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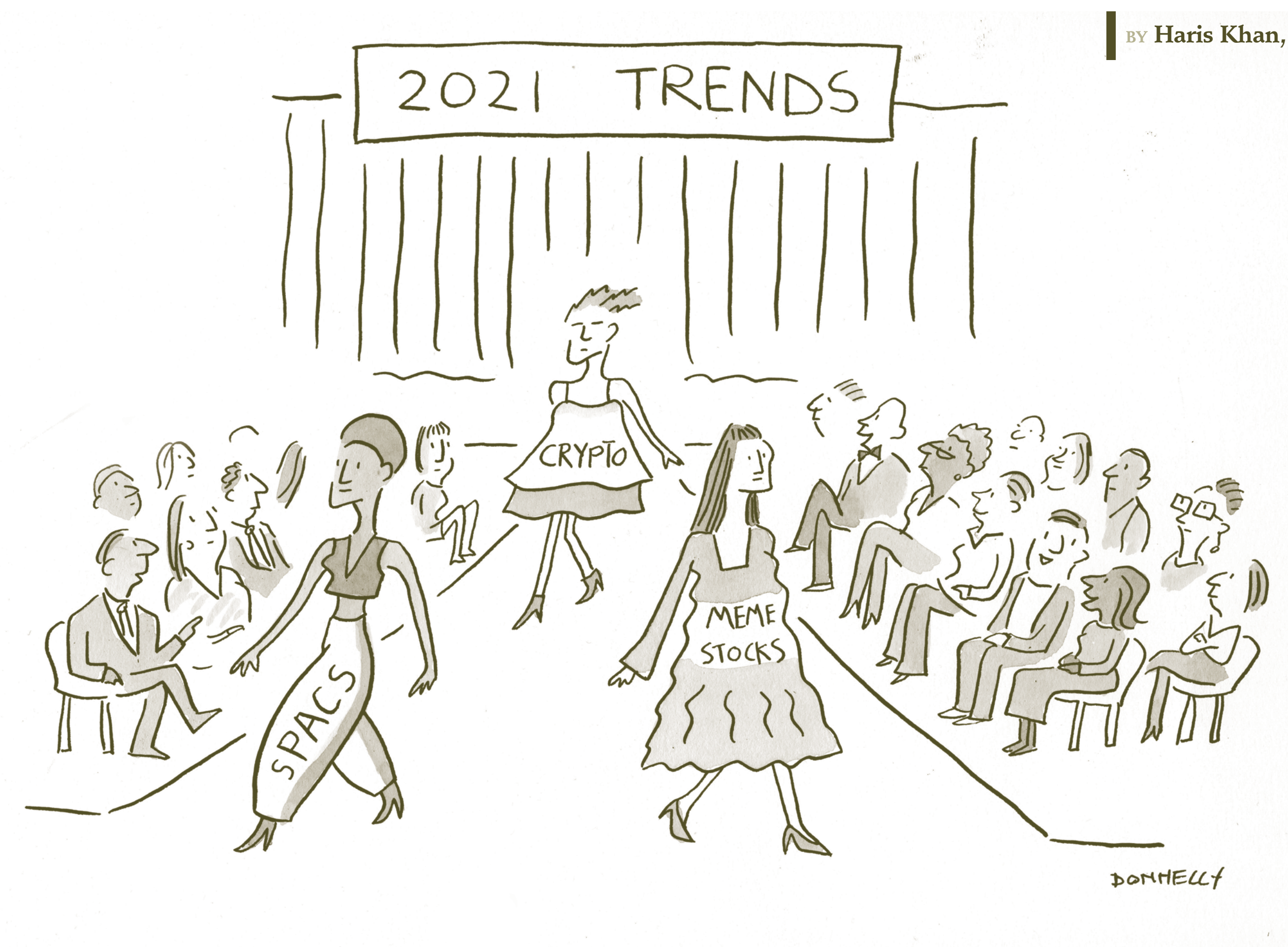

INVESTING TRENDS

MEME STOCKS, DIGITAL ASSETS, AND SPACS

In an unparalleled year of disruption and shutdowns, distinct investing trends emerged amid the global pandemic. Three of note are the rise of retail investing and meme stocks, digital assets' entrance into the mainstream, and the resurgence of SPACs. Fads in investing come and go, from the Nifty Fifty in the 1960s and 1970s to the dotcom stocks of the late 1990s. So, what brought about the trends of today? The backdrop was one of unprecedented stimulus, changes in technology and market accessibility, and behavioral shifts during the pandemic. As we delve into these investing trends, we can see the marked influence of that backdrop on each. »

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GameStop's Stock Increased 1,625% in January

The pandemic sparked explosive popularity of finance-related Reddit forums and Twitter threads, as many young people were out of work, underworked, or just stuck at home. Many such investors opened Robinhood accounts, followed Reddit pages, and invested based on momentum and camaraderie rather than fundamentals.[1] This group included swaths of investors who opened brokerage accounts for the express purpose of making bets on heavily shorted names such as GameStop.

Increasing income disparity and frustration over it provided motivation and set the tone for this frenzied buying activity, which was supported by the longer-term technology trends that enable broader availability of information and a greater ability for retail traders to organize. In many cases, stimulus checks provided the capital to put pent-up sentiments into action.

Taking a step back, stock fundamentals drive long-term valuations, while supply and demand drive short-term price movement. In the engineering world, "noise" is a form of interference that can modify or hide a meaningful signal. However, the noise around GameStop's 1,625% price increase in January 2021 alone had nothing to do with fundamentals. In fact, what started as a Reddit-fueled movement led to a Congressional hearing on the intersection of short sellers, social media, and retail investors.[2] Social media is not a new phenomenon, but the finance world was shaken by the extent of the coordinated mobilization that it facilitated. Investment professionals who had never heard of Reddit before certainly have now.

Fiscal and monetary stimulus, behavioral impacts of the pandemic, and new ways to organize created somewhat of a perfect storm. The prominence of meme stocks going forward remains to be seen, but we have strong conviction that, over longer periods of time, company fundamentals will outweigh short-term noise when it comes to setting stock prices.

The Digital Asset Market Hit $2 Trillion

Digital assets[3] are assets that exist entirely within computer networks and have no physical form. They are underpinned by a technology called blockchain, which can be thought of as a peer-to-peer system (as opposed to relying on a central authority acting as an intermediary) using cryptography (solving complicated mathematical puzzles) to validate transactions. The digital asset phenomenon was kicked off by a now-famous white paper written by a mysterious person or group of people named Satoshi Nakamoto called "Bitcoin: A Peer-to-Peer Electronic Cash System." Bitcoin has now grown to a trillion-dollar market cap, and hundreds of other digital assets have been created since.

While the technology is complicated and the whole phenomenon can seem overwhelming, a simple way to think of it is as the "internet of value." Since the internet was born in the 1970s, new protocols have been developed to transmit different things: FTP for files, SMTP for email, etc. While we have been able to shop online and send money to friends over the internet for decades, the internet has actually just acted as an interface—the actual transfer of value happens behind the scenes in the legacy financial system. Blockchain technology allows value to be transferred directly through a new computer network, with the promise of moving much faster and more cost-efficiently than it ever has before.

Different digital assets play different roles in this burgeoning system. Bitcoin, the original digital asset, is the market leader and has built a significant moat due to network effects, among other things. While even its use case is not entirely proven, it does have a firm grip as the main store of value, a "digital gold." Other digital assets are competing for other real-world use cases, such as lending or cross-border payments.

Though digital assets have been around for more than a decade, they moved firmly into the mainstream over the past year. The pandemic highlighted and exacerbated the financial disparity that exists in the world today, and the digital asset movement has an aspect of libertarianism, even anarchism, at its extreme. In addition, the extreme monetary and fiscal stimulus the government deployed during the pandemic induced fears of future inflation, and one promise of Bitcoin is as a store of value. »

Bitcoin has a known and finite supply built into its code, as opposed to U.S. dollars that can be printed in perpetuity. These factors, along with individuals sitting at home with more time on their hands to dabble in it, led to the huge rise in interest in digital assets we see today.

While the technology is promising and there is a large ecosystem of very smart people backing the efforts, we believe much of the digital asset market is still in early stages. Every day, as Bitcoin grows, the network effect creates a stronger and stronger case for its use as a "digital gold," if not for other purposes as well. There are indeed many parts of the legacy financial system that are ripe for technological disruption, but these emerging solutions are far from proven. As with any new technology or new industry, many if not most of the new entrants will ultimately fail. Further, serious questions surrounding issues such as ESG and government regulation and intervention are still unanswered. Digital assets have already gone through a number of boom-bust cycles, and we expect that to continue. While we believe this new asset class has the potential to play a meaningful role in the financial system of the future, we proceed with caution.

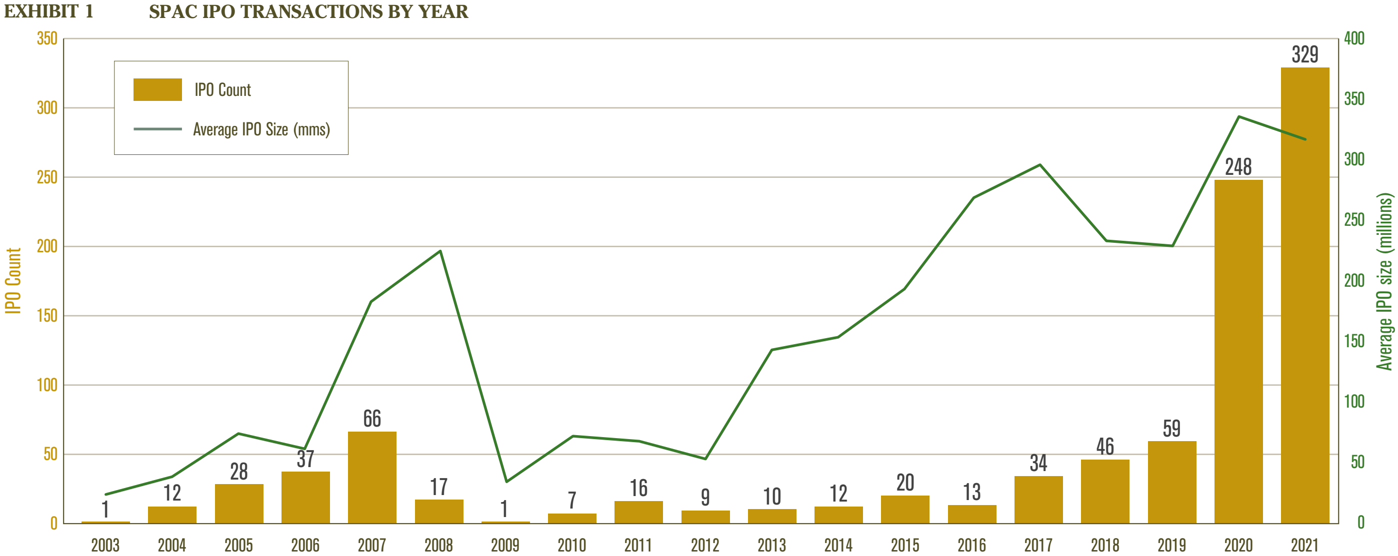
SPACs Are Over Two-Thirds of the IPO Market

Special purpose acquisition companies (SPACs), or "blank check" companies, are formed to raise capital through an IPO with the specific purpose of merging with a private company and thereby effectively taking it public. SPACs must first file with the SEC and publicly list their shares. As part of their structure, SPACs generally have two years to acquire a company or else must return raised capital back to investors. There are typically few constraints on the choice of target, lending opaqueness to what is a publicly available investment product. Two notable aspects of SPACs are their aggressive deal economics for SPAC sponsors and their role in enabling more companies to go public.

SPACs have had a colossal run in 2020 and 2021, in terms of both capital raised and the number of transactions. Many of the same factors that fast-tracked meme stocks and cryptocurrency drove the recent rise of SPACs. With retail investors devoting more time during the pandemic to new and speculative investments, SPACs garnered significant attention. SPACs were also popular leading up to the 2008 financial crisis, but then remained fairly dormant until the recent meteoric rise.

In 2020, 248 SPACs raised more than $83 billion with an average IPO size of $335 million (Exhibit 1).[4] Notably, there were more SPAC transactions in the first four months of 2021 than there were in all of 2020. Not only are a lot of SPACs raising capital and making acquisitions, but they »

EXHIBIT 1 **SPAC IPO TRANSACTIONS BY YEAR**



Sources: SPAC Analytics, RMB Capital; data through 5/26/21.

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are also taking up more of the total IPO space: In the first quarter of 2021, SPACs represented 69% of the entire IPO market.[5] SPACs have existed for decades but have never risen to this level of prominence.

Many observers view the recent celebrity involvement in SPACs, including stars like Shaquille O'Neal and Alex Rodriguez, as a sign that the phenomenon has hit a crescendo. Institutional investors may be wary, but retail investors may more likely be drawn by the endorsements of household names. The SEC has taken notice, issuing an investor alert in March that cautions against investing in SPACs solely based on famous sponsors or investors. Attaching a famous person to a SPAC certainly makes headlines, which can be valuable for a public fundraise. The link between celebrity involvement and financial performance is less convincing.

"SPAC-mania" has been driven by sponsors and target companies seeking to tap into the surge of retail investors' demand. As with meme stocks and digital assets, recent monetary and fiscal policy has contributed to the rise in SPAC fundraising as money is loose. Part of the newfound popularity is also based on the lower costs and regulatory barriers for private companies to go public compared to a traditional IPO process. If sponsors cannot continue to get attention from retail investors, the surge is likely to slow.[6] The persistence of significant SPAC issuance will depend on several factors, including continued easy money conditions, the ongoing regulatory environment, and the longer-term fundamental performance of the companies that emerge.

SPACs, like meme stocks and digital assets, brought disruption to the markets during the pandemic, and it is unclear how long SPAC-mania will last. We believe evaluating SPACs on factors such as the underlying business and the management team is more advisable than casually embracing or rejecting the trend.

The Bottom Line

Recent investment trends stem from some common factors, in particular, advances in technology that create new ways for people to communicate and to access the markets, along with significant government stimulus and changes in behavior due to the COVID-19 pandemic. Aspects of these trends will eventually prove to be overhyped fads and will fall by the wayside, but not everything should be dismissed offhand. At RMB, we expend considerable effort separating meaningful advancements in technology and market structure from mania, and we believe elements of each of these trends may represent positive developments—from increased accessibility of markets to improvements in financial infrastructure. However, we also believe advancements in technology and extraordinary stimulus due to the COVID-19 pandemic have converged to take prices of some assets to levels based more on mania than fundamentals.

At RMB, we are long-term investors—aware of the noise but focused on the signal. Different investment fads come and go, and they reinforce our conviction to focus on fundamentals in our aim for outperformance over the long term. ■

1 *See our "Commentary: What to Make of the Recent Short Squeeze" for more on the gamification of trading and liquidity boom.*
2 *U.S. House Committee on Financial Services, "Virtual Hearing—Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide," February 18, 2021, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407107.*
3 *The terms digital assets and cryptocurrencies are often used interchangeably. There are some differences in meaning that we won't go into here, but instead will use the broader term of digital assets to refer to the larger market.*
4 *McKinsey & Company, "Global Private Markets Review 2021," April 21, 2021, https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2021/mckinsey-global-private-markets-review-2021-v3.pdf.*
5 *Dealogic, "SPAC and US IPO Activity," April 9, 2021, https://www.spacanalytics.com/.*
6 *J.P. Morgan, "Flows and Liquidity: SPAC activity appears to have peaked," April 28, 2021, https://markets.jpmorgan.com/research/email/f6kgq5i4/sb2tjZRelVxcY358cg6h8w/GPS-3724252-0.*