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The Financial Advisor Newsletter

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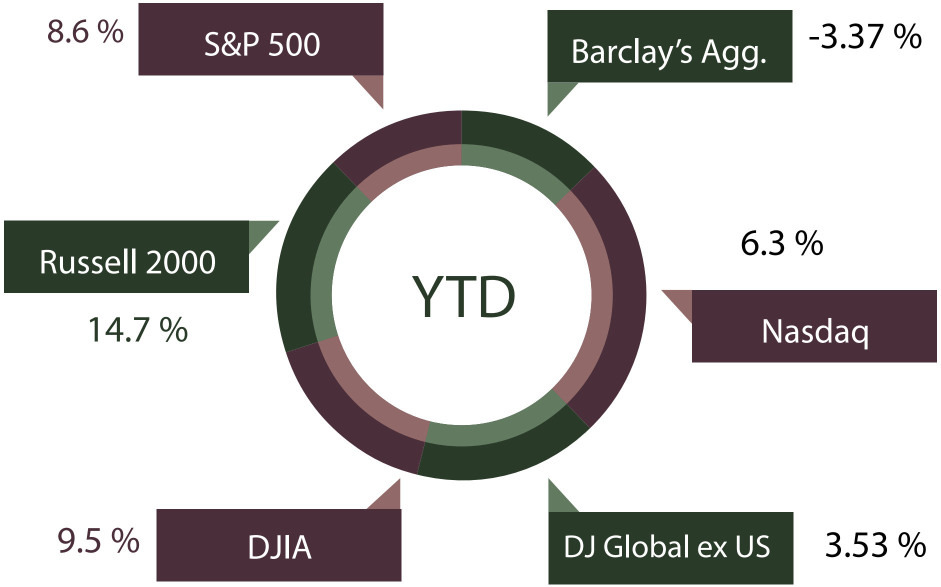
Front cover photo taken by Patrick L. Sullivan

ECONOMIC SNAPSHOT



Source: WSJ, April 1, 2021. Inclusion of these unmanaged indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will effect actual investment performance. Individual investor results will vary. Past performance does not guarantee future results. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow," is an index representing the stocks of 30 companies maintained and reviewed by the editors of the Wall Street Journal. The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Nasdaq composite is an unmanaged index of securities traded on the Nasdaq system. The Dow Jones Global ex US is a stock market index measuring equity securities traded globally in 64 countries, excluding the U.S. The Barclays Capital US Aggregate Bond Index is a benchmark index composed of US securities in Treasury, Government-related, Corporate, and Securitized sectors. The Russell 2000 index measures the performance of the 2000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

KEVIN'S VIEW

STORY VS. STORY

Financial markets are driven by the stories we all tell ourselves; much like many other parts of our world. These stories give structure and context to an otherwise unbelievably complex world. They are necessary and valuable otherwise we would become lost in a flood of constantly changing variables. There never is just one story. There is a continuum of them. They can range from a "Harbinger of Doom" predicting our imminent return to the Great Depression (or even to the Stone Age!) to the Pollyanna-ish prognosticator predicting a chicken in every pot and luxury car in every garage. We usually end up somewhere in between those extremes, but there is one thing that is very particular about these stories. The more people who believe in a story and adjust their portfolios accordingly the higher the likelihood some version of that story will happen. Of course, nothing is guaranteed, but it is an interesting phenomenon, nevertheless.

Right now, there is a fierce battle between two stories of what our Post-COVID world will look like. On one hand some think that a combination of continued unemployment along with lasting economic structural damage due to the virus associated lockdowns will lead to a period of deflation. Deflation is a serious issue and is what we faced in the Great Depression. If prices are going down consumers put off purchases because if you can buy it cheaper tomorrow, why wouldn't you wait? The problem is if everyone waits on their purchases then companies end up laying off personnel. Those newly unemployed then don't spend money either, so the cycle feeds off of itself and can become economically catastrophic fairly fast.

On the other hand, some think they massive governmental spending along with hefty central bank support for that spending will cause massive inflation. That inflation will drive up the price for goods and services and potentially weaken the U.S. Dollar. Those of you who lived thru the 1970s may remember this time. The U.S. inflation rate peaked around 12% a year at one point. By contrast, the inflation rate for the last few years has been between 1-2.5% annually. Any talk of inflation always seems to bring up visions of wheelbarrows full of bank notes to buy a loaf a bread. We are nowhere near those ideas, but just to put them into context, in pre-World War II Germany, the inflation rate got up to 41% per day, and in 2019 Venezuela reached an inflation rate of 9,586% per year. Nobody is predicting anything like that.

So, with these stories, what should investors believe in and what should they do? The likeliest answer is some combination of the above. We will probably see a bit of an economic dip at some point during the upcoming year, but it will likely be short lived and an increasingly inoculated populous should provide a economic bump towards the end of the year baring a major change in the virus. For portfolios, the answer is to stay diversified and stay flexible. We are at a time unlike almost any other in economic history in the United States, but our principals remain. □

DID YOU KNOW...

THINGS TO DO

Read up on RMDs: If over 72, take required minimum distributions (RMDs) from your IRAs and qualified plans. You must begin RMDs by April 1 the year after you turn 72. Subsequent distributions must be taken by Dec. 31 each year. That means if you reached 72 during 2020, and you delayed your 2020 initial RMD until April 1, 2021, you still have to take your 2021 RMD before Dec. 31, 2021. For more information, go to www.irs.gov/rmd.

Go house hunting: It's homebuying season. If you're considering buying or refinancing a home, keep an eye on mortgage rates and plan to review the terms with us, as such a major purchase will have an effect on your financial plan.

Spring 2021 Market Closures

May 31: Memorial Day

GAMESTOP, REDDIT, AND MARKET MANIA

What You Need to Know

From January 13 to January 28, 2021, the stock of GameStop, a struggling brick-and-mortar video game retailer, skyrocketed by more than 2,200%. Other stocks of small, struggling companies made similar though less dramatic moves. At the heart of this story are two very different sets of investors: (1) professional managers of multibillion-dollar hedge funds, who took large, risky positions betting that GameStop stock would drop in price; and (2) a small army of individual investors, connected through social news aggregator Reddit and other social media sites, who worked together to buy large numbers of shares in order to drive the stock price up.

As the stock price rose, fund managers were forced to buy more and more shares at ever-increasing prices to "cover their bets," while individual investors continued to buy shares in hopes of continuing the momentum. The opposing forces created a feeding frenzy that sent the stock to dizzying heights far beyond the fundamental value of the company. The stock price peaked on January 28 and lost almost 90% of its peak value over the next five trading days.

What is Reddit, and what were the Reddit investors doing?

Reddit is an online community with more than a million forums called subreddits in which members share information on a particular topic. Members of a subreddit dedicated to investing coalesced around a strategy to buy GameStop stock in order to push the price up and squeeze the hedge funds. While some investors genuinely believed that GameStop was undervalued, the movement developed into a crusade to beat the hedge funds in what amateur investors perceived to be a "game" of manipulating stock values, as well as a more pragmatic belief that there was money to be made by buying GameStop low and selling high. The fact that many young investors were gamers who felt an affinity for GameStop added to the sense of purpose. The strategy worked more powerfully than the amateur investors expected, and some who bought the stock in the early stages of the rally and sold when it was flying high earned large profits. However, those who joined the excitement later faced large losses as the stock plummeted. Once some hedge funds had accepted losses and begun to close their short positions, there was no longer demand for shares at inflated prices.

Article continues on page 7

A look at the

30-YEAR FIXED-RATE MORTGAGE OVER TIME

7.38%

16.63%

Yes, mortgage rates are rising...

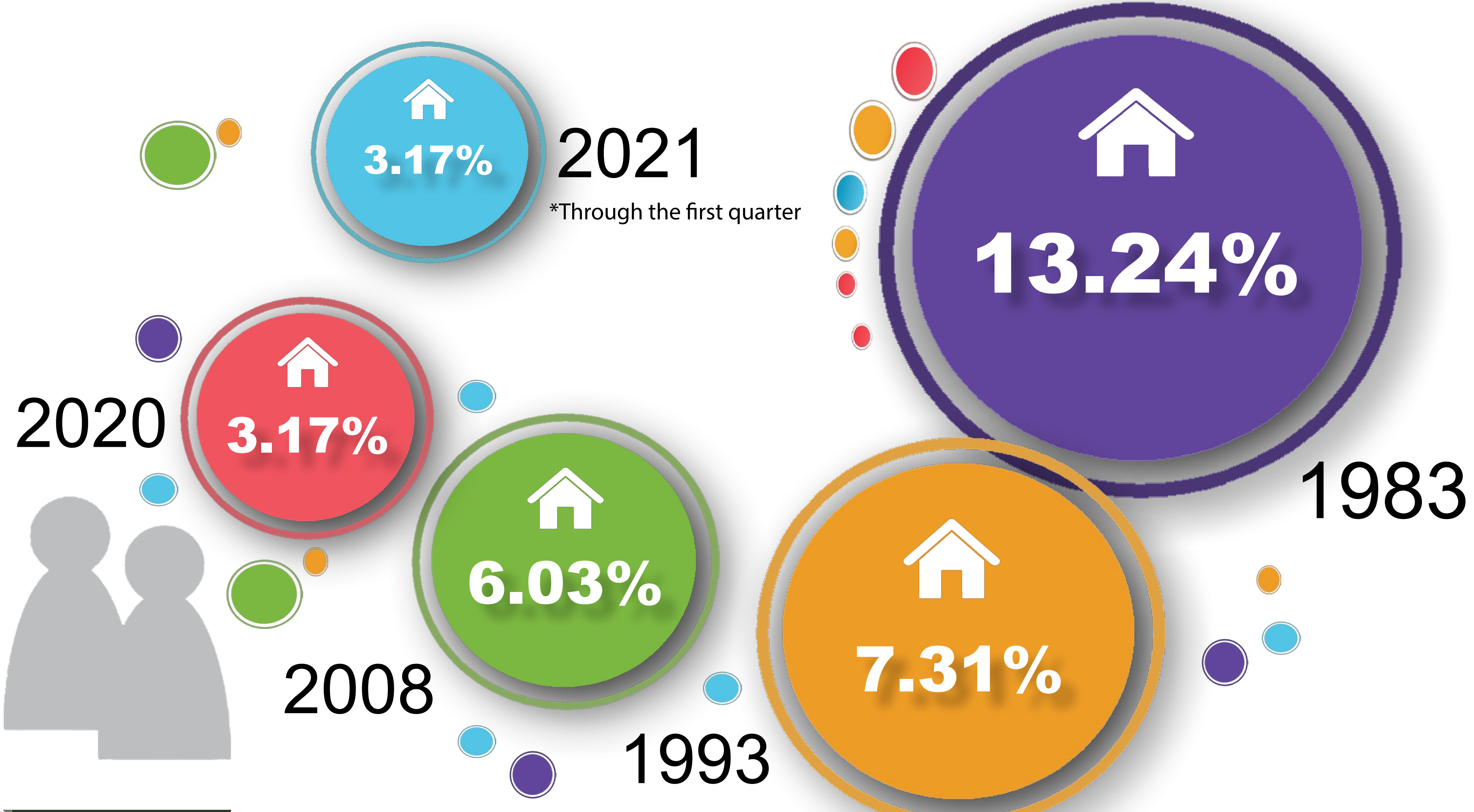
...but they are still historically low and affordable

1972

*First full year of data available. (1971 is the first year Freddie Mac began surveying lenders to determine the average 30-year fixed-rate mortgage rate.)

1981

*The highest annual average on record



Source, Freddie Mac

Why did brokerage firms limit trading activity for certain stocks?
At various points during the peak trading activity, some brokerage firms stopped the trading of GameStop and other heavily shorted and heavily traded stocks. They also placed restrictions on certain stocks, limiting trading to very small lots and/or raising margin requirements. The stoppages and restrictions elicited accusations of unfairness from investors and some members of Congress, who believed the brokerage firms were protecting the hedge funds. In fact, the moves were dictated in large part by clearinghouses that process trades from the brokers. By halting and/or restricting trading of highly volatile stocks, brokers were able to reduce the required collateral, which enabled them to meet the new deposit requirements in a timely manner. The restrictions also helped protect investors from being overextended and suffering outsized losses amid extreme volatility. The New York Stock Exchange (NYSE) regularly suspends trading of individual stocks when price swings exceed certain limits. On February 2, when the price of GameStop was plunging, the NYSE suspended trading five times throughout the day, with each suspension lasting less than 12 minutes.

What happens next?
It may take months or years before the full effects of the recent activity play out in the financial markets, but one clear takeaway is that social media, combined with accessible low-cost trading platforms, allows like-minded groups of retail investors to exert power that matches large-scale institutional investors. Some hedge fund managers have already stated that they will rethink their focus on short selling. Although the larger stock market remained resilient throughout the episode, extreme volatility is always a concern, and the Securities and Exchange Commission issued a statement saying, "The Commission is closely monitoring and evaluating the extreme price volatility...[which] has the potential to expose investors to rapid and severe losses and undermine market confidence. As always, the Commission will work to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation."

The huge price swings had little or nothing to do with the actual value of the companies, and they will need to make fundamental business changes to address the underlying weakness that caused them to be targeted for short sales in the first place. As an investor, the lesson for you might be to tune out market mania over "hot stocks," especially when there is little to back up the sudden interest other than speculation. The wisest course is often to build a portfolio that is appropriate for your risk tolerance, time frame, and personal situation and let your portfolio pursue growth over the long term. This strategy may not be as exciting as the wild ups and downs of stocks in the spotlight, but it's more likely to help you reach your long-term goals. □

U.S. HOUSING MARKET: TALE OF SUPERSIZED DEMAND

Low rates and millennials coming of age are expected to keep the pressure on.

Historically low mortgage rates, the work-from-home phenomenon and demographic trends have created "insatiable" demand in the U.S. housing market, Raymond James analyst Buck Horne wrote in a research note. Home sales hit a 14-year high in 2020, according to the National Association of Realtors, which is a sign the Federal Reserve's cut of the fed funds rate is having the desired effect for the economy. However, the imbalance of buyers to sellers has led to price increases and fierce competition that has reminded many Americans of the housing bubble in the mid-2000s.

This market is different, analysts say. "I could see this boom in housing continuing for some time, given the demand and some of the demographic issues," said Bill Geis, head of Private Client Banking at Raymond James Bank. That includes many first-time homebuyers, who only add to the demand side of the equation in a market where the supply of homes remains stubbornly low, with a deficit in 29 states, mortgage buyer Freddie Mac reports.

Bidding war blues

Meanwhile, the stories of homebuyer frustration continue to mount. One 24-year-old software developer spent months on the hunt for a starter home in Denver. He told USA Today he was outbid eight times, and his parents agreed to loan him money to boost his chances in a bidding war. In the end, he paused his search and moved in with his parents to save up for a larger down payment. He represents a trend that has led to a majority of 18- to 29-year-olds living with their parents for the first time since the Great Depression, Pew Research Center reports. In other words, there's another layer of pent-up need.

"We've seen an increase in demand for homes across the board," from first-time homebuyers to affluent clients buying second homes, Geis said, "as well as a need for more and more of our clients to become cash buyers," using bridge loans to secure the home and then mortgaging it later to gain a leg up in bidding wars. Recent figures reveal the haggling behind the scenes: Half of the home sales handled by U.S. Redfin agents have faced bidding wars over the past eight months, the real estate brokerage reported. Normally such a hot market would call forth supply as owners seize the moment to sell, but the pandemic has slowed things down – creating an ideal situation for homebuilders.

Building our way up

“Homebuilders have rarely – if ever – enjoyed a more favorable backdrop for selling new homes,” Horne said. The Census Bureau reported that 811,000 new homes were sold in 2020, up 18.8% from the prior year, thanks in part to the Fed’s pledge to keep rates near zero. The 30-year fixed mortgage rate in turn dipped from 3.65% in mid-March to a record low 2.65% in January 2021. That has boosted buying power and allowed people to stretch their budgets to buy more expensive homes. A 1% decrease in the interest rate equals more than $30,000 saved on a 30-year mortgage for a $200,000 home.

Homebuilders seem up to the task of helping to lead the economic rebound. In December, single-family homebuilding, the largest share of the housing market, jumped 12% to 1.3 million units, government figures show. That translates into economic growth. Building 1,000 single-family homes creates around 2,900 full-time jobs and generates $110 million in taxes and fees, according to NAHB’s National Impact of Home Building and Remodeling report.

A “cycle born anew”

Demographic trends have been a steady pillar for the housing market. The peak of the nation’s largest generation – millennials – turned 30 in 2020, a time of life when many people buy their first homes. This demographic inflection point, paired with the work-from-home phenomenon, will continue to fuel robust housing activity, Raymond James analysts say.

On top of that, “social shifts (de-urbanization, de-densification, Sun Belt migration) we believe can fuel an entire housing cycle born anew,” Horne said.

It’s not all tailwinds for housing, however. The Urban Institute’s housing credit availability index hit a low in 2020, meaning borrowers with less than perfect credit are having trouble getting a mortgage. Geis called the tighter lending standards “a little bit of a surprise.”

Also, the pandemic has only brightened the appeal of aging in place for seniors, which is part of the reason for the paltry housing supply. Boomers staying put accounted for millions of homes held off the market in 2018 by some estimates.

All of this means that the American dream of owning a home, a primary method of building financial security, remains out of reach for some despite record-low rates.

Between the heightened standards for lending and the fierce competition for existing homes, homebuyers are facing challenges. Still, sales keep surging ahead. “Without question, the housing recovery since mid-May has been nothing short of extraordinary,” Horne said. □

Source, Raymond James

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