

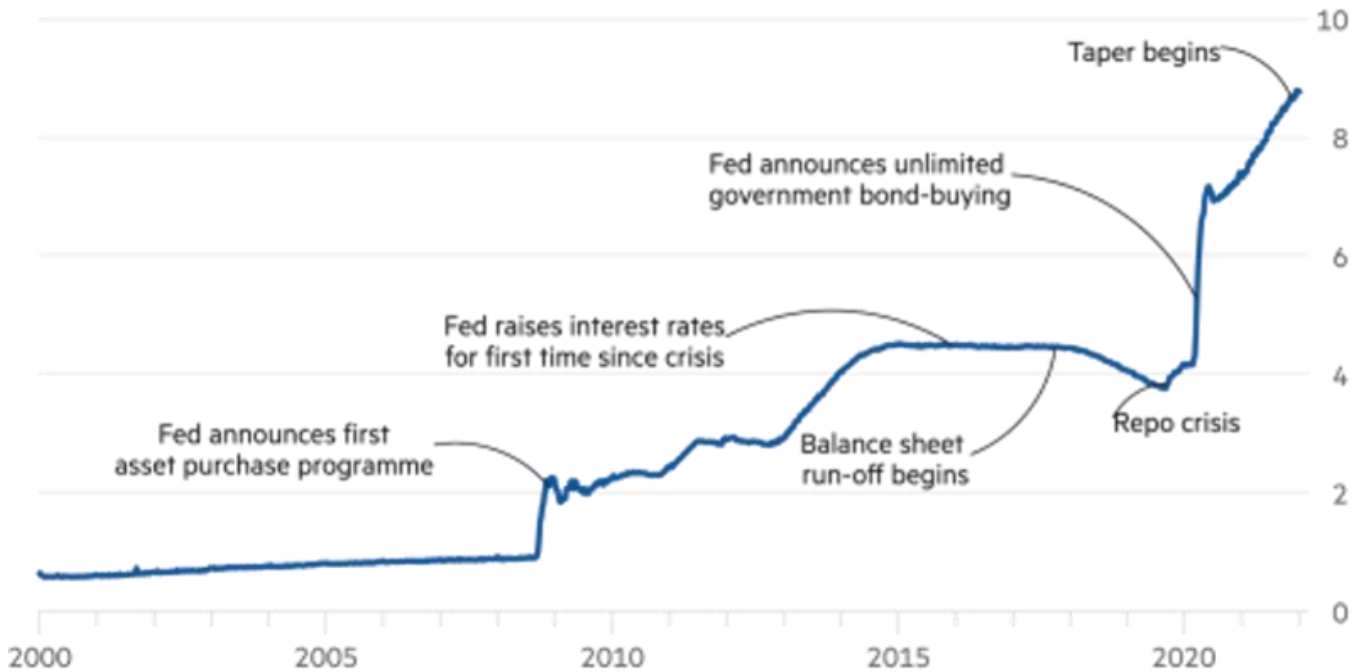
Jerome Powell, and his band of Fed Governors are out gathering as much kindling and dry interest rate wood to burn, [as eight](#), yes eight rate hikes are now on the table for 2022. And so are the Easter Bunny, Big Foot, and the Tooth Fairy. Fire away....



While I can only pretend to rap, and with an ode to Flavor Flav and the rest of Public Enemy, I say “Burn balance sheet, burn. I smell a monetary riot going on, so let that mother (trucker) burn...”

Fed's balance sheet plans have markets on edge

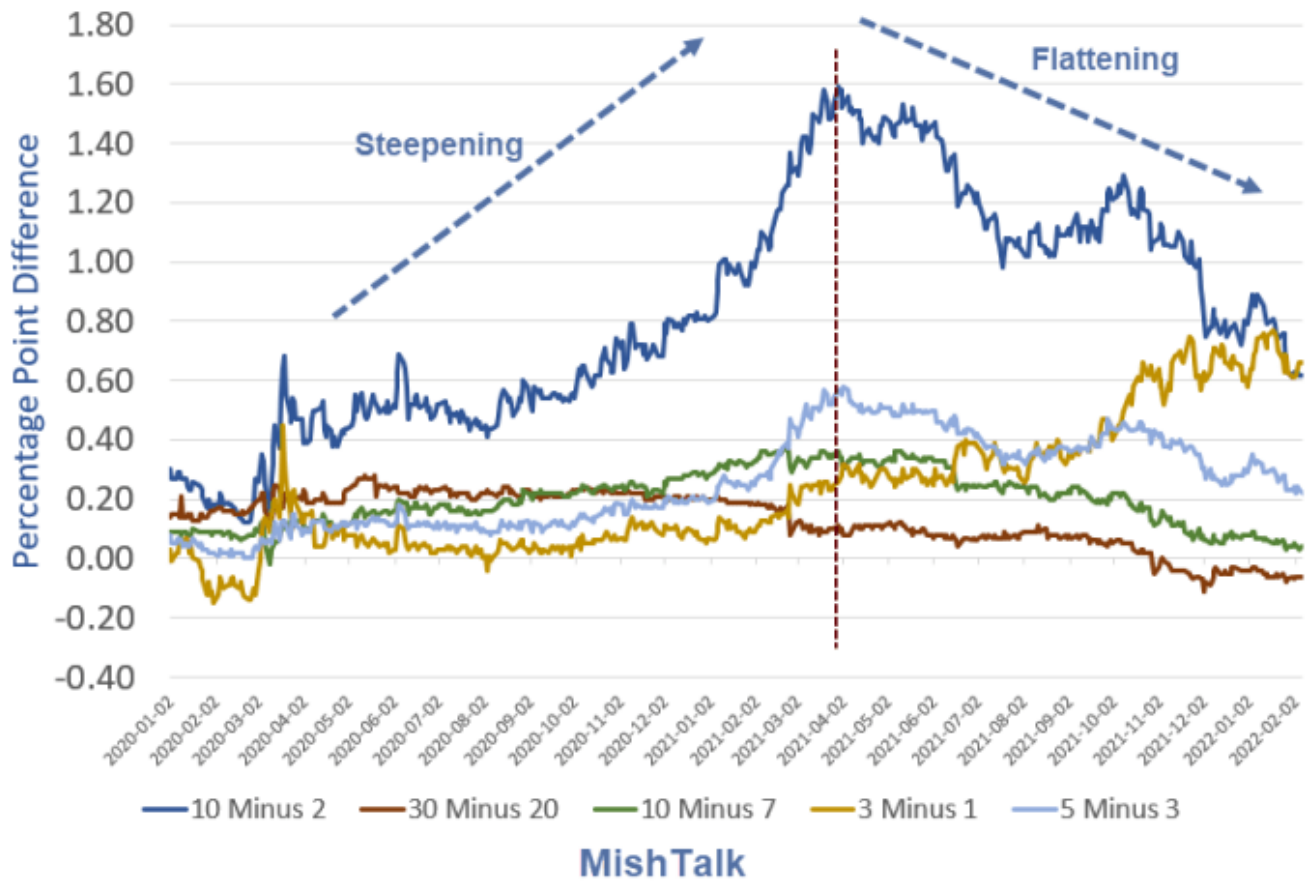
Assets held by the Federal Reserve (\$tn)



Sources: Federal Reserve, Bloomberg
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We have all kinds of subscribers of these pages. Some move billions, while the everyman reader out there is simply trying to figure it all out. Regardless of which camp you are in, here is what we will say to anyone regardless of financial class or social status: be long when a steepening yield curve is at your back, and short when the curve is flattening. Don't take our word for it, [take the Mish's](#). Notice the 'risk off' acceleration which started in the fall of last year? That's when the flattening accelerated.

Yield Curve Spreads Since January 2020



All we have left on the economic calendar this week is the now critical Consumer Price Index (CPI) to be released tomorrow. If the heat that inflation has been throwing off starts to cool, we can see a strong potential for a rally in risk of some consequence. If on the other hand this print comes in hot, [Katy bar the door](#), and we are going to feel bad about that arm of Catherine's.



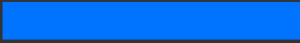





Two quick plugs for solid pieces of past work Stillwater has been producing lately. First up was the 'deep as the Marianas Trench' [lecture material delivered](#) to the students at USC's Marshall School of Business, Center for Investment Studies. If going an hour over because the conversation was filled with so much intellectual curiosity is wrong, we do not want to be right. See you students in a month for round two.



The other piece worth re-reading, or reading again for the first time, is the call of the month, year, and possible decade, when [The Big \(Facebook\) Short](#) hit your inbox two weeks ago. While we thought we were on to something, even we were surprised at the enormity of the reaction, as this was the biggest market cap loss in the history of markets. Experience, with a sidecar of good timing, for the win.

Big Stock, Big Misery

Facebook owner sets record for biggest one-day drop in market history

| Company name | Decline in market value | Date |
|----------------|--|----------------|
| Meta Platforms |  \$252B | Feb. 3, 2022 |
| Apple |  180B | Sept. 3, 2020 |
| Microsoft |  178B | March 16, 2020 |
| Tesla |  140B | Nov. 9, 2021 |
| Amazon |  130B | July 30, 2021 |
| Facebook |  121B | July 26, 2018 |

Source: Bloomberg calculations

Bloomberg

While the Facebook short call went out to a lot of big people at some big shops, there was one hedge fund in New York, with a legendary billionaire at the helm, that showed particular interest in our idea. Hint...



True to form, they challenged us on missing more signal in the thesis, like the magnitude the Apple privacy change would have, and an ESG angle they didn't find necessary. I won't deny them that view, as no call like this is perfect. That said, this was as close to a score of ten as you get in this business. You go, Tim. Thanks for saving the world.



Last lesson in the difference between the signal we saw, and the myopic noise other out there that we were focused on. First, our version of the setup...

“Facebook is a messed-up company that took their first mover advantage in social media and wrapped themselves around the immoral and exploitive idea axle. They were ahead of the curve, and now aren't. User growth is dying, and the privacy bar has been raised high. The metaverse will be real, just not as real as currently imagined.

If you are a mutual fund, don't own the shares. If you are a hedge fund with a shitty analyst that told you to stay in the stock, that's a 'you problem' not a 'me problem'. Fire the guy. If you are a kid just out of business school looking for a new gig, don't work there. If you are a parent, keep your kids off the junk.”



And this was the noise heavy, after the horse left the barn, look from one Wall Street analyst who happened to be an early employee of Facebook. Like back in the Harvard dorm early...

Thoughts on q4 21. Obviously, a tough day for \$FB shareholders but here's what long term investors should focus on:

First on competition. The risk from Tiktok is not existential. Short form video is growing rapidly on FB and Zuckerberg was extremely bullish on how Reels (FB's version of Tiktok) is growing. What's missing is the monetization component. Reels are under monetized but just as with Stories in 2018 and the transition to mobile back in 2012, Meta will ultimately monetize this new content format. It's not a matter of if, but when. In Sheryl's words, "we have a playbook". Meta's other apps, namely Messenger and Whatsapp are much less effected by Tiktok b/c they offer an entirely different value proposition. Meta will have to create a new ad unit in Reels, test it, and get advertisers up to speed so they can market to their customers through this new format. Not rocket science IMO, but will take a few quarters to build. Keep in mind, META still added 10 million daily active and monthly active users across its apps, and now reaches 3.59 billion people across the globe on one or more of its apps.

What's extremely important to note regarding Reels and its potential vs Tiktok, is that META's ad engine and monetization rates far exceed that of Tiktok. As a result, META can pay creators more to post their content on Reels. So if you're a creator, naturally, you're going to post content on the platforms that pay you the most money. While both Reels and Tiktok are growing, I think the monetization edge META has over Tiktok is very significant and in the long run will pull creators over. If we look at ad revenue / hour, META monetizes at 10x the rate of Tiktok. It simply has superior relationships with advertisers, better ad targeting, a larger audience, etc. etc.

On a side note, I believe Meta's focus on competition on the earnings call may also have been partially in response to ongoing anti-trust litigation. For any rational person to argue that Meta operates as a monopoly sounds crazy at this point.

Getting back to the business, it's worth noting META would have crushed earnings expectations had it not been for Reality Labs, which lost \$3.3bn in the fourth quarter. Not everyone believes in or cares about the potential value of the metaverse, but if you do, you should want META to make these investments now in order to reap future rewards. This is an integral part of their 10-year road map, and should be applauded. The breakout of Reality Labs highlights how incredibly profitable the core Family of Apps business is, with an extraordinary 48.68% operating income margin.

Wehner, the CFO, estimates IDFA to be a roughly \$10bn headwind for Meta in 2022. This is a huge number, but the flipside of the coin here is that it's a huge opportunity. There is so much at stake here both for META and their 10 million+ advertisers, not to mention the internet industry at large. If META solves the IDFA problem over the coming quarters, you're going to see a \$5-\$10 BN revenue swing in their favor. Keep in mind IDFA was eliminated in April '21. So Q122 is going up against a YoY prior quarter where FB had the benefit of not having any impact from IDFA. So logically, once we enter the second half of 2022, YoY comps should become more favorable and META will have had more time to improve their ad targeting and ad measurement tools. The CFO habitually throws cold water on guidance, and I think he left himself a lot of room to beat lowered expectations for Q122.

Quest 2 has been tracking quite nicely. The Quest store has crossed over \$1bn in content sales which shows that app creators can make money on the platform. It means Meta is having success building out this new ecosystem. The more people who buy Quest hardware, the more creators have an incentive to develop applications for this audience, which in turn will drive higher app sales. The Quest ecosystem circumvents Apple entirely and over time will become a much more significant component of overall sales.

Sheryl's commentary about Click to Messaging ads was super interesting:

- "Our largest monetization effort is Click to Messaging ads, where you click on an ad in your Facebook or Instagram feed and it opens a chat with the business in Messenger, Instagram Direct or WhatsApp. It's a great way for businesses to drive engagement. And we've seen lots of demand from consumers who want to use our messaging apps for everyday services like utilities, financial services, education and travel."

I suspect we will be seeing more on this subject as META's messaging apps are highly undermonetized. This is despite Whatsapp, Instagram, and Messenger each having over 2BN users. Maybe Click to Messaging becomes a revenue driver for META's messaging platforms. It seems like a clever way to monetize without being invasive.

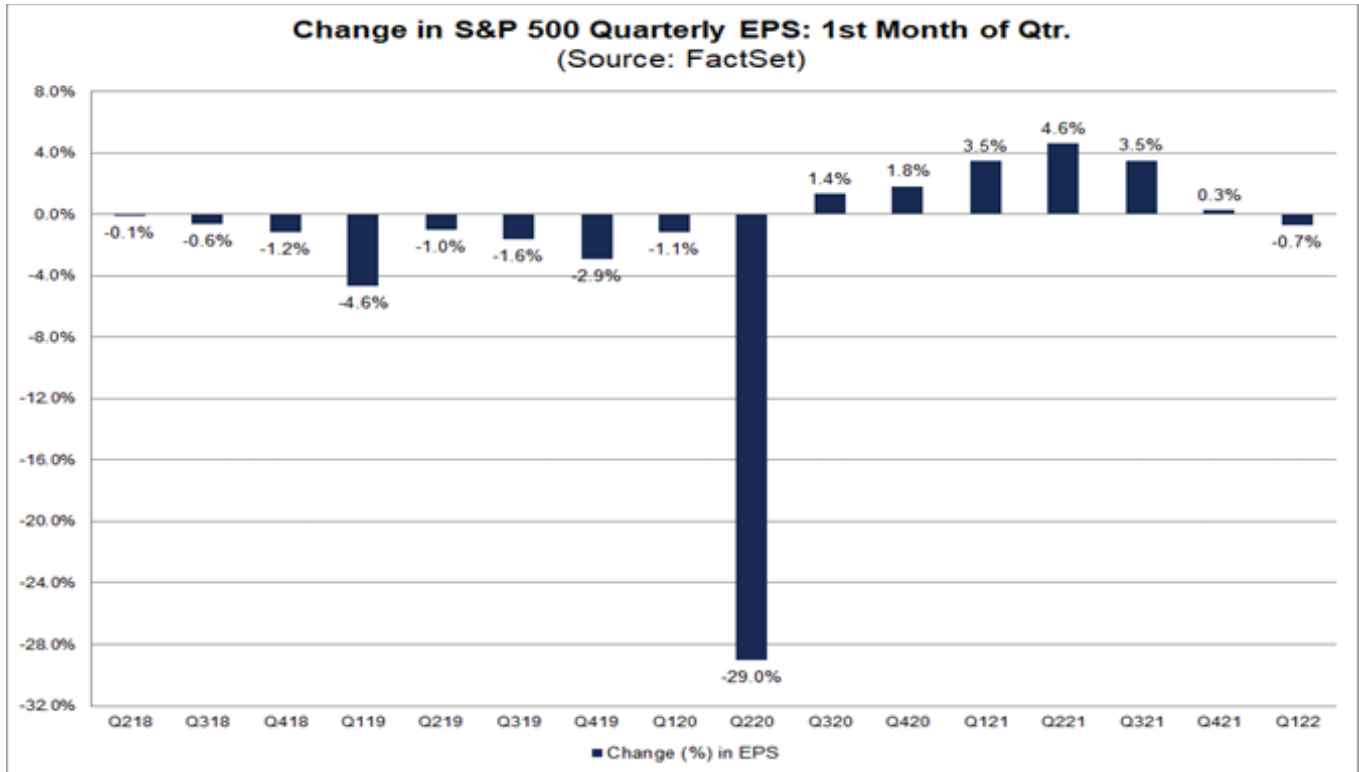
Lastly, FCF remains incredibly strong, so much so that META bought back \$19.2BN in stock in q4, and still has \$48bn or so in net cash. Operating CF was a whopping \$18.1Bn for the quarter. After today's collapse, META is trading at the lowest multiple in its history - roughly 7- 9x 2023 EBITDA depending on what you think forward number will be. Obviously, we are not in an ideal macro backdrop. The fed will be raising rates and we've seen a valuation reset in technology. But now is not the time to be selling a company trading at a trough multiple with numerous catalysts ahead that could (and should) re-rate the stock higher. This reminds me of the opportunity to own FB in 2018, when the stock fell from \$217 to \$125 on privacy & regulation fears. It didn't take long before the stock recovered.



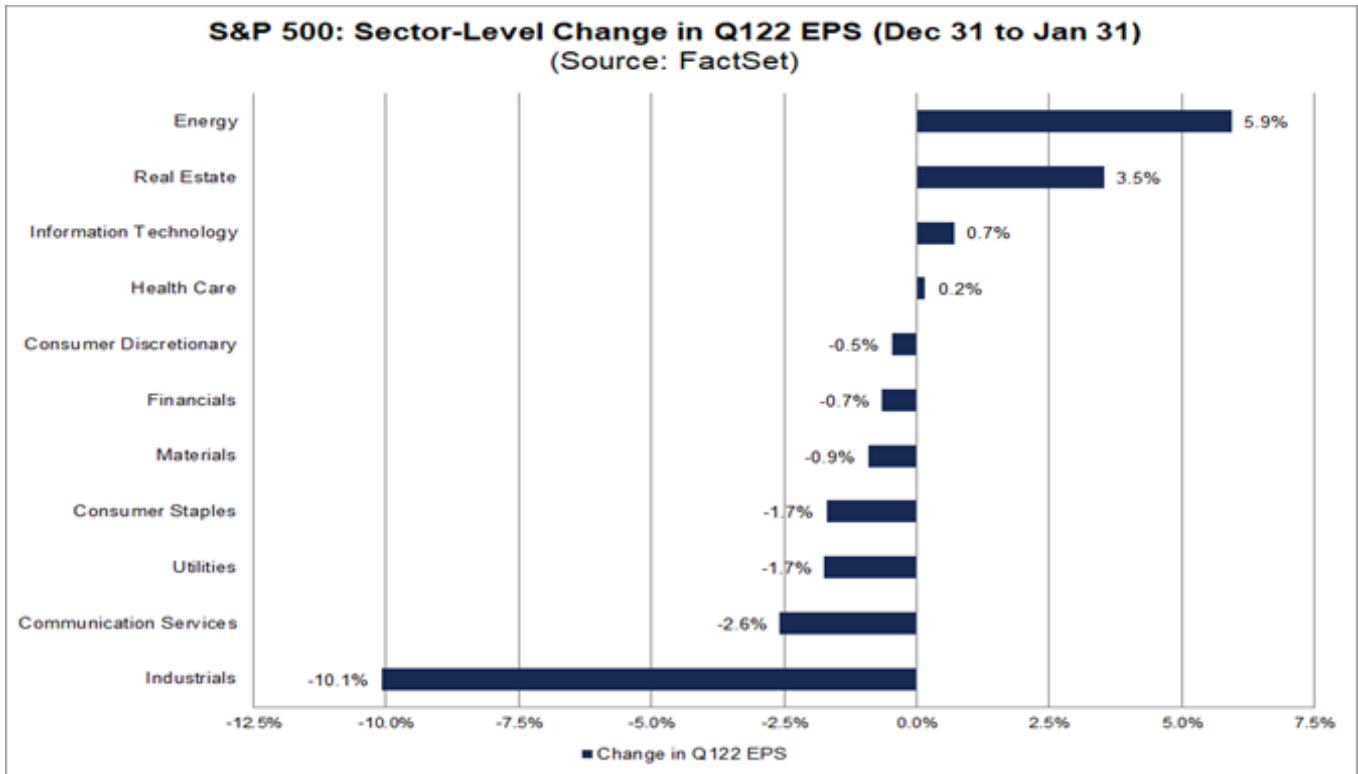
I personally am an enlightened wanderer of the shadowlands of Wall Street. In this business, sometimes I see it clearly, sometimes not so much. And I've lived to be okay with that in a neo-Zen kind of way. Now, pass me a frosty Budweiser and let's celebrate. I cowboied up when it was time to cowboy up, and went eight seconds on Dillinger, in his prime.



Back to today's markets, and what's going on under the surface in terms of earnings, with help from [FactSet's Earnings Insight](#). For the first time in a year and a half, quarterly earnings estimates are now in contraction mode. If you think this is a yellow flag for the markets and the economy, you would be right.



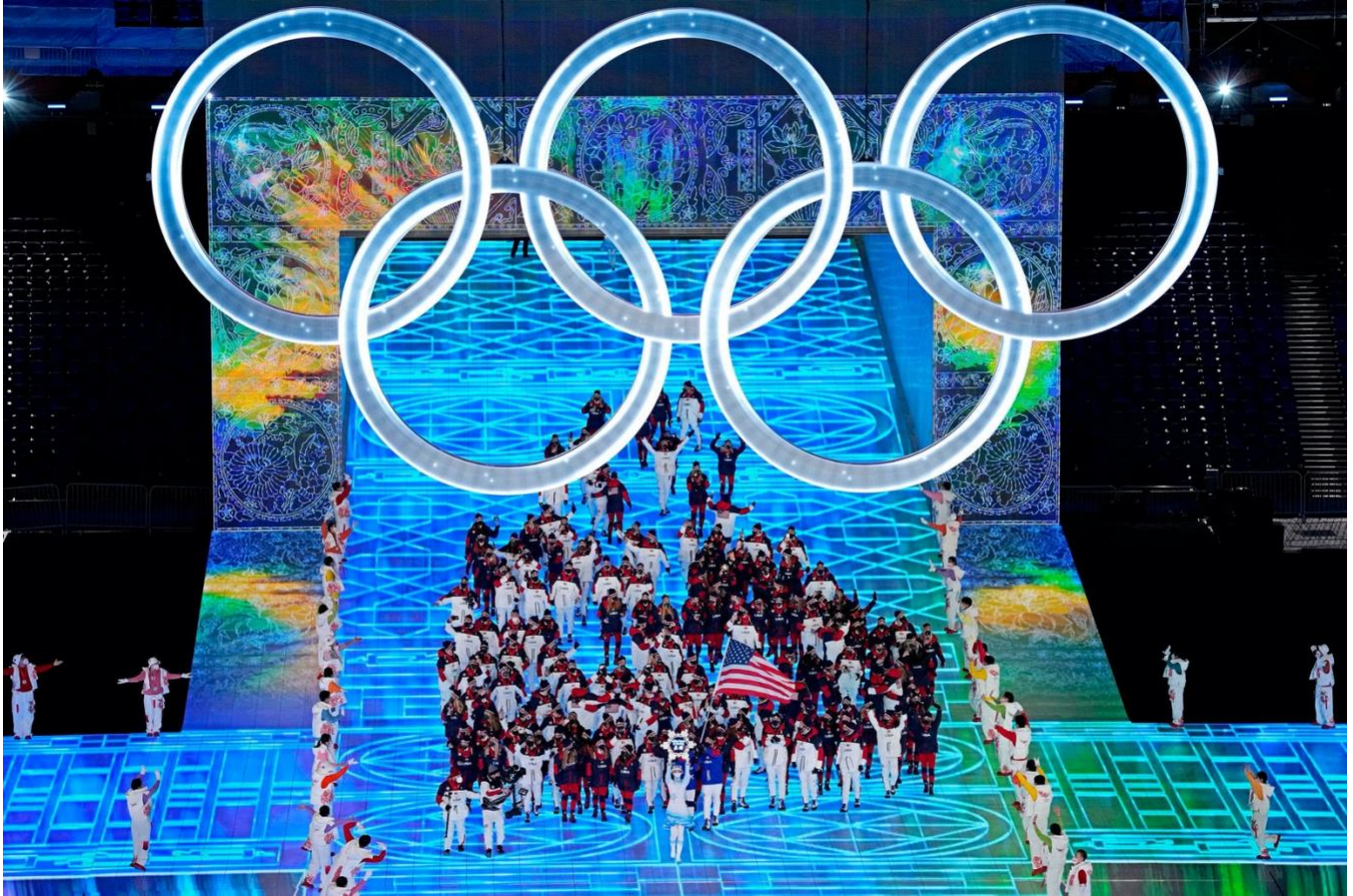
We are also seeing reductions in estimates for most sectors, aside from energy and real estate. The decrease in industrial earnings is confusing, as this should be the time in the business cycle when growth with decent runway offers a decent tailwind. For now, this is the aforementioned noise. Could it manifest into signal? We will know in the next few months.



While it's only Wednesday and we think we are safe, this is the craziest thing we saw this week. The Beijing Olympic freestyle and snowboard venue is located next to a nuclear power plant. Yes, an industrial park with a freaking nuclear power plant sitting on a canal that the Gowanus would frown down on is an Olympic site.



And you wonder why [ratings have plummeted](#) this year for NBC? Is a 40% to 50% drop even a big number these days? It sure feels like it is.



Dear International Olympic Committee,

There is a whole continent called Europe that is filled with Nordic destinations that evoke images of crisp snowcapped alpine mountains that might be available if you want to put the “winter’ back in Winter Olympics.

Your friend, and lover of a good ski race in a great venue,

Bryan Goligoski



That wraps up this week in the markets. See you back here next when we will take you deeper inside the story of why oil is trading near \$100, and what that means for already high gas prices. That's right, \$6.49 for premium in Southern California? Yikes.



el #2

Regular

Plus

Premium

5.999

6.299

6.499

\$ Price per gallon
(Tax included)

\$ Price per gallon
(Tax included)

\$ Price per gallon
(Tax included)

MINIMUM OCTANE RATING
(R + M) / 2 METHOD
87
P R E S S

MINIMUM OCTANE RATING
(R + M) / 2 METHOD
89
P R E S S

MINIMUM OCTANE RATING
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