Strategy Thoughts

December 2017

A boom in FOMO is yet another warning sign?

Introduction

I have never seen FOMO, or fear of missing out, so great as is now being manifested in Bitcoin. I have received more questions on this so called ‘crypto currency’ over the last month than anything else, ever, in my thirty six years of following investment markets. It is truly a wonder to behold and the mania driving it has now outstripped anything I have witnessed in my lifetime, or that I have read about historically. Someone I deeply respected during the tech boom of the nineties commented that attempting to jump off a run-away train could be harmful to your health (and wealth). This was certainly true, but, in the end, it was not as harmful to either when that run-away train finally was derailed. The same will be true for Bitcoin.

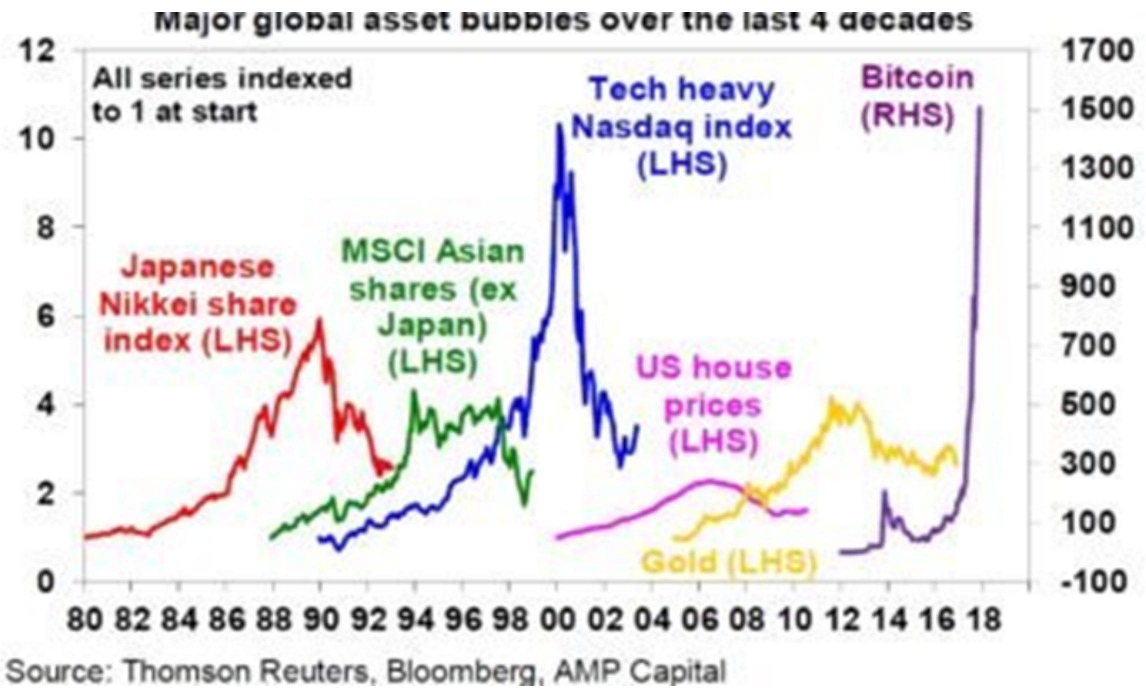
Apart from continued ‘extrapolation’ in prices little has changed over the last month, however, that price extrapolation has resulted in a further stretching in expectations. Dangerously, this leaves little room for surprise and great scope for disappointment.

FOMO is booming

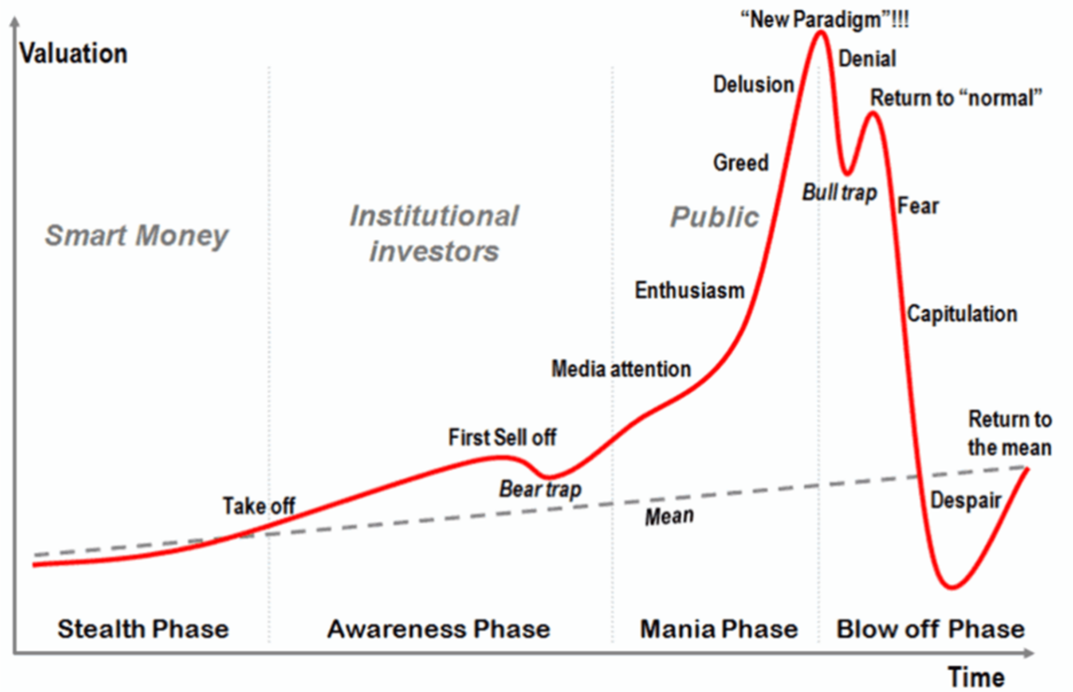
A year and a half ago I first wrote about the dangers of ‘There is no alternative’ or TINA, and ‘Fear of missing out’ or FOMO. Neither of which are prudent long term investment strategies. Back then I referred to an article that had appeared in Barron’s magazine;

> **Tina Fomo**
>
> Last week Barron’s magazine’s ‘Striking price’ column ran the following headline:
>
> **Tina Fomo: The Market’s Femme Fatale**
>
> The title was a clever amalgamation of two acronyms; There Is No Alternative and Fear Of Missing Out, that have become the primary justifications for investors remaining fully invested in, or even plunging now for the first time into, a bull market that is undoubtedly ageing and showing real signs of deterioration. The mere fact that these two acronyms are being used so extensively is in and of itself another sign of the deteriorating fundamentals supporting the US market. Whenever a rationalization for why any market should continue doing what it is doing becomes widely accepted it is highly likely that something will happen to shatter the broadly held comfort that was provided by the seemingly sensible and obvious rationalization. The broad and extensive use of TINA and FOMO, particularly now they are combined, certainly qualifies as such a widely accepted rationalization.

Obviously, with the benefit of hindsight, my cautionary interpretation of ‘Tina Fomo’ was wrong, as since then markets, despite becoming even more aged and showing further signs of deterioration, have continued to rise. But now, with the incredible and breath-taking ascent of Bitcoin we are probably witnessing the greatest example of FOMO ever. That Bitcoin is in a parabolic bubble is hard to argue. The chart below compares the price action of Bitcoin to the other great manias of the past few decades;



Exactly where Bitcoin might be in its own record breaking bubble, and how much further it has to rise, is obviously hard to say, however, the following schematic provides some perspective on this important question;



One thing is certain is that the public are very much involved. Anecdotally, while playing golf yesterday I heard from a friend, who is a butcher at a freezing works, that one of his co workers had recently resigned to become a full time Bitcoin trader! He may not yet have had the success of Dee Heath, but they do both illustrate the extent to which the public have got involved in this still relatively new market. Heath is a successful Sydney pole dancing instructor whose story Zero hedge publicised at the beginning of December;

Pole dancing instructor Dee Heath built a successful fitness business in western Sydney teaching “stripper fitness” classes that seem to be in vogue among millennial women.

But recently, Heath has discovered a new passion: **Investing in digital currencies.**

Heath has spent $5,800 on Bitcoin since July and has more than tripled her investment.

"Look, I love pole dancing* but lately my passion has definitely been Bitcoin," she told SBS News.*

Heath is spending less time on the pole and more time advising would-be bitcoin investors about navigating the world of digital currencies, even starting a website to explain the digital currency to novices.

"It comes with any investing, it's volatile at times, especially cryptocurrencies," *she said.*

"The good thing is when it goes down, you can buy some more, and ***you know it's going to go up at some point."***

Similar stories have been heard near the peak of all investment manias throughout history, and the more the stories are reported the stronger the FOMO grows on the part of those not yet in.

That FOMO may be the driving force behind Bitcoin was also recently highlighted in the Huffington Post under the headline;

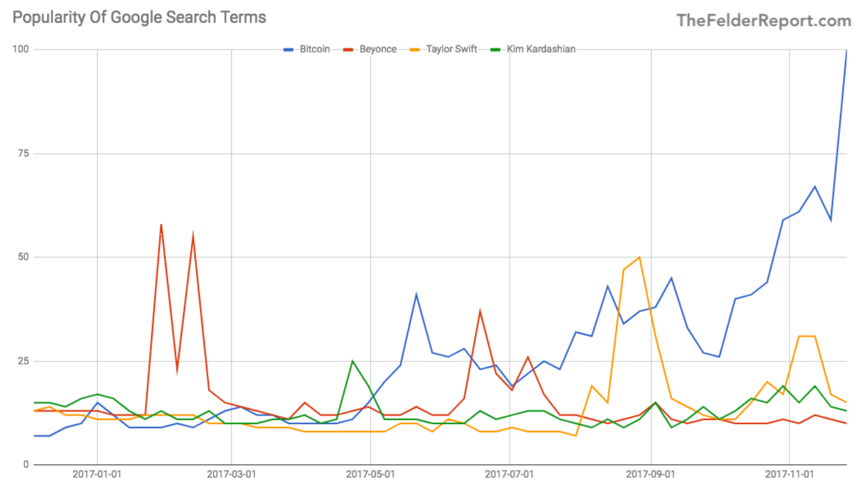
How the Cryptocurrency IOTA Fell Victim to the FOMO-FUD Cycle

> With the Bitcoin revolution in full force, the cryptocurrency market is also booming. Actually, ‘booming’ might be an understatement—exploding like a supernova is more like it. The crypto-economy is comprised of over a thousand different digital currencies, many of which are essentially offered as a way to buy what amounts to shares in a company that uses blockchain technology. Every day dozens of coins see price gains at rates that are extremely rare in the traditional stock market. Each month there are at least two or three that really surge in value and capture the attention of the online crypto-community at large. When these surges happen, word spreads quickly across the global infosphere, through social media platforms like Reddit, Twitter, and Facebook, creating a tidal wave of people rushing in to buy out of fear of missing out—or ‘FOMO’ in slang. Consequently, many of those investors become evangelists for their chosen coin, since one’s financial success then becomes dependent on that coin’s continued growth.

The full article can be found at; https://www.huffingtonpost.com/entry/how-the-cryptocurrency-iota-fell-victim-to-the-fomo_us_5a32fdb5e4b0e7f1200cf982.

It is well worth reading as it illustrates just how quickly FOMO can reverse into FUD when the hype finally hits a wall of Fear, Uncertainty and Doubt.

That Bitcoin is being widely followed is obvious, but the following chart really brings it home. It shows the popularity of google search terms and for the last three months, a period that has seen the price of Bitcoin rise almost six fold in price, searches for Bitcoin have outstripped those for Beyoncé, Taylor Swift and Kim Kardashian combined!



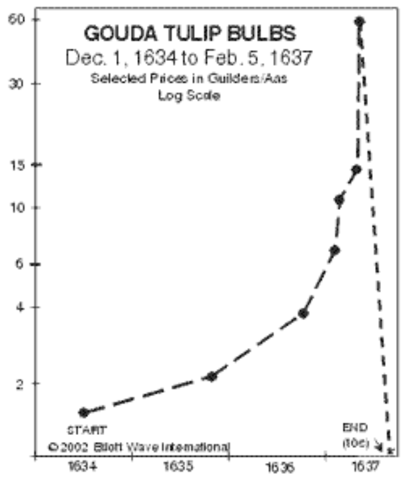
Perhaps the most appropriate description I have read recently for Bitcoin appeared in an article in the South China Morning Post;

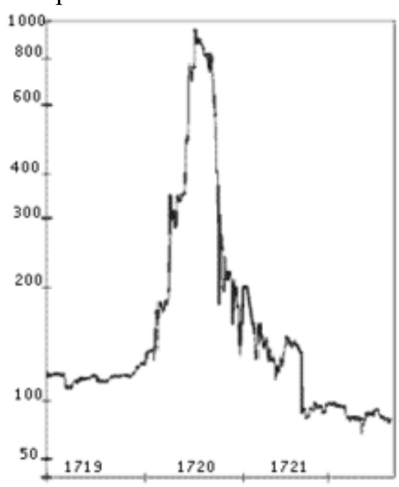
> **Why bitcoin could trigger the next global financial crash – crypto currencies like bitcoin are speculative derivatives with nothing to back them up, and that poses a danger to the financial system**

The article concluded;

> Bitcoin is a derivative – an artificial creation based on a series of promises that one person gives to another. It is seen as an attribute that nobody knows who gives the promise; yet dangerously, everybody assumes it is there. None of these promises implies payments, as does a share. The only value is that another buyer/investor/sucker will pay more today to take it off your hands. **Bitcoin is the Kardashian of the industry**; it is going up because it is going up – this is the Last Fool investment.

All investment manias have eventually fallen back to their pre parabolic price rise levels. This was true for South Sea Company 300 years ago (right) and tulip bulbs almost 400 years ago (left). More recently similar eighty to ninety percent collapses have been seen in both the Japanese stock market and the NASDAQ after their respective bubbles burst

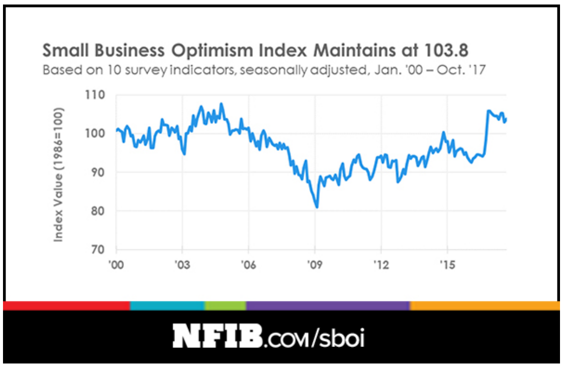




Where is the room for surprise?

It is surprises and disappointments that cause markets to move, and perhaps more importantly, precipitate important inflection points. The trough in March 2009 did not come about because the background news suddenly became more positive, far from it the news was miserable. At the time economists were forecasting that things, whilst already bad, were only set to get worse, and they did continue to deteriorate, just not as badly as the majority by then feared. The market began to rocket higher not because things were good, but because they were not quite as bad as expected, and this qualified as a positive surprise. The reverse was true eighteen months earlier in late 2007, the news did not suddenly deteriorate, it just failed to exceed or even match the by then extravagant expectations that were by then so prevalent. Unfortunately, there are echoes of those extravagant expectations once again. This is understandable, particularly as markets have been on a close to record breaking bull move, but it is important that investors maintain a disciplined approach that will allow them to avoid being swept up in the current enthusiasm and appetite for 'TINA' or 'FOMO'.

The following is a selection of headlines and charts that illustrate just how stretched expectations have become;

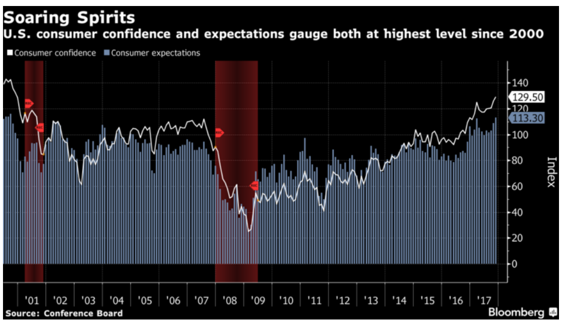


Business Roundtable CEO Economic Outlook Index Reaches Highest Level in Nearly Six Years

CEO economic outlook remains optimistic in fourth quarter

11:18 AM ET Tue, 5 Dec 2017

Confidence Reflects Focus on Pro-Growth Economic Policies



2018 Global Economic Outlook: As good as it gets Goldman Sachs Nov 2017

After exceeding expectations in 2017, the global economy is projected to carry forward its current momentum to generate a 3 percent growth rate in 2018. The conference board Nov 2017

The world economy is enjoying a synchronised upswing, in which most regions are generating good growth despite political upsets in some parts of the world. As a result, we have upgraded our global growth forecast for 2018 to 3.3% from a previous estimate of 3.0%. This marks a modest acceleration from 2017, which is also upgraded to 3.2% from 3%. If correct, this would make 2018 the strongest year for global growth since 2011. **Schroders Dec 2017**

By the end of November, with the US market recording yet more new highs, expectations for the future got headier and headier!

Dow logs longest streak of monthly gains in 22 years as it closes above 24,000

Current expectations, underestimation, or just wrong?

All this enthusiasm raises the very important question for investors, can there still be further positive surprises, is the current bout of estimate and target raising still underestimating, or are current expectations so stretched that the estimates and targets are just wrong. Not in magnitude but direction.

Each year Barron's magazine surveys leading stock market strategists to give a forecast for the year ahead. I have referred to this survey many times in the past primarily to highlight the futility of buying into supposed mainstream 'analysis' of what the market may have in store over the next twelve months.

Back in 2010 I produced a thorough review of the Barron's forecasts through the previous two cyclical bull and bear markets. What this review showed was that during bull markets the strategists are very good at extrapolating the good times further into the future, only unfortunately they consistently underestimate the strength of the bull market. This is certainly what happened over the past twelve months. The consensus forecast at this time last year was for a modest continuation of the bull market with the S&P500 rising to 2380, or about 6%. The market has actually delivered almost three time that gain so far in 2017, currently sitting up 17.4% for the year. Underestimation is not such a problem for investors. However, totally missing a reversal into a cyclical bear market is.

This is the other error that forecasters have consistently made, prior to and during the two very large cyclical bear markets that have been suffered over the last seventeen years the consensus forecast has **never** been for a down year and only one forecaster has ever been bold enough to predict such a thing. Ahead of the Global Financial Crisis, that began in late 2007, not one forecaster was forecasting a top, and even after it had begun in December 2008 not one forecaster was forecasting a down year, in fact the consensus forecast was for the US market to rise 12%. Unfortunately, 2008 suffered a 38% decline.

Going back further, to the aftermath of the tech wreck in the early 2000s the consensus forecast once again failed to see that 2001 might be a down year. The market actually continued its fall of the last nine months of 2000 and ultimately recorded a decline of 23%. This was the one occasion when one forecaster actually predicted a down year, perhaps not surprisingly they underestimated the magnitude of the decline.

This year all the strategist surveyed are forecasting a continuation of the now very aged bull market, and their average forecast is for a 7% rise from current levels. This then raises the two possibilities that history suggest are likely given this forecast; it is either, like so many other years this century so far, a massive underestimation, or, it is just wrong and will miss what may well turn out to be an even bigger inflection point than the previous two. Readers will not be surprised to learn that I continue to believe that a positive surprise, one that would produce another double digit return in this bull market, is substantially less likely than a disappointment that could severely rattle the sanguine and bullish consensus. A consensus that was justified by one of the strategists as being 'Rational Exuberance'. Perhaps this is his way of saying that unlike the late 1990s when, with the benefit of hindsight it is clear that 'irrational exuberance' reigned, 'it is different this time'!

The Barron's article concluded with;

> But investors aren't worried yet. So long as earnings are rising, rates are low, volatility is subdued, and every stock selloff is met with more buying, as happened again this past week, the bull will still rule over Wall Street.

Some of this is obviously true, it is clear that investors are not worried, unfortunately, when the majority see nothing to worry about that is just the time that one should be worried, it highlights just how stretched expectations have become. As Warren Buffet famously put it;

> Be greedy when others are fearful, and fearful when others are greedy.

Now, as the Barron's conclusion points out, others are far from fearful, now is not the time to be greedy. It should also be remembered that it is not just the level or direction of earnings, interest rates and volatility that determine the direction of the stock market. Earnings may well continue to rise, but if they start to fall short of what are now stretched expectations, particularly on the back of hoped for tax changes, then the risk of disappointment grows. The same can be said of interest rates, they may remain historically low, but if they are not as low as the majority now hope, then the risk of disappointment looms.

Conclusions

Neither FOMO nor TINA are sound rationalisations for investing in anything, and in the current environment the existence of such extreme FOMO, in the form of Bitcoin, highlights just how stretched expectations, and so prices, have become. The risk of disappointment across asset classes has only continued to grow. Preservation of capital continues to be the single most important objective for all investors as opportunities will present themselves eventually. However, they are unlikely to be promoted by pole dancers or freezing workers and they will not come along after record breaking bull markets have already been enjoyed.

Kevin Armstrong

18th December 2017