May 22, 2020

Dear client,

The Dow Jones Industrial Average is the index that we prefer to use. It is more appropriate for the type of stock portfolio that we have because it includes more of the cyclical and value stocks that we buy. The S&P 500, to me, is less of a representation for us, but most people are familiar with it.[1] Chart 1 below illustrates how far the S&P 500 has come from the March lows. The righthand side of the chart also shows that the U.S. stock market had given back part of the gains in the past week or so. To me, it looks like the market has entered a trading range.

Chart 1

Chart Source: Courtesy of Zacks

Why have the markets recovered from the bottom of the abyss? There has been an unprecedented amount of money pumped into the economy from the Federal Reserve and the U.S. Government. This has kept bankruptcies to a minimum so far, and has in effect, propped up the U.S. stock market.

The U.S. stock market is bifurcated with tech stocks being the primary catalyst for the upward drive in equity prices. The Nasdaq 100, as measured by the exchange-traded fund QQQ, is trading only a few percentage points below its all-time highs. Tech giants like Microsoft, Amazon, Facebook, Apple, Netflix, and Google are getting a kick upwards from this pandemic. However, the rest of the market is languishing; always a bad sign. History can certainly be the witness to that effect when the tech stocks precipitously declined in the dot-com crash of 2000. Chart 2 below shows that there is a growing spread between the Nasdaq 100 and the S&P 500. When there is a lack of market breadth, that usually spells trouble.

Chart 2

Chart 2: Courtesy of Zacks.

Are investors getting too optimistic about the U.S. stock market? Does there seem to be a gap between what is happening in the real world versus the investment world? With unemployment expected to be at 20% or more by the end of June, what are the implications for companies, states, cities, and counties? Will the economy recover overnight? After all, it took over 5 years for the 10% peak in unemployment from the 2008-2009 Great Financial Crisis (GFC) to recover back to pre-crisis levels. If the GFC is any indication of what may happen in the future, it will be years before we reach full employment again. If there is more unemployment, then there will be less demand. Less demand means less capital expenditures by companies, which means less employment. Therefore, we could expect spending on goods and services to decrease and this would squeeze corporate earnings and profit margins. We could also expect higher inflation 3 to 5 years down the road along with higher taxes to pay for all this stimulus.

Therefore, we are cautious, nibbling here and there, but not making major adjustments to the investment allocations at this juncture. We have bought some defensive stocks like Verizon, Keurig Dr Pepper, utilities, and Colgate-Palmolive. The valuation of the stock market, from my perspective, is slightly overvalued. Speculative fever is rising once again, sending companies without any earnings into the stratosphere while solid companies with a long history of making money are being given away. At some point in time, this situation has to be reconciled. For example, Moderna, the biotech company that is testing Phase 1 trials for a COVID-19 vaccine, shot up from $30 to $80 within the scope of six weeks. The company earns no money, started COVID-19 phase trials, and received government money. Why does any investor think that the U.S. Government will allow Moderna to sell their vaccine at an extraordinary price? Most likely the company will have to sell any vaccine they develop at cost plus. That is even if Moderna is successful at developing a vaccine. Approximately 80 other global companies are working on a vaccine at this moment. Gilead Sciences, with their drug Remdesivir, which is the now FDA approved for the front line drug if a person gets COVID-19, had its stock drop from $84 to $73 even though they are a money-making leader in HEP-C, HIV, and CART-T drug therapies. I believe this discrepancy is a bad sign for the U.S. stock market.

I am being cautious with my stock purchases. I am looking for a possible, but uncertain, pullback in the S&P 500 to the 2650 level. However, the timing is unclear.

We invite you to tune into our next conference call on **Wednesday, June 3, 2020 at 6:30 p.m.**, "What's Next?" To join the conference call, **please dial: 1 (669) 900-9128. Once prompted, enter the access code: 99001123525, then #, followed by another # button**. Please note there is ***not*** a participant ID.

Our weekly "Coffee with Dr. Steve" video is now available: Ma Bell Goes Away, Toothpaste Sundry Items. You can visit https://www.bfsg.com/coffee-with-dr-steve/ to view these videos each week. You can now follow me on Twitter @StevenYamshon for daily updates and you may view our BFSG Blog, where we post insightful articles on a weekly basis, at https://www.bfsg.com/blog/.

Wishing you a happy holiday weekend.

Best regards,

Steven Yamshon
Managing Principal

1. The S&P 500 is designed to be a leading indicator of US equities and is commonly used as a proxy for the U.S. stock market.