



## The Dollar Auction Game Paradox

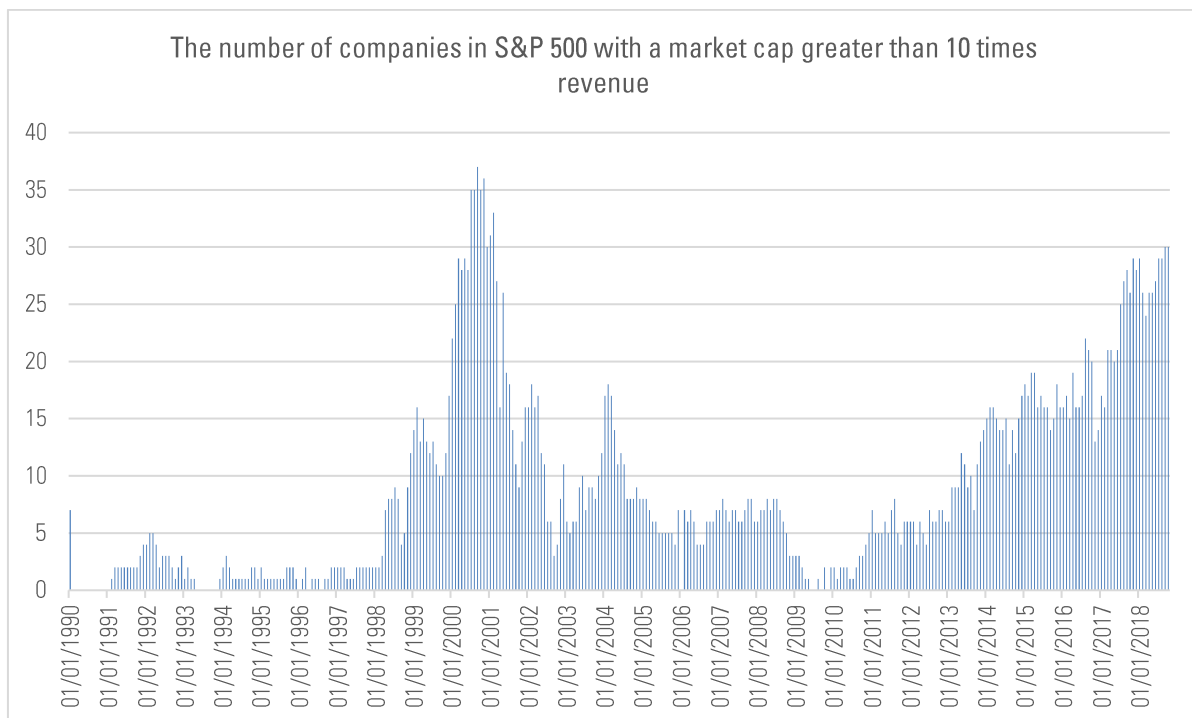
The Dollar Auction (Shubik, 1971) is a psychological experiment where a \$20 bill is auctioned off to a crowd. The rules are that highest bidder pays what they bid and receives \$20, while the second highest bidder also must pay what they bid. One would expect that the crowd would bid up to \$20 and no more.

Curiously, the bidding exceeds \$20 in most cases and can reach \$200 or more. Why? Auction fever. Bidding is exciting and the desire to avoid losses encourages higher and higher bids. People want to win; pride causes them to bid crazy amounts to win the auction, with any sort of rational thought long gone. In an extreme example of the experiment run by J. Keith Murnighan at Northwestern University<sup>1</sup>, the final bid amounts were \$1,950 and \$1,980. He noted, "Our two bidders were enormously overaroused and were unable to think clearly enough to realize the folly of continuing..."

I would contend that the stock market has a similar reality/value dynamic.

Like Soros says when value departs from reality it is normally the start of the bull market, not the end.

This global equity bull market is stretched by any metric and one chart which I really like is the one below, a chart showing the number of companies in the S&P 500 trading at a market cap of greater than 10 times revenue.



Source: 36 South, Bloomberg

What does 10 times revenue really mean?

No-one says it better than this....

<sup>1</sup> <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.924.5213&rep=rep1&type=pdf>

*It was almost a year ago I wrote “What Were You Thinking?” referring to a quote from an interview with Sun Microsystems CEO, Scott McNeely, that he gave a year or two after the peak of the DotCom mania:*

*At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at \$64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?*

Jesse Felder, The Felder Report, 27 September 2018<sup>2</sup>

And so we sit and observe and start knitting jerseys and balaclavas for the T-Rexes – the ice age, she is a-comin'!

*Engage people with what they expect; it is what they are able to discern and confirms their projections. It settles them into predictable patterns of response, occupying their minds while you wait for the extraordinary moment — that which they cannot anticipate.*

Sun Tzu, The Art of War

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<sup>2</sup> <https://thefelderreport.com/2018/09/27/yes-the-stock-market-is-just-as-stupid-but-hit-crazy-expensive-today-as-it-was-at-the-peak-of-the-dotcom-mania/>