Market Perspectives

PRIVATE CLIENT SOLUTIONS

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Micro Bubbles

There are clearly some areas of the market that have excess froth – renewables, clean energy, EVs, and special purpose acquisition companies(SPACs) are a few that come to mind. Their popularity is generally driven by developing secular trends and longer term changes in how society functions. But then there are the crazy excesses we're seeing in companies trending on social media. This week, Reddit's r/WallStreetBets lit a small fire under a struggling retailer, **GameStop (GME-US)**, as well as a little known Canadian company, **Blackberry (BB-US)**. Each has made parabolic moves higher in recent days. Earlier this month, Elon Musk tweeted "Use Signal", an encrypted messaging service, but investors mistakenly thought he was referring to **Signal Advance (SIGL-US).** The stock jumped over 1,000%, and for some reason, SIGL has maintained a lot of these ill-gotten gains. Then, yesterday Musk praised **Etsy (ETSY-US)** after buying a gift for his dog; the stock popped on the tweet. Welcome to herd mentality 2.0!

- Look no further than the top shorted US stocks, which have posted some pretty impressive returns over the last four weeks. Investing long in an equally-weighted basket would have produced a return of 116% (to underline the excesses, when I started writing this note earlier this week the average return was 67.6%). From the list, **GameStop (GME-US)** is the most egregious anomaly, trading over 3,000% above the consensus target price of $13.44. There is simply no fundamental reason for GME to be trading at this level, but it is because the herd is forcing hedge funds that are short the stock to cover. While we know, eventually, the shorts will almost certainly be right, the market can stay irrational longer than they can stay solvent. Unfortunately for hedge fund Melvin Capital, the herd forced them to exit (cover) their position yesterday at a significant loss, according to CNBC. The hedge fund also required ~$3bln in capital injections from its investors. Now that Melvin Capital is reportedly out of GME, perhaps the herd will move onto the next squeeze.
- We remain bullish on the market, but indices and sentiment are stretched at the moment. The S&P 500 is trading 15.9% above its 200-day moving average; this is more than two standard deviations above the mean bull market average. Considering historical periods when the market was this stretched, the S&P 500 was flat three months out (we exclude the 2009 bounce off the market low, including this event, the average is 1.2%).

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This herd mentality is reminiscent of the dot.com days where newbie investors rushed into the latest stock based on message-board rumours, but with a few subtle differences. Today's herd appears more sophisticated in that they are focusing on heavily shorted stocks forcing hedge funds that are short to cover, otherwise known as a "short squeeze." Investors that short a stock sell it today with the intention of repurchasing it in the future at a lower price – they believe that the stock will fall in value in the future. The most significant risk for a short seller is that they have unlimited loss potential. For example, if an investor shorted ABC and it appreciates by 300%, the investor will have lost that value. In contrast, if that same investor decided to buy ABC and the stock went to zero, the investor's loss is limited to only 100%.

The second difference with today's herd is that they are flush with stimulus cash with nowhere to go and limited avenues for entertainment, so why not roll the dice on the latest TikTok or Reddit thread. The significant levels of liquidity and economic lockdowns have clearly had some untended consequences.

Top Shorted US Stocks

Ticker	Name	GICS Sector Name	Short Interest as % of Shares Out	1-mth Return (%)
BBBY	Bed Bath & Beyond Inc.	Consumer Discretionary	62.8	98.2
GSX	GSX Techedu, Inc. ADR Class A	Consumer Discretionary	41.9	90.8
GME	GameStop Corp. Class A	Consumer Discretionary	109.2	634.4
TMBR	Timber Pharmaceuticals Inc	Health Care	969.4	90.9
CLVS	Clovis Oncology, Inc.	Health Care	41.6	68.2
LGND	Ligand Pharmaceuticals Incorporated	Health Care	61.6	47.9
CVAC	CureVac N.V.	Health Care	105.3	-2.9
FUBO	fuboTV Inc.	Information Technology	71.2	-0.6
MAC	Macerich Company	Real Estate	53.9	78.5
SKT	Tanger Factory Outlet Centers, Inc.	Real Estate	47.9	54.7
	Average		*156.5*	*116.0*

Source: FactSet

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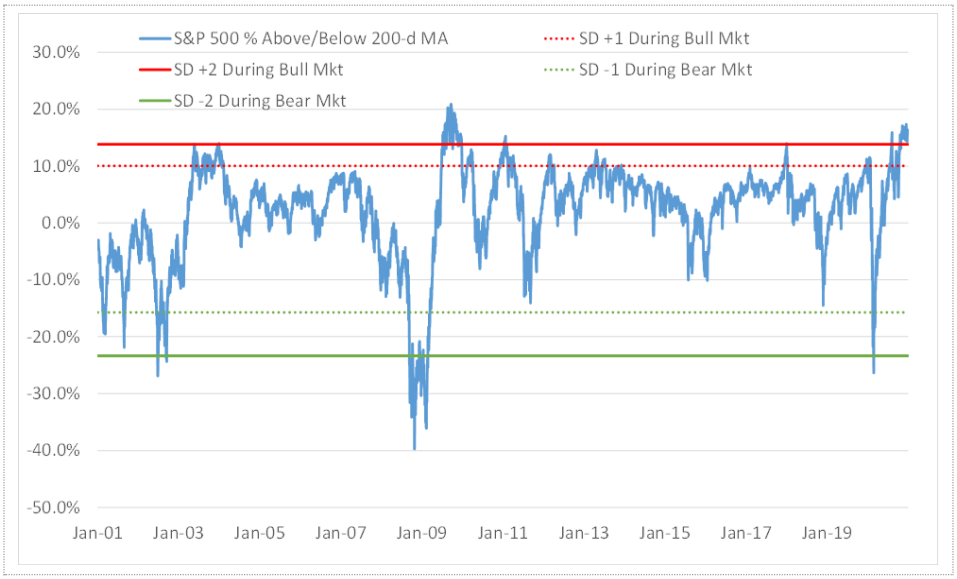
What is happening in pockets of the market is a distraction that can sway us from achieving our long-term investment objective. We must remind ourselves of our long-term investment goals and how we can achieve them. Chasing return in stocks with no fundamental reason for advancing can be a dangerous game to play, particularly when sentiment shifts.

Time for a Pause

We remain bullish on the market, but indices and sentiment are stretched at the moment. The S&P 500 is trading 15.9% above its 200-day moving average; this is more than two standard deviations above the mean bull market average. Considering historical periods when the market was this stretched, the S&P 500 was flat three months out (we exclude the 2009 bounce off the market low, including this event, the average is 1.2%).

S&P 500 Extended; Time for a Pause



Source: FactSet, Raymond James Ltd.

As we anticipate a pause, which may present an opportunity to put capital to work, we remind investors of the areas we see value over the next 11 months. These include:

- Value
- Cyclicals
- Small caps

Asset Class	Recommended Allocation -				+	Summary
Equities						**OVERWEIGHT**
Large Cap						From a long-term view, record monetary/fiscal stimulus and relative equity/bond valuation points to a positive bias towards equities. We believe we're in the early stages of a multi-year recovery and, as such, investors should consider moving further out on the risk scale, looking for opportunities within value and small caps.
Small Cap						
Quality						
Junk						
Growth						
Value						
Defensive						
Cyclical						
Bonds						**UNDERWEIGHT**
Government						We recommend an allocation to government bonds, given their low correlation to equities, and allocating to corporates to generate income. We would focus on short- to medium-term maturities. Investors concerned about future inflation can consider US TIPs and/or Canadian real return bonds.
Corp						
Duration (short)						
Duration (med)						
Duration (long)						
Alternatives						Alternative investments are unique and an allocation to the segment is highly dependent on a client's investment objectives, time horizon, liquidity needs and risk tolerance. Given the various factors that differentiate Alternatives from traditional investments, we recommend a more holistic approach wherein investors tailor certain funds from our Approved List to meet their needs.
Cash						**UNDERWEIGHT**
Regional Allocation						
Canada						The US fiscal and monetary response provides a significant tailwind for US equities; however, as the recovery takes hold, we believe investors will move further out on the risk scale, increasing exposure to international markets, particularly emerging markets. In local terms, we believe the S&P/TSX may marginally outperform the S&P 500 but, on a currency-adjusted basis, we see a similar return profile. As such, we recommend hedging some USD exposure.
US						
International						

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