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# "Hold My Beer"

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We've all seen the videos or might even have had the pleasure (or unfortunate opportunity) in person to witness a moment when someone attempts a daring or reckless act. The participant in said act overflows with confidence. Someone else may have successfully executed the task in front of them, perhaps even making it appear simple. The participant, at this point, likely shows contempt for the situation, dismissing any and all risks. Most outcomes, typically inebriated efforts, end in failure. On the rare occasion, against the deepest odds, one succeeds. The bystanders, most all of whom expected the worst are left shocked and mesmerized as if they've just witnessed a scene out of The Matrix.

In my last whitepaper "Don't", I pointed out the perils of indexing and the growing disregard many in the investment community had towards diversification. In their minds, after all, it was impeding their results! Risks? Meh. "Damn the torpedoes. Full speed ahead!" This mindset isn't new. Human beings have been wired with the same emotions since the dawn of time.

Even investor Stanley Druckenmiller, who famously worked alongside George Soros and profited over $1 billion by wagering against the British pound in 1992, has fallen victim to FOMO. Mr. Drunkenmiller shares the following story in a 2015[1] interview about getting caught up in the peak of the tech bubble against his better judgement:

> *"Well, I made a lot of mistakes, but I made one real doozy. So, this is kind of a funny story, at least it is 15 years later because the pain has subsided a little. But in 1999 after Yahoo and America Online had already gone up like tenfold, I got the bright idea at Soros to short internet stocks. And I put 200 million in them in about February and by mid-March the 200 million short I had lost $600 million, gotten completely beat up and was down like 15 percent on the year. And I was very proud of the fact that I never had a down year, and I thought well, I'm finished.*
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> *So, the next thing that happens is I can't remember whether I went to Silicon Valley or I talked to some 22-year-old with Asperger's. But whoever it was, they convinced me about this new tech boom that was going to take place. So, I went and hired a couple of gun slingers because we only knew about IBM and Hewlett-Packard. I needed Ventas and Verisign. […] So, we hired this guy and we end [positive] on the year — we had been down 15 and we ended up like 35 percent on the year. But the Nasdaq had gone up 400 percent.*
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> *So, I'll never forget it. January of 2000, I go into Soros's office and I say I'm selling all the tech stocks, selling everything. This is crazy. [Some internet company] at 104 times earnings. This is nuts. Just kind of as I explained earlier, we're going to step aside, wait for the next fat pitch. I didn't fire the two gun slingers. They didn't have enough money to really hurt the fund, but they started making 3 percent a day and I'm [sitting in cash]. It is driving me nuts. I mean their little account is like up 50 percent on the year. I think Quantum was up seven. It's just sitting there.*

*So, like around March I could feel it coming. I just – I had to play. I couldn't help myself. And three times during the same week [I think to myself] – don't do it. Don't do it. Anyway, [I couldn't stop myself]. I think I missed the top by an hour. I bought $6 billion worth of tech stocks, and in six weeks […], I had lost $3 billion in that one play. You asked me what I learned. I didn't learn anything. I already knew that I wasn't supposed to do that. I was just an emotional basket case and couldn't help myself. So, maybe I learned not to do it again. But I already knew that."*

FOMO, or the fear of missing out, is a real thing, especially in investing and it takes **ardent discipline to avoid**. Investors can get lulled into a false sense of security, or as in Druckenmiller's example, jealous mindsets and challenged egos lead them to do something they know they shouldn't do. Overwhelmed by emotion, they regrettably capitulate. Today, too many FOMO induced investors are lined up like lemmings chasing returns in mega-cap technology heavy indexes like the Nasdaq and the S&P 500.

Last week, we received a CPI report that registered the first decline in month over month inflation since the COVID pandemic. Good news, right? Well, the S&P 500 sold off by 0.88% and the Nasdaq closed lower by over 2% on the trading session. A cursory glance at those indexes might convince you that the market responded to that CPI report negatively; however, the equally weighted S&P 500 index **increased** by more than 1% on the day, while the Small Cap Russell 2000 index rose by over 3.5%! It is incredibly rare that the Russell 2000 outperforms the Nasdaq by over 5% in a single trading session. A "hold my beer" moment for the little guys?






This statistically significant outperformance from small caps is meaningful for two reasons:

1. It's rare. It's only occurred on 10 trading days since the year 2000 and many of the prior instances have taken place at material turning points in the market. For example, half of these instances occurred as the tech bubble was beginning to unwind in 2000. Small cap stocks had underperformed the Nasdaq materially in the late 90's, as had everything else. The table below shows how the Nasdaq performed following those first 5 examples where it underperformed the small cap index by 5% or more in a single day.

**Nasdaq 100 Fwd Returns When the Russell 2000 (IWM) - Nasdaq 100 (QQQ) 1-Day Rate Of Change Spread > 5%**

| Signal Date | Nasdaq 100 Forward Returns | | | | | |
|---|---|---|---|---|---|---|
| | 5 Days | 10 Days | 21 Days | 63 Days | 126 Days | 252 Days |
| 21 September 2000 | 4.3% | -2.1% | -1.6% | -36.5% | -51.2% | -67.5% |
| 8 November 2000 | 2.2% | -12.0% | -10.2% | -25.5% | -39.8% | -47.6% |
| 19 December 2000 | 4.1% | 3.7% | 12.3% | -27.6% | -26.7% | -32.9% |
| 9 March 2001 | -8.9% | -5.1% | -17.8% | 5.0% | -25.3% | -17.5% |
| 28 March 2001 | -14.2% | 3.3% | 13.7% | 10.3% | -27.4% | -12.4% |

2. The level or location at which it's happening. Refer back to the chart above and notice that small cap stocks are actually cheaper today relative to the technology heavy Nasdaq than they were at the peak of the internet bubble! Often times, the market unwinds extremes in pronounced fashions, just as it did in 2000. Thus, it does not come as a surprise to me that this rare and violent outperformance from Small Caps is happening at this juncture. While they may not occur to the same magnitude, I would imagine the likelihood that we see more of these events within the next 12 months is higher than usual.

Successful investing over time requires discipline. Sometimes that discipline temporarily gives you a sense of FOMO, but it over time keeps you having a sense of regret. Our mission at Reveille is to help our clients achieve their financial goals with minimal risk. You won't catch us, or your investments, peering over the proverbial ledge to get an awe-inspiring view, particularly when it's crowded. That's how accidents happen. Besides, there are better options available.

**Sources**

1. Bear Traps Report - https://www.thebeartrapsreport.com/blog/2020/08/04/druckenmillers-lost-tree-speech-more-important-now-than-ever/
2. Chart on pg. 2 – stockcharts.com
3. Table on pg. 3 – All Star Charts

**Disclosures**

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The NASDAQ-100 (^NDX) is a stock market index made up of 103 equity securities issued by 100 of the largest non-financial companies listed on the NASDAQ. It is a modified capitalization-weighted index. ... It is based on exchange, and it is not an index of U.S.-based companies.

Every type of investment, including mutual funds, involves risk. Risk refers to the possibility that you will lose money (both principal and any earnings) or fail to make money on an investment. Changing market conditions can create fluctuations in the value of a mutual fund investment. In addition, there are fees and expenses associated with investing in mutual funds that do not usually occur when purchasing individual securities directly.

Inclusion of these indexes is for illustrative purposes only.

Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns.

This is not a recommendation to purchase or sell the stocks of the companies pictured/mentioned.

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