The Antitrust Rhetoric Ramps Up

"This investigation has been bipartisan from the start… This is the most bipartisan effort that I've been involved with in five and a half years of Congress… Our founders would not bow before a king; we should not bow before the emperors of the online economy."
– Congressman David Cicilline during the July 29th, 2020 Antitrust Subcommittee hearing

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Blue and red seldom agree on anything these days, so when both camps find common ground on the same issue, it's enough to make anyone's ears perk up. Such was the case during last week's Congressional Antitrust Subcommittee hearing, where four of tech's biggest CEOs – Mark Zuckerberg of Facebook, Jeff Bezos of Amazon, Tim Cook of Apple, and Sundar Pichai of Google – spent hours being grilled by Congress. As has been widely reported in the days that have followed the hearing, it wasn't a particularly good day for Big Tech – at least from an optics perspective. Almost every minute of the four-hour hearing was spent diving into the misdeeds of these massive corporations, which are worth a combined $5.3 trillion, or 18.5% of the S&P 500.

As outlined in Louis-Vincent Gave's July 24th missive titled "Have Equities Become a Bubble," the phenomenal rise in Big Tech's share prices (largely defined as "FAAMG" or **F**acebook, **A** mazon, **A**pple, **M**icrosoft, and **G**oogle) over the last few years compared to the performance of their earnings over the same timeframe lead us to believe that mega-cap tech companies may once again be in bubble territory. And since it only takes a pinprick to burst a bubble, it's fair to wonder whether renewed antitrust concerns were enough to wreak havoc on Big Tech's supremacy. Investors answered that question with a resounding "NO!" in the days that followed the hearing, as Facebook, Amazon, and Apple all reported quarterly earnings that exceeded analyst expectations and added a combined $279 billion in market value to close the week. Put another way, this tech trio added three times the market cap of 3M…in a single day.

Looking in the rearview mirror momentarily, the scrutiny from lawmakers towards Big Tech ratcheted up in the middle of 2019. In the House Judiciary Committee's inaugural hearing on anti-competitive practices among Internet businesses, in June of last year, Congress argued that Big Tech's influence and dominance in various sectors of the digital economy had become too vast, putting FAAMG on high alert and making it clear that the business practices of these tech titans would be analyzed under a microscope. House Speaker Nancy Pelosi even went so far as to declare that "the era of self-regulation" was over, hinting towards increased government regulation in a sector of the economy that's been largely immune to oversight.

Fortunately (and I use that term very gingerly) for tech's behemoths, the Covid-19 pandemic redirected the attention of regulators towards other, more pressing matters. In an interview between Tyler Hay, CEO of Evergreen Gavekal, and Louis-Vincent Gave titled "The Corona Effect" that took place in May, we even made the following point:

> "We've never been through something like this so we have to keep an open mind as to how things will evolve. What seems pretty clear to me is that we will see much more government interference and regulation across broad sectors of the economy… An increase in the weight of government very seldomly increases the

> returns on invested capital for a given sector…
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> I'd much rather be involved in sectors where the level of government interference is going to be modest. To your point, tech stands out as one of those sectors. If you're buying software from Salesforce or Adobe or Microsoft, does the government have a good reason to come in and tell you what software to buy? It doesn't seem obvious and shouldn't be an immediate priority."

Between March and May, the Coronavirus pandemic was all-consuming. It seemed almost impossible to imagine a day where Congressional hearings on Big Tech's breakup would re-emerge on center stage. But, ironically, the very companies that were overlooked from a regulatory perspective throughout the pandemic, were also the companies that benefited most from a massive shift towards the digital economy. Therefore, the windfall was even greater for these goliaths as they side-stepped the regulations that real estate firms, utilities companies, healthcare providers, and others faced in the heat of the pandemic, while seeing a massive surge in demand for their services.

The question for investors becomes, is Big Tech too big for its own good? Put another way, is Big Tech a victim of its own success, and will the sheer size and influence of these companies lead to increased government regulation, hindering its ability to continue to grow?

If last week's hearing is any indication of the journey ahead for these companies, the likelihood that this cohort continues to sidestep regulation is doubtful at best. With its apparent bi-partisan support, the chances for a significant (and swift) antitrust outcome becomes even more likely if the Democratic Party sweeps the Senate, House, and Presidency come November, as polls indicate is a distinct possibility.

Perhaps more relevant to the future of these companies is not "if" regulation will happen, but "what" that regulation will look like and "how" it will impact them. The congressional questions from last week covered a long list of grievances on everything from exclusionary practices, to predatory pricing, to selling data, to app store transparency, to third party cookies, offering important clues to where antitrust action might focus.

But since it's impossible to know the extent of future antitrust investigations, its more useful to consider two buckets of potential outcomes: that Big Tech will be forced to "breakup" or that it will be forced to "open-up".

Breaking-Up vs. Opening-Up

The first potential outcome of antitrust action, that large Internet monopolies will be forced to breakup, is the "nuclear option" that would fundamentally alter the structure and direction of mega-cap tech companies. If this idea were to take root, companies like Amazon, as an example, might be forced to breakup different segments of its business. For example, Amazon Web Services (AWS) might be forced to spinout into its own business, Amazon's e-commerce platform might be forced to become a standalone product, Amazon Prime Video and Music might be forced to transform into separate streaming services… you get the idea.

Despite loud cries for this outcome, it’s a very regressive option that would undoubtedly face many challenges. Another possible result is that Big Tech might be forced to “open-up.” In other words, instead of ripping these businesses apart piece-by-piece, regulators might force them to pivot from platforms to protocols, thus making their competitive advantages “open” for other businesses to leverage.

Take e-commerce as an example. If consumers could buy an item as easily on other platforms as they could on Amazon, there would be more competition for their disposable income. Or consider search engines: If businesses were able to easily build on top of Google’s search algorithm, there would be more innovation across a broad spectrum of businesses that could utilize these protocols to compete for a larger share of global ad spend.

An Inflection Point

Based on emails from before Facebook’s acquisition of Instagram, Mark Zuckerberg acknowledged that he wanted to buy the company to neutralize Facebook’s competition. In last week’s hearing, instead of refuting or clarifying the emails, Mr. Zuckerberg acknowledged, and even bragged, about how Facebook used its market power to grow Instagram and push its competitors out of the space. In a similar “palm to the face” moment, Jeff Bezos confessed that Amazon fosters predatory pricing practices. The two comments underscore the terrible, horrible, no good, very bad day (as my son would put it) that Big Tech had last week.

The kicker in this entire saga is the technological Cold War happening in the background between the United States and China. TikTok, a very popular social media application owned by the Chinese company ByteDance, has recently been caught in the crosshairs of a debate over whether the company should be banned in the United States. Microsoft has been rumored to be interested in acquiring the company, which gained support from the Trump Administration at the beginning of this week. President Trump put further pressure on the company Thursday, signing an executive order that effectively sets a 45-day deadline for Microsoft, or another US company, to purchase TikTok’s US operations.

Proponents of the sale argue that personal information shouldn’t be “in the hands of the Chinese Communist Party” and should instead be controlled by a US corporation. Detractors point to the fact that forcing such a sale would only make Big Tech larger, actively encouraging something that would supersize a tech giant and undermine the antitrust action underway. Furthermore, if the United States forces ByteDance’s hand, people rightly worry about potential retaliation from China against US companies that do business in the country such as Apple, who is currently the biggest of the tech titans.

In fact, aside from domestic antitrust risk, we view the technological Cold War between China and the United States as the greatest threat facing mega-cap tech stocks that has yet to be recognized by investors. Even though the current rhetoric centers specifically around TikTok, over the past 18 months the war has continued to amplify, originally starting with ZTE before moving on to China’s technology hardware giant Huawei, TikTok, and now Tencent, another premier Chinese tech company. The current cavalier investor attitude about a tit-for-tat (or, in this case, Tik-for-tat) escalation between the US and China, with tech in the crosshairs, reminds Evergreen Gavekal’s CIO, David Hay, of the same kind of nonchalant view towards COVID back in early February.

This latest development underscores the genuine threat that “national security” can and will be invoked on impulse. Furthermore, it highlights the growing possibility of a regionalized tech landscape that would limit the upside for mega-cap corporations hoping to win market share in emerging markets such as China and India.

Conclusion
With all that's going on these days, it seems as though we've reached an inflection point. Either Big Tech will continue to grow, gobbling up companies such as TikTok, and expanding its global reach. Or it will face a day of reckoning and be forced to "breakup" or "open-up" due to US regulations, or scale back international expansion due to increasing tensions with China.

What's clear is that an increase in the weight of government very seldomly increases the return on capital for investors, so if the antitrust rhetoric continues to gain momentum and the Cold War between the United States and China further intensifies, other sectors of the economy and technology space will likely provide better returns to investors in the 2020s. But as Big Tech gears up for the domestic and foreign battle ahead, don't count on it to go down without a fight.

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