October 2020

“As the election draws near, intrigues grow more active, agitation is more lively and wider spread. The citizens divide up into several camps, each of which takes its name from its candidate. The whole nation gets into a feverish state; the election is the daily theme of comment in the newspapers and private conversations, the object of every action and the subject of all thought, the sole interest for the moment.”
- Alexis de Tocqueville's 1835 "Democracy in America"

For those of us predicting a Blue Wave election, the results once again proved that none of us are immune to Confirmation bias, one of thirteen that I cover in my class on Advanced Topics in Investments at OU. It is one of the primary reasons HCM takes a Quantitative approach to investing.

David Brooks from his Nov. 5th column: "progressives ... see America as divided between those enlightened cosmopolitans (Democrats) who welcome the coming diverse postindustrial world and those knuckle-dragging, racist troglodytes (Republicans) who don’t."

The "problem with this narrative is that it is perpetually surprised by events. Election after election, the emerging Democratic majority fails to emerge. ... it’s just astonishingly smug, self-congratulatory and off-putting."

While a clear majority of voters rejected Trump, Trumpism smashed "Wokeism". "**House Democrats Vent at Pelosi**" was featured on the front page of Friday's WSJ: "This was a loss," said Rep. Abigail Spanberger, who worked undercover as a CIA case officer before flipping the Richmond, Va. area district once held by Republican Majority Leader Eric Cantor in 2018, "This almost cost me my seat". ABC News elaborated on her comments during Thursday's call: "From a congressional standpoint, it was a failure. ... "We lost members we shouldn't have lost." ... "We have to commit to not saying the words "defund the police" ever again," she said. "We have to not use the words 'socialist' or 'socialism' ever again. If we are classifying Tuesday as a success and we run this way again, we will get f------ torn apart in 2022."

For Mr. Market, a presidential return to normalcy, with a Republican controlled Senate to check the Left's policy agenda resulted in the S&P 500's 4th consecutive gain of 1% or more on Thursday, the longest such streak since October 1982. From Friday's Global Investment Strategy report:

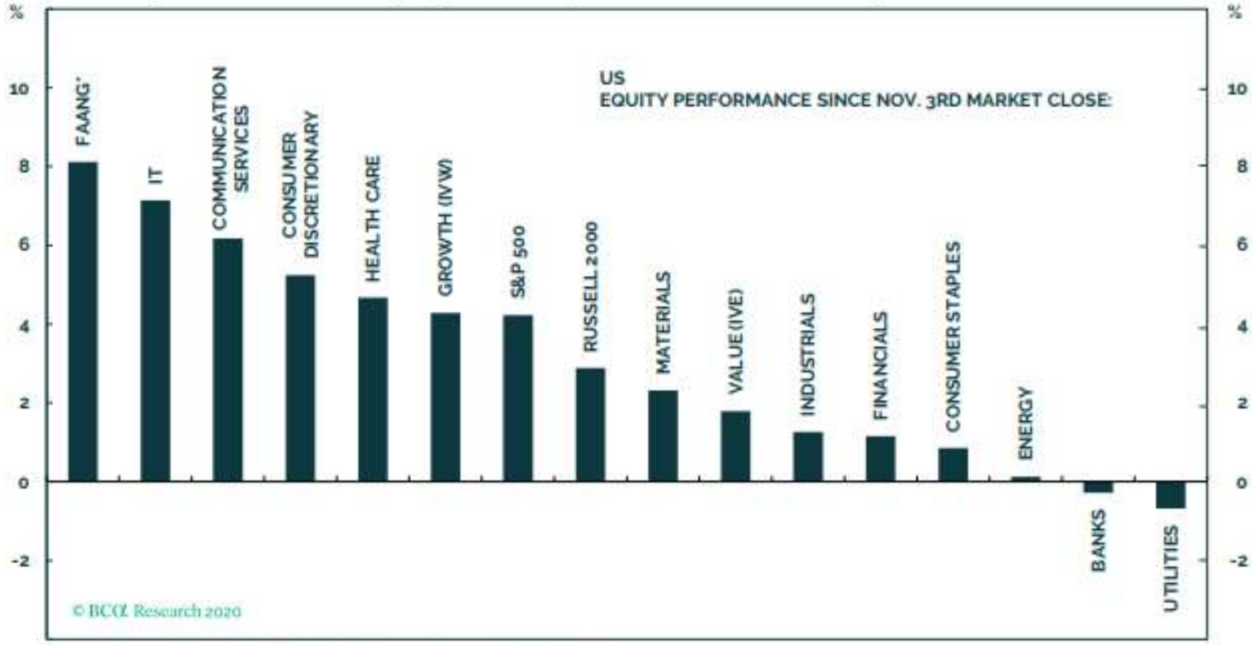
Assuming that Republicans maintain their majority in the Senate, tax hikes will remain off the table. This is good for stocks. Joe Biden would also lower the temperature on trade tensions with China. This, too, is good for stocks.

Conversely, the odds of a major fiscal stimulus package have dropped. ... the Republicans in the Senate have rejected calls for a large stimulus bill. With Joe Biden as President, Republican senators would have even less incentive to give the Democrats what they want. ...

Wall Street Versus Main Street

If one needed any more proof that what is good for Wall Street is not necessarily good for Main Street, the last three trading days provided it. The S&P 500 is up 6% since Monday’s close, spurred on by the reassurance that corporate taxes will not rise. In contrast, the 10-year bond yield has fallen 8 basis points on diminished prospects for a big stimulus package.

CHART 4
Growth Equities Benefited Disproportionately From A Post-Election Drop In Yields



* INCLUDES FACEBOOK, AMAZON, APPLE, NETFLIX, AND ALPHABET (GOOGLE).
SOURCE: BLOOMBERG FINANCE L.P. AND BCA RESEARCH CALCULATIONS.

The drop in bond yields since the election has raised the present value of corporate cash flows, leading to higher equity valuations. Growth companies have benefited disproportionately from falling bond yields. In contrast to value companies, investors expect growth companies to generate the bulk of their earnings far in the future. This makes their valuations highly sensitive to changes in discount rates. It is not surprising that tech shares – the FAANGs in particular – soared following the election (**Chart 4**). ...

Investment Conclusions

Stocks have run up a lot over the past few days on fairly weak breadth. A short-term pullback would not be surprising. Nevertheless, investors should remain overweight global equities versus bonds over a 12-month horizon.

The combination of ongoing fiscal and monetary support, together with a vaccine, will buoy global growth. ...

Value stocks typically do well when economic activity is picking up. That said, we are less sure about when the inflection point in the value/growth trade will arrive. As we have noted before, the “pandemic trade” benefits growth stocks, while the “reopening trade” benefits value stocks. For now, the number of new infections has not shown signs of peaking in either the US or Europe. Investors should ... be prepared to increase exposure to value stocks when clearer evidence emerges that the latest wave of the pandemic is cresting. ...

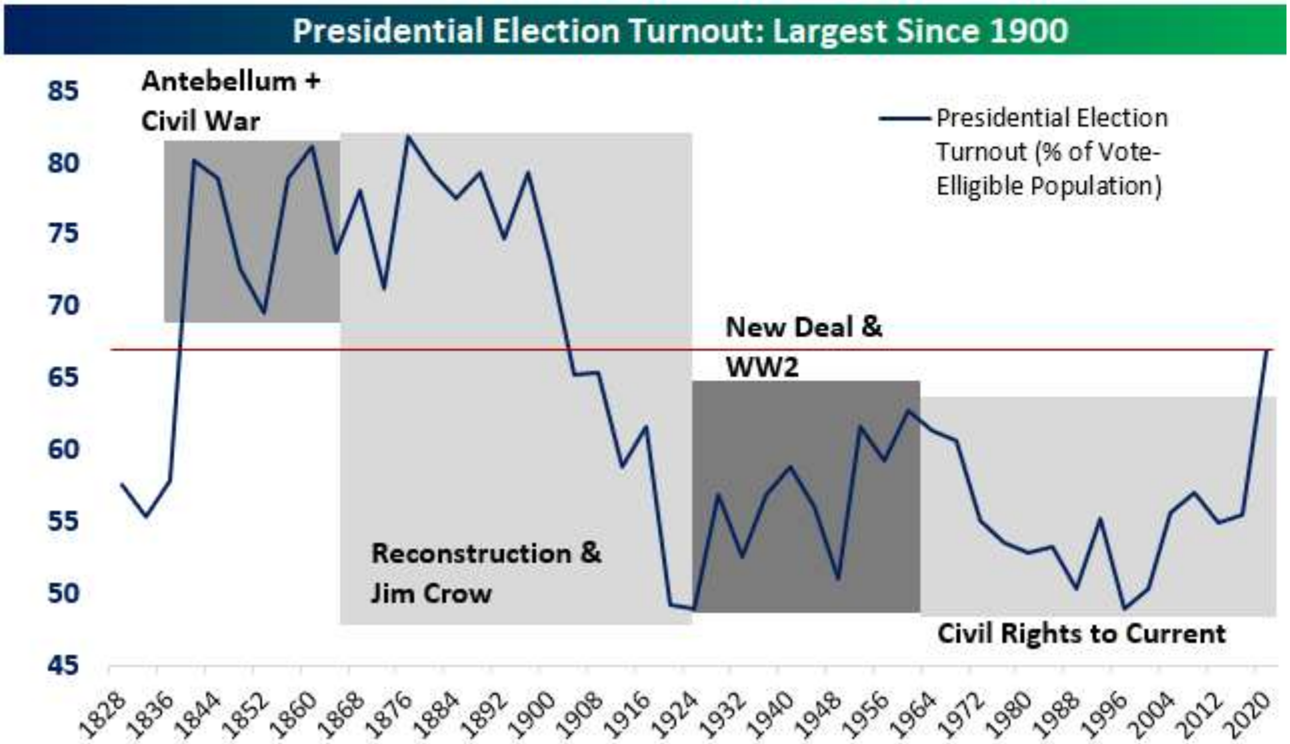
From Bespoke on Saturday:

Only in 2020 would we have the worst week before Election Day followed by one of the best Election Day weeks on record.

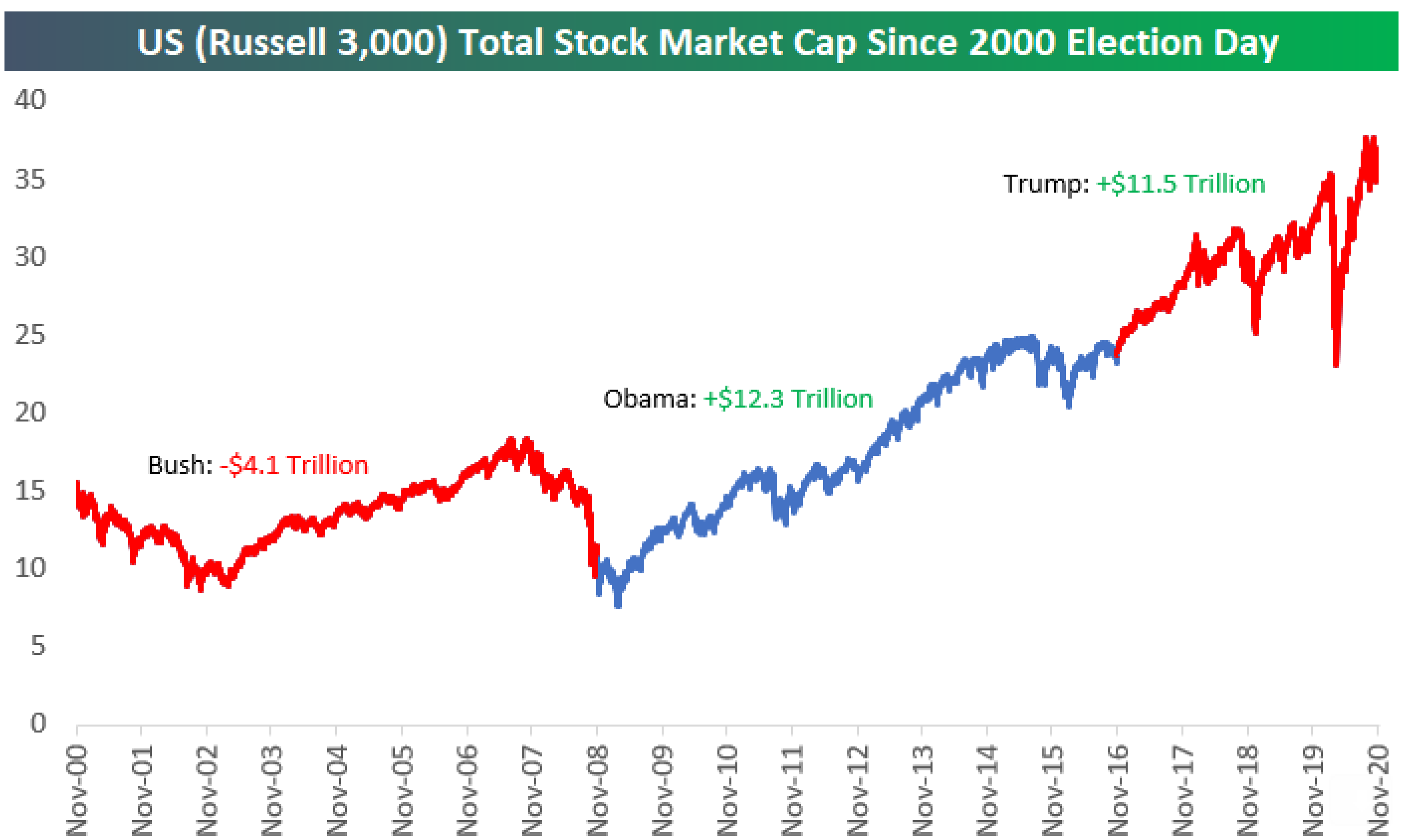
S&P 500 Performance Before and After Election Day: 1928 - 2020

		S&P 500 Performance (%)			
Year	Election Day	Full Week Before	Election Week	Winner	Loser
1928	11/6	1.39	2.73	Hoover (444)	Smith (87)
1932	11/8	-2.96	11.63	FDR (472)	Hoover (59)
1936	11/3	0.82	1.16	FDR (523)	Landon (8)
1940	11/5	3.26	1.35	FDR (449)	Willkie (82)
1944	11/7	1.10	0.70	FDR (432)	Dewey (99)
1948	11/2	-0.66	-6.48	Truman (303)	Dewey (189)
1952	11/4	2.04	1.06	Eisenhower (442)	Stevenson (89)
1956	11/6	1.53	-1.36	Eisenhower (457)	Stevenson (73)
1960	11/8	2.79	1.77	JFK (303)	Nixon (219)
1964	11/3	-0.33	0.44	Johnson (486)	Goldwater (52)
1968	11/5	-1.09	0.86	Nixon (301)	Humphrey (191)
1972	11/7	3.25	-0.43	Nixon (520)	McGovern (17)
1976	11/2	2.94	-2.02	Carter (297)	Ford (240)
1980	11/4	-1.83	1.34	Reagan (489)	Carter (49)
1984	11/6	1.29	0.11	Reagan (525)	Mondale (13)
1988	11/8	-0.80	-3.04	Bush (426)	Dukakis (111)
1992	11/3	1.11	-0.26	Clinton (370)	Bush (168)
1996	11/5	0.41	3.84	Clinton (379)	Dole (159)
2000	11/7	3.41	-4.26	Bush II (271)	Gore (266)
2004	11/2	3.14	3.18	Bush II (286)	Kerry (251)
2008	11/4	10.49	-3.90	Obama (365)	McCain (173)
2012	11/6	0.16	-2.43	Obama (332)	Romney (206)
2016	11/8	-1.94	3.80	Trump (304)	Clinton (227)
2020	11/3	-5.64	7.39 thru 11/6 PM		

Voter turnout in the most recent election was the highest in more than 100 years.



Both President Trump and Obama saw US equity market capitalization increase by similar amounts.



From Bespoke on 10/11:

A throwback to 2014, but a good one: Fidelity data showed that customers which performed best were those who had forgotten that they had an account with the broker.

Fidelity Reviewed Which Investors Did Best ...

Myles Udland Sep 4, 2014

On this week's Masters in Business program on Bloomberg Radio, Barry Ritholtz talks with James O'Shaughnessy of O'Shaughnessy Asset Management.

Ritholtz and O'Shaughnessy spend much of their discussion talking about the ways people screw themselves when investing, because nothing gets in the way of returns quite like someone who thinks they have a great idea.

O'Shaughnessy discusses a number of interesting analyses he has done with regard to the length of holding periods (spoiler: the shorter you hold a stock, the more likely you are to lose money) among other things.

But O'Shaughnessy relays one anecdote from an employee who recently joined his firm that really makes one's head spin.

O'Shaughnessy: "Fidelity had done a study as to which accounts had done the best at Fidelity. And what they found was..."

Ritholtz: "They were dead."

O'Shaughnessy: "...No, that's close though! They were the accounts of people who forgot they had an account at Fidelity."

There are numerous studies that explain why this happens. And they almost always come down to the fact that

our minds work against us.

Because of our behavioral biases, we often find ourselves buying high and selling low. ...

The absolutely terrible investment decisions that people make are something that just can't be emphasized enough.

We recently highlighted the above chart from Richard Bernstein that shows just how terrible you are at investing: don't forget it.

From NYT:

The Economy Is Down. Why Are Home Prices Up?

Government efforts to stimulate growth are lifting markets of all kinds everywhere.

By Ruchir Sharma

Oct. 31, 2020

Many Americans will have heard stories about people fearful of the pandemic fleeing from crowded cities and driving up home prices in the rest of the country. But there is a much bigger tale to tell here.

Housing prices started rising before the pandemic arrived. They are rising on average in U.S. cities as well as in rural and suburban areas. They are increasing not just in the United States but also worldwide, regardless of how hard a country has been hit by the pandemic. And prices are at or near record highs not only for housing but also, despite recent market wobbles, for stocks and bonds.

This is a global market boom in the price of … everything.

The common factor is not the virus; it is so-called easy money. Led by the Federal Reserve in the United States, central banks have been lowering interest rates for decades, hoping to stimulate economic growth, but much of that newly issued money keeps flowing into financial markets. This unintended boost has accelerated drastically during the pandemic, as central banks roll out multi-trillion-dollar stimulus plans. According to my research, the valuations of stocks, bonds and housing have risen sharply this year to levels seen only around 2000 and 2008 — periods characterized by financial bubbles.

This is not good news for most people. Market manias have an alarming record of bringing down the wider economy and of widening wealth inequality. In 484 cities around the world whose home prices are tracked by Numbeo, which compiles user-generated data about consumer prices, home prices are now beyond reach for the typical family in more than 400 of them. The least affordable U.S. city is New York, where median home prices (despite falling during the pandemic) are still more than 10 times the median annual income.

Going back at least to the 1970s, housing had always slumped during recessions, both in the United States and worldwide. People lose jobs and stop dreaming of bigger homes. But in the second quarter this year, amid the worst global recession since the 1940s, housing prices were up a robust 4 percent worldwide, and that was before the boom really took off. Since May, new-home sales in the United States have climbed by 67 percent, and prices by 15 percent. The median price of existing homes in the United States recently passed $300,000 for the first time.

This surreal "boom in the gloom" is a government creation. As central banks flooded money into the credit markets, rates on 30-year mortgages, which had been falling for years, plummeted to record lows — under 3 percent in the United States and under 2 percent in Europe. If you are dreaming of riding out the pandemic in a larger home, cheap mortgages now beckon you to act.

For now, housing is a bright spot in a struggling economy. But when prices are shaped by easy money, as much or more than by genuine demand, the result is often a severely skewed allocation of resources. Already, many investors are buying homes not as a shelter but as an alternative to stocks and bonds, which are even pricier.

The risk going forward is that the boom will leave more people unable to afford a home and that prices will eventually reach dangerous bubble levels. And when booms go bust, it takes time to unravel the bad debts, which ripple through the middle class, lengthening and deepening the resulting recession.

The response favored by many experts, including some Fed officials, is tighter regulation. But if regulators clamp down on mortgage lending, investors will borrow to buy something else — stocks and bonds, or even fine art, rare wines or some other exotic asset. When borrowing is nearly free, tweaking regulations will only shift money from one market to another.

For years, central banks said there was no reason to tighten monetary policy because there was no inflation. But as many economists have argued, there appeared to be no inflation because official indexes don't adequately capture asset prices. The United States, for example, includes only rent and a "rental equivalent" for home prices in its official indexes, which makes them increasingly misleading: Rents have lagged behind home prices for years and have slumped further during the pandemic, pushing the official inflation rate even lower.

Central banks need to take the menace of asset price inflation more seriously and to give the threat of stock, bond and especially housing bubbles more weight in their policy deliberations. This would not prevent central banks from bailing out an economy in crisis, when other concerns prevail. But once a recovery begins, it would nudge central bankers to start shutting off the easy money spigot a bit earlier than they otherwise would have — before an "everything boom" like this one becomes a full-blown bubble.

Ruchir Sharma is the chief global strategist at Morgan Stanley Investment Management, the author, most recently, of "The Ten Rules of Successful Nations" and a contributing opinion writer.

From Morningstar:

A Stock Market Bubble Is Forming

However, it has not (yet) become a mania.

John Rekenthaler
Oct 29, 2020

The Main Story
My friend Bill Bernstein has written a splendid book on manias, financial and otherwise, entitled "The

Delusions of Crowds.” (His title deliberately echoes that of the Charles Mackay classic.) It won't be published until February, but I can offer a sneak preview, by invoking the four conditions that he cites that historically have preceded investment bubbles. I then apply those precepts to the current U.S. stock market.

1) Lower Interest Rates

This item and the next owe to observations from economist Hyman Minksy, who emphasized the fallibility of the invisible hand. Minsky regarded the financial markets as inherently unstable, progressing from overly cautious to appropriately bold to distressingly speculative to eventually collapsing, at which point the cycle repeats. The third stage is fueled by reductions in interest rates, which create easy money.

We are certainly in that position today. Money could not be easier unless the government were to give it away, which, with a Federal Funds Rate of 0.09%, the Treasury is perilously close to doing. (Come to think of it, this spring’s CARES Act *did* disburse cash.)

2) Emerging Technology

When new technologies are believed to offer revolutionary benefits, investors disregard the traditional measures of value. The old rules, they believe, apply to a world that no longer exists.

That belief has become familiar. Trading at 15 times revenues and 100 times its expected earnings, Tesla (TSLA) is the shiniest example of a stock that has benefited from confidence in the power of scientific advancements; but in that aspect, it is joined by many of the S&P 500’s leaders. Clearly, the current U.S. equity marketplace expects great things from recently developed technologies.

Now for Bill's additions.

3) Investor Amnesia

As Bill points out, Minsky’s cycle won’t operate if investors have been chastened by previous crashes. Either they must be too green to have suffered through a financial meltdown, or they have banished such traumas from their memories.

Whether that precept applies today is uncertain. It obviously does to Robinhood’s youthful clientele; with a median age of 31, the typical Robinhood customer was but a teenager during the 2008 global financial crisis. However, most equity assets are managed by much older investors. One would think that they still recall 2008’s carnage. However, this year’s rapid recovery from what initially appeared to be a nasty bear market might have dispelled such concerns.

4) New Math

If investments aren’t expensive, they are not foolish. They might be highly risky--for example, the stock of a leveraged company that is attempting to survive a recession, while facing better-capitalized rivals--but if securities are reasonably priced, they can be sound choices for well-diversified portfolios. What makes them indefensible are unsustainable valuations, supported by arguments that changing economic conditions require a new form of investment math.

Here, too, the evidence is mixed. To be sure, U.S. stocks are costly by any traditional measure, supported by dingbats who claim that economic changes may have changed the equations. However, while the S&P 500’s price/earnings and price/book ratios currently exceed their pre-1995 levels, they aren’t remarkably high by the standards of the preceding 25 years. If current U.S. stock values indicate an investment bubble, then so have several other values during the past 25 years.

These days, Bill's four boxes have been largely checked. Without doubt, interest rates are low, money is easy, and investors have placed an abiding faith on new technologies. It is less clear that they have suppressed 2008's lesson, or that U.S. stock prices have crossed the line that separates bold from speculative, but both outcomes are possibilities. The bubble appears to have been established.

The B Plots

In addition to the prerequisites for forming a financial bubble, Bill provides "subplots" that reveal the extent of the contagion. Normally, investments interest only the wealthy, but during the late stages of bubbles they cross socioeconomic barriers to become national preoccupations. The four signs are as follows:

1) Conversation Starters

"First and foremost," Bill writes, financial speculation begins to dominate all but the most mundane social interactions; whenever and wherever people meet, they talk not of the weather, family, or sports, but rather of stocks and real estate."

2) Amateur Hour

As stories of newly minted wealth abound, people increasingly quit their jobs, intending to make a better living by "speculating in the aforementioned assets." They become the modern-day equivalent of gold prospectors.

3) Angry Bulls

Investors grow emotional about their purchases, into which they have poured so much of their future hopes. They become scornful of those with different views, if not outright hostile. Their investments become politicized.

4) Future Shock

As the bubble expands, thereby permeating the minds of investors so thoroughly that they cannot imagine any other reality than this being the best of all possible times, participants "begin to make outlandish financial forecasts."

Wrapping Up

These were all familiar events during the late 1990s. At that time, I downplayed my occupation when meeting strangers, so that I wouldn't be dragged into investment conversations. Some people became day traders. Morningstar's bearish technology analysts received death threats. And a July 1999 investor poll found respondents forecasting a 17% stock market gain over the next 12 months.

However, they are not much in evidence today. I can safely divulge my employer. To my knowledge, Robinhood's customers invest on the side, not for a living. Morningstar's equity analysts aren't treated so harshly. And in a summer 2020 poll, investors expected an 11% annualized return from equities. (Still too optimistic, but considerably less than during the heady days of the New Era.)

Thus, I would say that as bubbles go, the U.S. stock market is in the early stage. That doesn't mean that equity prices will continue to climb. For all I know, the bear will arrive tomorrow. If so, though, that decline would represent business as usual--the losses that occur when financial markets get ahead of themselves. For a true implosion, the investment news will need to become even better, before it becomes even worse.

John Rekenthaler has been researching the fund industry since 1988. He is now a columnist for Morningstar.com and a member of Morningstar's investment research department. John is quick to point out that while Morningstar typically agrees with the views of the Rekenthaler Report, his views are his own.

From Morningstar:

Blank-Check Companies: Be Careful

Nikola is not the first 'SPAC' to emerge in an explosion of 'strategic' IPOs in 2020. Here's what investors need to know.

Ruth Saldanha
Sep 30, 2020

If you've been following IPO news, or stock market news, or any investment news over the past six months, you will have heard references to *blank-check companies--special purpose acquisition companies*, or *SPACs*. Most recently, you might have heard about them in the context of General Motors (which is held by 3 clients) and Nikola.

Here's the backstory. General Motors made an announcement in September 2020 that it was getting into a "strategic partnership" with Nikola, an electric vehicle company that had not yet manufactured a product. According to the terms of the agreement, GM would receive an 11% equity stake in Nikola in exchange for manufacturing the Nikola Badger pickup truck using GM's own hydrogen fuel cell and battery technologies.

A couple of days after the deal was announced, Hindenburg Research published a report called 'Nikola: How to Parlay an Ocean of Lies Into a Partnership With the Largest Auto OEM in America'. The report claimed the authors had evidence of fraud perpetrated by Nikola.

Since then, the founder and chairman of Nikola has stepped down, the SEC and the Department of Justice are looking into the claims made in the report, and the stock has fallen over 20%. Stephen Girsky, a former vice chairman of GM and a member of Nikola's board, has taken over as chairman.

Nikola Not the First

Girsky founded an investment company called VectoIQ that then created a special company, which was publicly listed but had no business operations. VectoIQ was created specifically to take Nikola public via a so-called *reverse merger*: The SPAC merged with Nikola in June of this year, and Nikola became a publicly traded company as a result.

Companies that go public via reverse mergers circumvent some of the stringent requirements of the SEC. To understand how and why, you need to know what SPACs are and how they work.

What Are SPACs?

A special purpose acquisition company is a company with no real business operations. It exists only to raise capital via an initial public offering, or an IPO, and then use that capital to buy existing private companies.

"This atypical pathway to the public markets was once a niche strategy for small investment firms," Morningstar Pitchbook analyst Cameron Stanfill explains.

These companies own and manage nothing except the cash that they raise. Because of this, they are called *blank-check companies*. They are generally formed by investors, also called sponsors. Sponsors usually have experience and expertise in a particular sector, and it is assumed that the acquisition targets will be companies in that sector. Many sponsors are seasoned private equity investors.

"These early embracers saw SPACs as a way to extract fees from adding structure to a reverse merger," notes Stanfill. "The strategy has now become the hottest financial topic of 2020 after a massive uptick in the volume of these blank-check vehicles and as the stature of the investment professionals involved legitimized the space."

How Do They Work?

Stanfill describes the process like this: "At first, the SPAC follows the traditional IPO process, registering with the SEC, filing prospectuses, and running investor road shows. This entity then prices the IPO and raises the funds that will subsequently be deployed to acquire the target business. At this point, the SPAC is a publicly traded shell company and has assumed much of the cost and time commitments usually borne by the target company."

Once the SPAC raises capital, it usually has two years to complete a deal. If it does not, it faces liquidation. In the meantime, the capital is placed in a trust account, which earns interest at market rates.

What's interesting is that, when these companies have an IPO, they do not have to identity the companies that they want to acquire. Put another way, if you buy into a SPAC, you will have no idea what company you might end up owning. You don't even know *if* you will end up owning an acquired company.

The concept of a SPAC itself can be boiled down to a presold IPO for the private company that it acquires--without many of the stringent requirements, checks, and balances that go into a traditional listing.

Red Flags

Investors should remember that the long (and indeed, tedious) IPO process is in place to protect investors. When a company goes public via a traditional IPO, there is careful institutional and regulatory vetting, which ultimately benefits the investor by bringing issues to light.

Take, for example, the Nikola case. If Nikola was to have gone the traditional IPO route, there would have been a much more stringent due diligence and audit process than with the SPAC reverse-listing. It is important to note that, at present, the allegations of fraud are just that--allegations. The SEC is in the process of investigating the claims. But nevertheless, there are questions around whether the claims would have gotten as far as they have if the firm had gone through the traditional IPO route.

But let's go back to SPACs.

Why 2020?

SPACs have been around for at least 30 years. Why all the interest now?

Stanfill points out that direct listings were all the rage in 2019. "Then came the pandemic, which plagued markets with economic uncertainty, especially in public markets. The sustained volatility and the distinct price declines earlier in 2020 made IPOs and direct listings impractical options for the majority of private companies, which is where SPACs have found an opportunity. Unlike SPACs, direct listings do not allow private companies to raise any new capital during their transition to the public markets, which presents a problem for many startups, given the elongated economic ambiguity driven by the pandemic."

Essentially, he describes SPACs as large "boxes of money--that necessitate a much lower level of diligence than a similarly sized IPO of an operating entity since there are no financial statements to scrutinize."

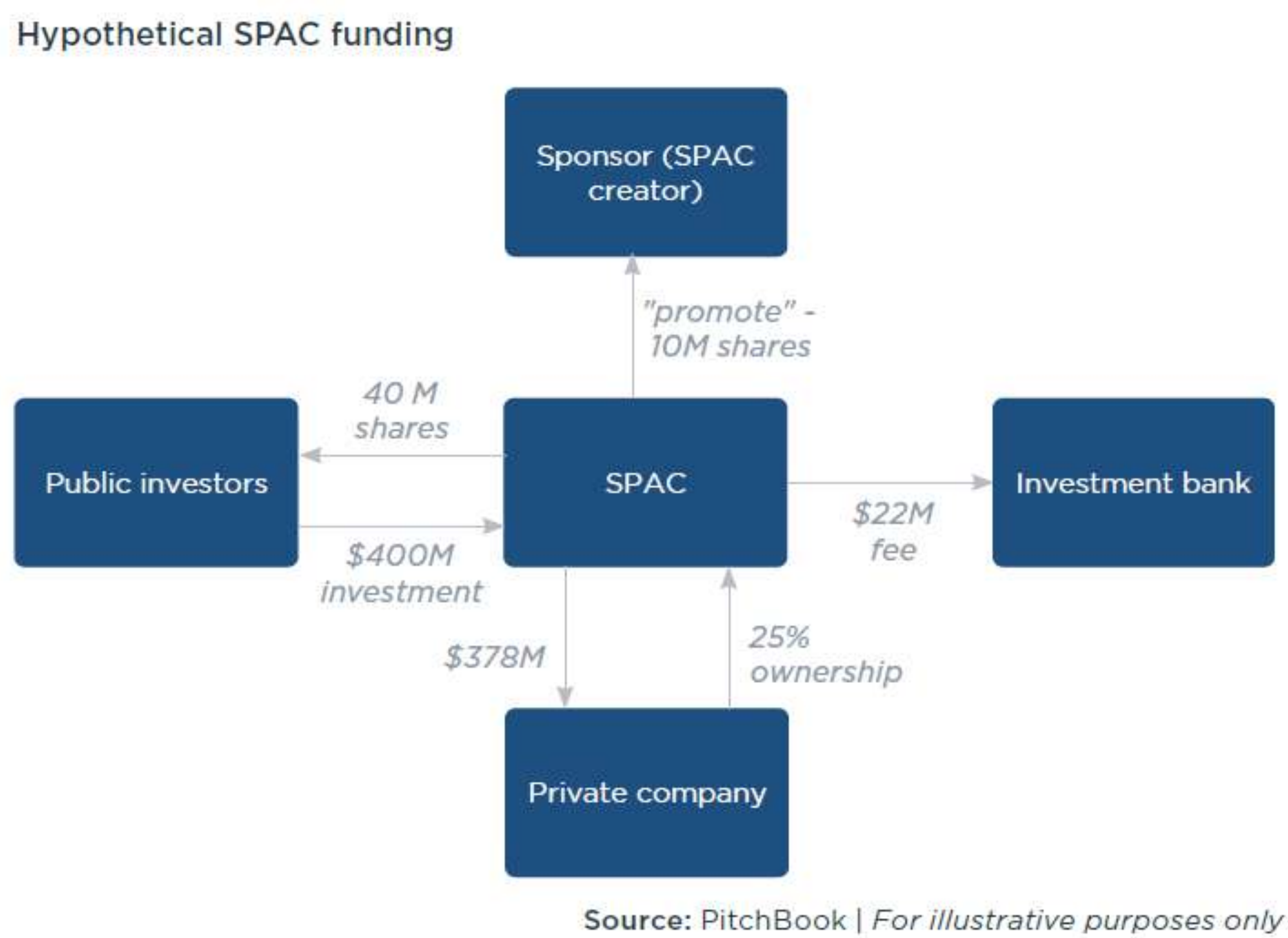
Now that traditional IPOs are relatively fewer, investors have flocked to SPACs in the hopes of hitting upon the next Tesla (TSLA) or PayPal (PYPL). With this increased demand, existing sponsors have raised higher amounts. For example, Chamath Palihapitiya's Social Capital Hedosophia's first two SPACs acquired Virgin Galactic and Opendoor. He has since launched three more SPACs.

The true value of SPACs rests in the companies they acquire, and that's the main draw for retail investors. But you need to weigh this potential against the costs and risks associated with the convenience of SPACs afforded to other people.

"Despite the benefits SPACs offer, they are not a cure-all. From a cost perspective, a merger with a SPAC nets out to essentially the same cost outlay to the company as a traditional IPO. The original IPO fees are paid initially by the SPAC itself--typically 5.5% of the amount raised in the SPAC," Stanfill says. He adds that the costs, along with the sponsor's profits and any investment banking fees, are implicitly passed on to the company.

Who Makes the Money?

It's not always smooth sailing, however. "Despite the benefits SPACs offer, they are not a cure-all. From a cost perspective, a merger with a SPAC nets out to essentially the same cost outlay to the company as a traditional IPO. The original IPO fees are paid initially by the SPAC itself--typically 5.5% of the amount raised in the SPAC--but these costs are implicitly passed on to the company along with the sponsor's promote and any investment banking fees related to the acquisition itself," Stanfill says.



He explains it with this example: If a hypothetical SPAC raised a $400 million IPO by selling 40 million shares at $10, the vehicle would pay $22 million in fees to the investment banks, leaving $378 million for the transaction. At the SPAC's founding in this scenario, the sponsors bought 10 million shares for a nominal fee rather than buying them for $100 million, therefore implicitly taking away capital that could have been raised by the company. In this simplified version, the company is implicitly paying $122 million to raise $500 million, leaving the company with $378 million, or a 22.4% cost of capital, without even factoring in warrants. This is relative to a traditional IPO raising $500 million, which at a 7% fee would cost the company $35 million, with the proceeds to the company totaling $465 million.

Should You Buy A SPAC?
Still want to go for an SPAC? As always, we guide caution.

- You do not know in advance the acquisition target, so you're taking a bet on the founder of the SPAC. Retail investors rarely have insight into the minds of founders and can only make bets based on public perception. This is a risk.
- Even if the founder has a target in mind, the SPAC might not be able to close the deal. If this is the case, and you get your money back a few years after the initial investment, that is an opportunity cost. An *opportunity cost* is what you lose in gains that could have potentially been made had you not invested in the SPAC.
- As Stanfill's note on fees to investment banks shows, there are a lot of people making a lot of money from SPACs--and those people don't seem to be retail investors.
- The success of the SPAC depends on the success of the company it acquires. As established, the research, due diligence, and checks behind these acquisitions may not be as stringent as they would have been in the case of a traditional IPO or public company acquisition. It again seems like the investor is the loser.

So, before you invest in an SPAC, ask yourself who is making the money, what they are making the money on, and if you have alternatives you could consider. And as always, invest based on your financial goals, risk appetite, and time horizon. When in doubt, seek a financial advisor.

Follow-ups

We doubt that divided government Gridlock will rescue big tech from anti-trust action and new regulation. From Oct. 7th's The Finance 202:

House probe faults big tech companies for monopolistic tactics.

The report's publication caps a 16-month investigation: "Amazon, Apple, Facebook and Google engaged in anti-competitive, monopoly-style tactics to evolve into four of the world's most powerful corporate behemoths, according to congressional investigators who called in a wide-ranging report for sweeping changes to federal laws so that government regulators can bring Silicon Valley back in check," Tony Romm, Cat Zakrzewski and Rachel Lerman report.

"The approximately 450-page document, released by the House's top antitrust panel, found that the four tech giants relied on dubious, harmful means to solidify their dominance in Web search, smartphones, social networking and shopping — and in the process evaded the very federal regulators whose primary task is to ensure that companies do not grow into such unmatched corporate titans."

From Oct. 5th's WSJ:

STREETWISE | By James Mackintosh

Few Places to Hide When Stock Market Plunges

September hurt shareholders, not only because stocks fell but also because the things they had bought to protect their portfolios also fell. From the S& P 500's high on the second of the month, stocks, Treasurys, gold, bitcoin and the VIX volatility index all dropped.

This total failure of hedging is unusual (Actually, it was a repeat of what we saw in 2020's Bear Market.), but investors need to get used to the idea that Treasurys no longer provide the ballast for a portfolio.

It wasn't just the normal pattern of asset returns that broke down. Within the stock market the correction in tech upended many of the reliable ways to minimize losses. High-quality stocks, companies with strong balance sheets and reliable profits, fell by more than the market. Smaller companies beat bigger companies.

Within the S& P 500, cheap or "value" stocks outperformed, although they still lost money. But while tech-dominated growth stocks lost out among large companies, among small companies growth beat value. Sector performance followed no discernible pattern either. And stocks that normally rise and fall faster or slower than the market, known in market jargon as high or low beta, didn't behave predictably.

Now the froth has been blown off the big disruptive growth stocks, we can hope that the normal market relationships will reassert themselves. But the biggest hedge against losses, Treasurys, probably won't be back as a useful tool for years, if ever.

The problem showed up in Japan in the 1990s after the country slashed interest rates and government bond yields plunged. But it has become most obvious with Germany. In the eurozone crisis of May 2011 to July 2012, German 10-year bunds gained 25%, similar to the loss on eurozone stocks. But by this year the plummeting yield and already-negative interest rates meant there was little more to gain: Bunds made almost nothing from the February stock-market high to the low and have provided essentially nothing since (Japanese bonds have lost investors a small amount).

Treasurys have now followed suit. In the first phase of the pandemic they made roughly 10%, before the brief period of chaos in the bond market. But since then they have been basically flat, giving investors little to no protection— including inflicting a small loss

as stocks fell from the Sept. 2 high.

The problem is that, with yields so low, it is hard for them to fall much further, causing prices to rise. The Federal Reserve might still step in with a new Operation

Twist to buy more longer-dated Treasurys, which could lower the 10-year yield a bit from its current 0.7%. But even if it was reduced to zero, that would offer a paltry potential price gain of 7% from the bonds.

Of course, the Fed could follow Japan and Europe in taking interest rates negative, which would create more space for bond gains, but policy makers have repeatedly insisted that such a policy would be inappropriate for the U.S.

It is worth noting that the U.K. used to say the same but is now openly contemplating the idea.

Even negative rates only provide a brief respite, though: The European Central Bank reckons it could in principle go as low as minus 1%, but if German bund yields followed suit, the price gain for investors would still only be 7%. That doesn't provide much protection against stock-price falls.

"Fixed income is now 100% fixed and 0% income," said Jan Loeys, long-term strategist at JPMorgan.

Mr. Loeys recommends investors give up on short-term hedging entirely and focus instead on how to make gains in the long run. This includes using more instruments that offer equitylike short-term volatility but more predictable long-run returns such as junk bonds or preferred stocks.

Investors are no more likely to be willing to endure short-term losses now than they were in the past, though, and the hunt for alternatives to Treasurys is strong.

The problem is that many of the suggested instruments are also sensitive to the same things as equities.

Gold, for example, is touted as the ultimate defensive asset, but it shares the sensitivity of stocks to inflation.

Both gold and bitcoin are also dominated by speculation, so when there is a speculative bust—as in September— they can be expected to share in the losses of stocks being dumped by traders rushing for cash.

For those with enough savings not to need to increase their wealth, Treasurys still offer a small guaranteed income, albeit less than expected inflation. The rest of us should plan for a more volatile portfolio and lower returns in the future than the past.

From Oct. 5th's WSJ:

A Misunderstood Investment

When you hear 'socially responsible' or 'impact' or ESG, you might be making wrong assumptions. Here are some of the biggest ones.

BY MEIR STATMAN

It is an investing strategy that goes by many names. Some call it socially responsible investing. Others call it social-impact investing, or just impact investing. Still others call it ESG (for environmental, social and governance) investing.

But whatever the name, they all have one thing in common: a lot of misunderstanding.

That's because investors think they know intuitively what socially responsible/social-impact/impact/ ESG investing is all about. But many of their assumptions are superficial at best or just plain wrong. Here's a closer look at some of those assumptions—and why they may not be quite as accurate as many people believe.

• Socially responsible investing is liberal investing.

The notion that social-responsibility criteria appeal only to liberals is a myth. Sure, exclusion of companies that harm the environment might well appeal mostly to liberals, as does the exclusion of companies producing or distributing weapons. But other common social- responsibility criteria, such as exclusion of companies involved in pornography, might appeal mostly to conservatives. And the exclusion of companies in tobacco, alcohol or gambling arguably would have no political affiliation.

Consider two other examples.

First, the Ave Maria mutual funds reflect conservative, religion-based values corresponding to the precepts of the Roman Catholic Church. The company says that "all investments are screened to eliminate any company engaged in abortion, pornography, embryonic stem cell research, or those that make corporate contributions to Planned Parenthood."

Then there's the Vitium Global mutual fund, formerly known as the Vice Fund. The fund's values might be described as libertarian, poking fingers in the eyes of liberals and conservatives alike. Its prospectus says that the fund "will invest at least 80% of its net assets…in equity securities of companies that derive a significant portion of their revenues from a group of vice industries that includes the alcoholic beverages, defense/aerospace, gaming and tobacco industries."

• Socially responsible people shouldn't separate their values from their investments.

I hear this a lot: If you're really true to your values, your investments need to reflect that. Well, that may be so for some people. But here's another way to think about it: Investors who separate values from investments can maximize their investment returns, without regard to their values, and stay true to their values by contributing portions of their investment returns or volunteer activities to organizations promoting their values.

A banker described to me doing precisely that when he invests in international mutual funds. "Do I investigate the companies in those international funds and determine whether they are paying their workers fair wages?" he says. "Absolutely not." Yet by making as much as possible, the banker believes, he is better able to stay true to his values. He and his wife devote a lot of time to their church's activities, "whether helping the community, educating the children, helping the church financially or working in the soup kitchen."

Other investors, however, would recoil at this. Advice to separate values and investments makes as much sense to them as advice to observant Jews to replace expensive kosher beef with cheaper pork and donate the savings to their synagogues.

• Socially responsible investments yield *higher* returns than conventional investments. Socially responsible investments yield *lower* returns than conventional investments.

I hear both arguments all the time. If you're a fan (or a seller) of socially responsible investments, you often argue that the returns are higher than a diversified index fund's. If you're not a fan, you say the opposite.

Both sides have plenty of evidence to bolster their claims. That's because there are hundreds, if not thousands, of studies comparing the returns of socially responsible investments to those of conventional investments. Some found that socially responsible investments yield higher returns than conventional ones, others found the opposite, and most found no statistically significant differences between the two returns.

For instance, when I studied four socially responsible indexes, I concluded that their returns were somewhat higher than the returns of the conventional S& P 500 index, but the difference between returns wasn't statistically significant.

All this gets even murkier when you compare the returns that *investors* earn as opposed to what *investments* earn. Here, the evidence *does* suggest that even when socially responsible indexes yield returns somewhat higher than conventional indexes, investors in socially responsible index funds and ETFs earn lower returns than investors in conventional index funds and ETFs. This is because socially responsible index funds and ETFs bear the higher costs of acquiring social-responsibility information, and because they suffer the higher costs of funds with relatively low assets. Higher fees result in lower returns to the investors.

• Socially responsible investors are unwilling to sacrifice returns for their values.

There is no doubt some truth to this. Indeed, many investors are enticed into socially responsible investing precisely by promises of market-beating returns. They are told they can do well *and* do good, with the emphasis on "value," instead of "values." In some sense, you could call these pseudo-socially responsible investors.

But the evidence also suggests that at least some investors are willing to sacrifice portions of their returns for staying true to their values. These investors expect to earn lower returns on their socially responsible funds than on conventional funds and are willing to pay higher fees.

Still, all investors, even socially responsible ones, are constrained in the returns they can afford to sacrifice. As one financial adviser said to me: "Even socially responsible investors want to retire someday." A woman described switching from a socially responsible mutual fund to a conventional one when the low returns of the socially responsible fund imperiled her financial security. Years later she received a large settlement as compensation for a serious injury. "I consider it a luxury that I now have the ability to invest more in line with my values," she told me.

• Socially responsible investors do good for others by divesting stocks of companies inconsistent with their values.

There's no question that investors get an emotional benefit by divesting stocks of companies that are inconsistent with their values. But do they do good for others? For instance, do investors deprive tobacco companies of money by divesting their stocks, thereby constraining the production of tobacco products and limiting the harm they do? ...