



11/20/2020: Trees, Storms and Tobacco Stocks

“Can you hear the wind, father?

Remember what mother used to say about the wind?

The wind cannot defeat a tree with strong roots.

You are still breathing..

As long as you can still grab a breath, you fight.

You breathe. Keep breathing.

When there is a storm..

And you stand in front of a tree..

If you look at its branches, you swear it will fall.

But if you watch the trunk, you will see its stability.”



This was my favorite quote from one of my favorite movies, *The Revenant*. Without thinking, I find myself relating the quote to trading and investing. Read the last part again: ***“If you look at its branches, you swear it will fall. But if you watch the trunk, you will see its stability.”***

When stocks rocket it's easy to look at the trunk and feel stable. Yet as soon those stocks turn south, the trunk turns to leaves. You lose your sense of stability. And even the slightest breeze shakes your faith in your holdings.

That's why I'm mentioning the quote now. We've had a *great* month in the equity portfolio. But we can't pat ourselves on the back. The moment we think we've "figured it out" is precisely when Mr. Market hands us a swift kick in the family jewels.

I don't know when it will come, but there *will* be a drawdown. And when that happens it's important to ***focus on the trunk***. Not the leaves.

Here's how we do that:

1. Obsess Over Risk Management
2. Focus on the underlying business

Obsess Over Risk Management

Before we enter a trade or investment we know *exactly* how much we're willing to lose on that position. Whether it's 50bps or 150bps, we make that decision *pre-entry*.

Not only does this help manage our *actual* capital, but it helps save our *mental* capital. We know that no matter what (barring gap down below our stop) our *worst case scenario* is the initial risk we put on the trade.

This allows us to endure volatile price movements without feeling like we're looking at the leaves. Take our investment in IBKR. Notice the number of price swings since our entry in mid-July (in chronological order):

- +19% (7 days)
- 0% (50 days)
- -12.34% (10 days)
- +10% (18 days)
- -9.71% (18 days)
- +17.85% (21 days)

Here's my point: **We can't control price movements. The only thing we can control is *what we buy, when we buy and where we sell (stop-loss).***

Focus On Underlying Business

Focusing on the underlying business is the same as focusing on the trunk and not the leaves. Consider the IBKR example. Do we think IBKR -- a multi-billion dollar corporation -- changes in business value by 19% upswings and -12% downswings over the course of a few months?

Of course not! Yet if you focus on price, the *leaves*, that's all you see. Suddenly *everything* matters and you forget *why* you bought the stock. You forget the core business fundamentals.

Remember, we have our initial stop in place. Who cares what the stock price does in the meantime? Our job is to monitor the fundamentals of the underlying business. Doing that divorces us from price. It divorces us from leaf watching.

"If you look at its branches, you swear it will fall. But if you watch the trunk, you will see its stability."

Tobacco Stocks: Global Ideas w/ Great Dividends

The contrarian in me can't look past the *massive* value arbitrage opportunity in tobacco stocks. Sure there's tech stocks ripping higher. But have you seen these tobacco dividends?

Check out these valuations on a basket of tobacco stocks (EV/EBIT):

- Altria (MO): 8.50x
- Philip Morris (PM): 11.63x
- Japan Tobacco (2914.JP): 9.62x
- Eastern Tobacco (EAST): 3.24x

And [thanks to Twitter](#), I found two more interesting tobacco companies like:

- Ceylon Tobacco (CTC.N0000): 6.25x
- British American Tobacco (BTI): 9.56x

Alex and I are digging into the tobacco space for a few reasons:

1. Large dividends backed by strong balance sheets
2. Monopolistic industry dynamics
3. Attractive long-term charts

We're narrowing down our favorite from the list. We'll shoot you a research report once we've made our final pick.

Market Beating Dividends on Cash-Flowing Businesses

Tobacco companies offer some of the highest dividends in the market. Check out some of these yields:

- MO: 8.61%
- PM: 6.26%
- EAST: 13%
- Japan Tobacco: 7.15%
- BTI: 7.26%

Some tobacco yields are better than long-term S&P 500 returns (roughly 7%).

Monopolistic Industry Characteristics

Another benefit to tobacco companies is their monopolistic industry characteristics. Tobacco isn't a *great* industry. There's tons of political pressures to remove their product from every shelf. Not to mention the fact that the product *can* kill you.

Safe to say there aren't competitors banging down the door to get in. This translates to high EBIT margins for those left. The US' two main competitors, MO and PM, generate 50% and 40% EBIT margins respectively. In other words, we're getting paid to wait until the cancer-stick party ends.

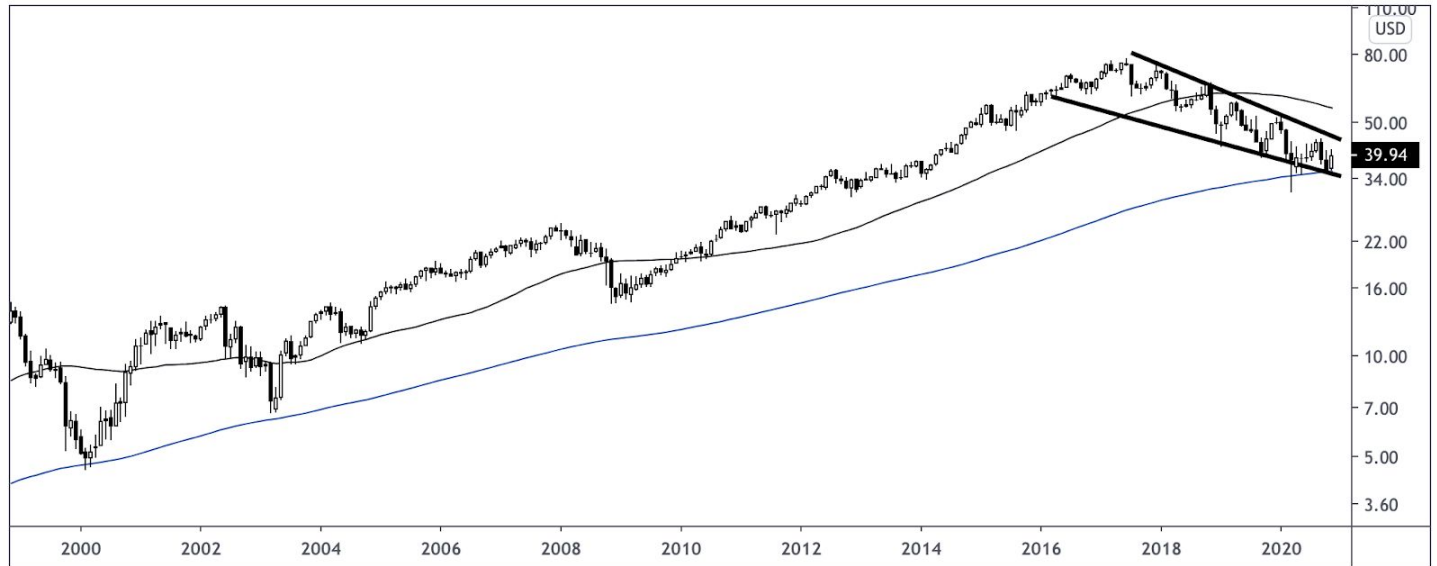
Despite the above bullish indicators, we're waiting for the last domino to fall: **technical confirmation**.

Long-Term Consolidation Trends in Tobacco Stocks

We *love* the look of these tobacco stock charts ...

Altria, Inc. (MO)

rockvuecap published on TradingView.com, November 21, 2020 14:22:09 EST
 BATS:MO, 1M 39.94 ▼ -0.12 (-0.3%) O:36.49 H:41.52 L:36.13 C:39.94



TradingView

MO is in the midst of a long-term bull wedge consolidating at the 200MA. We're looking for a breakout above its downward sloping resistance line (\$45.30).

Philip Morris (PM)

rockvuecap published on TradingView.com, November 21, 2020 14:26:53 EST
 BATS:PM, 1M 76.73 ▼ -0.78 (-1.01%) O:71.94 H:79.21 L:70.13 C:76.73



TradingView

PM is coiling below its 200MA on the monthly chart. We're looking for a breakout above \$80.35 for bullish confirmation.

Japan Tobacco (2914.JP)

rockvuecap published on TradingView.com, November 21, 2020 14:29:28 EST
TSE_DLY:2914, 1M 2153.5 ▼ -1.0 (-0.05%) **O:1981.5 H:2171.0 L:1980.0 C:2153.5**



TradingView

Japan Tobacco (2914.JP) looks like it's at the end of a four-year bull wedge / downward channel. We'll likely see significant chop as the stock works through its overhead selling pressure.

British Tobacco (BTI)

rockvuecap published on TradingView.com, November 21, 2020 14:35:46 EST
BATS:BTI, 1M 36.89 ▼ -0.22 (-0.59%) **O:31.95 H:38.31 L:31.79 C:36.89**



TradingView

BTI is consolidating below its 200MA on the monthly chart. We're looking for a breakout above \$46.61.

Classical Trade Setups

Long Carvana (CVNA): Ascending Triangle

rockvuecap published on TradingView.com, November 21, 2020 14:44:25 EST
 BATS:CVNA, 1W 234.30 ▲ +7.30 (+3.22%) O:206.00 H:236.43 L:205.65 C:234.30



TradingView

Long Potlatchdeltic Corp (PCH): Symmetrical Triangle

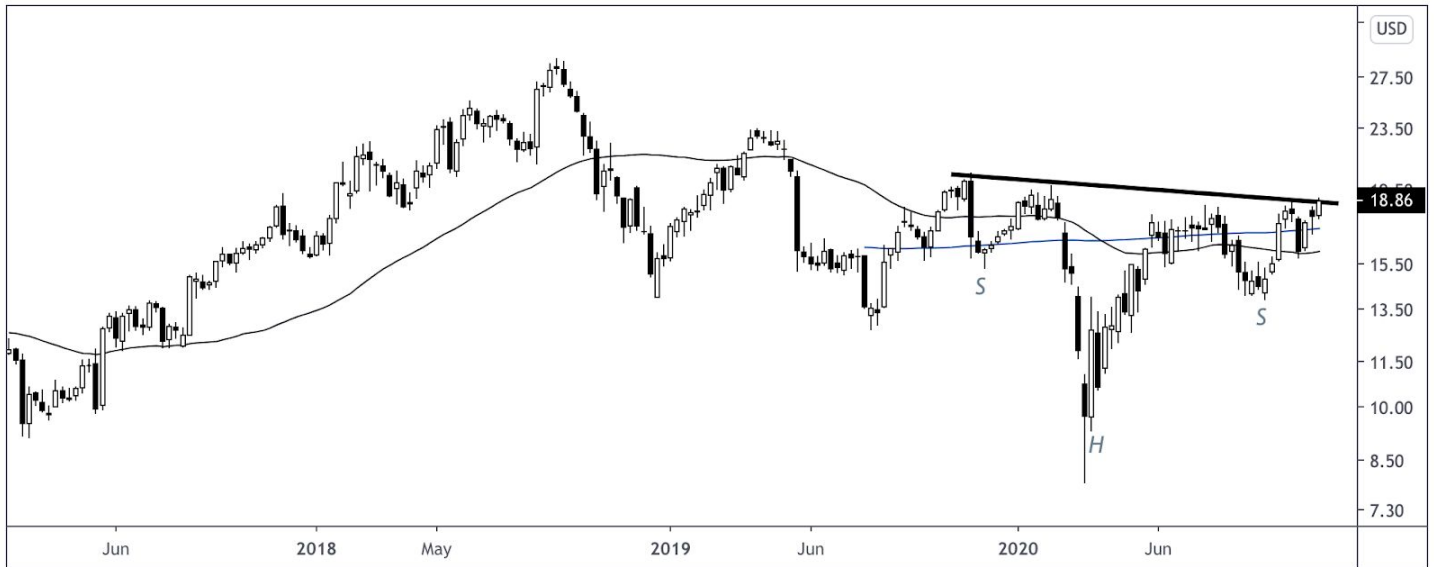
rockvuecap published on TradingView.com, November 21, 2020 14:45:53 EST
 BATS:PCH, 1D 45.25 ▲ +0.70 (+1.57%) O:43.97 H:45.35 L:43.97 C:45.25



TradingView

Long Pure Storage (PSTG): Inverse H&S

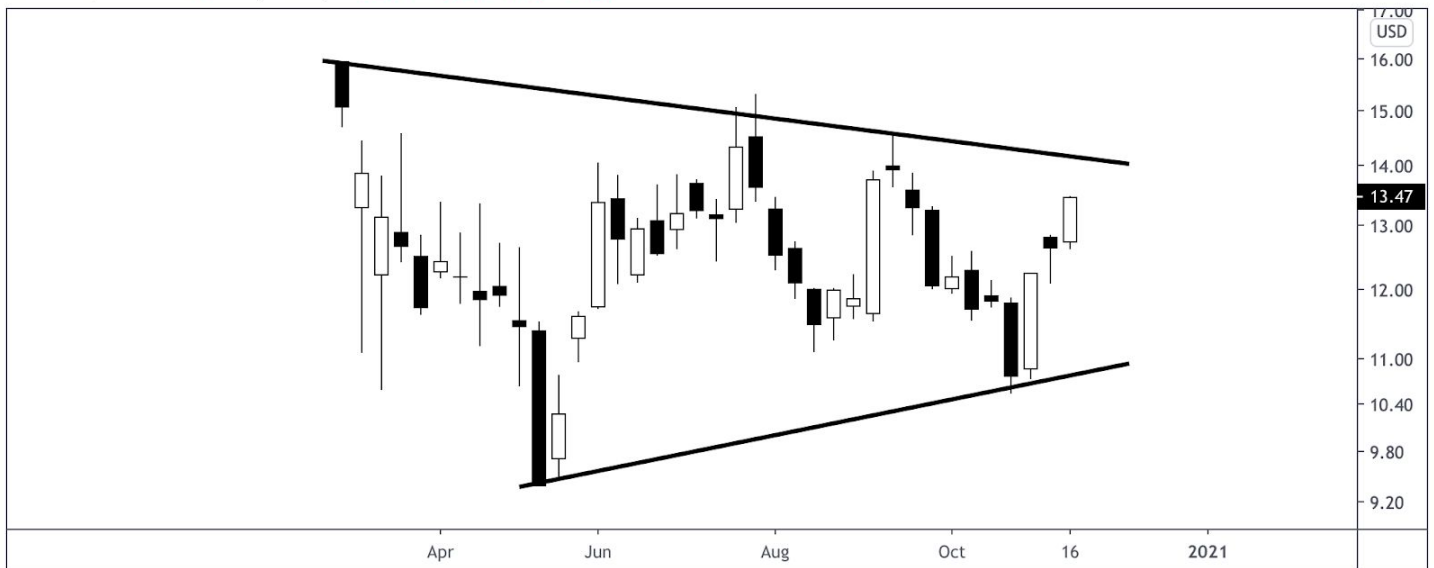
rockvuecap published on TradingView.com, November 21, 2020 14:47:31 EST
 BATS:PSTG, 1W 18.86 ▲ +0.11 (+0.59%) O:18.00 H:19.03 L:17.81 C:18.86



TradingView

Long CIA Brasileira (CBD): Symmetrical Triangle

rockvuecap published on TradingView.com, November 21, 2020 14:48:17 EST
 BATS:CBD, 1W 13.47 ▲ +0.40 (+3.06%) O:12.73 H:13.48 L:12.62 C:13.47



TradingView

Short Editas Medicine (EDIT): Head & Shoulders Top

rockvuecap published on TradingView.com, November 21, 2020 14:49:42 EST
BATS:EDIT, 1D 28.42 ▲ +0.39 (+1.39%) O:27.88 H:28.61 L:27.33 C:28.42



TradingView