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BUBBLE, BUBBLE SIGNS OF TROUBLE

Bubbles occur when prices totally disconnect from underlying values whether it was tulip bulbs in the 17th century, dot-com stocks in the 1990s or housing prices in 2007-2009. Great fortunes can be made and quickly lost during these speculative periods. After losing such a fortune in a major financial crash in London, known as the South Sea Bubble of 1720, it is claimed Sir Isaac Newton said that he "could calculate the motions of heavenly bodies, but not the madness of the people."

Today, we see bubbles floating all around us from special purpose acquisition companies (SPACs) to frothy initial public offerings (IPO's). A SPAC is also known as a "blank check" company as it is a shell corporation designed to take companies public with the promoters pocketing hefty profits. The SPAC raises money from investors with the intent to merge with a business within two years or return the cash to shareholders.

Investors have to take a leap of faith as they bet on something without a valuation or even an actual business. Not surprisingly, SPACs have had "un-spac-tacular" results. For the 114 companies that went public via SPAC mergers in the past 10 years, investors lost 16% on average if they bought a merged company's common shares on the first day of trading and held it for a year. With today's red-hot SPAC market and detached valuations, the losses now will likely be much greater.

The more conventional IPO market is also sporting extreme valuations as Wall Street is busy wheeling and dealing in a zero-interest rate environment. A good example is the recent IPO of Bumble, a women-centric dating app, which saw its stock price nearly double from its initial public offering price. This unprofitable company boasts a $7.7 billion market capitalization. Bumble will likely tumble after all the excitement fades following its first date with investors.

Individual stock bubbles have been inflating and deflating due in part to zero-commission trading among retail investors. A prime example is GameStop's stock. GameStop's stock price quickly deflated over 90% from its bubblicious high of $483 per share only to partly reflate recently as games continue. The Reddit retail investors also moved into marijuana stocks creating smoke bubbles that have also popped. Tilray, an unprofitable cannabis stock, saw its stock price puffed up more than fivefold in a month to $63 per share only to quickly drop more than 60% in a matter of days.

Recently, Tesla announced a $1.5 billion investment in bitcoin, a volatile cryptocurrency. This prompts talk of a dubious double-bubble. Both Tesla and bitcoin have had parabolic price rises, which have become disconnected from any type of valuation measures. Don't be surprised to see a SpaceX-like crash landing in the future. Given Tesla's recent addition to the S&P 500 index and current $650 billion market valuation, the collateral damage may reverberate across index funds.

Speaking of Elon Musk and cryptocurrencies, we cannot leave out Dogecoin, a digital currency that started as a joke. It features the face of a Shiba Inu dog and not much else. Following tweets about Dogecoin from Elon Musk and rapper Snoop Dog, Dogecoin's price spiked to be "worth" more than $10 billion. However, Musk realized his tweet was no joke and later encouraged holders to sell all of their Dogecoins. Sadly, those left holding the bag will end up with nothing but a pile of doggy doo-doo!

Investors should be cautious when Mr. Market morphs into Mr. Bubble. Bubbles are all about price and nothing about valuation. The further a bubble inflates, the greater the price drops when the bubble eventually pops. Following the dot-com bubble, the NASDAQ crashed 77% and many dot-coms disappeared. While we don't know how long the bubbly will flow at the current party, we do know that it won't end well for those late to leave. As Warren Buffett has wisely warned, "Be fearful when others are greedy and greedy when others are fearful."

This issue:

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