Boyar asset management

"Bull markets are born on pessimism, grow on skepticism, mature on Optimism, and die on euphoria."

–Sir John Templeton

January 25th, 2021

Signals of Market Froth?

If investors had known the major headlines of 2020 (a global pandemic killing millions, massive unemployment, and a contested presidential election) at the end of 2019, we doubt that many would have expected the S&P to advance 18.4% in 2020 or the Nasdaq to gain 43.64%. Today, as the coronavirus continues to rage, speculative fever abounds in the capital markets. According to Bloomberg, U.S. exchanges have raised a record of ~$180 billion in 2020 via public listings and $3 trillion of corporate bonds are trading with negative yields globally. In addition, special-purpose acquisition vehicles (SPACs) have raised over $80 billion in 2020 (more than in the whole previous decade). Then there's Bitcoin, the highly speculative cryptocurrency whose value jumped ~200% in 2020. Bitcoin's meteoric rise has continued into 2021 at one point reaching over $40,000 in value before falling ~20% in recent days to ~$31,840.

According to Bloomberg, the average first-day return for IPOs' was 40% in 2020, the third-highest ever after 1999 and 2000, and the Renaissance IPO exchange-traded fund tracking new listings advanced more than 100% in 2020. Capping it all off is Tesla, which gained ~700% and currently boasts a market capitalization of ~$800 billion (almost 18x the market capitalization of Ford Motor Company). On December 21, 2020, Tesla joined the S&P 500 by finally reaching the index's eligibility requirement for profitability.

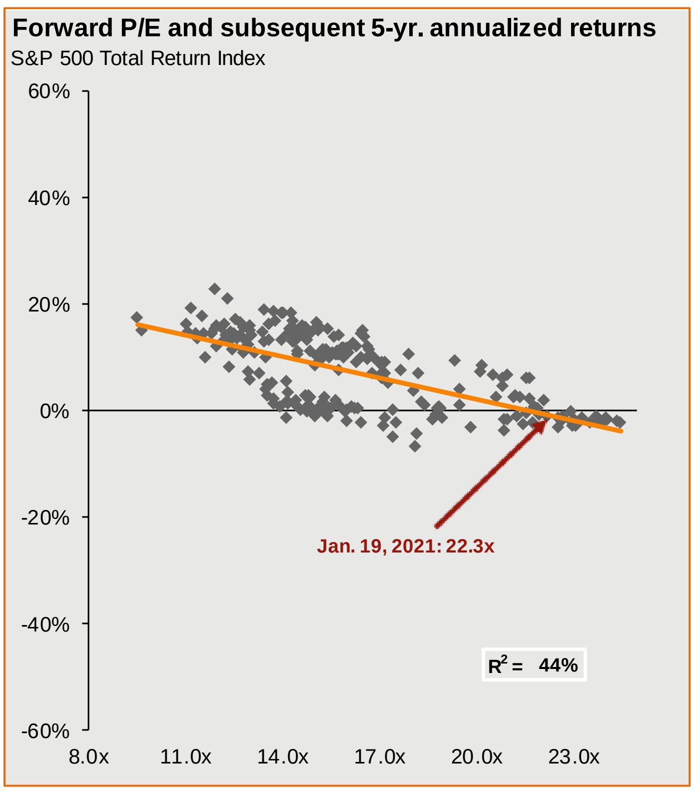
More than 30 companies raised over $1 billion via IPOs in 2020. Bloomberg says that biotechnology companies raised the most money, with over 100 listings raising ~$23 billion. Technology companies weren't far behind, at $19 billion. Both Airbnb and DoorDash advanced more than 80% when they initially listed. At current levels, DoorDash (a food delivery company that has lost money every year since its founding, though recently showing signs of profitability) is 4 times as valuable as pizza chain Dominoes, which is expected to report upward of $500 million in profits in 2021. In today's zero-interest-rate world, investors are willing to pay top dollar for growth, and after DoorDash's quarter ended September 2020 revenue grew to $879 million—up from $657 million the previous quarter—investors are bidding shares sky high. Maybe DoorDash will be able to scale and justify its lofty valuation, but today's investors are certainly paying a rich price for growth.

Investors wagering that the market rally would reverse course have not fared well thus far in 2021. Goldman Sachs Group Inc.'s basket of the 50 stocks with the highest short interest as a share of market capitalization was up 25% for the year through January 22nd 2021, compared with a total return of 2.4% for the S&P 500.

The fantastic returns in risk assets have come despite a terrible economic backdrop. The latest employment report showed that the U.S. had shed 140,000 jobs in December 2020. Hotel occupancy is down 28% year over year (a number that fell as low as 69% during the current crisis), TSA traveler traffic is down 64% (after a low of -96%), and U.S. seated diners are down 57% year over year, based on data from JP Morgan.

As of January 19, after having advanced 70% from last year's March 23 low, the S&P 500 was selling at ~22.3x forward earnings. (The 25-year average, JP Morgan says, is 16.59%.) Historically, when the index has sold at such a rich multiple, subsequent future 5-year returns have been poor. We don't expect investors in the S&P 500 to see robust returns in the medium term, but many stocks we follow are selling far below our estimate of their intrinsic value, and we think they could handsomely reward long-term patient investors. The next few years should give individual stock pickers a chance to shine.

P/E Ratios and Equity Returns



However, as has been widely reported, equity market returns have been far from democratic. Technology shares certainly led the market in 2020. The Nasdaq 100 advanced 49%, with 33 companies posting total returns of 50% or more—the most since 2013.

According to JP Morgan, as of January 19, the top 10 companies in the market-cap-weighted S&P 500 accounted for 28% of the index (back in 1996, the top 10 index components accounted for just ~17% of the index) and boasted an average forward multiple of 32.3x (whereas since 1996 the top 10 stocks have had an average multiple of 19.4x). The other stocks in the index are selling at 19.7x, well above their average valuation of 15.6x since 1996.

Historically, the spread between the valuations of the S&P 500's cheapest and most expensive stocks has been very different than they are currently. If you grouped all the stocks in the S&P 500 by valuation today, the 100 most expensive stocks would sell for 19 multiple points more than the 100 least expensive stocks, whereas the 25-year average for that spread is only 10 multiple points. Discerning investors hunting for bargains could experience future outsized returns by investing in high-quality businesses that for one reason or another are temporarily among the 100 least expensive stocks. Investors in the most expensive stocks could still do well in their investments going forward, but they'll need to be sure each business's underlying fundamentals justify the high price tag.

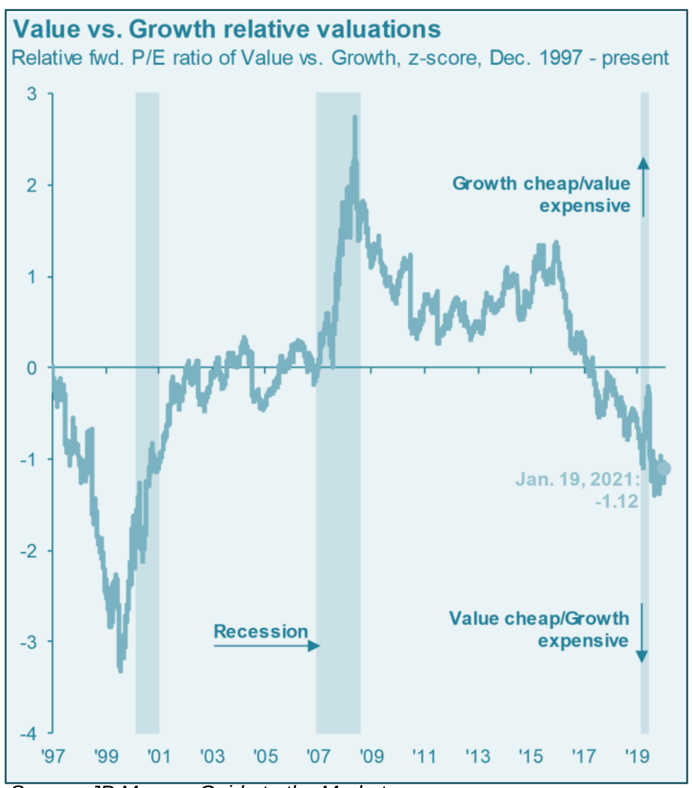
Has a Value Recovery Begun?

Since the stock market hit its low point in March 2020, value shares have significantly underperformed their growth counterparts. Value's underperformance is not just a near-term phenomenon—we've seen it over the past decade in defiance of historical performance norms. Mellody Hobson and John Rogers of well-regarded value investing firm Ariel Investments discussed such occurrences in a December 11th Wall Street Journal article:

"In the 10 years ended Sept. 30, 2020, the S&P 500 averaged a 13.74% gain annually compared with 9.85% for the Russell 2000 index and 7.09% for the Russell 2000 Value index. And yet, according to Ibbotson's 2020 SBBI Yearbook, one dollar invested in small value stocks at the end of 1926 grew to approximately $290,000 by the end of 2019. Alternatively, one dollar invested in large value, small growth or large growth stocks at the end of 1926 grew to approximately $35,000, $6,000, and $3,000, respectively, by the end of 2019."[1]

Now that the major indices are far from cheap and many of the current leaders are selling at valuations that seem unsustainable, value-oriented shares might be ready to emerge from their hibernation. As Hobson and Rogers observe, value has led the way across all sectors in the past 14 economic recoveries—but the catalyst for value's reemergence is anyone's guess. Perhaps a sustained rotation into value has already happened (value has outperformed since the election of Joe Biden and the announcement of multiple successful vaccine trials) or maybe we're waiting on something else (rising interest rates, perhaps?), but either way, we believe that after years of underperforming their growth peers, value-oriented shares will once again shine as they did in 2000.

Value vs. Growth



Source: JP Morgan Guide to the Markets.

[1] Mellody Hobson and John W. Rogers Jr., "How to Understand This Crazy Year in Investing—and What to Do Now," *Wall Street Journal*, December 11, 2020, https://www.wsj.com/articles/how-to-understand-this-crazy-year-in-investingand-what-to-do-now-11607698800?mod=hp_listc_pos3.

Presidential Election & Stock Market Returns

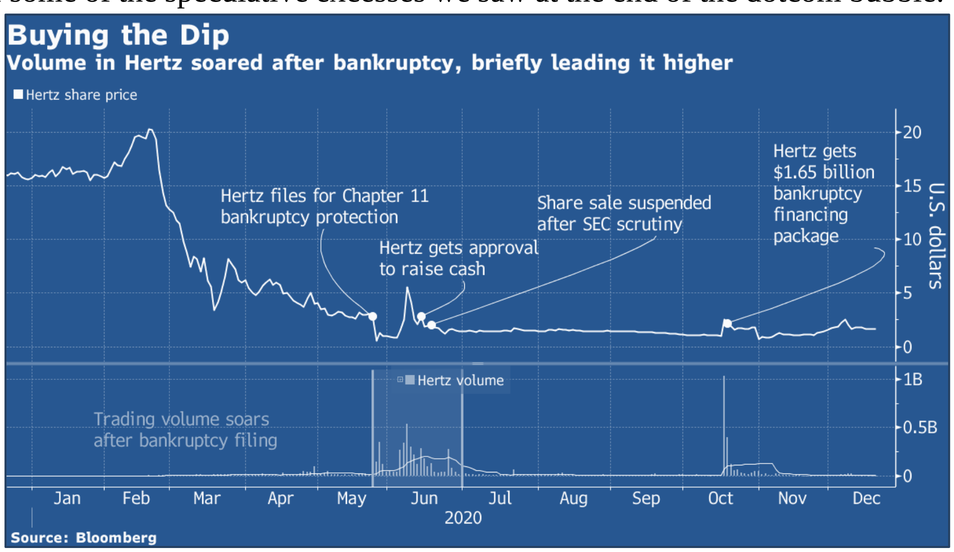
Pundits have been speculating about how The Biden Administration will influence 2021's stock market returns. In a normal political environment, such predictions are difficult enough to make, but the 2020 election was far from typical. Since 1949 we've seen only 4 first-year-elected Democratic presidents (excluding Harry Truman and Lyndon Johnson, who both initially took office prior to being elected because of the deaths of presidents Roosevelt and Kennedy). Each of these 4 cases occurred with a Democrat-controlled Congress and saw an average increase of 10.6% for the S&P 500, according to data from The Stock Trader's Almanac. The best-performing year was 2009, when President Obama took office and the S&P 500 increased by 23.5% (although it's worth noting that the previous year it had lost 38%). The worst-performing year was 1977, when President Carter took office and the S&P 500 decreased by 11.5%.

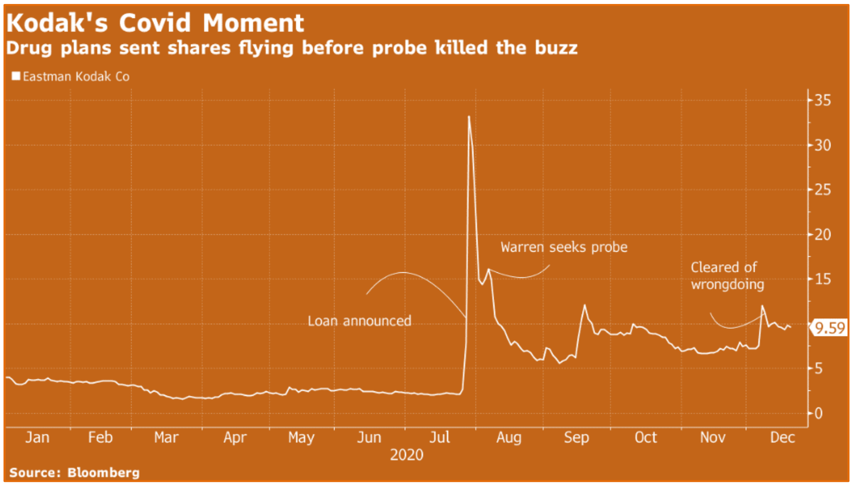
Since 1948 Democrats have controlled both houses of Congress and the presidency 27% of the time, with an average return of 9.8%, according to JP Morgan's Guide to the Markets. We've seen divided government 62% of the time, with an average return of 7.8%. The best returns have occurred when Republicans have controlled both the presidency and Congress, for an average return of 12.9%—although at only 11% of occurrences the sample size is relatively small. From a historical perspective, we are clearly in uncharted territory. Now more than ever, it is probably best to ignore the geopolitical noise and look for companies that are selling at significant discounts to their private market value instead of trying to predict how the actions of the president and Congress will affect future equity returns.

Irrational Investor Behavior

Fueled by the Robinhood crowd and Reddit chat rooms, investors in 2020 and thus far in 2021 have behaved in ways that remind us of some of the speculative excesses we saw at the end of the dotcom bubble. Here are some of our favorite examples:

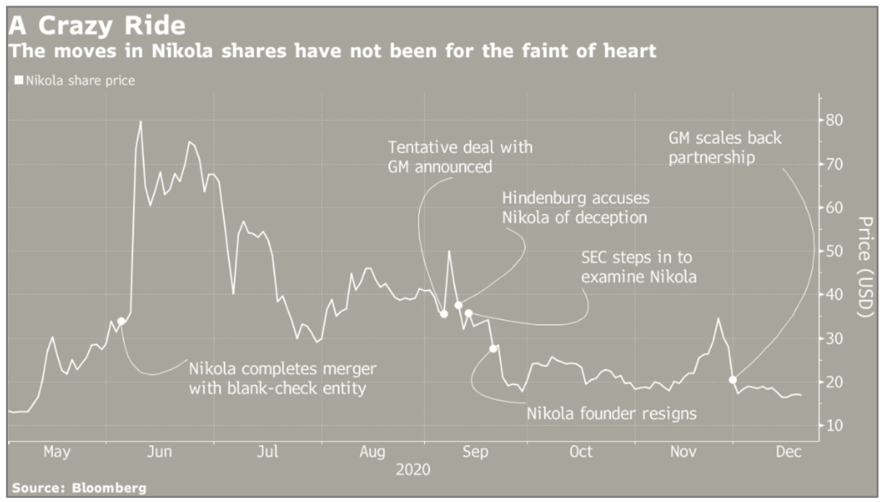
Amid the pandemic, Hertz filed for bankruptcy protection, plunging its share price to 55 cents. Thinking they had spotted a bargain, investors piled into the stock, raising its value to $5.53 on heavy volume. Sensing an opportunity, the company tried selling shares to raise capital, but regulators blocked the move. Shares now trade for ~$1.59.



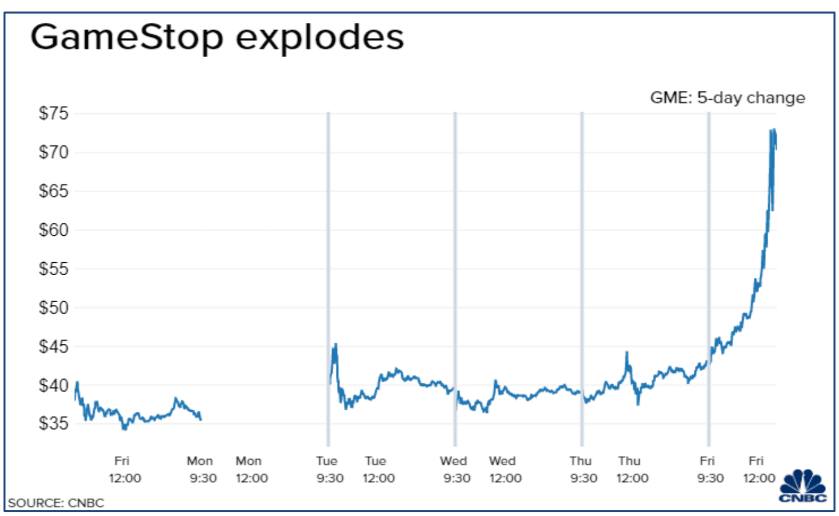


Once high-flying Eastman Kodak sprang to life this year after it was announced that it would receive a $765 million loan from the government to increase production of medicines to combat the coronavirus outbreak. Over three trading sessions in July, Kodak shares advanced by 1,481%, but they dropped sharply after critics questioned why the company had been given a loan in the first place. Shares finished the year advancing almost 90%.

Electric vehicle startup Nikola caught investors' attention when it went public through a reverse merger with a blank-check company. Even though it had zero revenues, at one point its market valuation was bigger than Ford Motor Company's. However, the bubble has partially burst (shares are down about 75% from its June high), and short seller Hidenburg Research has accused the company of deceiving investors. Chairman Trevor Milton has resigned, and shares now trade at ~$20, down from a June high of almost $80.



Wild investor behavior continued into 2021 with Bitcoin leading the charge, advancing from ~$29,000 on December 31, 2020, to over $40,000 on January 9 (before falling again to just under $32,000). Meanwhile, GameStop—the most shorted stock in the U.S. stock market, with 138% of its float shares sold short—advanced 250% during the first few weeks of 2021 (following a 209% rally in 2020), then over 100% the week of January 18 alone. (And that was only a 4-session trading week thanks to a holiday!) The recent stock surge came after the company announced that Chewy cofounder Ryan Cohen was joining its board, triggering short covering among hedge funds. This caught the eye of retail investors, resulting in a gigantic short squeeze (in a short squeeze, heavy buying forces short bettors to buy back shares to limit their losses). On January 22nd alone, 192 million shares traded hands, compared with the 30-day trading average of 23.8 million, according to CNBC. The situation got especially nasty when short seller Citron Research tweeted on January 19 that buyers at current levels are "the suckers at this poker game." On January 22, Citron announced that it would no longer comment on the company after attacks from the "angry mob" of share owners.



What Should You Do If You Exited the Market?

During the 1Q 2020 stock market swoon, most individual investors didn't exit the market—perhaps surprisingly, considering the conventional wisdom that individual investors zig when they should zag. Dalbar, a research firm that tracks investor moves into and out of mutual funds, wrote that "the average investor's appetite for equities has remained unchanged throughout the Covid crisis." Vanguard found that fewer than .5% of the retail clients and self-directed investors in its retirement plans panicked and moved to all cash between February 19 and May 31, as reported in an opinion piece by Nir Kaissar that appeared in Bloomberg on November 30, 2020. But what about those who left in March, at the panic lows? Should they enter now, after a 70% advance (in terms of the S&P 500), or wait for a correction and potentially cheaper prices?

If history is any guide, investors shouldn't be trying to time the market. Mr. Kaissar reminds us that in 2009, investors faced the same dilemma. In October 2009 the stock market had risen roughly 60% from its crisis low, but the macroeconomic picture was far from rosy. Even so, investors who went back in after the 60% advance have more than tripled their money (if they invested in the S&P 500) since then. Legendary investor Peter Lynch was never more right than when he said that "far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

As always, we're available to answer any questions you might have. If you'd like to discuss these issues further, please reach out to us at jboyar@boyarvaluegroup.com or 212-995-8300.

Best Regards,

Mark A. Boyar

Jonathan I. Boyar

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Past performance is no guarantee of future results. Investing in equities and fixed income involves risk, including the possible loss of principal. *The S&P 500 Index is included to allow you to compare your returns against an unmanaged capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks representing all major industries.* The Russell 2000® Value Index measures the performance of small-cap value segment of the US equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. *The S&P 1500 Value Index measures value stocks using three factors: the ratios of book value, earnings, and sales to price and the constituents are dawn from the S&P 500, S&P Midcap 400 and the S&P SmallCap 600. The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The volatility of the above-referenced indices may be materially different from that of your account(s), and the holdings in your account(s) may differ significantly from the securities that comprise the above-referenced indices. Your results are reported gross of fees. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) $1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.50% annual investment advisory fee would be $15,566 in the first year, and cumulative effects of $88,488 over five years and $209,051 over ten years. This material is intended as a broad overview of Boyar Asset Management's, philosophy and process and is subject to change without notice. Account holdings and characteristics may vary since investment objectives, tax considerations and other factors differ from account to account.*