PRO

Michael Kramer

Founder and Portfolio Manager: Mott Capital Management, LLC

{ INTERVIEW BY KHAI NGUYEN }

Michael has dedicated his career to investing in equities. He started following the market when he was 16 years old in 1994, when he was a sophomore at Manhasset High School. He has always had an interest in finding and investing in exciting growth companies. Michael financed the majority of his undergraduate education by investing in equities.

Michael is the founding member of Mott Capital Management, LLC in 2014. Prior to MCM, Michael spent the previous 7 years working as a domestic and international equity trader. During this time, he was responsible for handling trades in some of the most illiquid equities. Additionally, Michael has experience trading in some of the most exotic foreign markets.

In all, Michael has been working in the financial services sector since the summer of 1997, during his freshman year of college. He holds a BS in Finance and a BS in Management from LIU Post and an MS in Investment Management from Pace University, Lubin School of Business. In 2014 he received a Certificate in Financial Risk Management from New York University.

Michael enjoys to write and contribute to TheStreet and Seeking Alpha. Additionally, his work has been feature in Forbes and Fox Business News.

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Khai Nguyen: I'm here with Michael Kramer, founder and portfolio manager of Mott Capital Management. Michael, welcome and thank you for joining us.

Michael Kramer: Thank you, Khai. It's a pleasure to be here.

KN: Michael, can you begin by telling us your background and how you got started in the world of investing? I understand you financed your way through undergrad by investing, is that true?

MK: I started following the market 22 years ago when I was 16. My first experience was when I was home sick from school one day and I came across CNBC. I knew my dad had a portfolio and he had some stocks for me as well. I remember watching and found it to be really interesting. My interest just really grew over the years. I remember seeing Netscape go public. I'm sure many of your readers may have no clue what Netscape even is—it was an internet browser. It was essentially the stock that in my mind started the internet technology craze of the mid-to-late 90's. When I turned 18 and was ready for college, my father told me he had set some money aside for me. This was all the money he had saved for me. He told me to be careful with it as once it was gone, I'd have to take loans. He had built a nice portfolio for me to start life with. I took over handling it and got heavily involved with the markets at that point. The first stock I ever bought was ADT. It was eventually taken over by Tyco in the summer of 1997. That summer, MSFT saved AAPL from bankruptcy. AAPL was trading in the mid-teens and fighting for its survival.

I started working in the business when I was 19, the summer of my freshmen year. I decided to get a summer job so I walked up and down Cuttermill Road in Great Neck, NY, into all the office buildings. If I saw that a firm had a member of NYSE next its name on the directory, I would go up to the office and ask if they had any openings. I got a job with HD Brous. I remember it being an incredible experience being in a real investment environment. During my junior year I started a chapter of Financial Management Association with two friends where I became the president and by the end of my senior year, we had over 60 members.

Answering the second part of your question, yes, I did finance my undergrad school by investing. In fact, I finished with the same amount of money I started with, while paying for all of my tuition along the way. I remember having actually almost doubled it by the start of my senior year. The only reason I finished with same amount was because of the tech bubble busting in the spring of 2000.

KN: How would you describe your investment style?

MK: I have what I call a Conceptual Thematic Growth approach. To me, this means finding growth companies by looking for a theme or concept in society. Doing what I call connecting the dots. There are investment opportunities all around you. It is about being able to understand how that theme can progress. The concept that makes the theme work and how you can make money.

I'm not the type to use a model, or sit at my desk and find a stock that trades with a P/E at a discount to its peers. There is usually a reason for that discount, right? If you believe in the efficient market hypothesis, then you believe that all information is priced into the market at all times. So if that is the case, how can there be value stocks? Financial models make assumptions about the future that to me, are too hard to accurately predict with precision. I learned all of it in grad school when I was getting my MS in Investment Management, and I never liked it. I studied and I passed my test because I had too. Thinking about it honestly and logically, one of the most important values is your "R" value or your risk free rate of return. If we went back in time to 2010, what would you have used? 3%, 4% maybe a 5% rate? Everyone was expecting rates to be at 5% for the 10-year treasury in 2011. Well it is 2016 and we are still at 2% on the 10 year. So any model I would have used would have been completely wrong. How can you discount a cash flow if you can't even find a reliable "R"?

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Sometimes it just comes down to having a feel for things. It is having an idea and figuring out how to play it and thinking about what the long term prospects are for it. It always amuses me when a client or someone asks me if I am nervous about the market, or the market is going down, are you going to start selling. My usual answer is no. I usually ask them a basic question in return: if the market goes down 10%, how does that affect Gilead's ability to sell Harvoni to a Hepatitis C patient? Or if you have Hepatitis C are you going to be more or less likely to want Harvoni because the market is down? They usually respond with something like, "Well, why would that matter, if I was sick why wouldn't I want Harvoni?" And that's my point exactly. Now if Gilead cures everyone who has Hepatitis C, and they have no other drugs, that would be a reason to sell the stock, not because the market is in a bad mood. However, the problem with that of course is that market would start pricing this expectation prior to Gilead actually curing everyone of Hepatitis C. So you need to know when that time comes, and there is a certain feel to that. The market signal when that time has come. It is like being a baseball player. Some people can play and some people can't-in my mind there is no difference. You either have a feel for the market or you don't. It is a skill, not a science. Always remember that behind every machine and algorithm, there is a person with an emotion.

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KN: Can you go through your process of finding quality companies to invest for the long term?

MK: Sure. So a really great example was back in 2002-2004 when I was about 25 years old. I had gone home to see my parents for the weekend and they wanted to buy a new car. We went to a Cadillac showroom and after sitting in several different cars, I noticed they all had this XM Satellite Radio. I had heard of it before, but at the time most people that had it, had to have it installed which cost like $500 for the radio and installation. It was expensive. So I asked the salesperson about the radio and how much it cost to get one in the car, he said it was free. He told me the company was subsidizing the cost. I thought about that and thought to myself: if this is free in this car, what if they start giving these things away in other cars? I went back to work on Monday, and started downloading all sorts of research from First Call and reading about XMSR and SIRI. I started doing some simple numbers in my head. I don't remember the market cap at that time, but it became really apparent to me that if there were 150 million cars in the country and they got 10% of that market at about $100 a year we could be talking about some big revenue number in excess of a billion dollars a year. Now SIRI has well over 25 million subscribers.

KN: Tell us about Mott Capital Management, the strategy, and how it operates.

MK: Mott Capital Management was really something I have always wanted to do. I got the name Mott because I live in the Mott section of Garden City, New York. When I started the business in June

2014, I was interested in opening a fund. However, cost and things like getting potential clients were a problem. I decided to go the investment advisor route. I became registered with NY, NJ and PA. I started the capital raising process by literally going to family members and asking if they would invest with me. My initial investors were quite literally my father, my brother, mother-in law, and other family members, as well as my own money of course. I needed to make sure that when I started, I could develop a strategy that offered growth with reduced amounts of risk. I also wanted to make sure I didn't have different portfolios for everyone. So I took the idea of running one portfolio from my past employer, Gilder, Gagnon Howe & Co. and just running that portfolio across all the separately managed accounts. It allowed me to do a couple of things that benefited my clients. First, it offered my investors transparency into their accounts. Secondly, they retained ownership as my only ability was only making trades on their behalf and that is it. I can't move money around for them. Also, it allowed me to really concentrate just on following a few stocks and not having to worry about 100 different things. I decided that I would never use margin, as I have never liked the idea. In fact, I have never used margin in my whole life. I don't like the idea that if the market gets moody someone might force me to sell something. I want the ability to sell something because I want to, not because I'm being told to. I would never short either. Shorting is just messy. Locates, hard to borrow, paying rates, all part of the mechanics in holding a short. If the stock goes to zero, my return is only limited to 100% but my loss is infinite. That doesn't really sound too appealing to me. Too much risk, not enough reward. I have seen too many shorts go really bad. Also, I will only keep up to 19 stocks in the portfolio at all times. Each stock is weighted at 5% with an additional 5% position in cash. This is so that if one position blows up it doesn't kill the performance of the portfolio. It also forces me to not be emotional with the portfolio and build a bigger position in some names. It keeps it balanced.

We operate very basically. It is me at this point doing all of the research, operations and compliance. I have Manoj Dalvi, Ph. D., who joined me in May of 2015. He helps me come up with new ideas and talks to me about the stock market. I have known Manoj since 1998, as he was my undergraduate Finance Professor. He just has the ability to very quickly come up with answer and solution to almost anything. He was born in India, and moved here to get his Ph. D. in Finance from Columbia and his LLM from Harvard. He is one of the smartest people I know.

Ultimately though, I own 100% of the business and it is my livelihood, career and future at risk. Really it is also my family's future as well. I have two little girls, a 5-year-old and a 2-year-old, Ava and Ella, and my wife Rachel. I make all final business and investments decisions. Everything rest on my shoulders, but I love it, as it has been an incredible experience. Which is why I have such a passion for figuring how to make this work.

KN: During your interview with Gregg Greenberg at TheStreet, you talked about Alkermes, Tesla, and Disney. What are some of the other investment ideas you find interesting at the moment?

MK: Acadia Pharmaceuticals (ACAD) is a great long term conceptual growth story that I really have a passion for. I believe they have a game changing drug in NUPLAZID. The drug's PDUFA date is May 1, 2016. The company did a $300 million secondary the first week of January and the stock got crushed with everything else in the health care sector. Investors don't seem to realize that this is a positive because the company is preparing to commercialize this drug and they need to hire a sale force and start making it. The drug is for Parkinson's Disease Psychosis. I won't bore you with all the details, but it's a Selective Serotonin Inverse Agonist (SSIA) and specifically targets one serotonin receptor in the brain. The Phase III data showed very strong efficacy with almost no real side effects, which in the psychiatric space, is very rare. I think there will be other applications that it could work on as well. PDP affects about 400k people just in the U.S., so if they capture a third of that market or 150k patients at a pricing of about $12k a year, which is the cost for an atypical antipsychotic, it comes out to approximately $2.0 billion in revenues. Just in PDP. Its market cap today is only about $2.5 billion.

Vodafone (VOD) to me is an incredible opportunity, plus it pays you 5% a year just to hold it. Think about the number of people they have access to. They are in Europe, which has about 350 million people, India at 1 billion and Africa with another 1 billion. That is almost 2.5 billion people or a quarter of the world's population. People in some of these parts of the world don't have infrastructure for land lines in place-the only phone they know is the mobile one in their hand. It is like my daughter when she sees a touch tone phone and goes, "What is that daddy?" Their broadband connection is their phone. Only 10% of people in Africa have a smartphone and only 25% in India. Think about the growth in data consumption once these population start getting better technology and access to 4G.

Visa (V) and MasterCard (MC) are two of my favorite stocks as well. Just think about how much money you carry in your pocket today. If I have $30 in my pocket I'm lucky. Why? Because I use my credit or debit card for everything. Only 1/3 of consumers currently use their credit card for over 50% of their purchases. We are moving to a cashless society and we are not going back, ever. People have asked me about American Express, but it's not for me. They hold the debt, so why do I want to have the risk of another credit crisis and have to worry about default rates. For Visa and MasterCard the bank that issues the card holds the debt. Visa and MasterCard are like the George Washington Bridge Toll collectors, if you want to use their network you need to pay them. Investors have mentioned that Visa is expensive today because it trades at 24x forward earnings. My answer is, "How can one put a value on a global societal shift on people's consumption habits?"

KN: You've previously traded international securities in some pretty exotic places like Kenya and Pakistan. How did that experience mold your investment perspective?

MK: This was really an eye opening experience for me. First off, it taught me that unless you have boots on the ground in countries abroad, stay away. You can do all the research you want, but trust me, the locals know more than you and they can see you coming a mile away, especially if you have size to buy or sell. In places like Sri Lanka or Kenya, you have ID markets, so they knew when you were back.

I think it just got me thinking more globally in general though. I really enjoyed reading all the notes from brokers at night as things happened in different parts of the world. It made think about the vast population size outside of our borders. It made me think about shifts in lower income populations to middle income populations.

KN: What are some of the global trends you've seen recently that you find interesting as an investor?

MK: As an investor, it has been amazing to watch the changes in the investing world. I remember from when I was very young and probably right up to the financial crisis, when the U.S. sneezed the world would catch a cold. The global markets would look to the U.S. for stability. If Europe was down 2% it didn't mean the U.S. would be down 2% at the open.

Now the global markets are really one continuous market, with a slight break between 4 PM and the Australian open. Generally, when I get up in the morning I look at what Europe is doing first. 9 times out of 10, the U.S. futures are pretty much inline. The markets may operate in different countries and time zones but they are really interconnected, and I really see that become stronger in the future.

KN: You are a regular contributor to TheStreet, Fox Business, and Harvest, amongst other media channels where you've expressed a pretty strong opinion on the Fed. Can you discuss your thoughts on the Fed's monetary policy these last several years and how that may affect markets moving forward?

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MK: My view has been that the Fed is in a very difficult position, unfortunately. They have done all the right things. I admire what they have done and to be quite honest, I think we have been very fortunate to have had Ben Bernanke when we did. I think the problem the Fed has now is they have had no help. The federal government passed an insufficient stimulus measure in 2009 and that left holes in the economy. The other challenge is that the Fed has had to face structural shifts in employment. There have been jobs lost that, due to technology or globalization, are likely never coming back. The output gap in the economy is still about $500 billion so more needs to be done. Unfortunately, the market and the Fed have become tied at the hip. Any indication of a future rate hike sends the market into a tizzy.

KN: Who are your ideal investors and how do you make sure they are a good fit for your fund?

MK: I look for investors that can take a long term approach to investing. I want people that are patient and will not panic every time the market gets moody or volatile. Or get upset when a stock goes up and we haven't sold it. I believe in investing not trading. Every investment I make I think about whether or not I can hold the position for 3, 4, 5 years. If the answer is yes, then I buy it and if the answer is no, there is something that is a better fit.

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KN: What is your outlook for 2016 for the stock markets?

MK: Volatility and lots of it. To be honest, we started preparing for this in September 2015 and we started publicly talking about it by the middle of November. There are too many shifts going on in the world right now. We have central banks going in opposite directions, the Fed with its attempt at normalization, The ECB with QE and negative rates, and China with its Yuan devaluation. Japan has its own issues going on. I think though that there is enough easy money in the system that market shouldn't go down too severely but they really won't go up much either. Of course, if the Fed changes course, then I think a different story emerges which would probably send things higher.

It is my opinion that sometime before we get past the half-way point of 2016, investors will stop talking about normalization of the yield curve, and start talking about QE 4. We published a report on Seeking Alpha in October of 2015 talking about negative rates and if the Fed could go there. In my opinion it is a real possibility. In December we wrote an article for The Street talking about QE4 as well. A lot of this in my opinion could be avoided if the Fed actually had some help. But unfortunately our leaders in Washington choose to ignore it. They talk about all the great data regarding jobs and the economic growth. On the surface it all looks good, but under the hood you have a labor participation rate at 62% a 40-year low. U6 unemployment at just under 10%. Why is that? Why the disconnect? We wrote an article for The Street after that December Jobs number that showed exactly why. The job growth in this country has been unable to keep up with the population growth.

This translates into a stock pickers market. You have to pick your companies wisely and understand how economic conditions will affect them. Will a slowing China effect cell phone growth in Africa? Probably not. You have think in terms of each individual investment and how shifting economic impact it.