CARMICHAEL CAPITAL INC.

CLAUDE R. CARMICHAEL CFA, PRESIDENT
339 MAIN STREET, 2ND FLOOR, FRANKLIN, TN 37064
(615) 595-5800 – NYC (212) 580-5200 – FAX (615) 595-5825
claude@carmichaelcapital.net

April 19, 2021

2021 First Quarter Review
"Gamestop & Crypto Fever"

There was some wild action in the markets during the first quarter that is not reflected in the index performance numbers. The S&P 500 Index gained 5.77% while the previously red-hot NASDAQ Index cooled off a little and rose only 2.78%. From that you could think that it was a somewhat boring but positive quarter for stocks. However, interest rates jumped and pushed bond prices down; the Barclays 7-10 Year Treasury ETF fell 5.85% while the 20+ Year Treasury Bond ETF lost over 14% of its value in the first quarter alone. Deemphasizing bonds has recently proven to be the right move. But if you want to see some real entertaining action, step into our game room.

Gamestop, the moribund strip-center video game retailer, mesmerized the investment world as its stock jumped from $17 to over $475 per share fueled by buying pressure from small investors using the Robinhood brokerage service to squeeze hedge funds that had shorted the stock. For a while, the Robinhood organization lived up to its name, enriching the little guy at the expense of the big hedge funds after huge moves in Gamestop, AMC Entertainment and others. But alas, a lot of the little guys' profits vanished as skyrocketing share prices came back to earth, in some cases with a thud. Even our stake in ViacomCBS followed a similar script. Short sellers were squeezed as the stock ran from $35 to $100 per share from January to late March. In that case, there was a guy named Bill Hwang involved. Hwang, who Bloomberg called "the greatest trader you'd never heard of," lost $20 billion in two days and was forced to sell his large investment in ViacomCBS regardless of price, precipitating the "cliff dive" of the shares from $100 to the $45 per share range in 5 trading days. Fortunately, we booked some profits on the way up and were able to take advantage of that particular moment of market madness.

Meanwhile, cryptocurrencies such as Bitcoin and Ethereum are beginning to go mainstream even as they generate raging debates as to their investment worth or lack thereof. Brilliant people on both sides of the issue present persuasive arguments. Depending on whom you are listening to, cryptocurrencies are either the wave of the future or a return to the infamous tulip mania during the Dutch Golden Age that collapsed in 1637. While blockchain technology (upon which cryptocurrencies are based) will likely prove to be valuable, any particular currency's success will probably come down to a simple matter of acceptance, in the same way that your paper dollar is only useful if others are willing to accept them when you want to pay for a Coke. Since Bitcoin and Ethereum have "first mover status," they may carry an advantage into the new age of currency battles. Those battles are heating up because of the massive increase in the supply of those dollars that we shell out to pay for those Cokes.

The old saw is that "too many dollars chasing too few goods creates inflation." If the supply of Bitcoin is limited or can only grow slowly (like reserves of precious metals) and the supply of dollars is massive and seemingly limitless, which would you rather hold during a period of dollar debasement? Obviously, quite a few people are choosing the cryptocurrency.

Inflation is heating up. The Fed says it is only temporary, but they said the same thing about "quantitative easing" after the Great Recession bottomed in 2009. This money flood has helped create the third fastest annual surge in stock prices in history. More money has reportedly been poured into equity funds in the last five months than in the previous twelve years combined.
It is no wonder that speculation exploded, as evidenced by the likes of Gamestop and cryptocurrencies, and that interest rates have started to rise from near zero levels.

The dramatic speculative swings of the first quarter have partially masked a subtle shift in investment markets. Many of the high-flying tech stocks peaked in the frenzy of mid-February and quite a few have lost half or more of their value since that time. On the other hand, the heretofore lagging high-quality dividend-paying stocks that we tend to favor have experienced a quiet resurgence. We are almost afraid to posit a "return to value" in such a speculative environment, but there are signs it may be happening. If so, it would explain the S&P 500 beating the NASDAQ Index and some of our value stocks and ETFs beating them both.

The reopening of the economy is producing positive earnings reports and we expect robust GDP numbers for the next few quarters. With so much liquidity in the economy and a steady stream of good news, it may make a market "meltup" more likely than a meltdown. Still, after such a large move up as we've seen, it is useful to consider the average historical frequency of downturns in the S&P 500 according to market statistician Charlie Bilello:

5% decline - every 1.1 years,
10% decline - every 1.6 years,
20% decline - every 4 years, and
30% decline - every 9 years.

We should be prepared to take advantage of, and not be panicked by, the next market downturn and position our investments accordingly. Dividend stocks currently pay more income than some bonds. Dividends can increase with time while bond coupons will not. Companies with pricing power can manage inflation better than fixed income securities. Precious metals and other hard assets may provide ways to keep up with the decline in our currency's purchasing power.

You can help us by making sure that the allocation of assets in your portfolio is in line with your circumstances, desires, and appetite for risk. Please review these reports at your convenience and give us a call to discuss any details or changes you would like us to make.

Best regards,

Claude R. Carmichael CFA

Art Creel
Senior Portfolio Manager