Alex Lieberman, Co-founder and Executive Chairman of Morning Brew Hey there, I'm Alex Lieberman, co-founder and executive chairman of Morning Brew. This is season two of Fresh Invest, your favorite investing podcast sponsored by Fidelity Investments and powered by Morning Brew. Today's topic is one that will only be new to you if you haven't glanced at financial news in at least two years. We're going to talk about SPACs. The SPAC is kind of like the Wall Street equivalent of Crocs. Pro or con opinions are very strong. Some say they're revolutionizing the going public process for the better. And yes, by some, I mean Chamath Palihapitiya, though, of course, there are other SPAC supporters out there.

Alex But others say that if SPACs are a revolution, they're one where King George and Louis XIV stay firmly on their thrones, i.e., the same people are profiting from SPACs who usually profit from IPOs and the stock market in general. Basically, the SPAC debate is endless. So maybe it's time to step back from debating, review what SPAC actually are, and consider why they've become so prominent and why people's opinions are so strong. That's what we'll do in this episode with some help from Fidelity's John Gagliardi.

Alex John, welcome to the show.

John Gagliardi, Regional Brokerage Consultant, Fidelity Investments Great to be back.

Alex It is great to have you back. So let's start with people who are not season one listeners. Let's start with a little bit about who you are and what you do at Fidelity.

John Yes. So my name is John Gagliardi. I'm a RBC, or regional brokerage consultant. And if you ask my mother what I do for a living, she would say something in the stock market and she's not entirely wrong. [Alex chuckles] What I do is I work with Fidelity branches in New York, New Jersey, and I help our self-directed investors do what they love. They are independent-minded, and they want to get more control over their investing. So I bring them the knowledge and better tools and resources to make them better investors.

Alex Awesome. So I would have to assume that you've talked with more than one of your self-directed investors about this concept of the SPAC over the last two years, and now I want you to bestow this knowledge on our listeners. Tell me about SPACs. What are they?

John OK, let's do the FINRA explanation. So a SPAC, or Special Purpose Acquisition Company, is actually a shell company that's formed to raise capital through an IPO for the express purpose of acquiring a private company.

John Now, a traditional IPO goes through a very different regulatory process. For example, there's an underwriting group that puts together the deal, and they're called the syndicate. And these issues are highly regulated. They provide a large amount of information about the prospective company. Hence, the documentation is called a prospectus. The goal of a prospectus is to bring to light all of the details and records of what was once a privately held company.
Now a special purpose acquisition corp, or SPAC, raises money to go public with no business of its own, no assets, no earnings, therefore no real details. The prospectus on a SPAC, therefore, can be pretty thin and some people can consider them misleading. And a SPAC has a much easier filing process. Once publicly traded, a SPAC hopes to merge with a private company. Usually SPACs go public at 10. They try to make a deal. If the SPAC is unsuccessful making a deal, theoretically, investors will get their $10 back. But I think we'll talk a lot more about that theoretical part.

And just out of curiosity, I feel, like, SPACs have blown up in the last, again, few years. Is it a new concept? Did SPAC just come about? Have they been around for a long time? Like, why are they so in vogue right now?

So there's advantages for all parties. So for the sponsor, it is a faster and cheaper way to raise money and go public. For the target company, it could be a faster IPO at a lower cost. However, mergers can take longer than expected and can even go longer than a regular IPO. So all people who are making money in investment banking can potentially make more money, but not if the deal falls apart. If it runs into problems. Alex, investors. Investors can get access to something that's pre-IPO, potentially bigger risk and potentially bigger reward.

So, OK. Just to kind of level-set here. What I'm hearing is that the SPAC process can be faster. It can be a cheaper way to raise capital because you don't necessarily need to go through all of the hoops and all of the detailed filings that need to be done in a traditional IPO process. And so investors can hypothetically get in pre-IPO or earlier, which they wouldn't traditionally be able to do. And sponsors and companies just are able to go through an expedited process.

We saw this boom of SPACs in 2019 and 2020. But then I would say, recently, the SPAC activity has been significantly lower. You know, in Q2, there were only 110 deals raising $16 billion, compared with 320 deals raising $88 billion the quarter before. So what's happening here? If it is such a faster, more expedited, potentially better way, or faster way to make money, why is everyone not still doing this?

Unicorns. We're running out of unicorns. [Alex chuckles] Now, a unicorn is a company that's valued at over a billion dollars, and likely on its way to going public. But there's only so many of those unicorns out there. There's only one DraftKings or one Virgin Galactic. These are some of the early 2019 and 2020 deals that are well-known success stories. The supply of these fantastic private companies may be dwindling.

It's not unlike a great party. If you show up late, there's probably not a lot of fantastic-tasting food left at the table. If we looked at the quality of stocks overall, though, four years ago I was showing clients that there were only 3,500 stocks trading at $10 a share or more. Markets were partially going up because of lack of supply. Today, demand still may be high, but, the number of SPACs are still relatively high to meet that demand. But the quality might be questionable.

We've come a long way. Today, we have about 4,200 stocks now trading above $10. So we've seen a 20% increase in the tradable public market, let's say. And that's largely because of SPACs.

So you talked about quality for a second. And I love the analogy of being late to the party and being left with the chip crumbs instead of the chips. Let's talk about a few
examples here. And I think these are great examples that illustrate some of the downsides of SPACs. Two that come to mind are Nikola and Lordstown Motors. Why is it that we’re seeing iffy deals come about, where maybe the businesses aren’t even close to as valuable as what they tell the market? And what can we learn through these SPAC deals that have ended up being kind of sour deals in moving forward in this market?

John Yeah, that guacamole doesn't look right. [Alex laughs] They're bad actors, right? Bad actors are always drawn to new technology. And in the case of Nikola and Lordstown, they're in the same boat as Tesla. EVs, electric vehicles, are happening. Charging stations are popping up at Walmart and hotels. People are still telling me, though, that Tesla is a fake company.

John It's very hard for people to change. And whenever these changes happen, there are a lot of people out there who will be saying, oh, these people are just full of hot air. They're just in the business of raising money. And it is true—bad actors will appear in every hot market, no doubt. But it's like asking the bank robber, why do you rob banks? That's where the money is. [Alex laughs]

John But investors—the key for you is buyer beware. They're not all going to be Teslas. Tesla is a different company. You know, we're talking about a company that's now part of the S&P 500, in the top 10. It's a real company, folks. Let's get over that. But not every company can turn into Tesla.

Alex For sure. So, I think that the next—I would say progression of SPACs—is the question around the process and is there going to be regulation around the process? And I think it makes sense. Anything where a boatload of money is being raised through this—I don't want to say new—but exciting or popular vehicle for raising capital and going public, and one in which you can do it faster because you don't have to provide all of the information about the business because it's a shell company that's listing and then acquiring a business later on. The question is regulation.

Alex And SEC chair Gary Gensler has come out publicly criticizing SPACs and suggesting that regulation is on the way. So, what do you foresee is going to happen as it relates to SPAC regulation, and do you think that is going to change the way in which SPACs are raised and the activity in this space?

John I would sum it up in one word: slow. By the time the SEC gets regulation, finalize its market, the market will be in a very different place. The market for SPACs have run its course. Before the rules are crafted, it won't really matter that much to this generation of SPACs. Heightened regulation may be another great sign of a market top.

John Other examples are things like magazine covers. By the time very traditional magazines like The Economist—by the time they get ahold of a topic and decide to put it on the cover, it's usually at the end of the story. So we may be seeing some of that now in regulation. Heightened regulation may be just another sign of SPACs already running their course and peaking.

Alex So, you know, a lot of this conversation has been about the sponsor, the acquiree, institutional investors, and regulators. But I want to turn this back to the listener—the retail investor. Where do retail investors net out here? Like, why should they care about SPACs? Has the SPAC been a boost for retail investors? Like, how does this actually impact you or I when we're thinking about our own portfolios?
John I got to tell you, Alex, begging. The retail investors have been begging me for years for access to IPOs and even pre-IPOs. How could I buy something before it goes public? And SPACs are exactly what the doctor ordered. They are pre-IPO companies, and there's probably a hundred of them available right now.

John But be careful what you wish for, my novice investor friends. Investors need to do their homework. Read your prospectus. Read any report you can get your hands on. There might not be much out there. Look at management and their experience. If you invest in anything blindly, your results will most often be bad.

John No successful investor ever sues anyone, ever. I've never seen anyone say, Oh, I made so much money on this deal. I don't know what to do with it. Let me go sue the people that made this IPO. Let's go sue the people that ran the SPAC. So why is that? Nobody ever sues anyone about something that's successful. So this is something where you know the deals might not come to fruition. It's part of the bargain of the risk-reward. It's potentially higher risk, potentially higher reward. So you have to keep that in mind as an investor that you're buying something that's very uncertain.

Alex So, this has been an awesome masterclass in SPACs. And I want to finish it up with questions from our listeners. Or rather, I want to finish this up with a question from a listener. Today's question for John is, do SPACs make the market frothier? Should this tell us that we're towards the top of a market? How should we be thinking about the spot in the cycle we are because of SPACs?

John That's always the question. Is this a good buy or is this goodbye? And really, no one ever knows. And I always like to quote—it always goes back to Charles Dow. In 1890, he was quoted as saying, "Markets can remain irrational longer than you can remain solvent." So are we in an uptrend? Yes, absolutely. Will that uptrend continue? Don't know. No one knows. But, it could probably last a lot longer than anyone suspects. And like every bull market, this bull market's no different. It's the bull market people love to hate, and SPACs are part of that frothy, hot bull market. And let's hope it keeps going. No one knows. That's what I'll leave off with. [chuckles]

Alex John Gagliardi, thank you so much for joining the show again. And for all your wisdom around the thing that is the SPAC. Really appreciate your time.

John Thank you for having me, Alex.

Alex SPACs are a funny thing. Just a few years ago, they were considered dodgy. Six months ago, they were all the rage. And now, they're somewhere in between. I guess it just goes to show that trends and fads aren't just for fashion and music. Wall Street has them as well. SPACs recent journey also gets me thinking about the division between institutional and retail investors, and how that's being blurred to some degree.

Alex It's pretty fascinating when a finance trend is drawing attention from both the biggest private equity groups and your college roommate who just downloaded an investing app. The democratization of finance is something we've heard a lot about in recent years, and you definitely see that show up in the SPAC conversation. All that may have gotten you wondering about whether you should get in on a SPAC investment, maybe especially now that the space isn't quite so crowded like it was several months ago.
**Alex** If that's you, you should definitely tune into the next episode. John and I will discuss the pros and cons of a SPAC investment for those of us who aren't Jay-Z or Richard Branson, which is to say, most of us.

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**Erica** See you next time.

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