Mind the GAAP and 9 Other Surprises for 2023

As 2022 draws to a close we contemplate the year ahead from a left-field perspective. Our goal is to provide some food for thought over the holiday period.

Our views on ten potential surprises for 2023 which challenge the consensus view. Any thoughts/comments are most welcome.

1) A global recession doesn't eventuate

Doom and gloom commentators dominate the headlines. Don't trust their forecasts for 2023. These same people have predicted twelve of the last three recessions. Again, the drums are beating louder than ever for a recession in 2023. Usually, when everyone expects something to happen - it doesn't. No central banker wants to "over-tighten" and be responsible for causing a recession. Afterall, despite high inflation and rising interest rates the economy remains remarkably resilient. Inflation has started to fall, central banks are inching closer to pausing, consumer spending is robust and most importantly we are at full employment.

2) Big Tech gets bigger

It's been a difficult year for the big US Technology companies. There is no shortage of experts calling for their demise and a change in market leadership. But not all big Tech is equal. Companies like Microsoft and Alphabet have dominant market positions and provide products the world cannot live without, will continue to prosper. Along with Amazon, these three companies hold 66% market share of the cloud computing industry. A market expected to reach well over US$1tn by 2030 (currently US$217bn) as more corporates take advantage of the scalability and cybersecurity benefits that the cloud offers.

3) Costco increases membership fee by $10

Famous for their cheap hot dogs, roast chicken and petrol, Costco offers a great value proposition by charging an annual membership fee. The current fee of US$60 was last increased on 1 June 2017 with increases typically occurring every five and a half years. While there has been no official announcement from the company, CFO Richard Galanti has indicated that an increase is a matter of when not if. Historically increases have been in the order of $5. This time around we think it will be more. With almost 120m members worldwide, an extra $10 for example equates to $1.2bn of additional revenue per annum, the majority of which will drop straight to the bottom line.

4) Mind the GAAP

It is common for start-up companies particularly in the Technology sector to pay employees with stock and options. It helps attract and retain staff and conserve cash. When the company share price is rising everyone wins. To blur the impact on financial performance, companies publish an "adjusted EPS" number which serves to remove the cost of share-based payments. However, when share prices fall the company is required to issue additional shares and options to maintain prior period compensation levels. The gap between reported/GAAP EPS and "adjusted EPS" expands. Historically, when valuing high growth, early-stage businesses, the market has invented all sorts of fancy metrics to justify the share price. With a renewed focus on GAAP accounts, the worm is slowly starting to turn. Valuations do not look as attractive and the downside risk for the more prolific share paying companies is elevated.

5) Bitcoin collapse continues

This may not be a surprise to most people however there are still true believers out there hanging on by a thread. The sole purpose of Bitcoin and Cryptocurrencies is to bypass official payment channels to facilitate illegal activity. Any attempt to regulate the space defeats its purpose. The recent spate of high-profile crypto exchange collapses is the tip of the iceberg.

6) Stronger AUD

Since the Australian Dollar floated in December 1983 it has averaged approximately 0.75 US dollars and tended to mean revert. For most of 2022 it has languished in the 60's as the interest rate differential between Australia and the US grew wider. This now appears to be moderating, providing a floor for the AUD. In other words, the USD has peaked. A China re-awakening and associated demand for Australia's natural resources is the next piece of the puzzle needed to push the AUD above 80 cents.

7) China best performing equity market

For many western investors China is un-investable. Through a combination of extended Covid lockdowns, intense regulatory pressures on their biggest companies and high-profile property collapses, the future looks bleak. However, it is always darkest before the dawn. Premier Xi has been effectively appointed for life and appears to be making a genuine effort reconciling with foreign leaders. To prosper Xi needs the support of the west. And he knows it. China will re-open eventually and it will be game on.

8) Bob Iger saves Disney

Disney's share price is down close to 40% this year as mounting losses in the streaming business have spooked investors. In his first 15-year stint leading Disney, Bob Iger successfully completed several acquisitions and boosted the company's market capitalisation five-fold. After a short absence he returns to set "Disney on a path to renewed growth." We expect the new management team to focus more on streaming profitability with an emphasis on quality over quantity.

9) Private equity market valuations deflate

What do WeWork, Greensill, Wirecard and FTX all have in common? They, along with many others, were all funded in large part by Softbank's Vision Fund. With large sums of money to deploy, Softbank were more than happy to finance rockstar entrepreneurs based on questionable due diligence, who were selling the dream. In the process they bid up prices to stratospheric levels, distorting private market valuations across the industry. If the Vision Fund was around at the time of Theranos it would have had a peak valuation closer to US$90bn rather than US$9bn. The day of reckoning for a lot of these businesses has arrived. The write-downs have only just begun.

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10) Harry & Meghan documentary flops

Aggressively spending on content is nothing new for Netflix but the Harry & Meghan show takes things to another level. Yes, it has generated enormous publicity for Netflix however given the cost it will also need to generate an enormous number of viewers. How you measure success in this case is obviously highly subjective and we observe with interest how Netflix will spin it.