

## ‘Tis the Season; Signs of the Impending Holiday are Everywhere

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Letter No. 101

The Holiday blitzkrieg has begun. There are parades, decorations, mass media messaging, Hallmark movies, and so much more. The western world is consumed with an upcoming holiday season. As I write this (on the third Sunday in November), it seems an oddity that we haven't even enjoyed Thanksgiving Day with all of the blessings that surround that special holiday. The bigger event, the annual commercialized year-end holidays, are already in focus. They're here. They are hard to miss. The signs are everywhere.

Actually, this isn't much different from what is happening in our markets either. I believe we are in the midst of a grand, potentially late-cycle bull market party with all of the signs of excess on full display. That is also hard to miss. The bull market party has been building a head of steam for over a decade, and now many of the charts of the most bullish of bull stocks are going up rather quickly, an exciting (but potentially dangerous) development. The last great bear market (the housing crisis of 2008-09) has become a distant memory. There is an entire generation of investors and speculators that never experienced the pain and helplessness that nearly everyone else felt watching their investment portfolios melting away in that last rout, many losing half (or more) of what they had acquired (on paper). House flippers likely fared much worse.

Our Federal Reserve has been feeding greater and greater financial liquidity into the system (so as to underpin the economy, and by extension, the markets) for so long that some may now believe that bear markets are simply a thing of the past. With each day that passes where the major stock averages continue to grind higher and higher, ever greater confidence is instilled into its participants. As all bull markets go, eventually the mood becomes giddy, the levels of risk-taking start to run amok, bravado results in more and more leverage (so as to amplify one's gains), and soon enough we are left with a full-on *"carnival-like" atmosphere* where everyone comes to believe they can get rich quick. It is the stuff bull markets are made of.

There is some sage advice that came from a famed investor nearly four decades ago;  
*“...bear markets are born out of maximum optimism.”*

*– Sir John Templeton –*

Just as the signs of the upcoming holidays are everywhere today, the signs of great optimism can be found in nearly every corner of our domestic markets too. You don't need to look very far. To veterans of the markets, here are some of the signs of excess:

- Sustained rallies with little to no pull-backs or corrections
- Record amounts of leverage
- Low ratio of puts to calls (option positioning)
- Different stocks attracting very high levels of volume, often on suspect news announcements and frequently when there are high levels of “short interest”
- Larger percentage of stocks with little to no current earnings; many without positive cash flows (“story stocks”)
- Extremely high levels of traditional financial ratios (price/earnings; price/sales, price/book value, etc.)
- Analysts constantly upgrading future price objectives just to stay ahead of spiraling stock prices, some who may be abandoning their own financial disciplines in the process

Of course, no one knows when the top tick will arrive, thus bookending this current bull market. No bell ever rings at the exact top. The signs of great optimism above have been a hallmark of every prior late-stage bull market cycle, yet they are just a sampling of such late stage behavior. Yet, the crowds keep showing up to trade in their favorite stock du jour. I can't blame them; markets exist for the purpose of providing a platform for buyers and sellers to come together and swap at a given price. Many of those participants understand risk, they are well-informed, and they have confidence in their trading abilities. Further, not all of their objectives are the same. While some participants buy a stock with intent to hold it for the very long-term (which could be measured in years or even decades), others may have the intent to only hold a position for a few days, or a few minutes, or sometimes, **just for a few seconds**. We can never underestimate all of the machinations that go into the daily volume of trading.

“New Era” themes are now on full display, such as electrification, green energy, artificial intelligence, the cloud, the “metaverse,” the “omniverse,” and so on. One challenge we all face today is that the future of tomorrow is still a long way away. Where markets used to “discount the future” with the consideration of where things might be in a few quarters or a year or two out, today the market-leading stocks seem to be discounting a future much further out, perhaps by an entire generation or more. A relatively new buzzword is “Total Addressable Market” (TAM for short). With TAM, investors are weighing just how big certain markets can get, and just how much value should be afforded to companies today that might still be around for those big TAM’s of the future. At some point investors and speculators will be forced to address accuracy, because the future rarely turns out to look like some of the biggest assumptions being made in the present.

There was a great message on a social media platform this week:

***“The losers buying gas cars in 2021 have the same mindset as those buying horses in 1921”***

This was followed by a reply from a well-respected veteran financial news writer:

***“... The real losers will be those buying EV stocks in 2021, just like those buying auto stocks in the 1920’s...”*** (EV stands for “Electric Vehicles”).

The late 1920’s was an era that was significantly influenced by the fast-growing motorcar industry, as it might have been one of the most impactful industries of that era. In addition to the millions of autos being produced, it supported a rubber industry for tires, a steel industry, a gas and lubricant industry, road and transportation infrastructure, and so much more. Like every new industry though, it may have gotten ahead of itself from the standpoint of public participation in the capital markets. More and more people piled into the available publicly-traded stocks of that time (often using borrowed funds so as to leverage their returns) in the hope of goosing their portfolios from the seemingly endless prosperity. Sound familiar? Eventually this over-bought, over-valued, over-bullish wave gave in to the mighty crash of 1929 and nearly everyone suffered in the wake of the ensuing disaster. Suddenly, all of the things that reinforced the bullish behavior on the way up was reinforcing the collapse on the way down. Losses in stocks and losses from bank closures left little extra cash or available credit to buy autos. It sent the entire industry, along with its many suppliers and ancillary partners into a deep retrenchment. The more that were laid off from the factories, the fewer that were left

to do the consuming. Econ 101, supply and demand. Many of the smaller manufacturers of that era could not stay in business. Hundreds of companies servicing the new era of transportation closed their doors while only a few survived (but with great struggle), such as Ford, Packard, Crosley, Plymouth, Studebaker, and GM, among others.

The equivalent of a massive modern industry today is the alternative energy industry, and all of the ancillary businesses and technology that support its growth. Like the car companies of the 1920's, many companies today are fighting and scratching to create a niche in this vast industry, but many are dependent upon stock investors willing to take chances on unproven upstarts for their seed capital, often with little or no financial track record. A lot of companies have come into existence with a business model that can't support real earnings for many years into the future, if ever. Many more are simply "story stocks" where there is a lot of "sizzle" but maybe not so much "steak." This will likely continue to evolve, and there are likely to be long-term winners and losers, but in the moment the market has been awfully generous in supporting nearly anyone and everyone with a marketable idea in this particular space. Once again, many market veterans can find much to be alarmed about, but it is up to each individual to assess their own individual tolerances for risk of potential loss and invest (or speculate) accordingly.

So what is the seasonal holiday message in all of this? Where might we be headed? For those who have been invested in the stock market for a long time and who track the markets closely, there are plenty of early warning signs that we have likely entered the silly stage for stocks, options, and other "at risk" investments, but that doesn't mean it is going to end any time soon. I can't emphasize enough that it cannot be known in advance when the last upward gasp of the markets has been taken. You only get that with the benefit of hindsight. Optimism is pervasive, and I'll leave it at that. Bull market cycles find new participants. When markets are in the midst of a powerful upward trend and it seems as though anyone can get rich, greed can easily win the day. When an easy profit is made once, the natural reaction is to go back for more. Greed is why casinos can stay in business. They understand this raw human emotion, and they rely on it for business success. Easy profits from uber-bullish markets seemingly makes everyone a genius. Beginner's luck? Before you know it, that novice investor who has been treated well by the big bull trend is "all in," and sometimes leveraged using borrowed funds to press their exposure. This is the

stuff that big bull markets are made of, but these are also the kinds of excesses, in my opinion, that are necessary in order to start to build up the underpinning foundation of the next major cycle, that of the bear. Every major bull market cycle, whether in stocks, real estate, collectables, art, etc., all come to similar conclusions where prices eventually go into a “melt-up” mode on the charts. The question then becomes, how high is too high? Sound familiar to you?

Stand back and take a look at a number of charts of the favorite stocks today, the glamour stocks and the “story stocks.” Many of those charts are already in an upward mode. The funny thing is, how high the prices go have little bearing on what the “fair market value” is. This often goes undiscovered until it is too late and the (sometimes) lack of good fundamentals only gets exposed after a serious and unexpected “correction” (or crash). Even though many will later admit they should have seen that coming (while it was probably obvious to others), the emotion of greed was just too powerful and after all, it seemed everyone else was in on it too. Solidarity in numbers isn’t always a plus when it comes to the financial markets.

Here is a last thought on this subject. When it comes to the latest stages of a long-running bull market, the way I see it, the first ones out are sometimes the only ones out. The choice of whether to participate or not is up to each individual investor/speculator. We each need to decide individually whether we are huge risk takers or more interested in staying true to our individual investment disciplines to preserve capital. For those who identify that capital preservation is a significant objective, it can be quite painful to be sidelined when others are seemingly making it hand over fist and the talking heads on the financial channels are screaming about all the money everyone else is making in the midst of the massive bull market.

Eventually valuations will matter. Eventually, I think, financial metrics will get back in line with historic norms, but likely only after achieving a rather shocking decline to below “fair market value” first, as that is often how the full-market cycle works. This latest episode of wealth creation that is occurring in pockets of the economy that seems to be popping up around us almost daily doesn’t reflect how real wealth is built in a normal well-functioning economy. Rather, it is a symptom of the cresting of speculation following the long road of the Fed-fueled liquidity episode that has now been in place for over a decade. Most investors aren’t going to want to believe this of course, because to do so would be tantamount to the admission that this could just

as easily go up in smoke when all of the mechanics driving prices higher become the inverse drivers of doom when it all works in reverse.

The bottom line is that as we enter into the final days of this calendar year, investor enthusiasm appears (to many) to be exceeding investment fundamentals and traditional value metrics in many ways and in many different assets. Every bull market has a job to do, but the biggest job it has of all (I think) is to capture and maintain the maximum amount of money (and participation) in the market long enough to extract the maximum amount of damage in the next phase. This often coincides with the occurrence of an exhaustion phase which subsequently cedes to the next cycle, that which belongs to the bear. In my opinion, we may well be in an exhaustion phase now, but again, that will only become apparent with the benefit of hindsight. How should you be positioned so as to work toward your own desired outcome? I am here to have that conversation.

On a housekeeping note, Stifel is no longer accepting new enrollments for Stifel Access. It is being replaced with Stifel Wealth Tracker. If you need assistance with the changeover, please contact Jeanne Jensen at [jensenj@stifel.com](mailto:jensenj@stifel.com), or (715) 362-1719.

**Have a happy holiday season everyone, for you and your extended families.**

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