DIVIDENDCAFE | PODCAST TRANSCRIPTION

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Hello and welcome to this week's Dividend Cafe. I am your host, David Bahnsen. I am recording in our beautiful Newport Beach, California studio, and I'm very excited for Thanksgiving week. But right now, this very second, I'm excited to bring you today's Dividend Cafe, where we're gonna talk about CEO scandals, the role of the CEO, what it means to investors, how to think about this whole state of affairs. It obviously is not a topic I'm making up out of thin air. The catalyst, the sort of inspiration for the topic is the recent revelations of Jensen Huang at NVIDIA, the apparently multiple extramarital affairs, the removal of his position. That whole incident caused me to think about this at greater length, but that incident is not the subject of today's Dividend Cafe. I wanna be clear, we do not own NVIDIA at The Bahnsen Group, and we never have. And so I'm not talking about this subject 'cause of some direct pertinence, relevance around NVIDIA, around the AI story. But I will say, I think that there is a lot of relevance. It is obviously an event that has some degree of adjacence to market circumstances. So there is a kind of all at once, "Hey, this thing's happening, what's it mean?" element. But then the theme of Dividend Cafe is much higher level. CEO departures, board governance, how investors need to think about these things that can sometimes become all-encompassing events. So we're gonna unpack it, and I hope there will be a fair amount of both history and future and present analysis, all the above, that will be useful to you today.

Let's start with a basic question. Is a head coach worth their salary? And so this applied to sports, is controversial enough in, in its own right. The analogy I use is Bill Belichick, who, let's just start with the obvious. The guy won six Super Bowls as the head coach of the New England Patriots. So many could say that answers itself. Obviously, the head coach is that big of a difference maker, six Super Bowls. But then you go, "Okay, fair enough." But the star quarterback, Tom Brady, left the team and went and won another Super Bowl without Coach Belichick on his own at a team that had been previously somewhat mediocre, Tampa Bay Buccaneers. Bill Belichick went on to go three and 14 or maybe it was four and 13 in his final year at the Patriots, declining each year in the post-Brady years. Now, some of you that are not football fans are saying, "What is this up to the CEOs?" And some of you that are not CEO fans are saying, "Can you please keep talking about football?" But let me mix these two things together because it is an analogy that I think works for our purposes. It's undefinable, it's immeasurable, it's imprecise, and it is admittedly subjective. I think a sports fan would have to be a fool to say that Belichick had no role in the success of the Patriots in that period. But I also think a sports fan would have to be a fool to say he was the sole reason. There are counterfactuals. And in that tension, in that gray area, it's kind of one of the things that at least I speak for a lot of guys, being a guy who is a sports fan, that they just love to sort of banter

about. But you never get conclusions because it is non-falsifiable, it's non-verifiable, and there is an analogy here in the world of CEOs being able to measure the value they bring. Are there some who are worthless? Are there some who are transformative? And are there a heck of a lot that are somewhere in the middle?

I think that that is very likely the case, that, that latter position. We look at the NVIDIA moment here and you say, okay, well, you got a CEO who is a founder and had been there 31 years. But first of all, let me put a chart up real quick so we can be clear on what we're talking about right now Well, you see in red there where NVIDIA's stock was at the point that the CEO scandal came out and his resignation and where it is now. But what you see in the week, two, three, four weeks before that is that obviously NVIDIA was already going through a certain stock decline before the news. So, all at once, the news was some sort of impact here in this short-term window, but it was not the only one. There are other factors going on. And on a go-forward basis, which we cannot yet answer, it is not merely about how's the company gonna do without their charismatic, visionary founder there anymore. They are dealing with the aftermath of what we do not know. What are the national security issues? Where is the role of government? What kind of political things are gonna happen out of this? What export controls were violated, and what will the impact be to future revenues if there's a cracking down of China exports? All of these things remain to be determined, which is out of that uncertainty, a lot of what I think is the market pressure at the moment. Then if you take away all of the ramifications of that story and just go back to the prior story, which is the overall AI ecosystem, the financing systems and structures that are in place, the risks that NVIDIA has with counterparties in neocloud, in data center, in hyperscaler.

There's just a big, big story there, and it is not one that anybody can answer specifically, but it's certainly one that goes a lot bigger, deeper, wider than the CEO story itself. And yet, I think that what we have to think about here is most companies being in that boat, most companies having a Belichick-Brady situation where, yes, it's very relevant, but no, it isn't the whole story, and how do we unpack some of it? And by the time I'm done today, I think we're gonna have an answer as to how we think about it from a fiduciary and prudent standpoint of sound investing.

Let's make a distinction right now in the difference between tragedy and scandal. A CEO leaving can be, and often is, an impactful event in the stock. The scandal in this Jensen Huang moment is salacious. There's extramarital affair, there's potential espionage, there's questions about a honeypot endeavor. There's questions about all these other things involving national security. But then a CEO could go with no wrongdoing and infect the stock a lot. And I think one of the more famous examples of this in recent times is when Steve Jobs was diagnosed with cancer. Now, remember, initially, he was diagnosed with pancreatic cancer in 2004, underwent a surgery, and some of the best, you have to assume, best medical care available. And it was largely believed that, that he was kind of free of that.

And in fact, the iPhone launch took place after that. The initial came out and a lot of the initial Apple ecosystem took place in 2007, '8, '9, before his cancer returned. And there was a six-

month leave when he was diagnosed, re-diagnosed with cancer in 2009, where Tim Cook became kinda introduced to the American people as a kinda interim key leader in the Apple organization. I'm sure he was very well known internally before that, but not externally, and he became more of a household name. But then Jobs came back. Apple is rocking and rolling, and then in 2011, the stock was hammered when it was announced he needed another leave. And then ultimately, he ended up resigning. And then literally, I think it was just two months later that he tragically passed away. Very young man, relative to, how we think about these things. A very, a very sad story. And Tim Cook, in that case, took over when Apple had a $450 billion market cap, and when he left, it had a, a $4 trillion market cap. So what you have was a stock volatility in 2011 around the news that there was something happening with Cook. But then you had a very thoughtful succession and a CEO who'd already been an interim CEO who was ready to go move. And then I will just candidly say it, you have a company that if a baked potato was running it, it would've done pretty darn well. Now, that is not me saying that Steve Jobs didn't matter as one of the great visionary leaders in history, 'cause he most certainly did. But the company was able to continue going when Steve tragically became ill. It's not to say Tim Cook didn't matter, because he was one of the great successor heir CEOs we've ever had, and you see the value creation that took place and a lot of the expansion in Apple's economic model and, and recurring revenue that Tim drove as the CEO from, what would that be? About 2011 to 20- 2012 to 2025 And then the third element about the baked potato is merely me commenting on how primed for success Apple was, their market leadership, the power of their technology, the power of their patents, their consumer popularity. No, I don't think that they would be a $4 trillion company with a baked potato at the helm, but I do think it would have been a pretty successful company. And so I don't think anything I just said is contradictory. But again, you're in that spot there of immeasurable value added from a CEO, but recognizing significant value added all at once, that not being connected to a scandal per se. Strategy matters, and this is the interesting thing about a CEO is are we talking about CEOs as executors, implementers, integrators, or are we talking about them as key strategic thinkers? History is filled with plenty of examples of all the above, and sometimes they are mutually exclusive, sometimes they're not. But you think about somebody strategically. You know, I, I am very, very fond and have studied extensively Lou Gerstner, what he accomplished at IBM 1993. That was one of the key strategic CEOs in history, where you took a company losing hundreds of billions and turning it into making hundreds of billions, and the value creation he did out of a total strategic transformation, basically moving IBM from one of the major product companies of the 20th century to one of the major solution companies of the 1990s into the 21st century. There's other times where it's not so much a strategic transformation, but a, a continuity. And, and Steve Ballmer at Microsoft, when he took over for Bill Gates, he held on to Office, he held on to Windows, but then set the table for what would end up becoming a major entrance into cloud and into mobile. He experimented with other things that didn't do as well, particular handheld devices and some of the consumer product things Microsoft did. But when the new

FRIDAY – NOVEMBER 20, 2026

CEO came in at Microsoft, I think that what one of the things Ballmer's never gotten enough credit for is how Nadella ran with an infrastructure that Ballmer had put in place. That, that wasn't a full transformational thing. It was kind of holding on to legacy but setting the stage for it, and then certainly Nadella proved to really drive success at Microsoft with a, with a transformational move strategically into cloud. There are different ways in which you could think about the role of the CEO, and some can be successful, some can be unsuccessful. But my point being that there is a need to understand what we're even talking about with a CEO's value. Is it as an executor operator? Is it sometimes that they're just a custodian of a great company in a given point of time? And that could prove to be a good point of time or a bad point of time. I love using political analogies here.

I don't think it's a stranger to anyone who knows me, my affinity for the President of the United States in my youth, Ronald Wilson Reagan and Ronald Reagan did implement economic initiatives that were causative in economic growth. Massive marginal tax rate reduction, deregulation, energy independence a successful prosecution of Cold War strategy. These things did drive economic growth, but you just have to be a partisan to not acknowledge that Reagan was a beneficiary of good timing as well, coming after 1970s stagflation and into a period of great economic renewal. And so again, the both/and here is that Reagan all at once helped create some of that economic growth and was a beneficiary of some of that economic growth. And I think you have to be a partisan to not say the same thing about Bill Clinton in the 1990s. He did cut capital gain taxes. This is when the Kennedy and Clinton, very popular Democrats of the post-war American era, were actual capital gain tax cutters. Clinton was a strong dollar president. He passed welfare reform, a lot of free trade legislation, and at the same time, he happened to be president in a period of the internet coming to life and being president in the immediate post-Cold War period, and that peace dividend that came therewith. So I think that both Reagan and Clinton are wonderful examples of presidents who deserve some credit for economic policy, and also presidents that were beneficiaries of fortunate timing and circumstances. I would say that the inverse is true with President George W. Bush. He happened to come in in the immediate aftermath of a tech bubble bursting and savaging parts of the American economy.

He happened to come in right at the very point at which 9/11 took place and forever altered much of our national security landscape and the economy. And then, of course, exited at the other bookend with the financial crisis coming in and representing one of the great existential economic moments since the Great Depression. So that, that is not exactly the, the type of timing you would wanna sign up for as a president. When you look at examples of Reagan and Clinton, when you look at examples of Bush, and again, people could say Bush had some good policy, which I would say had some bad policy, which I would say. My point is never to make it mutually exclusive that they were the cause or they were not at all the cause, but rather to point out the nuances that go in and the role of timing and luck. And I don't know why we would think it's any different with a CEO. Jack Welch is a very famous example in American

history. I mean, he basically got to come in in a period where a company that was more levered to American economic cyclicality than you could imagine went through a period of tremendous American pro-growth cyclicality through the entire decade of the '80s and '90s, and exposed to so many of those economically cyclical businesses that benefited, and then he just happened to be retiring, like, the day before 9/11 And a couple years then what proved to be the, the financial crisis that wreaked havoc in the GE Capital business. Welch, probably more than anyone I've studied, had the dual luck of incredible entrance timing to the CEO chair and incredible exit timing before the bad stuff. Does that mean he didn't do some tremendous things? It does not. He did actually some tremendous things and some very challenging things that his successor had to sort of deal with.

But nevertheless, we are used to thinking of presidents, we're used to thinking of football coaches, and we're certainly used to thinking of CEOs in the context of what circumstances they enjoyed, sometimes even when it was more incidental than causative. And so when I think about CEO activity, I try my best to avoid those things that were outside of their control and think about the things in their control. And obviously, extramarital affairs and espionage scandals are in their control. But you know, there are scandal things that happen that are different than, for example, a tragedy of a Steve Jobs getting sick. But I also want to be clear that I'm not talking about CEO leaving around fraud and criminality. You know, with Ken Lay and Jeff Skilling at Enron. You think of Bernie Ebbers at WorldCom. You think of the Sam Bankman-Fried at FTX. Elizabeth Holmes at Theranos. In some cases, a little less so WorldCom and a little more so Theranos and FTX, but these and Enron, I think, would be more in this latter category, as we came to find out. But these were kind of broken companies, that their fraud did not ruin the company. It was that they were just a fraud to begin with, and when the fraud was discovered, it exposed the company. So I can't evaluate a CEO on the basis of how good they were at doing fraud or, or the fact that they got in trouble for fraud when they just had a bum company to begin with, like Theranos.

I think that there are other things that push CEOs out outside of fraud and criminality, and outside of, like, an extramarital affair with Jensen Huang that's connected to espionage. It's a very high-profile thing. I really do believe it very likely seems to be the most high-profile CEO scandal we could think of. But you know, both McDonald's and Nestlé in recent years removed a CEO for a consensual romantic relationship with a coworker that didn't go through proper disclosure channels. Uber famously removed Travis Kalanick, where he was kind of a mean guy. He got caught on video yelling at an Uber driver, and he supposedly was harsh with his team and things like that. It's not for me to say what was legit and, and isn't legit and so forth, but I, I think that when we think about CEO behavior, there's all these different categories. When you think about CEO performance, there's different standards, criteria, and it leaves you with the question as an investor, and certainly for us in my seat as a professional investor, what does matter in a CEO? Do I wanna sit here and say personal character doesn't matter? I mean, it's easy to say, "Hey, if they get caught doing fraud, that's bad." We all know that. I wouldn't waste

your Dividend Cafe time with that. I'm not gonna say in the case of an extramarital affair that I don't think it matters, 'cause I do. I think that character and morality and judgment matter, including in the job they do.
But I wanna be careful in, in the limiting principle because I think it would be tremendously naive and easily falsifiable to say that any CEO who has an affair must not have been effective as a CEO. Unfortunately, in a fallen world, there probably are CEOs that did their job well even though they had personal, issues and skeletons in their own personal life. The fact of the matter is that we can hold these tensions in a loose way that generally speaking, I happen to really prefer CEOs that are people of strong wisdom and judgment and character and morality, recognizing that some draw outside the lines in their personal life. And when it gets into a, a point of espionage and export control violations with China potentially connected to your infidelities, that's a very different story. But I also am limited as an investment professional by what I can know. I, I can't go run a background check on every CEO. I don't know their personality defects. I don't know when they're gonna get caught on tape at a Coldplay concert with the head of HR. What I can know is the board. What I can know is whether they have a board of directors that is doing its job to some degree in the form of governance, in the form of constraint, in the forms of accountability, in the forms of succession planning, that avoid loose cannons. That might be loose cannons in their personal demons. They may be loose cannons just in the way that they autocratically run the company. And at the end of the day, I believe that the best investment ramification of this subject is to actually prize the infrastructure of governance, of accountability, of rejecting autonomy, of treating succession planning seriously. I would love to be able to know when a CEO is a psychopath so I can avoid it. I would love to know when a board has a way to govern psychopathic behavior. And all things being equal, I would prefer the CEO be a person of sound wisdom, judgment, morality Some questionable personal behavior will happen in a fallen world, and I don't wanna make light of it, but I wanna be comprehensive in, in how we think about this. At the end of the day, that CEOs can be autonomous and unaccountable psychopaths is something I need to be aware of and avoid, but I think that when those things happen, it has far more to do with the board than it does the CEO itself, a board that is allowing it. Companies reap what they sow. It is so hard today. I'm gonna read to you the last two paragraphs of Dividend Cafe as we call it quits today, but I think this captures the sentiment I wanted today to leave you with. It is so hard to compete, win, create value, and demonstrate a perpetual ability to grow earnings for shareholders that I prefer to be invested in companies that facilitate these objectives with as few distractions as possible. We all know fraud and accounting shenanigans get in the way, but boards that pay no attention to succession, a CEO is accountable to no one, I'm sorry, I think that can be just as bad. Every human being who has ever served as a head coach, a president of United States, or a CEO is replaceable. No one is indispensable, not Steve Jobs, not Ronald Reagan, not Bill Belichick, and not Jensen Huang. But what is of unbelievable value, the kind that provides profound premium to value creation, is wisdom, character, and diligence, and to that end, we

work. Thank you for listening, watching, and reading The Dividend Cafe. Have a wonderful weekend. We'll see you on Monday