PWM Weekly Observations

February 6, 2021

Philip G. Palumbo, CFP®
Chief Investment Officer

Doug Augenthaler, CFA® CFP®
Chief Portfolio Strategist

Taking Stock of 2020

There is no doubt 2020 was one for the record books and in more ways than one. We were planning this commentary several weeks ago, but the craziness continued into 2021, so we postponed the comments until this week. Surviving through 2020 required discipline because it is far too easy to get caught up in the day-to-day mayhem and lose perspective on the big picture, whether discussing COVID or investments.

We'll leave COVID to the experts, but as far as investments are concerned, we like to think about investing as being rational and tied fundamental factors, like earnings and revenue growth, or macroeconomic trends. What is often overlooked is the behavioral aspect of investing. Being rational is much easier when the market is not collapsing, or rocketing higher because at those extremes, emotions become very powerful. Markets collapsing (fear) and markets rocketing higher (greed) can easily get the best of us and lead us to emotional investment decisions, which are typically much less than optimal. What happened last week with GameStop as well as last year in the stock market are terrific examples of this.

There are few, if any, that would argue that GameStop was fundamentally worth $300+ per share last week, yet people continued to buy, driving the stock to almost $400! So how did it get there? Emotions. The stock went from $15 to $50, to $150 to $250… OMG! This stock is flying. I have to get in! After all, there is nothing quite as disturbing as watching your neighbor get rich.

Today we call that FOMO (Fear Of Missing Out), but it is fundamentally an example of herd behavior. Herd behavior is a primary reason that many investors tend buy in bull markets and sell in bear markets. Without a herd mentality, GameStop never would have reached $300 in the first place.

The herd was also at work last year, and in both directions! Back in on Feb. 19 of last year, the market topped and just over a month later (March 23) the S&P 500 Index had declined 33.9%. By all appearances, the market was collapsing. People were heading to the exits in droves and if you didn't feel an urge to follow them, then you have some supernatural power. In less than a years' time we are now at new highs (3,863 on the S&P 500 as this is written), which is about 73% higher than on March 23, 2020.

If you had followed the herd; if you had listened to your emotions; you probably would have been selling as we approached the bottom, when maximum emotional pressure was applied. Compounding the problem, you would likely have been too nervous to recognize the market turn and also missed much of the rebound. That type of behavior can be incredibly damaging to the long-term portfolio returns. And there are many more biases that impact how we think and how we invest, and not in a good way. As far as we are concerned, the only way to overcome these biases is to stay aware that they exist and prepare for the day that the temptation of these biases are at their peak. In times of stress, there is nothing more comforting that the realization that you are prepared for the stress.

The pandemic wreaked havoc on markets in 2020 and as turns out, it provided us a great opportunity to test our mettle. Despite those human urges to follow the herd, we stayed the course and stuck to our disciplined investment approach. Of course, past returns never guarantee future performance, but in 2020, we stuck to our plan and the plan worked well. As the pandemic hit and equites were hit hard, our diversified approach worked in textbook fashion, limiting our downside exposure. The decline in equity value moved our portfolio allocations out of balance, so as stock market declined, we rebalanced portfolios to add equity exposure. The timing was not perfect nor were we trying to be perfect. We were simply following our investment discipline and rebalancing portfolios when required.

Of course, this re-balancing was followed by a massive stock market rally which continues today and recently we rebalanced again, this time removing equity exposure to again bring portfolios back into balance. Not every rebalancing will work precisely as intended, but over time, keeping portfolios in balance has proven to be a favorable strategy for us. Our long-term plan allowed us to overcome emotion and act in a rational way, thereby avoiding actions that could have been highly detrimental to the portfolio.

On to 2021!

Some Closing Comments on the GameStop Short Squeeze

And we're (almost) back. Last week we noted the following: *"In the long run, this is not unlike a game of musical chairs. When the music stops, you do not want to be the one without a chair, or in this case, be the one unable to sell the stock at a profit, or even a small loss. This is effectively a zero-sum game. Some will make a lot of money and others will lose it."* Well, the long run didn't take very long. After hitting closing at $325 last week, GME is trading at roughly $60 as this is written and one well known Reddit trader with a foul handle admitted on Wednesday to losing $19 million in two days – and is still long.

GameStop will eventually return to something approximating its fundamental value, which we would guess is somewhere in the $10 area. There is no analysis there, it's just where the stock was trading in the months prior to the squeeze. If you were quick enough to get in as it rose and then smart enough to get out, you won. If you were late to get in and/or failed to get out, you lost.

1) Expect some complaining from the losers.
2) Expect some regulatory window dressing to 'deal with the problem'.
3) Expect the hedge funds to rebound, with one eye always looking out for the danger they never saw coming until the last few weeks.

The more things change, the more they stay the same.

What We're Reading

[How Not to Be a Contrarian]

[Two Dem. Senators Have Outsized Influence on Biden's Agenda] **(3 min. video)**

[Silver Coin Sites Seize Up as Buying Frenzy Takes Hold]

[The Silver Squeeze & the Coming Boom in Commodities] **(Bloomberg, Sub. Req'd.)**

[U.S. House expected to advance Biden's $1.9 trillion COVID aid package]

[Hedge funds rush to get to grips with retail message boards] **(FT – may require sub.)**

[Biden officials considering action on student debt relief]

[Jan. payrolls barely grow even as the unemployment rate fell to 6.3%]

[Police seize $60 million of bitcoin! Now, where's the password?]

[4 Reasons Retirees Should Care About the New Coronavirus Stimulus Package]

[Natural Gas Higher on Anticipation of 'Massive Gains' in Heating Demand]

Markets This Week

The market schizophrenia Is remarkable. After the debacle of last week, stock came roaring back this week. Most equity categories were up In the range of 4% to 6% ofr the week! The laggard was Helath Care, rising 'only' about a half percent ofr the week. Meanwhile, the energy stocks continue to show amazing signs of Ife after being in a multi-year coma. Fixed Income was gereally down slightly, with the exception of long duration bends. Commodites also had a strong week.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	4.77%	3.70%	20+ Yr. Treasuries (TLT)	-2.61%	-6.15%	Consumer Disc. (XLY)	6.31%	7.12%
Dow (DIA)	3.91%	1.88%	Barclays US Aggregate (AGG)	-0.51%	-1.25%	Info. Technology (XLK)	4.96%	4.08%
NASDAQ (QQQ)	5.34%	5.62%	Intermediate Municipal (MUB)	-0.04%	0.30%	Financials (XLF)	6.70%	4.78%
Russell 1000 Growth (IWF)	5.10%	4.28%	US Corporate Bonds (LQD)	-0.60%	-2.42%	Health Care (XLV)	0.52%	1.97%
Russell 1000 Value (IWD)	4.79%	3.80%	Barclays US High Yield (HYG)	0.63%	0.25%	Utilities (XLU)	2.32%	1.42%
Vanguard Mid-Cap (VO)	5.85%	5.34%				Industrials (XLI)	4.98%	0.50%
Vanguard Small-Cap (VB)	6.72%	8.87%				Energy (XLE)	8.24%	12.30%
						Materials (XLB)	4.12%	1.60%
International Equities	**1 week**	**YTD**	**Commodities**	**1 week**	**YTD**	Consumer Staples (XLP)	7.29%	1.94%
MSCI EAFE (EFA)	3.20%	2.40%	Commodities (PDBC)	4.73%	8.06%	Comm. Services (XLC)	6.77%	5.82%
MSCI Emerging (EEM)	5.50%	8.84%	Gold (GLD)	-1.62%	-4.79%	REITS (VNQ)	3.71%	3.74%
						Homebuilders (XHB)	5.49%	10.36%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: IEX Trading & PWM Research.

Retirement Planning:

[What's the best way to reduce the taxes on my estate?]

I want to find the best way to leave a Roth IRA to my kids.

Tax Planning:

[Last Minute 2020 Tax Planning You Can Still Do—In 2021]

Taxpayers still have some tax planning opportunities.

Estate Planning:

[How Do I Settle a Parent or Other Loved One's Estate?]

Many people put off thinking about what happens when they die and don't prepare for the inevitable.

Health:

[The Therapeutic Value of Reading]

Neuroscientists and psychologists (and your high school English teacher) will tell you: Books are good for the brain.

Entrepreneur:

[Marketing and Brand Management: Thinking Beyond The ROI]

Building a brand is an often unsung but equally essential aspect of marketing.
