DIVIDENDCAFE | PODCAST TRANSCRIPTION

FRIDAY, JULY 3, 2025

Hello and welcome to the Dividend Cafe. I am your host, David Bahnsen. We are doing a special Thursday, July 3rd release of the Dividend Cafe this week, because Friday when the Dividend Cafe normally goes is 4th of July, our Nation's 249th birthday, and we wanted to get Dividend Cafe out to you beforehand.

We hope you enjoy your long holiday weekend, but in the meantime, I want to talk to you today about one of the things that I consider perhaps the most important subject in all of investing, dealing with the reality of bubbles, of manias, of speculative affairs that are capable of doing absolutely fatal damage to investors. It would be easy enough to say the solution to dealing with bubbles is to avoid them all together and thereby not have to worry about the aftermath of bubbles and what damage they can do for investors. The problem is, it is never quite so simple.

First of all of the people I'm talking to right now, are people, human beings. Human people susceptible to conveniently forgetting and ignoring and not liking the message about bubbles when that message is most important. So we're gonna talk a little bit today about the psychology of some of this that I think is at the very foundation of what we do for a living at The Bahnsen Group, why this profession exists in a lot of ways, but secondly, even apart from some of the sort of behavioral and human psychological elements to this, that again, are embedded in human nature itself, bubbles are often not very easy to identify. Alan Greenspan, I think erroneously, but nevertheless famously said that one can never know something is a bubble until the time that it is burst, and I'm not sure that's entirely true. I joke in Dividend Cafe this week, the famous line from Justice Potter Stewart he was talking about pornography when he said he couldn't define it, but he knows it when he sees it. And that was it, somewhat humorous, there's this kind of wit to it. And you can say that there's something similar about bubbles in that.

They're not scientifically definable. Is there a specific price level, a specific valuation level, a specific level of investor euphoria or asset flows? Is there some quantifiable metric that we then say, this is now in the line of being a bubble or is it rather a general ill-defined element of mentality?

That then gets defined as a bubble after the bubble is burst. And so that's the challenge and complexity of what we're dealing with today. I talk about the definition of a bubble in science where you're literally talking about air that has been trapped inside of a thin layer of liquid.

And what happens when that kind of bubble bursts is the bubbles no more. The air itself is escaped into the atmosphere and the liquid itself evaporates, where sometimes when you look at bubbles in financial vocabulary, Beanie Babies still exist, some of the dotcom companies still exist, so it doesn't evaporate in the atmosphere the way a soap, a bubble might.

But nevertheless, the financial damage is such that there's a significant crash event. That means you get to define it by the crash, meaning by the burst, not the existence of the bubble itself. So there is embedded in the nature of things here, something going on that is not very helpful. Investors don't have the luxury of identifying easily these things until it can be too late. And so that's why I spent a lot of time on this topic.

I've been professionally managing money for 25 years. I've been a member of adulthood, if you will, for over 30 years. I myself went through the dotcom implosion. I learned a significant amount from it as an investor.

I went through the 2008 housing bubble and that burst, you could I've studied immensely in my own academic and professional pursuits. The Japan bubble, the asset bubble of the 1980s. And there is a real tremendous amount of literature available about financial excesses and speculations going back centuries that I have chosen to spend a lot of time studying.

I think that we can learn a lot from history here that informs some of our actions in the present and decisions we want to make for the future. I use the baby beanie excuse me, beanie Baby story of the 1990s. A lot to make fun of, bubbles, to make fun of investor acidity. That there were people buying $5 stuffed animal toys that couldn't have cost 60 cents to make for a thousand dollars, believing they were gonna sell 'em for $2,800 and $3,500 and whatever.

It is easy to say how silly human beings can be, but. There is first of all a really important difference between a lot of the bubbles we wanna understand and look at potential bubbles that could surface in investing reality Now. The story of Beanie Babies, the underlying product of a Beanie Baby was very literally a $5 stuffed animal.

And while now with the gift of hindsight, we can make sort of cultural jargon out of pets.com and web van. The Super Bowl commercials of the late 1990s and all of that carnage that was done, it does look incredibly pitiful in hindsight. But that's not a beanie baby. And let's not forget that the basic promise of the internet that led to that bubble actually all came true.

The internet did transform our lives. It did create trillions of dollars. A couple of the surviving companies are themselves, multi-trillion dollar companies today, or Googles and Amazons. There are certain dot coms in the late nineties that excelled, whether it's payment companies like PayPal or auction sites like eBay.

There are plenty of success stories out of that moment, and their valuations got way ahead. Then they crashed, then they rebuilt. To use pets.com and webvan is important to remember the thing that matters about the era, which is people losing their mind about objective reality. There was still an underlying product there.

The South Sea bubble that I've studied quite a bit from the early 18th century that famously made a popper of Sir Isaac Newton. You're talking about one of the smartest human beings who ever lived who got sucked into it. But again, that story was basically. A monopolistic equity play on trade between economic superpowers.

It sounded like it made sense, but then it became a story of excess, divorced from reality, divorced from valuation logic. I. The Beanie Baby thing is true as a parallel to the extent that it gets into the part that matters about pathology of human beings being afraid of being left out. The greed and envy factor of seeing others make easy money and wanting the easy money, I.

But the underlying product was so ridiculous that sometimes we can forget that, Vegas condos in 2005 were still a place to live, even if they were two or three times in price, what they should have been. So I guess my first point I wanna start with is that a bubble is not defined by the preposterousness of the underlying asset.

Bubbles can materialize out of that, which is actually brilliant. It could be normal, and yet it can also turn into something utterly asinine. Technology itself lends itself to bubbles in the sense that they do create great human progress. Technology is where we got radio technology is where we got the automobile technologies, where we got television the personal computer and then of course the internet, cloud, et cetera.

Now the latest, and we're gonna spend more time talking about this in a moment, is artificial intelligence. The world of technology does not create bubbles, but it lends itself to this situation where something very good exists because human beings are capable of great technological innovation, and yet at times those technologies become obsolete.

At times they lose competitive advantages. And other times they just simply get head to head with competition. The valuation matters because that is the nature of investing. I did a Dividend Cafe about this a few weeks ago, but there are also certain elements that become a bubble, become a very dangerous investment, a dangerous risk reward, trade off.

Not because they had a great product and then became a less compelling product, but because they didn't have a way of making money, and this is what's so interesting about the internet story of the 1990s, is you had some companies that had really cool websites that had absolutely no chance of ever making a good dollar.

You forget that there were basically entire multi-billion dollar valuation. Comp web companies that their entire revenue model was banner advertising on the websites. And yet, are we gonna use that to take away from the revenue model that materialized out of Google? I. The highest ad revenue generating machine in world history, are we gonna use that to take away from the revenue capacity of Amazon?

And what became of the e-commerce behemoth? So there were companies that had great business models and ultimately became success stories. But there were also companies that not only were dealing with valuation excess. But we're just bad businesses, so you have to separate those two.

The question is how we think about it in the modern context when, I'm sorry, there's no comparison. When you're looking at the two, the mag seven names, the 2025 and the Revenue Generation, the business model, sophistication and success of Nvidia Meta, Google, Microsoft, apple, these companies. And to try to make that comparable to Webvan.

There, there's, there, you're basically talking about primary equity capital was needed in the late 1990s. Because there was no revenue, that was what paid the bills, was the equity capital these companies we're talking about now are entirely self-funded a thousand times over from cashflow. So that is a difference, and yet it doesn't represent a difference in the issue I'm focused on, which is of course.

Our, the reality of valuation, the reality of is investor psychology, the attractiveness of the investment. And so we wanna be careful about these distinctions. The Beanie Baby thing, the dot com, where we stand. Lemme say this business planning, it's easier to say, I'm gonna avoid Webvan because I don't see how they ever make any money. Johnny in 1999 did not lose his money on Webvan in 2000 because Webvan had a bad business model and he had analyzed the fundamentals and was unwilling to accept the reality. The cash flows were not gonna materialize, or there wasn't a solid revenue model, or there were holes in the business plan.

What attracted people to dot com in the nineties is that they hoped these cruddy companies would go up. Their friends were all seeing the companies go up, and the companies had themselves been going up. So people assume they still would, it was momentum and envy and fear of missing out on steroids. Look, there were other companies that are far better companies than Webvan that set a lot more investor capital on fire than the, I'm using, I'm picking on pets.com and Webvan.

In 2017 Yahoo and AOL, put together, sold for $5 billion. All right. Their combined market cap in the late nineties had been hundreds of billions of dollars. So they sold Webvan at one point was an $8 billion company. And Yahoo and AOL put together, sold for less than Webvan, and Webvan, I think had $130 of revenue.

So you see my point, low quality companies, high quality companies, it doesn't matter when they become darlings of the investing public. And there is this psychological break from analysis, from objectivity, from value, from common sense, that is a precondition for a bubble. I quote Howard Marks in early 2000. He said, people look to the share price for an indication of how the company is doing. Isn't that backwards? In the old days, investors figured out how the business was doing and then set the share price, and I think that's a great way to think about what can lead to bubble like conditions. Do we think the stock price tells us how a company's doing or does how a company is doing? Tell us about the stock price. I am a fundamentalist when it comes to stock analysis and the way I view public equity investing. I care about the fundamentals of a business, the the quantifiable fundamentals, as well as more qual qualitative components about management, about a company, about business model, about competitive positioning. And of course we measure and apply so much of this through the lens of being dividend growth investors. What I would suggest is that when the entire framework changes to being a reflection on how can I buy a stock for one price, sell at a different price, these are supposed to be things that are an effect of something, not a cause of something that you symptomatically are dealing with something very different when the vocabulary changes, there is a cognitive disconnect about what creates wealth. Value is created on a high return, on invested capital. The there is a free cash flow that comes from a well executed business model. And when you believe that math is irrelevant, the discount rates do not matter, and in fact, the earnings generation and earnings growth doesn't matter. This is symptomatic of a of the preconditions to a bubble forming now a lot of times what people will say, “It's okay. I recognize everything you're saying, but there's no denying David that investors do go down this path for a period of time stock prices do go higher, and for one who enters at that right price and exits before the masses lose their mind. You can still make good money and avoid for yourself the burden of fundamental analysis of boring, 10% type returns. You can basically have it all by writing these bubbles, being a beneficiary of them, not a victim of them.”

And of course, that presupposes this sort of exit timing. Along with the masses that I think has always been the fatal flaw. And I referenced Howard Marks a few moments ago in reading a paper he had written 25 years ago.

As I was doing research for this Dividend Cafe, I came across a quote from the late Barton Biggs. Barton had been at Morgan Stanley for many years. I myself am a Morgan Stanley alum and Barton passed away a little over 10 years ago. He was a legend. But this quote I'm gonna read to you and then I'm gonna tell you when he said it.

It's just utterly fascinating. The technology, internet and telecommunication craze has gone parabolic. And what is one of the great, if not the greatest manias of all time, the history of manias, is that they almost always have been solidly based on revolutionary developments that eventually change the world.

Without fail, the bubble stage of these crazes ends in tears and massive wealth destruction. Many of the professional investors involved in these areas know that which is going on today is madness. However, they argue that the right tactic is to stay invested as long as the price momentum is up. And when momentum begins to ebb, then they will sell their positions and escape the carnage since they have very large positions.

They all follow the same momentum. I suspect they are diluted in thinking they will be able to get out in time because all other momentum investors will be doing the same thing. Barton wrote that on November 29th, 1999, just three months before one of the most spectacular crashes, a bubble burst, if you will, in human history.

It's not different now. Then or in the future that buying on the madness of crowds on the belief that you'll be an exception to the madness of crowds is an arrogance a hubris that does not end well. Now all of this is set up for the question as to whether or not the current environment with Mag seven ai big tech.

Represents a bubble. A couple things I wanna make very clear about bubbles and about the current environment. The dotcom bubble was a valuation fomo, fear of missing out atrocity, but it also was a fundamental disaster around a gazillion companies that had no business trading, even at a million dollar valuation, let alone multiple billion dollar valuations.

Housing bubble number two that led to 2008 was debt fueled. It could not have existed apart from leverage. Excess credit led to excess asset prices, the inevitable decline of those asset prices, where then there's not an underlying drop in the absolute debt led to a debt de-leveraging a spiral. As critical as I am.

About the Mag seven valuations. Neither one of those conditions I just said apply to the Mag seven ai big tech moment in which we find ourselves. Now, I'm not done yet. There's gonna be some other important points to make. Web van pets.com does not apply to Mag seven. These companies are not exactly web van and pets.com, but nor does the debt leverage credit conditions, which are really the biggest driver of the biggest asset bubbles in history.

The Japanese real estate of the eighties, our own financial crisis, even indot com by the way, there was a significant amount of margin ownership. Now on the margin, is there, no pun intended, is there some. It built up leveraged ownership of Mag seven. Of course, hedge funds have some leverage. There's margin buying.

The, there, there's a very minuscule element of debt field ownership of Nvidia compared to Japanese real estate in the eighties. The Vegas condos, right in the two thousands. It's a very different period. But am I saying there's not a bubble? No. I'm just pointing out that those are two very different dynamics.

Here's the issue that makes this so difficult right now. The fundamentals of these businesses today are amazing. They're cashflow generation, their marketplace positioning, they're competitive superiority. These are tremendous companies, but a half dozen of 'em making up 32% of the S&P 500.

Is absolutely unprecedented and it's actually double what has been most of the past precedent. Even at the tech/telecom bubble of 2000, the top seven companies right before the crash were 22% of the market. Now we're dealing with 32%. There is an irrational exuberance in the AI moment. I think that's fair to say, but I would point out that when Alan Greenspan talked about irrational exuberance in the technology sector in the 19, late 1995, that crashed didn't happen until March of 2000.

I think that the biggest driver of investor behavior right now around Mag seven and AI does seem to be the worst mode of imaginable, which is fear of not owning something that your friends own, that sort of FOMO factor. It's not something that I generally expect to end very well. I love this quote from Charles Kindleberger.

There is nothing so disturbing to one's wellbeing and judgment as to see a friend get rich. You're not gonna find a period. And when you study the history of investor psychology, that when you get this sort of connected to greed, euphoria, human nature, it doesn't end badly now.

Another point worth making in this current moment is everything I just said. The last four or five points I made. They were true a year ago. They were true two years ago, but here we are. So these are obviously not good timing points. I'm making objectivity and rationality are not prevalent right now, and that is a concern.

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Is it a bubble or is there a different level of concern here? Does the nomenclature actually matter? I would argue that if we're not in a bubble, there's bubble adjacent characteristics evidenced in the psychology and some of the metrics of the current moment. But the better way to look at it is to game out a handful of outcomes and to think about which of these outcomes you're willing to live with or live without.

Is it possible that the Mag 7, AI, big tech world, crashes and burns? Of course it is. That would be bad. Is it possible the Mag7, AI world will not crash and burn, but will be subject to a prolonged period of subpar mediocre returns? I think that is probably a higher probability than even the first option, but also would not be good.

Is it possible that the world will that this whole space, this world will see above market returns for years to come? It's possible. Do I think it's likely? I do not. Is it a poor risk reward trade off? I think it is. And is it possible that they will rally hard from here, but then go into a real bubble crash environment, the type we've seen before, so have a blow off top from here, followed by utter carnage?

It's absolutely possible in all four of those scenarios, and I'd be hard pressed to know what a fifth option may be. I don't like any of those four. I admit one of them is better than the other three, but even that one comes with an unattractive risk reward trade off. I believe that what you have to remember here is the reality of valuation in investment decisions.

That it's not what you buy, it's what you pay that counts. Howard Marks, again, quoting him the great distressed debt investor. I also believe that beyond the basic argument for value orientation, mathematical warnings about nosebleed valuations. That there is a kind of broader set of considerations that really have to be understood right now.

So I'm gonna close out with seven quick concluding comments that I hope will be a helpful summary conclusions of this important subject. The current environment has necessary but not sufficient. Preconditions of a bubble. What is going on right now in investor psychology is always there before a bubble, but that's different than saying it guarantees us that there is a bubble.

Number two, there's little regard for the fact right now that competition could come up that changes some of these leadership names. Some of these disruptors could become disrupted. Market leaders do not generally stay market leaders forever. Now what if that means a company has an 80% market share, goes down to 70% market share.

That's still a pretty impressive market share, 70%. But it would require giving up a significant amount of share, a significant downturn in total value. So the leadership position right now. Represents a potential liability that I don't think anybody recognizes. One company in the mag seven today was even in the top 20 of companies 25 years ago.

Only 14 of our top 20 companies today were top 20 back then in the turn of the century. The reason for this is a very good thing in the

American economy. It's how our system works. Praise the Lord, we are dynamic. And leadership companies often get replaced by new leadership companies. That is an unappreciated fact in today's mag seven, big tech world.

Number three, the facts of a case are relevant when you're ascertaining the investment merits, meaning looking at the telecom predictions from the 1990s, most of them did happen. The facts ended up being really good. But the investor results were atrocious. Great stories that became bad investments.

There's hundreds of years of support for this. That's not to say it does happen exactly that way, but it's ridiculous to assume it couldn't happen in this current moment. Number four, the Mag seven ai big tech world has benefited from the index nature of ownership on the way up. There is an equal proportion of consideration on the way down that the selling, excuse me, buying, be getting, buying that is helped this sector via index ownership, could very well cut the other way in a downturn. Number five. The only principle that I believe is more readily defensible to me than the principle that valuation matters is the principle that when people start telling you valuation doesn't matter, is the time at which valuation matters the most. Be incredibly wary and cautious of people beginning to explain to you how, actually that old school way of looking at things doesn't really apply anymore.

Those are extremely dangerous words throughout investor history. I don't know if we're gonna end up looking back on this period as calling it a bubble or not. I think it's entirely possible that old Cisco Nvidia parallel. I did a ding cafe on that a couple years back. Could be a play as well.

Fear of a bubble burst is a good reason to be cautious, but it's also not the only reason to be cautious. You may just wanna be cautious out of general prudence, not fear of a bubble burst, but in the context of a risk reward, trade off the more muted return going forward, out of valuation adjustment.

Doesn't require some sort of fatal apocalyptic ending, but it could still very well be a very cogent investment decision. And then finally, number seven, I have seen crazier frothier, more bilious moments than the one we're in now. I don't think that's a very ringing endorsement for the Mag seven ai big tech world.

But this one has some hair on it. But I'll tell you, we've seen worse even before we had the gift of hindsight. So all of that factored in to me. It calls for caution. It calls for prudence. It calls for an awareness of the environment around us. It doesn't lend itself to screaming doomsday predictions.

It also doesn't lend itself to rationalizing and self-justifying objectively bad investor behavior. It calls for learning from the lessons of history and being smart. Fundamentally, as we go forward. I hope this has been beneficial. I've covered a lot of ground. We've gone longer than I normally do.

Enjoy this long holiday weekend. Check out DividendCafe.com where the chart of the week is, and I'll be back with you in the Dividend Cafe on Monday. Thanks so much for listening, watching and reading the Dividend Cafe.