Fresh Invest: SPACs in your portfolio
Season 2, Episode 6 Transcript

Alex Lieberman, Co-founder and Executive Chairman of Morning Brew What's up, everyone? I am 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.

Alex Today's topic is the finance section's dark horse of the past year, SPACs, and whether they're a good place for your hard-earned money to grow.

Alex Whether you want to invest in a SPAC sponsor or target is your decision. But if you decide to go for it, there are a few things you should know. If you're listening to this podcast, you probably like to stay up to date on financial news, which means that over the last year or so, you've probably heard some eye-popping numbers and stats about SPACs. And you may have wondered, is there an upside here that I should get in on? It's only natural.

Alex But like any other financial tool, a SPAC has both benefits and risks. You may have heard about some of those risks lately, as SPACs have drawn criticism from the SEC and investors in recent months. So is a SPAC a wise investment? What kind of due diligence is necessary? And what are the red flags? Today, I'll chat with John Gagliardi about those questions and others so you can make an informed decision.

Alex John, thanks for being back on the show.

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

Alex So let's quickly set the foundation. What exactly is it that you do at Fidelity?

John So my name is John Gagliardi. I like long walks on the beach and stocks that go up. But my role title is regional brokerage consultant. And what that means is that I'm very fortunate to work with very independent-minded investors who want to take charge of their assets, whether in part or in whole, where they want to be the ones deciding what to buy and when to buy it. And I help them bring the knowledge and the research necessary to make them better investors.

John An appointment for me can easily go through their branch and they can meet with any of the regional brokerage consultants throughout the country. And no, you do not have to be a Fidelity client to request an appointment. So, please feel free to reach out.

Alex Awesome. So, John, you have talked, I would assume, with dozens of people about this concept of the SPAC over the last few years. And when you think about it, it's a pretty weird investment. You're committing money to an entity that has no operations. It's a shell — a company that sort of doesn't exist yet. How can retail investors be confident that they're literally not just lighting their money on fire or flushing it down the drain?

John Well, I would not say that they're flushing, but they are definitely walking down that road of larger-scale risk-reward. So, deals generally go public at $10 a share on a SPAC. And if the deal should not happen, theoretically you're supposed to get your $10 per share minus expenses. Now, how much will be left after expenses? And I have clients say, John, I can't lose. And that's always a red flag for me.

John A SPAC operator could take on expenses whereby the $10 per share get diminished. And before you realize it, there's not a whole lot of money left, especially if they weren't able to find a deal. And you might not be left with that $10 a share you originally thought you might be left with. So I always tell people, theoretically you should get your $10 [chuckles] a share back, but theoretically they could burn through expenses and maybe you only get $6 back after years of waiting.

Alex So, similarly, a SPAC may find a target in a few months or it may take over a year, or the sponsor could even fail to find one and simply return investors' money after a two-year period. Given that uncertainty around the timeline of finding an acquiree, how should investors determine how much of their assets in their portfolio they're willing to hand over to a SPAC?

John Alex, when you asked me to come on the show, I decided to do some of my research. So I asked a 40-year veteran financial advisor, how did SPACs play out in prior bubbles in 2000 and 2008? And he said that there were clients because, believe it or not, SPAC-mania found its way into those markets as well. And he said that he had clients that had only gotten back 6 and $7 per share on deals that had gone bad. And sometimes that was after years of litigation by the investors.

John So dollar-wise, that doesn't sound like a lot. So I put in $10 a share and I only got back 7. But, look at all that upside potential. However, you have to think of this as percentages. So 30 and 40% losses can devastate a portfolio. So a), do your homework. Always do your homework and read prospectuses and anything you get your hands on. You have to read beyond the ramblings of a TV personality. And b), manage your SPAC investing at a level where a 30, 40% loss is an acceptable loss. If your upside is DraftKings or Virgin Galactic and some of these fantastic deals that happened in the past, it could make sense.

Alex The other thing here is beyond just, like, the potential downside, like, the sheer dollar downside from 10 to 6 or $7 a share, which again, on a percentage basis, is [chuckles] a large loss, I think there's a lot of questions about the types of businesses that end up going through the SPAC. Generally, I think we see in the news a lot of SPAC targets are in these sexy growth industries, like electric vehicles, green energy. Should retail investors be wary of SPACs that are geared towards what I would call higher-volatility, buzzier sectors, or should they not?

John There's no doubt. EVs and green energy are sexy. But let's look at a name like DraftKings. DraftKings that went public through a SPAC, it had great growth fundamentals prior to it being a SPAC, when it was a privately held company. And the success of SPACs like DraftKings and others like it, they really ignite the imagination for investors.

John Now, if you can't produce great financial numbers, well, stories are cheap and easy to manufacture, and claiming to be the Tesla of trucks or claiming to be an organic plastic that disintegrates in landfills — wow, that sounds fantastic. But remember, it's just a story. A company's ability to deliver on those fantastic goals is not so easy. Rare is it for there to be a management team that can deliver on those fantastic promises and create that success that companies like a Facebook, a Tesla, or Google — it's very hard to deliver on those promises and get it done.

John But to be fair to the bull market, I still to this day have clients who are short Tesla, saying it's a scam. Tesla is in the S&P 500. It's in the top 10. It's a real company, according to Standard & Poor's. And having included it in the S&P since 2020, it really shows that there is a place for EVs. So when we try to attach our new SPACs that we're looking at to that kind of success, you have to remember there's only one Tesla. They've been at it for 10 years. It's not a new company. [chuckles] You know, this wasn't an overnight success.

Alex So, I want to also focus now on the management team of SPACs. So the folks that raise the SPAC end up looking for the business to acquire. If you're a retail investor that is thinking about whether to put money to work in a SPAC, how much does the management team of the SPAC matter, and if it does, what sort of skills and experience should you be looking for in these management teams?

John Well, management is absolutely part of the story on both sides of the deal, for sure. And I always say there's three things that make a stock go up: the story, the numbers, and the chart. And the story on management goes a long way. So Virgin Galactic, for example, had billionaire founder Richard Branson. But we have to remember, he had been working on space tourism for 18 years. Virgin Galactic went public via a SPAC, but Branson already had experience running airline and travel.

John And so, experience really does count. So if you're looking at a SPAC and you're looking at long-time Google or Facebook veterans leaving their company to run a startup, and the prospective SPAC shell company was run by a former Goldman Sachs banker, well, that pedigree is going to really count and go a long way. And that's a pretty good story.

John But again, stories are cheap and easy to manufacture. You're not always going to turn those into good investments. So how much in dollars can you afford to lose if the downside is as big as 30 or 40%? That's always a good place to start. Always start with the risk, and your investment size will be appropriate for you.

Alex So, I want to focus on this one piece you just said, which is stories are easy to manufacture. We have seen a growing number of lawsuits brought by SPAC investors that have claimed that they lost money because of shoddy accounting. Without commenting on just any specific SPAC or any ongoing litigation, can you provide some context on just accounting practices or things that investors should look out for as potential red flags when they're thinking about putting money to work in a SPAC?

John So the lack of transparency is really part of the risk-reward game, and it's all potential, right? We don't know a lot about these companies. And for years, clients were begging me for IPOs and pre-IPOs, and the market came bearing hundreds of SPACs. They're exciting, but do your homework. Read your prospectus. Investigate management. Do this before you buy. And it's always good to size your position correctly, as I had mentioned.

John I got to tell you, Alex, I say this every time on Morning Brew: The market — it only allows you to control three things, and only three things. When do I buy? When do I sell, and how big is the position? So, take your time to manage the portfolio. I know it's boring, but if you're doing it and it's boring, you're probably doing it right.

Alex Love it. So I want to finish with a new thing we're trying on the show this season, which is questions from the audience. And today's question for you, John, is why are there so many SPACs associated with celebrities and nonfinancial folks like Steph Curry and Paul Ryan? And going back to the question of management, how should this inform our way of thinking about the potential of a given SPAC?

John Well, that's the whole thing is, it's notoriety, right? Everyone knows Steph Curry, like, great basketball player. Paul Ryan, this noted politician. I'm waiting for the Alex Lieberman SPAC, right?

Alex There we go. [John laughs].

John So whenever there's someone that's well-known out in an industry, they're going to attract a lot more eyeballs. And that's what SPACs often lack because otherwise, it just sounds like, OK, it's a shell company and they're looking to merge with a tech company. OK. And there's a hundred of them out there. How do you differentiate yourself? And they try to find a good spokesperson or initial investor to draw investors to that SPAC, which, if they raise more money, of course, they could maybe even potentially get a much better deal.

Alex Love it. John Gagliardi, thank you so much for joining Fresh Invest again and really appreciate all your insights about SPACs.

John Thank you for having me. It's always fun.

Alex Well, now I have something to talk about if I ever meet A-Rod or Richard Branson in person. Like I said in last week's episode, it's pretty fascinating how SPACs have gone in and out of fashion, like fanny packs and bucket hats. And just like adding a fanny pack or a bucket hat to your repertoire, if you're going to join the SPAC trend, you really want to do it right to avoid disastrous consequences.

Alex To me, SPACs are an especially people and personality-driven asset class. You're betting on a group of people, a management team, and their wisdom in identifying a target. If you consider yourself a good judge of character, or at least a good judge of financial acumen, a SPAC investment may be something you want to explore. But if not, maybe stick with something you're more comfortable with.

Alex Next on season two of Fresh Invest, Fidelity and I will tackle another asset folks ask us about a lot — real estate. And not just whether to pull the trigger on that two-bed Colonial. We'll get into commercial real estate and various financial tools to get you in the property market. See you next week. Thanks for joining, everyone.

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