

December 2020  
Fountainhead Partnerships Fund (FHPF)  
Quarterly letter

*“Nothing in this world can take the place of persistence. Talent will not; nothing is more common than unsuccessful people with talent. Genius will not; unrewarded genius is almost a proverb. Education will not; the world is full of educated failures. Persistence and determination alone are omnipotent.” Calvin Coolidge (30th President of the United States 1923–1929).*

**Portfolio performance and commentary:** FHPF was up 3.3% in the month of December and 10.5% for the fourth quarter. FHPF was up 30.7% in 2020 whereas S&P 500 was up 16.3%.

A lot has been written about how strange 2020 was, so we don't think we can add much about the uniqueness of the last year. For us the lesson of 2020 isn't that a giant, unpredictable "black swan" can wreak havoc on the best forecasts. Rather, it's that whatever seems most obvious is least likely to happen. Our philosophy of believing in stocks as ownership in businesses and avoiding short term market forecasts has allowed us to have the exact same companies in our portfolio for the entire year.

Electric Vehicles and Financial Technology: two trends in innovative technology in 2020 that have graduated from the venture capital industry to the stock market, perhaps prematurely. We have been covering both of these themes for a long time but the valuations at which these companies are listed in the stock markets seem to be based on promises rather than profits – or even revenues.

Consider the example of solid-state batteries (SSBs) that are among the new generation of advanced battery systems offering several advantages over the current battery technologies such as lithium ion. SSBs have novel chemistry because their structure uses solid electrodes and electrolytes. In most battery designs that use liquid electrolytes, product performance is limited at high temperatures due to the early degradation of electrolytes. But solid electrolytes offer higher working temperatures, faster charging times, and considerable energy storage in a compact battery.

The entire global solid-state battery market, according to BCC Research, was only \$65.8mn in 2019 and is estimated to reach \$400mn by 2025. On the other hand, just one company – Quantum Scape (\$QS) that was listed at \$5bn market cap – was trading recently at a valuation of \$60 billion! QS forecasts no revenue until 2025. The total market cap of these *future* producers of battery systems in US only is over \$200bn, racking up a 2025 industry P/S multiple of 500x! We can see ourselves owning some of the battery technology stocks some time from now to 2025, but at the moment we think more money can be made by a couple of disciplined short positions in this space.

In a research paper of 2018, [Two Centuries of Innovations and Stock Market Bubbles](#), the authors studied the relationship of *stock price bubbles* around 51 innovations in the last two hundred years from various industries, including Automobile in 1886, Radio in 1919, VCR in 1956 and mobile phone in 1979. The authors found that 37 out of 51 breakthrough innovations particularly in technology required or created a stock price bubble that allowed the company to raise capital cheaply for their experiments. Invariably, in every price bubble around an innovation, the authors found, once the companies raised the required capital, their stock price dropped to the actual fundamentals, leaving investors to wait for a long time to recover losses.

In our view, the 2020 recession has started a new economic cycle. However, the pace at which this economic cycle is moving feels like, borrowing a cricketing analogy, a T20 game rather than a five-day

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test match. Within nine months of this economic cycle, for example, the US unemployment rate has come down by a magnitude which took four years in the last economic cycle that started in Nov-2009. The stock market recovery is no different this time.

The most important fundamentals to watch this year would be the trajectory of interest rates in US and the credit policy in China; both would have a significant impact on stock prices. The key determinant of interest rates would be whether we get a persistent rise in inflation. Never in history have we had a persistent rise in inflation when the unemployment rate is as high as it is now i.e. 7% in the US. Although some may argue that inflation has already started rising, particularly in food and metal space, our view is that this has more to do with supply constraints rather than a surge in demand due to higher incomes. Also, there are some structural changes that may have also changed the shape of the economy coming out of the recession. A slower birth rate in an already aging demographic economic profile, digitization, work from home, less business travel, restructuring of the entire architecture of hotel and restaurant industry are factors that are more likely to suppress inflation pressures going forward.

Another argument for high inflation is monetary, given the stubbornly high deficit and double-digit money supply growth for a long period of time. This is a complex argument. *Milton Friedman famously said, "Inflation is always and everywhere a monetary phenomenon"*. Our simplified explanation is that as long as the increase in money supply does not increase credit creation in a significant way (or accelerate money velocity), increased government deficits are unlikely to cause inflation. Any additional liquidity will flow into asset prices rather than creating excess demand. The trickiest situation would be to monitor that if we are wrong in our view and inflation indeed rises, then how would Central banks react to rising inflation. Will they raise rates to reduce the inflationary pressures and allow the market-based rates to go higher or would they apply a Yield Curve Control (YCC), increase their bond buying program, and let the economy run hot? The answer to this question will be the most important determinant of stocks valuation in 2021. Our best guess is that central banks will not give up without trying the YCC.

So, what does this paradigm mean for our portfolio? As mentioned in the beginning, our portfolio construction is not based upon any particular economic and market scenario. A large part of our long equity portfolio, in our opinion, is composed of companies whose earnings trajectory depends on those secular themes that have their own fundamentals and structural drivers. We are quite satisfied with our holdings and their relative position sizes in the portfolio. Our key job in 2021 will be how efficiently we keep an eye on the developing risks in the stock market, like bubble stocks or interest rates, and the fallout of these risks on the overall stock market.

**We wish all of you A very Happy and Safe 2021.**