

Center for Strategic and International Studies

TRANSCRIPT
The Reopening

“Leon Cooperman: ‘Capitalism Will Be Changed Forever’”

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Andrew Schwartz: You're listening to The Reopening. The podcast that asks, "How will America work through the COVID-19 pandemic? How will we innovate, and how will it change our global economy?" Each week we invite top business leaders to share their insights on the road to economic revival here at home, and around the world.

Scott Miller: In today's episode, we're joined by Wall Street legend Leon Cooperman. Leon was the head of asset management for Goldman Sachs for many years, and then established his own firm, Omega Advisors. We'll talk with Leon about changes in global markets, and the role for business and government as the country recovers.

Andrew Schwartz: I'm Andrew Schwartz.

Scott Miller: And I'm Scott Miller.

Andrew Schwartz: And this is The Reopening.

Andrew Schwartz: Lee Cooperman. Thank you so much for joining us today and making time out of your busy schedule. Scott and I wanted to ask you some questions about the future of the economy, what's going on now, how you see things. Look, this isn't your first rodeo. You've been through some major cyclical things in the market. How do you see what's happening now? And what bearing does it have on the future of our economy?

Leon Cooperman: Well, you're quite correct when you say it's not my first rodeo. This is the eighth recession-induced bear market I've lived through. This is different than the ones in the past because it's a combination of a financial crisis, oil price collapse, and of course the Coronavirus, which has caused a broad-scale shut down of the economy. In none of these past cycles I've lived through, ever, was there a broad-scale shutdown of the economy. And this also unfortunately occurred at a time when the stock market was very expensive by historical standards.

Leon Cooperman: If you study past cycles, and the last comment will be the most relevant, on average, a typical bear market declines about 25%. This one went down 37%. So 35% peak to trough. Larger than average, but not unusual. What was unusual was the speed with which it occurred. It lasts about a year and recessions last about a year. So that's the tie up. GDP contracts about 2%, earnings drop somewhere between 15 and 20%. Importantly, and this is a very important observation—it explains the market action. Importantly, the stock market bottoms are on average about three months prior to the economic bottom. So the low so far was March 27th. And I think the economic trough will probably be somewhere around June, so that relationship would have held.

Leon Cooperman: So I think the good news I have for the listeners, is I think that the 2187 low of March will be the low of the market cycle. But in all honesty, with the market now over 3000, that's not saying a hell of a lot. And I've been

surprised by the speed of the market rise. And that comes from somebody, I am bullish about the virus being fixed. I have this simplistic view that when the world focuses on a problem, that there's enough intelligent people around the world that they will find a solution to the problem. And I am optimistic that the economy will open up starting this month that we're in, and it's already starting.

Leon Cooperman: But I think all of that has kind of been discounted. And I have a list of 10 items that make me conservative at the current time. But I think the market has discounted the good news.

Andrew Schwartz: You famously put out these 10 items and people are talking about it. So tell us what you think.

Leon Cooperman: Well, I don't know about famously, but anyway, and let's take them one at a time because with the market acting better than I thought that I'm examining each one of these assumptions.

Leon Cooperman: So number one observation, capitalism as we have known it will likely be changed forever. And what makes me say that is, when the government protects you on the downside they have every right to regulate the upside. So the government's going to be in our pants in a way that they've never been in the past. And there's a recent example of that. I don't know if it was a Senator or a Congressman. I didn't catch his name. But someone came out and said, "The airlines should not fly with a load factor of an excess of 67% because of the virus." And he went on to say that, "If you don't like it effectively lump it. We bailed you out." Well, there's no airline I know can make money at a 67% occupancy or load factor. So that's number one.

Leon Cooperman: Number two, the country is moving to the left and taxes are going to go up. Quickly if Biden wins, more slowly if Trump wins. But I think taxes have to go up, as they should go up, given the fiscal condition of the country.

Leon Cooperman: Third, I've been saying this now for three years. We've been living in an abnormal world and that low interest rates are indicative of a troubled economy and [inaudible] not bullish. What I mean by an abnormal world, going back three years ago, two years ago, a year ago and even now there's probably about \$14 trillion of sovereign debt that carry to negative interest rates. To say to yourself, if you lend money to Japan, or Germany, or Switzerland for 10 years, you get back less than you lent them 10 years later. I mean, it doesn't make any sense. It's not what the world is all about. Okay?

Leon Cooperman: So everybody that's cheering on these negative interest rates, take a look at Japan and take a look at Europe. European and Japanese price earnings ratios are lower than they are in the United States, and they have negative interest rates. So if you're a capitalist, you don't want negative interest rates. And I think debt is growing much more rapidly than the economy is growing. The country was founded in 1776. We had no debt. We now have about 23 or 24 trillion of sovereign debt. So now that's what? 250 odd years. And that debt is

going up by 4 trillion or \$3 trillion a year. And it's a growth rate well in excess of the growth in the economy, which means to me that more and more of our national income will have to be devoted to debt service, which will be a retardant on economic growth.

Leon Cooperman: Fourth, demand is likely to come back slowly. If you're talking about a sporting event or a concert, I think that they're going to have to have a vaccination in place and a vaccination card. If you want access to a sporting event or a concert you'll have to show your vaccination card. That's at least a year away.

Leon Cooperman: Fifth, business will incur substantial compliance costs. You'll see the need to comply with new rules and regulations.

Leon Cooperman: Sixth, there'll be substantial equity issuance by companies, not equity repurchases like we've seen in the last five years, but equity issuance. So United Airlines, which I don't single out in a negative way. They just got caught. But they brought back 35% of the company in the last five or six years, probably pay an average price of \$65 a share. And recently they sold a billion dollars of stock at roughly \$25 a share. So I think you're going to see a lot more of that as big dollars have been lost and more and more companies are going to have to raise capital to replace what they've lost.

Leon Cooperman: Seventh item, a big supporter to the stock market the last five years has been about a 2% reduction annually in outstanding shares. As companies took their free cash flow and their earnings and [inaudible] to stock repurchase. That game is largely over. I disagree with it, but I think stock repurchase has almost become a dirty word. I think clearly those companies that are forced to take government assistance, they could forget about stock repurchase, but even those that don't, I think it would be very lucky to do it given the uncertainty of the environment.

Leon Cooperman: My eighth observation is, profit margins tend to be mean reverting and profit margins were at a very record high in January when we came into this. Think about it. You're supposed to be in balance in your budget when you're fully employed. We were running a trillion-dollar deficit in January when the economy was fully employed and all this other stuff that's being done.

Leon Cooperman: My ninth observation, credit is cheaper than stocks. Not government credit, but corporate and high yield credit. High yield basically is about 7%. You take one divided by seven. It's about a 15 multiple, and the S&P is not going to do a 20 times earnings. So the stock market is more expensive than credit, and that's not a good thing.

Leon Cooperman: And finally, I said this a month ago. It's now become more commonly accepted and understood. But I'm a watcher of Warren Buffet and Charlie Munger, for good reason. Uncharacteristically, Buffett sold his airline stocks into weakness, I see he sold his Goldman Sachs stock, and he's been sitting on 135 billion dollars in cash, doing very little. So, if the greatest investor in my

generation and really, in modern history, is having difficulty figuring out what to do, who am I to be so bold?

Leon Cooperman: So my bottom line is, and it's higher than it was a month and a half ago. I got to recognize the market is telling me I'm wrong. But I think to me a fair value in the market is the following. Take 25% of the S&P and say that's in the large cap growth technology sector of the market. I give them a 30 multiple, which is about where they are today. And I say, "The other 75% of the market is worth 16 times earnings." 16 time, if you're a bull, you would tell me that's low relative to interest rates. I'd say it's slightly high relative to history. So if I take 75% at 16 and 25% at 30, that's a weighted average multiple of a little over 19, which would equate to about 29, 25, and the S&P, and the S&P is currently around 3050.

Leon Cooperman: I'm normally bullish, but I would find myself very conservatively postured at the current time. I think the market is fully adequate, fully capitalized. And I would make two other observations that make assessing the market difficult. Number one is, probably 70 or 80% of the volume is no longer being done by human thinking. It's done by the machines. And the machines basically buy strength, they sell weakness, and they exaggerate the moves up and down. And I also say more recently, China and Hong Kong are becoming front page news and I think that is not a positive development. Anything can happen there. So I would say overall, I would give you a conservative assessment of things.

Andrew Schwartz: So there's a lot to unpack here. I want to bring my colleague Scott Miller in here. And I think Scott wants to ask you some questions about capitalism.

Scott Miller: Yes. I'd like to start where you started, which is this notion of, you can't privatize the gains and expect to socialize the losses. And I still remember well how frustrated voters were back in the financial crisis with the notion of, "Too big to fail."

Leon Cooperman: I'm a capitalist. And I take to quoting one of the great capitalists, and very articulate gentleman, Winston Churchill, where he said, "The main vice of capitalism is the uneven distribution of prosperity. The main vice of socialism is the equal distribution of misery." I famously said, "You don't make poor people rich by making rich people poor." Well, the Redistributionists got their way by sending rich people who have lost a shitload of money here. And so they're eating out or flattening out this income disparity.

Scott Miller: Yeah, fair point. But let me talk about the companies themselves, because we woke up over the weekend and read that Hertz rent-a-car is now bankrupt. Bankruptcies are happening, and what it appears to happen is the largest and companies with the best balance sheets, but large companies tend to be surviving this, riding it out. The companies that were already weak and trying to muddle through are basically meeting the end of the line, whether it's JCPenney or lots of brick and mortar retailers.

Leon Cooperman: I think very highly of them, but I think JCPenney, it's problem started when Bill Ackman got involved. I think his first name was Bob Johnson, Matt Bolin, and the first thing Johnson said was, "We're going to eliminate the word sale out of our vocabulary." And they started losing enormous market share and they got themselves into trouble. And then I think Neiman Marcus, the other one, I believe got leveraged up in an LVO.

Scott Miller: Well, that's happening a lot. And what you're seeing-

Leon Cooperman: Well, I'm not sympathetic to that. You live by the sword, you die by the sword and-

Scott Miller: And we wind up with fewer bigger companies at the end of all this.

Leon Cooperman: And then the government is attacking Google and Facebook, and Amazon, the companies that have really provided us a great comfort in this unusual period.

Scott Miller: Oh, they're definitely adding value. Yes.

Leon Cooperman: And you see this reflected in the stock market because the stock market is two markets. If you're smart enough to be in the top notch quality names, you're doing reasonably okay. And then NASDAQ is unchanged for the year or down a nominal sum of money. And everything else is sucking wind.

Leon Cooperman: So tomorrow night it's a ladies' investment club. There are 15 ladies. They gave me a list of their holdings. And I said to myself, "They ought to be giving me advice rather than me giving them advice."

Leon Cooperman: Apple, 25 times earnings, Facebook, 32 times earnings. Square, Inc. [inaudible] big multiple. Amazon, 125 times current earnings. Visa, 38 times earnings.

Andrew Schwartz: They're doing pretty good.

Leon Cooperman: They're doing very well, but they own that sector of the market that is been performing well. And the other stuff that's complex or has a certain amount of leverage and hair associated with it is going nowhere. And you got to decide your style. I tend to be a more of a value investor. So I have some of those tier one companies but the bulk of my investments are in second tier companies, which are not doing as well, but I see great fundamental value. And one of the two things are going to happen. Either the top tier will correct to come down to the second tier, or the second tier will catch up to the first tier.

Andrew Schwartz: Any tips there?

Leon Cooperman: Yeah. Tips in the context of individual companies?

Andrew Schwartz: Sure.

Leon Cooperman: Well, I hesitate but my favorite idea is not a stock, it's a bond. But I don't know if it's suitable for your audience. They have to be a QIB. But there's a company called Ligado. Ligado owns billions of dollars of spectrum, of 5G spectrum. They spent the last five or 10 years trying to get it approved by the FCC in terms of its usage. And it took so long because of the Department of Defense, bogusly in my opinion, has objected. I go back to President Eisenhower who said, "Be aware of the military industrial complex." So the military complex objected.

Leon Cooperman: Finally, the FCC, by a vote of five to zero, approved the spectrum use. And they have a bond that's standing that picks at 13% and matures in December that is going to be worth par. So the total debt outstanding against that issue is about two and a half billion. But the value of the spectrum approaches 10 billion. So you're adequately covered. So you buy a bond at 85 and you get par in December and you're going to get a 13% coupon while you wait.

Leon Cooperman: But now there are a lot of things to be done in the market. And my concern is the market is so trendy. When a trend reverses they take the [crosstalk] and play with the girls.

Scott Miller: Yeah. Your reversion to the mean is always a factor.

Andrew Schwartz: Lee, let me ask you this. If government is going to bail out big businesses every time there's a crisis and small businesses end up losing, aren't we in effect socialists?

Leon Cooperman: [crosstalk] small business as well. Aren't they-

Andrew Schwartz: They are now. I mean-

Leon Cooperman: But I just read now, in fact, if I leave your screen, that people's unemployment benefits are now exceeding what they were making when they were employed.

Andrew Schwartz: But I guess, why are we bailing out bad businesses though? I mean, if the airlines hadn't bought back stocks...

Leon Cooperman: Well, it's a form of social welfare. Go back to '08. If they let AIG go bust and didn't lend them assistance or Chrysler in the cycle before, it would have a lot of social welfare payments to make, which there would be a lot more unemployed people. So by helping out these companies that have a liquidity crisis, not a solvency crisis, you're avoiding the social welfare payments they would have to make to unemployed people.

Leon Cooperman: So I think that the government is doing what they should be doing. It's a shame that they had to do it okay? And there'll be a price to be paid for it in the long term, which the market is not focused on. Right now, the market is

focused on zero cost of money and we're coming back. My country club has 710 homes. They finally opened up to serve dinners, okay? I went to dinner the night before last and there were five couples that had the courage to go to dinner.

Andrew Schwartz: Right.

Scott Miller: Yeah. You can lift all the restrictions you want. Your consumer behavior is going to be a factor in recovery.

Leon Cooperman: I know people in the restaurant business. They tell me, "You cannot make money if you're less than 50% occupied." And with the social distancing, there's no way they're going to be 50% occupied.

Scott Miller: No, it's a tough road.

Leon Cooperman: I think we come back very slowly, and the market is coming back very fast. And you don't know whether it's because of zero interest rates and the government hands out all these checks where the money is going to Robinhood, not the charity, which I support. It's a great charity. But Robinhood the brokerage firm, they're playing in all these high, multiple stocks.

Andrew Schwartz: But if we're bailing out airlines who, and this isn't anything against the airlines, we're just using this as an example. The airlines spent the last 10 years buying back stock instead of putting away cash on hand. And now there's a disaster and we got to bail them out. Doesn't that somehow stifle innovation and the ability of little guys to create new things that we should be looking at? New models?

Leon Cooperman: I'm sympathetic to what you're saying, but I think this fire is something highly unusual.

Andrew Schwartz: Right.

Leon Cooperman: I mean the companies are suffering a penalty. I mean, people say that in '08, Lehman Brothers did go bankrupt, Bear Stearns didn't go bankrupt. If you own Bear Stearn stocks at 80, 90, or 100, and you got \$2, as far as you're concerned, they went bankrupt.

Andrew Schwartz: Yeah.

Leon Cooperman: So I think there's tremendous pain and suffering being inflicted on these industries being bailed out. The executives, United Airlines have options, which really are just totally out of the money now. And frankly, they could not have foreseen this virus, I guess.

Andrew Schwartz: So what's government's role going to be going forward?

Leon Cooperman: I believe that they're going to have an increased role in the economy. I think for sure you can forget about buybacks. I think they could end up dictating dividend policy. And I view that as a negative.

Andrew Schwartz: Yeah.

Leon Cooperman: I'm a capitalist with a heart.

Andrew Schwartz: Right.

Leon Cooperman: I'm actually, without any self-serving bragging, I've been very lucky. I'm the first generation in my family to be born in America, first generation to go to college. All my schooling up until my MBA was public school. Public grade school in the South Bronx, public high school in the South Bronx, public college in the West Bronx. I followed the advice of [inaudible] and I went West to, at that time was Hunter College, now called Lehman College.

Leon Cooperman: And I get an MBA from Columbia. I wind up at Goldman Sachs and had a great run. I've made a great deal of money. I respect money, but I don't have any enormous use for money. I've figured out 30 years ago, there are only four things you can do with money. And I'd say this to all your listeners.

Leon Cooperman: The four things you could do with money is number one, you could please yourself. Buy art, buy a home, buy planes, buy boats. I happen to be of the belief that much accumulated possessions brings with it aggravation. So I'm of the view, "Less is more." I don't collect art. I have nice art, but it's stuff that I like looking at. It's not valuable. So first thing you do with money is pleasure yourself. I don't like accumulating things.

Leon Cooperman: Second thing you do with money, give it to your kids. But if you have a lot of money, giving all your money to your children is a mistake because you deprive them of sense of self-achievement.

Leon Cooperman: Third thing you do with money is give it to the government, but only your schnook gives the government money you don't have to give. You pay your taxes. You're a citizen. You pay your taxes called upon you. But you don't volunteer. And I say the guy that's most knowledgeable of the tax code in America, who is a generous guy in the end, is Warren Buffet. Basically, he's given all his money away to charity, to Bill and Melinda Gates. He's not giving as little as possible to government, because he doesn't pay himself anything, he doesn't pay dividends, and he's going to give it all away.

Leon Cooperman: Fourth thing you could do with money is you recycle it back into the economy to make the world a better place. And that's what I've chosen. That's why I've taken The Giving Pledge with Buffet and supporting those institutions and organizations that made a difference to me and my family in my lifetime.

Leon Cooperman: But the government is in our pants. And that affects my thinking. I think the multiple in the market should be penalized for that role of government, but I

think they're doing what they have to do. And the economy is going towards more concentration, no question of bigger getting bigger and the successful getting more successful, as they should in some degree. I mean, why should we break up Google? I mean, why should we break up Amazon?

Scott Miller: Well, let me shift gears to China if I could. U.S.-China tensions have been rising for some time now. There's lots of talk about decoupling. There's a particular form of it that's happening on financial markets, which is the now bipartisan proposal in the Senate for the companies listed on the New York Exchange, headquartered in China, to have to meet all the SCC requirements for transparency. What do you think is going on there? And what's your overall view of this relationship, which is big and important but fraught with problems?

Leon Cooperman: Well, I would say I'm not an expert in China relations, but I would say that the president wants to get reelected and it seems that he's pivoting towards blaming China for all the problems. And that's probably not going to be, in the end, a good thing. I think what China is doing in Hong Kong is not doing... I think they had an obligation now to 2047 or 2050 to leave Hong Kong as it was, and they're now trying to take it over in an extreme way. And I think all this thing will lead to geopolitical tensions, which are not good.

Leon Cooperman: I believe in free markets. I believe the world prospers by world trade. We're all better off. I believe in the law of comparative advantage. I think that we're better off having peaceful coexistence with China. The world is better off with open and free trade. And these tensions in the end are not good.

Andrew Schwartz: But having tensions with China is becoming a bipartisan issue. Republicans and Democrats both viewed China unfavorably. Do you see us going down a bad road with China?

Leon Cooperman: Potentially, yeah. I mean, China's not going to roll over. I look at healthy competition. China innovates, we innovate. Target is a better company and Walmart is a better company because of Amazon. We tend to do our best when we're challenged. If you have the capacity and the knowledge and the work ethic, people that basically innovate, challenge other people. And so, I think it would be very bad if we try to legislate China out of business, rather than out-compete them.

Leon Cooperman: I do believe we should have a level playing field. So I think Trump has done a good thing by opening up a dialogue about trade with China. But I don't think we should take a political course.

Scott Miller: Yeah. Look, there are two ways to win a race. One is to run faster than the other guy. The other is to slow the other guy down. And I'm with you. I'd rather run faster.

Leon Cooperman: Exactly. In fact, it's funny you say that because when I was in business, I required everybody I hired to read about a parable, about a lion and a gazelle.

It says, "Every morning in Africa, a gazelle wakes up. It knows it must run faster than the fastest lion, or it will be killed. Every morning a lion wakes up and knows it must outrun the slowest gazelle, or it will starve to death." It doesn't matter whether you are a lion or a gazelle. When the sun comes up, you'd better be running.

Leon Cooperman: I think essentially, trade with China, competition with China is constructive if it's a level playing field. It has not been a level playing field. The president's tackled that, but I don't want to basically go overboard politically.

Andrew Schwartz: Let me shift a little bit and let me ask you about something else. You're a firm believer that education is the way to advance in America, that attaining a really good education is the way to get ahead. What do you see is the future here in education? Schools in doubt, online education might reinvent itself in a really great way.

Leon Cooperman: I think minorities are being screwed here by the shutting down of the economy and working at home. They don't have the computers and the infrastructure as some of the rich kids have. It's very unfortunate. Look, I just side to statistics. The average lifetime earnings of a college graduate is well in excess of a million dollars more than a non-college graduate. Okay? So the education gives them the skill set to be more competitive in the economy. And that's what my family and I have decided to devote a lot of our resources.

Leon Cooperman: We have something called Cooperman College Scholars, where we are paying college tuition for 500 kids in Newark, New Jersey to go to college. It would hopefully change the trajectory of their life. And I think faster economic growth will do us well to absorb more of the labor force.

Leon Cooperman: So it's faster growth of education. And it's not necessarily through the tax code. I do believe in the progressive income tax structure, by the way. I think rich people should pay more and what I've been rallying for five or six years and it can't get a straight answer for most people is, rich people pay the majority of taxes in the country. What should the maximum tax rate be on wealthy people? Because that will define the revenue yield to the government and the government has got to size themselves that revenue yield. Okay?

Leon Cooperman: If you ask Bernie Sanders, he'd say 90%. If you ask Elizabeth Warren, she'd play 70%. I asked Warren Buffet seven years ago what he thought. And he had a very rational response. If you make over a million dollars a year at 35%. If you make \$5 million more, 40%. Well guess what? Depending on what state you live in, you're already well past that. Okay? The federal is 39 and New York, Connecticut, New Jersey. What? Another 12, 13, 14% in total or something like that? So you're a well over 50%. California, 13%.

Leon Cooperman: So we're there and I think when you start asking people to give you a 60, 70% of what they make through their work effort, is just morally wrong. We may get there. I'll pay whatever tax are demanded of me. I'm not leaving the country, but I don't think it's the right policy.

Andrew Schwartz: Well, how do we get these people who have been left behind caught up? I mean, is online education going to be available to them? And will it be of value the way in-person education will be?

Leon Cooperman: Look, it's like you go to a dinner table, you see somebody sit down with an iPhone. They're your dinner companion and they're looking at their emails and their iPhone. I think we need social interaction. There's a lot to be gained. I made friendships when I went to business school 50 odd years ago with guys that I'm very friendly with to this day. Mario Gabelli is one of my closest friends. [Inaudible] Sandberg. We met at Columbia Business School, and I think there's a lot of benefit from social interaction. I don't think we want to be a society that is everything is virtual.

Andrew Schwartz: Do you think that this crisis puts us in a place where we just become a virtual society or do you think we bounce back?

Leon Cooperman: I think there'll be more working at home than there have been in the past. Real estate seems to be a big fatality. Companies have figured out that they could do more of this at home, but I don't think it's going to replace social interaction.

Scott Miller: Those of us who've been working at home for 11 weeks agree with you.

Leon Cooperman: I have a wife. I'm married 56 years, 55 years. I got to take her for a ride on the weekends because she has cabin fever. I ride to nowhere. I had an interesting ride last weekend. I went to Mizner Park in Boca Raton, and I saw a hundred cars on line waiting for free food. People that need meals. Terrible.

Andrew Schwartz: Terrible situation.

Scott Miller: Let people go back to work. You're absolutely right about that.

Leon Cooperman: Yep. Yep.

Andrew Schwartz: Lee, thank you so much for your generous time today. This has been absolutely fascinating.

Leon Cooperman: I want the country to do well and we got to work together.

Andrew Schwartz: Lee, we can't thank you enough. And surer words have never been spoken.

Leon Cooperman: Thank you very much.

Scott Miller: Yes. Thank you.

Leon Cooperman: Stay safe. Stay healthy.

Andrew Schwartz: Thanks for listening to the Reopening. If you liked this episode, please write us a review and subscribe wherever you find your podcasts. You can also find other podcasts from the Center for Strategic and International Studies at [csis.org/podcasts](https://www.csis.org/podcasts).