MARKET INSIGHTS

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Up, Up, and Away!

As we charge full speed into a new year, it is often enlightening to stop, reflect, and discuss certain aspects of our day-to-day vantage points, stepping back to take a look at the forest instead of just continuing to contemplate the collection of trees before us. Over the last year, our conversations have slowly shifted from being classified as essential to getting our jabs (thankfully), and while we would argue that plenty of madness still pops up in many of the markets in which we participate, it is a very different breed of madness from a year ago.

No recent occurrence within the markets better exemplifies that madness than the recent run on "meme" stocks. GameStop, a bricks and mortar seller and buyer of new and used video games and gaming consoles, is a company that, alongside its stock GME, had essentially been left for dead for the better part of a decade. Revenues peaked in 2012 just shy of $10 billion annually and have since embarked on an unrelenting march lower, brought on by the shift to streaming games, web-based licensing, mobile and smartphone gaming, and of course Amazon and internet retailing. Even with a recent explosion in gaming connected directly to COVID stay-at-home orders, GME could not seem to get their act together and grow. The company ended 2020 with annual revenues of $5 billion, and a third year in a row reporting a net loss for earnings. Then for a few short days at the end of January, there was almost no other news except for the stunning rise of the stock. On the heels of a short-seller report about the company (arguing that the stock was basically worthless), the stock rocketed from $44 per share to a high of nearly $500 per share over the course of 5 trading days, a spectacular gain of over 1,000%. At its peak, the company was valued at nearly $35 billion, when mere weeks earlier the market cap was under $500 million. Revenues hadn't improved, profitability hadn't magically appeared, and the business hadn't managed to turn around years of decline. Yet, the price of the stock went mad. Not to spoil the surprise, but in about the same amount of time, the stock slid back below $50 per share.

Besides some entertainment value, what can be learned from this story? Admittedly, profits can be made by those with the skill/luck, timing/luck, and fortitude/luck to buy high and sell higher. But what if you're more comfortable with an approach that is consistently repeatable, less fraught with risk, and does not cause heart palpitations? Alas, the difference between trading and investing becomes apparent. As much fun as it was to watch the stock, the company's imploding revenues and consistent money-losing kept the name far away from our client portfolios. Some could say "well if you had bought it at $40, it could have been great!" Well, yes but with a touch of poor timing you could have also bought it at $440 and faced a vastly different outcome. Given the objectives of our clients, our focus on financial fundamentals, and multi-year investment time horizons, 10-day stock bubbles may not be the highest and best use of our energies.

> ***"What has been done will be done again; there is nothing new under the sun."***
> Ecclesiastes 1:9

Seeing the risk, chaos, stress, and large losses for many in the wake of such bubble stocks bursting, one might think them to be a rather rare occurrence. A quick trek down memory lane shows just the opposite. As recently as June of last year, Hertz stock (again, on death's door prior to the bubble) exploded higher by over 700% in about 4 trading days. Now, that same stock is legally worthless as the company proceeds through

bankruptcy. A few months before that we watched as “Pot Stocks” experienced the same boom/bust madness. The list of recent examples is long, and ranges from meat substitutes to 3D printing. The intoxicating appeal of getting rich quick by moonlighting as a trading mastermind seems to be embedded in human nature, with numerous examples of similar tales stretching throughout history. A favorite story of the bubble phenomenon is that of the Dutch Tulip Craze from the 1630s. Over the course of about 3 years, the prices of certain types of highly desirable and rare tulip bulbs rose from a non-noteworthy level to the point that they cost about 2 months’ salary for the typical skilled laborer. Then inexplicably, over the course of about 3 months around 1636 those prices rose to the equivalent of 10 years’ worth of skilled labor income. The story goes on to tell of families selling homes, land, and all earthly belongings to buy a single tulip bulb in hopes of gaining vast wealth overnight. Unsurprisingly, just a few months later, those same bulbs were nearly worthless. In an interesting but somewhat morbid parallel to GameStop, this spectacle took place around the same time as another global pandemic - the Black Plague - was resurging in areas of Europe, killing a recorded 50 million people. The book titled Extraordinary Popular Delusions and the Madness of Crowds tells this and dozens of similarly ridiculous stories from throughout history. It was written in 1841 and is several hundred pages long; just imagine how long it would be if it included more modern madness.

The excitement, intrigue, and potential opportunity that orbits an asset experiencing a pricing bubble has proved too enticing for human nature to ignore time and time again. But for many, the risks and inconsistency of trading asset bubbles are not a feasible answer to long-term family finances. So how do we fight this facet of human nature? For starters, focusing on the fundamentals of an asset – its profitability, business resilience, cash flows, and prospects – and then paying a historically fair price to acquire that asset, results in a much more repeatable and controlled approach to investing. Sure, trading in bubbles can be profitable, but more often than not, those stories of large and fast winners are simply Pied Pipers leading the next group of unsuspecting bag-holders.

Returning to more timely items, there have been reports of surging interest rates in the face of expectations for inflation lifting off. Yes, rates have moved higher recently, but we have found that a dose of perspective helps cut through the overly colorful language used to describe the move. The surge is coming from an environment where 10-year Treasury bonds were yielding 0.50%, a low point set in the depths of a global pandemic about a year ago. Frankly, we should all be hoping that the economy has started to improve from where we were then, so as a result of that improvement yields should be rising. Perhaps we should be asking: “what is normal, and where are we in relation to that?” The nearby chart displays where we are compared to historical levels, with a bright red line depicting the average interest rate, a point that could be considered normal relative to the last 60 years. If interest rates continue to normalize, there are implications from a portfolio management perspective. However, with VBGA client portfolios currently positioned with very short bond durations, and equity holdings of companies with growing revenues and responsible levels of debt, higher yields should not be a calamitous event. Candidly, it sure would make investing in bonds more interesting than it has been for the last several months.

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