred Wilson, Michael Moritz, Danny Reimer, Bill Gurley. They were investment analysts in public markets before they became venture investors, or Mike Moritz, who was a journalist. Yeah, which is a journalist is just an analyst. It's another, if you're a good journalist, it's another word for analyst. Yeah, it was really,

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really interesting looking at that list. So like, you know, there are people in there like Jim Getz, Alfred Lynn, Danny Reimer, Jan Hammer, Fenton. So if you look at all of these folks that are just tier one people, and we know all of them, the one common thread amongst all those folks is that unbelievably commercial. And so Jason, in a moment like this, where you have to really hold the entrepreneur's feet to the fire or be their partner to make extremely hard decisions, you have to have the ability to be respected by them in those moments where you can force a very difficult decision. And then separately, if you have to basically force liquidity so that you prioritize your limited partners, how do you do that while still managing the relationship with the entrepreneur? How do you know that you just need to cut your losses and get out? These are very difficult tradeoffs that I think folks haven't been trained in doing to David's point. So it'll be really interesting few years to see how these organizations. I think this goes, this goes to Sax's point about, hey, the ecosystem, if it's hard, if it's contancorous, if there's sand in the oyster, it could make the pearl. If you have a congenial relationship with your product manager VC and everybody's champagne and caviar and high-fiving, maybe that's not as good as having a Bill Gurley, a Michael Moritz, and having a foil, maybe, who is putting pressure on the management team, hey, we need to hit these numbers, Friedberg and then Sax. Yeah. Look, I think one counter argument here may be that there is this friggin' tidal wave of AI companies and there is this incredible amount of lubricant in the dry powder that's sitting on the side of the market right now that all these venture funds raved in the last two years that is going to lubricate all these AI companies into every vertical and every market. So every company's wrapped up in an AI cloak, like a magic invisibility cloak. Every AI company's got an AI hat and a badge and a tattoo now or every company's being rewritten as an AI company and the money wants to find its way into AI and it wants to rewrite every industry with AI. So I think similar to what we saw with mobile and the social web, going back 10 or 15 years, we're seeing this AI wrapper and this AI technology enabler rewrite the possibility of every vertical and the VCs have capital, more capital than they had 15 years ago or 10 years ago or even 7 years ago. So there is this counter narrative which may be that the game goes on, the band continues to march on, the current crop dies out, but there's immediately a new crop waiting right behind it or what happens is the herd dies and everyone runs to the back of the herd and gets recapitalized because I can tell you every startup I know that's not going well, everyone's talking about leaving to go do an AI company and the venture funds are ready to write money. I think you're right about that. I think the question is the actual person making the check, will they be more or less likely? And at least what history would tell you is that we've hired an entire generation of people that, and this is clear, do not map to the people in our industry that have actually generated returns. So you're right, they may take this money and misallocate it into these companies that are just rebranding themselves, but that just goes and further proves that there is a type of person that hasn't been recruited into these venture firms yet that was the first generation that made all the money. I think it's always been the case that there is some difference between the background of the VCs and the backgrounds of the founders. I mean, you guys mentioned Gurley and Moritz. Like we said, Moritz was a journalist who had written a book about Apple. He was a technical per se. And Gurley was an investment analyst on Wall Street before he then made the transition into VC. As we both know, they're like legendary VCs. I think that what you want to see in a VC, I think the background matters a little bit less

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than how curious are they? How good are they about learning a new area? How good are they at being like a heat seeking missile? Basically, just like zeroing in on what is the hot space and specifically what is the best company within that space and somehow figuring that out, being able to assess a founder, that's a very subjective thing. So I think there's lots of qualifications that you want to see in a VC. Now, at the same time, I do think that if AI is the next wave and the next sort of platform opportunity, as we all think it is, I do think that places more of an emphasis on technical skills. And I was literally just having this conversation at Kraft that, gee, maybe the next hire we should make at Kraft should be someone who's really deep technically so they can help go deeper on technical due diligence of AI companies.

They've never made money.

What's that?

They've never made money in the history of our business.

Who?

Those people. That archetype of hire has never done that on behalf of LPs or GPs.

Well, in biotech and life sciences, they have.

But what kind of hire?

The best investors, usually PhDs there.

He's saying a technical hire who worked in the trenches at a company is not as fit to get-

No, has not in the past.

Has not in the past.

Has not in the past.

Has not in the past.

Has gotten DPI, whereas somebody who is-

Right.

More commercial.

Able to analyze a business, commercial.

Oh, yeah, yeah, yeah, yeah.

The ideal person-

Is going to be able to get returns.

Right, right. So look, I think the ideal person would be someone who's

a family, a great investor, but also has some technical background and some technical chops.

We also have a team approach at Kraft.

So if you have someone who's very technical, they can just diligence the technical aspects of the deal.

Somebody else can be responsible for making an assessment of the founders.

How we've solved this is we have a group of third-party individuals that we work with that we keep on retainer, that we compensate.

And whenever we need to do deep technical diligence, we partner with them to do that work with us.

And what it allows us to do is get the best of their technical thinking without also putting them in a position of trying to adjudicate whether this company is good or not.

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What I'm trying to understand is what is this technical edge and can I understand the boundaries of that?

But I still keep the investment decision to myself and my partners because otherwise the difficulty is, in my experience, deeply, deeply technical people are extremely good at diligence, but generally are poor at making investment decisions because there's a part of their brain that flips on, which is like, I could do it better or I could do it this way or I could do it that way.

And I think that anchoring bias can be very dangerous.

And you almost want to be a little dumbed down from that depth of knowledge because you either find everything that is not worth doing, and then you can miss a market, or you miss the thing that is good enough because you're like, oh, well, I would have done X, Y, and Z in a different way. So we kind of use them, but we keep them at arm's length so that they never feel the pressure of having to actually decide on our behalf how the money should be spent.

Yeah, that's interesting.

Yeah, the number one thing we're doing at this early stage is tracing our founders, I know this sounds crazy, on accounting best practices and pricing best practices.

And we literally have founders who have never made a plan.

I'm talking about at the seed stage who don't know accounting.

And so we are running four seed stage startups, and I'm kicking myself that we didn't do it two years ago or three years ago, but better late than never, on how to just maintain their books and understand operations and the operational lack of discipline in the market.

I'm seeing Series A and Series B companies that literally don't understand their own accounting.

And so when we start talking to their accountants, there is a huge gap between what the accountants think of this business and what the founders think of these businesses.

And founders think they have more revenue than they have or less revenue.

They really don't even know how to calculate their runway in an honest way.

And so there is, back to your point, Chamath about on the venture side of the business, a lot of product focus, a lot of operational focus.

There's not enough focus on just the bottom line.

The reason that happened is what Friedberg said before, which is like somebody would build something, there was a little bit of momentum.

And you'd have to go and present these bona fides to these entrepreneurs to get into the deal.

And so what venture firms thought was the right bona fide to present is, oh, I built XYZ product at this other company.

And they thought that that edge could get you into a deal, maybe, but it could turn out that that was the wrong company to be in in the first place.

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And so you just missed an entire generation of value creation because it happened sort of off-piste.

Off the trail, yeah.

You really do need to understand fundamentally, because we're talking about public markets here, the Facebook analogy, what is the ultimate earnings?

The terminal buyer.

That is going to get thrown off this business.

And that's what the whole industry needs to, I think, pivot to, and just that needs to be the operating principle.

Do you guys know how much money Facebook, Amazon, Google, and Microsoft raised combined total before they went public?

That's very small.

I mean, Google is minuscule.

Less than a quarter billion dollars.

Unbelievable.

Yeah.

All four companies.

The inefficiency is extraordinary.

And then on top of this inefficiency, I don't know if you're seeing this.

They were all profitable when they went public.

I think on top of all this inefficiency is a dependence on venture debt.

I don't know if you're seeing this sacks, but the amount of focus on adding debt to unprofitable companies over the last five years has been just extraordinary.

I don't understand what.

I've never understood the venture debt model or really how it works.

I feel like it's a category that doesn't make any sense.

Say more.

I mean, well, I mean.

Explain it to people what's happening.

I don't really understand how it makes sense for lenders or for founders to be honest.

I think the whole industry doesn't make any sense.

For founders, I don't like it because the money has to be paid back.

It's debt.

So founders take in this venture debt thinking like it's an equity round, but without dilution with some warrants.

And they don't realize, well, wait a second, we got to pay this back in a year or a year and a half out of the next round they do.

But that creates an overhang on the next round because the new VCs coming in, they want their money to go into the company, not paying off a bank.

So it actually makes the next round less attractive.

The other thing about it is that the lender is not getting an equity reward.

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So they don't want to take equity risk.

They may be getting a nice coupon.

I might be getting 9% or something like that, which sounds high for debt, but they're not taking true equity risk in the company.

So the last thing they want to do is be your last six months of runway.

Right?

They want to be your first six months of runway and then get paid.

And then get paid off on the back end.

And I think a lot of founders think, oh, well, I'll take this money and it'll extend my runway from 18 months to two years.

But what will happen in that last six months is all of a sudden, the bank will come to you and say, no, no, no, no.

Like you have this or that material adverse condition.

It's called a Mac out.

And there's all these like terms that founders don't understand because it's highly legalistic covenants.

And so all of a sudden, the founders find themselves with a lot less flexibility in that last six months to a year.

Either a covenant gets triggered that makes them pay back the money immediately or their business flexibility goes way down

because they're consulting with their bank about everything.

All of this is coming home to roost right now.

I think it's a terrible deal for founders.

And I think that even for the lenders, I mean, I guess I assume that these banks know their business better than I do.

But I think that the reason I don't trust it as a category from a lender point of view or from like an investor point of view is that all the data about defaults over the last five to 10 years happened in this free flowing zero interest rate environment.

And so the startup mortality rates were artificially low because it was so easy to raise.

So yeah, venture debt makes sense in an environment in which founders are generally able to raise the next round and then pay back the venture debt.

But let's say that that tweet storm you mentioned, Jason, can you bring that back on the screen?

I actually think this tweet storm is basically correct is, you know, I've referred to on this show before that I think one of the things that built up during this bubble is latent startup mortality.

So many startups that should have died from not being able to raise the next round lived because they're able to raise money.

And what the tweet storm is predicting is that the second half of 2023 and then 24, you're going to have a huge crunch where all these companies

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have to go out and raise.

They've been waiting.

So they're all going to get to the point where their cash is so low they have to go out and raise.

And now all of a sudden they're going to be confronted with the new market conditions.

I wonder how many of them have venture debt as an overhang.

And those ones, yeah, and they're going to find they have less runway than they thought because again, those banks, you know,

they are going to try and collect the debt before the start runs out of money.

Not, you know, when it runs out of money.

Catch two falling knives.

Yeah, exactly.

So, look, I just wonder what I don't trust is whether the return models on venture debt that were created over the last five to 10 years will be a good predictor of what the returns will be in the next five to 10 years when a lot of the mortality that should have happened in the past now happens in the future.

Well, I mean, then in fact, correct me if I'm wrong here, but

I'm also starting to see really gnarly term sheets.

People foreclosing on businesses.

People offering like literally had a term sheet come in like,

we're going to forgive the last note and take this business over for a dollar and everybody gets wiped out.

The amount of bad feelings that you have to go through,

even if there is a core business to Friedberg's point earlier,

hey, they raised a hundred million,

but there's a 50 million dollar business in here that people would love to invest in.

Who wants to go through the hand-wringing, the negotiation, the toxicity of a recap?

It's an extremely hard process to go through.

Are you going through any recaps right now, Sax?

And what is the approach of the firm in terms of dealing with these kind of situations?

Do you even want to start that discussion up?

Or is it too painful?

Well, we're not at the, I don't think for most of our companies,

we're at the recap or restructuring stage.

I mean, I'm talking about the ones that aren't going well.

People still have a fair amount of cash in the bank.

And we've been beating the drums for literally a year.

But what about new opportunities?

A new opportunity comes to you.

It's one of these overhang companies that wants to restructure.

Would you even engage that or is it just too hard?

I looked at seven at the end of last year

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and I tried to reprice three of them.
And every single one was able to get a convert done away from us.
Yeah. So, I mean, yeah.
We tried to find a market clearing price for this equity,
but nobody wants it to David's point
because there's too much money on the sideline.
And people are willing to give them a lifeline
that doesn't force them to come to hard terms
with what the reality of the moment is.
Yeah, I agree with that.
We're not quite there yet.
And I think the reason why that tweet you posted got some traction
is it's saying, listen, the crunch is going to happen.
Second half of 2023 and 2024,
that's where you're going to see the down rounds.
That's where you're going to see the restructuring,
the recaps and all the rest of it.
And look, I'm sure like every VC firm is going to be a player in that.
But yeah, it's going to be a lot of miserable work for founders.
This is where you're going to see people's true colors.
When you have to recap a company, and this is when you can really start to see.
Do you guys remember how crappy it was in 2003 to be here?
Remember 2003?
Painful.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
Oh, my God.
I'm lucky to raise \$500K on a \$3 million.
Like what a brutal year.

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Yeah.

And there's going to be a lot of that.

I think the next 18 months, or let's say the next two years, there's going to be pretty rough for a lot of companies.

And it's just that they didn't cut enough.

I mean, we've been beating on the drums for a year for companies to lengthen their runway.

And some did to some extent, but many didn't do enough.

And they're going to get caught in this crunch.

Can we just go to that chart that Brad put out?

I think that what a lot of founders don't quite understand still is that things are just never going back to 2021.

I think a lot of founders listening to the top of the show,

where we're talking about inflation is under control, they see the market rally,

Facebook's up 25%, they may be thinking, okay, we just have to weather the storm for six months or a year, and then everything's back to normal.

And I think what's important to understand is that the market did bottom out about a month ago and is up pretty nicely.

If you see here, this is the SaaS index.

It's the median enterprise value divided by next 12 months revenue.

And it was really beaten down at the end of the year, at the end of last year, coming into this year, it was like four to five X multiples of next 12 months revenue for SaaS companies.

That's all the way up to 6.1 now.

So you're talking about 20% to 50% rally for a lot of companies, which is huge.

We're still below the long-term median, which is just under eight.

But what people need to understand is that even if we revert all the way to the mean of eight, which I think at some point we will, that's still well below the bubble of 21, where they got to 16.

So even if things continue to inflate, valuations will still never quite be where they were in 2021.

If you think it's getting back to 12 or 16, it's not happening.

For high growth companies in 2021, you were in the public markets, you were seeing multiples of 30 to 35 times.

Now those companies are maybe at 8 to 10 or 12.

I think the reliable way that we can look at this for the future is that

we're never going to see these kinds of multiples again unless rates are zero.

And all kinds of tourist capital need to find a home to escape zero percent returns in every other asset class.

But if even the safest asset class now will give you 3.5%, 4%, this is probably the new normal for quite a long time.

And we're going to be back in that early 2000s kind of mindset, which takes a lot of hard work to build value around.

We talked about the sort of whipsaw economy, and there's a lot of mixed inflation data.

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I think founders need to understand that there's a bifurcation.
What's happening in the tech ecosystem is not necessarily what's happening in the overall economy.
The tech ecosystem is clearly going through a reset and a recession.
Job cuts are now the rule, valuations are much lower.
Whereas, in the overall economy, we saw a job support today of over 500,000 new jobs.
So the fact of the matter is that even if the overall economy avoids a recession, that doesn't mean that things are just going to bounce back.
Tech and also depression slash recession, best case is recession for tech.
Well, tech is a boom-bust cycle, and we had a phenomenal 10 years of boom.
Now we're in a bust.
And so I would just tell founders, look, it's good if we have a soft landing in the economy, I wouldn't assume that that's going to happen.
I still think there's a really good chance of recession later this year.
But it almost doesn't matter for you.
What matters is your business and the capital availability for startups, which is fundamentally different and will remain different than it was in 2021.
Freberg, you were talking in the chat about Adani Enterprises and Hindenburg doing this short research and publishing it.
Stock has just absolutely gotten clobbered.
They were trading at, gosh, \$4,100 was the 52-week high, and this thing has just cratered in the last five days.
I'm going to explain what's going on here.
Well, I mean, the story that the conversation I thought it would be interesting for us to have is the role that these short seller research analysts play in driving efficient markets by identifying perhaps things that the market broadly is missing.
Particularly, given that a few weeks ago, we were all talking about the FTX debacle and how no one was doing their diligence and no one was digging in and no one was revealing publicly what was going on inside of that business that ultimately caused significant losses.
The claims made by Hindenburg is that this company, Adani, which is founded and run by a guy named Gautam Adani, he started the company, I think, 30, 35 years ago, and he's built this thing into this sprawling empire, as people would say, where he owns ports. He owns mining companies.
He owns energy transmission businesses.
He's got a whole green energy business, and he's taken a bunch of these companies and he's floated them publicly, so they're all publicly traded.
There's some degree of interrelatedness between all these businesses.
It reminds me a lot of, I don't know if any of you guys remember Aiki Batista out of Brazil. Do you guys remember this guy where he built this sprawling empire, very broadly diversified, industrial conglomerate with lots of different segments and used a lot of leverage, a lot of debt to grow the business, and a lot of interrelated, interparty transactions, and ultimately the whole thing kind of came crashing down, and that the Sadani business, it's super technical and super complicated, all the kind of accounting shenanigans that Hindenburg is claiming has been going on, and capital market shenanigans that they're claiming

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have been going on with this business.
But their kind of report, which I think is like 400 pages long, has caused-
The response was 400 pages.
The response was long, too.
Yeah, and then the market shrugged off the response, but didn't really care,
and they kept selling the stocks off.
So there's like seven or eight publicly traded companies,
all of which are just getting decimated.
Look, I don't have any strong opinion on this business.
I kind of skimmed through the thing.
But it really made me question how such a big, call it, accounting or capital markets
fraud, if it really is that, can go on, and how much of a role these sorts of players play
in the market, and whether you guys think that this is a good thing in the market
to have these short seller reporters out there doing this analysis, publishing it.
Jason, by the way, you called out Nicola, Nicola, the electric car company, as you know,
Hindenburg put out that Nicola report stock tanked, right?
They claimed it was all fraud, et cetera, and then the thing got destroyed.
Trevor Milton got convicted, yeah.
Right, and so I mean, I guess do you guys think that these guys have a positive role,
net net, in the market in kind of identifying and calling out this stuff?
Because we all have friends that are on the wrong side of short sellers and they complain
about it, and it can be really difficult to grow and build a business when people.
Elon had these guys literally claiming he was running a fraud for years and years,
and it was an intense amount of scrutiny because when the stock was less trafficked in,
when we were in it in 2015 and 16 and 17, that was the constant refrain.
And Elon was constantly batting back folks like this who would make claims.
And the way that these guys are allowed to operate is because they use the First Amendment
and say, we have the right to say this stuff.
I think that shorting falls into two buckets.
One is you use it as a hedging instrument.
So when we talk about spread trades like long Google, short Facebook,
or long Facebook, short Google, you should be allowed to short.
I think that that's a very reasonable thing to do.
I think the question is, if you were on the inside of a company and you say XYZ is happening,
for example, Trevor Milton, and it causes the stock to go up and it turns out to be fraudulent,
he's held accountable.
The question is, should there be the same responsibility for people on the outside
who, if they have enough distribution, can say the exact opposite of XYZ is happening?
In this case, XYZ is not happening, which then causes the stock to go down.
Because what the business model of these short sellers is, write a document.
It looks very polished and very credible.
Put on some positions, then put the document out.
If the stock goes down, you close it out.

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In my opinion, I think that short sellers are a really important part of a well-functioning market or the ability to short.

But what I would like to do is take an extra step, which is you should hold these folks accountable the same way you'd hold an insider accountable, which is almost to the effect of when you put out this screed, if you make money from it, it should sit in escrow, and the SEC should actually adjudicate whether it's true or not.

So in the case of Hindenburg and Nicola, they shorted the stock, they put out a report, it turned out they were right, all that money is completely well-earned.

Now, what if this Adani thing turns out to be not true or true?

Nobody knows right now, except 50% of the market cap has already been wiped out.

So that's where things I think are in a bit of a gray area.

The last thing I'll say is that if you look at it in the developing world, there's a very gray line between some of the leading entrepreneurs and these governments, because these entrepreneurs are doing the work of some of these governments.

Whether it's Ike Batista in Brazil in one moment, right around natural resources, or Adani in Ambani in India, or a lot of the people that have made a lot of money in China, or the people that are making money in developing markets, Turkey, Russia, etc.

The government uses very talented entrepreneurs to go and concentrate capital to do business. They integrate capital to develop infrastructure progress.

We did that in America in the 1800s as well.

So that's where I think you have to also balance it, because his response was basically like, this is an attack on India, and in a way, you can see where he's coming from, right?

Because he's building ports and roads and bridges, and he's like, without this stuff, how is India supposed to even exist in the 21st century?

That's a reasonable claim.

So I agree with you, Freebrook, I don't know whether the report is right or not.

But this extra step of actually having the SEC actually tell us what the answer is, I think would be a very important improvement to how this kind of stuff works.

The other improvement that the SEC has been proposing in Rule 13 F-2 is that people would need to disclose their short positions.

This proposed rule would require institutional investment managers,

I'm reading from the SEC website, managers exercising investment discretion over short positions meeting specific specified thresholds to report on the proposed form, SHO, information related to end of month short positions and certain data into the effecting of such short positions.

That is a no-brainer.

That should absolutely pass.

The commission would aggregate the resulting data by security, thereby maintaining confidentiality of the reporting managers and publicly disseminating the data to all investors.

This new data would supplement the short-sale data from the public of over-lending of stock. This is less about who's doing what and it's much more about are we creating critical fail points in the system by seeing over-leverage and over-lending in certain credit assets.

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Well, there should also be some rules about the spreading of fear, uncertainty, and doubt.

That FUD, that happened with Tesla Q, paradoxically, thousands of...

No, but that's an example of people essentially lying in public to try to get the stock to move and Tesla's not a fraud.

That's a real company.

I mean, they were waiting car of the year while this was going on.

But there was a real...

He lived cause to that company, right?

Yeah.

To employees that got spooked, to partners that may have gotten spooked.

The pressure, we saw this, the pressure on Elon in those periods of time.

He was on the knife's edge where there was the potential where the company may not have been able to finance its cash flow needs because of those Tesla Q guys.

And so it's not to say that the Tesla Q guys can't say it, but they should be forced at some level to prove it if you can create crazy stuff.

I posted a link, by the way, for anybody that's interested in reading this.

There's a person called Carson Block who's being investigated.

Yes.

Because he may have pushed the boundaries of how short sellers do this.

It's a really fascinating read in the Atlantic for anybody who wants to read it.

But this is sort of where the short selling thing can a little bit go awry.

And the title of this is The Man Who Moves Markets and it's quite a really interesting read if you're interested in how all of this stuff works.

All right, everybody.

That's the All-In Podcast for February 3rd and 4th.

For Saks, Friedberg, and Shemoth, I'm Jay Cowell, the world's greatest moderator.

And we'll see you next week.

Love you, boys.

Bye-bye.

Oh, man.