F.O.M.O. – Fear Of Missing Out – It’s real, it’s powerful and it is no fun.

One of the most difficult things to do as an investor is to have the patience and discipline to avoid market bubbles which feel incredibly compelling as they form. The one that we are experiencing today is perhaps the greatest of them all and so it exerts a tremendous pull on our psyche to join the thundering herd.

AMERICA'S TOP 1200 FINANCIAL ADVISORS · PULLOUT SECTION
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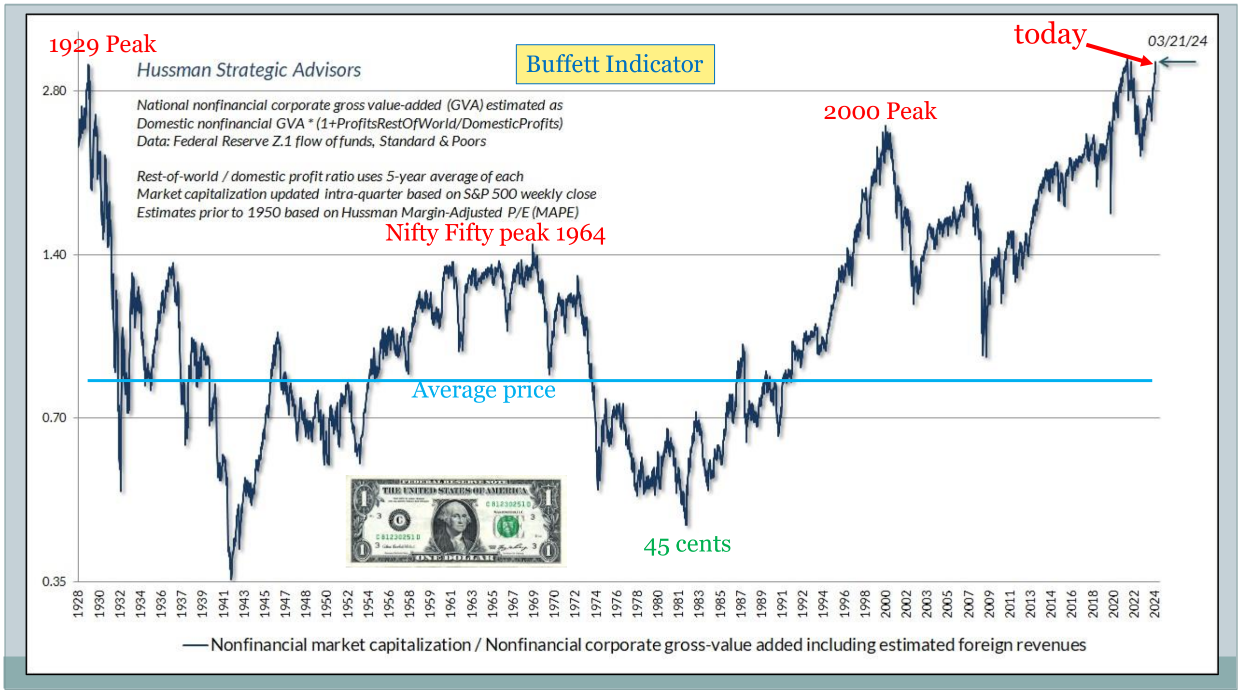
MARCH 16TH–22ND 2024
AMERICA'S PUMPED-UP ECONOMY

It has been in the news that the Fed may cut interest rates later this year and that may be the reason for the ongoing rally in U.S. stock markets, centered mostly around the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) and the possibilities of A.I. (Artificial Intelligence).

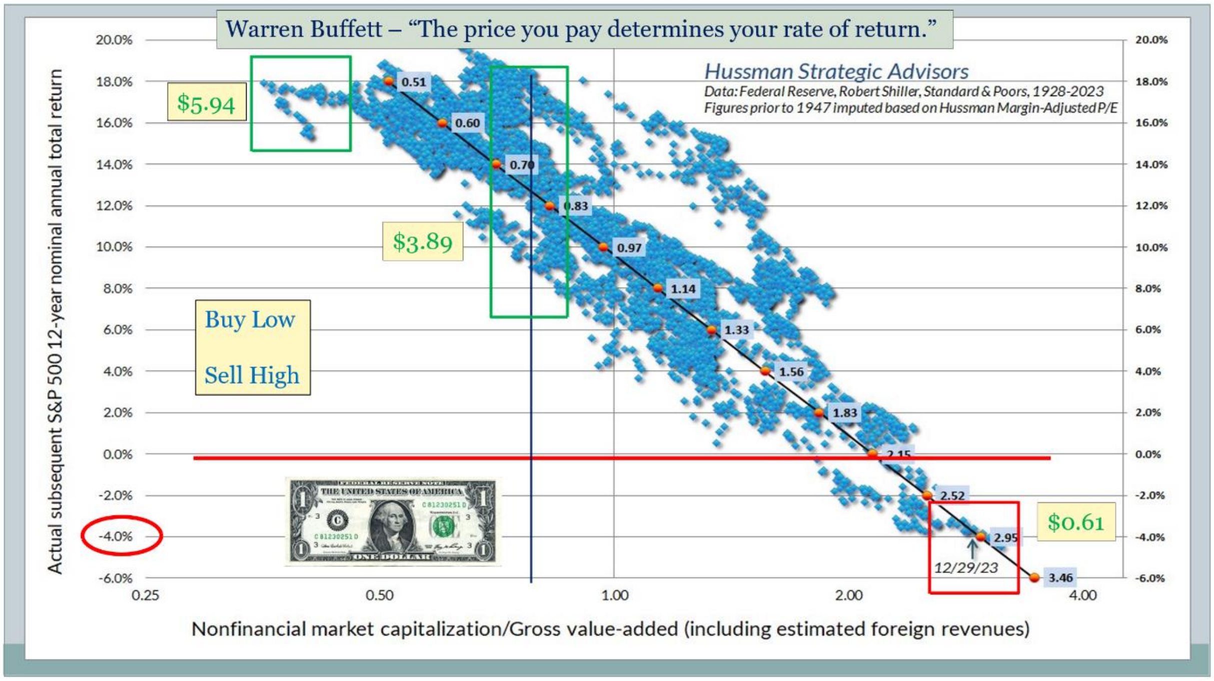
Buying the Magnificent Seven or major stock indexes at today’s elevated prices would be investing at the highest price at which stocks have ever traded. All previous instances that even come close to today’s price level, 1929 and 2000, ended very badly for investors. Our objective is to buy low and sell high, yet today stocks trade at the highest 1% of historical valuations.

We are not talking about the numerical level of the indexes like the Dow Jones Industrial Average around 39,000 or the S&P 500 around 5,200. Those numbers don’t tell us much aside from the fact that they are at record highs. More meaningful is how much we are being asked to pay for each dollar of corporate revenue at today’s stock price. If the market were trading at average valuations, we could buy a dollar of revenue for just eighty cents. When the market is cheap a dollar of revenue has sold as little as thirty-five cents. Today we would be paying over three dollars for the same dollar of revenue.



Source – Hussman Strategic Advisors

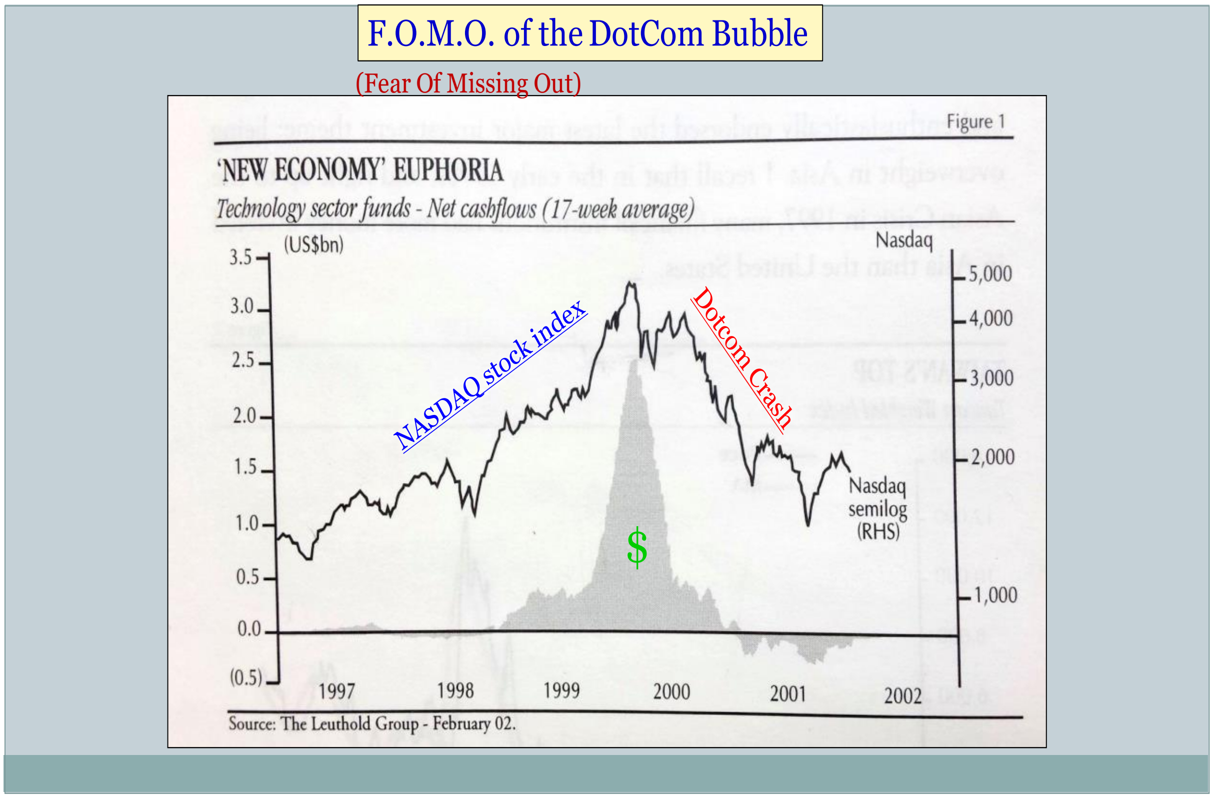
We don't need to guess what this high price portends for investors over the longer term because we have nearly a hundred years of data shown in the chart below. Since 1928, **every time** that investors were tempted to buy stock at today's prices it ended badly without exception. All those data points are contained within that red box at the bottom right of the chart below and show that paying three dollars for a dollar of revenue that should normally cost about eighty cents has resulted in a four percent (circled in the bottom left corner of the chart) loss compounded annually for twelve years. It turned each dollar invested into sixty cents twelve years later. That would be a major setback.



Source – Hussman Strategic Advisors

We sometimes wonder why our grandparents were so conservative, saving tin foil and safety pins for a rainy day and investing mostly in bank c.d. s. The Great Depression, which began with stocks priced as high as they are today, saw the Dow Jones Industrial Average fall by ninety percent and not get back to even for over twenty-five years. I am not saying that is what is going to happen now, just that it is one of just a few historical precedents that we have where stocks got this expensive.

What makes successful long-term investing so difficult for most people is that our emotions often tell us to do the exact opposite of what we should do, which is buy low and sell high. It feels great to run with the herd and buy what is popular no matter the price, especially while that price is rising. The longer a bubble persists and the higher it goes, the more compelling it becomes, and today’s bubble may be the greatest of them all. The Fear Of Missing Out, known as F.O.M.O. for short, compels investors to abandon prudence and make investments that they shouldn’t. Reviewing many charts, data and history over my thirty-three years as an investment advisor, the chart below illustrates this phenomenon better than any other I have seen.



F.O.M.O. of the DotCom Bubble

(Fear Of Missing Out)

Figure 1

'NEW ECONOMY' EUPHORIA

Technology sector funds - Net cashflows (17-week average)

Source: The Leuthold Group - February 02.

What it illustrates is the tech-stock/dotcom bubble of the late nineties rising steadily in price and finally peaking in early 2000 before crashing by 82% over the next two years. The gray area below shows investor cash flows into the tech-sector funds as the bubble neared its peak. Most of the investment dollars arrived just before the crash, when investors had been seeing their friends and neighbors get temporarily rich and developed a serious case of F.O.M.O. that they couldn't resist.

Many sold their solid, non-tech investments so they could take the proceeds and join the Dotcom mania, causing many valuable non-dotcom stocks to get amazingly cheap. This offered a terrific opportunity for savvy investors to bottom feed on quality stocks that had been abandoned. Speculators who took their cash and plowed into the peak of a speculative mania when it felt most irresistible vaporized their hard-earned savings. They experienced a financial setback that took many years to recover from if they recovered at all. Why did they do that? F.O.M.O.

What is so interesting from a historical perspective is that despite uniformly negative outcomes, as humans we are so susceptible to this behavior and do it over and over again. I think it is part of our wiring from hundreds of thousands of years of evolution. We are social creatures, mindful of what our neighbors are doing. We are drawn to the safety and comfort that increased wealth represents. Look at these quotes analyzing the great investment bubbles of history, 1929, the Nifty-Fifty era of the sixties and the Dotcom mania peaking in 2000. They describe almost exactly what we are experiencing today. The costumes and sets change, but the actors are essentially the same.

About 1929:

From – *The Business Week, November 2, 1929*

This is the longest period of practically uninterrupted rise in security prices in our history… The psychological illusion upon which it is based, though not essentially new, has been stronger and more widespread than has ever been the case in this country in the past. This illusion is summed up in the phrase 'the new era.' The phrase itself is not new. Every period of speculation rediscovers it… During every preceding period of stock speculation and subsequent collapse, business conditions have been discussed in the same unrealistic fashion as in recent years. There has been the same widespread idea that in some miraculous way, endlessly elaborated but never actually defined, the fundamental conditions and requirements of progress and prosperity have changed, that old economic principles have been abrogated… that business profits are destined to grow faster and without limit, and that the expansion of credit can have no end.

– Benjamin Graham & David L. Dodd, Security Analysis, 1934

(Benjamin Graham was Warren Buffet's Professor of economics at Columbia University E.T.)

The 'new era' commencing in 1927 involved at bottom the abandonment of the analytical approach; and while emphasis was still seemingly placed on facts and figures, these were manipulated by a sort of pseudo-analysis to support the delusions of the period. The 'new-era' doctrine – that 'good' stocks (or 'blue chips') were sound investments regardless of how high the price paid for them – was at bottom only a means for rationalizing under the title of 'investment' the well-nigh universal capitulation to the gambling fever.

– John Brooks, Once in Golconda, 1969

The 1929 boom was, in fact, quite a narrow and selective one. It was a boom of the handful of stocks that figured in the daily calculation of the Dow Jones and New York Times indices, and that was why those well-publicized indexes were at record highs. It was also a boom of the most actively traded stocks bearing the names of the most celebrated companies, the stocks mentioned daily by the newspapers and millions of times by the boardroom habitués – and that was why it was constantly talked about.

About the Nifty-Fifty stocks of the mid-Sixties:

– Forbes Magazine, 1977, The Nifty Fifty Revisited

The Nifty Fifty appeared to rise up from the ocean; it was as though all of the U.S. but Nebraska had sunk into the sea. The two-tier market really consisted of one tier and a lot of rubble down below. What held the Nifty Fifty up? The same thing that held up tulip-bulb prices long ago in Holland – popular delusions and the madness of crowds. The delusion was that these companies were so good that it didn't matter what you paid for them; their inexorable growth would bail you out.

– Adam Smith (GJW Goodman), The Money Game, 1967

This is what produces bull market tops. Obviously no one rationally would want to buy at the top, and yet enough people do to produce a top. It is really quite amazing how time horizons and money goals can change when there are stocks around that are going up 100 percent in six months."

About the Tech Bubble of 2000:

– John P. Hussman, Ph.D., March 7, 2000

The market is in a two-tier frenzy between the 'new economy' stocks and the 'old economy' stocks. Anyone who has studied the concept-stock mania of 1968-69, or the 'Nifty Fifty' mania of 1972 has to be getting chills here. We've seen two-tiered markets before: most prominently in 1929, 1968-69, and 1972. The inconvenient fact is that valuation ultimately matters. That has led to the rather peculiar risk projections that have appeared in this letter in recent months. Trend uniformity helps to postpone that reality, but in the end, there it is. Given current conditions, it is increasingly likely that valuations will begin to matter with a vengeance.

And lastly from market analyst Bill Bonner who's work I have read for almost thirty years, writing about today:

Today's bubble seems most similar to the dot.com bubble of 1998-1999. Then too, prices went wild as investors thought new technology would make their stocks much more valuable. Amazon, for example, went up 21 times in the two years 1998-1999. People thought it would just keep going 'to the moon.'

Instead, it crashed 92% and didn't get back to its 1999 peak until 7 years later. Then, it went to Mars.

Of course, 7 years is not that long. But most of the leading stocks of the period were not so lucky. Then, as now, the big money was concentrated in just a few stocks. All of them crashed, and most have still not come back.

And we're not talking about the flakey dotcoms – like Pets.com – or even about pie-in-the-sky, one-stock tech wonders such as Global Crossing. We're referring to the cream of the crop…the biggest and best companies in the USA at the turn of the millennium. Adjusting today's prices to inflation, we see that only two of the top 10 companies are in the black for the period – 2000-2023 – Microsoft and Walmart. The rest suffered a combined loss of over $1 trillion in market capitalization, in today's money.

The Path Down

To put this another way, an investor – in 1999 – who bought the leading can't-go-wrong companies, had an 80% chance of actually going wrong. Cisco, GE, Intel, Exxon, Oracle, IBM, Citigroup, and Lucent all lost money for investors over nearly a quarter of a century, anywhere from a 12% loss at Exxon to a 100% wipeout at Lucent.

And now, investors are betting on the Magnificent 7 – Apple, Alphabet, Amazon, Meta, Netflix, Nvidia and Tesla. Which of them will survive? Which will prosper?

We don't know. But that's the trouble with being on the tippy top of a mountain. Whether you're a stock market, a single company, such as Nvidia…or an entire empire – all the paths go down.

This is a situation that I have been highlighting for WAY longer than I would like to. We arrive at the highest valuations of all time only by reaching and then surpassing price levels that proved to be quite dangerous previously. It is as tedious for me as it probably has been for you. It is no fun being a naysayer and preventing people from experiencing big gains that seem to be there for the taking, missing out on the intoxicating euphoria of bubble.

I am reminded of a story about legendary investor Jeremy Grantham who founded and led the investment firm called G.M.O., managing billions of client assets through the dotcom bubble period and refusing to buy into the frenzy. As a result, some sixty percent of the clients for whom they were managing money took their savings and walked out the door so they could join the herd themselves. At a Wall Street firm, he almost surely would have been fired, but it was an independent fund that he had founded and so he could stay the course that he believed to be prudent.

His comment was something like “I can’t prevent people from doing what they are inclined to do, despite our advice. We owe our diligence to those who continue to entrust us with their savings.” As the dotcom bubble proceeded to crash by over eighty percent from the 2000 peak, G.M.O. went on the compound client capital at double digit rates because while many investors sold whatever they owned in the rush to buy into the tech bubble, G.M.O. was buying many of the high-quality stocks that had been abandoned were now dirt cheap.

Grantham has a legendary status within the industry for having the foresight to see what was coming and the discipline to trust his analysis, maintaining his commitment to clients under what must have been enormous pressure. He also set them up for strong future returns by investing in the valuable assets that investors had abandoned in their rush to join the mania.

I believe that the same risks and opportunities exist today, and we are positioned and continue to invest with that in mind. I wish you strength in dealing with the Fear Of Missing Out. It ain’t easy. Let me know your thoughts.

Thanks,

Ed

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