The Conservative Strategist

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Selloff and rally dangerously concentrating wealth

Income and wealth in America are as unequal as they have been since the late 1920s, and more unequal than any G7 Nation today.

So much for the wealth-spreading propensity of stock market participation. The long bull market has been part of the problem, not part of the solution. Consider this: In 1989, the richest 5% of families had 114 times as much wealth as the median family in the second quintile (one tier above the lowest). By 2016, the top 5% owned 248 times as much wealth as the second quintile, a greater than doubling of relative wealth, according to Pew Research Center.

Widening inequality in the S&P

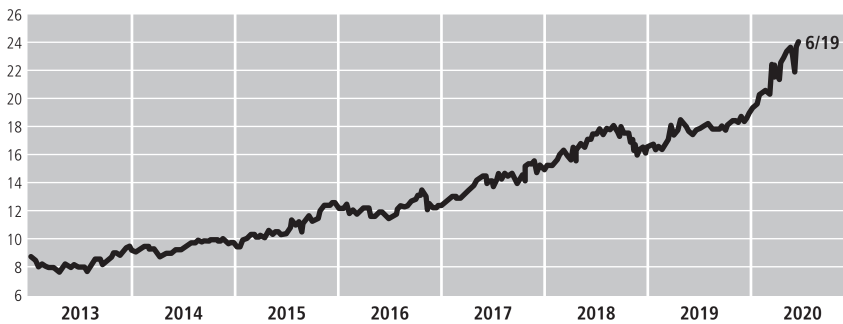
Personal wealth concentration is one matter. In the COVID-related volatility of 2020, we have seen extraordinary concentration among the top 1% of stocks as well. The so-called FANMAGs *(FaceBook, Apple, Netflix, Microsoft, Amazon,* and *Google)* have outperformed so markedly in 2020 that their share of the overall stock market value of the S&P 500 has shot up from 18% at the beginning of the year to more than 24% at this writing.

Think about that for a moment. Six stocks out of 500, just 1.2% of the index, now constitute nearly a quarter of the wealth of the S&P index. Seven short years ago, that figure was just 8% of total index value.

Of course, this concentration further aggravates individual wealth inequality as well. Jeff Bezos, founder of *Amazon,* is now worth $172 billion, 50% more than anyone else. The other mega-rich largest individual stockholders of the FANMAGs (Mark Zuckerberg, Laurene Powell Jobs, Reed Hastings, Bill Gates, and Sergey Brin/

Big tech gets bigger

FANMAG percentage share of S&P500 market value, 2013-2020



The share of the S&P500 for the FANMAG stocks has doubled in the past four years and tripled in the past seven. It has increased a significant three percentage points just during the COVID crisis. *Source: yardeni.com*

Larry Page) have also seen their wealth balloon to gargantuan levels, at a time that nearly 30 million Americans are unemployed, and the average stock portfolio that does not hold the FANMAGs is down double digits for the year.

Twist of fate

These megatech companies are benefitting to one degree or another from the burst of online activity during the lockdown, as well as the virus's longer-term implications. *Netflix,* up 43% this year, has seen subscriptions surge. *FaceBook,* too, has been helped by the surge of activity as folks double-down on their cyberspace connections.

But perhaps no company benefits more from the lockdown than *Amazon.* Not only are we all ordering much more from *Amazon* because of the widespread closure of brick-and-mortar stores. But analysts are ascribing a higher multiple to *Amazon*'s stock price because of the distinct possibility that e-commerce will grab an enormous amount of market share long-term as many brick-and-mortar franchises either go bankrupt during COVID, or emerge from this crisis in a shrunken and hobbled state. ■

The Markets June 30, 2020	Price/Yield	Gain, Qtr	Gain, YTD
US Stocks (S&P 500/Vanguard Index)	3100.29	20.52%	-3.15%
International Stocks (Vanguard Index)	15.84	18.08%	-10.65%
Emerging Markets Stocks (Vanguard Index)	25.31	19.84%	-9.62%
Real Estate Stocks (Vanguard REIT Index)	26.11	13.41%	-13.93%
Bonds (30 year US Treasury/Vanguard Index)	1.41%	0.51%	21.45%
Dollar (US Dollar Index)	97.39	-1.68%	1.04%
Gold (London Afternoon Fix)	$1771.60	10.11%	16.96%
Money Market Funds (IBC Index/7-day yield)	0.20%	-0.89%	-1.51%*

*change in yield

Portfolio Planning

Enter the newbie

All the cinemas may be closed. But we've seen this movie before. And it doesn't end well.

With apologies to Bruce Lee, call it *Enter the Newbie.* Typically, in the very late stage of a major bull market, novice investors (newbies) pile in, thirsty for what seems like easy money.

This season's volatility has ushered in a kind of *Newbie Effect on Steroids.* Upstart discount broker *RobinHood,* which aims at millennial micro-investors with zero commissions, the ability to purchase fractional shares, and a teched-up trading platform, has opened more than three million new accounts in Q1. And that's when the market was tanking! On the Q2 rebound, new accounts continued apace.

A rush of newbies

Why this explosion of newbies? Seven reasons.

First, the lockdown has deposited millions of antsy folks in front of their phones, tablets, and desktops with way too much time on their hands.

Second, the closure of casinos and sports betting has sent hordes of gamblers looking for action.

Third, the Fed and Congress have greased the skids with trillions in stimulus. With the economy all but shut down, much of the excess that has not paid for necessities has gone into savings and investment (the savings rate shot to a multi-decade high in Q2). Prudent or not, many a new brokerage account was opened with unemployment and/or stimulus checks.

Fourth, two new developments have turbocharged small investor participation. Zero commissions, now the norm at the major discount brokers, has eliminated fractional trading costs. And the advent of fractional share trading means there's no longer any barrier to the tiny investor owning a piece of any corporation. As little as $5 *(Schwab)* or even $1 *(RobinHood)* will buy you a piece *(Schwab* and *Fidelity* call them slices) of an otherwise high-priced stock.

Fifth, there's the prevalence of social media platforms where small investors trade tips and ideas. This has sparked many a speculative frenzy recently. Amidst the *Black Lives Matter* protests, the June 22 *Barron's* reports on a craze for small African-American-owned or -oriented businesses. One of them, *Urban One* (symbol: UONE), a multimedia company that operates radio stations aimed at black listeners, shot up 20-fold in one week after a surge in online chatting about the company. Trading volume in the stock rose from 10,000 shares per day to as high as 57 million shares. Crazy stuff.

Sixth, there's the self-reinforcing lure of easy money, in everything from biotech penny stocks in search of a COVID vaccine, to hyper-volatile airline and cruise ship stocks for a rebound bet, to the so-far resilient FANMAGs *(FaceBook, Apple, Netflix, Microsoft, Amazon,* and *Google),* which now sport a collective market capitalization greater than all but two of the world's stock markets. And part of the lure is what we'll call the *recovery narrative* — that we soon will bounce back stronger than ever due to the discovery of a vaccine augmented by the sugar-high of government stimulus.

Finally, add in ultra-low margin rates and cash accounts that now pay next to nothing, and you have near-perfect conditions for speculative fervor.

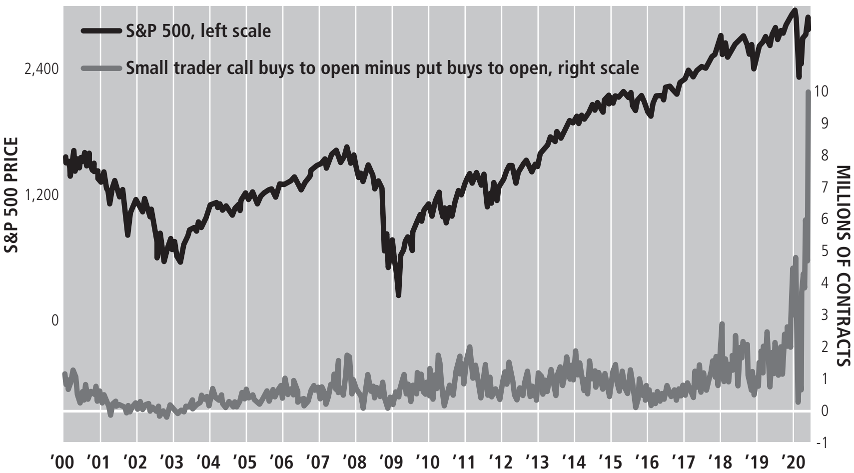
Beware the newbie

It isn't that all these newbies are moving major markets (though they are exercising outsized influence in the penny-stock arena). Their collective buying power amounts to con-

(Continued on page 4)

Insane level of bullishness by small investors

Small trader new call buys minus new put buys, millions of contracts

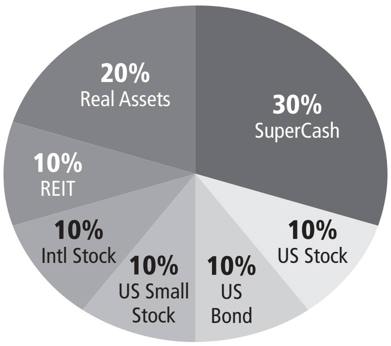


Call options are leveraged bets the market will rise. Puts are leveraged bets the market will fall. No mystery here how the small investor is betting. Note the spike to five million at the February high, then the drop to less than 300,000 at the March lows, and the superspike to 10 million in recent days — twice the level of call buying versus the February peak. As hedge fund manager Leon Cooperman says: "This will end in tears." Source: SentimentTrader

SuperDiversified Portfolios (SDPs)

The selloff made sense. The rally? Not so much.

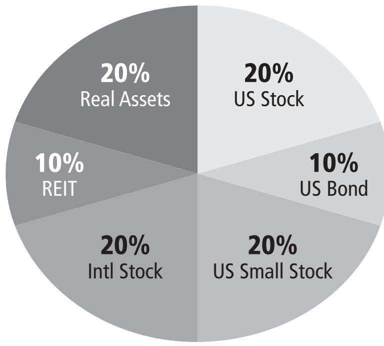
SDP1 ***Conservative***



2nd Quarter **11.23%**

Year-to-Date **-4.43%**

SDP2 ***Moderate***



2nd Quarter **16.78%**

Year-to-Date **-7.54%**

It's reasonable to expect a global pandemic that results in a widespread business shutdown to bring down markets substantially. The 35% peak-to-trough decline into late March was only average for a bear market. One might argue that this crisis merited more than an average response.

The ensuing rally, however, made much less sense, since by late June, the S&P actually briefly traded above where it began the year. That's amidst a pandemic that won't go away quietly, as well as the most significant nationwide protests since the Vietnam era, neither of which existed on January 1.

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

SuperCash a port in the 2020 storm

Asset Class	Mutual Fund	Performance 2nd Quarter '20	Performance Year-to-Date	
SuperCash	PIMCO Instl Low Duration	2.36%	2.28%	Best
	Merger	2.33%	-0.12%	Worst
	Calamos Market Neutral	5.03%	0.99%	
US Stock	Vanguard Index Trust 500	20.52%	-3.15%	
US Bond	Vanguard Long-Treasury	0.51%	21.45%	
US Small Stock	Vanguard Small-Cap Index	26.65%	-11.47%	
Intl Stock	Vanguard Intl Index	18.08%	-10.65%	
REIT	Vanguard REIT Index	13.41%	-13.93%	
Real Assets	PIMCO Commodity Real Return	11.71%	-19.97%	

Our SuperCash funds are hanging in there in a challenging time, with one up 2%+ at mid-year, while the other two are hovering about the flatline. That helps out portfolio stability when some asset classes remain down double digits.

PIMCO has benefited from lower short-term rates. *Merger* has held its own as deal flow from corporate consolidations continues surprisingly robust. And *Calamos* has navigated an environment where the convertible bonds it owns have done no worse than the stocks it shorts.

Holbrook Income

With stock prices again in la-la-land and bond yields virtually vanishing, it's a rough time to source new investment ideas. We've had to dig further and into more esoteric areas. Esoteric doesn't mean riskier, but it does take more homework. This column will highlight some areas in upcoming issues.

BDC baby bonds

While yield is scarce in general, one corner of the investment world to find fatter payouts is in so-called BDC baby bonds. BDCs are business development companies designed to lend money to middle-market companies. Unlike the banks, BDCs have much stricter lending ratios and stronger balance sheets.

While BDC stocks have been somewhat volatile, the bonds have been less so, and sport high yields in the wake of the COVID selloff. Baby bonds are exchange traded and investment-grade, with $1,000 denominations and $25 par values. Most currently trade at a discount, so there's no fear of them being called away. We don't have the credit expertise (or the time) to analyze individual issues, but one mutual fund with a hefty allocation (48% as of late June) to BDC baby bonds is *Holbrook Income I* (HOBIX), with a current yield around 5% and an effective duration of only 2 years. Because of the steep discount and the short duration, the yield to maturity of the average holding in the portfolio is over 10%.

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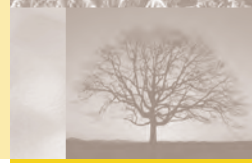


Enter the newbie *(Continued from page 2)*

siderably less than one of the larger institutions.

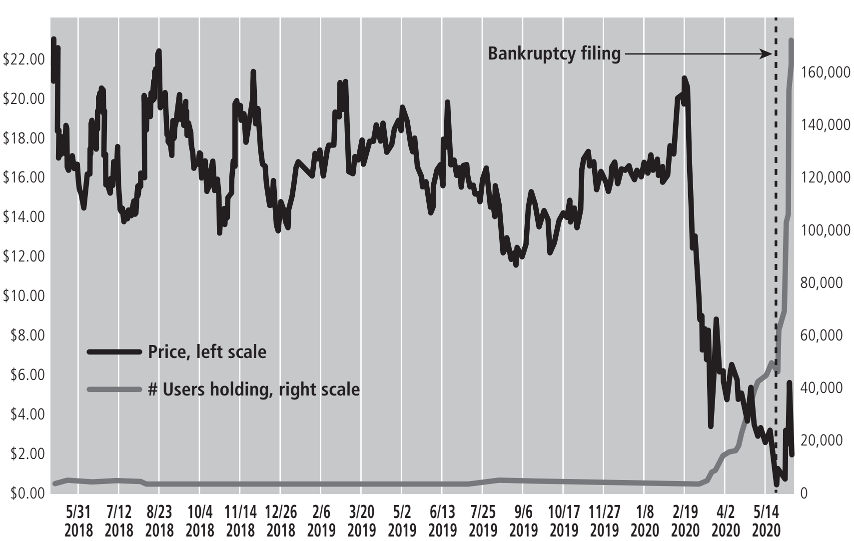
Instead, it's that the *en masse* entrance of newbies is a sign that we are very, very late in this long bull market. After all, markets have a way of transferring capital from the unsophisticated to the sophisticated. In a bull market's early stage, well-capitalized and savvy investors accumulate shares while others are still panicking. In the middle stage, big institutions and the general public join in, powering the bulk of the bull's gains. And in the later stages, the savvy investors of Stage One are sellers, and so are some of the big institutions, as stock is distributed from so-called strong hands to the weaker hands of day traders, newbies, or both — setting up the end of the cycle as a new generation of sheep are sheared.

No market for old men?

In contrast to this hyperactive, hyper-bullish cohort of newbies is a select group of hugely successful veteran value-oriented investors whose words and actions we monitor regularly. This group includes Warren Buffett, Howard Marks, Stanley Druckenmiller, Jim Rogers, Jeffrey Gundlach, Paul Tudor Jones, and Ray Dalio, head of the world's largest hedge fund. All are over 60, all are billionaires, all are currently bearish, and most are frankly bewildered.

Trading 'til it Hertz

Hertz stock price vs. number of *RobinHood* holders of the stock, 5/1/2018 to 6/11/2020



In a Chapter 11 bankruptcy, as Hertz filed for on May 18, common stock holders are wiped out as the stock usually settles at zero. But tell that to the 100,000+ RobinHood *traders (newbies) who piled in* after *the bankruptcy filing, sending the stock up as much as 14-fold from its price on May 18 before it once again cratered. Bankrupt stocks seldom act like this unless there are hordes of unsophisticated investors who do not understand how bankruptcies work.*

Source: RobinTrack

Sage advice

Despite a 35% stock market decline into March 23, Warren Buffett did not part with more than a billion of his $130 billion cash hoard at *Berkshire Hathaway,* finding no bargains at all.

Other samples:

Druckenmiller: *"The risk-reward for equity is maybe as bad as I've seen in my career."*
— Economic Club of NY webinar, May 13

Gundlach: *"We never left the global financial crisis. [Growth since then] has all been debt based, and it's all been revealed. We've lost the jobs, and now the policies are the same."*
— ThinkAdvisor, June 10

Jones: *"If a year from now we are still in the same situation, it will be called a second Depression."*
— CNBC, May 11

Dalio: *"Think of the virus as like a tsunami that comes in. And if it goes away completely and we never see it again, it still will produce damage, the financial damage ... incomes that are lost, balance sheets that are hurt, restructurings that need to take place. So that will impede the recovery."*
— CNBC, May 14

When the world's most successful investors are nearly all uniformly cautious, and a group of newly-minted traders are throwing their money at the market with abandon, it's not hard to decide which side to be on. ■