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Digital Transformation Creates Industrial Graveyard

Michael Markowski | Monday, 16 May 2016 16:39 (EST)

Now accelerating at warp speed is the transformation from the industrial economy to the digital economy, based on developments occurring the week ended May 13, 2016. Share prices of the digital economy companies Amazon and Facebook hitting all-time highs while and four major department store chains hit new 52-week lows has resulted in a new dimension of risk being added to the world's equities markets.

The carnage that I witnessed for all of the department store companies last week ranks as one of the most memorable throughout my 40-year career in the capital markets. What is now happening gives new meaning to the catchphrase ["the rich get richer and the poor get poorer"](#). See ["Old-school American Retail is getting Crushed by Capitalism"](#), May 14, 2016.

On Thursday, May 12, 2016, share prices of two of the companies leading the charge for the digital economy, **Amazon (AMZN)** and **Facebook (FB)**, hit all-time highs. Uber's shares do not trade because it is not yet a public company. Conversely, share prices of Hertz and six brick-and-mortar retailers that reported earnings for the week ended May 13, 2016 that have business models being disrupted by Amazon and Uber, all declined by at least 10%. The financial results released by all seven were well below the estimates of Wall Street's analysts. Amazon negatively impacted results for **Gap Inc. (GPS)**, and five department stores, and likewise... Uber impacted **Hertz (HTZ)**. Please see *Bloomberg's*, April 21, 2016 article entitled, ["Uber Overtakes Rental Cars Among Business Travelers"](#).

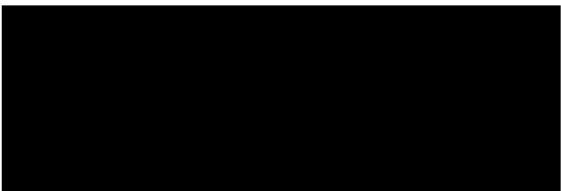
Share price performance for brick and mortar companies reporting earnings for week ended May 13, 2016

Company	Symbol	Price 5/6/16	Price 5/13/16	% decline
Hertz	HTZ	\$9.00	\$7.70	-14.4%
Nordstrom's	JWN	48.06	39.16	-18.7%
Macy's (M)	M	37.65	31.22	-17.0%
Kohls (KSS)	KSS	41.37	34.51	-17.1
Dillards (DDS)	DDS	67.10	59.86	-10.4
The Gap Inc.	GPS	21.67	17.34	-19.9
J. C. Penney (JCP)	JCP	8.26	7.31	-11.5%

What underscored the reporting of dismal financial results by the six retailers was that the US Commerce Department reported on Friday, May 13 that retail sales in the U.S. had increased by 1.3% for the month of April 2016. Gap and four of the five department stores reported year-over-year sales declines. The lone holdout, Nordstrom (JWN), reported an anemic increase. Upon its annual results last month, Amazon shares soared to new all-time highs, which were eclipsed this week. See April 28, 2016, ["Amazon.com Announces First Quarter Sales up 28% to \\$29.1 Billion"](#) press release.

The dichotomy between the financial results and share price action of Amazon and Facebook, and the seven household name brick-and-mortar companies should not be discounted. What happened since the beginning of 2016 is stunning! The week ending Friday April 13, 2016, would make the perfect pilot for *Nightmare on Wall Street*, a new series starring the Digital Economy as the villain, and the Industrial Economy as the victim.

Evolution of the transformation of the economy from industrial to digital that began in 1995 is not dissimilar to what happened after the transformation from the agricultural to the industrial economy that began in 1880. The manufacturers of horse-drawn carriages went out of business, while funders and developers of goods and services needed by the newly burgeoning industrial economy built dynastic wealth from 1880 to 1920. The video below entitled, "Decade ending 2020, best ever for creating dynasty wealth" provides details on the economic agricultural-industrial-digital transformation that has been underway since 1880:



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Over the 40 years that I have been in the capital markets, I have found that it is difficult for even savvy investors to grasp that there is *not* an infinite amount of capital available that can be invested into stocks. As of August 2015 the total value or [market cap of all U.S. stocks was \\$19.8 trillion](#). Because the amount that is invested into stocks is finite, there is a [yin and yang](#) effect. Capital moving into Amazon, Facebook and Google, driving their shares to new highs, is offset by the liquidations of shares of other non-digital companies. When an increasing amount of capital is allocated to digital economy companies the result is a decrease in the amount of capital that is invested into industrial companies. Therefore, the higher the share prices of the digital economy companies go, the lower the share prices of the industrial companies must go. The same principle applies to the price to earnings ratio.

That share prices of the world's leading digital economy companies Amazon, Facebook, **Priceline (PCLN)**, **Alphabet (GOOG)**, **LinkedIn (LNKD)** and **Netflix (NFLX)** traded at all-time highs since November of 2015 is very bad news for the global stock markets. The news is not likely to get any better for the global industrial economy. I predict that all six dominant digital economy pure plays will go to new all-time highs over the next 52 weeks. (My prediction assumes that the markets do not crash.) six are, and will continue to grow at double digits through at least 2020. All have cash flow models that are superior to 99.9% of all businesses on the planet.

Declaring that capital flowing out of shares of all of the world's brick-and-mortar companies into six companies having an existing aggregate market cap in excess of one trillion dollars — on its way to \$5 trillion — will “increase volatility” would be an understatement. There are many analysts who are predicting that Facebook, Alphabet and Amazon will eventually get to \$1 trillion valuations. One analyst is predicting that [Amazon could fetch a \\$3 trillion valuation by 2025](#). What is now happening is especially bad for those large companies that have brick-and-mortar business and revenue models that are vulnerable to Amazon and the privately held unicorn disruptors, including Uber and Airbnb, etc.

Digital disruptors are the industrial economy's biggest nemesis. They severely disrupt industries, some of which have been in existence for a millennium or longer. The taxi and limousine and hotel industries are prime examples of industries that are being severely disrupted by digital “attackers”.

Unquestionably, the most famous digital disruptors are Uber and Airbnb. However, the king of all of the disruptors is not Uber: it's Amazon, which was also the very first digital disruptor. Amazon was founded by Jeff Bezos to digitally disrupt the centuries old bookstore industry. From books, Amazon went into electronics, fashion and media, etc. Amazon announced that it was adding grocery items including coffee, tea and diapers to its private label offerings which would be available as early as the end of May. See *CNBC*, “[Amazon is launching new private labels, including food and diapers-WSJ](#)”, May 15, 2016. *MarketWatch* published the following article entitled, “[Amazon is about to overtake Macy's as biggest seller of clothing in U.S.](#)”, on May 13, 2016.

The Web brands of Amazon, Yahoo and eBay became iconic during the late 1990s. However, of the three, only Amazon had a digital disruptor business model. Both eBay and Yahoo were first mover companies. First mover companies are also members of the growing digital economy. Please see the video below entitled, “Why companies qualifying as a ‘First Mover’ have the potential to get to \$1 billion valuations almost instantly”:

Digital disruptors are lethal. Upon their models being honed they automatically begin to virally spread online to wreak havoc for the brick-and-mortar industry they are disrupting. The cash flow models of digital disruptors rank among the very best on the planet. They require very little if any advertising expenditures. I cannot recall ever having seen an advertisement by Amazon, Uber or Airbnb. The video below entitled, “Digital disruptor companies have the potential to get \$10 billion valuations quickly” explains what Uber did, and what other startup digital disruptors must do to become successful:

For the S&P 500 will prove to be the high for the current bull market that began in March of 2009. In my August 26, 2015 article entitled, "[Major U.S. Indices Will Go to All-Time Highs in 2016: Current Correction Underway will be Short-Lived](#)" I provided the logic for my recommending the six digital economy companies. The six went on to new all-time highs by the end of 2015. In my [December 2015 interview with Opportunist Magazine](#), I further elaborated on the phenomenon of the share prices of digital-economy companies going up, while shares of brick-and-mortar companies would be declining. The revenue and profits for the digital economy leaders will continue to grow at a double-digit pace for at least the balance of the current decade, and at the expense of the brick-and-mortar economy. The digital economy will continue to grow regardless of any calamity that might hit the world economy.

Since March 2016, I have been predicting that the indices of the world's developed countries have already entered into a bear market. Negative interest rates had begun to spread virally in February after the Bank of Japan instituted a negative interest rate policy. Prior to the onset of the negative rates, I had been predicting that the bull market would last until at least 2018. I had believed that it would take until 2018 before the digital economy would be negatively impacting the industrial economy's brick-and-mortar companies.

The two biggest risks that the world's economies and markets now face have surfaced since the beginning of 2016. They are negative interest rates and a digital economy that is exerting its dominance over the global industrial economy and its brick-and-mortar companies. Given this swiftly developing situation, there are only a handful of worthy large-cap companies in the world to invest in. They include the world's six foremost large-cap digital economy companies that I had originally recommended in my August 2015 article. They are now all back at the top my radar screen. Please see "[New Indicator to Predict Future Market Crashes](#)", March 7, 2016.

My recommending any large-cap, or any equity-related investment opportunities other than micro-cap companies or venture capital, is contingent upon an investor or their advisor being prepared to monitor the NIRP Crash Indicator (NCI) that I developed in February 2016. Please see "[Acclaimed Analyst Produces 'NIRP Crash Indicator'](#)"; also see "[Micro-Cap Shares Can Easily Multiply During A Market Decline Or Recession](#)". The indicator enables an investor to have what would be equivalent to a portfolio insurance policy. Disaster can be avoided by following a strategy of purchasing put options on their holdings, or a futures contract on the S&P 500 when the NCI reading goes to ORANGE (crash imminent) from YELLOW (caution). Such a strategy is only possible because the NCI's readings have been reliable and potent. Please see "[NIRP Crash Indicator Ideal for Futures Hedging and Trading](#)", May 11, 2016.

The six large-cap digital economy companies that are now on my radar screen are Priceline, LinkedIn, **Netflix (NFLX)**, Alphabet (GOOG), Amazon, and Facebook. **Disney (DIS)** is back on to my screen because it has the content that the six need to compete with each other. Shares of the shippers **UPS (UPS)** and **FedEx (FDX)** are also keepers. To compete, or just survive, all department stores and retail stores selling anything shippable will have no choice but to transition to conducting a higher portion of their sales online. As of the date of this report the six of the nine companies on my radar screen in the table below have been officially recommended. I will add Amazon, Facebook and Fedex upon their share prices correcting.

Recommendations @ 5/13/16		
Company	Symbol	Price 5/13/16
Alphabet	GOOG	\$709.92
LinkedIn	LNKD	127.04
Priceline	PCLN	1278.64
Netflix	NFLX	87.88
Disney	DIS	100.52
UPS	UPS	100.66

Shares of companies in this report that are being negatively impacted by Uber and Amazon should be sold on strength and should be avoided as long-term investments. I also recommend that the shares of **Wal-Mart (WMT)**, **Target (TGT)** and **Sears Holdings (SHLD)** be avoided. The shares of any and all brick-and-mortar retailers, which market and sell utilitarian products including diapers, bathroom tissue, detergents, less--perishable food items including candies, coffee, nuts, tea, etc., that can be easily shipped, should be avoided.

The shares of **Proctor & Gamble (PG)** should be sold in perpetuity. It is the one behemoth company that is the most vulnerable to Amazon's disruptive tactics. From reading Amazon's recent product private labeling announcement it is very clear that the attack that the "King of Disruption" is mounting will take market share from Proctor & Gamble. Proctor & Gamble, which generate \$76 billion of revenue in fiscal 2015, is completely defenseless against Amazon. Proctor and its brands, which include Pampers and Tide, will not be able to compete against Amazon's lower prices and same-day delivery system because all of the company's products are marked up and sold from grocery store shelves.

Finally, the shares of **Avis Budget Group (CAR)** should be avoided. Another huge and inherent disadvantage that retailers and rental car companies have (when compared to the digital disruptors) is traffic congestion. Shopping and purchasing habits of consumers have been permanently altered by worldwide traffic problems, the result of governments not adding adequate infrastructure. The preference is for purchases to be shipped to one's doorstep, and to ride in the carpool lanes. Traffic congestion is accelerating the transformation from the industrial to the digital economy.

industries will begin. I am currently working on a report that will include my recommendations for those companies positioned to benefit. The report will provide details regarding how online equity crowdfunding has the potential to become one of the largest sources of revenue for the digital economy and five of its leading companies.

The rapidly morphing digital economy, especially the emergence of online equity crowdfunding, was the impetus for founding the exclusive Dynasty Wealth (DW) Investing community. DW's specialty is to identify and produce ongoing research on companies that have the potential to multiply by 10- to 100-times in value within five years. Without the transformation from the industrial to the digital economy, which began when Netscape unveiled its Navigator browser in 1995, it would have been impossible to establish such a community. Digital economy companies — including disruptors and first movers — certainly manifest such potential. For example, a \$10,000 investment into Uber's 2010 private placement was valued for \$105 million in 2015, equivalent to a multiple of more than 10,000 within 5 years.

My 40 years of experience in the markets and the extensive research that I have conducted on the digital economy has enabled me to identify several outstanding disruptors and first movers. What distinguishes these is their potential to disrupt industries as large as, or even larger than the industries that Uber and Airbnb are disrupting. One recent digital-disruptor discovery is disrupting the \$593 billion grocery industry and its vendor supply chain. The company provides non-GMO and organic foods directly to a consumer's doorstep at prices that are below conventional foods. It also has patented a process that enables it to grow and deliver fresher and higher quality organic produce and at lower prices than now available in **Whole Foods (WFM)** and other grocery stores.

The most fascinating disruptor that I am now following is one that has developed software and systems that are very disruptive to the social media industry and Facebook. It quickly grew to over one million registrants after launching its beta version. Based on some new developments and the June launch of the next version of its software the company's monthly unique visitor count will grow by an annualized 10,000% by the end of the summer. The number of monthly unique visitors will grow from a most recent 80,000 to 10,000,000.

For an overview and access to links to the subjects that I cover, including the digital economy, negative rates, perfect shorts, and micro-cap stocks please go to www.michaelmarkowski.net. Free access to the NIRP Crash Indicator is available at www.dynastywealth.com.

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