

STORM WATCH

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Last week a “100-year” event struck yet again when the citizens of the central southern portion of the U.S. got the deep freeze. Many were unprepared. They were without backup fuel, generators, battery power, or other means to sustain below-freezing temperatures, and many had no plan of what to do. An Arctic Blast blanketing the U.S. and the Soviet Union in mid-February was the result of a splitting of the Polar Vortex hanging over the Arctic in January. There was an adequate and advance warning issued nearly three weeks prior that extreme weather conditions were likely to move farther south than usual. The financial consequences may be significant as water pipes burst, people had to leave, and energy markets experienced chaos.

This latest saga is just a subset of other recent “100-year” events. Some believe that the storms have become more vicious, the wildfires are more massive, the mudslides more devastating, the volcanic eruptions are more violent, and the temperature events are more extreme. They insist that global warming is the root cause. Other scholars insist that we are simply witnessing more of what has always existed, complex climate cycles that are simply an ongoing feature of Mother Earth. Is our society at any greater danger than prior generations? Are we failing as a nation to be better prepared? What is the adequacy of the average American emergency contingency plans? After nearly every weather event there are those who will lay blame at the feet of our elected government leaders, the tax-funded agencies such as FEMA (Federal Emergency Management Agency) and some state and local emergency response agencies, but the first place to look is in the mirror. We all have a stake in proper preparedness and we all should accept personal responsibility to ready ourselves and our loved ones for unexpected events, particularly when and where there is an adequate lead time. A dearth of information is available on the internet on how to properly prepare an average household for any number of potential future disasters, but planning takes a little time, a modest amount of money, and most importantly, some self-motivation.

The Emergency Alert System (EAS) relies on a consortium of broadcasters and other national communications networks to alert all citizens of pending emergency conditions. The most common of these is the “**Storm Watch**” and “**Storm Warning**” designations. “Storm Watch” warnings are generated when atmospheric conditions may be favorable to more severe conditions developing but are not yet of immediate danger. A “**Storm Warning**” is a much more urgent message that signifies severe activity has been sighted and may have a high likelihood of increasing in intensity in short order with little time to do much more than to take cover immediately. Although “Storm Watch” allows adequate time to prepare, not all of these alerts result in an upgrade to a “Storm Warning.” Further, the time one has to wait for conditions to significantly worsen can be nebulous. These weather alerts serve the specific purpose of allowing all citizens to do advance preparation and to monitor storm activity so that more extreme cautionary measures can be taken if necessary. Check your water and food supplies, your back-up power source (and batteries), have appropriate attire at the ready, and know that the kids and family pets are safe. If you are a community volunteer, you have additional obligations.

OK, but this is a letter that focuses on important financial matters. What’s the point? Just as the weather can change from sunny and beautiful to dangerous and damaging, so too can the financial landscape. Perhaps it would be prudent to have a “market alert” system in place for that as well. If given an adequate warning of nefarious activity that could escalate at any time to a severe condition, those who are most concerned about capital preservation might find it beneficial. To those in that category, here is a fair warning. There is currently a significant amount of circumstantial evidence that market conditions warrant a serious similar alert. Let’s call it a “**Crash Watch**”, the financial equivalent of a “**Storm Watch**”. Just as a “**Storm Watch**” implies the atmospheric conditions may be favorable for a severe to extreme weather event, a “**Crash Watch**” might imply the same, a severe to extreme market crisis event. A disturbance that might lie in the not so distant time ahead.

Some highly respected and seasoned investment professionals have noted such a “watch” alert and have been quietly taking precautionary measures by proactively repositioning their clients and themselves to an openly defensive

posture. They are prioritizing “Capital Preservation” strategies over “High-risk” investment strategies. Some of this repositioning involves some combination of reducing exposures to stocks, stock funds, and lower credit quality issues. Additionally, they may be shortening their bond maturity durations, raising some cash, and purchasing short-maturity to intermediate-term Treasury Notes and Bills, among other defensive strategies. Some are beefing up their exposure to precious metals as an alternative asset class. Not all investment professionals mind you, but enough who are well known within the industry and who have rather impeccable résumés and who have demonstrated significant investment acuity over extended periods of time. There is no perfect timing mechanism when it comes to the markets, but there can be many observable markers for astute investors to recognize, determine their severity, and then act accordingly. That is what is occurring amongst this group.

Recent market strength has been the headline story with the three major stock averages eking out one new incremental high after another recently (Dow Jones Industrial Average, the S&P 500, and the NASDAQ). There has also been a significant spike upward in the small company index over the past several months, a sign that bullish exuberance may be spreading to further corners of the markets. But the real story is in the most speculative areas of the markets. High Beta stocks, new issues, stocks with ultra-high short interest, “theme” stocks and sectors, SPACs (more on this below), and more. Some claim that we are in a “New Age Economy.” They see the massive amounts of Federal Reserve stimulus as a driving force that is underpinning the general economy, and that the consumer is as strong as ever despite the massive shutting in of individuals and the shutting down of so many small and medium-sized businesses following the initial announcements of the pandemic. Those in the bull camp look forward and believe that the economy is more likely to experience a lift-off once the populous starts to get back to a more traditional way of life, travelling more, dining out more, going to events again, and more. They insist that this will drive corporate profits “to the moon” and beyond. Their bullish outlook is showing up in all kinds of interesting places in the stock markets.

There are detractors who believe that any and all of the potential good news (and then some!) is already generously reflected in the prices of the majority of

investment securities today. There is a growing body of skeptics who see current market conditions as a potentially massive financial bubble that has fomented due to wild late stage speculative behavior. To them, the clues are everywhere. Over the course of the last four to five months there have been days (and even weeks) where there has been clear evidence of forced “panic buying,” which is the opposing action to “panic selling.” Simply put, it appears that herds of traders are stampeding into securities that have displayed steep upward momentum. The greater the momentum, the more they seem to buy. It appears there is a shared fear that they might miss out on potentially massive profits if they fail to participate immediately. (There is an acronym for this ... “FOMO,” or the fear of missing out.) There have been several recent trading sessions where FOMO has been extreme, and this is a feature that has appeared near the peak of every past bull market. Storm Watch item One. Next, the new issue market has been on fire. Nearly every new IPO (“Initial Public Offering”) has been immensely over-subscribed with prices getting marked up way beyond private market valuations, and in some cases exceeding (by far) even the most bullish of valuation levels imagined by those who know best, the pros who are underwriting many of these offerings. Investors have displayed a nearly rabid appetite for virtually every new issue, most of which are companies that have yet to achieve consistent profitability. Storm Watch item Two.

The Volatility Index (VIX, “the Fear Gauge”) is remaining stubbornly above 20, serving as an effective “Contrarian Indicator” and coincident with over-exuberance that has appeared near the end of prior bull market cycles. Storm Watch item Three. Short-sellers have been badly bloodied in recent sessions. Some of the greatest market gains have derived from a group of stocks with well-known large short interest, stocks that have been identified by professional traders as having very weak fundamentals but they believe that is not yet reflected in their current share prices. The expectation is that they will sell off, yet, these types of stocks are being embraced by a herd of presumably (mostly) younger and more aggressive traders who want to “take on” the short sellers and “squeeze” these questionable stocks to some unimaginable higher price levels. Short-selling and short-squeezes are a complicated concept, but just know that the above activity is often just another syndrome associated with late-stage (or “terminal phase”) bull market cycles. Storm Watch item Four.

All of the above conditions can serve to draw in even more new money, more new investors, and promote an increase in leverage ratios (borrowed funds for the purpose of increasing risk exposure), all a symptom of significant greed that is necessary to get to the bull market peak even faster. FOMO anyone? Storm Watch item Five. You see, historically this is how all long-endurance bull markets ended up and why they can often be so spectacular and frenzied at the top. Not every stock is a winner, mind you. There are just enough stocks that simply dazzle. A handful of massive winners make the news headlines and in so doing, enhances the perception that nearly any stock is worth owning and that is what keeps the money flowing. In the current market some of the biggest winners are the ones that have little to no earnings. It's awfully hard to do financial analysis on money-losing companies, but it can be awfully easy to spin a tale of great riches because of the business they are in. It seems that today the formula for stock success may simply mean being in the right sector, the New Age Economy sector. Electrification? Check. "Green" and good for the planet? Check. Potential participation in Artificial Intelligence? Check. Space travel? Check. Food delivery? Check.

Let's not forget to mention the SPACs; "Special Purpose Acquisition Corporations." This is a concept that seems to rise out of the ashes of every past bear market in one form or another at just about the peak of the following bull market cycle. A SPAC is a company where money raised from investors is intended to be used for acquisition of a private company (or group of companies) that will fit a niche. The acquired private company is now a publically-traded entity. In effect, this is a process to bring a company public without having to go through the IPO hurdles. This more or less circumvents many of the most stringent IPO requirements and essentially avoids certain regulatory disclosures. The sponsors of these securities are often experienced hedge fund titans and other more seasoned executives, but some of the recent crop of SPAC offerings has come with celebrity endorsements and lesser credentialed individuals at the helm. The sheer number of new SPACs has been mind-numbing, and (to me) may be just one more signal of a late stage bull market action. Storm Watch item Six.

Terminal phase behavior in any bull market can usher in a certain level of unprecedented hubris, runaway risk management, and can even have some real “in your face” ultra-speculative behavior that can shine like a big bright-red warning beacon. This was on full display in the last week of January and the first few weeks of February as hordes of day traders (and aggressive hedge funds) gathered up collective trading ques from online platforms and then herded into the names of some highly shorted, poorly run companies that by most measures were quickly running out of the means to survive. Storm Watch behavior. Lastly, let’s not overlook the “Bulletin Boards” (otherwise called the “Pink Sheets”). The “Pinks” are where you can find masses of stocks that perhaps used to trade on the major exchanges such as the New York Stock Exchange or the NASDAQ, but for various reasons have been since “delisted” and this is where they go to die. They are often considered highly speculative “penny stocks” (because many of them trade for, well, pennies per share), and their trading volumes have often gone dry. Suddenly though, we are once again witnessing renewed interest to the extent that completely worthless enterprises are getting bids that are pushing their valuations into multi-million and even billion dollar capitalizations. It is unbelievable. Shares that for all practical purposes have been left for dead are magically rising from the ashes like the mighty Phoenix, appealing to those most speculative spirits in the most speculative corner of the markets. Alert: Storm Watch.

All of the above are the actions that may inspire novice investors and momentum fanatics alike to participate, many of whom, in my opinion, are often completely seduced by the seemingly never-ending upward thrusts of price and the prospects of endless profits. Valuations and caution can be thrown to the wind. Bearish viewpoints get mocked. Those with extensive market experience may be looking at this with a puzzled look and with jaundiced skepticism, likely because they possess memories of bubbles past. They have seen these signs before and they have been through prior collapses of terminal stage bull markets. They know what can come next. The younger, often more aggressive and fearless traders of today have a name for these skeptics. **“Boomers!”** They brashly defy history because the winning seems so easy and they are not held back by the scars of having previously lost vast amounts of wealth to the great bear markets of the past.

When it becomes too easy to make money and participation is exploding with new participants who come with little experience, limited resources, and little sense of history, the likelihood of getting to the peak sooner potentially goes up. Although no one can predict the markets with any certainty, the ultimate topping process may have a few more months or it might go on for another few quarters; that remains unknowable. However, for each day that passes and the upward trajectory remains, there can be true pain and angst for those who have already left the party. The party always seems to end the same. At the climax, those who are still playing to win are often drunk with greed and as such, few are likely to get out with their retained profits. There is an old saying that at the top of a bull market, the first ones out are likely the only ones out. When the music stops the first draw-down can often be abrupt, shearing off 10% to 20% losses in a span of only weeks or even a few days. This can come as a shock to those still remaining and absolutely paralyze the last ones who came late. Once that first thumping arrives, even the most seasoned of investors aren't sure if they should be buyers or sellers. In the last stages of a wild bull market the prospects of a "trap door" opening up under the markets can become very real. It's not uncommon that upon that first drop, a brief (but spirited) rally can follow but if history is a guide this last spurt is likely doomed to fail, and the line of least resistance is "down" with a potentially massive decline. It is this second wave that draws the majority of the blood.

I do not mean to come across as some sort of boogeyman or doomsayer. I am giving you my view of what has become a changed market environment over the past weeks where tremendously high speculative activity exists and where that lines up nicely with some of the most speculative market peaks in history, such as the Dutch Tulip Mania, the South Seas Bubble, 1929, and the 2000 Tech Bubble. One cannot predict in advance when market cycles will end, but one can certainly observe for themselves in real time what is happening on the ground and be open to the possibility that a "**Storm Watch**", or in this case, a "**Crash Watch**", may be worthy of being issued. For some, perhaps it is the time to begin preparing for what might lie ahead. Reallocating ones assets to go on the defensive and take the position of prioritizing capital preservation is not a bad thing. We have a new administration, we are continuing to get pandemic

warnings, we must weigh just how much (or how little) the actual economy may continue to recover, we must judge how long the system may continue to stay afloat with the massive ongoing Federal Reserve support operations, I believe we will continue to witness a massive and growing national deficit, and more. Most of all though, we must consider the telltale signs of highly speculative excesses at work today and then consider the lessons learned from periods of prior excesses and the resultant actions. Each investor must decide what is most appropriate for their own risk tolerance levels of their hard-earned savings. I am here to have those conversations.

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Indices are unmanaged and are not available for direct investment. Past performance is no guarantee of future results and no one can predict the markets with any certainty. Index returns include the reinvestment of dividends but do not include adjustments for brokerage, custodian, and advisory fees. The Dow Jones Industrial Average (DJIA) is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The NASDAQ Composite Index is a capitalization-weighted index that is comprised of all stocks listed on the National Association of Securities Dealers Automated Quotation System stock market, which includes both domestic and foreign companies. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. Diversification and asset allocation do not ensure a profit or protect against loss. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. Alternative investments involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing tax information, are not subject to the same regulatory requirements as more traditional investments, and often charge high fees, which may erode performance. An investment is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment.