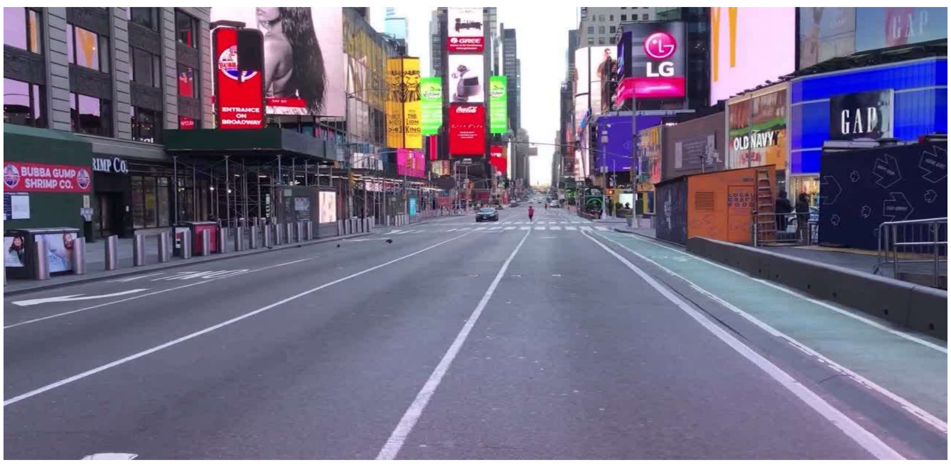
ONE CRAZY YEAR!



Times Square was empty as the coronavirus put New York City on lockdown.

We are coming out of the sharpest recession since the Great Depression. Businesses are still closing left and right. The virus has killed 400,000 Americans; the nation's capital is in turmoil... and the stock market is booming. What gives?

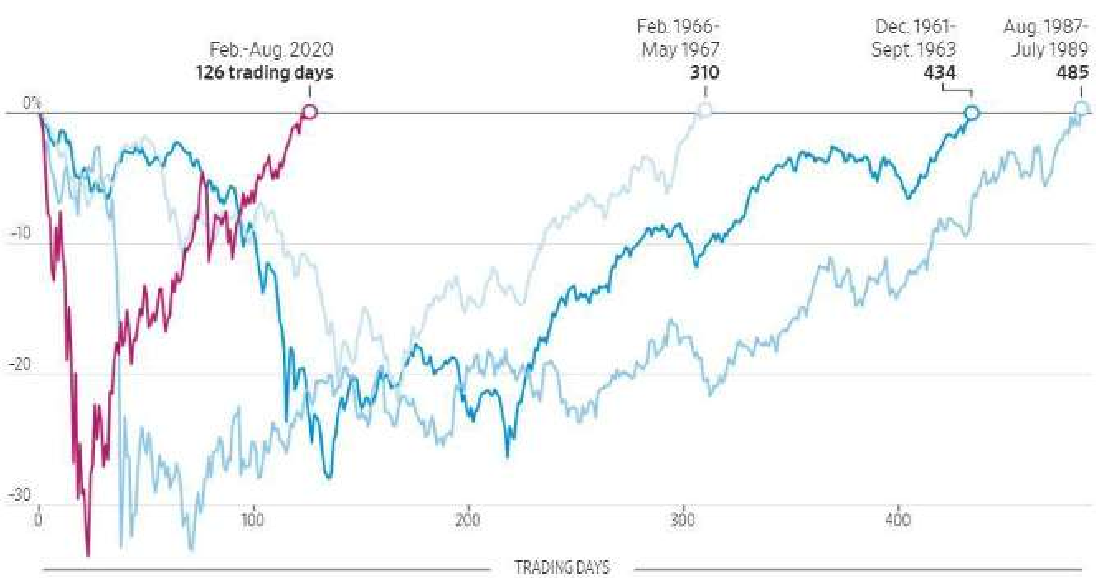
The first week of 2021 brought new records for the pandemic in the U.S. Nearly 1.6 million people across the nation tested positive for the coronavirus, higher than any other week yet recorded. Hospitalizations rose to a record-setting 132,370 cases continuing to strain already fatigued health-care workers. Earlier this month, the country for the first time surpassed more than 4,000 deaths in a single day. The experts are forecasting an increase in cases, due to the rolling back of restrictions, as well as colder weather forcing many indoors where the virus survives longer and spreads more easily.

Most importantly however, vaccines will be out in volume in 2021 and will likely begin making an impact in returning the country to normalcy. However, the approval of a vaccine does not mean an immediate end to the pandemic. It will take a lot of time to manufacture and distribute enough doses for everyone, and not everyone will be willing to take it. All signs indicate that natural herd immunity remains far away.

Meanwhile, we are working out of a severe recession. In 2020, the economy suffered not one, not two, but three cataclysmic events. First, the pandemic got out of control. Next, the world's biggest economies were forced to literally shut down. Finally, oil prices at one point turned negative, (something that had never happened in history) putting extreme pressure on one of the country’s most important industries.

Typically, in a recession, the Gross Domestic Product (GDP) drops by a few percentage points. But the second-quarter GDP plunged by a whopping -32.9%--the largest quarterly drop ever recorded. Yet, 2020’s big financial story is one of stock market gains. The Dow gained 7.2% for the year, and the S&P 500 recorded a 16.3% gain. The NASDAQ surged a whopping +43.6%.

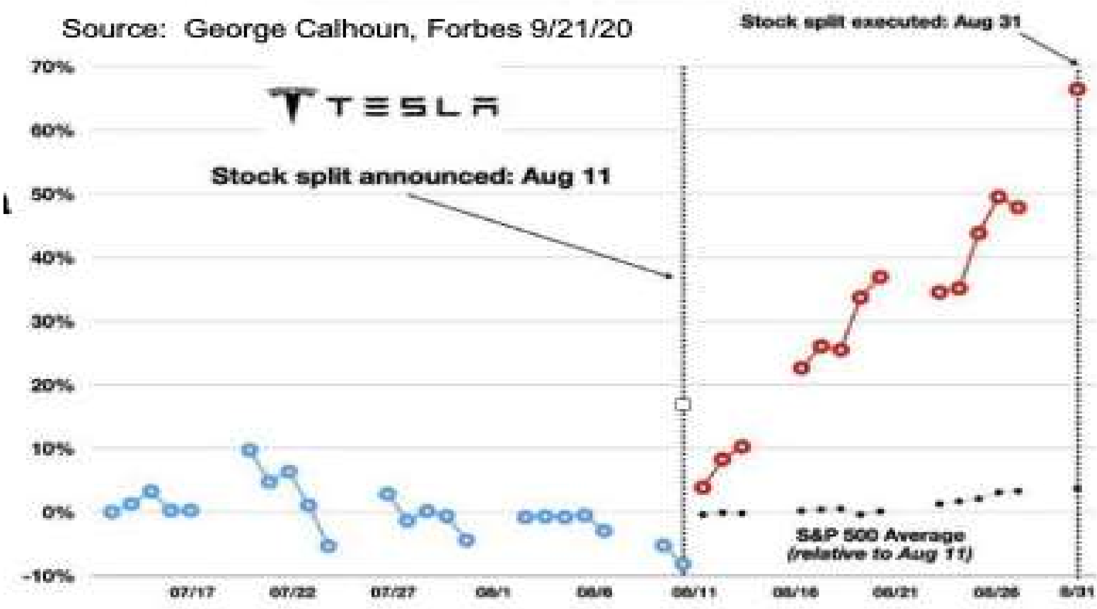
S&P 500 fastest recoveries following a bear market, from record high to new record



Source: Dow Jones Market Data

All of this caused one of the shortest and most severe market crashes on record. The S&P dropped -30% from a record high and back to a new record high in just 126 trading days. (See chart above.) The market has been so strong it is starting to look a little… *Crazy.* <u>Below are 3 Crazy examples</u>:

1. TESLA



In August, Tesla announced a stock split, an action with absolutely no economic consequences. Nevertheless, Tesla stock soared a staggering 70% in the twenty days after the announcement. This is equivalent to slicing a pizza into sixteen slices instead of eight, and then seeing customers pay 70% more for that same pizza.

2. NIKOLA

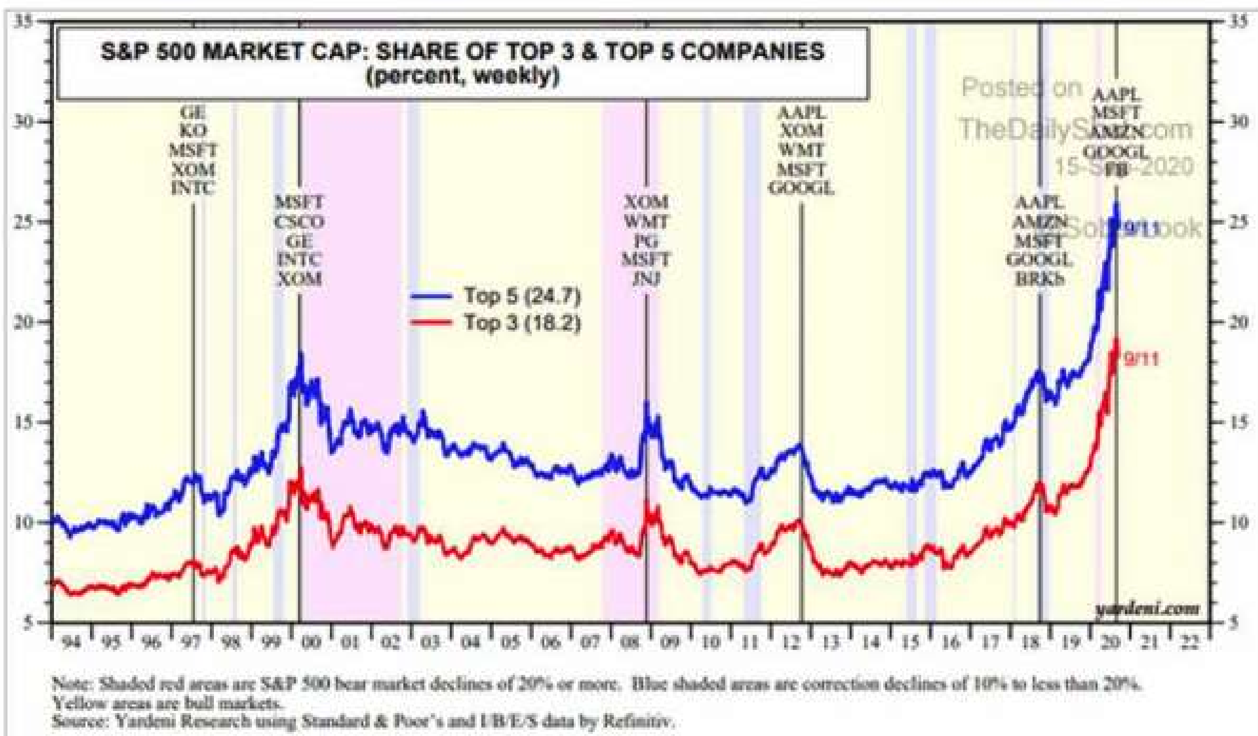
Nikola, an aspiring producer of electric and hydrogen fueled trucks with absolutely <u>no functional products and zero revenue</u> saw its value shoot up in excess of $30 billion after its reverse merger SPAC Initial Public Offering (IPO).

3. THE ASCENT OF APPLE

Apple Price to Trailing Earnings

The chart (above) shows the ratio of Apple's price to last year's earnings (P/E). For 9 years, this important measure of value remained between approximately 10 and 20.

In 2020 Apple's price in relation to its earnings topped at 40. What changed? Certainly not Apple's aggregate revenues or earnings, which have hardly grown over the past six years. The market in Q3 2020 decided Apple was worth 40 times trailing earnings. As a result, Apple became worth more than the entire Russell 2000 Index of 2,000 smaller U.S. public companies.



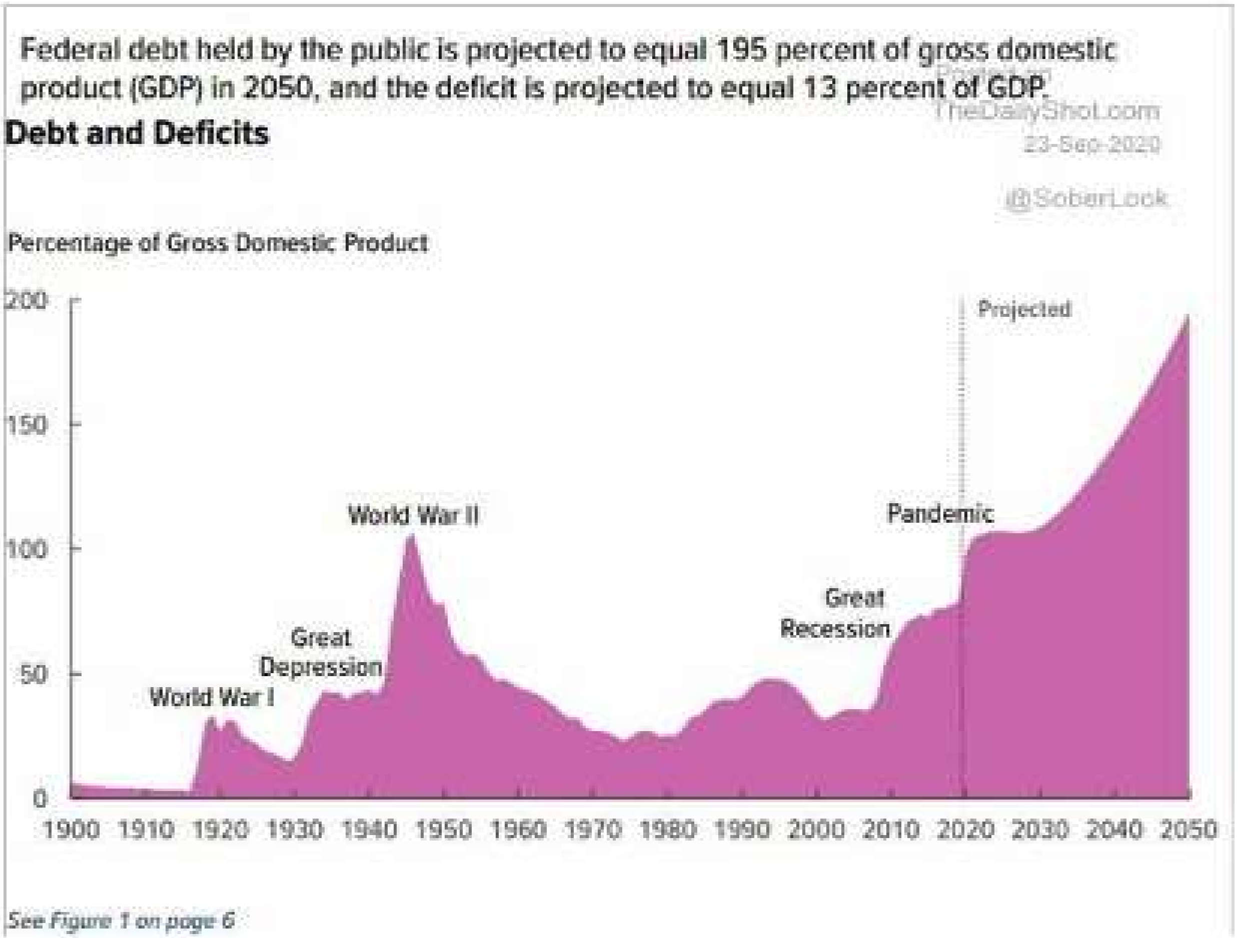
The graph above shows how the five largest stocks make up an astounding 25% of the value of the S&P 500.

Apple is not the only stock to experience a parabolic increase in market value. Even after a recent sell off, the S&P continues to be led by the Big Five tech companies that we discussed in detail in our 2019 Year End Report.

The continuing appreciation of large tech stocks has led to the greatest ten-year outperformance of growth stocks versus value stocks of all time. One explanation for some of these extremes is that younger individual investors are gambling with their $1200 stimulus checks and chasing stocks they know and love (like Apple) higher.

Also, most major brokerages recently eliminated trading commissions for retail investors, making this gambling activity "free". Not only has retail investor trading volume increased dramatically, but the ratio of stock option trading volume relative to regular stock trading volume has spiked.

It’s All About the Debt



As the chart above indicates, Government debt surpassed 100% of GDP for the first time since WWII and only the second time in the nation’s history.

Perhaps the biggest reason the stock market is still booming is that this recession does not feel like a recession to many people. This is because the government response completely dwarfs the actions taken during the Great Recession. 2020 has witnessed, by far, the biggest government cash giveaway of all time.

We all remember the $1,200 checks mailed out to average citizens at the height of the pandemic, but the PPP “loans” were many times larger. The $1,200 stimulus checks amounted to $180 billion in total whereas the PPP funneled $500 billion to businesses and business owners. Many businesses needed this money to survive or keep their workers employed. Other businesses requested these giveaways when they had no interruption to their business. Calling them “loans” is an incredible piece of marketing since the vast majority never had to be repaid. They went straight to the bottom line.

Another important economic boost came from the extra $600 per week in unemployment benefits, which resulted in many unemployed people earning *more* on unemployment than from their lost jobs. This expired in August but was extended for six weeks at $300 per week by President Trump's executive order.

Put all these government programs together and we have the first recession where the personal income of many Americans actually went UP!

Remarkably, the government handed out so much money that, despite the worst unemployment this country has ever seen outside the Great Depression, personal income *increased* at a **12%** rate. Thus, while GDP (what we produce) plummeted, personal consumption spending rose! The end result is a recession that doesn't feel as crushing as the last one, and a stock market that quickly recovered its losses.

<u>How is it possible that the government can spend this much money?</u>

One answer is that *both* political parties are on board with massive deficit spending. Another answer is that the Federal reserve has put newly printed money into the hands of investors via buying bonds that already existed. Also, the Fed put newly printed money into the hands of the government by buying about $2.3 trillion dollars in bonds.

The degree to which both activities (money printing and government deficit spending) far surpass what took place during the Great Recession and Global Financial Crisis. The Biden Administration promises trillions more in government debt. Debt of this magnitude has never happened to this extent in this country.

This is basically the new **Modern Monetary Theory (MMT)** in action. Once attributed to Bernie Sanders as a socialist notion, spending without taxing has obviously been politically expedient for both political parties lately. This debt is clearly unsustainable. However, just because something is unsustainable does not mean it will stop. "Unsustainable" may go on longer than many expect. This new decade may be dealing with the repercussions long after the virus has been defeated.

However, it <u>is important to keep the current picture in focus:</u> stocks are still cheap compared to bonds. The Fed just printed a *bazillion* dollars, many of which are sitting in money market funds earning zero percent interest. These dollars will ultimately make their way into the companies that make up our markets.

These arguments do have at least some merit, but don't forget that at this level, stocks also come with exceptional levels of systemic risk. Arguably the single biggest investment priority is to manage the systemic risk.

Government actions have encouraged a process in the name of ‘compassion’ that has left us with heretofore unimaginable levels of systemic risk.

The” Waterfall” decline in the S&P 500 – and the Record-Breaking Recovery

Between February and March, the S&P 500 dropped over 35%. 2020 was a year beset by a public health crisis, civil unrest, political dysfunction, and uncertainty across just about every facet of life. Yet the S&P 500 still posted a +16% return for the year, following a powerful surge in 2019. Never mind the fact that there was a global pandemic, a contentious election, and a steep and scary bear market to begin the year.

<u>How Long Can the Bull Market Last?</u>

After the rollercoaster year of 2020, the beginning of 2021 has provided investors with record market highs. This has many investors wondering how much more upside is possible in 2021, and if a crash is on the horizon.

At times like these, the stock market seems to defy all expectations and looks totally disconnected from reality. Investors instinctively know that something is out of whack. But history tells us this type of ‘disconnect’ often happens, particularly when Federal stimulus intervenes.

Uncertainties and fears are normal and natural for investors. In January every year, investors eagerly seek the predictions of “talking heads” and turn to the gurus promoted by the financial entertainment media who will clarify the uncertainties and set the course for another successful year of investing. How soon they forget that one year ago, virtually none of these same “seers” saw the disastrous market breakdown that would occur just 3 months into 2020.

We believe that the market is unpredictable.

The stock market has no emotional connection to what is happening at the moment. It doesn't read the headlines, nor consult with the gurus. To this day, it has largely shrugged off the effects of both political parties as we documented in our November *Election Edition*.

Warren Buffet's mentor Ben Graham has described "Mr. Market" as "manic-depressive." If anything, the market is always out ahead of the economy. In 2021, it is likely to see the effects of more government stimulus; Covid-19 vaccines; accelerating earnings, strengthening GDP growth, and a wall of liquidity. It may also be seeing looming inflation, continuing COVID-19 related unemployment, and increasing bankruptcies.

The stock market is fully valued by historic measures-- trading near 23x forward earnings. The peak in 2000 saw a price to earnings ratio (P/E) of 26x. Many investors may wonder how much more upside is possible. Others believe that as long as investors expect interest rates to remain low and bonds to pay so little, investors will likely be more willing to pay higher premiums to own equities (stocks).

Instead of trying to guess how much more upside is possible, our team will be focusing on our charts and on the hard data and economic indicators that will most likely impact your investments and determine your outcomes over the long term. This market has been far more resilient than many investors ever thought possible. That suggests whatever craziness we have experienced can continue for some time. Fundamentals really don't matter much in this environment. While this establishes a less than satisfying prospect for investors, <u>there is a silver lining</u>:

The virus will pass, the elections are over, and our government and economy will still run. Companies will continue to earn profits, and as the owners of those businesses, long term investors will continue to benefit.

Stay Tuned…

DISCLOSURE:

ProActive Capital Management, Inc. (PCM") is registered with the Kansas Securities Commission. Such registration does not imply a certain level of skill or training.

The information or position herein may change from time to time without notice, and PCM has no obligation to update this material. The information herein has been provided for illustrative and informational purposes only and is not intended to serve as investment advice or as a recommendation for the purchase or sale of any security. The information herein is not specific to any individual's personal circumstances.

PCM does not provide tax or legal advice. To the extent that any material herein concerns tax or legal matters, such information is not intended to be solely relied upon nor used for the purpose of making tax and/or legal decisions without first seeking independent advice from a tax and/or legal professional.

All investments involve risk, including loss of principal invested. Past performance does not guarantee future performance. This commentary is prepared only for clients whose accounts are managed by our tactical management team at PCM. No strategy can guarantee a profit. All investment strategies involve risk, including the risk of principal loss.

This commentary is designed to enhance our lines of communication and to provide you with timely, interesting, and thought-provoking information. You are invited and encouraged to respond with any questions or concerns you may have about your investments or just to keep us informed if your goals and objectives change.