January 8, 2021

Re: <u>January Conference Call on Wednesday, January 20, 2021 at 6:30 PM</u>

Dear client,

First and foremost, I wish everyone a safe and healthy New Year. Several of my clients, friends, and family have been stricken by COVID-19 and it has been a struggle for them, to say the least. Thank goodness, they are slowly recovering and none of them have passed away, except Adriana's mother, who we lost to COVID-19 in November. This is a horrible disease, and the after-effects will be with us for a long time. There is no silver bullet and although the vaccine will help, it will only be truly effective if 75% to 80% of the population take it.

In 2020, the U.S. stock market deviated from the real economy. The real economy shrank, while the stock market expanded and eventually the two have to reconcile. However, the economy could have been worse if it wasn't for all the stimulus, courtesy of Uncle Sam. As it was in 2009, the Federal Reserve Bank did what it had to do and took interest rates to zero, printed a ton of money through quantitative easing, and bought corporate bonds to prop up the bond market. On the fiscal side of the government, stimulus money was hyper-pumped in the system that pretty much was equal to the output of GDP.

Last year in January 2020, I was of the opinion that the U.S. stock market was overvalued. I started to reduce the stock allocations because of this. In late February through March 23rd of 2020, the stock market could not figure out what the ultimate outcome of the COVID-19 pandemic would be, so the S&P 500[1] declined approximately 33% in a short period of three or so weeks. This was incredible to see, with defensive stocks on average falling more than the speculative ones. I had never seen this happen before in my 40-year career. You would think utilities and Verizon would be safe havens since they pay steady and generous dividends, especially in a zero-interest rate world. Utilities were really hit hard.

Out of the ashes, like a phoenix, stocks were reborn and started to climb back from the abyss. As we did in 2009, we slowly started to rebuild the allocations back up. Since I am not a "bet the ranch" type of investment manager, I wanted to see how things would transpire before I jumped in. Admittedly, we were slow in buying back stocks because I was concerned about a suckers' rally and hedge-fund manager Bill Ackman telling the world stocks need to go lower. Of course, he was saying that so he could make more money on his short positions and then scoop up bargains for himself. This is one reason why I ignore Wall Street, its pundits and crystal ball gazers. I make my own decisions based on the facts and data. I believe in long term sustainable performance, not short-term gains that could lead to a permanent and substantial loss. This way of investing seems to have worked out for me and my investors over time.

Here we are in the beginning of a new year and speculation and gambling are rampant once again. I believe the stock market is once again overvalued, and Bitcoin (Chart 2) has gone uncontrollably wild. Novice retail investors (Chart 1) have been driving up some of the most speculative stocks like Tesla, Snowflake, and Zoom. By the way, Tesla would have no earnings if it were not for the solar credits the company gets from the government.

Chart 1

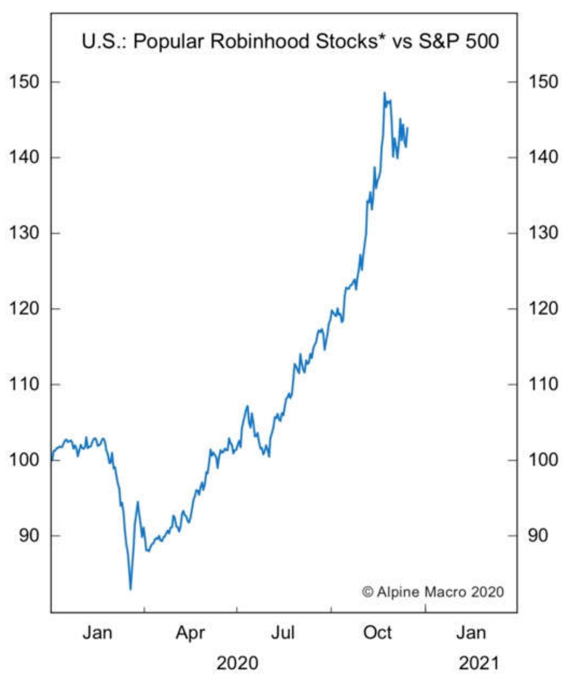
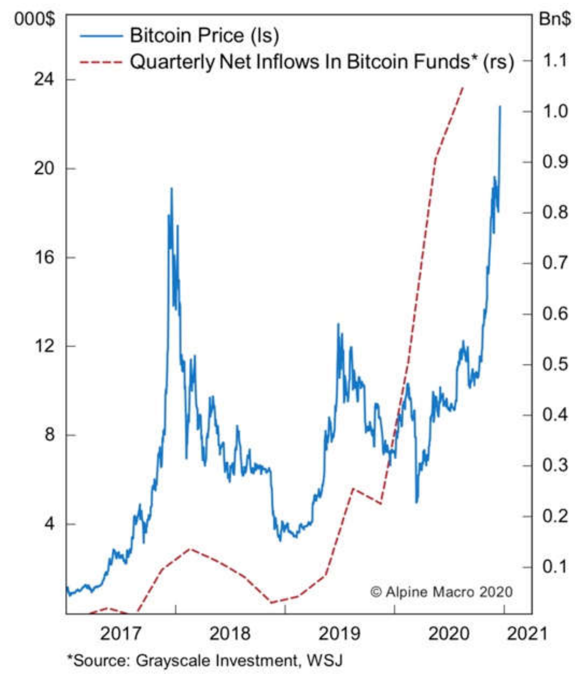


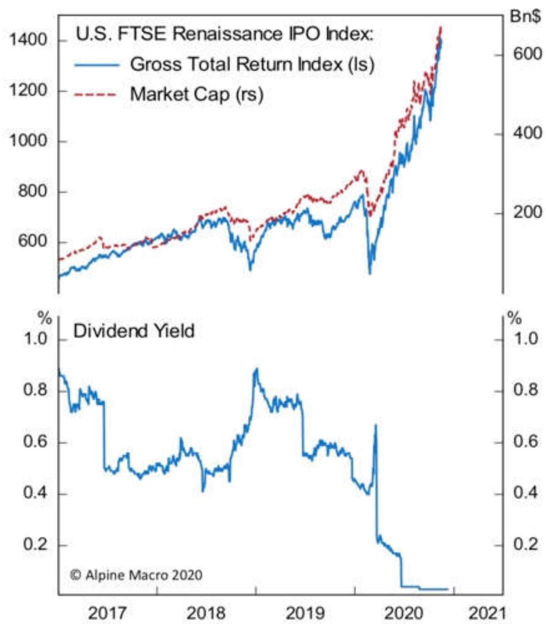
Chart 2

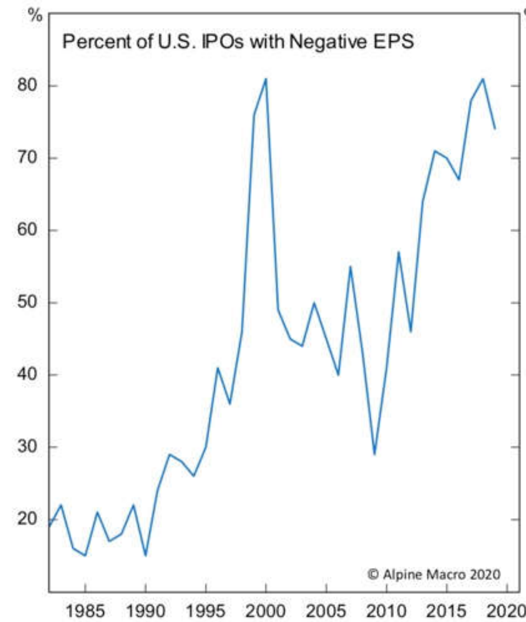


Another sign of the froth in the market is the number of Initial Public Offerings (IPOs) that HAVE NO EARNINGS. In 2020, the IPO market without earnings was second only to the year before the dot-com bubble burst (Chart 3). This is usually a bad sign and that of a toppy market. This is not to say that the market can't go higher. In 1996, I wrote an article that was published in the book, *Human Action and the Securities Markets,* that essentially stated that markets swing from pessimism to optimism and back again. Although the market is overvalued and may be near a top, speculative behaviors could drive it even higher, especially if more stimulus is forthcoming from the fiscal side of the government. I suppose under a new presidential administration and a Democratic congress, the money will be overflowing.

Increasing Signs Of Market Froth And Speculation

Chart 3

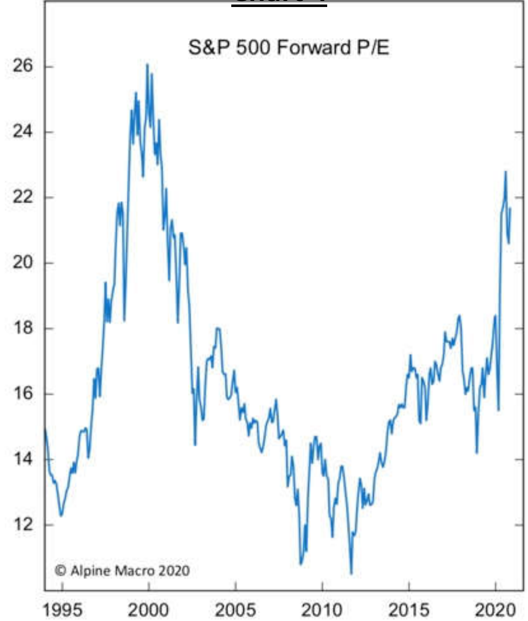




Source: Warrington College of Business, University of Florida

With the forward S&P 500 price-to-earnings ratio[2] (P/E) at a multiyear high, it is time to be cautious once again and not buy with abandon. The last time the S&P 500 P/E was this high was in 1999, right before the dot-com crash (Chart 4). We will still buy stocks, but we will be even more careful in what we buy.

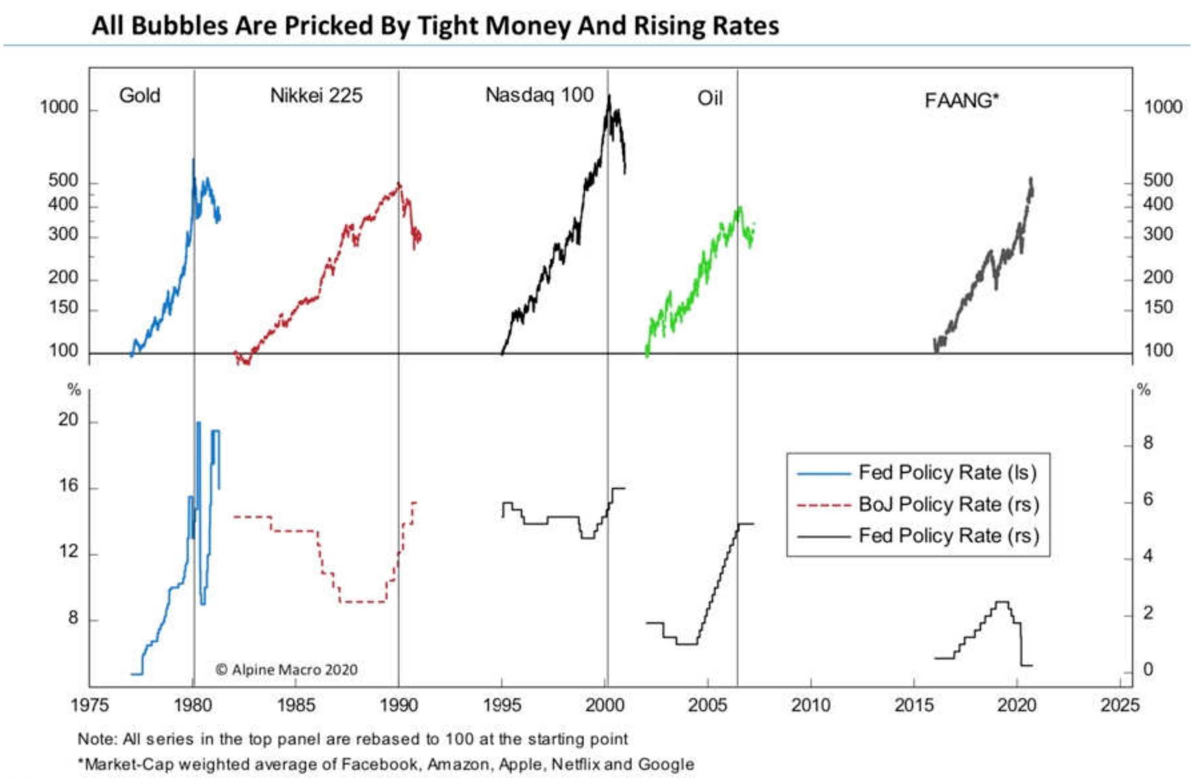
Chart 4



Interestingly enough, the markets seem to be rotating away from the high-priced mega-cap stocks and more towards the value type of stocks that we like and what we concentrate on. Hopefully, that will continue.

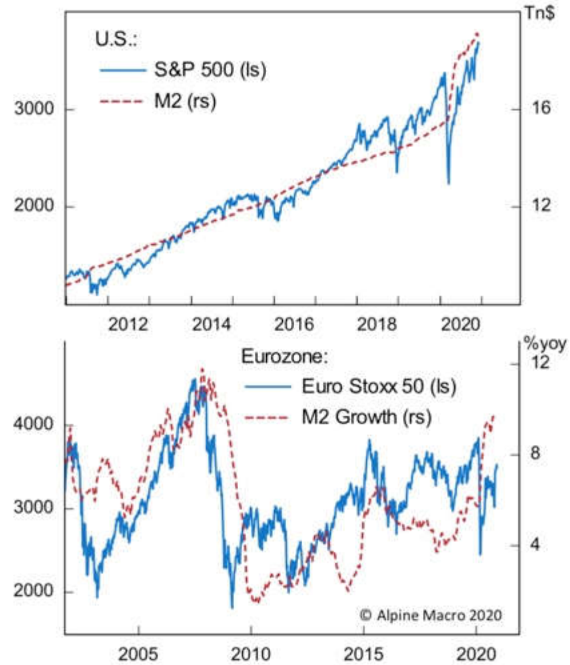
What will prick the stock market bubble?

In a speculative mania, an increase in interest rates is the usual suspect that will prick the bubble. Why? Because it increases the cost of money that speculators use to add to their margin debt and the cost of money that credit depends on goes up. My research has shown that in almost every instance where the U.S. stock market has declined it has been precipitated by a rise in interest rates. If you are interested in attending, **I will be talking about what ends market rallies in my Advanced Security Analysis Class at UCLA on Thursday, January 21, 2021, starting at 6:30 P.M. Katie can send you the Zoom link if you like to attend**.



If interest rates rise substantially, over 2% in my opinion, then the economy may falter and so will the stock market. If the economy recovers due to the rollout of the vaccine and the government reduces stimulus in 2020, then it may be that the Federal Reserve will not be able to prevent a rise in interest rates. There is no doubt in my mind that this market rally has been fueled by cheap money. Chart 6 shows the correlation between the S&P 500 and the increase in the money supply (M2). The Fed printing presses are on 24 hours per day.

Chart 6



Our prognosis is that the markets should hold up if interest rates don't back up too much over 1.5%. In 2018, when interest rates were approaching 3%, the economy and the stock market couldn't handle it with the S&P 500 diving almost 20% in the first three weeks of December. The market quickly recovered in January 2019, but only because Chairman Powell said that the Federal Reserve would raise rates very little if at all. This all amounts to Love Potion Number 9.

Please join me on **Wednesday, January 20, 2021** for our January conference call in which we will discuss last year's results, how we will manage your assets in 2021, buying the dip, and why we do what we do.

When: January 20, 2021, 06:30 PM Pacific Time (US and Canada)
Topic: BFSG Conference Call Hosted By Steven Yamshon

Please click the link below to join the conference call:
https://bfsg.zoom.us/j/95587997509?pwd=aHkwMkVyL2dPSVdUQzRzT2NrSmVkZz09

Or Telephone:
US Dial: +1 669 900 9128
Webinar ID: 955 8799 7509
Passcode: 388235
International numbers available: https://bfsg.zoom.us/u/alGmHPujP

Thank you for your confidence in us and I look forward to seeing you on the call. Katie will also be calling you to set up individual appointments either via zoom or phone to discuss your performance for 2020.

All the best,

Steve Yamshon
Managing Principal

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per share earnings (EPS) and is one of the most widely used valuation measures for stocks.