Rochester Financial Services

Fee-Only® Financial Management Services

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February 2, 2021

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
30,688	3,826	13,613	2,151	1.11%	4.43%	$1,837	$54.79

Investment Strategy Report

Despite An Increase In Volatility, the Stock Market Can't Be Stopped By Gamestop

We had thought that 2020 was the year to remember, in terms of a tumultuous market and record volatility. The assumption was that 2021 would most likely see a return to quieter times, a return to normalcy. And then there was Gamestop, Reddit, and Robinhood. How could a stock representing a dying business model surge 20 fold in a matter of weeks? Is the stock market just an irrational casino? And the bigger question is, what effect would this frenzied trading activity have on our portfolios and the rest of the stock market?

For those of you who had better things to do and weren't following the craziness of the Gamestop phenomenon (and please forgive me if I am off a little on the details), Gamestop is a video game maker whose stock price was under $20 per share back in December. The stock was targeted by the online site Reddit whose members began touting the stock and urging followers to buy it. It is a stock that is heavily shorted by hedge funds – meaning that they thought the price was too high and bet that the price would fall. Because of the heavy buying activity at brokerages such as Robinhood, the price began to climb, causing hedge funds to have to close out their short positions (meaning that they too had to buy the stock), further pushing the stock price higher. The only reason why we should be concerned about this is that it appeared that the professional traders (hedge funds) were experiencing heavy losses, causing them to sell blue chip stocks (like Apple and Microsoft) to raise money to cover their losses.

This is the explanation offered as to why stocks dropped around 4% last week. After beginning the year on a positive note (S&P up 2.6% and Nasdaq up 5.8%), was this irrational trading frenzy going to stir up market volatility and torpedo the ongoing market recovery? As I write here on Tuesday afternoon, it appears that a modicum of rationality is coming back to the markets. Gamestop, which topped out last week at $483, is now trading at about $95. And the rest of the stock market, in sort of a see-saw response, has spent the last 2 days surging higher, with the Nasdaq having erased last week's losses and again at a record high. So the technicals, which Robinhood traders exploited to pounce on a heavily shorted stock to make out-sized gains, appear to be giving way to market fundamentals.

And the fundamentals should be able to continue to have a positive influence on stock prices. As an example, both Apple and Microsoft posted strong profit reports last week, only to see their prices drop. Those losses are in the process of being reversed this week. We are still in the midst of 4th quarter earnings season, and positive earnings and revenue surprises are ahead of estimates by 17.3% and 3.3%, respectively, according to Louis Navellier. Despite the surge in Covid cases in January, the economy continues to experience a strong recovery. Estimates for GDP growth for 2021 average a very robust 4%, and the FOMC estimates that the unemployment rate will drop to about 5% by year end. The housing industry continues to be very strong, as low interest rates and an exodus from the cities to the suburbs, has spurred the boom in home construction. Consumer spending is very strong as stimulus money has found its way to consumers, plus the fact that employment among high wage earners remains high. In addition to strength in the housing sector, there is also strong car buying demand. The results from the ISM manufacturing and services surveys continue to be at elevated levels.

It should also be noted that despite this strength in the economy, we should be approaching a point fairly soon in which the ramping up of vaccinations, plus the immunity of those who have recovered from the virus, should lead to the beginning of the end of this crisis. Once the market senses this, higher stock prices should follow suit. We could see participation from all areas of the market, both those companies that would benefit from a re-opening of the economy plus those that have helped improve productivity during the crisis.

For of many of you, I have added small cap stock funds to our portfolios in an attempt to benefit from the recovery in small businesses across the country. This will hopefully increase our performance while also spreading out our risk into a broader range of the market. Small caps surged in November and have outperformed since then. I expect this trend to continue. *Jeff Feldman*

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