Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

The CIO Monthly Perspective

June 1, 2021

Jimmy C. Chang, CFA

Chief Investment Officer
Rockefeller Global Family Office
(212) 549-5218 | jchang@rockco.com

A WALK DOWN MEMORY LANE

30 years of wax and wane; is this time different?

On the surface, May 2021 looked like a rather boring month with a 0.5% gain for the S&P 500 Index, just 0.67% shy of its record high. In reality, however, it was a pretty volatile month with a 4% intramonth drawdown and big moves on the inflation and cryptocurrency fronts.

The April CPI, PPI, and PCE Deflator data all came in well above expectations. Inflationary pressure was clearly stronger than what the Fed had expected, yet the august body is still sticking to the "inflation is transitory" narrative. Investors seemed to have become more accepting of this narrative as the 10-year U.S. Treasury yield, after briefly surging above 1.7% post the CPI data release in mid-May, started a steady descent to month-end. Some attributed it to the Chinese government's more aggressive stance on curbing loan growth and speculative activities in the commodity complex. Others would point to the recent softening in U.S. growth expectations. Our system is also aflush with excess cash, as shown in the Fed's overnight reverse repo surging to nearly half a trillion dollars. Falling long bond yields led to a rotation in favor of growth stocks in the back half of the month with some of the speculative meme stocks – e.g., GameStop and AMC Entertainment – making a strong comeback.

Cryptocurrencies took a nasty drubbing. It started with Elon Musk's tweet that Tesla would no longer accept Bitcoin as payment for its vehicles due to concerns about its negative environmental impact. The decline accelerated after China cracked down on Bitcoin mining and trading. It's the most intense round of selloffs in more than a year, with Bitcoin having lost as much as 50% from its mid-April peak. The thrashing might have inflicted sufficient psychological and technical damage in the near term to scare away some investors. Regulatory risks also appear to be rising.

The selloffs among cryptocurrencies are the continuation of a trend that had started in January. One by one, the darlings of this epic bull market – alternative energy, biotech, disruptive technologies, fintechs, SPACs, etc. – have been losing altitude. Some have even dipped into bear market territory. Optimists can argue that this is a sign of market resiliency — that the broader indices have continued to move higher in spite of these pockets of weakness. However, it could also be an indicator of subtle distribution and a gradual loss of momentum. Given the still strong macro backdrops, I will continue to give this bull market the benefit of the doubt. However, I suspect market volatility will likely trend higher as the debate over the stickiness of inflation is far from being resolved.

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YAKUZA WAR

It was a lazy afternoon on October 10, 2019 in the Japanese port city of Kobe. Several police officers were standing guard in front of a building where Yamaken-gumi, an organized crime syndicate, or yakuza, was holding its monthly board meeting. There was heightened alert among authorities that Yamaguchi-gumi, Japan's largest yakuza, would attack the Yamaken-gumi in retaliation for a recent murder attempt. Two months earlier in Kobe, a Yamaguchi-gumi underboss was seriously injured when an assailant on a motorcycle pulled up next to the car he was driving and fired several shots at him, point-blank.

In August 2015, Yamaken-gumi had broken away from the Yamaguchi-gumi with several other disgruntled factions and formed a rival yakuza called Kobe Yamaguchi-gumi (KY). The split was an ostentatious snub to Yamaguchi-gumi's powerful kumichō, or godfather, as it took place during the group's centennial celebration. Two months later, a yakuza member affiliated with KY was found dead in Osaka with a gunshot wound to the head. The killing kicked off more than three years of bloody tit-for-tats rarely seen in Japan, one of the safest countries in the world.

At about 2:30 pm, a silver sedan pulled over in front of the building and an old man came out with a camera in hand. The police asked to see his ID, warned him that the place was not safe, and told him to move the car. The old man fumbled for a business card and said that he is a magazine reporter covering the yakuza. While the police were talking to the elderly reporter, two members of the Yamaken-gumi emerged from the building. The reporter turned to look at them, then quickly pulled out a gun and fired, fatally hitting both men. The sudden commotion caused much confusion at the scene, but one of the officers managed to wrestle the shooter to ground, arresting him shortly after. The hitman, a 68-year-old yakuza foot soldier, was allegedly stricken with a terminal illness and had agreed to carry out the shooting after being assured that his family would be taken care of by the Yamaguchi-gumi.

Two months after these Hyman Roth-like killings (à la *Godfather 2*), police arrested one of KY's bosses for perpetrating the prior August's drive-by shooting. The arrest sent shockwaves through the yakuza world as it was unheard of for a mafia boss to personally carry out a hit job. Was Kobe Yamaguchi-gumi so short on foot-soldiers that the boss had to do the dirty job by himself? Unfortunately for Kobe Yamaguchi-gumi, once people started doubting its strength, it was game over. Various affiliated gangs soon dissociated themselves from Kobe Yamaguchi-gumi. It might have marked an end to the multi-year yakuza civil war, as one of the Yamaguchi-gumi underbosses observed, "It's easy to see the tide has turned…no one wants to take sides with a punching bag."

Equity Markets Indices[1]	4/30/21 Price	5/31/21 Price	MTD Change	YTD Change
MSCI All Country World	702	711	1.4%	10.1%
S&P 500	4181	4204	0.5%	11.9%
MSCI EAFE	2269	2334	2.9%	8.7%
Russell 2000®[2]	2266	2269	0.1%	14.9%
NASDAQ	13963	13749	-1.5%	6.7%
TOPIX	1898	1923	1.3%	6.6%
KOSPI	3148	3204	1.8%	11.5%
Emerging Markets	1348	1376	2.1%	6.6%
Fixed Income				
2-Year US Treasury Note	0.16%	0.14%	-2	2
10-Year US Treasury Note	1.63%	1.60%	-3	68
BBG Barc US Agg Corp Sprd	0.88%	0.84%	-4	-12
BBG Barc US Corp HY Sprd	2.91%	2.96%	5	-64
Currencies				
Chinese Renminbi (CNY/$)	6.47	6.37	-1.6%	-2.4%
Brazilian Real (Real)	5.44	5.22	-4.0%	0.4%
British Pound ($/GBP)	1.38	1.42	-2.8%	-3.9%
Euro ($/Euro)	1.20	1.22	-1.7%	-0.1%
Japanese Yen (Yen/$)	109.31	109.58	0.2%	6.1%
Korean Won (KRW/$)	1112.40	1110.65	-0.2%	2.2%
U.S. Dollar Index (DXY)	91.28	89.83	-1.6%	-0.1%
Commodities				
Gold	1769	1907	7.8%	0.4%
Oil	63.6	66.3	4.3%	36.7%
Natural Gas, Henry Hub	2.93	2.99	1.9%	17.6%
Copper (cents/lb)	448	468	4.4%	32.9%
CRB Index	200	206	3.0%	22.6%
Baltic Dry Index	3053	2596	-15.0%	90.0%

Source: Bloomberg

While the Yamaguchi-gumi might have won the civil war, it was a pyrrhic victory. The violence has led to tougher enforcement by the authorities on this semi-regulated industry, resulting in dwindling yakuza membership. COVID-19 has hurt yakuza's revenues made from human trafficking, adult entertainment, food stalls, and loan sharking. Several yakuza fanzines that romanticized the underworld's lifestyle for recruiting purposes were shut down due to a lack of funding. The mystique of yakuza was further diminished by former gangsters who have broken their vows of silence with tell-all books. There is a Japanese proverb, "Had the pheasant not screamed, it would not have been shot." Perhaps the yakuza has become all too visible for its own good. Now, there is no turning back.

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LOST IN TRANSLATION

My first visit to Japan was in the spring of 1991. It was quite a different country thirty years ago. Its economy was booming while the U.S. was just limping out of a recession that would eventually cost President George H.W. Bush a re-election. The epic Japanese bull market had peaked 16 months earlier, but the country's real estate market was still bubbly. The official discount rate was at a cycle-high of 6% as the Bank of Japan was trying to slow economic growth to fend off inflationary pressure.

I was an IBM marketing representative covering accounts that included the U.S. operations of several Japanese banks. My clients had global ambitions at the time as four of the world's top five banks by asset size were Japanese. The conventional wisdom at the time was that Japan Inc. would someday surpass the U.S. in size. Just a few months earlier, the New York Times had run an article titled *"THE WORLD: Japan's Shrewd New Investment Strategy"*.

My colleague, an urbane Japanese expatriate on assignment in New York to support our Japanese accounts, made sure that I would have a nice "gaijin" tourist experience. I recall standing in awe at Shibuya Crossing, with my jet-lagged senses suddenly pulsating with flashing neon lights from above and the synchronized movements of thousands of pedestrians. I prayed at the Sensō-ji Temple and sang at a karaoke bar for the first time. We did not have enough money to venture into one of those Ginza hostess clubs frequented by businessmen, though my partner did point me to some stocky men in fine suits emerging with swagger from a club and entering a waiting German luxury car. "Yakuza," he whispered to me, and I quickly shifted my stare away from them.

I left Japan with much optimism that my Japanese accounts would help me achieve my sales quota that year. Little did I know at the time that Japan was about to enter a "lost decade" and my Japanese accounts would soon start selling their overseas trophy assets and retrench.

CONFESSION OF A DOT-COM TECH ANALYST

In 1994, the Chief Information Officer at U.S. Trust, one of my former accounts at IBM, helped me transition from selling technology products to analyzing the industry as an equity analyst at the firm. The tech industry was on the cusp of explosive growth. PC and networking equipment sales were brisk as businesses were rapidly adopting the client-server architecture. Microsoft was gearing up for its Windows 95 operating system introduction. Several startups – Amazon, Netscape, Yahoo! – were just being established. By late 1994, the strong demand for technology products led to a shortage in semiconductor chips, especially DRAM. It triggered a parabolic rise in the share price of DRAM maker Micron – a 447% surge from the start of the fourth quarter in 1994 to its cyclical peak in early September 1995. However, as supply started to catch up with demand, DRAM prices began to fall and the share price of Micron wound up losing most of the 447% appreciation in a span of a few months. It marked the first of the many boom-bust cycles that I would encounter as a professional investor.

The semiconductor's boom-bust cycle turned out to be just a sideshow in the dot-com frenzy, which was kicked off with Netscape Communications IPO on August 9, 1995. The share price was initially set at $14, raised to $28 at the last minute, and soared to a high of $75 before closing at $58 on its first day of trading. The speculative froth in technology and the Internet prompted the "irrational exuberance" comment by Fed Chairman Greenspan in December 1996, but his warning was quickly dismissed as a faux pas.

On May 15, 1997, Amazon went public at $18 per share and closed the session at $23.5 for a gain of 31%, a disappointing first trading day performance by that era's standard. However, the stock soon caught fire and soared to nearly $100 by the following April, prompting the company to split the stock two-for-one in early June 1998. The split triggered another buying frenzy that tripled the share price in five weeks. Amazon then lost nearly 50% of its value by mid-September 1998, when markets were hit with the Long-Term Capital Management's (LTCM's) near collapse. Greenspan responded by orchestrating a bailout and cutting the Fed Funds rate 75 bps between September and November. These rate cuts, which some consider to be the origin of the Fed-induced moral hazard, turbocharged the market and propelled Amazon's share price to more than triple from its September nadir to $240 ($480 pre-split, 27 times its IPO price of $18) on December 15, 1998. On the following day, Henry Blodget, an Internet analyst at CIBC Oppenheimer at the time, gave investors an early Christmas present by raising his price target for Amazon to $400. Blodget's big call made him an instant Internet celebrity and sent technology stocks to the moon.

On the last day of 1998, Denver-based Janus Capital Group launched the Janus Global Technology Fund, which became an overnight success. Janus was best known for its aggressive growth investment style. The dot-com-fueled bull market soon enabled the firm to capture 28% of the inflow to the U.S. mutual fund industry in 1999. In the first four months of 2000, Janus had taken in nearly as much new assets as it did in all of 1999. The Janus Global Technology Fund rode the dot-com wave and delivered an astounding 330% return from inception to its peak on March 9, 2000.

As a tech analyst during that go-go era, I was getting rock star-like reception at client events, as people couldn't get enough of the growth stories about B2B, B2C, 3G, online

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advertising, application-service-provider, etc. I was well fed at numerous IPO luncheons while listening to management of concept companies promising the moon. I would walk away either wondering why anyone would buy the IPO of a two-bit company with an outlandish valuation, or lamenting that the company looked so promising that not enough shares would be allocated to my firm to make a difference. I started filing away all of the IPO prospectuses and many sell-side reports that came across my desk with the expectation that, in due time, they will become interesting relics from a once-in-a-generation bubble. I had even thought that my daughter, then just three years old, could use them as research materials for a paper on market bubbles if she ever decided to major in finance. In perfect hindsight, I should have known that the market top was nigh when, in early 2000, my late mother, frustrated that she couldn't get a stock tip from me, asked how I managed to keep my job as a tech analyst if I was so negative on the sector.

Unbeknownst to most investors at the time, the stock market had reached its dot-com era peak in March 2000 – the NASDAQ Composite and the S&P 500 indices topped out on March 10th and 24th, respectively. Many were still expecting the good times to continue in the summer of 2000. During that summer's echo-bubble, the NASDAQ had rallied 35% from its interim low; the S&P 500 Index had come within 0.4% of its March peak on September 1st. There would be three more bear market rallies with gains of 25%, 41%, and 45% during the NASDAQ Composite Index's 79% slide from March 2000 to October 2002. At its nadir in October 2002, the Janus Technology Fund, the one-time darling of mutual fund investors, had lost 85% of its value from its March 2000 peak and 35% since its inception date. Many investors even bailed on the mighty Amazon, which suffered a maximum drawdown of 94% during that brutal bear market.

THE HOUSING & CLEAN TECH BOOMS

The year 2001 had an ominous start – the NASDAQ Composite dropped 7.2% on the first trading day of the year. On the following day, Fed Chairman Greenspan surprised investors with an aggressive inter-meeting rate cut, taking the Fed Funds rate from 6.5% to 6.0%. It triggered a 14% rally in the NASDAQ Composite, the biggest single-day percentage gain in its history. It was the start of an easing cycle that took the Fed Funds rate down to 1% by June 2003, but it was not enough to reverse the NASDAQ's downtrend. The beneficiary turned out to be the U.S. housing market.

A confluence of drivers – low interest rates, lax lending standards, financial innovations, and Uncle Sam's implicit guarantee for various Government-Sponsored Enterprises such as Fanny Mae and Freddie Mac – created an epic housing boom in the U.S. House flipping was in vogue, and lenders were incentivized to make subprime loans to low-income borrowers. Stocks of U.S. homebuilders were some of the best performers during that period. For example, from the start of 2001 to its cycle-peak in July 2005, the share price of DR Horton appreciated 474%.

At an investment conference in 2005, I ran into a brash New York University professor who was pontificating about the U.S. housing market being a bubble. I followed, with much interest, his debate with market bulls on an online message board at the time. His negative views were, of course, unpopular and some nasty forum participants were hurling insults at him, calling him "boobini," which rhymed with his last name.

Nouriel Roubini turned out to be far more prescient than most macro prognosticators. Former Fed Chairman Ben Bernanke had repeatedly said in 2006 and 2007 that the U.S. housing market was fine and that issues in the subprime mortgage space would be contained. One respected sell-side economist tried to assure investors of a soft-landing by characterizing the decline in home prices as "rust, not bust." At her 2010 Fed Vice Chair confirmation hearing, Janet Yellen acknowledged belatedly that regulators had failed to "connect the dots." Interestingly, housing stocks were quite predictive of the crisis ahead – after an aborted rally to make new highs in mid-January 2006, their share prices started to decline precipitously, well ahead of the eventual subprime blowup. All told, DR Horton wound up losing 90% of its value from its July 2005 peak to its trough in November 2008.

As equity investors started to pivot away from housing stocks in 2006, Wall Street found a new darling of speculation – Clean Tech, or the Green Bubble. Alternative energy solutions were in vogue during the mid-2000s due to the surge in crude oil prices. The WTI crude oil price had soared from $42 per barrel at the start of 2005 to an all-time-high of $145 in July 2008. Investors eagerly snapped up shares of companies with names that featured words "sun," "solar," or "wind." First Solar's share price surged from $20 at its November 2006 IPO to $311 by May 2008, an Amazonesque gain of 1456% over 18 months. Unfortunately, the Great Financial Crisis took everything down, and the share price lost 96% of its value over the next four years.

The Lehman Brothers' bankruptcy in September 2008 triggered a sharp plunge in global financial markets when margin calls forced traders to sell anything that had liquidity. Nearly 13 years of the S&P 500 Index's price appreciation was wiped out when it troughed at an intra-day low of 666 on March 9, 2009, a level last seen on September 11, 1996, three months before Greenspan made his irrational exuberance comment.

The Great Financial Crisis was finally brought under control thanks to a combination of unprecedented initiatives. The

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lame duck Bush Administration got Congress to pass the Troubled Asset Relief Program (TARP) to help recapitalize U.S. banks. The Fed dropped helicopter money through quantitative easing to reliquefy the financial system. President Obama then signed a $787 billion rescue bill into law in February 2009, an amount that was considered huge at the time. These moves set in motion the longest economic expansion and equity bull market in U.S. history. However, in spite of the powerful rally off the bottom in March 2009, the 2000s was still a lost decade for equities. The two epic bubble implosions led to a 24% decline in the S&P 500 Index. On a total return basis, the index was down 9% cumulatively for that ten-year period. It was the index's first decade of loss since the Great Depression.

UP & DOWN WITH METALS & COINS

In late 2008, Chinese policymakers came to realize how destabilizing the Great Financial Crisis would be to its regime and responded with a 4-trillion-yuan infrastructure stimulus program ($585 billion), which was equivalent to 13% of its GDP. This aggressive stimulus reversed the freefall in the commodity complex and fueled an inflation shock that eventually triggered regime-toppling protests across the Middle East -- the Arab Spring. From its trough in December 2008 to the peak in February 2011, the price of copper surged 271%. However, rising inflationary concerns and a housing bubble then forced Chinese policymakers to put the brakes on its red-hot economy. As China's demand slowed, copper prices rolled over and eventually dropped as much as 58% from its 2011 high.

The world's brief inflation scares in 2011 would soon give way to deflation fears as the European Sovereign Debt crisis flared up and banks were forced to deleverage. In June 2014, the European Central Bank lowered its benchmark interest rate to negative territory, which kicked off the biggest bond bubble in history. Two years late, even the 30-year Swiss bond yield had gone negative, eventually troughing at -0.7% in August 2019. While I can understand why someone would accept negative interest rates in the short run to park excess cash, I have a hard time justifying negative yields for a 30-year bond. Of course, with Swiss bonds of 20 to 30-year maturities yielding around 10 bps now, those who had purchased the bond in the summer of 2019 are sitting on double-digit losses.

On Thanksgiving 2017, my daughter was home from college, where she was a liberal arts student. Perhaps it was a sign of rebellion that she had never shown any interest in finance despite my advice that it would be a rewarding field for someone who is intellectually curious. To my surprise, she finally broached the subject of finance at Thanksgiving dinner, but it was about Bitcoin. The cryptocurrency was in the midst of a parabolic surge, having gone from around $1,000 at the start of the year to above $8,000. She said many of her friends had made handsome profits trading Bitcoin, and perhaps she should look into it. Of course, right after I talked her out of speculating on something with no intrinsic value, Bitcoin soared from $8,200 to over $19,000 by mid-December 2017. I managed to salvage some credibility in my daughter's eyes when Bitcoin fell back to $8,200 by the following February and bottomed at around $3,100 in mid-December 2018.

THE MOTHER OF ALL BUBBLES

In March 2020, SARS-COV-2, a virus of dubious origin, abruptly ended the longest economic expansion and equity bull market in U.S. history. Economic activities came to a screeching halt, and liquidity had evaporated. Policymakers responded with every bazooka that they had deployed over the last decade and upsized them multi-fold to maximize the impact. The Fed expanded its balance sheet by $3 trillion in a span of just three months, and Congress had appropriated $2.5 trillion of rescue funds by April 2020. These aggressive moves limited the bear market to just 33 days, the shortest in history. Then, just as the U.S. economy was poised to reopen thanks to the success of Operation Warp Speed, Congress doled out another $2.8 trillion of fiscal stimulus to turbocharge the recovery. These unprecedented stimuli, in conjunction with pent-up demand, as well as supply chain disruptions, have enabled each of the aforementioned bubbles to resurface concurrently. That is, all of the bubbles that took place serially over the last quarter century have made comeback in the current bull market!

The biggest bubble of all is arguably in the cryptocurrency space. From the beginning of 2019 to its recent peak in mid-April, Bitcoin had appreciated a whopping 1,600%! Unlike the 2017 cycle which was powered by individual investors, Bitcoin now has institutional participation, including corporate buyers such as Microstrategy and Tesla. Interestingly, Nouriel Roubini, who has earned the Dr. Doom moniker for his prescient call on the housing bubble, is again playing the role of Cassandra by incessantly calling Bitcoin a fraud on Twitter. He has been, of course, roundly ridiculed by crypto bros and told to stay poor. I have a nagging hunch that Dr. Doom could turn out to be right to some degree, as this unregulated space may be fertile ground for fraudsters to run Ponzi schemes that make Bernie Madoff look amateurish.

Bitcoin's parabolic rally phase for this cycle might have been jinxed by a text from my daughter in mid-April. Just like in November 2017, she asked me what coins she should invest in since it seemed like all her friends were riding their investments to the moon. Her question has turned out to be a good contrarian timing indicator.

In the real economy, strong demand from reopening and pandemic-related supply disruptions have driven up

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commodity prices from copper to iron ore. Since the start of 2019, copper and iron ore prices have risen 81% and 154% to their respective peaks. The surge in commodity prices has prompted China to start reducing its credit impulse, as it had done a decade ago, in order to forestall rising inflationary pressure.

Strong demand also led to a shortage in semiconductor components and created a classic up-cycle. Share prices of Micron, the poster child of my investment career's first semiconductor cycle more than a quarter century ago, nearly tripled from the end of 2018 to its recent high in April, which was just 1% shy of its all-time-high reached during the dot-com echo bubble in July 2000. Alternative energy stocks also enjoyed the best bull-run since their hay days in the mid-2000s. From the beginning of 2019 to its peak in late January 2021, First Solar's share price went up 153%, but still lagged many of its peers.

Here in the U.S., the pandemic drove many urban dwellers to look for single-family homes in the suburbs and created a red-hot housing market rivaling the mid-2000s' bubble in some regions. Lumber prices have more than quadrupled from two years ago, and homebuilder stocks are once again on a tear. The aforementioned DR Horton has seen its share price tripled from the start of 2019 to its all-time-high in early May.

The pandemic has also turbocharged many so-called disruptive technology stocks that were already darlings of growth investors. Wall Street was quick to seize on the market's elevated risk appetite and hunger for growth stocks to open up the IPO spigot. All told, 456 U.S. entities went public in 2020, the most since the dot-com era's 547 offerings in 1999. Amazingly, more than half of the IPOs in 2020 - 248 to be exact - were special purpose acquisition companies (SPACs) which basically had investors entrust their money with the companies to make acquisitions. The poster child of this era of disruptive-growth-at-any-price investment style is perhaps ARK Investment Management. Its flagship ARK Innovation ETF has generated an astounding 330% return from the start of 2019 to its peak in February 2021. ARK's meteoric rise is reminiscent of Janus Capital Partners' success during the dot-com era.

As is human nature, greed and hubris would inevitably lead to investment failures, some spectacularly, even in the best of times. The sudden collapse of Archegos harkens back to 1998's LTCM saga. On the bright side, there was no systemic damage in 2021 despite much larger losses.

The one distinguishing feature of the current market cycle is the degree of excess and fearlessness. A horde of individual investors can leverage social media to squeeze heavily shorted stocks to the moon, as in the case of GameStop. The market value of a cryptocoin created as a joke can be bid up to tens of billions of dollars, far exceeding the market capitalizations of many well-established companies with real products and services. The recent frenzy in trading non-fungible tokens (NFTs) appears to be another sign of irrational exuberance. Come to think of it, perhaps I can try to monetize my collection of IPO prospectuses from the dot-com era. Anyone interested in a NFT backed by a copy of Pets.com's IPO prospectus from February 2000?

EVERYTHING GOES IN CYCLES

In the spirit of full disclosure, let me acknowledge that I am prone to be biased toward the conservative and skeptical side, as the twin bubble implosions in the 2000s have left an indelible impression on me. Instead of rushing headlong to ride the upswing of an asset bubble as great traders would do, I tend to look at what could potentially go wrong. I am the type who believes that defense wins championships.

My concern about these erstwhile bubbles enjoying a concurrent rebirth is not a prediction of an imminent implosion since, to paraphrase the great John Maynard Keynes, markets can remain irrational longer than one can stay solvent. Financial bubbles can ferment for a long time until their fundamental and psychological underpinnings start to deteriorate. One can also question if it's appropriate to use the word "bubble" to describe these highly valued assets since it implies that they will implode at some point — an outcome that can be open to debate.

At the present, fundamentals for most sectors are on the upswing, and there is still plenty of liquidity in the system. The psychological underpinnings, however, are trickier to figure out. There is a parallel between speculative bubbles and Kobe Yamaguchi-gumi's situation -- the game will go on only if the participants keep their faith. In Kobe Yamaguchi-gumi's case, the game was over when its affiliated yakuza sensed its weakness. In a financial bubble, many participants knowingly overpay for assets on the belief that there are others willing to pay even higher prices. This is the reason why leading cryptocurrency evangelists were tripping over each other to tweet about their "diamond hands" (the tendency to hold on to the asset no matter the fluctuations) after the recent price collapse. In the absence of intrinsic values among cryptocurrencies, crypto enthusiasts need to convince those with weaker hands to keep on believing in order to keep the game going.

The Fed also plays an important role in supporting asset prices. For more than a decade, its ultraloose monetary policy has provided strong fundamental and psychological underpinnings for financial markets: lower interest rates offer a theoretical justification for higher valuations, and the so-called "Fed put" encourages riskier behaviors as the central bank is expected to come to the market's rescue should something go awry. This may be one of the reasons

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why the Fed has been so insistent that higher inflation is transitory. If it were otherwise, the Fed would have to start taking away the proverbial punchbowl.

Is it possible to inoculate one's portfolio against the potential implosion of these pockets of highly valued assets? Well, it depends on the nature of the implosion. The negative impact of a specific sector suffering a material drawdown can be lessened with diversification. For example, in 2000, the bursting of the dot-com bubble took the NASDAQ Composite Index down 39%, but the S&P 500 Equally Weighted Index and the utilities sector generated gains of 7.6% and 57%, respectively. On the other hand, it would be a tougher task if the rupture turns out to be systemic, as was the case during the Great Financial Crisis. The good news today is that the financial system appears to be in a strong position.

Another way to deal with perceived asset bubbles is to go on the offensive. An asset bubble implosion can be a lucrative opportunity for those who can skillfully short against the bubbles. It is admittedly easier said than done, as it could be dangerous to short a stock simply because it is expensive. Shorting is a craft that requires not only analytical acumen, but also the right temperament, appropriate position sizing and leverage, and a "feel" for the market. A well-managed long-short equity hedge fund can add value by exploiting mispriced opportunities in both bull and bear markets. Indeed, some funds had fared very well during the bursting of the dot-com bubble and the Great Financial Crisis. While the Reddit crowd's daring short squeezes have inflicted big losses on some funds this year, I view them as a screening tool to evaluate a hedge fund's risk management. In short (no pun intended here), one of the most fertile investment environments in a decade for long-short funds may be around the corner.

Another move to consider is to take some profits on high-flying U.S. stocks as a source of fund for non-U.S. equities. Many foreign countries are lagging badly behind the U.S. in vaccination rollouts and re-openings. As a case in point, major cities in Japan are still in a state of lockdown, and Japan's economy has slid back to contraction in the first calendar quarter of 2021. In an effort to encourage people to stay home, Tokyo Governor Yuriko Koike has asked businesses to turn off their lights after curfew. The once-spectacular neon signs and flashy billboards overlooking the bustling Shibuya crossing have gone dark now. However, to use the Fed's favorite phrase, this dark period for Japan and many other countries is only "transitory." As they get the pandemic under control and reopen the economy in the coming months, their economic and earnings growth will be accelerating just as our stimulus-fueled growth starts to decelerate.

In retrospect, during the early days of the pandemic, I did not foresee that the U.S. would emerge from it with such a powerful upswing. However, today's prosperity is living on borrowed time as our national debt and unfunded liabilities have grown substantially larger. It is prudent to think of what could go wrong down the road and do a bit of hedging while things are going swimmingly. Just remember that everything goes in cycles, and all things are transitory except for death and taxes.

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