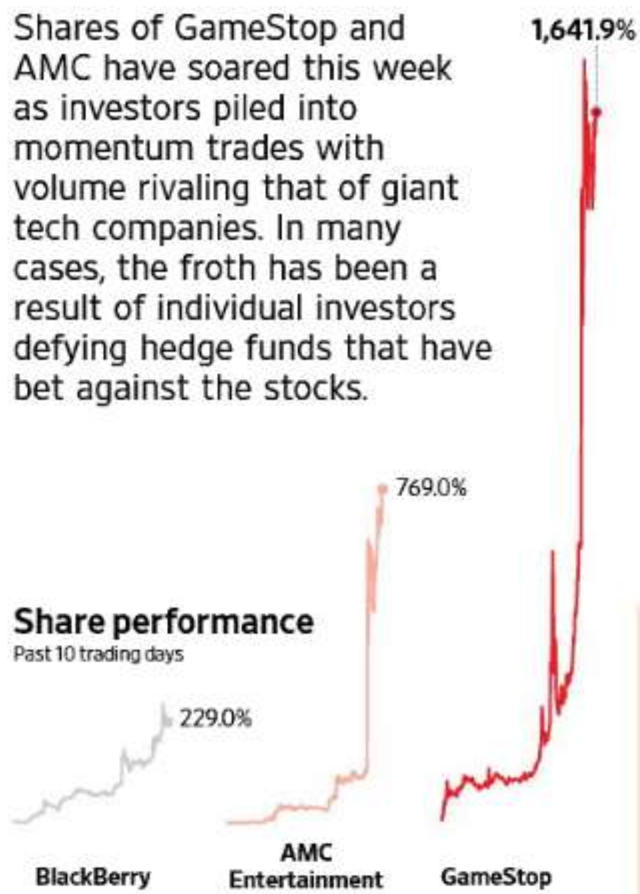
January 2021

The evidence for the Many Worlds Interpretation of Quantum Mechanics grew throughout the month. On January 6th Trump's mob sacked the Capitol in his attempt to overturn the election, resulting in his second impeachment, with all but 10 Republican members of Congress voting to give him another pass despite 5 deaths. American death's from Covid-19 continued their inexorable climb to over half a million. As reported in Friday's WSJ, the U.S. economy's 3.5% contraction last year was "the largest decline since just after World War II and the first since 2009 in the wake of the financial crisis." But conclusive evidence that we now live in Bizarro World was finally reported Thursday. The WSJ's front page headline:

Individual Investors Rout Hedge Funds

*By **Gunjan Banerji, Juliet Chung** and **Caitlin McCabe***

The power dynamics are shifting on Wall Street. Individual investors are winning big—at least for now—and relishing it. An eye-popping rally in shares of companies that were once left for dead including GameStop Corp., AMC Entertainment Holdings Inc. and BlackBerry Ltd. has upended the natural order between hedge-fund investors and those trying their hand at trading from their sofas.



Individual investors have vaulted the three stocks, which have received hundreds of thousands of mentions across social media since early January, into the ranks of the most traded stocks in the U.S. market.

On Wednesday, GameStop shares hit a high of $380 intraday, briefly giving the videogame retailer a market value of $26.5 billion ....

While the individuals are rejoicing at newfound riches, the pros are reeling from their losses. Long-held strategies such as evaluating company fundamentals have gone out the window in favor of momentum. War has broken out between professionals losing billions and the individual investors jeering at them on social media. ...

The newbie investors are gathering on platforms such as Reddit, Discord, Facebook and Twitter. They are encouraging each other to pile into stocks, bragging about their gains and, at times, intentionally banding together to intensify losses among professional traders, who protest that social-media hordes are conspiring to move stock prices. ...

The mammoth gains have forced money managers to dump bets that the stocks would fall, magnifying the rally. Bearish investors who took short positions have lost $23.6 billion this year through the close of trading Wednesday on GameStop alone, according to financial analytics company S3 Partners, including $14.3 billion on Wednesday when the stock price jumped 135%, its largest percentage increase in history, to a record $347.51. ...

Immediately below that lead story came an attempt to explain the inexplicable:

GameStop Shows Epitome of Bubble

BY JAMES MACKINTOSH

GameStop is the platonic ideal of a stock bubble.

A combination of easy money, a real improvement in the company's prospects, technical support from a short squeeze and a mad rush to get rich or die trying pushed stock in the retailer up 64-fold from late August to Wednesday's close. Anyone who has held on for 10 days made gains of more than 10 times their money.

It is tempting to see GameStop as merely clownish behavior in a chat room having some amusing effects on a stock few care about. That would be a mistake.

Sure, the wildly popular Reddit group wallstreetbets— slogan: like 4chan found a Bloomberg terminal— is full of childish chat. There are plenty of calls for the stock to go to $1,000 or more (it started the year at $18.84).

But GameStop's soaring stock—and similar moves in BlackBerry, Nokia and others— is a bubble in microcosm, with lessons for those of us worrying about froth elsewhere in the market.

GameStop's rise started with some genuinely good news, just as bubbles always do. Ryan Cohen, who built up and sold online pet-food retailer Chewy, started building what is now a 13% stake for his RC Ventures in GameStop last year. He pushed for the staid mall-based seller of videogames to improve its internet sales. This month he joined the board.

Mr. Cohen's arrival means GameStop at least has a chance of joining the 21st century. From the first disclosure of his stock purchases in August to the end of November the shares tripled, helped too by the improved prospects for the vaccine- driven reopening of the economy.

Along the way, some private investors latched on to the stock, and it became an item of discussion on Wall Street Bets, or r/WSB as it is known.

This month the stock moved into the pure speculative phase, producing several daily jumps of 50% or more, and fundamentals were abandoned. Many cheerleaders on r/WSB stopped even making the pretense of arguments about Mr. Cohen's chances of turning the company around. Instead, there were two justifications for buying: wanting to get in on the price action, and the self-fulfilling prospect of hurting the large numbers of short sellers.

As the late economist Charles Kindleberger put it: "There is nothing as disturbing to one's well-being and judgment as to see a friend get rich. Unless it is to see a non-friend get rich."

The scale of trading in GameStop shares is as extraordinary as the daily gains in price, suggesting widespread disturbance to people's judgment. On Tuesday, $22 billion of shares changed hands, more than in

Apple, the world's largest company, and double GameStop's market value. Adam Smith, the founder of economics, called speculative manias "overtrading," and this is what they look like.

The hope of getting rich is only part of what is inflating the bubble. Mr. Kindleberger argued that speculative manias needed innovative sources of financing, and the private traders on r/WSB have one: the shift last year to make trading in options free on Robinhood and several other platforms.

Options, like other derivatives, allow traders to use implied leverage to boost their bets, similar to borrowing money. In the same way that Japan's bubble in the 1980s was fueled by cheap mortgages and low Federal Reserve rates combined with collateralized debt obligations to support the housing bubble of the 2000s, the bubble in GameStop is aided by an increase in the money supply of private stock traders.

Bubbles also frequently have support from technical factors that prevent the asset from being priced correctly. In the late 1990s, many dot-coms had a small float available, and none for short sellers, making it hard or impossible for those who doubted the story to have their views expressed in the share price.

In GameStop, there are plenty of short sellers, but they are making things even worse. The stock is caught in a vicious short squeeze. Short sellers had borrowed and sold more than 100% of the stock outstanding, as some was borrowed again. As the price rose, at least some of the hedge funds bought back shares to prevent further losses, so pushing the price up even further.

The most obvious parallel here is to K-Tel, the TV retailer of compilation tapes and the Veg-O-Matic food processor, among other things.

It announced in 1998 that it was moving online, prompting a jump in the shares that turned into an extraordinary short squeeze. K-Tel's appropriately named public-relations representative, Coffin Communications, gave this wonderful justification to the Washington Post: "Which do you think has more likelihood of success, a pure start-up that has never sold a product, or one like K-Tel that has been in business for 35 years?"

It turned out the answer was a pure startup, and K-Tel's shares collapsed—but not before they had soared from $3.34 to more than $35 in under a month.

Warren Buffett attributed to his mentor, Ben Graham, the line that "in the short run, the market is a voting machine—reflecting a voter-registration test that requires only money, not intelligence or emotional stability — but in the long run, the market is a weighing machine."

The absence of emotional stability on r/WSB is obvious and has worked out beautifully for buyers of GameStop so far. But when the stock is weighed, many will be found wanting, as they always are in bubbles.

Friday's WSJ headline:

Brokers Cool Off Highflying Stocks

Robinhood, other online firms limit access to GameStop, AMC ...

BY CAITLIN MCCABE

Popular online brokerages restricted trading in highflying stocks including GameStop and AMC Entertainment, sapping some of the euphoria around shares of companies that individual investors have sent skyrocketing in recent days.

The restrictions, from brokerages including Robinhood, Webull, E*Trade and Interactive Brokers, left traders hoping to capitalize on this week's eye-popping gains with only two options: hold or sell. They also fueled a firestorm of criticism among users and some members of Congress who have called for hearings on the matter.

The rally in the shares fizzled Thursday: GameStop dropped 44%, and AMC lost 57%. ...

Morningstar joined in:

With GameStop, Hedge Funds Might Enjoy the Last Laugh

If stock prices become irrational, (some) hedge funds rather than individuals stand to benefit.

John Rekenthaler
Jan 29, 2021

Evolving Views
The day that I interviewed for a position at Morningstar, on Feb. 6, 1988, the Dow Jones Industrial Average closed at 1,910. Most Wall Street veterans were cautious. Stocks had righted themselves since October's "Black Monday" crash, thereby averting disaster, but the Dow Jones had nevertheless gained 150% over the preceding six years. The market's glory days appeared to be behind it.

Equities then began to rise. They grew by 15% for the rest of 1988, and double that amount in 1989. With only brief respites, stock prices increased for another decade. It became the greatest bull market in U.S. history. Throughout that ascendancy, the old guard muttered that stocks had become foolishly overpriced. Eventually, I paid them no more heed.

Good call. Clucking disapprovingly at the folly of the next generation, while reciting cautionary tales from one's youth, produces easy applause. Such comments once impressed me, as an aspiring investment analyst seeking to benefit from those with greater experience. However, as I learned, those gods are false. I vowed that when I became older, I would behave differently.

I have tried my best. When bond yields tumbled 10 years ago, I refrained from pronouncing the bond market a "bubble." (Admittedly, recent events have pushed me closer to that edge.) Over the past two years, I have defended the trillion-dollar valuations placed on the stock market's leaders, attempted to explain Tesla's (TSLA) soaring price/earnings ratio, and considered Bitcoin's investment merits. Such assets aren't for me, but I can see why they might be for somebody else.

A Step Too Far
But GameStop (GME) exceeds my tolerance, and not by a narrow margin. GameStop's stock hasn't merely crossed the line that separates investing from speculation. It has leapt over that barrier .... If given a choice between buying GameStop stock or Dutch tulips, I will take half a dozen bulbs and a bag of garden soil, thanks much.

To recap *the* January 2021 investment story, GameStop is a video-game retailer that, until very recently, possessed a stock that interested almost nobody. Six months ago, GameStop's share price was $4. As I write those words, the stock now trades at $347.

The reason for GameStop's 8,675% gain--which equates to a tidy annualized 750,000% rate of return--has nothing whatsoever to do with its operations, and everything to do with speculation. The company's business is garbage. Sadly, that statement is a metaphor; better for the firm it did engage in waste removal. Instead, it runs brick-and-mortar retail shops that were struggling to keep their customers even before COVID-19's arrival, and which now are in dire straits.

(GameStop's stock price is now $264. This stock has the half-life of a mayfly.)

The People's Revolt

Rather than profit growth, or revenue growth, or *anything* growth, GameStop's performance derives from investor behavior. These are the salient facts:

1) Despite the company's declining fundamentals, GameStop's share price had gradually appreciated to $19 by New Year's Day.

2) That gain attracted short sellers, largely hedge funds, who believed that an unprofitable, shrinking company that operated a dinosaur business didn't deserve its $1.5 billion market capitalization.

3) When GameStop appeared on the list of most-shorted stocks, a social media campaign began on reddit. If retail investors purchased enough GameStop stock, they could profit by creating a"short squeeze," while also punishing the hedge funds. David wins, Goliath loses!

4) Purchase they did. And then some. The increase in bids was far larger than the number of shares that had been borrowed, meaning that most of GameStop's subsequent gain came not from shorts closing their positions, but instead from the new buyers.

This sequence has led many to portray GameStop's rally as a morality play, with everyday investors banding together to punish Wall Street sharks. Objects a writer for *Business Insider*, "Stop with the terrible GameStop punditry. GameStop trading is not a class war, an Orwell novel, or an event with broader societal implications." It is instead, he maintains, a "technical market story," about what can happen to stocks when too many shorts target the same lightly traded issue.

(As I finished that sentence, an email arrived: "You could write about the reddit community pushing up the price of GameStop stock and costing investment banks a bunch of money." Thanks, son. Twenty-seven years old, and it took the GameStop incident to prompt his first column suggestion. If that doesn't indicate how this saga has caught millennials' attention, I don't know what will.)

Win the Battle, Lose the War

Unfortunately, to mix the classical allusions, David's victory is Pyrrhic. Unless institutional investors bail out individuals by purchasing their GameStop shares, which seems unlikely, the public will lose that which it has gained. Before long, this stock will return to its starting point. The round trip is inevitable.

The broader implication is troubling. That "penny stocks" can skyrocket, even during calm investment climates, is an accepted market reality. Small breezes can send feathers on long journeys. But at its peak, by which I mean three hours ago (!), GameStop's market capitalization exceeded $30 billion. That is no feather. The current level of stock-market speculation is substantial.

Indeed, I would rate it as the highest since the late 1990s--clearly above that which preceded the 2008 global financial crisis. (The housing market is another story.) In the late 1990s, too, everyday shareholders embraced day trading, through newly popular discount brokerages, thereby propelling the shares of technology companies. It was an exciting time, marked by investor optimism.

Then came the New Millennium, and the technology-stock crash. Day traders suffered sharp losses. In contrast, hedge funds posted excellent returns. Most had long since exited technology stocks, leaving them to the enthusiastic amateurs (and, it must be confessed, to more than a few mutual fund managers). The hedge funds had dropped some relative performance on the way up, but they more than recovered their lost ground on the way down.

It would not surprise me to see history soon repeat itself.

John Rekenthaler (john.rekenthaler@morningstar.com) 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.

As reported in Saturday's WSJ, "For the third straight day, the stocks at the center of a social-media frenzy—led by GameStop and AMC Entertainment—did the opposite of the Dow industrials. Friday, GameStop rose 68% and AMC jumped 54%. ... For the week, GameStop soared 400%, and AMC jumped 278%."

So how did we end up in this Upside-Down world? Fortunately, that was finally revealed in the very center of Saturday's WSJ front page:

The Man Who Drove GameStop Mania

Online influencer Keith Gill helped turn the investing world upside down; 'I didn't expect this'

BY JULIA-AMBRA VERLAINE AND GUNJAN BANERJI

BOSTON—The investor who helped direct the world's attention to GameStop, leading a horde of online followers in a bizarre market rally that made and lost fortunes from one day to the next, says he's just a normal guy.

"I didn't expect this," said Keith Gill, 34 years old, known as "DeepF—ingValue" by fans on Reddit's WallStreet-Bets forum .... He said he didn't set out to draw the attention of Congress, the Federal Reserve, hedge funds, the media, trading platforms and hundreds of thousands of investors. ...

To many of them, Mr. Gill—who until recently worked in marketing for Massachusetts Mutual Life Insurance Co.— is the force behind the quadruple-digit gains in shares of the videogame retailer GameStop, up more than 1600% this year through Friday. On Wednesday, the stock jumped 135% to $347.51, a record, before plunging to $194 a share Thursday and then sharply rebounding to end the week. At the start of the year, GameStop shares went for around $18.

Many online investors say his advocacy helped turn them into a force powerful enough to cause big losses for established hedge funds and, for the moment, turn the investing world upside down.

Mr. Gill posted a screenshot of his brokerage account Wednesday, showing a roughly $20 million daily gain on GameStop shares and options. “Your steady hand convinced many of us to not only buy, but hold. Your example has literally changed the lives of thousands of ordinary normal people. Seriously thank you. You deserve every penny,” replied one Reddit user, reality_ czech.

The next day, Mr. Gill posted another screenshot—showing about a $15 million loss. After Thursday’s market close, his E*Trade brokerage account, viewed by the Journal, held around $33 million, including GameStop stock, options and millions in cash.

“He always liked money,” said Elaine Gill, his mother. As a child, she said, “he would get money from those scratch tickets that people didn’t know they’d won. People would throw them on the ground….A lot of times there was still money on them.”

Mr. Gill’s online persona— he goes by “Roaring Kitty” on YouTube—has drawn tens of thousands of fans and copycats who share screenshots of their own brokerage accounts. As the GameStop frenzy peaked this week, hundreds of thousands of new investors downloaded applications like Robinhood to join the action, according to Apptopia. ...

Keith Gill, 34 years old, works in the basement of the house he rents in Wilmington, Mass. He has a large following of small investors on Reddit and YouTube who say his advocacy and instruction helped turn them into a powerful market force.

From Morningstar for those unfamiliar with how a short squeeze occurs:

Crowd-Sourcing a Short Squeeze

How individual investors are changing the dynamics of a well-known strategy from the institutional investor playbook.

Dave Sekera, CFA
Jan 27, 2021

Short squeezes are nothing new, as institutional investors have played this game for years. What's new are the players: Crowdsourcing among individual investors has led to a lightning-fast evolution of the traditional short-squeeze play.

With its high short-interest ratio and availability to pile on additional leverage through the options market, GameStop (GME) was a prime candidate for a short squeeze. What started on a Reddit board was then further amplified on Twitter by a few high-profile investors announcing their purchases of out-of-the-money call options. All of this activity culminated in a stock price explosion from $19 to as high as $380 in intraday trading over the course of two weeks.

Short investors were carried out on stretchers.

Like any other trading strategy that works in the short term, this strategy is starting to catch quickly and is spreading to other stocks with high short-interest ratios.

Make no mistake about it: During a short squeeze, the increase in the stock price has absolutely nothing to do with the long-term fundamentals of the company and everything to do with the short-term technicals. However, once a short squeeze comes to an end, look out below.

In a typical short squeeze, once all of the weak shorts are margined out of their positions and the forced buying ends, the stock price will come crashing back down to earth. And just like no one wants to try to catch a falling knife until it hits the floor, fundamental investors focused on the long term won't re-enter the market until the stock is significantly undervalued.

... These situations are more of a cautionary tale of the inherent risks of shorting individual stocks, especially those that already have a high short-interest ratio.

The Mechanics of the Short Squeeze
Prior to the stock rally, the short-interest ratio on GameStop hit 260% at the end of last year. With a short-interest ratio well over 100%, many of the shorts were "naked," meaning that they sold stock that they were not able to borrow, an especially precarious position.

As the stock price first began to rise, many of these investors were forced to buy the stock to cover their positions, which in turn sent the stock price up. As the price rose, other short-sellers began to buy as their margined positions quickly moved against them. It was a self-perpetuating cycle.

The stock price really got moving as other investors purchased out-of-the-money call options. The dealers that sold those call options then bought the stock to hedge their delta, the rate of change of options price due to change in underlying stock price.

As the stock rose even further, those dealers were forced to buy even more stock as the price neared the strike price. Our guess is that many institutional stock investors who were long the stock prior to the rally have called their trustees in order to instruct them to pull their availability to lend the shares out.

As the short squeeze rapidly expands across the markets, it appears that many hedge funds have looked to cover their shorts before they are next in line. As losses are being racked up on the short positions, some highly leveraged funds may have to sell some of their long positions to cover their margins.

Don’t Confuse Trading With Investing

Shorting stocks helps to keep the market in balance over time as it provides a natural resistance for overvalued stocks to become even more overvalued. However, after getting burned in a short squeeze, many of these investors will become much more hesitant to short stocks in the future. This could limit that natural balance between investors' opinions on whether a stock is over- or undervalued. In addition, options dealers will look to charge higher premiums, thus greater implied volatility, on the options they sell in order to protect themselves against wild price swings.

While this trade has worked for now and is still expanding to other stocks, don’t confuse what is happening with investing. This isn’t some new riskless way for investors to make money.

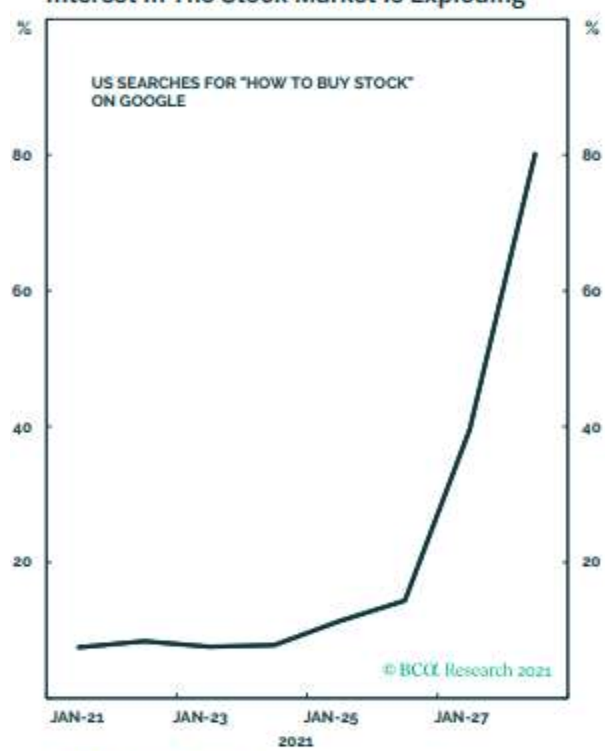
Once enough of the shorts have been flushed out, there won’t be any new buyers to keep the stock price propped up, and, like a plane hitting an air pocket, the stock price will drop to levels where fundamental investors will start buying. ...

Global Investment Strategy's take from Friday's report:

Bubble Trouble?

Last March ... we noted that “The shift towards even looser monetary policy in the US and elsewhere has increased the probability that stocks will rip higher, perhaps even entering a full-fledged bubble like they did in 1998 after the Fed cut rates in the wake of Long-Term Capital Management‘s implosion.” Our words raised eyebrows at the time, but now seem increasingly plausible.

CHART 1
Interest In The Stock Market Is Exploding



SOURCE: GOOGLE TRENDS.

Retail Traders On The Attack

This week brought further evidence of financial excess: GameStop, a has-been brick-and-mortar retailer, soared to stratospheric levels in an epic short squeeze fomented by users of the “wallstreetbets” Reddit group.

Short interest for the median S&P 500 stock as a percent of market capitalization is at multi-year lows these days. Thus, a broad-based short squeeze of the sort that GameStop and a handful of other stocks experienced is unlikely to occur. Nevertheless, recent market action could send a message to retail investors that the “sky is the limit” when it comes to buying stocks, and anyone who bets otherwise risks having their account blown up.

In any case, this week’s events further fanned interest in the stock market. Robinhood app downloads surged over the past few days while Google search queries for “how to buy stock” exploded (**Chart 1**). With a huge amount of excess savings on the sidelines and more “stimmy” checks in the mail, there is still plenty of cash that can go into the market.

It’s Not 2000

Despite the growing parallels with the late 1990s, we think it is too early to pull the plug on stocks. One key reason why the bubble burst in 2000 was that the Fed was hiking rates. The Fed funds rate peaked at 6.5% in May 2000. Today, the Fed funds rate is near zero, and as we discussed last week, even bountiful fiscal stimulus is unlikely to prompt the Fed to shift to a more hawkish stance anytime soon.

In January 2000, the 10-year Treasury yield stood at 6%, 2.7 percentage points above the forward earnings yield on stocks. Today, the 10-year yield is 3.3 points below the earnings yield (**Chart 2**).

The outlook for the global economy remains strong. The rollout of vaccines should invigorate growth later this year. This week, the IMF revised up its global GDP growth forecast by 0.3 percentage points for 2021. The Fund now expects the global economy to expand by 5.5% this year and 4.2% in 2022.

HCM doesn't short stocks. **"It's ruined a lot of people. You can go broke doing it. ... It's a whole lot easier to make money on the long side." -** Warren Buffett on Shorting

After our experience with QMNIX, we also don't use funds for clients that short stocks to reduce risk. From Morningstar:

Rocketing Stocks Short-Sheet Long-Short Equity Funds

An epic rally in the underdogs of Wall Street illustrates the challenges of short-selling.

Bobby Blue
Jan 27, 2021

Long-short equity funds offer an appealing pitch. If you think a manager can pick good businesses to invest in, why wouldn’t they be able to pick bad ones to bet against?

So far 2021 has demonstrated that reality is more complex. Many stocks that a lot of managers have been shorting, or betting they would crater, have blasted off instead, exposing short-sellers, including many active long-short strategies, to mounting losses. It’s been a hard-knocks refresher course on the perils of short-selling and long-short approaches in general. Such strategies should be able to keep up in strong equity environments and theoretically can act a hedge for investors worried about frothy markets.

Fundamentals often prevail in the long run. In the short term, technical factors can overwhelm a fundamental thesis. This is fine for unleveraged buy-and hold investors, who can ride out drawdowns. In a worst-case scenario, they may lose 100%, but they can limit the damage by controlling the size of the position in their portfolios. A short position, however, can lose much more than 100%, and quickly. Here’s a primer on these and other quirks investors considering long-short funds should keep in mind.

It's Harder Than Just Picking Losers

First, let's review of how shorting works. Short-sellers borrow shares they want to bet against from brokerage firms, then immediately sell them to the market. At a set date in the future, the sellers return the shares to the brokers by buying them back in the open market. If the stock prices are more than what they initially paid, they lose the difference. If it’s gone down, they can book the difference as profit.

These dynamics create challenges that long-only managers don’t face. These stocks are often from challenged companies trading at low prices, which can make them acquisition targets for opportunistic buyers that often offer a significant premium. Stocks can double, triple, even quadruple on short-sellers, leaving them on the hook for any gains above their initial short-sale prices. Compounding losses may force long-short managers to use idle cash or sell other positions to pay back their brokers. If managers don’t trim short positions, their portfolio positions and influence on performance grow larger and larger.

When this happens, the lending brokers rightfully begin to worry about the short-sellers’ ability to pay them back. The higher the leverage, the more of a concern it becomes. Brokers issue a margin call, or force short-sellers to post more collateral. This, if managers don’t have the necessary cash on hand, can force them sell some long positions to raise cash, which can drive down the long holdings’ prices and beget further losses. Leverage, which managers often use on these trades, can multiply these problems and lead to even more frenetic trading.

When It All Goes Wrong

The confluence of the above-mentioned factors can lead to chaos in a heavily shorted stock. If the stock price begins to rally, short-sellers may rush to purchase the stock in the open market to return to their broker. This increased demand for the stock drives its price higher, creating a feedback loop called a short squeeze.

The start of 2021 has been full of land mines for short-sellers. Exhibit 1 shows an equal weight basket of the 12 stocks in the Wilshire 5000 Total Market Index with total short interest (the percent of total shares outstanding that short-sellers have bet against) greater than 50%. It’s risen more than 100% in just 16 trading days through Jan. 26, highlighting the extreme pressure that short-sellers are under right now.

Stocks like GameStop (GME), Bed Bath and Beyond (BBY), and AMC Entertainment (AMC) have all been rocket ships in January. Options market dynamics, increased interest from retail investors (including active Internet forums like the r/wallstreetbets hivemind), and increased chatter from financial news media have all

Exhibit 1: Stocks With at Least 50% of Total Float Shorted

Stock	2021 Return	% of Float Shorted
GameStop Corp Class A	1857%	261%
SunPower Corp	636%	57%
iRobot Corp	135%	63%
B&G Foods Inc	115%	51%
Bed Bath & Beyond Inc	107%	84%
AMC Networks Inc A	47%	94%
Ligand Pharmaceuticals Inc	46%	107%
Altice USA Inc Class A	28%	51%
Children's Place Inc	11%	65%
Sinclair Broadcast Group Inc	1%	55%
Sally Beauty Holdings Inc	-12%	53%
Macerich Co	-20%	88%

Source: Morningstar. Data as of January 26, 2021.

contributed to excess volatility in these names. This in turn has forced short-sellers to either exit at a massive loss or post more collateral to maintain positions, which requires them to sell some of their long positions--potentially creating a run on those names as well.

Perhaps short-sellers are right about these businesses' fundamentals, and they're destined to fail. Morningstar Analysts rate five of the 12 heavily shorted stocks, with all but one trading above its fair value estimate. But as economist John Maynard Keynes once said, "the market can sometimes remain irrational longer than you can remain solvent," ....

None of the 99 distinct funds in the long-short equity Morningstar Category earn a Positive Morningstar Analyst Rating; seven get Neutrals and one Negative. This is often because shorting is challenging, not because the team's stock-picking abilities are flawed. Indeed, several of the teams with Neutral ratings also run long-only funds that are Morningstar Medalists, like Diamond Hill and Boston Partners. For the most part, they've avoided the worst of the short squeeze thanks to their diversified short books, but their mediocre trailing five-year returns show they've still been challenged.

Just 20% of funds in the long-short category have been able to deliver positive alpha, a risk-adjusted return measure often used as a proxy for manager skill, versus the S&P 500 over the trailing five years, showing how scarce winners are in this space. While it's undoubtedly a difficult environment for these managers, short-selling remains challenging in good times and bad.

Exhibit 3: Long-Short Equity Fund Analyst Ratings

Name	Morningstar Analyst Rating	Tot Ret YTD (Daily) USD (%)	Tot Ret 1 Yr (%)	Ann Tot Ret 3 Yr (%)	Ann Tot Ret 5 Yr (%)
AQR Long-Short Equity I	Neutral	5.01	-13.91	-10.00	-1.29
Gabelli Entpr Mergers & Acquisitions Y	Negative	2.55	5.29	3.31	4.82
Boston Partners Global Long/Short Instl	Neutral	1.39	-0.49	-1.87	0.79
AB Select US Long/Short I	Neutral	1.22	10.23	8.31	8.46
Gotham Absolute Return Institutional	Neutral	0.41	-6.19	-0.16	3.40
Neuberger Berman Long Short Instl	Neutral	-0.60	15.27	7.94	8.14
Diamond Hill Long-Short A	Neutral	-1.08	-0.55	4.21	5.68
Boston Partners Long/Short Rsrch Instl	Neutral	-1.30	-8.25	-2.62	1.05
S&P 500		**2.57**	**18.40**	**14.18**	**15.22**
Long-Short Category		**1.81**	**7.89**	**4.00**	**5.07**

Source: Morningstar.Data as of January 26, 2021.

Changing the subject, one more from Morningstar:

Today's Markets Are in Uncharted Territory

Investing when interest rates (and bond yields) are no more.

John Rekenthaler
Jan 7, 2021

The Very, Very Long View
To write that today's bond prices are unusual is to greatly understate the matter. In a recent interview, veteran market observer Laurence Siegel--who formerly worked in research at Ibbotson Associates and the Ford Foundation, before currently serving as director of research at the CFA Institute Research Foundation--states that current interest rates are "literally unprecedented in human history."

Per Siegel's sources, which date back 5,000 years (!), nominal interest rates in countries (or, for most of that history, empires) that were successful enough to be remembered have always been positive. Until the mid-19th century, they were almost always highly positive, at 8% or more. The lone exception was the height of the Roman Empire, where rates briefly hit 4%.

In that context, states Siegel, the negative short-term interest rates that are now offered by Switzerland and Japan, along with the effectively flat rates that exist in other developed countries, are without precedent. Says Siegel, "The idea that you have to pay somebody to lend them money simply turns the universe on its head.

Gravity works backwards. Apples fall upwards. I don’t claim to understand it.” Longer securities aren't much different; Japan's 10-year bond pays a meager 0.10%.

In Theory
Naturally, being a researcher, Siegel promptly attempts to understand what he claims not to understand. His first attempt to analyze interest rates came by considering classic monetary theory, as presented by Milton Friedman and Anna Schwartz, but to no avail. The surge in inflation predicted by monetary theory, following steep U.S. money growth, has not arrived. Comments Siegel, “I’ve been positioned personally for a lot of inflation in my portfolio since about 2008, so I’ve been wrong over and over for about 12 years. Please don’t take my investment advice!” ...

In response to the struggles of conventional monetary theory, Siegel has embraced an updated version, the Fiscal Theory of the Price Level, which Siegel rebrands as “New Monetarism.” According to New Monetarism, money-supply growth will not lead to inflation if the monetary expansion consists of “exchanging one type of government liability for another--exchanging cash, one liability, for another type, long-term debt.” So far, so good.

However, there is a catch. Per New Monetarism, “The fact that bonds have not fallen in price indicates that the public believes the debt will be paid back whole in real terms. For that to happen, the government has to run a primary surplus (revenues minus expenditures other than interest in the national debt) in the future. Market prices are, thus, telling us that--contrary to intuition--future surpluses are rightly or wrongly what the people who buy bonds are expecting.”

Hmm. I suspect that *you* do not foresee the United States recording a budget surplus anytime soon. Nor, to his credit, does Siegel. He continues, “I guess I am supposed to believe the market, but I have a hard time with [that part].”

Live First, Learn Later
My point is not to bury Siegel’s claim. (He has done the work, not I.) It is instead to demonstrate how bond-market theories have struggled to keep pace with the market’s results. (Tellingly, three academics have recently updated the math behind The Fiscal Theory of the Price Level, to account for 2020’s valuations.) Forty years ago, the prevailing theory suggested that Paul Volcker’s attempt to throttle inflation ultimately would prove successful, thereby sparking a bond rally. Today, the market’s results come first, and then the explanations follow.

This is not unusual with investments. For example, from 1871 through 1959, the dividend yield on the S&P 500 always exceeded the income from 10-year U.S. Treasuries. The common argument was that stocks should offer higher yields than government-guaranteed bonds, because stocks carried greater risk. That view held for almost a century, ... until it didn’t. (Although now it does once again.) Many thought that stocks had become overvalued. Eventually, those objections ceased, for the simple reason that the marketplace dissented.

Similarly, until recently a figure exceeding 25 for the Shiller Cyclically Adjusted P/E Ratio (Shiller CAPE Ratio) was considered unsustainable. Such amounts had occurred briefly during the late 1920s, the late 1990s, and the mid-2000s, each time presaging a crash. Since 2015, though, the S&P 500 has remained firmly above that mark, which predictably has led to arguments that the statistic should be revised to reflect that conditions have changed.

Looking Forward
While we wait for theory to catch reality, there are a few things to acknowledge about the current bond market. First, current interest rates reflect enormous confidence in the underlying institutions. People wouldn't accept nonexistent (or even negative) yields unless they were absolutely, positively certain of receiving return of their capital. (It is odd that such confidence coexists with the boom of cybercurrencies, which implicitly undermine the claims of sovereign currencies.)

Second, it's a challenging climate for tactical asset allocators, who attempt to profit by knowing when bonds are a better buy than stocks, or vice versa. Such decisions rely either on investment theory, or on repeating performance patterns that have previously occurred. When interest rates move where they have never been before, those compasses disappear. The tactical allocators fly blind.

Finally, such low rates have already caused spillover effects and will continue to do so. All things being equal, low rates also benefit non-bond investments, because their competition has become so weak. (It's not terribly difficult to outgain an annualized return of 90 cents on every $1,000, which is what 3-month Treasury bills now pay.) In addition, easy money facilitates greater borrowing and thus higher leverage. How these factors will play out is anybody's guess.

This isn't to caution against investing. Exiting the marketplace is usually unwise even for the short term, and almost always over the longer haul. Rather, it is to caution against relying too heavily on received wisdom. There are times when investment guides, whether formulated by theory or observation, are relatively reliable. This would not appear to be one of those times.

John Rekenthaler (john.rekenthaler@morningstar.com) 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.

Positions

ACI - The genesis of most of our IVA System picks starts with InsiderInsights' weekly insider transactions tables, with an occasional recommendation from The Insiders Forum also qualifying. However, our analysis of Albertsons started with Dan Rasmussen on Jan. 25th:

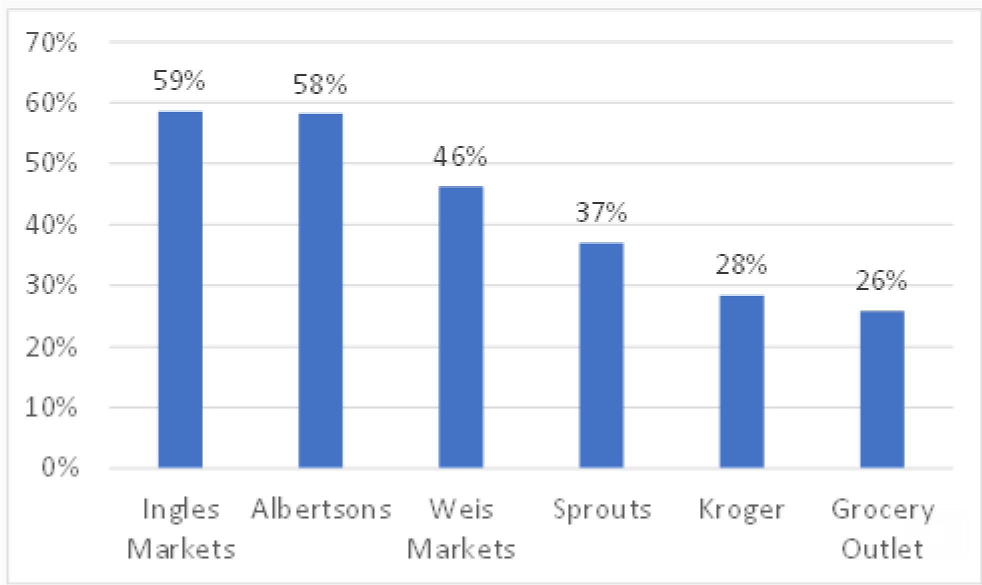
The Grocery Store Puzzle

Grocery stores have had a banner year, so why are their stocks underperforming?

The 2010s were a difficult decade for US grocery stores. Competition intensified as European discount grocery chains entered the US and Amazon bought Whole Foods. Smaller players like Dean Foods went bankrupt. Margins were thin, and unionized workforces and pension funds drained profits.

But COVID hit the grocery industry like an electric shock from a defibrillator. Over the past twelve months, EBITDA is up about 40% on average for publicly traded grocery chains, as evidenced in the chart below.

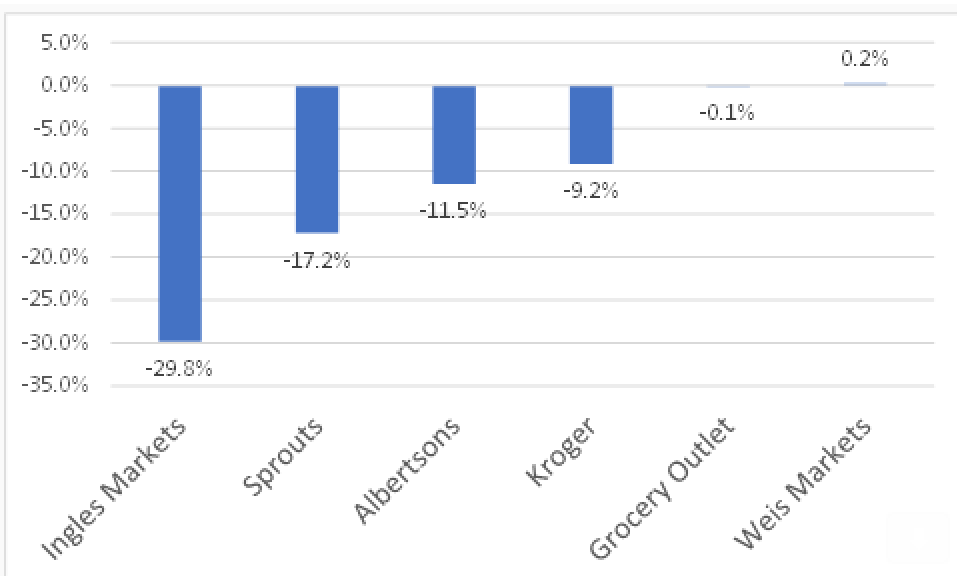
Figure 1: LTM EBITDA Growth



Source: Capital IQ

These companies came into this year heavily leveraged, and they used these windfall profits to delever by about $4B, or about 10% of aggregate market capitalization. They have also reinvested some of these profits in technology and facility upgrades, improving their abilities to work with grocery delivery companies like Instacart. Yet despite this massive growth, increased technology investment, and deleveraging, their stock prices have fared poorly, with only Weis Markets beating the US market index.

Figure 2: 2020 Grocery Store Equity Returns vs. US Market Index



Source: Capital IQ. Note: Albertsons relative return shown since IPO on June 25.

Why have the stocks done poorly despite tremendous growth? Simple. Multiple compression.

Investors seem to be convinced these are one-time windfall profits that don't have a material impact on firm valuation. Investors think next year comps will be negative, everything will be about deceleration, they'll be left with a razor-thin margin, and they'll be afflicted by the same litany of problems from the 2010s. Below is a table comparing EBITDA multiples (the 2nd of our 3 valuation metrics) at the beginning of the year to the present.

Figure 3: EBITDA Multiples over Time

Company	12/31/2019	12/31/2020	% Change
Kroger	7.2x	5.4x	-25%
Albertsons	6.0x	4.1x	-32%
Grocery Outlet	19.2x	18.8x	-2%
Sprouts	7.0x	5.3x	-25%
Weis Markets	5.0x	4.2x	-17%
Ingles Markets	6.8x	4.2x	-38%
Average	**8.5x**	**7.0x**	**-17%**

Source: Capital IQ. Note: Albertsons shown since IPO on June 25.

Investors value the future income stream of these companies at significantly lower valuation multiples today than 12 months ago. There is a compelling logic to this derating, given that 2020 was obviously an unusually good year for grocery stores.

Yet consider another set of stocks, the so-called FANMAGs (Facebook, Apple, Netflix, Microsoft, Amazon, and Google), which are also widely considered to be beneficiaries of the coronavirus pandemic. These companies grew EBITDA on average only 9%, yet the stock market rewarded them with 22% higher EBITDA multiples on average, driving the stock prices up 52% on average. These stocks now trade at an average of 30x EBITDA.

Why did multiples go up rather than come down? Investors believe that the tech companies' 2020 growth represents an acceleration of a long-term trend, rather than a windfall profit. Therefore, they increased their valuations even as these companies demonstrated above-trend growth. A recent Wall Street Journal article argued that COVID had propelled companies into the future. "COVID has acted like a time machine: it brought 2030 to 2020," an executive at Shopify told the Journal. "All those trends, where organizations thought they had more time, got rapidly accelerated."

But in an excellent essay, growth investor Gavin Baker points out the weaknesses with applying this narrative only to ecommerce companies and ignoring the positive impact COVID has had on physical retailers like grocery stores. He argues that since Amazon acquired Whole Foods it has been clear that the future was omnichannel and that physical retail infrastructure was valuable. The problem was that physical retailers generally had trouble adapting to the digital side of things. COVID forced them to learn. "If most e-commerce companies have been pulled 1–3 years into the future in terms of their revenue, then the e-commerce businesses of most category leading brick and mortar retailers have been pulled 5–10 years into the future," he writes. "COVID has permanently changed their destiny and driven significantly higher long term steady state FCF outcomes for them."

The grocery store chains have dramatically improved their ability to do online ordering, grocery delivery, and in-store pickup. And there's the potential that the demand for groceries has actually been structurally altered by work from home. One or two additional days working from home would mean a lot of revenue shifting from business lunch restaurants to grocery stores. And perhaps COVID has also taught people new skills or new habits and trained patterns of behavior that might not mean revert immediately after the vaccine.

Tech companies could show the profit mean reversion most investors expect grocery chains to demonstrate, or grocery store chains could demonstrate the “acceleration” effect Gavin Baker postulates, or things could happen exactly the way the market expects. The truth is we don’t know what the future will hold for grocery stores any more than we know what it will hold for the FANMAGs or Shopify. But we can see the power of narrative in the way the market has treated one set of COVID beneficiaries versus another, and we can see how that narrative has translated into wildly divergent stock price movements.

The market's selloff at the end of last week provided an acceptable entry point. On Friday we bought ACI for 3 clients @ 17.28, and @ 17.35-.36 for another. This morning we were able to purchase for a 5th client @ 16.95.

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
08/19/2020	1	Theilmann Michael		23,546
08/14/2020	1	Sankaran Vivek		25,000
08/04/2020	3	Davis Steven, Allen Sharon...		10,100

BPY - On January 4th this diversified REIT with significant mall exposure announced that "Brookfield Asset Management has offered to purchase all the limited partnership units of Brookfield Property Partners it doesn't currently own (about 357.6 million units or 40% of those outstanding) for $16.50 apiece." We sold that day for 4 clients @ 16.80:

BPY 17.01
yahoo!finance
20.00
17.50
17.01
15.00
12.50
10.00
7.50
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
202