



Ropes Wealth Seeks to Pop Your Bubble Worries

Stocks have been seemingly on a nearly nonstop rip higher since March of last year, up over 70% to record heights and causing some to question if the market has lost touch with the pandemic's reality. As we have described, massive support from the Federal Reserve, lifesaving deliverance in the form of COVID-19 vaccines, and efforts by Congress to pump stimulus into the economy have provided solid justification for the market's moves. But how much is too much?

Indeed, companies in the S&P 500 are expected to report that their profits fell by about 2% in the fourth quarter of 2020 compared to the fourth quarter of 2019. For the full year, that puts corporate earnings down a little more than 12%. However, that is good news, as at the onset of the pandemic it appeared earnings were poised to slide by over 30% for the year!

It is also expected that the fourth quarter should mark the end of our earnings drought. Looking ahead, S&P 500 profits are expected to rebound in the first quarter 2021, with analysts forecasting a nearly 17% year-over-year jump and a more than 46% surge in the second quarter. For the full year, corporate profits may rise more than 22%. Some believe that the impending reopening of our economy is the most underrated market story of the year, and that a breakthrough will come in the second half when folks re-emerge from lockdowns vaccinated. Travel, delayed medical care, sporting events, concerts, dining out, and even shopping at a mall will be tops on our to-do lists. Pent-up demand will create a surge of spending that solidifies a recovery in corporate earnings and aligns fundamentals with valuations.

Of course, recent market action has challenged investor psyche, as we impatiently wait for those vaccines and profits to recover and yet stock prices continue to tick higher. The broad stock market looks expensive by most traditional measures, but with interest rates effectively at 0%, there are seemingly no alternatives. All of this fervor has investors openly debating whether the market is in a dangerous bubble, after months of batting away the possibility.

Bubbles have been a regular occurrence through history, going back to tulips in the 17th century and Pets.com at the close of the 20th. The most glaring example of excess sweeping Wall Street was GameStop's stock, which soared 1,625% in January. Shares of the struggling video game retailer have since fallen, but they remain way beyond a price that is rational based on its profit prospects. Other money-losing companies have surged as well, showing how easily some investors are pushing up prices for an investment, despite its risks. And with smaller investors driving much of the action, experts are making comparisons to the shoeshine worker giving stock tips in 1929.

Massive support from the Federal Reserve means dollars are sloshing around markets looking for investments, and young and money-losing companies are rushing to take advantage by selling their stock to the public for the first time. Companies raised more than \$60 billion last year through IPOs of their stock, the most since the dot-com bubble peaked in 2000. Within tech companies, only 19% of IPOs were for profitable companies last year, compared with the more typical 49% of the last two decades.

In fact, the fervor to invest in the next hot young company is so voracious that some CEOs are skipping the IPO step altogether. Instead, they're selling themselves to companies armed with cash by investors and tasked to find young businesses that don't yet have shares trading in the public market. Such special purpose acquisition companies, or SPACs, have exploded in popularity. Last year, SPACs raised \$76 billion from investors, up from \$13 billion a year before. In the first three weeks of 2021, they raised another \$16 billion.

Yet, for all the worries and warning signs, there is cause for optimism. If daily life does indeed get closer to normal this year, earnings should rise as expected and stock prices should be more reasonable in historical context. Unemployment should decline, consumer spending should recover and converge with pent-up demand, and growth should meet the high expectations set by stock prices. The backdrop of low interest rates and stimulus spending will likely remain, with only the vague threat of tax increases as a potential risk on the horizon. Indeed, the Fed has explicitly targeted 2023 at the earliest for interest rate hikes, and said for the first time that they are willing to keep rates low for a while after inflation tops its 2% target. And for now, President Biden has indicated tax increases are dependent on economic conditions and it may not be until the budget reconciliation process later in 2021 that tax talk revives.

Therefore, for now, we see no cause for alarm, but maintain our cautious optimism. We concede there are pockets of "mini" bubbles in some market segments, but dispute the notion that there are extreme overvaluations forming one of the greatest bubbles in financial market history, as some have recently implied. However, even in the absence of a bubble, markets can drop significantly, as we have seen multiple times in the past decade. Bubble or not, we plan and prepare for volatility, because whatever happens with interest rates or sentiment, that is one thing that will not change about markets. For this reason, we remain focused on the careful selection of investments with fundamentals that justify their pricing, and on an allocation that is broadly diversified and prudently managed in pursuit of our dual mandate of preservation and growth. Underlying it all is a focus on resilience, such that even when setbacks occur, they are not long-lasting and do not limit or alter the trajectory of your financial goals and our work on your behalf to achieve them.

Your Ropes Wealth Team

The Ropes Wealth team continues to operate remotely, with a skeleton crew in the office on a daily basis to tend to mail and administrative requests. We enjoy our conversations with you by phone, Zoom, and in socially distanced settings, and hope to have continued good discussions in all of these ways until it is safe for us to meet in person again.

Thank you for your trust and confidence and best wishes for your health and safety always.

Please click [here](#) to access our full team contact card.

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