Social Capital's performance vs the S&P 500

	Annualized Percentage Change	
	Gross IRR	In S&P 500 with dividends included
2011 - 2018................	29.4%	13.5%
2011 - 2019................	32.9%	15.0%
Overall Gain	997%	325%

To the supporters and stakeholders of Social Capital:

This is the second of our annual letters where we discuss our investments and other thoughts on technology, markets, and our mission.

Eight and a half years ago, we started Social Capital to tackle hard problems like cancer, space exploration and climate change at a time when few investors were doing so. While many investors fawned over social networks, photo-sharing apps, and other consumer-oriented investments, we invested in healthcare, education, and frontier technology businesses like space exploration and artificial intelligence. Many of the companies we backed were initially unable to raise money from other institutional investors until we stepped in to give them the long-term, patient capital they needed. We hoped that we would be rewarded for these bets in good time. In 2018, this hope started to become a reality and we concluded that the traditional approach of fund management and asset gathering wasn't going to be enough. It would definitely generate huge fees to put in our pockets but, ultimately, not make a meaningful impact in achieving our mission. This is a difference that makes a difference in today's increasingly complicated world and so we iterated. We closed ourselves to outside capital and became a technology holding company in mid 2018.

As we write to you today, we look forward, optimistically, to the future despite its intermittent calamities. As the world changes, our tactics will evolve but our goals will remain the same: we want to empower entrepreneurs to solve the world's hardest problems while generating compounding returns, both economically and socially, for the long term.

What the hell is going on

Imagine a time of incredible economic expansion and wealth creation punctuated by periods of class warfare, strife and political upheaval. During the Gilded Age of the 1870s-1900 we saw all of these: rapid economic growth, wage growth, immigration and expansion of social programs like education with the standardization of primary schools and the emergence of high schools. At the time, the major industry of growth was the railroads which in turn led to technological expansions in factories, mining and farming. As is the case today, Wall Street played an important role during the Gilded Age as a financial intermediary and financed everything including a bubble in railroads which eventually burst. While this economic expansion was happening, immigrants fled to America in droves and a class division started to emerge with the 1% owning more than 25% of all property and the bottom 50% owning less than 4%.

If you replace 'railroads' with 'technology' and re-read these last few sentences, does any of this sound familiar?

During the Gilded Age's 30 year run, there were two major market shocks - both depression-level in their intensity and effect on the economy - The Panic of 1873 and the Panic of 1893. The post Civil War South remained economically devastated and its economy couldn't functionally evolve away from low-value commodities. Politically, people were more active than ever with the two parties roughly splitting sentiment and votes. That said, the era was marked by a slew of forgettable Presidents with much of the focus on Congress and local governments even though Congress was largely impotent and stalemated.

If you replace 'The Panic of 1873 and the Panic of 1893' with 'The Dot-Com Bubble and the Great Financial Crisis' and 'post Civil War South' with 'The Heartland' does any of this sound familiar?

Societally, the Gilded Age saw the beginning of many important social movements including the push for a women's right to vote, the protection of workers through unionization, the ending of child labor and the awarness of the negative consequences of monopolies. Meanwhile the leading companies of the day, the railroads, began to become reviled. Farmers became focused on the monopolistic nature of these carriers and began demanding price caps. A constant refrain of negative rhetoric was associated with these railroad companies. The most hated entrepreneur in the country was Collis P. Huntington, the president of the Southern Pacific Railroad. Per a textbook on the topic: "Huntington came to symbolize the greed and corruption of late-nineteenth-century business. Business rivals and political reformers accused him of every conceivable evil. Journalists and cartoonists made their reputations by pillorying him.... Historians have cast Huntington as the state's most despicable villain."

If you replace 'Collis P. Huntington' with 'Bezos or Zuckerberg'...well, you get the point.

It's now most useful to go to the punchline. The Gilded Age seems to have many similarities with today - both economic and societal. That said, it's most important to ask not what was right or wrong with the Gilded Age, but what came of it? How did Americans internalize the dynamics of the period and respond? What can we learn from this and how similar may our reactions be today? The answer is that the excesses and lopsided nature of the Gilded Age ushered in the Progressive Era, which is elegantly summarized in Wikipedia as follows:

"The Progressive Era was a period of widespread social activism and political reform across the United States that spanned the 1890s to the 1920s. The main objectives of the Progressive movement were addressing problems caused by industrialization, urbanization, immigration, and political corruption. The movement primarily targeted political machines and their bosses. By taking down these corrupt representatives in office, a further means of direct democracy would be established. They also sought regulation of monopolies (trust busting) and corporations through antitrust laws, which were seen as a way to promote equal competition for the advantage of legitimate competitors. They also advocated for new government rules and regulations, and new agencies to carry out those roles, such as the Food and Drug Administration."

The modern gilded age

Over the past thirty years, we've seen our own version of the Railroads and have created our own Gilded Age. A few companies have done wonderful things with technology, creating a massive downdraft of costs and an attendant upswing in value - a consumer surplus like we could have never imagined. But it came with a cost.

For a few companies, entrepreneurs and their employees, massive gains in wealth, status and influence were realized. Meanwhile, for the rest, wages stagnated, insecurity grew and the cost of this lopsided economic allocation became increasingly obvious. Most people are now left to internalize why they won't live better than their parents, and even more concerningly, that they won't be able to give the chance of a better life to their children. In turn, populism is on the rise. Whether its via surrogates on the right who want stricter borders and nationalistic economies or their equivalents on the left that demand universal social programs, increasingly loud refrains are being made for change - *any change*.

Whether you believe in it or not, or whether you like it or not, these changes are easily visible through the political proxies that represent them. And while the first versions of any product (iPhone, Facebook, Google Search) are modest in scope, they are deep in ambition and the political theater and its populist iterations are no different. Well after Trump, Warren and Sanders are political footnotes, newer, faster, better versions of progressive ideals will be at hand both in the US and abroad and the world will be at a political crossroads.

In *this* context, the last few years seem very much akin to the beginning of the end of our modern Gilded Age and the beginning of a new Progressive Era.

The tightening of the regulatory noose

The first signal that the modern Gilded Age is ending will be symbolized by reigning in Big Tech (MSFT, AAPL, AMZN, GOOG, FB) and the only way to do this effectively is with trust busting. Across the world, governments are realizing a growing responsibility to act by stepping in and attempting to break up these behemoths, forcing divestitures, demanding transparency, and in the specific case of ad-based businesses, modifying auctions to limit artificial bidding wars and disabling broad scale data gathering and surveillance of people. While some may argue that this is, in some ways, anti-capitalist, this is the most realistic way of making capitalism work for everyone versus the few.

As governments and regulators take this first step, they will have to be careful to make sure Big Tech doesn't find a way of helping write the regulations to promote and cement their monopoly. In order to do this effectively, regulators will need to convene broad groups of disinterested experts who can cogently explain how each of Big Tech's business models work, what the positive and negative effects of them are and how to ring-fence their impact, protect and promote small businesses and guarantee individual civil liberties and privacy.

If the regulator's efforts are successful, Big Tech will be broken up within the decade.

This means that some of iPhone, Azure, AWS, Amazon Retail, Google Search, Youtube, Gmail, GCP, Facebook, WhatsApp and Instagram may all be distinct companies who are explicitly not allowed to share data amongst each other. Further, any of these companies with a 3rd party ad-network capability will have to divest it. This initial phase will allow the "demand" side of the internet economy to more effectively compete with the "supply" side.

The second step in ending the modern Gilded Age will be taxation.

Governments will eventually demand that any revenues and profits generated by Big Tech inside of their borders from their citizens should be subject to local taxes. While, initially, this will be a sticky issue with respect to tax treaties, tariff wars and the like, the reality is that the increasing nationalism in various countries is a trend that is at its beginning versus its end and makes this outcome more and more likely. Further, exogenous events like the coronavirus pandemic will make stronger cases for more resilient *national* economies, *less* globalization and *more* restrictive borders and trade agreements.

If these first two phases come to pass, it will dramatically slow down how Big Tech compounds their monopolies by making them smaller and less profitable. By slowing down their profitability and ability to use money as a weapon, governments and regulators will help prevent lock-in and incentivize more competition.

The last step in ending the modern Gilded Age is changing market incentives specifically around stock based compensation, M&A and taxation of options.

Governments can do a lot to make it more expensive for Big Tech to hoard human capital and allow this talent to flow more naturally to small businesses and startups so that they can more effectively compete and create vibrant ecosystems. They can do this by making stock based restricted stock unit (RSU) compensation extremely expensive to companies above a certain size or profitability by taxing them more onerously and forcing GAAP reporting of stock based compensation. At the same time, they can favor a more simple, remunerative tax treatment for employees who choose to receive stock options or income from small companies. Lastly, governments should prevent any further M&A from Big Tech including the deceptive practice of acqui-hiring.

Essentially, by making the incremental engineer more costly for Big Tech while making that same engineer less expensive for startups, we can stimulate an entirely new wave of entrepreneurship we weren't expecting.

If these steps are undertaken, Big Tech will be crippled. If one reads the tea leaves, it seems like it is the time and many governments are sounding the drum to action. While Big Tech initially created a lot of value, the incremental value they deliver now comes at too high of a cost if these companies are left intact as they are. The value created is an increasingly decaying function (it's difficult to name something truly innovative that Big Tech has invented in the last decade) while the need for true progress is increasing.

Climate change is worsening every day. Life expectancy in developed nations is plateauing or even falling and the education system is increasingly failing young people in preparing them adequately for the future. These gaps could have been filled by the massive R&D budgets of Big Tech (cumulatively more than $600 Billion in the last decade) who promised to change the world and eradicate its evils, but it's clear that it isn't happening as they seem more focused on protecting their monopolies than advancing humanity.

If not waiting on Big Tech, we could also continue to wait for governments to step in and solve these issues. This is naive as the reality is that they can't and they won't. The gridlock in Washington, Brussels and elsewhere means that entrepreneurs are needed more than ever and that smart, ambitious ideas are society's lifeblood.

Talent hoarding

Another overlooked outcome with the rise of Big Tech is that it has been conducting a massive intellectual sterilization and greenmailing of STEM grads. Again, imagine what these thousands of new grads could be doing in climate change, healthcare or education? Instead they ended up collecting massive RSU packages to work on irrelevant features for long-tail products that impact very few or stale, irrelevant features for products that are already at scale. I have tried to recruit too many smart people who are wasting their prime years of productivity working in Big Tech because ‘the pay is too good’.

We have a responsibility, as a society, to stop this talent hoarding. We went through a similar intellectual lobotomization leading into the Great Financial Crisis. At that time, talented STEM graduates were seduced by tantalizing pay packages to work at hedge funds. PhDs in physics were more likely to be working on options trading models than working on next generation clean energy or space exploration.

After the GFC, STEM grads fled Wall Street in droves but the lobotomization didn’t stop because Big Tech took over the starring role. Carbon sequestration? Resource scarcity? Materials Science? No thanks. Photo-tagging, short form video uploading and ad targeting were the work du jour.

A new space race

A common theme amongst optimists is how much technological advance we have seen and how these advances seem to be accelerating. I am of the opposite camp and believe, roughly, that the rate of progress has been steadily declining since we landed on the moon in 1969. While I can’t explain the 1970s and 1980s, the modern Gilded Age’s lack of technological progress is easier to understand. The intellectual lobotomization of smart, young STEM talent has been an explicit strategy by Big Tech fueled by unseemly profitability and hi flying stock prices. If you can’t innovate but are wildly profitable, wouldn’t *you* also just pay the incremental talented engineer to work for you *on anything* versus working for a competitor or, worse still, work for themselves and invent something disruptive that could impact your monopoly? Of course you would...and they have.

If you were a bright, ambitious engineer graduating in STEM in the early 1960s this wasn’t the case. You went to work on something meaningful. The momentum towards spaceflight was a call to arms for the smartest and hardest working amongst us. These bright men and women worked to invent new capabilities and entire ecosystems in fuel cells, gas storage systems, thermodynamic materials, engines, mechanical timers and clocks and control systems to name a few. The cost of the entire Apollo program was $25 Billion or $150 Billion in today’s dollars.

Big Tech spent $75B on R&D in 2018 alone. Put another way, this means that in two 2018 equivalents of R&D spending, Big Tech could have sent people to the moon and back. It's fair to say, however, that what we have witnessed instead can graciously be described as something less ambitious and impactful than that.

This misallocation of capital won’t end until we demand it - every government, regulator and individual now has a role to play whether you know it or not.

On markets
I am generally of the view that we have exhausted the ability for central banks to meaningfully manage inflation, in either direction, but that doesn't mean it won't continue to drive stock prices higher by unnecessarily cutting rates and flooding markets with money. Our simple framework is this: as money gets cheaper, the credit markets continue to expand because CEOs become motivated to artificially boost EPS. They do this by buying back stock, seek bad acquisitions, make poor capital allocation decisions or avoid taxes. All enabled by borrowing massive amounts of essentially free money. It shouldn't surprise you to know that these decisions also result in ever increasing CEO pay.

And as rates continue to fall, investors are forced to re-evaluate risk premiums and look to own growth of any kind, even if that growth is in year 5+ of a business plan (a forecaster's wet dream). The result is a seemingly ever higher stock market. For the programmers reading this, let me summarize this in pseudo-code:

For a company:

```
while interest_rates_tomorrow are less than or equal to interest_rates_today
        borrow cheap money
        buy back stock
        show wall street rising earnings_per_share
        get paid more
repeat
```

For an investor:

```
while interest_rates_tomorrow are less than or equal to interest_rates_today
        focus on years 5+ of any model if it shows growth however unbelievable
        buy the stock
        if the company is buying back stock
                buy more stock
repeat
```

As you can imagine, this has created a complex, interconnected credit-equity bubble. And like other bubbles before it, it will end badly. When it does, hopefully the human toll of these nested bad decisions aren't too significant. In the case of Boeing, however, part of the hard landing has already been written and the consequences have been devastating with the loss of 346 innocent lives in two plane malfunctions. Digging deeper, it seems we can trace these tragic outcomes, in part, as the result of poor capital allocation and decision making by a CEO focused excessively on his compensation. Per the incoming CEO of the fired CEO:

"I'll never be able to judge what motivated Dennis, whether it was a stock price that was going to continue to go up and up, or whether it was just beating the other guy to the next rate increase," he said. He added later, "If anybody ran over the rainbow for the pot of gold on stock, it would have been him."

I hope all CEOs reading this internalize how important it is to build a sustainable business and remember what Charlie Munger says about your incentives:

"Show me the incentive and I will show you the outcome."

On performance

We had a fabulous year in 2019. It was our first full year operating as a holding company with no pressure from limited partners or the need to raise funds and manage the resulting incentives that come with partnerships. I've learned that investing isn't a team sport. Company building is a team sport but capital allocation isn't. It's about a few good decisions, from time to time, supported by a lot of idiosyncratic thinking, reading and debate. I'm thankful to my team who helps me make these good decisions.

Our returns last year lifted our inception to date ("ITD") performance by more than 350bp. We only report ITD performance because this is how our money compounds and allows us to not overly scrutinize any one year but focus on a repeatable pattern of long term thinking and behavior. Since inception in 2011 we have compounded our money 997%, beating the S&P 500 (with dividends reinvested) by more than 3 times.

At the same time, in 2019, we generated more than $1.7 Billion in cash and cash equivalents. This focus on liquidity was an important goal. Liquidity will be increasingly important over the next few years; as you read this remember the moments of widening credit spreads, frozen repo markets and flash crashes. Selling, when appropriate, and generating cash in a thoughtful way seems to be a prudent decision for the next several years. The impact of externalities and exogenous events are no longer priced appropriately into the market - which seems to us as a signal to focus on it. Cash on hand will result in buying opportunities, even if they are short in duration, as the tide runs out from time to time and exposes the naked among us.

In 2019 we completed two transactions. The first was an investment of more than $500M into Virgin Galactic creating the first and only publicly traded commercial human spaceflight company. We were given the opportunity to partner with Sir Richard Branson and his amazing team at Virgin and Virgin Galactic. A more charismatic, amiable and optimistic person I have yet to meet and it has been an honor working with him and his team thus far. The second company (which we are choosing to keep confidential for the time being) was an acquisition of a venture backed company that had raised almost $100M of traditional VC money. We bought this company because of our belief in their technology and market. I'm excited by both of these investments and think very highly of their long term prospects.

Cash versus options

This second acquisition also allowed us to do something unconventional focused on employee compensation - we eliminated all options and paid people more. We asked what the salary surveys for each role in the company were and proceeded to pay everyone at the 100th percentile. Typically, startups pay at the 40-50th percentile and make up the difference with the potential future gain of options. Companies like Netflix, however, have shown that high cash compensation is oftentimes more valuable and helps retain their most experienced and high-performing talent. We have embarked on this path with this company and will replicate it wherever we can. We think paying people a high current income is what is *most* useful to *most* people. It allows them to live well, take care of their family, focus on working on what they love and allows the company to buck the trend of poor retention rates typical of most startups. For those employees that also want to own equity, we make it available each year for purchase. This is the truest form of ownership. Like in the stock market, you pay money for owning a piece of a company you want. Regardless, by paying a much higher living wage, we think we are making more content, happy and better retained employees. If we had a typical minority position in a startup, these changes wouldn't have been possible because the venture capitalists would have surely blocked it.

Anti-correlation of money raised to value created

While some venture capitalists have proven to have great intuition and good capital allocation decision making, most of them are not up to the task of partnering with entrepreneurs to help usher ambitious new ideas to fruition. These ideas could be a compensation idea like the one above, or, even more importantly, the reason for the company to exist in the first place.

Now more than ever, the practitioners of venture capital continue to decay in capability and the historical experience they draw from - they've never done anything important! They are increasingly motivated by the incentives of up-rounds, bigger funds and fee-based compensation. The flood of fast money has created a surfeit of these overnight practitioners with questionable sources of capital and even more questionable backgrounds. The most telltale signs of this trend are in the decaying governance in high flying unicorns and the ravenous capital consumption of some of these companies.

Consider the following:

Big Tech raised a total of $1.345B in venture capital before going public of which $1.3B was Facebook alone. This means that Apple, Amazon, Microsoft and Google raised less than $45M *combined* before IPO. Even on an inflation adjusted basis, this is incredible and tells something very important about a raft of today's startups.

They are not technology companies. They are tech-enabled hybrids. Tech companies don't need to raise a lot of money. So to all employees out there: beware of the company that raises too much money and calls themselves a tech company. And when the founders are selling in these ever increasing rounds but you, as an employee, are not allowed...well...it says something dysfunctional about the governance, CEO, business model or all of the above.

While there is nothing wrong with being a tech-enabled hybrid, the returns, business model quality and valuation frameworks are different than those of tech companies. As we've seen with WeWork ($14B raised), Uber ($25B raised), Lyft ($5B) and a few other hi flying private companies, the public markets will rationalize valuation and enforce a valuation model that won't allow tech-enabled hybrids to be valued like pure-play tech companies.

Expect more of these valuation resets as companies stay private longer (dumb), have poor or negative unit economics to drive growth (dumber) and continue to be over capitalized (dumb and dumber to).

Board members have a responsibility to help founders navigate these complexities but, except for a few VCs, the venture capital industry is letting down an entire generation of founders. A reminder to founders: VCs are incentivized to generate high salaries via ever larger funds and their attendant fees. Beware the VCs that raise funds every year - the best practitioners take their time and do not get distracted from the real prize - carried interest - which only comes when you and your employees are successful. As it turns out, grin-fucking you so they can write a big check and get closer to raising a new fund is easy to do but being a line in the sand that enables good decision making and helps you be patient while they, themselves, practice it too is much harder. Especially in today's gold rush venture capital mindset. Pick your VC wisely.

A corollary to this is that as governance has decayed and the focus of most VCs is on uprounds and markups, there has been a meaningful decay in strategy at many startups.

Startups are increasingly building product features that depend more on a balance sheet of capital to differentiate themselves versus customer value that is unique and defensible. This creates feature wars that quickly become balance sheet wars when other startups or incumbents decide to copy these features. Free stock trading, hi-rate savings accounts, subsidized hardware tied to software, vacation rentals and ride sharing are some current examples.

While any one feature can quickly drive customer adoption, if capital allows others to compete - they invariably will. The problem with this kind of decision making is that your original customer has now come for a free toke of a cigarette butt - for a feature that has costs, but is subsidized by your last fundraising round. If you then expect that same user to stay for a paid, three course meal, you may be disappointed. Said differently, if you encourage your users to act like hobos, they will, and your only solution is to keep raising capital which isn't always possible.

Work with us

Many of the opinions raised thus far are complicated and potentially off-putting. That said, our track record has reaffirmed our need to be, if nothing else, candid and honest. In that spirit, we would be remiss without speaking directly to entrepreneurs and employees reading this: if you are working on something hard and useful, we want to meet you. Maybe we end up partnering with you so you can work on these ideas in a supportive but challenging environment where capital is plentiful, compensation is great and a compelling need to change the world is the priority.

Living a life of purpose and forgiveness

As we enter the final years of the Gilded Age and usher in the Progressive Era, a more civilized culture will hopefully abound. Today, it's not just the stock market but also the fragmentation, polarization and judgement that are at all time highs.

Is this really the hallmark of a society that is progressive? No. It's the remnants of unhappiness, resentment and anger that personify the Gilded Age. That said, it's so much easier to be happy and see the bigger picture when you focus on what matters. So how does one focus on what matters? I've found it possible by asking questions like "what matters to me?" and "what is important to me?" These may sound like the most basic questions but they are also the most critical. And especially now, these are the questions that need lucid, non-judgemental answers from each of us.

For me, I have learned that my family, my health and what I know (knowledge) are the most important things that matter to *me*. Work, money and friendships are important but come strictly after the first three. What doesn't matter? Everything else, particularly, what others think about me and my decisions.

These truths about myself help me make defensible decisions and focus on the long-term impact I choose to have. To get to these truths about myself, I spoke to many dozens of people to learn what is important to them, why, and how they got to those realizations. These people have represented all levels of success and failure and beyond what I learned from them explicitly, my implicit learnings on this journey have been even more important which I offer here:

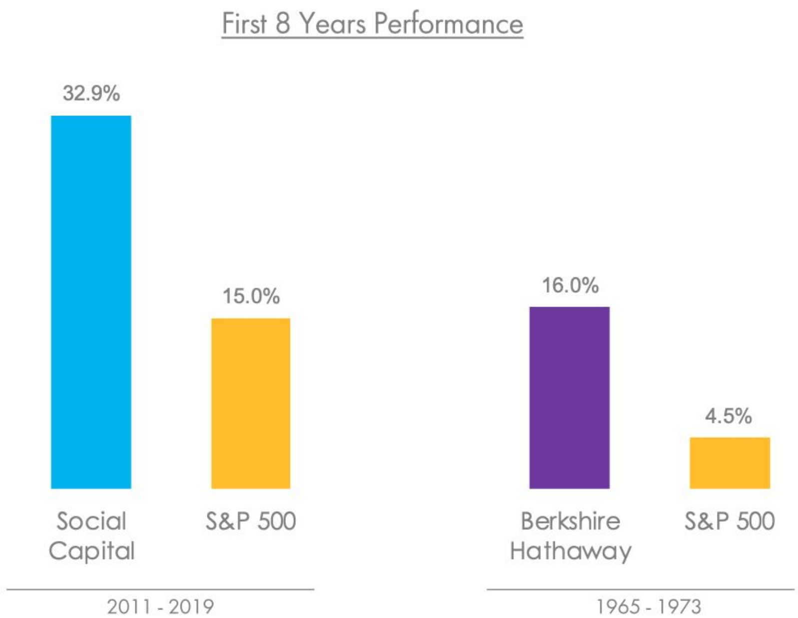
- *Be emotionally rich and available.* It's worthwhile and teaches you to have the patience to be compassionate versus harsh. Then observe what happens when you follow this advice.
- *Be coherent and honest with other people.* It makes life much fairer for both yourself and the person in front of you. When you practice honesty with compassion, amazing relationships will be born.
- *Take the advice of others but carefully consider how it applies to you.* What works for others may not work for you.

Secrets hidden in plain sight
Along the way, I've also become more observant of simple truths that are presented to us every day. In the crush of day to day life, these secrets are hidden, but when your mind slows down enough to take them in, their simplicity and elegance are worth internalizing. I offer one of them here:

"Put on your oxygen mask before helping others"

We've been told this innumerable times on airplanes and see it written in the safety cards in the seat pocket in front of us. But what it says is something beyond the obvious which is that you cannot help others until you help yourself. When you are at your best, you can give your best in any situation and to those around you. Keep that in mind as you build for the long run.

And speaking of the long run...



Respectfully,

Chamath Palihapitiya
CEO
March 9, 2020

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The performance from S&P presented “in S&P 500 with Dividends Included” represents the gross return of the S&P from contribution dates from all private funds through December 31, 2019. The S&P figure is determined using the total dollar value of the index as of December 31, 2019.