TRUMP, TARIFFS AND TESLA: INVESTING AND POLITICS!

Globalization Backlash and Government Disruption!

CONFESSIONS…

- I see the world in **shades of gray**, and in a world where more and more people see only black and white, that makes me an outlier. Thus, if you are reading this post expecting me to post a diatribe or a tribute to Trump, tariffs or Tesla, you are likely to be disappointed.
- The second is that **much of my work is in the micro world**, where I value companies and analyze their corporate finance policies, and the **work that I do on macro topics** or variables is to help me in that pursuit.
  - That said, **to value companies today, I have no choice but to bring in the economics and politics of the world** that these companies inhabit.
  - The problem with doing so, though, is that it is **easy to be reactive**, and to **let your political leanings drive your conclusions**. That is why I want to step back and look at the two larger forces that have brought us to this moment,.

GLOBALIZATION: RISE, EFFECTS AND BLOWBACK

- Globalization has taken **different forms through the ages**, with some violent and toxic variants, but the current version of globalization **kicked into high gear in the 1980s**, transforming every aspect of our lives.
- I am no historian, but in this section, I will start with a very short and personal history of how globalization has played out in my classroom, examine its winners and losers, and end with an assessment of how the financial crisis of 2008 caused the movement to crest and create a political and economic backlash that has led us to today.

GLOBALIZATION: A PERSONAL HISTORY

- When I started my teaching journey at the University of California at Berkeley in 1984, **business education was dollar-centric, with business schools around the world using textbooks and cases written with US data and starring US companies**. My class had a sprinkling of European and Japanese students but students from much of the rest of the world were underrepresented, and they went to work for companies that were primarily domestic in operations.
- Today, business education, both in terms of location and material, **has become global**, with European and Asian business schools routinely making the top business school list, and class materials reflecting this trend.
- As businesses have globalized, **consumers and investors have had no choice but to follow**, and the things we buy (from food to furniture) and the companies that we invest in all reflecting these global influences.

GLOBALIZATION'S WINNERS
1. CHINA

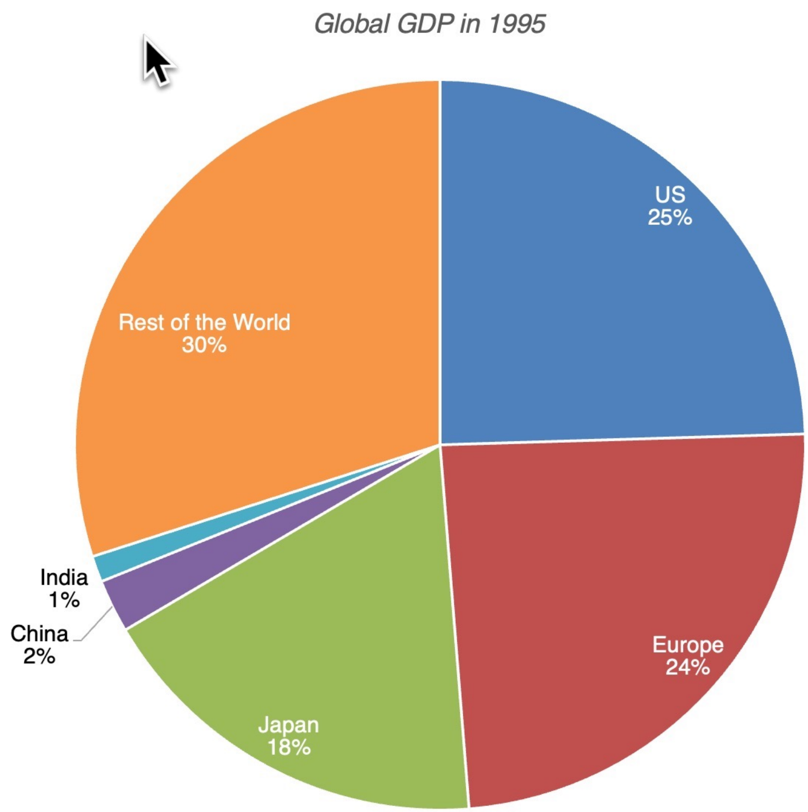
	1980	1985	1990	1995	2000	2005	2010	2015	2020	2023
US	24.96%	33.34%	25.94%	24.53%	30.28%	27.27%	22.59%	24.24%	24.90%	26.11%
Europe	25.97%	18.48%	25.69%	24.21%	19.28%	22.20%	19.20%	15.67%	15.47%	14.86%
Japan	9.86%	10.97%	13.86%	17.80%	14.68%	10.11%	8.65%	5.89%	5.89%	3.96%
China	1.67%	2.38%	1.57%	2.36%	3.58%	4.78%	9.14%	14.66%	17.13%	16.76%
India	1.63%	1.79%	1.40%	1.16%	1.38%	1.72%	2.52%	2.79%	3.12%	3.36%
Rest of the World	35.91%	33.05%	31.54%	29.95%	30.80%	33.93%	37.91%	36.75%	33.49%	34.95%

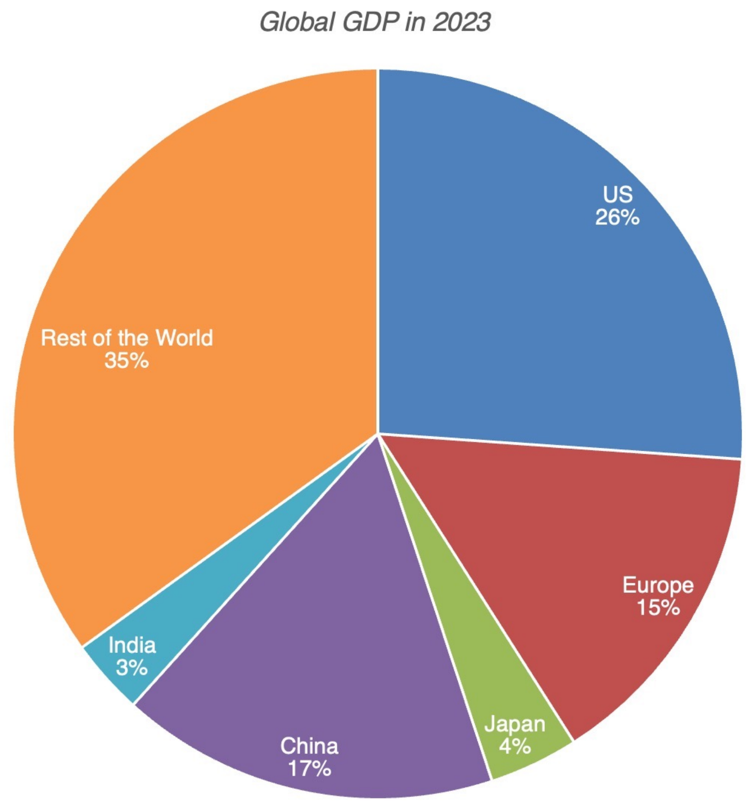
Percentage Share of GDP Change in time period				
	1980-1990	1990-2000	2000-2010	2010-2023
US	27.13%	32.95%	20.87%	40.68%
Europe	25.61%	4.79%	27.22%	9.61%
Japan	17.96%	13.70%	3.44%	-4.99%
China	1.48%	6.54%	21.21%	37.58%
India	1.18%	1.13%	5.25%	6.07%
Rest of the World	27.42%	24.41%	64.49%	38.04%

THE OTHER WINNERS

2. **Consumers**: Consumers have benefited from globalization in many ways, starting with more products to choose from and often at lower prices than in pre-globalization days.
3. **Global Institutions** : While the World Bank and the IMF predate globalization, their power has amped up, at least in many emerging markets,]and the developed world has created its own institutions and agreements (EU and NAFTA, to name just two) making it easier for businesses and individuals to operate outside their domestic borders.
4. **Financial Markets (and their centers):** Over the last few decades, not only have more companies been able to list themselves on financial markets, but these markets has become more central to public policy. As financial markets have risen in value and importance, the cities (New York, London, Frankfurt, Shanghai, Tokyo and Mumbai) where these markets are centered have gained in importance and wealth, if not in livability, at the expense of the rest of the world.
5. **Experts**: We have always looked to experts for guidance, but globalization has given rise to a new cadre of experts, who are positioned to identify what they believe are the world's biggest problems and offer their solutions in forums like Davos and Aspen, with the world's policy makers as their audience.

GLOBALIZATION'S LOSERS
1. JAPAN AND EUROPE

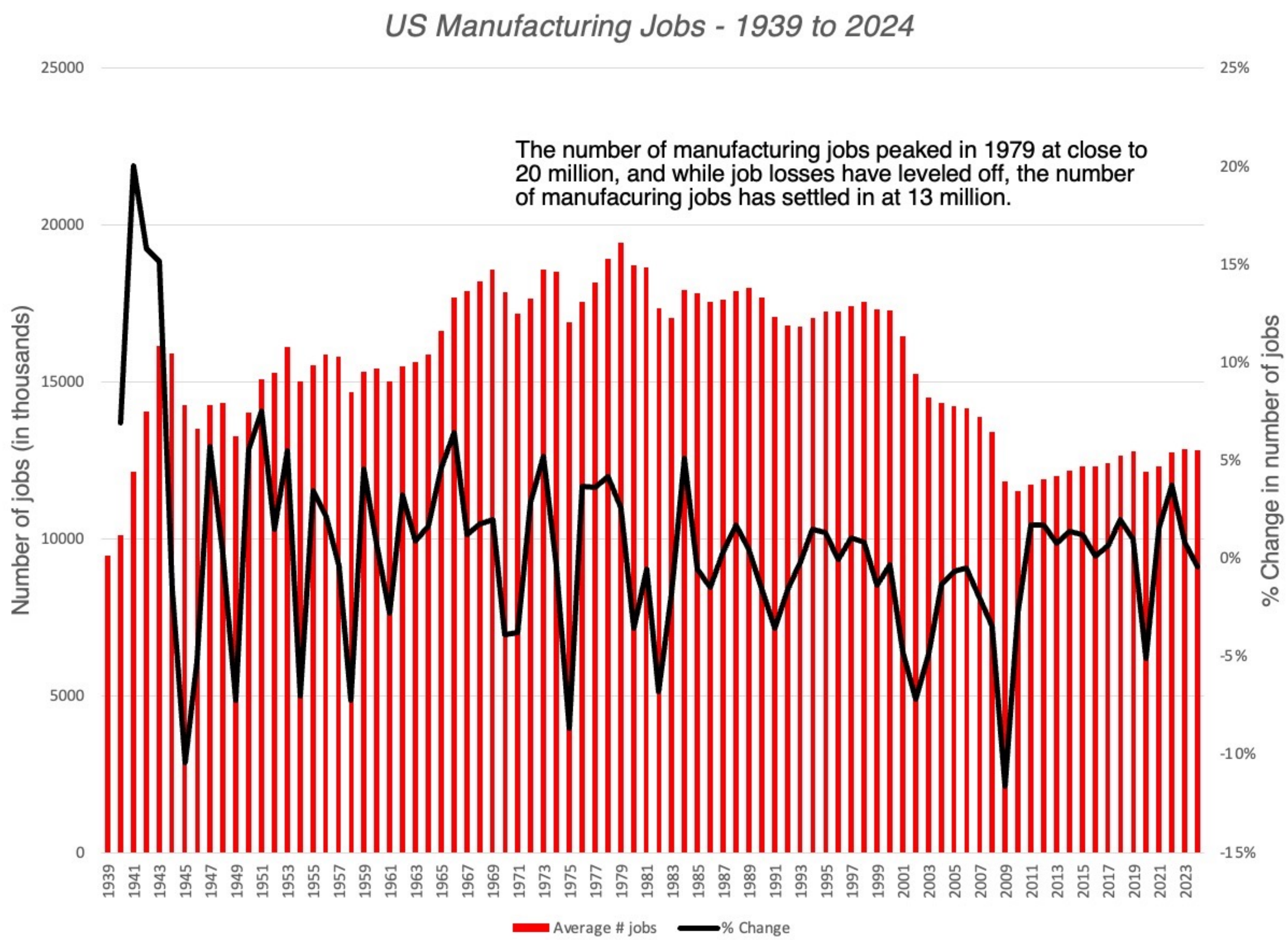




2. CONSUMERS & 3. SMALL BUSINESSES

2. **Consumers, on control**: . From food to furniture, consumers lost in terms of control of where their products were made, and by whom.
3. **Small businesses**: While there are a host of other factors that have also contributed to the **decline of small businesses**, globalization has been a major contributor, as smaller businesses now find themselves competing against companies who make their products thousands of miles away, often with very different cost structures and rules restricting them. The disappearance of the small firm effect, where small firms historically have earned higher returns than large cap companies, and globalization is a contributing factor.

4. BLUE-COLLAR WORKERS IN DEVELOPED MARKETS

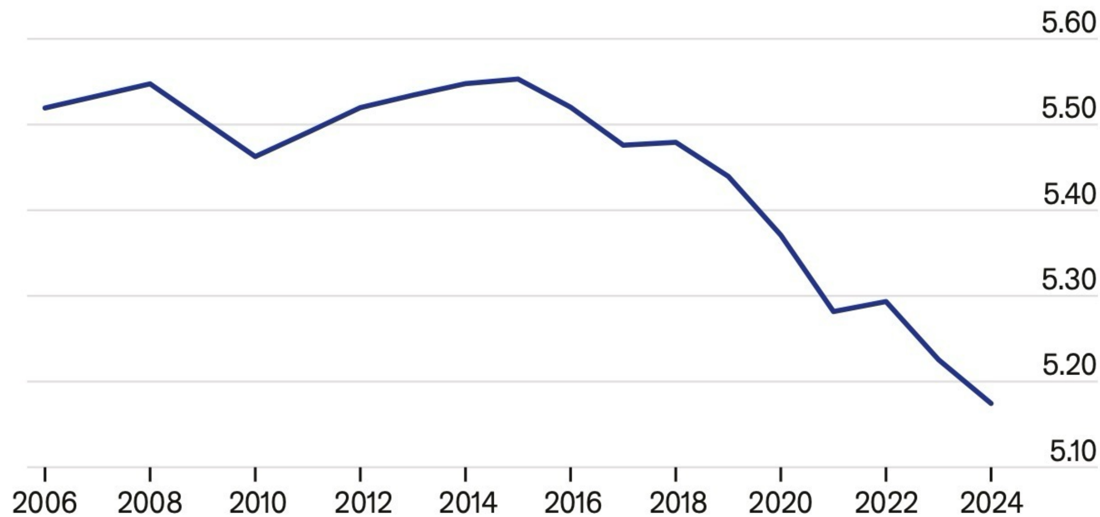


5. DEMOCRACY

	# Countries	% of countries	% of world population
Full democracies	25	15.0%	6.6%
Flawed democracies	46	27.5%	38.4%
Hubrid regimes	36	21.6%	15.7%
Authoritarian regimes	60	35.9%	39.2%

Charting democracy's ups and downs, 2006 to 2024

Global average Democracy Index score out of 10 (10=best)



Source: EIU.

THE 2008 CRISIS AND AFTER EFFECTS

- Coming into this century, the march of globalization seemed unstoppable, but **the wave crested in 2008**, with the financial market crisis. That crisis exposed the failures of the expert class, leading to a loss of trust that has never been recovered.
- While the initial responses to the financial crisis were incremental, the **perception that the world was still being run by hidden (global) forces, unelected and largely unaccountable to anyone**, has continued, and I believe that it has played a significant role in British voters choosing Brexit, the rise of nationalist parties in Europe, and in the election of Donald Trump in the United States.
- To those who are nostalgic for a return to the old times, I **don't believe that the globalization genie can go back into the bottle**, as it has permeated not only every aspect of business but also portions of our personal lives. The world that will prevail, if a trade war plays out, will be very different than the one that existed before globalization took off.

DISRUPTION: THE PLAYBOOK

- **Find a business to disrupt**: The best businesses to disrupt are large (in terms of dollars spent on their products/services), inefficient in how they make and sell these products, and filled with dissatisfied players, where no one (or at least very few) is happy.
- **Target their weakest links**: Legacy businesses have a mix of products and services, with profitable products/services servicing less profitable, but still necessary products/services. Disruptors go after the former, leaving legacy businesses with a less profitable and viable product mix.
- **Move quickly and scale up**: Speed is of the essence in disruption, since moving quickly puts status quo companies at a disadvantage. With access to significant capital from venture capital, private equity and even public investors, disruptors can scale up quickly, unencumbered by the need to have well formed business models or show profits.
- **Break rules, ask for permission later**: A willingness to break rules and norms, knowing that their status quo competitors will be more averse to doing so, and that the rule makers and regulators will take time to respond.
- **There is no alternative**: By the time the regulators or legal system catches up with the disrupters, they seem to have become so ascendant, and the status quo so damaged, that there is no going back to the old ways.

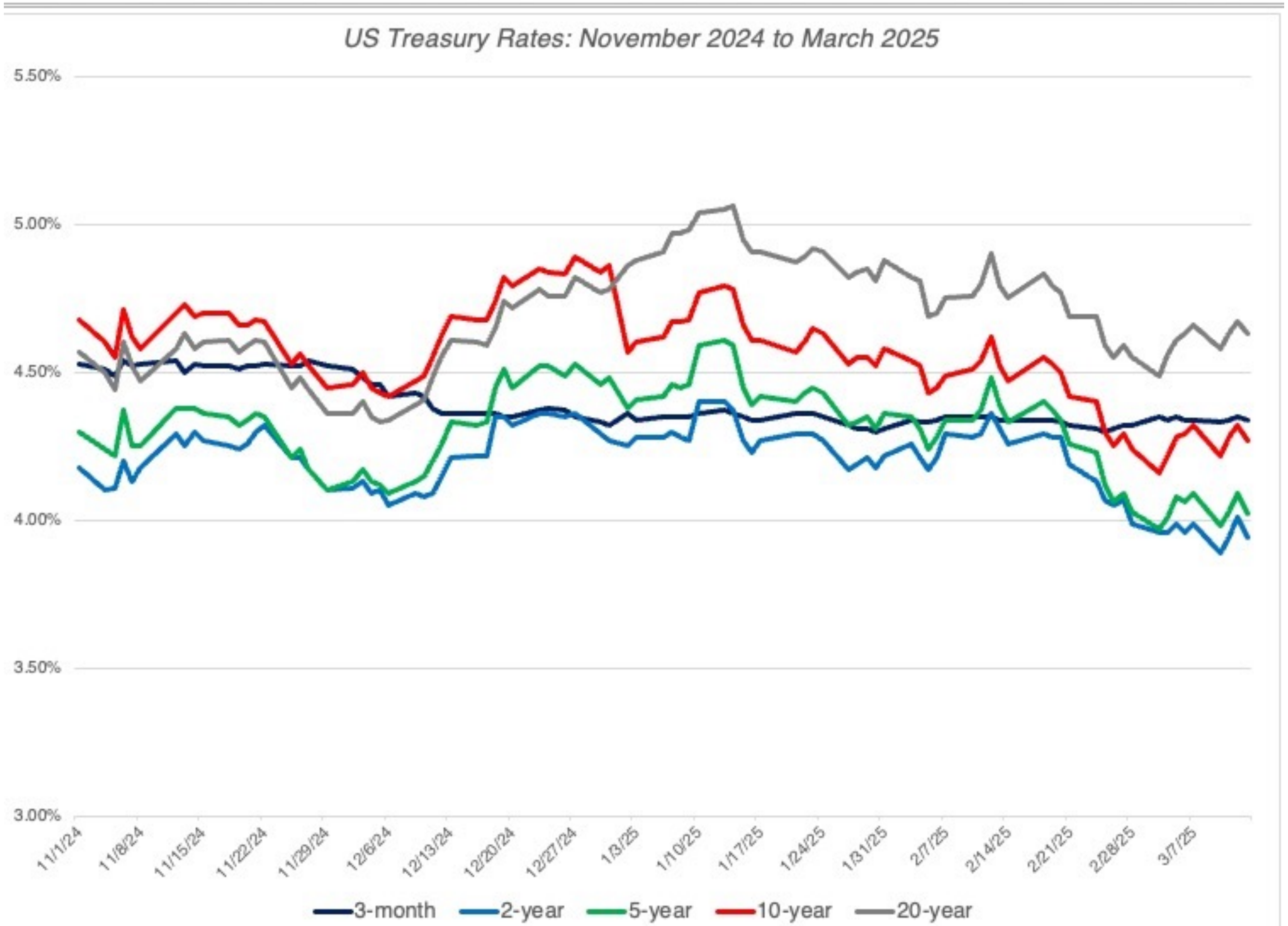
DISRUPTION'S WINNERS AND LOSERS

- The **obvious winners from disruption are the disruptors**, but since many of them scaled up with unformed business models, it is less in the form of profits, and more in terms of their market capitalizations, driven by investors dazzled by their potentials, and making founders, employees & investors wealthy. As these disrupted businesses prioritized scaling over profitability, consumers benefited from bargain-basement prices, sometimes below cost.
- The **clearest loser from disruption is the status quo**. As legacy companies melt down, in terms of profitability and value, the damage is felt in concentric circles, with employees who faced wage cuts and job losses, and investors seeing write downs in their holdings
- The **peripheral damage is to the regulatory structures** that governed these businesses, as the rule breakers became ascendant, leaving rule makers impotent and often on the side lines. To the extent that these regulations and rules were designed to protect the environment and the public, there are side costs for society as well.

DISRUPTION GOES BIGGER!

- For much of its history, disruption has been restricted to the business space and it has had **only limited success when directed at systemic inefficiencies in less business-driven settings**.
- In governments, **Nayib Bukele, in El Salvador, and Javier Milei, in Argentina**, have not just pushed back against the norms, but have reveled in doing so, and they were aided by the fact that the governments were so broken that many of their citizenry viewed any change as improvement.
- As we watch Elon Musk and DOGE move at hyper speed (by government standards), break age-old systems and push rules and laws to breaking point, I see the disruption playbook at play, and I am torn between two opposing perspectives.
  - On the one hand, it is clear **the US government has been broken for decades and tinkering at its edges has accomplished little to reduce the dysfunctionalities of the system.**
  - On the other, though,, since **breaking the US government is not the same as breaking companies**ere are millions of vulnerable people and a break that is not fixed quickly could be catastrophic. There is a middle ground here, and unless DOGE finds it quickly, this disruption story will have lots of casualties

MACRO EFFECTS:
1. INTEREST RATES



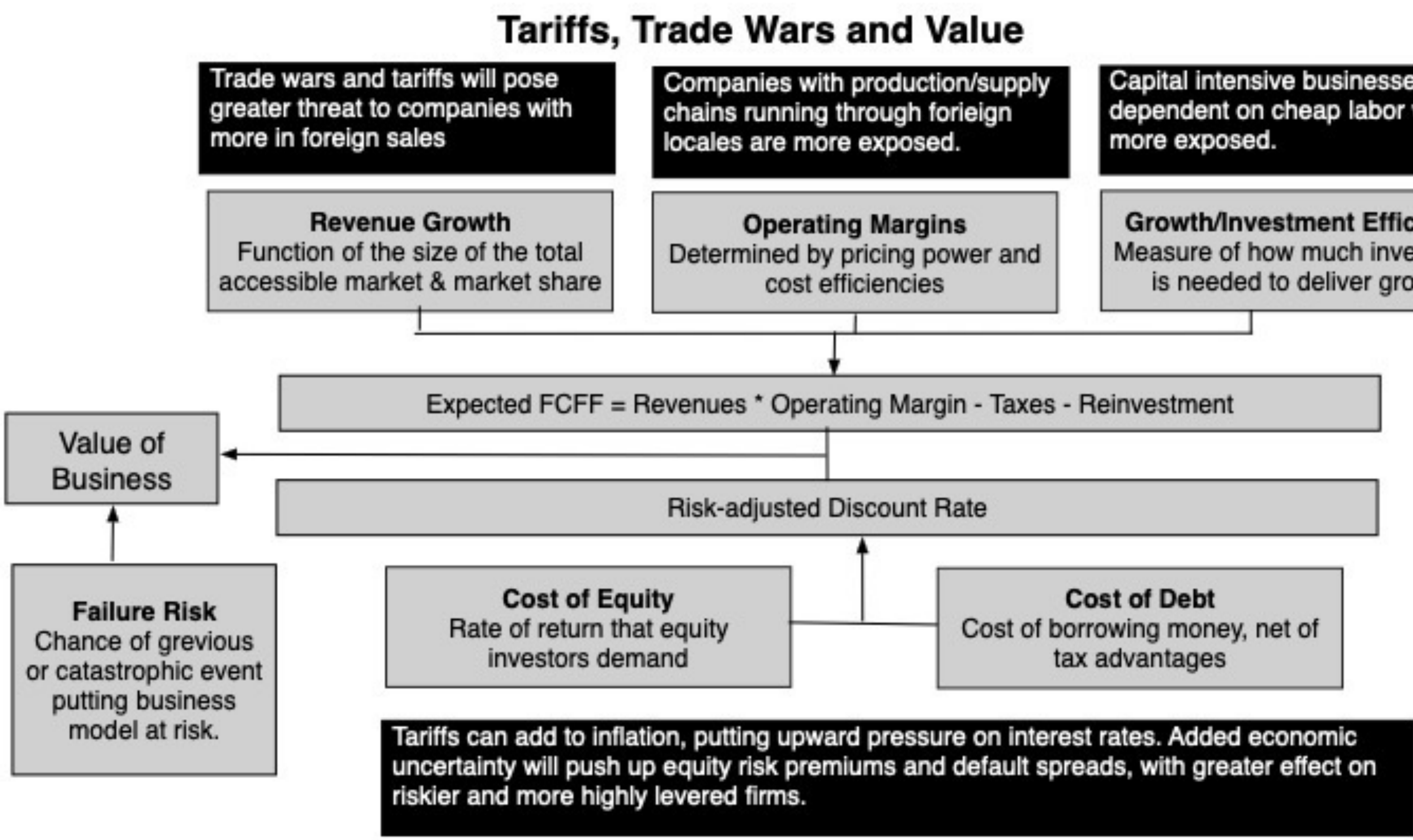
MACRO EFFECTS:
2. EQUITY RISK PREMIUMS

Date	S&P 500	10-year US Treasury	ERP	Expected Return
1-Jan-24	4770	3.88%	4.60%	8.48%
1-Feb-24	4846	3.94%	4.50%	8.44%
1-Mar-24	5096	4.27%	4.33%	8.60%
1-Apr-24	5254	4.21%	4.23%	8.44%
1-May-24	5036	4.69%	4.40%	9.09%
1-Jun-24	5278	4.38%	4.27%	8.65%
1-Jul-24	5460	4.36%	4.12%	8.48%
1-Aug-24	5522	4.09%	4.12%	8.21%
1-Sep-24	5648	3.90%	4.06%	7.96%
1-Oct-24	5762	3.81%	3.94%	7.75%
1-Nov-24	5705	4.28%	4.29%	8.57%
1-Dec-24	6032	4.18%	4.07%	8.25%
1-Jan-25	5882	4.58%	4.33%	8.91%
1-Feb-25	6041	4.54%	4.27%	8.81%
1-Mar-25	5955	4.22%	4.35%	8.57%
14-Mar-25	5521	4.28%	4.68%	8.96%

Election day: November 5

The equity risk premium for the S&P 500 has jumped from 4.35% to 4.68% in just the first two weeks of March, putting it at the highest level since the start of 2024.

MICRO EFFECTS
1. VALUE DRIVERS



2. AND STORY EFFECTS

- There is another way in which you can reframe how the shifts in politics and economics will play out in valuation. I have long argued that every valuation is a bridge between stories and numbers, and that to value a company, you have a start with a business story for the company, check to make sure that it is possible, plausible and probable, and connect the story to valuation inputs (revenue growth, margins, reinvestment and risk).
- Staying with that structure, the **value of a company can sometimes be affected by its political connections or by the government acting as an ally or an adversary**, making the government a key player in the company's story.
- While that feature is **not uncommon in many emerging market companies**, when analyzing US and European companies, you had the **luxury, historically, of keeping governments out of company stories**, other than in the roles of tax collectors and regulators.
- That time may well have passed, and it is entirely possible that when valuing companies now, you have to bring the government into the story, and in some cases, **a company's political connections can make or break the story**.

TESLA: THE STORY HITS ROADBLOCKS

1. **A rethinking the "electric cars are inevitable" story**: For the last few years, it has become conventional wisdom that electric cars would eventually displace gas cars, and the question was more about when that would happen, rather than whether. In 2024, you saw doubts creep into that narrative, as hybrids made a comeback, and the environmental consequences of having millions of electric cars on the road came into focus.
2. **The rise of BYD as a competitor for electric cars**: Since its founding, Tesla has been the symbol of the rise of electric cares, and legacy car makers have struggled to keep up with it. in 2024, BYD, the Chinese electric car company, sold more electric cars than Tesla for the first time in history, and it is clearly beating Tesla not just in China, but in most Asian markets and even in Europe, with lower prices and more choices.
3. **The politicization of the Tesla story**: There has been a backlash building from those who do not like Musk's political stances and it is spilling over into Tesla's sales, in Europe and the United States. As long as Musk remains at the center of the news cycle, this is likely to continue, and there is the added concern, even for Tesla shareholders who agree with Musk's politics, that he is too distracted now to provide direction to the company.

An Auto Story, with a political twist						Mar-25
In 2024, Tesla saw its auto revenues decline from 2023 levels, driven by three forces - an easing in the shift from gas to electric autos overall, the rise of BYD as a global competitor and Elon Musk's political presence. While all three will continue to weigh on the company, the long term prognosis is that electric car demand will continue to rise, and that Tesla and BYD will battle for that market, with the former winning upscale customers and the latter in the mass market. Tesla's energy business continues to grow strongly, and the potential from software and robotaaxis remains, albeit a few years into the future.						
Story and Inputs						
	Base year	Year 5	Year 10		After year 10	Link to story
Revenues (a)	$ 97,690		4.22%		4.22%	the electric car business, splittling the upscale and mass markets.
Operating margin (	11.19%	11.19%	13.08%		14.30%	Tech twist gives a boost, but price cuts and cost pressures will cap margins
Tax rate	20.40%	20.40%	25.00%		25.00%	Global tax rate
Reinvestment (c)		Sales to capital =	3.00	RIR =	28.13%	reinvestment in the near years.
Return on capital	14.29%	Marginal ROIC =	35.37%		15.00%	Cost of entry will limit competition.
⇨ Cost of capital (d)		9.37%	8.35%		8.35%	Moves to median company cost of capital
The Cash Flows						
	Revenues	Operating Margin	EBIT	EBIT (1-t)	Reinvestment	FCFF
1	$128,939	13.18%	$16,989	$13,523	$10,416	$3,107
2	$158,396	12.86%	$20,371	$16,215	$9,819	$6,396
3	$186,421	12.51%	$23,329	$18,570	$9,342	$9,228
4	$224,728	12.52%	$28,146	$22,404	$12,769	$9,635
5	$276,791	13.08%	$36,214	$28,827	$17,354	$11,472
6	$321,433	13.46%	$43,276	$34,050	$22,321	$11,729
7	$366,075	13.75%	$50,338	$39,143	$22,321	$16,822
8	$410,716	13.98%	$57,400	$44,106	$22,321	$21,785
9	$455,358	14.16%	$64,462	$48,940	$22,321	$26,619
10	$500,000	14.30%	$71,524	$53,643	$22,321	$31,322
Terminal year	$521,100	14.30%	$74,542	$55,907	$15,728	$40,178
The Value						
Terminal value			$ 972,840			
PV(Terminal value)			$ 408,556			
PV (CF over next 10 years)			$ 81,236			
Value of operating assets =			$ 489,792			
Adjustment for distress			$ -		Probability of failure =	0.00%
- Debt & Minority Interests			$ 14,390			
+ Cash & Other Non-operating assets			$ 36,563			
Value of equity			$ 511,965			
- Value of equity options			$ 38,080			
Number of shares			3,197.00			
Value per share			$ 148.23		Stock was trading at =	$220.00

THE BOTTOM LINE

- While it is easy to blame market uncertainty on tariffs and trade wars for the moment, the truth is that the **forces that have led us here have been building for years, both in our political and economic arenas**.
- In short, even if the tariffs cease to be front page news, and the fears of an immediate trade war ease, **the underlying forces of anti-globalization** that gave rise to them will continue to play out in global commerce and markets.
- For investors, that may require **a shift away from the large cap technology companies** that have been the market leaders in the last two decades back to **smaller cap companies with a more domestic focus**.