Tulips and Tokens

-J. Kevin Meaders, J.D., CFP®, ChFC, CLU*

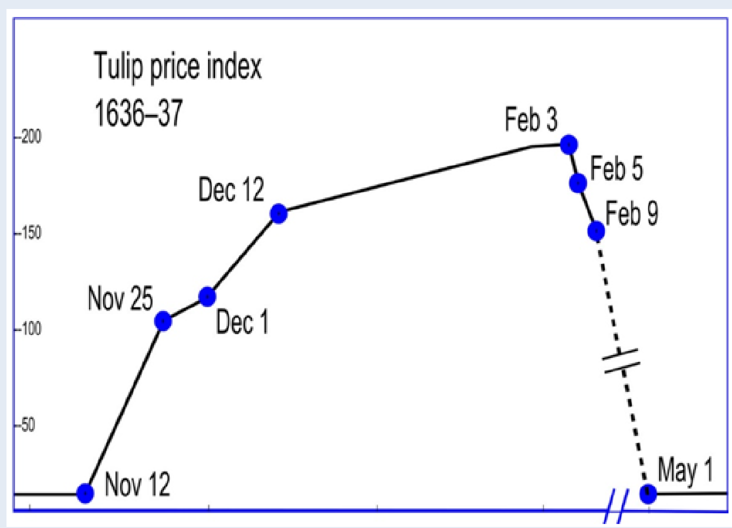
April 2021 – Throughout history we have seen amazing changes—some good, some not so. The 15th century brought the Guttenberg Press and the entry of the New World into the European consciousness. Suddenly the world was a lot smaller, and information proliferated widely. One of the European nations to thrive in this era was the Netherlands. They weren't explorers or conquerors, they were merchants.

By the 17th century, the Dutch had become immensely wealthy and in 1636, according to an 1841 account by Scottish author Charles MacKay, the entirety of Dutch society went crazy over exotic tulips. As Mackay wrote in his wildly popular, *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*, as prices rose, people got swept up in a speculative fever, spending a year's salary on rare bulbs in hopes of reselling them for a profit.

Mackay dubbed the phenomenon "The Tulipomania."

"A golden bait hung temptingly out before the people, and one after the other, they rushed to the tulip-marts, like flies around a honey-pot," wrote Mackay. "Nobles, citizens, farmers, mechanics, sea-men, footmen, maid-servants, even chimney-sweeps and old clothes-women, dabbled in tulips."

When the tulip bubble suddenly burst in 1637, Mackay claimed that it wreaked havoc on the Dutch economy.[1]



Perhaps you already know what I'm alluding to? That's right, Digital Nonfungible Tokens, or NFTs for short.

According to a report from Nonfungible.com, Sales of digital nonfungible tokens soared to more than $2 billion in the first quarter (of 2021)— more than 20 times the volume of the previous quarter.[1]

Certainly, something has caught on here. You have probably known about Nonfungible Tokens for some time now, but for those of us new to them, what are they?

Well, to put it succinctly, it's digital art. Or maybe a better way to say it is "art in digital form." Supposedly the buyer is the sole owner of the original art, which apparently has a value to several wealthy people. Even the NBA is getting involved since several of their players have "digital highlights" of them doing something great.

"A LeBron James highlight sold for $200,000. A Zion Williamson edition went for a little less than that. The National Basketball Association has officially aligned itself for the future of the trading card marketplace, and currently, this game is sold out.

The NBA partnered with Canadian-based Dapper Labs, makers of the CryptoKitties game, to make its version of a collectible digital asset. NBA Top Shot is a crypto-collectible consumer can purchase as a non-fungible token (NFT). Each collectible is tied to a blockchain -- a digital ledger similar to the blockchains used for digital currencies like bitcoin. This effectively gives each NFT a unique and non-hackable certificate of authenticity. So even if somebody makes a perfect copy of the highlight video, it will instantly be recognizable as a fake."[1]

I am currently looking at an NFT that just sold a few days ago for $1,298,362.38. Someone paid that. Here’s what the description says:

"This NFT comes with a full length audio visual experience of one hour which we have carefully created over the course of the last twelve months. You will receive a unique hand-crafted box, which includes a hard drive that contains the only copy of the high-quality file of the film, making it a truly unique art piece."[1] And that's it. No test drive. No sneak preview.

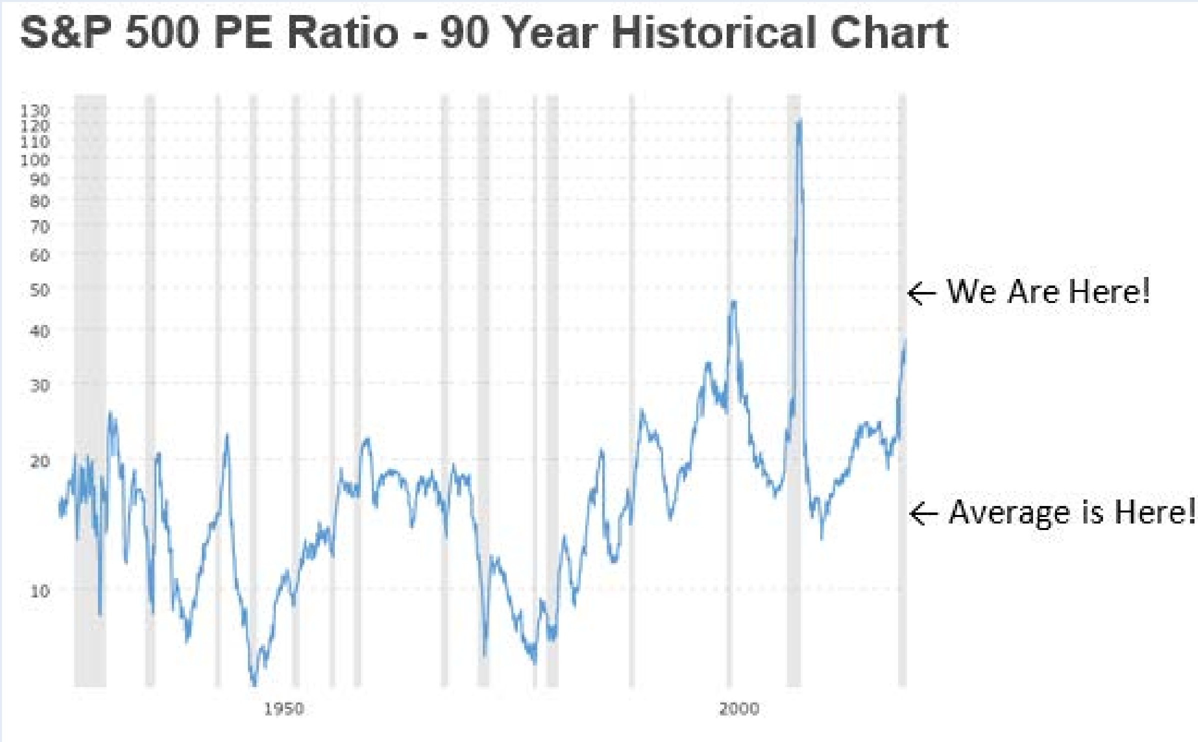
Okay, so it's like owning your own personal movie or art clip, or image, or anything really as long as it's authentic and unique.

I point this out because it doesn't matter whether it's African tulips in 1636 or non-fungible tokens in 2021, human nature has not changed. An economy is the amalgamation of millions of people making billions of decisions every day. Some of those decisions work out, some don't.

Remember back to 1999 and 2007, when we saw the same kind of "irrational exuberance?" Human nature, for some reason, becomes driven by greed and intoxicates the rational mind, leaving it helpless in the face of obvious folly. The core belief is that someone else will always value it more, later.

This naturally brings me to the stock market.

Today, April 15, 2021, the Dow Jones hit a new all time high of 34,000. As you probably remember, one of our most dependable natural indicators is the price to earnings ratio of stocks, particularly the S&P 500.   P/E ratio, for short.



As you can see, this is the 90-year historical chart of the P/E ratio up until 2020. In all that time, the average—the mean—is 15.92, and now it's almost 47! Some say the economy is different this time. Sure, they said that in 1986, and 1999, and 2007.

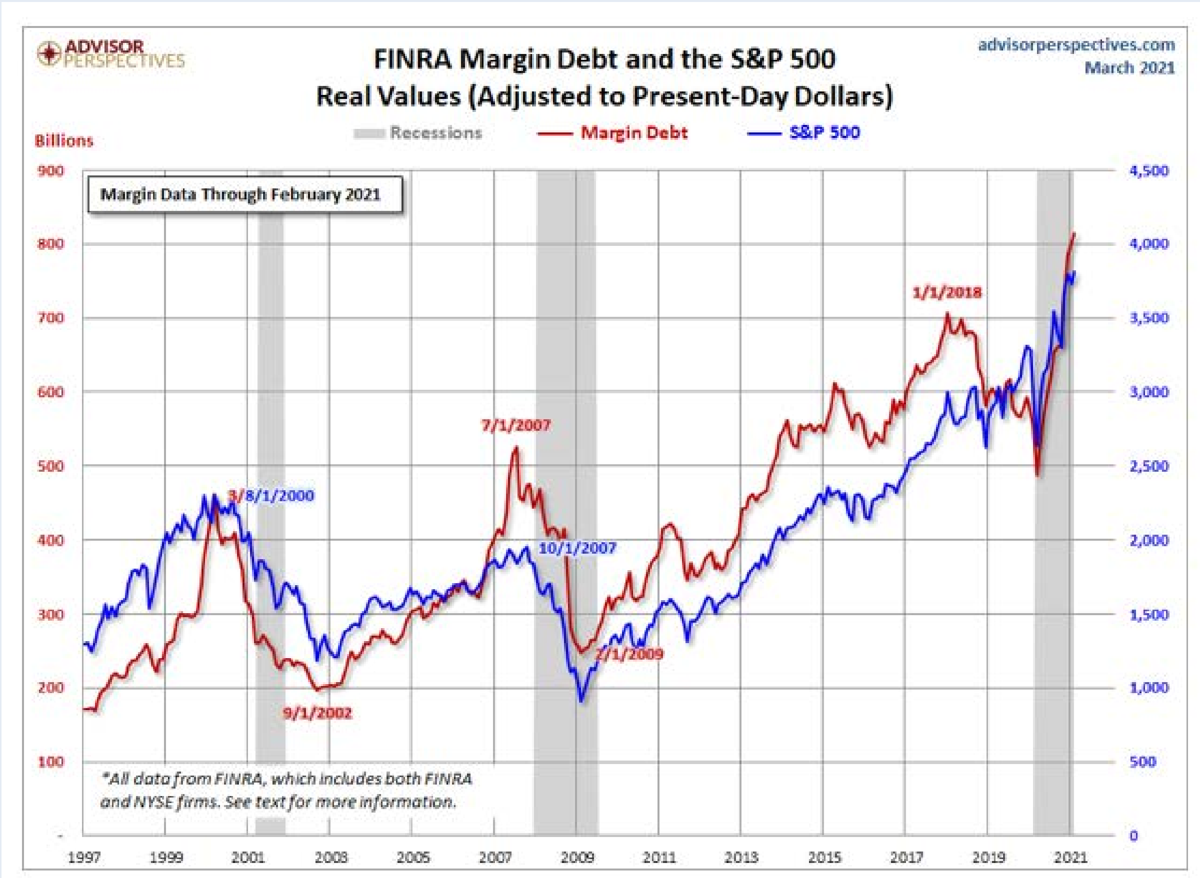
And yes, of course it is different this time. We now have digital non-fungible tokens and myriad crypto-currencies. We even now have a state-sponsored digital currency after China's introduction of the e-Yuan.[1] But human nature has not changed; these are just tulips of a different kind.

Even worse than losing money you have, is losing money you don't. This is what really got us into trouble during 1929. So many people were so excited about investing in the stock market that they borrowed money to invest. When stock prices started falling, they had to sell stocks to cover their margin calls. But this put pressure on stock prices, which meant more margin calls, thus more stock sales, thus lower stock prices, and so on.

I believe we are setting ourselves up for this downward spiral again. The chart below compares the S&P 500 to the amount of margin--borrowed money.

The blue line is the S&P 500 and the red line is margin debt. You can see that they track pretty close together, and also that as the S&P has reached 4000, the total amount of margin debt has exceeded $800 billion.

Next to zero interest rates have the effect of warping normal decision making because it's like free money. Why not buy a stock with a 50 P/E when I don't even have to use my own money? Hell, why not a 1000 P/E? History has proven this to be a dangerous precedent to coming market woes.



In addition to soaring stock prices, we have seen rising interest rates. But the interest rates are not rising by and in and of themselves (as Immanuel Kant would say), they are rising because bond/treasury prices have fallen. Why? Because there is more supply than there is demand. Treasuries and other high-quality bonds are a risk-off position, and often move opposite to stocks, which are a risk-on position.

All of this makes perfect sense and indeed sets us up masterfully for a fantastic buying opportunity as those of us who know cycles repeat themselves wait in safety. There is always euphoria before a massive selloff, and we are either there or not far off.

The rest of 2021 is setting up to be a great year for stocks as more people get the vaccine and get back to work. Once the travel industry gets back up and running, I think there will be a gradual return and then a relentless wave of pent-up would-be travelers. I'm sure the global elites and aristocrats are enjoying this time to visit world sites without all the commotion and intrusion caused by the petty-bourgeois and bourgeoisie.

So, what could crash this market? Another strain of Covid which circumvents current vaccines? Another 9/11 style terrorist attack? A conflagration with China? An armed conflict between Iran and Israel? The breaking off of a massive ice sheet? The death of Paul McCartney? I just don't know. Every time the overture is a new surprise, but the finale sounds just the same.

In any event, we are your partner in whatever comes our way, and as you may have gleaned, our number one charge is to preserve your assets and protect your income. If that is not also your number one goal, let's talk.

Remember that we will soon be transitioning to Cetera from Voya. This should be totally seamless for you without any effort or expense on your part. We are very excited about the transition and the new resources that we will be able to offer.

My line is always open to you and your family. If you or they have questions or concerns, I urge you to contact me at directly at kevin@magellanplanning.com or 404-257-8811, though I will most likely have to call you back.

Our office expansion is finally complete, and we look forward to welcoming you back in for a cappuccino or latte or just plain coffee. As always, we appreciate having you as a client and a member of our family.

My very best to you and yours, Stay Safe!

J. Kevin Meaders, J.D. CFP, ChFC, CLU

[1] https://www.history.com/news/tulip-mania-financial-crash-holland
[1] https://www.cnbc.com/2021/04/13/nft-sales-top-2-billion-in-first-quarter-with-interest-from-newcomers.html
[1] https://www.cnbc.com/2021/02/28/230-million-dollars-spent-on-nba-top-shot.html
[1] https://nonfungible.com/project/superrare/SUPR/23154
[1] https://www.bbc.com/news/business-54261382

About J. Kevin Meaders

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Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC).

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- Tax planning through a relationship with our in-house CPA to manage tax obligations throughout the year and prepare a tax return that considers current tax laws. (www.magellantax.com)

Our relationship doesn't begin and end with the preparation of a plan and the appropriate documents. We establish close personal relationships with our clients and their families and maintain those relationships through regular 'check-ups', market commentaries and educational Lunch & Learns.

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