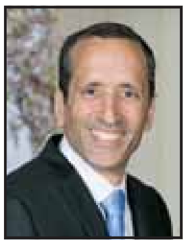
Fangover



By Jonathan Caplan

Have you ever been to a chasuna or a party, had a drink or two, and then a few more? For a while you were feeling great. Without mentioning all the gory details that transpired later that evening, you wake up the next morning with a terrible hangover. You make a promise to yourself (bli neder, of course) that you will never let that happen again. But before you know it, you forget about the prior bad experiences. You lose all your discipline and repeat the cycle once more.

Now I confess that I have had a drink or two here and there. Perhaps at a Purim party or during a night out with "the guys." But those days are more or less a distant memory for me. After nursing a bad hangover or two in my youthful days, I have learned that it is best to avoid the fallout from getting too inebriated!

Getting 'Drunk' on Hot Stocks

The experience of a hangover can be an apt metaphor for the experience many novice investors suffer sometimes in the financial markets. At first it feels good to "get in on the market action." But after suffering sharp losses and losing their nerve, many investors will resolve to limit painful losses of principal and bail out of an errant investment. Thus, I am coining a new term for the experience of impulsively investing in a questionable security and then losing a lot of money: Fangover.

A double entendre is intentional in this term. I have heard stories of investors who slavishly follow the advice of media talking heads like CNBC's breathless host, Jim Cramer, who I believe coined the acronym "FANG" stocks. FANG represents four of the hottest technology stocks over the past decade: Facebook, Amazon, Netflix and Google.

To be sure, these stocks had substantial runs for many years. But then came 2022, when rising interest rates and rising inflation have taken a toll on stocks in general, and those with questionably high valuations in particular. One could argue that these four stocks are receiving their comeuppance this year after years of elevated investor exuberance. Netflix is faring the poorest with losses of over 60%. Facebook (now known as Meta Platforms) had a monstrous sell-off after it reported a revenue slowdown in its first-quarter earnings report. Amazon and Google (now known as Alphabet) are faring better, but losses this year on both are well in excess of the negative returns on the S&P 500 index.

For those latecomers to the FANG trade, it is a time for serious reflection. And this goes for all those who bought into former high-flying stocks such as Zoom, Peloton, Beyond Meat, Robinhood and a host of other stocks that have registered staggering declines from their peak prices in a relatively short time frame.

Is the Market Rigged Against the Little Guy?

This is a topic I have written about in prior columns. Many times, when individual investors make an investment, sadly they perform little to no due diligence. If one bought Peloton at $150 and a year later it trades below $15, do they attribute their misadventure to the "big boys" on Wall Street and claim that the market is rigged against the little guy? Or do they try to honestly analyze where they went wrong? I believe that their experience could very well be due to taking advice from questionable sources. They may have done little to no analysis of the stock's valuation and they certainly failed to assess the downside risk. It would have made no difference to this type of investor (or shall I say "speculator") whether the stock was trading at $100 or $150 or $200. If they liked the "story" they decided to buy regardless of the gap between the stock price and a disciplined and thoughtful assessment of the company's intrinsic valuation and growth prospects. Successful investors act in a disciplined fashion and are able to determine the fair value of the stock. While the undisciplined investor chases a "hot" stock at any price just on the basis of questionable opinion, the disciplined investor will make an unbiased and thoughtful risk-and-potential-reward assessment.

The Buffett Way

Warren Buffett is fond of saying that "only when the tide goes out do you discover who has been swimming naked." One can easily argue that 2022 is a year when "the tide has gone out" quite far for the equity markets. And the sight "ain't too pretty." Many market participants are experiencing miserable performance in this bear market. But value investors are performing better than the conventional averages. At Caplan Capital Management, Inc., we endeavor to swim in what we judge as more conservative sectors and individual stocks in the market. We look for stocks with valuations that we believe are much more reasonable than many of the formerly high-flying growth stocks.

A Word to the Wise

We believe that the performance of the markets in 2022 is a clarion call to investors to adopt a disciplined approach, which we see as one of the most important ingredients for successful long-term portfolio performance. I have no idea whether many of these high-flying technology stocks have bottomed yet. But I do know that we are increasingly finding plenty of stocks that trade at valuations that offer potentially strong returns without significant downside risk.

Avoid the Fangover

Getting back to my financial metaphor, I would argue that having a few too many drinks that result in a hangover is not such a pleasant experience. But investing haphazardly in the market, resulting in a "Fangover," could be much more painful.

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