



# TRILLION DOLLAR TOPPERS: MARKET TRIGGERS, VALUE DRIVERS AND PRICING CATALYSTS

Bridging the divide between value & charts

# Trillion Dollar Capitalization

- Apple and Amazon each hit a trillion dollars, drawing press attention and commentary about what this moment means for markets, investors and the companies themselves.
- I have followed both companies and valued them for more than two decades, and this is as good a time as any to see how they got to where they are today, and what the future holds for each company
- Before I value them again, here is a far more basic question: Should hitting a trillion dollar value (or a hundred billion or a billion or any other number) matter to investors?

# It is human nature to attach significance to numbers..

- ❑ As human beings, we do make more of a fuss around some numbers than others, especially with age and birthdays.
- ❑ In some cases, the fuss is merited, as when you turn eighteen, since you will be able to vote and be treated as an adult in the legal system, or sixty five, since you may be entitled to your pension and social security benefits.
- ❑ In others, it is a concocted milestone, as is the case when you turn thirty or forty or fifty years old, since little changes in your life, as a consequence.

# Investors do the same...

- Price triggers: When a publicly traded company's stock price drops below a dollar, it is often punished, because it risks being delisted, putting liquidity at risk. When the stock price rises above \$1,000, the company may come under pressure to do a stock split, because it has become "too expensive" for retail investors to buy.
- Capitalization triggers: With young, privately owned companies, getting a pricing of more than a billion dollars gets you unicorn status, though it is not clear what that branding entitles you to, other than a little public attention.
- Operating metric triggers: Within corporate finance, there are similar triggers built around revenues and profits, with management contracts tied to revenues reaching a billion dollars or EBITDA cresting one hundred million.

# The Market Reaction to Triggers

- While some investors view them as side games, there are others who build much of their investing around market triggers.
- Value investors, and especially those raised on the classics, scoff at price triggers as distractions from their focus on earnings and moats but they often have their own triggers, based upon earnings or book value.
- In contrast, a great deal of technical analysis, as an investment philosophy, is built on triggers, many built around price per share.

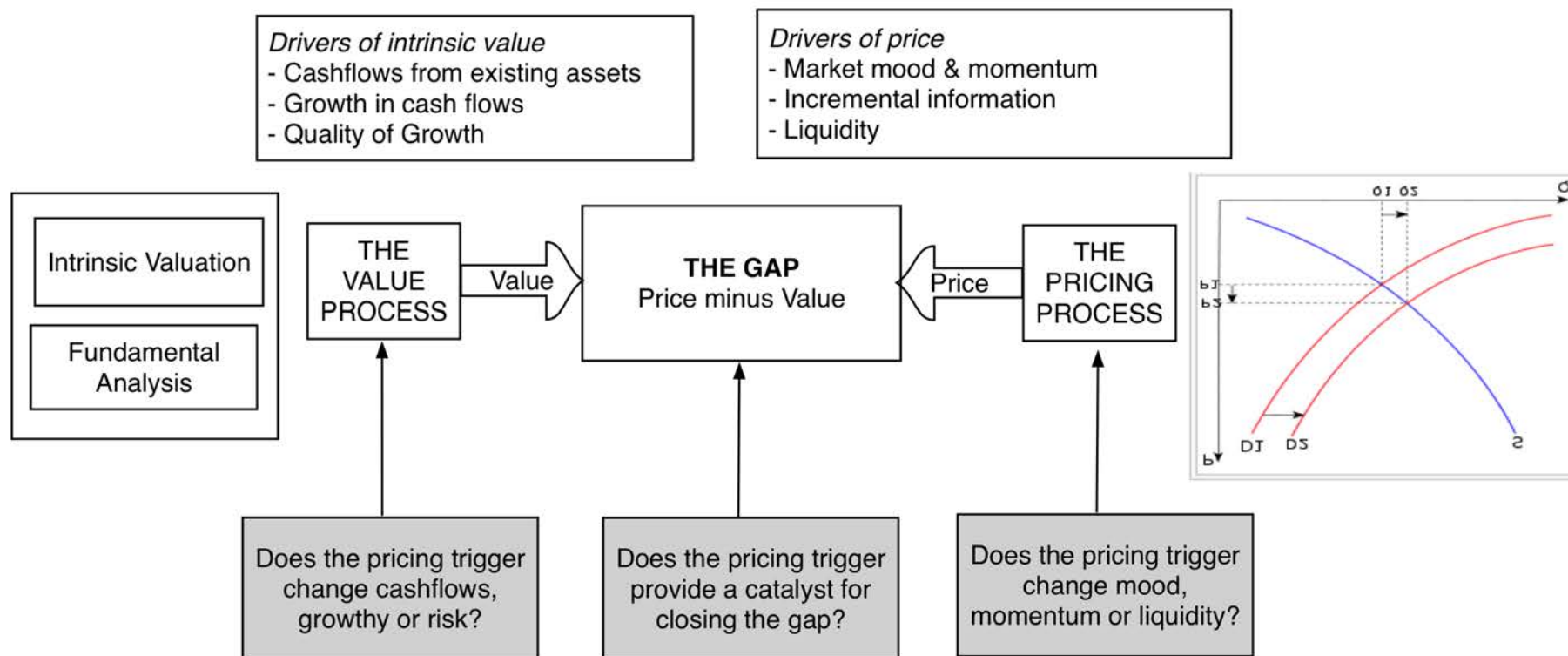


# Should triggers matter? The market speaks..

- With stock splits, the market not only reacts positively to the split but these stocks continue to do better than expected in the months after.
- When a stock approaches its 52-week high, there is some evidence that the high price acts as a barrier.
- There is some evidence that support and resistance lines have price effects; one study focusing on exchange rates concluded that pricing trends in currency rates are more likely to be interrupted at support and resistance lines.
- A general study of technical analysis (and price patterns) concludes that technical indicators, such as head-and-shoulders and double bottoms do have a price impact, though it is unclear that you can make money of these price movements.

# A Framework for Understanding Triggers

## Pricing Triggers, Value and Price



# 1. Value Effects

- If a market trigger has an *effect on one or more of the three drivers of value*, which are cash flows, growth and business risk, it can affect value.
  - ▣ Revenue or earnings triggers set by companies can have an effect on value, if management compensation is tied to them.
  - ▣ With some corporate borrowings, there are covenants tied to stock prices or earnings, the violation of which may lead to consequences for the firm, sometimes taking the form of higher interest expenses and sometimes a change in control.
  - ▣ With convertible bonds and preferred shares, the conversion price can become a trigger for a change in value, if it results in a significant increase in shares outstanding and in debt ratios.
- Consider the [grant that Tesla's board of directors gave Elon Musk](#) in March 2018, where he will get billions of dollars in shares and options in the company, if he can deliver on a variety of targets, some related to market capitalization and some to operating performance. (12 market capitalization triggers, 8 revenue triggers and 8 EBITDA triggers).



## 2. Pricing Effects

- Psychological effect: If a market trigger has an effect on market mood or momentum, it can affect prices, even though it has no effect on fundamentals. For example, when a company's stock price drops below its support line, it creates a negative *psychological effect* that can cause more selling, with prices falling even further.
- Liquidity effect: If crossing a pricing barriers affects liquidity, it can affect prices. (Examples: Price dropping below a dollar, Unicorn companies)
- Herd effect: where crossing a pricing or value trigger can lead people who have been sitting on the sidelines to act, pushing up prices if they decide to buy and pushing down prices when they sell.

### 3. Gap (Catalyst) Effect

- The *attention garnered* by crossing even an arbitrary threshold can lead to a reassessment of the company. This is especially the case with smaller and lower profile companies, which can often be ignored by investors and analysts, in a market where larger and higher profile companies garner the bulk of coverage.
- To the extent that these companies are being mispriced, the attention can lead to a *closing of the gap* between price and value.
- Note that this *reassessment can cut in both directions*, with unnoticed strengths coming to the surface, and increasing the prices of some companies, and unnoticed weaknesses being unearthed in other companies, resulting in prices dropping.

# Trillion Dollar Trigger? Looking at Apple and Amazon

- No value effect: Neither Apple nor has options or convertibles that will unlock at the trillion dollar capitalization and thus there should be no value effect.
- Some pricing effect: There may be a pricing effect, but it is not clear in which direction. On the one hand, you can argue that for some long term holders of the stock, crossing the trillion dollars may be a culmination of a long and successful journey, leading to selling. On the other hand, there are others who may have resisted both stocks as overpriced, who may decide that this is the time to capitulate and buy the stock.
- No stockholder reassessment, but... As two of the most widely tracked and followed companies in the world already, it is not likely that there will be any major reassessments in either company, on the part of stockholders, nullifying the gap effect. There is one potential black cloud that comes with the increased attention, at least for Amazon, which is that the company's success may be drawing the attention of anti-trust and regulatory authorities.

# Using triggers in investing

- If you are a trader: It does not surprise me that charting and technical indicators are built heavily around these triggers. If you are a good trader, and I believe that they are some, your strength is in assessing how these triggers change mood and getting ahead of the market on these shifts.
- If you are a value investor: While your focus should remain on value, you should consider incorporating pricing triggers into your value mission for two reasons.
  - ▣ Some triggers have value effects.
  - ▣ If market triggers can operate as catalysts, causing price to move to value, incorporating them into your investment process can unlock the value mistake that you have found.

# My bottom line

- I am a value investor, but I do look at pricing triggers, especially with small cap, lightly followed and emerging market companies.
- If I value a stock at \$6 a share and it is trading at \$4.10/share, but its historical low price is \$4 (the support line), I may wait to buy it, hoping for one of two outcomes.
  - The first is that it hits the support line and does not drop below it, signaling a positive shift in momentum, indicating that this would be a good time to buy.
  - The second is that it drops below its support line, resulting in a negative shift in momentum and more selling, allowing me to buy the stock at an even lower price.
- My primary decision of whether to buy or sell a stock is driven by value judgments, the question of when to do it can be affected by market triggers.

# Back to Amazon and Apple

- I own shares in Apple and I don't own any (right now) in Amazon.
  - ▣ With my Apple shares, I have been rewarded well over my almost three-year holding period, and the question then becomes whether the trillion dollar market capitalization should make a difference in whether I continue to hold the shares.
  - ▣ With Amazon, I saw little reason to buy the stock a few months ago, as I noted [in this post](#), where I argued that it was a great company but not a great investment. The question then becomes whether market capitalization crossing the trillion dollar changes that assessment.
- My next post....