Macro Update and Stock Shopping List

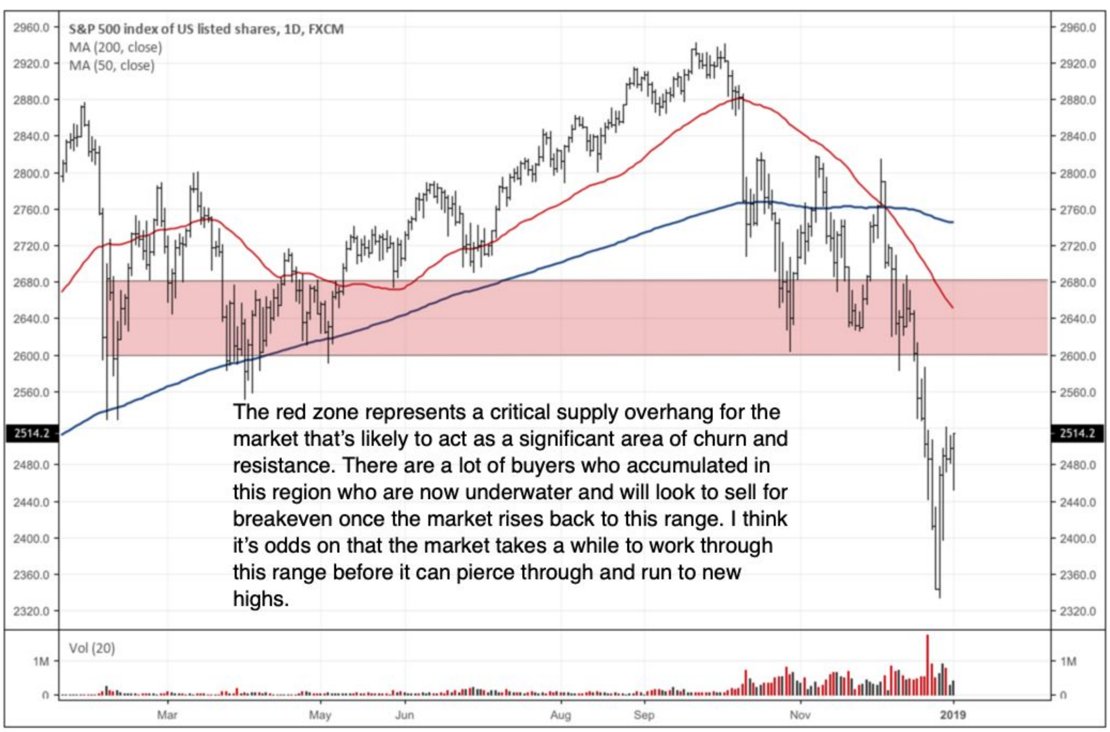
Good evening Operators,

Hope everyone is recovering well from their New Years celebrations and ready to dive back into markets for the year.

Just wanted to share with you some quick thoughts on the market, the dollar, and gold. And then at the end, I've got our **Stock Shopping List** with our favorite names that we're looking to begin buying over the coming weeks.

Alright, let's jump in…

The S&P 500 is trading higher off a short-term bottom. We should see it run up into the 2,600+ range — its 50-day MA acting as an attractor (red line) — but as I note on the chart below, the market is going to bump into significant resistance here. There are a lot of players who bought into this range that are underwater and who will look to close out their positions for breakeven once price climbs back to these levels. This is called a supply overhang.



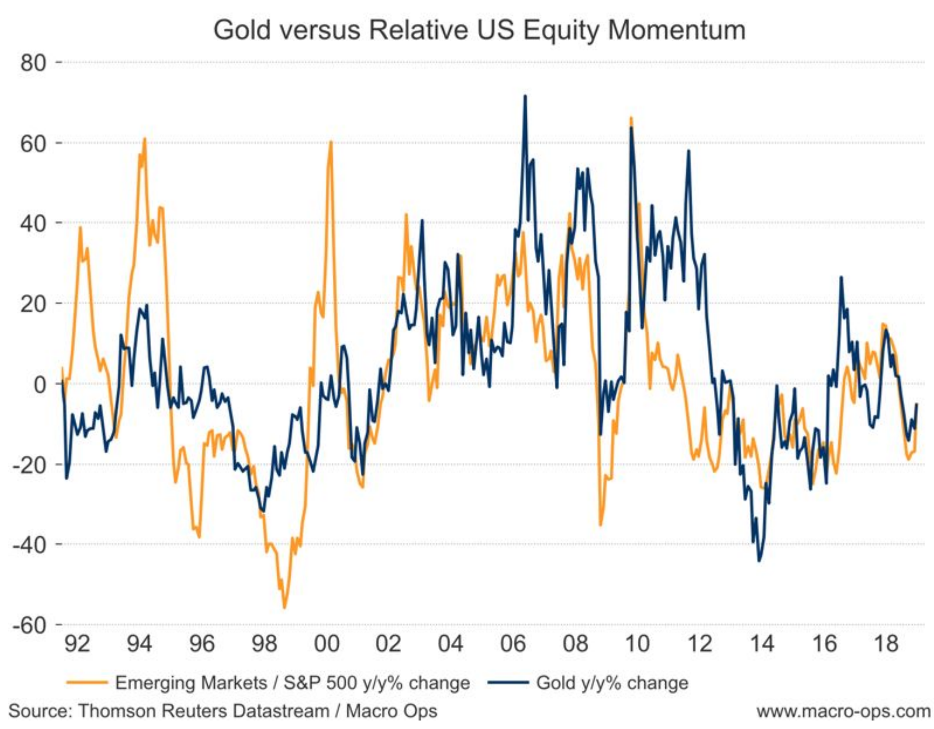
With large supply overhangs like this, it typically takes the market a number of attempts before it can break through and move to new highs. The supply needs to be worked off and so I'd expect to see a reversal around the 2,650-75 range followed by a selloff to recent or even new lows — double bottoms are typically the pattern we see after large selloffs like these.

This action will also help to reset that last bit of stubborn sentiment I pointed to in last week's [market update.]

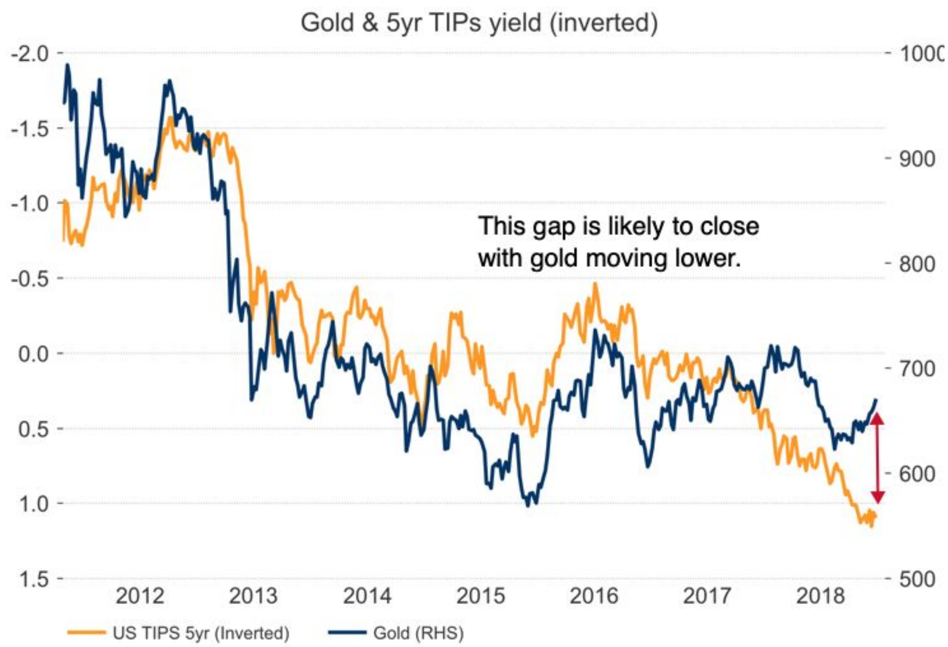
Last week, I tweeted this about gold.

Here's a closer look at the chart. **Gold is now at a major make or break inflection point** (chart below is a weekly). If it's turned away and closes lower for the week then that sets it up for a good sell signal.

For those of you who are new to the group, I view gold as a reflection of global relative demand for USD assets (ie, the relative attractiveness of USD assets such as stocks, bonds, and the dollar versus the RoW). This is why gold trades in lockstep with relative equity momentum of EM vs. US equities.



The RoW is currently seeing slowing economic growth while growth in the US remains relatively strong. This higher growth is driving higher real rates in the US. The below chart shows the widening gap between the inverted yield on TIPs (the real yield) and gold. We should see this gap close with gold going lower.



I've also commented in the past about how platinum often leads gold. The current gap between the two metals should be concerning for gold bulls (red lines is platinum and black is gold).

One thing to note is that January tends to seasonally be the strongest performing month for gold (chart via Commodity Seasonality). You don't ever want to trade off seasonality alone but it's something to keep in mind. I think after the unusually strong December month for the yellow metal that perhaps that performance was pulled forward. In any case, let's watch gold closely. A weak weekly close will set it up for a high R/R short opportunity.

And then we've got the dollar.

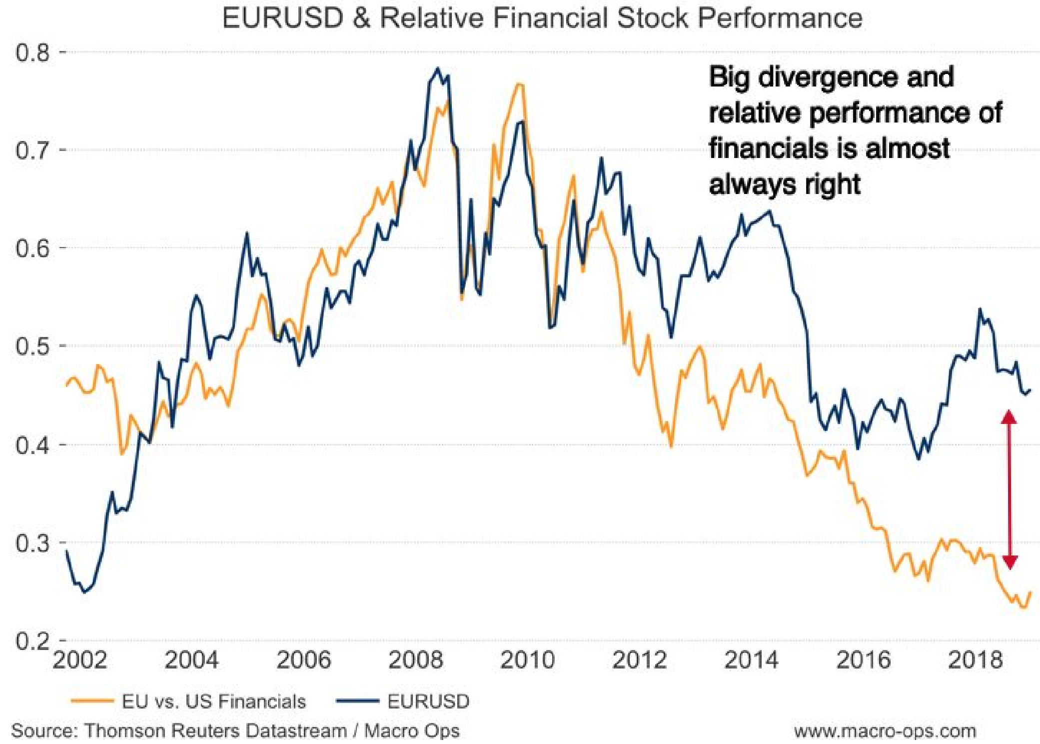
Last week I noted (link here) how the divergence between gold and the dollar and how gold often leads the dollar at turning points. The key word there is often, as in not always. That relationship may or may not hold this time around. So stay open minded and flexible.

The EURUSD might be seeing a key reversal day today. We'll need to see if it holds into the close. The aussie is also making new lows against the dollar. Ultimately, we want to be short both pairs against USD.

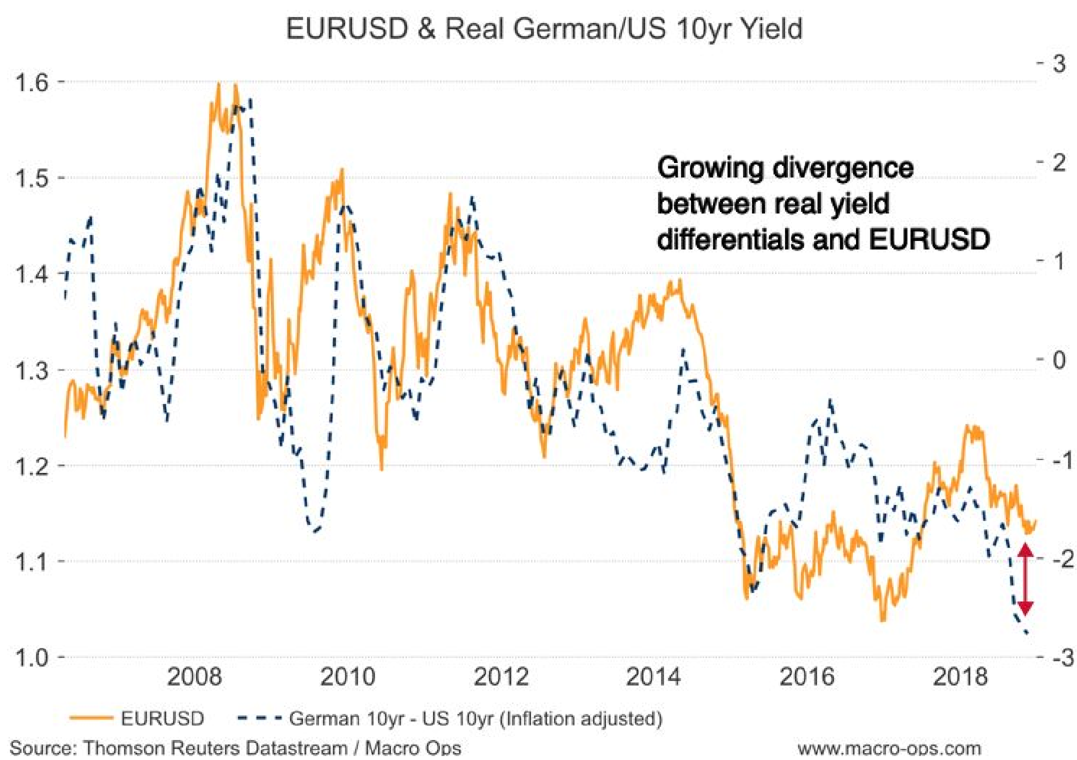
The reasons why we want to be long the dollar against the euro and the aussie are pretty much the same for both. When looking at currencies we want to look at: rate differentials, growth differentials, relative equity momentum, and positioning.

Capital flows to where it believes it will earn the highest risk-adjusted return. Both Europe and Australia have large exposure to China — which just printed its first contraction in PMI since May of 17' — while the US economy is more insulated to slowing Chinese demand.

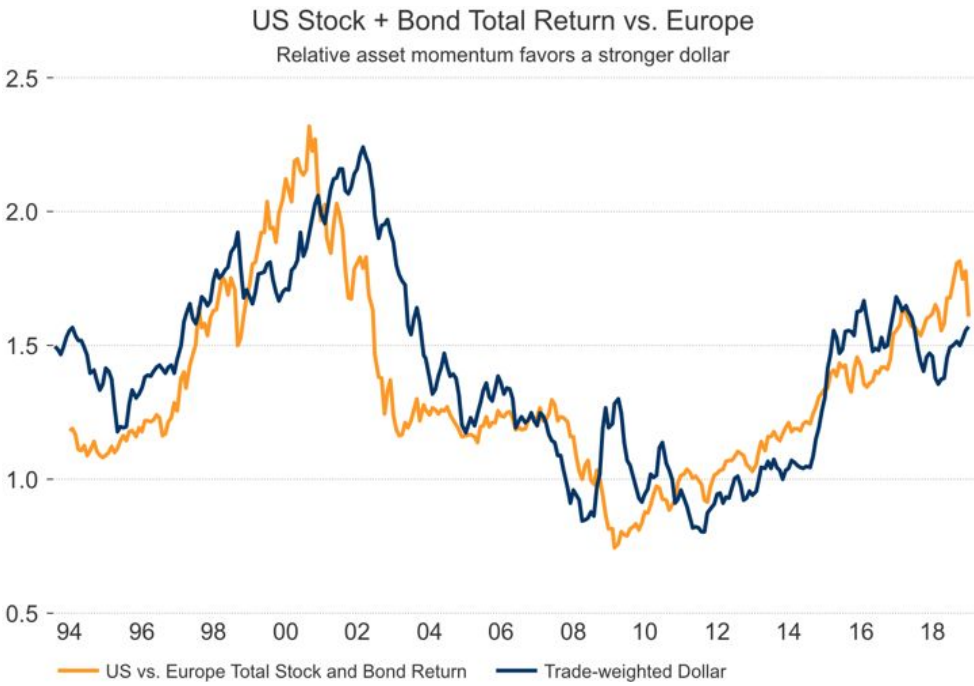
Looking at the euro (though same holds true for the aussie) we can see that relative financial stock performance between the US and Europe favors a much lower euro. Financials trade off growth and rate expectations which is why this is a key indicator to track for currency pairs as the relative financial stock performance almost always leads.



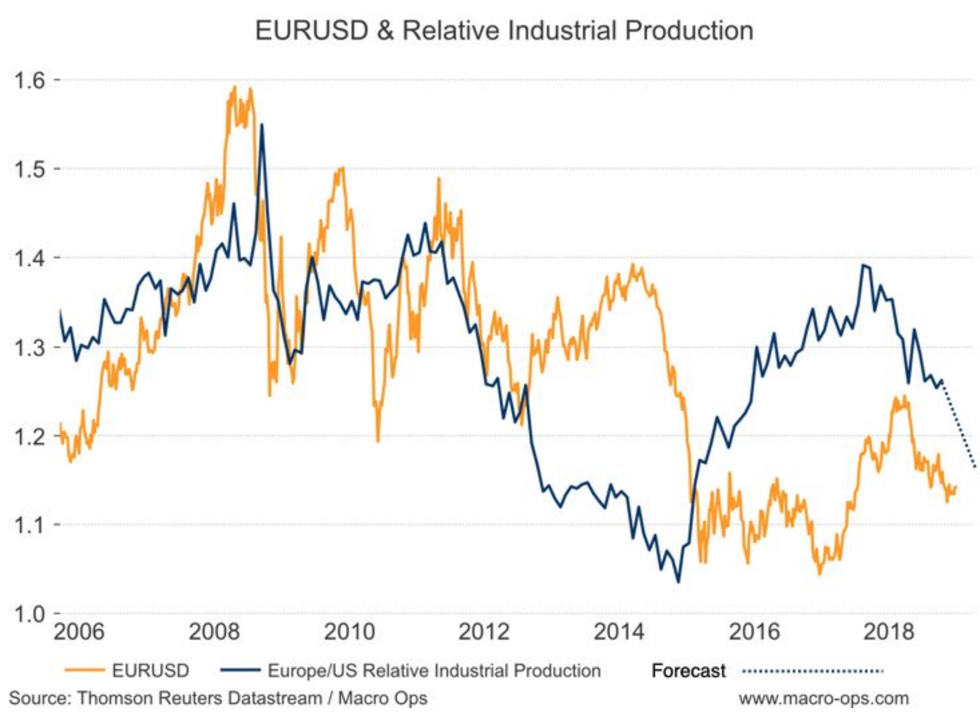
The most important rate differential to track is the real (inflation-adjusted) 10yr yield. The current difference in rates also suggests we'll see a much lower euro.



Relative total stock and bond performance favors a much stronger dollar versus the euro.



And the trend in relative economic growth favors a much lower EURUSD pair.

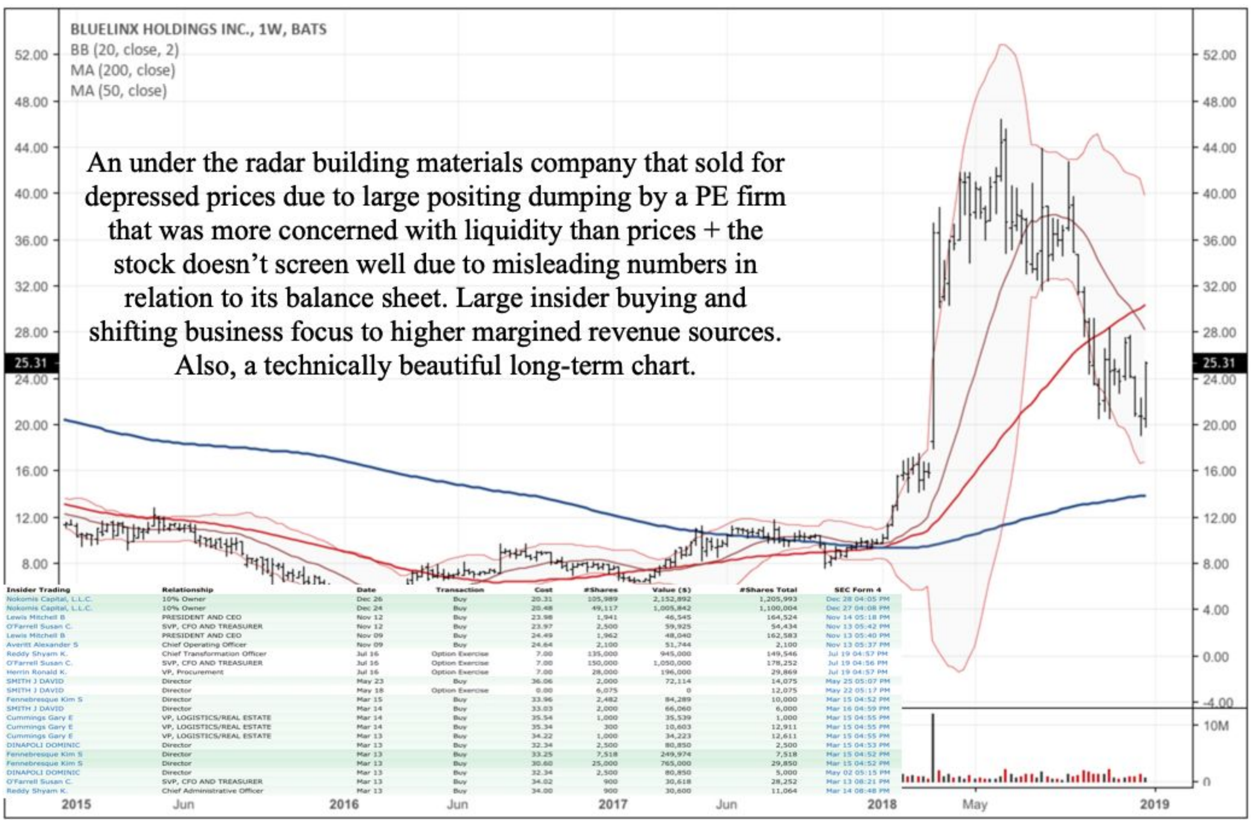


The short-term bear case against the dollar is just that positioning and sentiment remain somewhat crowded to the long side, though much of this has been worked off and is now less of a headwind. And then, the gold divergence which I mentioned above and which is hardly an iron-clad heuristic.

Technically, EURUSD remains in a tight coil resting on significant support in its 200-week moving average. This is around the spot 1.13 level. If we see a weekly close below this level then I think it'll be high-time to load up on short EURUSD. But, until then, we'll patiently watch the dollar pairs from the sideline.

Now onto our Stock Shopping List.

BlueLinx Holdings (BXC)



Insider Trading	Relationship	Date	Transaction	Cost	#Shares	Value ($)	#Shares Total	SEC Form 4
Nokomis Capital, L.L.C.	10% Owner	Dec 26	Buy	20.31	105,989	2,152,892	1,205,993	Dec 28 04:05 PM
Nokomis Capital, L.L.C.	10% Owner	Dec 24	Buy	20.48	49,117	1,005,842	1,100,004	Dec 27 04:08 PM
Lewis Mitchell B	PRESIDENT AND CEO	Nov 12	Buy	23.98	1,941	46,545	164,524	Nov 14 05:18 PM
O'Farrell Susan C.	SVP, CFO AND TREASURER	Nov 12	Buy	23.97	2,500	59,925	54,434	Nov 13 05:42 PM
Lewis Mitchell B	PRESIDENT AND CEO	Nov 09	Buy	24.49	1,962	48,040	162,583	Nov 13 05:40 PM
Averitt Alexander S	Chief Operating Officer	Nov 09	Buy	24.64	2,100	51,744	2,100	Nov 13 05:37 PM
Reddy Shyam K.	Chief Transformation Officer	Jul 16	Option Exercise	7.00	135,000	945,000	149,546	Jul 19 04:57 PM
O'Farrell Susan C.	SVP, CFO AND TREASURER	Jul 16	Option Exercise	7.00	150,000	1,050,000	178,252	Jul 19 04:56 PM
Herrin Ronald K.	VP, Procurement	Jul 16	Option Exercise	7.00	28,000	196,000	29,869	Jul 19 04:57 PM
SMITH J DAVID	Director	May 23	Buy	36.06	2,000	72,114	14,075	May 25 05:07 PM
SMITH J DAVID	Director	May 18	Option Exercise	0.00	6,075	0	12,075	May 22 05:17 PM
Fennebresque Kim S	Director	Mar 15	Buy	33.96	2,482	84,289	10,000	Mar 15 04:52 PM
SMITH J DAVID	Director	Mar 14	Buy	33.03	2,000	66,060	6,000	Mar 16 04:59 PM
Cummings Gary E	VP, LOGISTICS/REAL ESTATE	Mar 14	Buy	35.54	1,000	35,539	1,000	Mar 15 04:55 PM
Cummings Gary E	VP, LOGISTICS/REAL ESTATE	Mar 14	Buy	35.34	300	10,603	12,911	Mar 15 04:55 PM
Cummings Gary E	VP, LOGISTICS/REAL ESTATE	Mar 13	Buy	34.22	1,000	34,223	12,611	Mar 15 04:55 PM
DINAPOLI DOMINIC	Director	Mar 13	Buy	32.34	2,500	80,850	2,500	Mar 15 04:53 PM
Fennebresque Kim S	Director	Mar 13	Buy	33.25	7,518	249,974	7,518	Mar 15 04:52 PM
Fennebresque Kim S	Director	Mar 13	Buy	30.60	25,000	765,000	29,850	Mar 15 04:52 PM
DINAPOLI DOMINIC	Director	Mar 13	Buy	32.34	2,500	80,850	5,000	May 02 05:15 PM
O'Farrell Susan C.	SVP, CFO AND TREASURER	Mar 13	Buy	34.02	900	30,618	28,252	Mar 13 08:21 PM
Reddy Shyam K.	Chief Administrative Officer	Mar 13	Buy	34.00	900	30,600	11,064	Mar 14 08:48 PM

The best risk/reward opportunities are typically found in stocks that don't screen well. This is due to the rise of quants along with the free and wide access to a plethora of various screeners and algorithmic stock ranking systems available to any and all. Because of this, **any obvious quantifiable mispricing quickly gets repriced in the market.** Long gone are the days when buying a stock just because it has a low PE made you money.

Now, the best opportunities are in stocks that are mispriced because their true value is distorted and disguised by the popular GAAP accounting numbers and ratios that people typically look at. If you're interested in reading more on this then check out our Value Investing Manifesto.

BXC is one of these stocks.

Valuation	
Forward P/E (NTM)	19.2x
Trailing P/E (LTM)	10.6x
Price/Book	103.2x
Price/Sales (LTM)	0.4x
EV/EBITDA (LTM)	20.2x

Capital Structure		
Market Cap	$	229.6M
Total Debt	$	770.6M
Cash	$	7.6M
Other	$	1.0
Enterprise Value	$	992.6M

The company is a wholesale distributor of building products with distribution centers across the Eastern US. Previously, BXC served as the captive distribution arm of Georgia Pacific (GP) which is the country's largest producer of plywood. In 2004, BXC was spun out of GP by a private equity buyer who did what PE firms do, they saddled the company with lots of debt. This wasn't great timing of course, with the housing crash just around the corner and all. And in 2017, the PE firm was forced to liquidate its holding in the company at bargain prices.

The stock is underpriced *because* it doesn't screen well. The GAAP balance sheet likely understates the value of the company's real estate to the tune of a couple hundred million dollars while also overstating its leverage.

Here's the following from Matt Sweeney of Laughing Water Capital on the opportunity in BXC (with emphasis by me).

> While buying from a seller that is not concerned with price is a good place to start, by itself this is not sufficient for investment. We were further attracted to the business because of its misleading GAAP balance sheet, which we believed **under-stated the value of the company's real estate by almost $200M.**
>
> Importantly, the company had been monetizing their real estate through sale-leaseback transactions, which allowed the company to paydown debt. While the mechanical screeners that rule the markets were viewing the company as levered ~8x, **we believed the company had already reduced its leverage to ~6x, and could be theoretically almost debt free if they simply continued to monetize their real estate.**
>
> More important than this theory however, is the reality: **they just don't need all of the land they have.** Because the company started as a part of GP, their footprints were designed to accommodate storage of plywood and other sheet goods. Storing plywood requires a lot of space for a small amount of margin, and is thus not a good business to be in.
>
> Additionally, a look at BXC's product mix vs. public competitors showed significant room

for margin expansion through moving into more value-added aspects of the building supply distribution business. Combining the above elements, I felt that BXC was significantly mis-understood by the market, and that there were multiple ways to win in the years to come.

What I did not consider was that BXC would announce a merger with a competitor that has a highly complementary business and footprint only months after our purchases. Shares more than doubled on the news, driving BXC into a top 5 position for us. While it may be tempting to just take the money and run after a move of this magnitude, reviewing the transaction indicates that the combined company may be cheaper now in the low $30s than it was below $12 just a few months ago. **This is a business where scale matters, and the opportunity to take costs out of the combined business and drive revenue through consolidating the footprint to more fully utilize square footage, leveraging purchasing power, leveraging administrative resources, and cross-selling complimentary products is very real.** It is not difficult to envision scenarios where the combined company can generate $8 to $12 in free cash flow per share looking out a few years, which when combined with a likely de-leveraging of the balance sheet leads to the potential for significant additional upside.

An expanding business that's moving into higher margined products combined with the benefits of increasing scale make BXC an attractive company. The opportunity is made even richer when you also consider the pace of deleveraging in the balance sheet (lower debt makes the equity worth significantly more) and a business that should be generating $10+ in free cash flow in the coming years. The stock is currently only trading at $25…

Insiders think the stock is a steal at current prices and have been loading up on it — typically a good sign. And from a technical perspective, the chart looks great. It's broken out of a large base and has now retraced to the lower band of its weekly Bollinger Band.

For more info on BXC you can read this dated but still relevant write-up from Adestella Management on the company (link here).

SharpSpring (SHSP)

SharpSpring is a small under the radar SaaS business that provides marketing automation software to small and mid-sized businesses. The bull thesis for SHSP is simple, it comes down to two things (1) an incredibly high LTV/CAC ratio (more on this below) and (2) lean pricing model allowing them to grow market share faster than their competition.

Here's the following from value-focused hedge fund manager, Scott Miller, of Greenhaven Road Capital (emphasis by me).

> *Purchasing SharpSpring's software gives a customer licenses for use with up to three clients. The software is also white-labeled so that an agency can present it with their own branding and can upsell if they choose. With this model,* ***SharpSpring has an attractive LTV/CAC ratio typically greater than 6. In English, that means that for every $1 they spend acquiring a customer, that customer will generate $6 in lifetime value.*** *The right way to run this business, in my opinion, is to spend every available dollar on sales and marketing to build the customer base, not worrying about short-term profitability. SharpSpring management agrees, and recently executed a convertible debt offering to access additional resources for marketing.*

> *SharpSpring operates in an oligopolistic market with three primary competitors: HubSpot, Act-On, and Pardot (by Salesforce). HubSpot is the largest competitor and in a difficult competitive position relative to SharpSpring.* ***HubSpot has a large customer base paying in excess of $30K per year versus SharpSpring charging less than $5K per year.*** *HubSpot cannot easily slash prices 75% to compete on price, and given the near-parity of the offerings, offering a "stripped down" version is also not viable.* ***These dynamics have driven adoption and market share gains for SHSP, particularly among smaller agencies.***
>
> *SharpSpring has benefitted from multiple expansion, but also has executed well. Product revenue grew 40% in their last reported quarter. In a more recent press release, the company announced a record number of new customers in Q3 while maintaining marketing efficiency (their LTV/CAC should remain above 6).* ***There is a very long runway for growth for SharpSpring. The company will benefit from secular tailwinds in an industry growing over 20% per year. There is also a history of acquisitions in the space at premiums to where shares trade today****. SharpSpring came to my attention through a conversation with Jeremy Kahan of North Peak, a manager the Partners Fund is invested with.*

SHSP operates in a fast-growing industry that has a long runway. If the company continues to grow at this pace, which we think is very likely given its obvious value proposition to customers along wtih its ability to profitability leverage growth through its CAC spend, then SHSP makes for a likely takeover target for one of the bigger players. And without a takeover, the company stands to grow its business and its stock price by a matter of multiples.

The technicals for the stock look great. It's broken out of a long base and is currently coiling in a wedge. Anywhere in this range is a good area to begin accumulating a position.

Fiat Chrysler (FCAU)

We first pitched the long case for Fiat back in our May 2017 MIR titled *The Five Stages of Disbelief* when the stock was trading for $11. It went on to more than double over the following year but has now fallen back roughly 40% from its recent highs and is back around $14.50 a share. The recent selloff though is not due to any fundamental changes to the bull case (though Fiat's incredible CEO/capital allocator Sergio Marchionne passed away in July of last year) but rather just your typical retrace/profit taking following a 100%+ rise.

The bull case for Fiat is straightforward. It's incredibly-stupidly cheap, has top-notch management, it's growing and generates tons of FCF, and has many options to drive shareholder value (further spinoffs, accretive acquisition etc..)

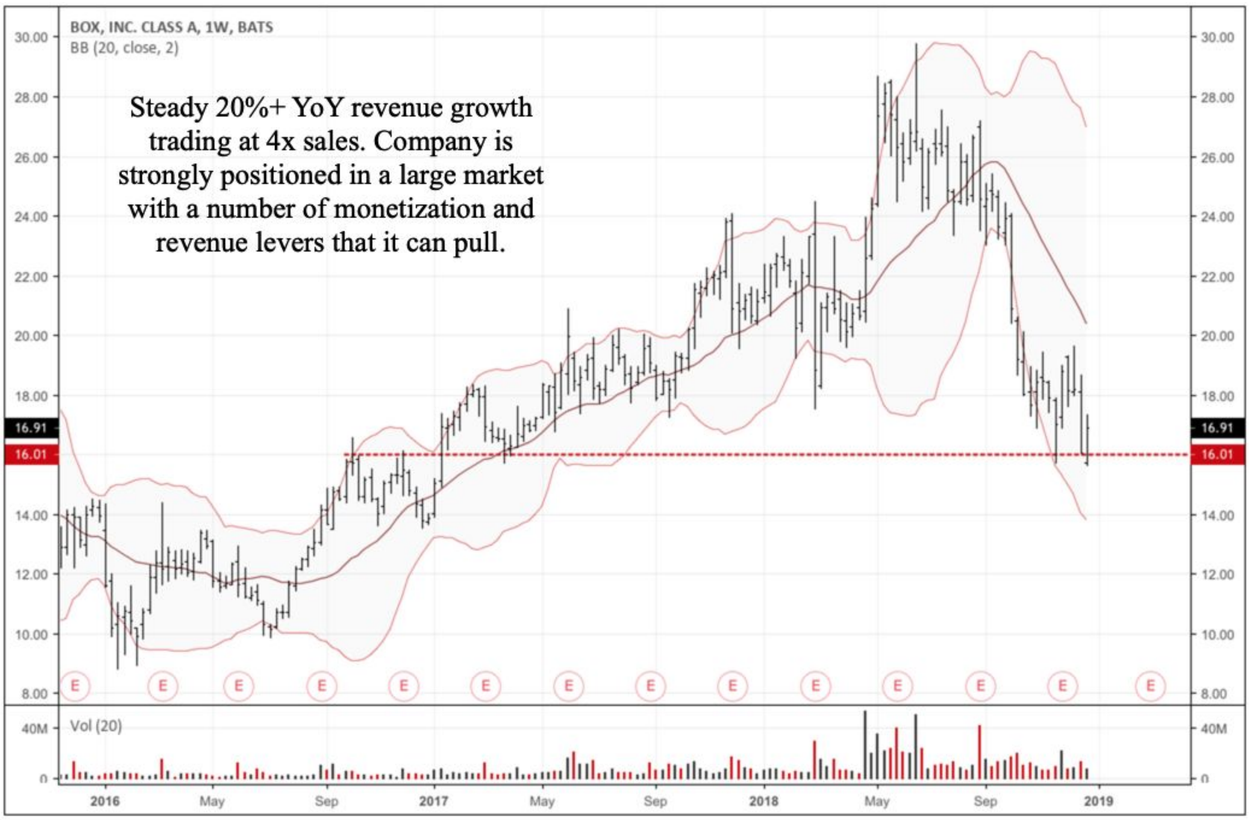
The company is going to end the year with over $7 per share in net cash following the recent parts sales. If you apply a very conservative automaker PE multiple of 5 on the core auto business after subtracting cash, you get a price target of over $35 a share — over 140% higher. The current stock price implies a PE of less than 2…

This is the reason why Fiat is the number one "Big Bet" by top value fund managers (link here).

Technically the stock is set up for a great buying opportunity. It's currently trading at its lower weekly BB and major support in its descending wedge pattern. I think Fiat is gearing up to start another run. We plan to start building a position over the coming weeks.

For more on Fiat, read this recent letter from [ADW](ADW).

Box Inc (BOX)



Box is a perfect example of a company that is intentionally underearning and so appears expensive on the surface — something we discussed in the Value Investing Manifesto.

This idea came to us via Scott Miller. You can read his long write-up on the bull case for Box here. But I've selected the most important points and have included them below (emphasis by me).

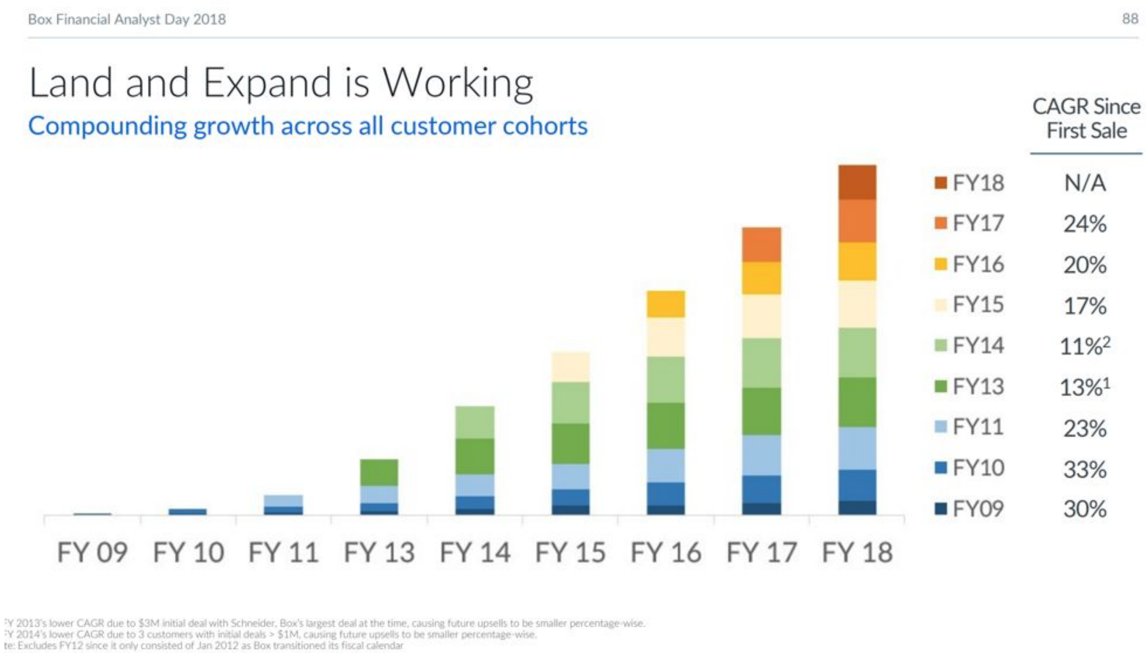
> *The first theme is companies that are "undermonetizing" can be attractive investments. The second theme percolating is also an obvious one: data is today's gold, and it is unlikely that companies will, on average, spend less on accessing, sharing, and protecting it. There is real career risk in skimping on data, and data management and cybersecurity have significant tailwinds for the next decade or longer. None of these*

experiences or themes are blindingly brilliant, but collectively they are the underpinnings for our investment in Box, Inc. (BOX).

Box operates in a massive market that they refer to as "Cloud Content Management" and size at $45B per year. I think no matter how we define it, it is likely growing and worth multiples of Box's current revenue. Last year, Box generated operating cash flow while spending roughly two-thirds of revenue on sales and marketing and product development (54% and 20%, respectively). Over time, a company's value should approximate the rates of return that they can get when they reinvest capital. As discussed before, ***with a customer base of 87,000 companies, it is easy to see a very high ROI on new product development****. I am typically skeptical of sales and marketing spend as it can be a sugar high to drive short-term growth. However,* ***with customer retention rates running in the above 90% and net dollar retention running well above $100, Box is actually probably not spending enough on sales and marketing****. There is a slide on page 88 of their investor day deck (link) that shows revenue growth by cohort. It is beautiful. Several different years of customer cohorts have been compounding revenue growth well in excess of 20% per year. Now, marketing effectiveness may deteriorate over time, but* ***the last two years have seen CAGR's of 24% and 20%, and there is still a largely untapped international opportunity as the U.S. constitutes 76% of revenue****.*

In the long run, Box has the opportunity to continuously ***improve their business through a virtuous cycle of retaining customers and improving monetization****. Product improvements lead to greater value-add, which leads to greater utilization, greater lock in, lower churn, and higher revenue per user. Revenue growth and margin expansion are highly probable, with multiple expansion a possibility.* ***No additional capital is required to grow.*** *There is a long runway for growth, and multiple opportunities for additional products to be sold into a large and attractive customer base. Continued revenue growth of 20%+ for the foreseeable future, coupled with operating leverage and a very valuable customer base, create an interesting set-up.*

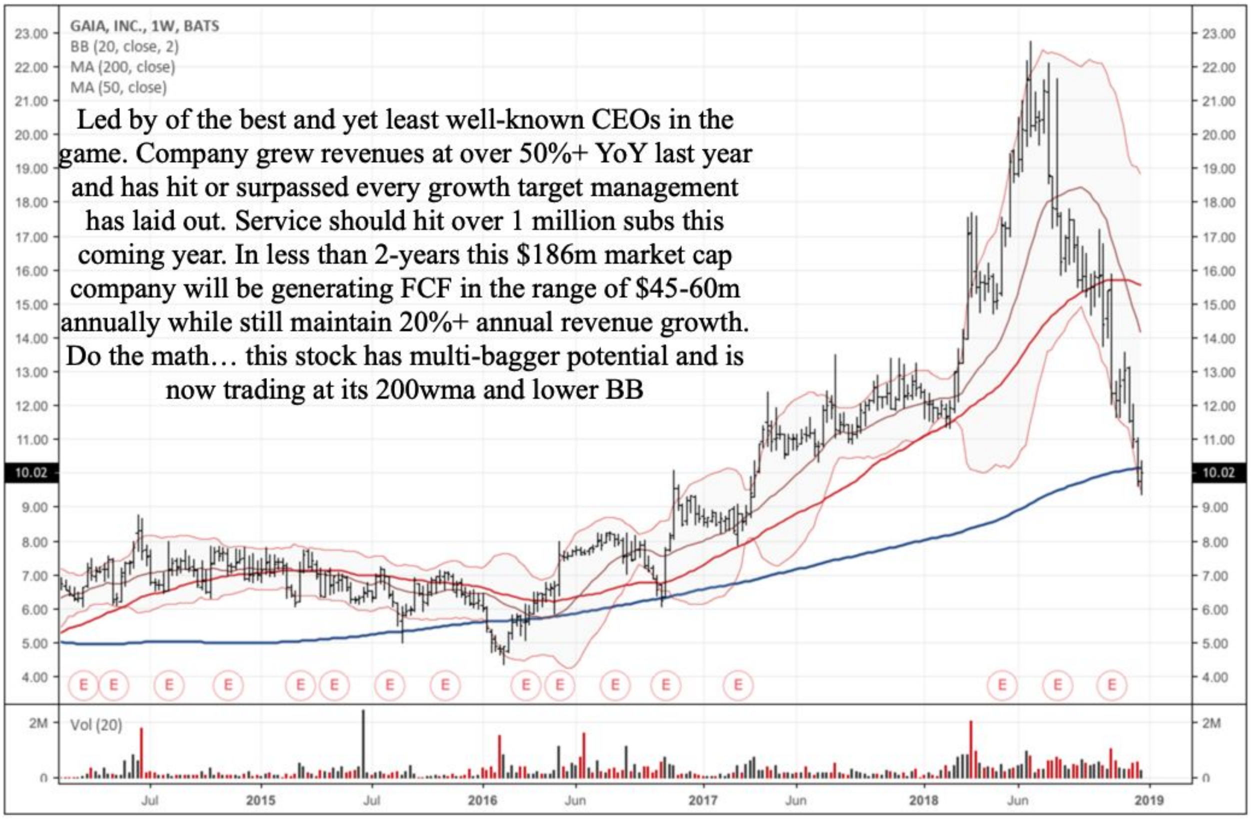
Below is the slide Scott was referring to. Box's ability to continue to grow revenue growth from existing customers through new product additions shows the company's incredible value proposition to users as well as their potential to continue to leverage these existing relationships.



Many people make the mistake of comparing Box's business to that of Google Drive or Dropbox's and they dismiss the company as operating in a crowded space. But that's not the case at all. Box has a clear differentiator in its ability to service large enterprise customers and offer them data storage capabilities that **meet regulation and compliance needs**.

Box is currently down close to 50% from its recent highs. It's trading near its lower weekly BB and looks to have put in a double bottom. This area gives us a great R/R buying opportunity.

Gaia (GAIA)



We first pitched GAIA in our March of 2017 MIR titled *The Capital Cycle*. Back then it was trading for around $8.40. Over the subsequent 18-months, it ran up approximately 147%, to nearly $23 a share. It's since had a sharp selloff of over 50% and is now trading down around $10 a share. The fundamentals of the bull case though haven't changed one bit. In fact, they're even stronger now than they were then.

Here's an update I wrote on the stock from early last Fall. These financial projections still stand.

> GAIA has been crushing it and consistently so. Jirka Rysavy, the CEO monk, one of the best and lesser-known capital allocators in the game, is setting the bar high and surpassing it every quarter. With the company's current and expected growth, there's no reason why the stock can't/shouldn't 3-4x from here. Just look at the numbers.
>
> Their service is expected to hit one million subscribers by 2019. That equates to a revenue run rate of roughly $110m. The business is fully funded for the next 24 months at which time it plans on lowering spending on customer acquisition and bringing down growth from the current 80% y/y rate to a more sustainable 20%.

> **So in under two years, this $200m market cap company will be generating free cash flow somewhere in the ballpark of $45-60m**. And what type of multiple do you give a company that's growing free cash flows at roughly 20% a year? 15 or 20x maybe?
>
> Let's be conservative and give it a cash flow multiple of 15. 15 times $50m is $750m which is 3.75x higher than where it's trading right now. **A 20x multiple would give it a market cap of $1B which would mean the stock would trade at $65 a share.**
>
> Jirka is one of the few CEOs that I would back in nearly any endeavor. The guy has a long history of delivering results and building big highly profitable businesses. GAIA looks set to be another notch on the belt.
>
> The stock had been battling the $13 level for the last six months but it finally punched through last week. A large holder of the stock that we know, had a large sell limit order there that has finally been fully liquidated.
>
> This should clear the way for the stock to run.

GAIA bears say that the company struggles from high CAC and low sub retention. They say that their content library is mediocre in both quality and scope. I remember people saying the same things about Netflix (NFLX) in the early days. What they're missing are the benefits of scale.

Greater scale and operating cash flow means greater content spend, which means more content and of better quality. More users and more content and greater time operating means more data points and increasing visibility on what type of content pays. And you get all this while your CAC (customer acquisition costs) actually come down because you have greater brand recognition and benefit from word of mouth. The bears miss all of this entirely.

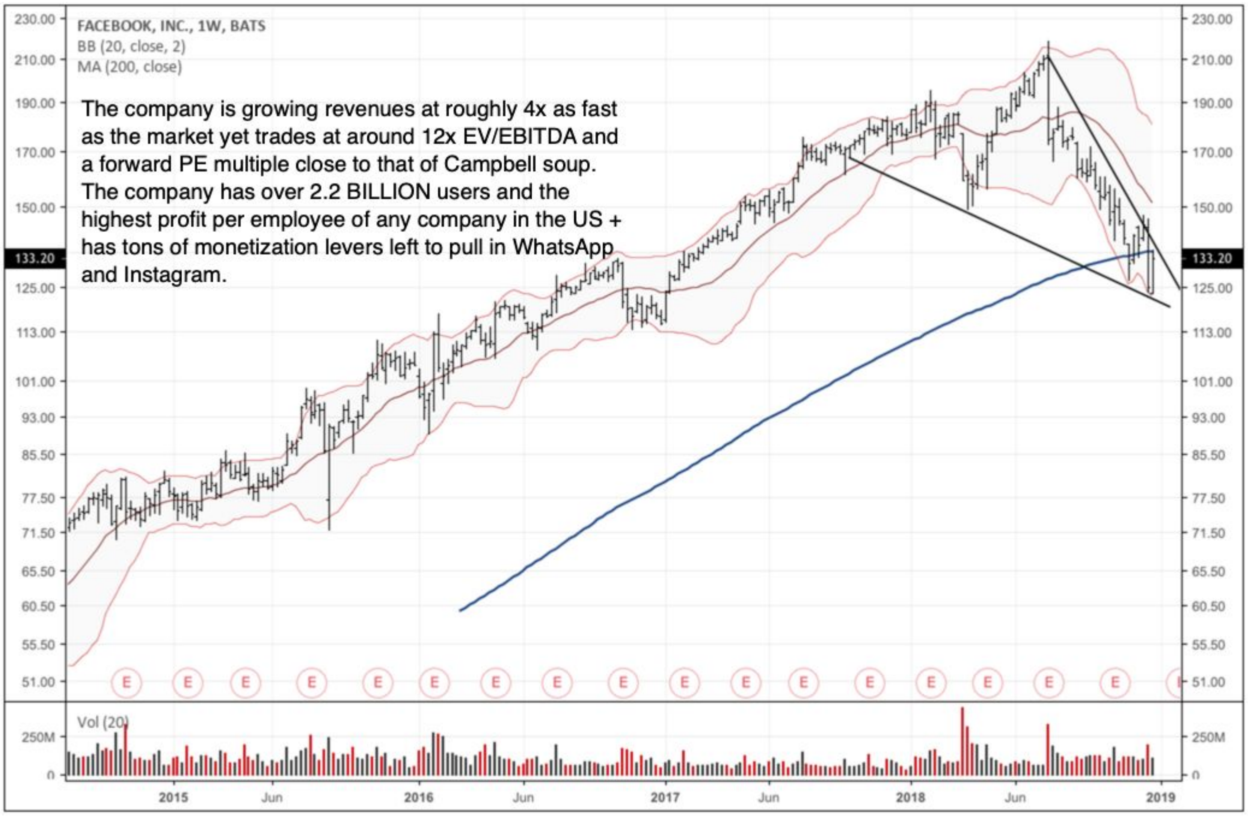
Ultimately, we're betting on Jirka. He and his team of executives are the ones who will be iterating off the data; doing more of what works and less of what doesn't. Jirka has an incredible history of success and he's not someone you want to bet against.

The only thing outdated in my GAIA write-up from last Fall, seeing as how the stock is now cheaper, is that the upside is significantly higher — in the 6x range.

The stock is currently trading at its 200-week moving average as well as its lower weekly BB. This is a great level to begin building a position.

For more info on the GAIA bull thesis read this from [Laughing Water Capital].

Facebook (FB)



We've spilled a lot of ink writing about the bull case for FB. So I'll keep this one short. The stock is set to continue growing revenues 4x as fast as the broader market yet trades at roughly 12x EV/EBITDA and a forward PE multiple that is roughly in line with that of Campbell Soup. This is crazy…

The company has 2.2 billion users and numerous levers it has yet to pull to monetize its incredibly large user base; think Whatsapp and Instagram.

The stock is currently trading in a tight descending wedge and off its lower weekly BB. Now is a good time to begin building a position. There's lots of upside to this stock and an incredible margin of safety at these prices. THE BAD NEWS IS MORE THAN BAKED IN.

For more info on the FB bull case, read this great write-up from Saber Capital Management (link here).

Trupanion (TRUP)

Trupanion was one of the first stocks we pitched when we started MO back in 2016 (you can find the write-up here). Back then the stock was trading for $16 and we thought the company had an incredible runway and was materially undervalued. The stock went on to rise nearly 190% over the subsequent 18-months. It has since been caught up in the recent market volatility and has sold off around 50% from all-time highs.

There's been a growing chorus of bears ranting about the company's customer acquisition practices and other such nonsense. And the stock now has an incredibly high short float, approximately 40% of all shares. This means there's ample fuel on the fire should the stock find a bottom and these shorts are caught rushing to close (ie, buy back the shares they sold).

You can learn a lot about a company and its leadership by reading their annual letter. Trupanion's Founder/CEO, Darryl Rawlings, writes one of the best, in my opinion (here's last years). He thinks how a smart capital allocator *should* think and is focused on all the right things.

The bull case that we wrote in 2016 still stands. The pet insurance market is grossly underpenetrated relative to other Western markets. This means that there's a huge market opportunity available and TRUP is the clear leader in the US.

The stock is now trading at 3x revenues and is growing sales at 20%+. While this isn't terribly cheap, it's not expensive either. And given the size of the market opportunity along with the quality of management and the company's market leadership, we think there's plenty of drivers to move this stock higher. The high short float is just icing on the cake.

For more info on Trupanion, read this recent bull case from [Wiedower Capital.]

That's all I've got for our shopping list so far. We'll put out updates should we make any changes or new additions. There's a number of stocks that almost made the list, such as Spotify (SPOT) and Interactive Brokers (IBKR). But we always prefer to concentrate our holdings and so had to whittle the list down to our absolute favorites.

Then, of course, we still really like our two largest holdings which are Disney (DIS) and Google (GOOGL). But we already have full positions in them.

I'm also seeing some incredible deals in the oil and gas space. The fracking industry is still in the early stages of what's likely to be a major washout. The fact is is that the majority of frackers have negative unit economics. This means that their businesses are unsustainable without the continuous injection of major investor capital. As we move into a more liquidity scarce environment we're going to see more of these companies go belly up.

The long-term impact of this will be much higher oil prices. And the companies that can survive this downturn will rise by many multiples in the next cycle. There's a number of names with strong balance sheets and good FCF that are trading at extremely depressed prices (check out RIG, WTI, MDR). They're probably headed lower in the short-term as investors flee the space and throw the baby out with the bathwater. But I'm considering putting on a small starter position in a few of the names soon.

If you'd like to learn more about this, then I highly suggest reading Bethany Maclean's latest book "Saudi America". It's a fantastic and quick read on all the troubles facing the industry and where things are headed. She was also recently on the MiB podcast with Bloomberg's Barry Ritholtz which is worth a listen if you want a short overview of the book (we'll be writing a lot on this topic in the month's ahead).

As far as building positions in these names, we're going to be starting small and patiently adding only once the market action begins to suggest a solid bottom is in. Like we discussed at the start, we're probably not there yet.

If you've got comments/question please share them in the CC

Hope you're all having a great week!

Your Macro Operator,

Alex