August 27, 2020

A DOUBLE ISSUE REPORT

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The Bull Market Returns

In the past six months, most investors have experienced a roller coaster ride with regards to the economy, social issues, lifestyle, and the stock market. We recently witnessed the fastest rebound for the S&P index bear market to a bull market which rebounded around 50% off its lows. We observed stock market movements correlated to healthcare events rather than economic influences. I have never seen anything like this in my lifetime.

Even though some stock market indexes have hit new highs, the strength of the S&P index has been concentrated on the tech industry in particular 10 super large companies. "The stocks of Apple, Amazon, Alphabet, Microsoft and Facebook, the five largest publicly traded companies in America, rose 37 percent in the first seven months this year, while all the other stocks in the S&P 500 fell a combined 6 percent, according to Credit Suisse."[1] "Those five companies now constitute 20 percent of the stock market's total worth, a level not seen from a single industry in at least 70 years. Apple's stock market value, the highest of the bunch, reached $2 trillion on Wednesday — double what it was just 21 weeks ago."[1] "Howard Silverblatt noted that the 10 largest stocks in the S&P 500 accounted for 27.6% of the index's capitalization. That makes the benchmark the "most top-heavy index" since the 1960s"[2] Last week I listened to CNBC reporter Bob Pisani state that the S&P is at new highs but 35% of its 500 holdings are down 25% and another 60% are down at least 10% off their new high. Recently Financial Times said, "K-shaped recovery spotlights overreliance on tech giants."[3] "The S&P smashes record highs but average stock in the index is 28% below its peak."[3] According to Cornerstone Macro, a research group, "Share prices of a fifth of S&P 500 companies were more than 50 percent below their all-time highs yesterday."[3] "The divergence has stoked concerns that the eye-catching rallies in the S&P 500 and the technology-heavy Nasdaq Composite are masking big strains on businesses across the country."[3] "Just three sectors have outpaced the S&P 500 so far this year. Technology shares are up 27 percent in 2020, followed by a 23 percent gain by consumer discretionary stocks."[3]

I believe the strong rebound is a result of large liquidity provided by the Federal Reserve coupled with other stimulus actions from our government. Many interest rates are getting closer to 0%. In fact, muni yield hits its lowest level since 1952 despite the pressure of COVID on municipalities. These low interest rates have caused many fixed income investors to look for alternatives. In addition, we have seen more activity from retail investors. This can be partially attributed to lower commissions, virtual services, staying at home, speculation, gambling, and momentum investing along with not being able to bet on sports.

2020 Election in Unprecedented Times

Many investors are extremely worried about the upcoming election and I feel many people are voting against a candidate instead of for one. I believe the stock market is starting to factor a Biden victory; however, we are seeing early signs of what may transpire after the election with fighting and disagreements on an additional stimulus and benefit package. At one point, there was a $2.5 trillion difference between the Republican and Democrat proposals. However, now there seems to be no compromise. I believe most investors want a government with a check and balance system that does not allow one party to dominate.

> "That's according to LPL Financial Senior Market Strategist Ryan Detrick. In a note published on Monday, Detrick looked at historical data dating back to 1950 and found that the stock market performed best when Congress was split between Republicans and Democrats. Stocks, as measured by the S&P 500, returned 17.2% on average when Congress was split between the two parties. The average annual stock return drops to 13.4% when Republicans are in control of Congress and drops to 10.7% when Democrats control both the House and Senate."[4]

It is too early to predict who will win the election or the aftermath. There are many variables that could change the election outcome (i.e. voting by mail due to the COVID crisis). In addition, you must factor in the electoral makeup, debates and people verbally supporting a candidate but not voting. In the interim, COVID progress and economic advances may also play a major role in the election.

Most observers expect that a Biden victory would lead to an increase in personal and business taxes, increase in regulations, more cooperation with our allies, continued hostility with China with a different approach, more spending on alternative energy and jobs, and more spending on social problems (i.e. healthcare and student loans). While Biden and Trump both believe we should increase infrastructure spending, the approach will be different depending on who wins. In Bidens' case, there will be more emphasis on increasing jobs. But most ideas cost real money and may take time to implement especially with a weak economy and high deficits. "Government debt has soared to levels not seen since World War II."[5] Even though President Trump is unpredictable, we have a good idea where he stands economically. But we will see what transpires with the election.

In the past six months, we have seen unprecedented changes in our lifestyle and investments. There has been very little predictability due to the healthcare crisis. This has led to increased volatility and uncertainty in making decisions. We have seen many larger companies thrive, big cap tech stocks in particular. I believe small and medium companies are not doing as well due to weaker balance sheets and
market share and lack of financial flexibility. It seems that the US population is experiencing similar disparate outcomes. Many people have capitalized on this unfortunate situation which has generated a great deal of wealth especially for tech titans. But our healthcare crisis has also exacerbated the disadvantage and misfortune of minorities and people struggling to survive and maintain their lifestyle. Hopefully, our economy and working conditions will improve and more people will get back to work and share in the American dream.

Housing Trends

Over the past five months, there has been incredible changes in consumer spending due to the healthcare crisis. I believe 20-25% of our economy has not significantly rebounded from the lows that we experienced. Many of these industries are heavily tied to public interaction such as travel, entertainment, restaurants, sports, and the like… These industries are not likely to rebound until a vaccine or healthcare solution arises to ease concerns and instill consumer confidence.

On the other hand, the housing industry has experienced a positive shift. "Buoyed by record low mortgage rates and an influx of remote workers seeking more living space, existing home sales surged by a record setting 24.7% month-over-month in July with prices hitting an all-time high, according to the National Association of Realtors (NAR)."[6] Obviously, lower interest and mortgage rates mean more affordable housing.

But the number of houses on the market is down dramatically partially due to low builder inventory and workers. Plus, seniors are staying in their homes longer due to COVID fears in assistant care or nursing facilities. Millennials are also starting to shift. "First-time buyers accounted for 34% of sales in July, NAR said, a category that includes many millennial buyers."[7] Many millennials are moving away from large cities or dense urban areas to rural or suburban areas that are more affordable and progressive. "Why pay city prices, when you can't live the city life?"[8] "Right now if you move 25 miles east of downtown L.A., you can get the same size house and lot for about half the price," says Julie McDonough, a real estate agent at AmeriSell Advantage Properties in Southern California."[8] Furthermore, many buyers don't commute as much and require different amenities that were not essential before such as a home office and a space for kids to study or spend free time.

In addition, consumer spending has shifted to homes instead of vacations, shopping, entertainment, gym memberships, etc. People tend to have more time to focus on their home whether it be for home fitness, pools, expansions, landscaping, etc. We have also seen a shift in the ladder of life… buying a first-time home, moving from a condo to a home, upgrading to a larger home, moving from a major city to a tax advantage area, etc. We have experienced a mass exodus of wealthy people moving to less taxing states. This is especially true for New Yorkers and is partially due to anticipated higher Federal and State taxes and the COVID crisis. I believe social unrest has also played a role with many people worried about their business, safety, and law and order.

While overall housing has been a bright spot on the economy. This upward trend in housing could be impacted by the following concerns: 1) Lumber prices have skyrocketed in the last three months or so which makes housing more costly since lumber is a major cost factor. 2) A lack of skilled workers (i.e. plumbers, carpenters, electricians) in many areas especially since it is a boom or bust business.3) High unemployment which generally hurts the affordability of housing and lending risk. 4) Foreclosures are expected to rise. The Federal Housing Administration mortgages reports, "The affordable path to homeownership for many first-time buyers, minorities and low-income Americans -- now have the highest delinquency rate in at least four decades."[9] And many state moratoriums on mortgage delinquencies could be lifted soon. This is certainly a concern and could lead to further frustration with the inequality issue.

Tensions with China

A cold war between China and the United States is apparent and seems to have gotten colder when China increased their influence and exerted more control over Hong Kong. Even though we need China and vice versa, their actions will accelerate the division and lead the U.S. to speed up changes to our supply channels.

In addition, there has been increased hostility and scrutiny over Chinese tech companies being a front for the Chinese government. For example, President Trump has given TikTok (a social media platform) a ban of use after 45 days. "The critical field of conflict is technology, the foundation of economic growth and national security. Since the founding of the People's Republic, Chinese leaders, including the President, have declared a national policy to "catch up and surpass" the developed world's technology. For China's leaders, "technological progress is not only a means to economic and military prowess," writes Harvard's Julian Baird Gewirtz, 'but also an ideological end in itself—offering final proof of China's restoration as a great power after decades of struggle.'"[10]

As mentioned in previous newsletters, I believe there are six major U.S. tech monopolies that are considered the crown jewels of our country. While they seem to operate with little government influence or interference it is likely because they are competing against a powerful Chinese government and their unfair practices and theft of U.S. intellectual property with a "win at all cost" mentality.

With the upcoming election, China is waiting to see if a new administration arises and handles them in a different way. My guess is that Biden would not be as tough on China but may use a different approach to get our allies to confront China along our side; however, this could be a big risk if European and other Asian countries choose to go their own way. These countries do not have the tech dominance or onslaught of China targeting their tech companies like the U.S. Therefore, they may be able to capitalize on the friction by increasing trade with China. Either way, this is a big issue that will continue to escalate but has broad support with both Republican and Democratic parties.

The Tesla Revolution

With more people stuck at home with minimal opportunities and activities, one could derive that there is an increase in the retail sector actively trading stocks and securities. "Retail investors have accounted for as much as 25% of the stock market's activity amid coronavirus-driven volatility, Joe Mecane, the head of execution services at Citadel Securities, said in an interview on Bloomberg TV on Thursday."[11] New trading platforms and lower commissions have acted as an accelerant to this trading. I believe this has led to more trading, volatility, trends, and momentum investing. It reminds me of the "dot com" stocks in the 1999-2000 timeframe and there is no stock that seems to exemplify this more than Tesla.

"Tesla's stock blew through the roof this past week, gaining 24%, or $399, to a new closing high of $2,049.98 and valuing the electric vehicle leader at $382 billion. Investors have piled in ahead of Tesla's 5-for-1 stock split, which will take effect on Aug. 31—the same day as Apple's split."[12] This has propelled Apple stock but not to the extent of Tesla. "The stock, which touched a low of about $350 in March, has almost quintupled since then and crossed $2,000 on Thursday, over 10 times the level it was trading at this time last year. Tesla shares closed up 6.6% at $2,001.83 in New York, at an all-time high. The stock has closed at records on four of the past five trading days."[13] I believe Tesla is currently trading at an absurd price earnings multiple. With this latest increase in value Elon Musk has become the fourth wealthiest man in the world. The Tesla valuation is currently higher than Walmart. "Tesla's valuation is currently about $373.1 billion, while Walmart is hovering around $369.8 billion, according to Bloomberg data."[13] For most investors this is worrisome and excessive but not to many of the cult like followers that continue to push Tesla's stock higher. "But there's another story: the story of the rise and fall of oil giants like ExxonMobil (NYSE:XOM), Royal Dutch Shell (NYSE:RDS.A) (NYSE:RDS.B), and BP (NYSE:BP). Last week, Tesla stock passed $2,000 a share for the first time in its history, making Tesla worth more than those three oil giants combined."[14]

Another interesting comparison is Tesla's capitalization is more than the two largest car manufacturers in the world (Toyota and Volkswagen) combined. These two companies are expected to manufacture over 20 million vehicles compared to Tesla's 500,000 this year. But most investors probably do not realize that a large part of Tesla's profitability comes from government subsidies for being an electric car manufacturer. Elon Musk has stated several times in the past that he thought his stock price was overvalued and in July, Tesla sales in China suffered dramatically. Nevertheless, what propelled the recent advance is probably the stock split and frenzy that has occurred. I believe this resembles what former Chairman Greenspan said is irrational exuberance. Tesla does make a good car and it is part of the future but only time will tell how impactful it will be. It is said that "Musk, co-founder and chief executive officer of Tesla, has 38 million followers on Twitter — and he rarely misses an opportunity to use his online influence to taunt short-sellers."[15]

Conclusion

In conclusion, there are many companies that I feel have gotten ahead of the fundamentals and have stretched valuations. At some point in time that will matter. Many of these stocks have appreciated significantly beyond what most people would expect to be reasonably priced. We have seen excess liquidity skew many valuations followed by momentum investing and trend setting. Many of these companies exhibit growth, more predictability, potential market share gains and predictability in future earnings. But the question arises: What is the proper valuation? This bifurcation is occurring in our country and many citizens are benefiting from the healthcare crisis and its impact on the stock market. But in the end, there needs to be better allocation of government resources to narrow the inequality. One hopes there will be more breadth in the stock market but in the meantime, one must be very selective.

With the elections coming up, there is more uncertainty which exacerbates the healthcare crisis. However, I think the economy will dictate whether either leader can implement dramatic change after the election. I believe we are at the mercy of finding a solution for COVID whether it be a vaccine, treatment, or cure. We could also experience supply chain issues getting the product to market. My best guess is that we will see 2-3 solutions in first quarter of 2021 that would likely be given to certain groups at first. But it is hard enough to convince people to wear face masks or trust science and will be even tougher to persuade people to get vaccinated. Due to the potential timeframe for a healthcare solution, I think we could expect more stimulus and further subsidies to be given to those in need. I still anticipate many permanent job losses and high unemployment for the foreseeable future. But any stimulus and/or subsidies would provide a bridge until we can restore public confidence and allow the economy and lifestyles to recover until there is a healthcare solution and a sense of normalcy. Meanwhile, I believe in the short-term there will continue to be a disconnect between the stock market indexes and the economy as well as big capital stocks versus small capital stocks. This can create more risk but also generates opportunity. I believe selectivity has rarely been more important. As always, I am optimistic our country will do the right thing over the long-term.

Optimistically Yours,

Raymond F. Saleeby
President

Did You Know

A record 46 billion-dollar companies have filed for bankruptcy in the US this year as the pandemic continues to wreak havoc and it's far from over, say experts
https://markets.businessinsider.com/news/stocks/record-46-billion-dollar-companies-filed-bankrupcy-this-year-ft-2020-8-1029525534#

New tax breaks can help clients use investments for giving
https://www.fa-mag.com/news/new-tax-breaks-can-help-clients-use-investments-for-giving-56941.html

Virus relief efforts give rise to new tax strategies
https://www.nytimes.com/2020/04/10/your-money/coronavirus-wealth-taxes.html

Home is where the tax breaks are
https://www.wsj.com/articles/the-tax-breaks-for-homes-that-help-you-now-11596792602

The Pandemic Tax Breaks Every Small Business Should Know
https://www.wsj.com/articles/small-business-owners-dont-forget-special-pandemic-tax-breaks-11598002206

5 tips for saving the $1.9 million Americans say they need to retire
https://www.investors.com/etfs-and-funds/personal-finance/retirement-planning-save-1-9-million/

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The average American debt by type, age, and state
https://www.businessinsider.com/personal-finance/average-american-debt

Bill Gates: 'I was so jealous' of 'genius' Steve Jobs
https://www.cnbc.com/2020/08/24/bill-gates-i-was-so-jealous-of-genius-steve-jobs.html

The net worth in America by age, race, education, and location
https://www.businessinsider.com/personal-finance/average-american-net-worth

These are the world's richest families
https://www.bloomberg.com/features/richest-families-in-the-world/?sref=Ro2vIlyD

20 US presidents who were in secret societies
https://www.businessinsider.com/us-presidents-who-were-in-secret-societies-2017-4

Did You Know (Continued)

10 Things the Pandemic Could Change (from William Blair Funds)
https://blog.williamblairfunds.com/ken_mcatamney/10-things-the-pandemic-could-change/

Our habits have changed. These gadgets are proof.
https://www.wsj.com/articles/our-habits-have-changed-these-gadgets-are-proof-11590325201

Warren Buffett's partner Charlie Munger is famous for his colorful commentary. Here are 12 of the Berkshire Hathaway vice-chairman's best quotes
https://markets.businessinsider.com/news/stocks/warren-buffett-berkshire-hathaway-charlie-munger-12-best-quotes-2020-5-1029210949

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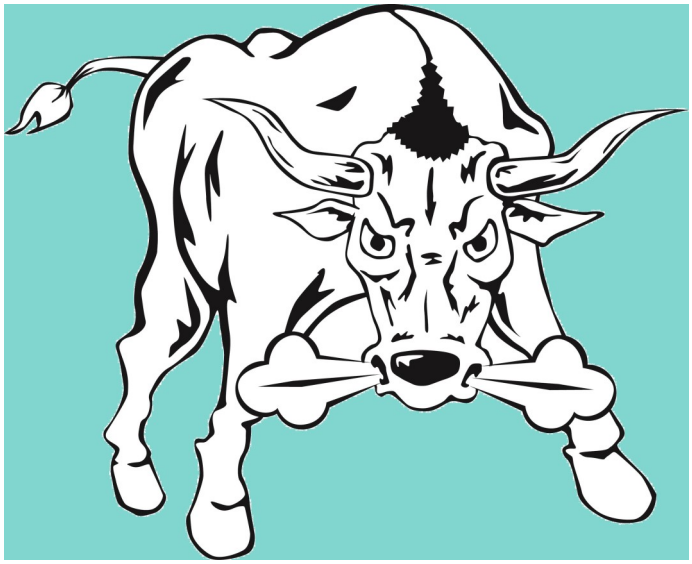

Footnotes

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