Generational Differences

I am a member of Generation X. Have you ever wondered why a simple letter X represents this generation instead of having a more interesting name like the Silent Generation, Baby Boomers, and Millennials do? It's because no defining major event happened during our formative years. The Vietnam War ended around the time of our birth followed shortly thereafter by the end of the Cold War. Capital markets were stable and quite profitable from 1982 all the way through to the Millennial generation. Though the brief war with Iraq caused a recession in 1991, it was minor. Even the stock market crash of 1987 now looks like a mere blip in the big picture, and even in that year, the market ended in positive territory.

Major global events picked up dramatically once our generation birthed the next generation. A three-year, grueling bear market followed the Internet Boom of the late 90s. Terrorists smashed into the Twin Towers and the Pentagon resulting in war with Iraq and Afghanistan. A real estate bubble helped cause the Great Recession. The unequal recovery from that devastation coupled with the rise of social media cracked open today's massive political divide. Then came the pandemic.

The resulting economic turmoil has surpassed the damage done during the entire Great Recession. In three short weeks last year, the stock market fell 35%, and unemployment skyrocketed. Gross Domestic Product (GDP) fell at an annualized rate of 31%, the worst reading since the Great Depression. For comparison purposes, GDP fell at an 8% rate during the Great Recession. Thousands of businesses have failed. If not for the tremendous amount of government support, thousands more would have failed, and many more still may. However, the stock market has strongly rebounded. Through the first quarter of this year, the major market indices neared their all-time highs.

This isn't a completely irrational response by the market as many companies did very well during the lockdown period, especially those in technology and those that could easily adapt to a more online world. Usually, our economy falls into recession only when there are supply and/or demand imbalances created during boom times that need correction. As we self-induced this recession with mandatory lockdowns, when the lockdowns lift, growth could occur more rapidly than after previous recessions. Now that vaccines are rolling out in earnest, there is a light at the end of the tunnel. We've seen a rotation in the first quarter away from some of 2020's big winners in tech towards some of the more cyclically sensitive stocks.

While the market response in general hasn't been completely irrational, there have certainly been pockets of pure insanity. The poster child for this insanity is the market action in the stock of the company Gamestop. Gamestop operates in a declining, some might even say dying, industry. The company owns retail stores that primarily sell video games. Modern game consoles, however, no longer need the physical discs to operate their games. Gamers simply download games from the internet. Recognizing this, the company has made moves to pivot away from this field. Still, the type of transformation this company needs to survive, let alone thrive, will take years to implement. As a result, big hedge funds and institutional managers shorted this stock. When you short a stock, you are betting the price will fall.

Enter Robinhood and Reddit traders. Robinhood is a new, online brokerage firm that caters to the small guy. Many of these small guys found themselves with stimulus checks, and with much of the country in lockdown, they had fewer places to spend the money. Many chose to deposit their $1,200 in a new brokerage account. Reddit is a social media message board site. One of its message boards focuses on day trading. Active members of this message board are notorious for bragging about their financial blunders, often posting pictures of their most recent failed trades. My Generation X mind cannot begin to understand the attitude of some of these young whippersnappers. Anyway, folks on this message board noticed that the number of shares sold short against Gamestop was greater than the number of shares outstanding. Theoretically, this shouldn't happen.

Rallying as a mob, they attacked the shorts, and the message board filled up with pictures of Gamestop purchase orders from members' Robinhood accounts. As the stock rose, the investors who had shorted the stock started losing money. To cover their positions, they too needed to buy. This is called a short squeeze. At first, the rise was somewhat gradual. The stock went from $3/share in November to about $17/share in January. That's a pretty big move on its own, but the fun was only beginning. With nobody left selling or shorting, the stock shot up to $438/share!

To put this number in perspective, the market valued this company at well under $1.0 billion back in November. A $438/share stock price values it at $30.0 billion! There is no amount of justification, rationalization, or transformation to warrant such a valuation. The market simply isn't functioning properly with this stock. When this is over, the stock will fall back to the single digits or low double digits, and many of these Robinhood millionaires will lose it all. The best hope for the company is to issue new shares to capitalize on this insanity and help in their transformation, which they indeed intend to do.

Every generation seems to have some craziness to it. The current generation has the Robinhood traders bidding up stocks seemingly at random. There are also pockets of exuberance in many new tech themed areas from electric vehicles to alternative currencies. The Boomers had the Nifty Fifty. The Xers had the Internet Boom. What we can learn from past generations is that there are no sure things. Yes, some of the Nifty Fifty stocks continue to do well, like Johnson & Johnson and Disney. Another batch of names are okay investments today, like Coke and Dow. Then, there are the ones that couldn't keep up with the times and disappeared, like Kodak and Burroughs. The same could be said about the Internet Boom. Microsoft and Qualcomm are still excellent companies. Cisco and Intel are holding their own. Lucent and Nokia have all but disappeared.

Our task right now is to steer our clients away from the craziness and continue to invest in the rational parts of the market. The wind is at investors' backs as a lot of money is flowing into stocks. In the first quarter alone, $400B flowed into global equities. This surpasses the largest amount that has ever flowed into global equities in an *entire* year ($295B in 2017). With this much money pouring in, there will undoubtably be other areas of craziness. The fear of missing out is a powerful force. Ultimately, however, experience suggests the best investments will be in good companies with strong balance sheets and decent growth prospects trading at reasonable valuation levels. Certainly, my fellow Silent Generation and Baby Boom advisors would agree.

Sincerely,

Tony

Tony DiGiovanni , CFA Chief Investment Officer