

Game Over



By Jonathan Caplan

Well, you heard it here first. Do not say you were not warned. In February 2021 we penned an article describing how certain segments of the stock market were trading with fantastical and unrealistic valuations. Case in point: the meme stock frenzy that began in January 2021. The struggling video game company Gamestop became the poster child for a speculative phenomenon, when all traditional principles of investment discipline were cast aside. Speculators were interested only in trying to make a quick killing. We laid out our concerns in The Jewish Link as follows:

"I recommend viewing this type of activity for what it is: speculation. Many of us enjoy the thrill of gambling or speculating in the hopes of making a killing.



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We buy lottery tickets. We play games of chance in casinos. But we know that the odds of success are generally not in our favor. Because of this, we tend to set limits on those activities as excessive risk taking can lead to unhappy outcomes." (The Jewish Link, March 25, 2021)

A few months later we highlighted this emerging disconnect between prudent investing and sheer speculation in our quarterly Investment Review communication with our clients. In that piece, we cautioned clients that the SPAC (special purpose acquisition company) craze was not grounded in any investment reality and that the speculation could end very badly.

So here we are in January 2022, less than a year later, and many of the most speculative stocks have plunged dramatically. I am not here to tell you "I told you so." My message is once again that successful investors should be able to differentiate between irrational exuberance and investment discipline and rigor, which can make a huge difference in investment success for the long term.

Why Should You Care?

To many folks, it may not be clear why we should really care about market speculation. But many readers likely have large sums of their retirement assets invested in stock mutual funds. If the stock market is showing signs of fragility, as it has in the past few weeks, one's retirement assets are likely suffering. We have not had a sustained bear market in equities for some time. But with the Federal Reserve pulling back on monetary accommodation and the declining fiscal stimulus, we could be at the beginning of a period of time when stocks are vulnerable to sustained lower, or perhaps negative, returns.

OK, Now I Am Scared

If you believe I am suggesting that the time is ripe to get out of the stock market, you are sorely mistaken. In upcoming articles, we will make the case that stocks

should remain the cornerstone of investment portfolios, even for retirees who need to supplement their retirement incomes. Moreover, I believe that there are many stocks in the market today that are fairly valued, if not significantly undervalued. Our firm's research team is finding an increasing number of stocks that we consider trading in undervalued territory. Thus, we are viewing the dislocation in the stock market as an opportunity to reposition portfolios with stocks that are being marked down with little fundamental reason.

Other Thoughts on Our 'Theory of Relativity'

Last month we described what we called the "theory of relativity" with regard to investment decision making. Many unseasoned investors and speculators will look at the steep sell-off in highly valued stocks and make the case that they have uncovered "value" on a relative basis. But for many of these stocks whose prices have fallen dramatically, there is a reason why their prices have collapsed: The prospects for the future enterprise value are just not anywhere near where the stock trades today.

To be sure, not all of these stocks will be in the doghouse forever. And there could be value in a company that has seen its stock price collapse. The key is making an unbiased determination of the future prospects of the company and then calculating a realistic estimate of the intrinsic value.

Going It Alone

I am sure that there are many investors that have seen their investments sour in the past few weeks. Some seasoned investors will have the discipline to ride out the volatility. Others may capitulate and throw in the towel by getting out of the market entirely. Many investors have the tendency to make the wrong decisions at these key decision points in the market cycle. Taking one's cues from the sound bites of random talking heads on CNBC is not a reasonable path forward. One should be ques-

tioning whether she is comfortable withstanding the market volatility as the year unfolds. Those with limited investing experience will conclude that they are not equipped to weather the storm on their own and seek advice to position their portfolio for long-term success.

Choosing a Professional Portfolio Manager

If you come to the conclusion that you need professional help, I urge you to do your due diligence. I would caution you that some advisors have sales prowess but lack experience in investing in bear markets. Do not be shy about questioning their experience and challenging their proposed strategies. Determine whether they have insights that resonate and that they can offer more than "boilerplate" advice. Finally, be certain that you have full confidence in their financial acumen and integrity so that you will be in a strong position entering the next bull market cycle.

Jonathan D. Caplan, a former Wall Street executive, is president and founder of wealth management firm Caplan Capital Management, Inc., with offices in Highland Park and Hackensack. He holds a BA from Yeshiva University and an MBA in finance from New York University Stern School of Business. You can find other recent investment articles by Jonathan at www.caplancapital.com/blog.

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