MARATHON INVESTMENTS Newsletter, January 24, 2021

The S&P 500 closed at 3,841.47 on Friday, up 1.9% for the week and up 2.3% year-to-date.
After taking a pause in the last few months, large technology companies traded upwards on earnings optimism, triggered by strong subscriber growth at Netflix. In certain areas of the market, risk levels are increasing dramatically with traders ignoring fundamentals, like valuation and earnings power. Bubbles are appearing in certain areas and margin debt is at an all time high.

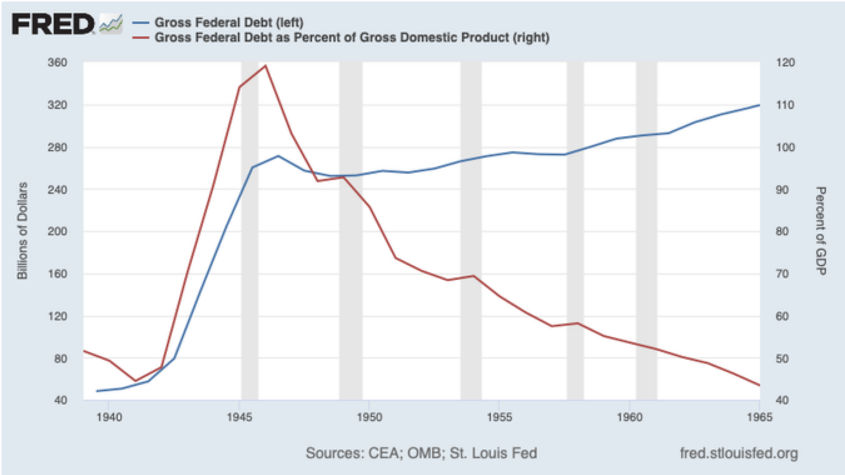
The S&P 500 index's forward price/earnings ratio is approximately 25, higher than where it was pre-pandemic and much higher than its historical average of 15x. A lot of good news, like vaccines and new government stimulus, is already discounted in stock market prices. Investors who stick to reliable companies backed by solid fundamentals will grow their purchasing power over time, but speculators who throw their money in the wind will lose it.

Proponents of the Modern Money Theory (MMT), or what I call Magic Money Tree, argue that government deficits don't matter and that we can easily pile on more. This idea that we can enjoy virtually unlimited government spending when interest rates are so low ignores the risk that all that debt may need to be refinanced at a higher rate down the road. By kicking the can down the road, our children, and their children, will have fewer and fewer life choices and chances, thanks to our extravagant spending. It is their future that hangs in the balance.

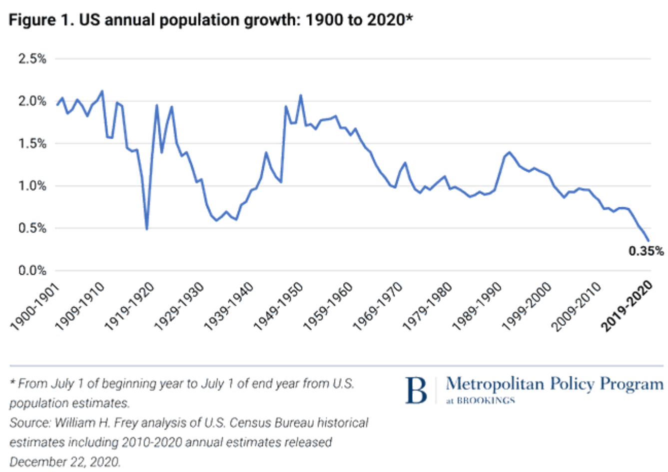
Seth Klarman, CEO of value manager the Baupost Group, compares investors to 'frogs in boiling water.' The Fed has broken the market. Central bank policies and government stimulus have convinced investors that risk to capital 'has simply vanished.' As with frogs in water that is slowly being heated to a boil, investors are being conditioned not to recognize the danger. Low interest rates have made projected cash flows more valuable, he said, a point many investors have unwisely used to justify valuations on companies that sit far above historic norms.
The Fed's policies exacerbated economic inequality, referring to a K- shaped recovery that has seen "the fortunes of those already at the top bounding swiftly upward, while those at the bottom remain on a downslope without end."
The Fed's drastic measures have helped to boost economic activity and rescue ailing businesses, Seth Klarman said. "But they have also kindled two dangerous ideas: that fiscal deficits don't matter, and that no matter how much debt is outstanding, we can effortlessly, safely, and reliably pile on more."

Do government deficits matter? That's a debate that goes back as far as Thomas Jefferson.
The new President has proposed a whopping $1.9 trillion rescue package, and that's just the beginning. With education, infrastructure and climate change proposals all on their way, spending only will swell from there. Joe Biden has said that taxes on the wealthy will pay for some of this.
Today, interest rates are effectively zero—and financial markets seem to believe they will stay that way for decades. Government debt has passed the pull-your-hair-out benchmark of 100% of GDP, but low rates have kept debt service comfortably below 2% of GDP.
Last week, former Treasury Secretary Lawrence Summers said the government, if it wanted to, could lock in low interest rates for the foreseeable future with 30-year debt. There is even talk of issuing 50-year debt, which might not be a bad idea. Summers believes smart government investments pay for themselves. Incoming Treasury Secretary Janet Yellen seems to agree, she said now is the time to 'act big' to shore up the economy.

Paul Krugman, economics professor and Nobel Prize recipient, tells people why we won't have to pay debt down. Here is what happened after WWII: 'because of inflation and growth, debt as a share of GDP declined steadily.' – see graph.
Indeed, debt as a % of GDP declined from 120% to 40% between 1945 and 1965 (red line), but in those days, we had high employment and population growth, as well as high labor productivity, which is not the case today. Inflation will always help debtors and punish savers.

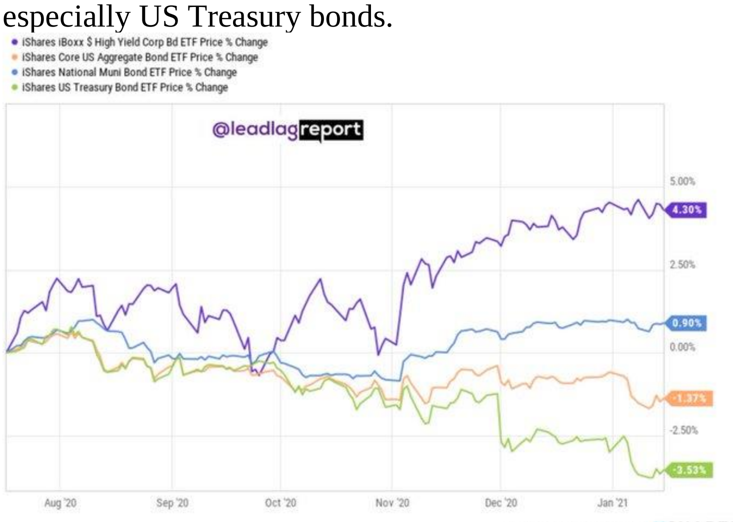


Slowing population growth in the U.S.: 1900-2020



Margin debt is at an all time high. This is a double-edged sword. Stock market leverage is an accelerator when stocks rise and investors borrow money to chase after more stocks. The inevitable bad news is that stock market leverage is also an accelerator on the way down, when stock prices are falling and brokers issue margin calls to their clients to forcefully sell stocks to remain compliant.

High risk appetite has caused the junk bond ETF to outperform other major bond classes over the past 6 months, especially US Treasury bonds.

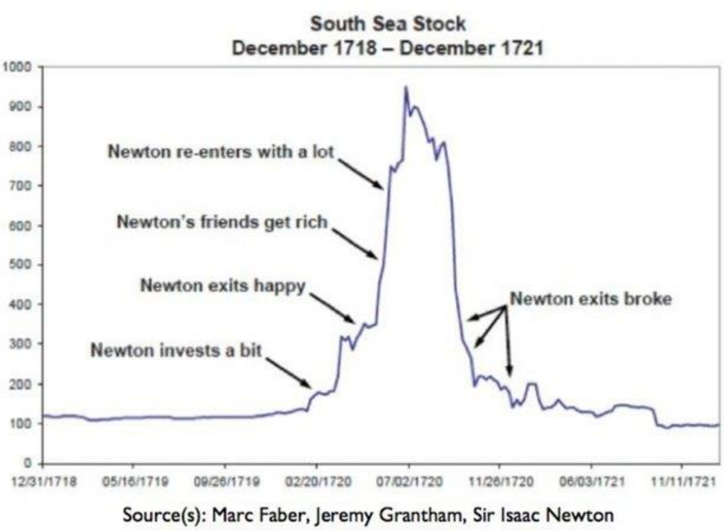


The gamification of trading, by Jay Wood, describing the current 'growth at any price' mood in the stock market:

> "Trading is essentially free for all and now it has become an all-out free-for-all. Yet, we needed a catalyst to really get this party started. What could it be? How about a global pandemic that crashes the market, shuts down sports and quarantines everyone to their homes? In fact, let's make it better - give everyone a "stimulus" check.
>
> Since Covid-19 we've seen the advent of Davey Day Trader, Tik-Tok Investors and pockets of individual stocks routinely moving 10-20% IN A DAY. For a long-term investor, a 10% gain in a year is considered above average. In 2020/21, if you can't find the 10% winner each day you feel as if you are out of touch.
>
> The rotation from sector to sector and stock to stock is like watching a tennis match trying to keep our eye on the ball.
>
> First, we hit the FAANG stocks.
>
> Now focus on the work from home stories.
>
> OK, go back to cruise ships and airlines.
>
> Wait, we need to speculate on vaccine makers. Good point, but don't forget all the IPO's.
>
> IPO's are great, but can we spice it up a bit? Heck yeah - have you seen these SPAC's?
>
> Nice! What else you got? Bitcoin! Please stop - this is about stocks.
>
> How about what's old is new again? Grab me some GM, Ford, GE and US Steel.
>
> What's been asleep for a long time? Glad you asked. Let me reintroduce you to the financials and oil sector. Sweet!
>
> What about the election results? Let's chase alternative energy, electric vehicles and pot stocks.
>
> What if there's chaos around the election? No problem - gun stocks.
>
> There's always an opportunity and something new."

"Although it's easy to forget sometimes, a share is not a lottery ticket… it's part ownership of a business." – Peter Lynch, former manager of the Magellan Fund at Fidelity Investments.

A lesson from the past: Back in 1720, Sir Isaac Newton owned shares in the South Sea company, the hottest stock in England. Sensing that the market was getting out of hand, the great physicist muttered that he <u>'could calculate the motions of the heavenly bodies, but not the madness of people.'</u> Newton dumped his South Sea shares and pocketed a nice profit. But months later, swept up in the wild enthusiasm of the market, Newton jumped back in at a much higher price and amount and then lost a fortune. For the rest of his life, he forbade anyone to speak the words 'South Sea' in his presence.



Building wealth in the stock market requires patience and discipline. Marathon Investments selects quality companies with strong balance sheets which generate above average cash flows and dividends. The company is expanding and interested in new clients and referrals. Portfolios are personalized, there are no investment minimums and costs are low to ensure that you benefit the most in the ***long run.***

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Thank you for your interest, Hans

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Reaching financial success is a marathon, not a sprint. Slow and steady wins the race.