



## TESLA, ELON MUSK, & THE INTEGRITY OF THE PUBLIC MARKETS

I happened to be out of the office when the news of Tesla's "plan" to take itself private hit the tape. The details were sketchy and when we heard the news my colleagues and I immediately asked ourselves two questions: 1) how could Elon Musk possibly fund this? 2) Has anyone been able to revive Recession Rick? As readers of these pages know, Rick is the office skeptic who is often accused of knowing the price of everything and the value of nothing. He has turned the short position of Tesla in his personal account into something of a crusade in the office against what he feels is undue hype. In the car on the way back into the City and listening to CNBC's coverage, it seemed very unlikely, at least to me, that Mr. Musk had a financial plan that any serious CEO, Board of Directors, law firm, or investment bank could believe would justify such an announcement for a public company with a market capitalization of over \$50 billion via Twitter. "Gang, I don't know much about this," I e-mailed my colleagues back in the office, "but if Musk isn't serious, this risks a spell at the old Crossbar Hotel. As a public company you have a fiduciary duty to, well, the public."

This essay in no way offers any recommendation to buy or sell shares of Tesla. (TSLA, \$355.49) Personally, I have never owned a share nor have I borrowed one to short it. While, as strategists and economists, we are style-agnostic at Strategas, we would find it difficult to describe an investment in a company bleeding cash at its current rate as anything more than speculation. Two Fridays ago, the first installment of our summer essay series on the future of the investment industry discussed at length the existential threats facing both the buy side and sell side of our business.\* Chief among them has been the decline in the number of public companies, the explosion in the size of the private equity industry, and the lack of access the individual investor has to investments in the country's most promising and exciting companies. Near record highs in the major indices have yet to restore the public's confidence in the markets. Understandably people find it difficult to erase the memory of two fifty percent declines in the S&P 500 and a rogue's gallery of financial villains since the dot.com bust. Believe it or not, there have been *net redemptions* from domestic equity mutual funds and ETFs since the market bottomed in 2009. This is not a healthful vote of confidence in an economy that, by all accounts, is strengthening. And so, one must wonder, after all the drama, tears, and scandal, where are the regulators?

As a small broker-dealer of 55 people, Strategas is subject to rather exhaustive examinations of its operations from both FINRA and the SEC to make sure we are in

\*2018 Summer Essay Series Part I, "The Future of the Investment Industry," 8/3/18.

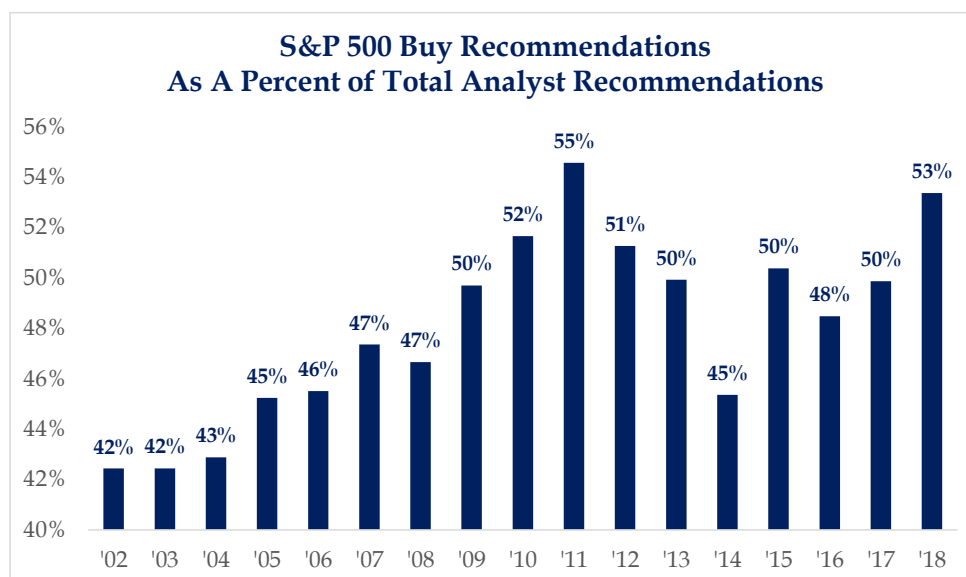
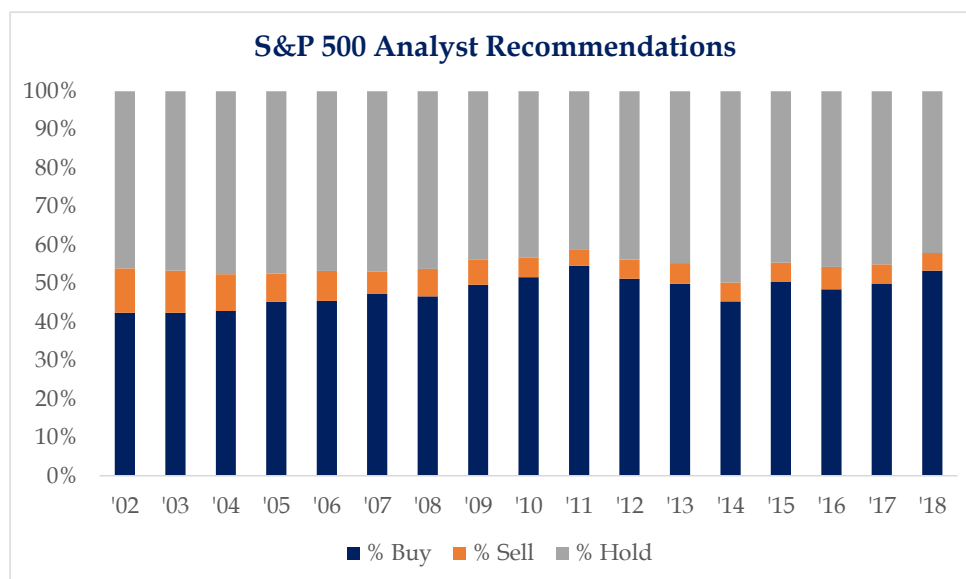
compliance with the voluminous rules regulating the markets. Without enormous reservoirs of money or personnel, we never view this as easy or particularly pleasant. Still, it is an unavoidable cost of doing business. It is worth it, I believe, because I view the public markets as a bedrock feature of America that turns money into capital and breathes life into the dreams of entrepreneurs. Even more important, in a way, is that deep and open capital markets allow the average guy to come along for the ride. Writ large, America's Wall Street has lifted more people out of poverty *globally* than any other economic system in the history of history. Unsurprisingly, our work has shown that countries with more developed financial markets have higher standards of living. The integrity of this system is directly critical to the professional lives of six million people in the United States and remains the lifeblood of capital formation.

All this brings us back to Mr. Musk and others like him who treat access to the public markets as an entitlement and little more than a game to either cash out or fund high-risk schemes that often separate individual investors from their money. In my career, I have never seen a CEO obsessed with short-sellers create lasting value for shareholders. Often these men and women want the benefits of the public markets – namely money – without the inconvenience of answering to the company's real owners, otherwise known as shareholders. In much the same way gamblers view the guy who plays the Don't Pass line in craps, no one is particularly fond of short sellers. Still, they provide an important function in free and open markets – like dividends, they remind management that it isn't, ultimately, their company. If Mr. Musk finds it uncomfortable to deal with the public markets, one wonders how he might feel if he had to answer to a consortium of private equity shops that will eventually demand a return on their investment. Naturally, there could be a *deus ex machina* ending to this episode where an investor with either an extraordinarily long-time horizon or who is obsessed with the vanity of a company who wants to “change the world” will pay the premium Mr. Musk suggested last Tuesday. But was a serious plan in place that included extensive valuation analysis, legal counsel, Board approval, consultation with regulators and/or a hundred other necessary tasks a responsible head of a large public company would consider before Mr. Musk sent his Tweet last Tuesday? One wonders.

There was a time in American life when the majority of citizens possessed real trust in their public institutions. In our current anything-goes society such concepts seem hopelessly Victorian now. Perhaps more troubling is that our current political and social divisions tempt all of us to look the other way when someone on “our side” misbehaves. If a man lives long enough, he'll get to see just about anything. Perhaps I shouldn't have been surprised then that a CNBC commentator suggested – on the floor of the New York Stock Exchange no less – that Mr. Musk's mission and goals should exempt him from answering questions about whether his behavior constituted market manipulation. By that reasoning, one could infer that securities laws should only apply to the fossil fuel industry,

tobacco companies, defense contractors, fast food chains, or a variety of other companies unfavored by elites. According to the SEC's own website *"(m)anipulation is intentional conduct designed to deceive investors by controlling or artificially affecting the market for a security. Manipulation can involve a number of techniques to affect the supply of, or demand for, a stock. They include: spreading false or misleading information about a company; improperly limiting the number of publicly-available shares; or rigging quotes, prices or trades to create a false or deceptive picture of the demand for a security. Those who engage in manipulation are subject to various civil and criminal sanctions."* Time will tell whether Mr. Musk's behavior rose to such a standard. Still, inquiries should be made. Nothing less than the integrity of our public markets is at stake.

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