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Investment Review and Outlook

The performance of the equity markets in the first quarter of 2021 would have seemed improbable early in the year. As the new year unfolded, the markets faced some unsettling events such as the surge in Covid-19 cases and the ugly insurrection on Capitol Hill. But the surge in vaccinations along with the ultimate peaceful transition of presidential power helped calm investor jitters, resulting in respectable returns for equity investors. That said, fixed income returns were quite weak as long-term interest rates began rising.

We believe that the main driver of both the equity and fixed income markets is expectation of a strong economic rebound. The economy may experience growth at the fastest pace in nearly four decades. Rising vaccinations coupled with the acceleration of the “reopening” of the economy will be major catalysts. Other drivers, including the unprecedented monetary and fiscal stimulus, will help drive strong economic performance and rising corporate profits at a more rapid pace than many believe. So, is it time to go all in on equities?

Without throwing cold water on a bullish thesis, we are vigilant with regard to some of the unintended consequences of some of the growth drivers. We are closely watching signs that the markets and the economy could become overheated. That could be manifest by continued upward pressure of longer-term interest rates as well as a possible overshoot on the inflation front. We also believe that loose financial conditions are artificially driving up the prices of certain financial assets including the “meme” stocks, SPAC’s (see below) and perhaps cryptocurrencies. We are also watching the bond market for signs that fixed income investors are demanding increasingly higher interest rates, despite the extreme monetary accommodation from the Federal Reserve.

While we are by no means bearish on the equity markets, we are maintaining a selective stance. Stocks that we deem attractively priced and that are not artificially being propped up by the confluence of stimulative actions by the Federal Reserve and Congress will be our strategic focus as the year unfolds.

Spac and Spin

The popular household cleaner Spic and Span has a storied, 100-year history as “the perfect detergent” for cleaning one's house. One advertisement from 1980 boasted that Spic and Span was “the last real value in town.”

Fast forward to recent years when Special Purpose Acquisition Companies (thus the acronym “SPAC’s”) have become the latest craze on Wall Street. In short, they are known as "blank check” companies or "shell companies" that raise money in order to acquire or merge with unspecified private companies. In essence, when one invests in a SPAC, one is betting that the management of the SPAC are capable of finding private investments and purchasing them at a discount to their fair market value.

Now we see no problem with creating new vehicles for bringing private companies to market. But there is potentially a problem with the ebullience of investors, who seem to believe that all SPAC's are created equal and are all capable of making astute acquisitions at attractive prices. This is manifest by the run up in share prices this past year for many SPAC’s, even if the management has no discernible successful track record. Ultimately, we believe that only the best managers will succeed in their mission of acquiring private companies at very attractive valuations. Moreover, the proliferation of SPAC's has been nothing short of astounding. According to Wikipedia, in the past 5 years, the number of SPAC IPO's has grown from 20 to 248 with a dollar amount growing from $3.9 billion to $83.3 billion. We see a potential reckoning not too far in the future. Thus, we recommend being skeptical of the “spin” and avoiding the “SPAC.”