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# Wall Street Fantasies, Main Street Realities

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I've been of the opinion for some time now that equity markets are overvalued and attractive opportunities are scarce. For the last couple of years, markets have fit a common pattern of overconfidence seen in the latter stages of a bull market, wherein a sense of complacency sets in along with a general belief that the markets will keep going up. Market cheerleaders will chime in with theories as to why high valuations are justified and sustainable, until some kind of catalyst proves otherwise.

So far, the Covid-19 situation has not proven to be such a catalyst. Despite the dramatic swoon in stock prices during the first quarter of the year, by my estimation markets did not become cheap - rather they went from a condition of significant overvaluation to one of more modest overvaluation. They have since moved back up into stretched valuations.

Given the effect of the pandemic situation on the economy, governments have been taking unprecedented stimulative policy actions. These steps are required to help support the economy - i.e. businesses and consumers. But steps designed to support Main Street have also set Wall Street ablaze in a speculative frenzy.

As an investor who takes a long term view and is willing to exploit short term negative sentiments, I always advocate a forward looking approach to valuation. The markets appear to be taking this to an extreme however, with very aggressive assumptions for the timing of a recovery. It defies logic, and that's because psychology is overriding fundamentals. Many market participants appear to be anticipating that other market participants will be encouraged to invest in the markets and will drive up prices, so therefore they should also get in lest they miss out.

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This is a great example of a common emotional factor that drives bull markets - fear of missing out ("FOMO"). Assumptions used to justify these moves are too optimistic, and this dynamic introduces a lot of additional risk into the equity markets.

This speculative fervor is particularly focused on certain technology stocks, with the rationale that those businesses will do better during the virus-induced recession. We did have enough comfort to take a position in Alphabet (Google's parent company) during market lows last quarter, but I cannot see how the pricing of the other large tech stocks is justified. Given current market prices, the risk/reward profiles of many of these popular names are very unattractive based on fundamentals.

I continue to keep the equity portfolios very defensive, which includes a cash allocation of close to 30% in the Total Equity Portfolio (I had brought the cash down to under 25% during the first quarter by way of some opportunistic buying,
but it has crept up again in the second quarter due to some opportunistic selling).

During the market drop in the first quarter, our holdings held up better than the market on average. For the most part these value names were not swept up in the speculative frenzy of the second quarter, but that's not unexpected given the type of psychology that was driving markets in the last few months. During bull markets, giving up some short term gains is the price of protecting capital. My goal in equity investing is to provide meaningful long term gains (as I have), and it's much easier to do that if I don't lose your money in the first place.

At Your Service,

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