February 2021

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Resolute Connections

We can’t send out a February newsletter without addressing the latest craze that has swept the US stock market - basically day traders driving up the stock prices of companies with less than stellar prospects to stratospheric levels. Can someone please cue up the Artist Formerly Known as Prince (or was it just Prince?) hit song ‘1999?’ Just asking as today’s market action is like reliving the 1999 dotcom era that ended the last century all over again, and that song seems so appropriate for today. See more in *Gambling vs. Investing*.

President Biden’s Administration has made some proposals that would affect our taxes, prominently including a complete rollback of the 2017 tax cut for some, more in *Tax Bill Will Wait*. Finally, while a bubble in next to worthless stocks is forming, there may be one forming in crypto currency. *The Soaring Crypto* discusses the latest fantastic investment that may be entering bubble territory.

Please be safe and we wish you continued health. If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

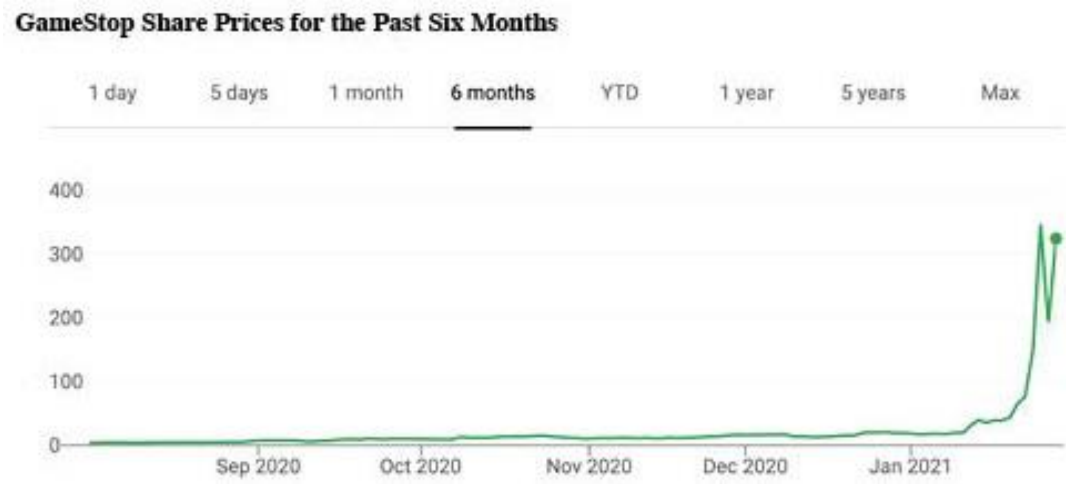
Gambling vs. Investing

The financial media took a brief break from predicting everything that will happen in 2021 (don’t laugh; it’s their yearly habit) to bring us the engaging story of how masses of small amateur investors managed to bid the share prices of three largelyunprofitable companies—GameStop, AMC Entertainment Holdings and Blackberry—up nearly 1,000 percent, collectively. GameStop alone rose more than 14,300%—surely some kind of record for a firm whose market share is eroding and which most analysts think is clinging to an outmoded business model. (The company sells video games through bricks-and-mortar retail outlets in a world where everything can be downloaded.)

The story was allegedly about David (the small investors) pitted against Goliath (several prominent multi-billion-dollar hedge funds), and the only reason you heard about it is because the small investors won and nearly put the hedge funds out of business.

Market professionals recognize the story as a classic short squeeze; investors on one side (in this case the hedge funds) borrow the stock of companies they think are overpriced, expecting to buy them at a discount after the fall, allowing them to pocket a quick profit. These short sales have an expiration date, so if the stocks unexpectedly rise in price, the short-sellers have to scramble buy the stock at the inflated price to limit their losses. On the other side of the gaming table were a group of amateur investors who engage in online conversations on chat site Reddit/wallstreetbets, who ganged up to raise each other's bids. When the hedge funds were forced to buy to close out their positions, the share prices went through the roof. The hedge funds, meanwhile, lost an estimated $5 billion on their bets, roughly $1.6 billion on January 29, when GameStop's stock jumped 51%.

What the financial media neglected to mention is that this activity is not investing; it is, instead, a form of gambling, and the story tells us a great deal about the mindset of many retail investors these days. When their goal is to make bets, and destroy other gamblers at the table, the game for everybody else becomes increasingly dangerous. Take a look at the past 6 months of GameStop's stock price and see if you can pinpoint when the gamblers started taking an interest.



Toward the end of every bull market cycle, there is an invisible line that is crossed, when the public starts to think of the stock market, not as a way to share in the growth and profits of public enterprises, but as some kind of roulette wheel where the ball always seems to stop on a higher price. These share owners cease to be long-term investors, and prices are bid up not based on the underlying value of the companies, but on the expectation that whatever you buy, at whatever price, someone else will come along and pay a higher price.

Of course, markets only work that way for a short time, typically at or around market tops. Eventually, the share prices of GameStop, AMC Entertainment Holdings and Blackberry—and perhaps many other stocks that are being gambled with at the moment—will return to something that more closely resembles the real value of the real company. Long-term investors have tended to win the kitty over every past historical time period, while gamblers have seen their short-term winnings evaporate in the ensuing bear market. The jubilant traders on Reddit/wallstreetbets (does that name not suggest gambling?) can enjoy their winnings today, but it may not be long before they're counting their losses and wishing they hadn't gambled away the money that could be used to buy shares when they finally go on sale.

Tax Bill Will Wait

The new Biden Administration has made some proposals that would affect our taxes, prominently including a complete rollback of the 2017 tax cut for taxpayers with income above $400,000. The plan would also tax capital gains at the same rates as ordinary income for people with more than $1 million in income. The corporate tax rate would rise from 21% to 28%. The estate tax exemption would drop by about 50%, and the proposal would eliminate the step-up in basis on assets held at death.

There is talk about student debt forgiveness, but it is not in the current bill under discussion. Actually, forgiveness is really not the appropriate term as the tuition/room/board has been paid and the colleges aren't giving the money back. Why don't we call it 'transferness' as the debt would be transferred from those families and students that benefit from their college degrees to the US taxpayer, roughly 65% of whom don't have college degrees. Surely that 65%, many of whom are earning less than their college graduate counterparts, will happily pay the higher taxes that will be required to transfer this debt to the US taxpayer, right?

But we digress - the first priority in Congress appears to be the $1.9 trillion coronavirus relief proposal, which includes direct payments of $1,400 per person, and includes a number of tax provisions. The bill would expand the child tax credit (from $2,000 to $3,000 per child or $3,600 for each child under 6) and child tax credit (up to 50% of all child care expenses for children under 13, up from $3,000 to $4,000 for one child and up from $6,000 to $8,000 for multiple children.) The Earned Income Tax Credit would be expanded as well; currently, only those making $16,000 or less qualify for the credit, but the relief bill would raise the cap to $21,000, and expand eligibility to workers 65 and over.

To pass any tax increases, the incoming President would need to gain the support of every single Democratic Senator to pass any tax legislation. And some Democrats—including Joe Manchin of West Virginia—are questioning the wisdom of raising taxes when the U.S. economy is still recovering from recession. So, we will need to watch the political winds and examine the actual bills as they move through Congress before we can make any recommendations.

The Soaring Crypto

What was the highest performing asset over the decade ending on January 1? U.S. stocks? International bonds? Commodities? The stock market of a random emerging nation?

Any of those might be decent guesses, but they're all wrong. The asset (if you can call it that) which delivered the highest performance, by a wide margin, was the crytocurrency known as Bitcoin. A single Bitcoin rose 9 million percent over the past decade.

There are a few problems with calling Bitcoins "assets," much less "investments." The first is that they are not backed by any government—or, for that matter, any tangible asset. If you own shares in a stock, there is the actual company backing up those shares. If you own municipal bonds, there's a state or local agency that is pledged to make sure you get your money back plus interest. The value of dollars, yen, pounds and rubles are all guaranteed, respectively, by the U.S. government, Japan, the UK and Russia.

Why is that a problem? If, one day, enough people decided that Bitcoins—basically entries into shared accounting systems on computers around the globe—were worthless, well, it would be hard to get anybody to exchange your bitcoins for actual currency.

There does appear to be actual fluctuation in this trust level. The coins gained 165% in the final quarter of 2020, rallied again in the first three days of 2021, reaching a peak price above $34,000 per coin, and then suddenly fell 13% in a single day. That's significantly more volatility than one experiences owning even the riskiest stocks.

The second problem with Bitcoins is that it's still hard to use them as actual currency. A small number of retailers will accept them, though they appear to be a favored way to buy and sell large quantities of illegal narcotics and automatic weapons on the global marketplace. There are roughly 6,370 Bitcoin ATMs in the U.S., which theoretically will convert some of your coins into dollars, but these automated systems are causing money laundering concerns among government officials.

If you've ever been involved in a ransomware attack, you probably have some familiarity with Bitcoin. The hackers who steal or encrypt your files typically want to be paid in the cryptocurrency, although this illicit activity still accounts for only one percent of all Bitcoin transactions.

Maybe the biggest problem with having millions of dollars stored in a "wallet" on your computer is that if you lose your password, or your laptop, or you die without telling anyone else your password, then your coins—and that part of your net worth—will vanish forever. Many millions of dollars of Bitcoin investments have already been lost in exactly this manner. With actual investments like stocks, bonds, commodities etc., a custodian keeps careful track of what you own and provides access so you can see the value of your account at any time of the day or night.

And perhaps as an addendum, whenever an asset rises 9 million percent for no obvious reason, it's possible that we are experiencing a bubble that could burst at any moment.

Source:
Bob Veres Inside Edition Newsletter

For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.