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New York City Parks Photo Archive

Fear, Greed & Boredom

1920's in Central Park

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The cover photo of the since demolished Central Park Casino captures the Roaring Twenties in New York City. With many pundits predicting post-pandemic behavior to resemble that era, the current contrast of New York today to that image is stark: Simply being out in a crowded venue seems like a distant memory, especially to those residing in cities where social distancing was never a way of life. Months of limited social interaction appears to have impacted behavior in many ways, especially when it comes to investing.

Fear and greed have been widely accepted emotions driving markets to excessive highs and lows, but has boredom contributed to some of the anomalies we have seen within equity markets and other asset classes? Has trading become a form of entertainment during this prolonged period of social isolation?

Fear and greed have been such good contrary indicators that Warren Buffet, in one of his annual letters to Berkshire Hathaway shareholders, stated, "Be fearful when others are greedy and greedy when others are fearful." These sentiments do not fully explain recent oddities such as the rise in "meme" stocks and non-fungible tokens (NFTs).

If boredom has in fact driven us to invest in what is new and interesting, perhaps investor behavior is set to pivot as society reopens. In which case, what has been capturing the imaginations of many may soon lose luster as other activities compete for attention and share of wallet. One indicator to monitor will be trading volumes which surged during the pandemic and may easily wane. In 2021 they are twice the level than they were in 2019.

This surge in volume has been accompanied by a lack of style consistency, with rapid rotations between stay-at-home technology stocks and pandemic recovery beneficiaries. To further illustrate recent investor behavior, we looked at data from Fidelity which discloses the stocks with the largest volume of orders on its website, for informational purposes.

As of April 1, the top five included: Tesla, Aerocentury, Gamestop, AMC, and Nio, a group with seemingly little in common. Gamestop and AMC are leading meme stocks, whose share prices received such a massive boost from message boards that both companies issued new stock to capitalize on their elevated share prices. While Tesla and Nio are both electric vehicle manufacturers they are at different ends of the spectrum of product development. Aerocentury is an aircraft lessor that recently filed for bankruptcy. There is not much consistency in this group in terms of size, valuation, or growth prospects. Arguably, the only common thread is that each of these stocks have had extraordinarily volatile share prices compared to the broader markets.

We can systematically isolate and measure just how important volatility has been to investment returns for the last year, beyond just eyeballing the data from Fidelity. As a discrete factor, volatility has worked extraordinarily well since the onset of the pandemic. Bloomberg decomposes seventeen factors driving markets, and volatility has been number one over the last 12 months for both the S&P 500 as well as the MSCI World Indices.

Consider normally important factors such as growth, value, size, momentum, and dividends were all beaten by volatility, whether in the U.S. or non-U.S. markets. The preference for volatility in equity markets has been seen in other asset classes, such as cryptocurrency, and NFTs. As an example of how highly valued NFTs have become, Twitter founder Jack Dorsey sold the digital rights to his first tweet for $2.9 million.

Two hundred years ago, Baron Rothschild famously said, "Buy on the sound of cannons, sell on the sound of trumpets." If we are truly on the verge of winning the battle against Covid-19, what would be the type of stocks to sell and what would be interesting to buy?

Consistent with volatility having been the top factor in markets, it certainly seems like investors have hastily barreled into what they expect to be the next hot sector without thoroughly considering the fundamentals. As an example, oil stocks have experienced a substantial rebound even though the long-term price of oil has barely budged. Oil's long-term demand outlook is arguably worse than it was pre-pandemic as the adoption of working-from-home has greatly accelerated. We expect some form of working-from-home is here to stay, even at a reduced level from where it has been. This would also impact demand for business travel and office space, both of which may not fully recover until 2023 or 2024. However, the enterprise values for most hotels and airlines today are higher than they were prior to the pandemic, suggesting that some of the obvious pandemic recovery themes are already fully priced.

There are some less obvious themes that look interesting considering the economic outlook. We are arguably embarking on one of the most interesting cycles in modern economic history. Several estimates compiled by Bloomberg have the U.S. economy growing by more than 7% in 2021, a feat achieved only once since 1955. While Europe and Japan are lagging a few months behind the U.S. on vaccinations, they should have rapid recoveries once they fully reopen.

Despite pent-up demand that is already supportive of stronger global growth, U.S. cyclical growth should be further bolstered by fiscal stimulus, which is unprecedented during an economic recovery. Already in 2021, the Biden Administration has legislated spending equal to 9% of GDP with another 11% pending that could extend strong growth through 2022.

With this economic backdrop, there are three sectors that look especially interesting as we exit lockdowns: 1) financial services, 2) industrials, and 3) healthcare. To be clear, most stocks in each of these sectors are up substantially from the lows of a year ago. However, we can still find many companies whose share prices appear to be reasonably valued within these sectors.

Financial services stocks are one of the few sectors in which we can identify growing companies for 10x earnings compared to broader market multiples of roughly 23x expected earnings in 2021. This sector has mostly lagged the broader markets despite recent strength driven by rising rates. Within financial services, many banks and insurers are still selling below pre-pandemic levels - a rarity in today's equity markets.

Industrial companies have been strong performers of late with excitement about the beginning of an economic recovery, augmented by proposed aggressive fiscal spending on infrastructure. No matter the timing or the size of the infrastructure bill that gets approved, we believe that there will be more spending on renewables, electric vehicles (EVs), electrical grids, and other industrials geared to fighting climate change. We see potential opportunities in some of the less obvious ways of participating in these themes. For example, we believe component and battery suppliers present more interesting opportunities within the EV space than most of the auto manufacturers.

We also believe healthcare is particularly interesting. The biotech sector, as measured by the XBI ETF, has plunged 25% from its February highs through early April. In the current climate of investors looking for interesting pandemic themes, biotech revenues do not appear to be heavily geared for an economic recovery. But for investors who have long-term horizons, we believe the sector offers a potential opportunity to identify companies with compelling clinical data, which is typically an important catalyst of growth.

Let us also consider that the Biden Administration has broadened its definition of infrastructure to include various measures of human capital. While we may see more regulation on drug pricing, we could also see more overall

spending on healthcare. Given the world's aging demographics and rising obesity levels, healthcare should have better long-term growth opportunities than the market perceives. The obesity epidemic shows no signs of abating globally, with nearly 30% of Americans and over 20% of Europeans fitting the definition of being clinically obese. These levels have been growing consistently for years, suggesting an investment opportunity that could last well in excess of more cyclical recovery themes.

Finding attractive themes in the current market is more challenging because of valuations. Price-to-earnings ratios have soared during the pandemic, despite corporate profits in 2021 that are just now recovering to levels that were expected a year ago. If rates keep rising, it will be harder to cite them as justification for current multiples of 23x expected earnings on the S&P 500 Index.

So far, it has been the proverbial "free lunch" with aggressive central bank and fiscal policies mitigating an economic disaster. Economic forecasts early in the pandemic called for a 10% to 15% contraction in U.S. GDP in 2020, which turned out to be a mere 3.5% decline. However, stabilizing the U.S. economy came at the cost of $5.3 trillion spent on pandemic relief without asking taxpayers for one dollar of revenue to pay for it.

The U.S. Federal Reserve has so far come to the rescue, growing its balance sheet more than what it did during the global financial crisis. It has also promised to keep rates unchanged until 2023 despite signs of budding inflation. Former Fed Chair William McChesney Martin said the job of the Fed was to "take the punch bowl away," but Chairman Powell has pledged to keep the liquids (and liquidity) flowing.

Current market valuations are merely one sign that greed is abundant. When our neighbors' kids are doing well trading cryptocurrencies and NFTs, and home flipping is back in vogue, greed appears to extend beyond equities. After 13 months of lockdowns, boredom is debatably even more widespread than greed.

Contrast that backdrop with: 1) the amazing reality that scientists created efficacious vaccines in months that in the past would have taken years, potentially saving tens of millions of lives and years of hardship, 2) unprecedented fiscal stimulus driving average U.S. wages higher during the recession - something never seen in modern economic history and 3) equity markets having a historic rise from the bottom over the last twelve months. Although greed and boredom are abundant, the one emotion in short supply these days is fear.

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