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“Will it be different this time?”

Part II: Current Financial Trends

Are we due for another collapse? The current investment landscape and how it affects financial professionals.

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Hindsight is 20/20. Every financial bubble is accompanied by often extreme levels of behavior that, when looking back, seem like glaring red flags. We saw this in 2000 when investors were buying anything and everything that had ".com" after its company name or was somehow related to the proliferation of the internet. Prior to the 2008 financial crisis, anyone with a heartbeat could get a seven-figure mortgage without proof of income or assets, or any other now-required proof of financial stability. However, today, you don't have to look far to see behavior patterns that suggest we could have another reckoning in the near future.

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We are seeing the biases of overconfidence, herd mentality, and FOMO ("fear of missing out") play out in multiple areas in the current investment landscape. Fast-growing trends like the influence of social media, the craze in cryptocurrency, and the hype around real estate show just how impactful these biases can be. (See Part 1: A Closer Look at Financial Bubbles.)

We are once again seeing signs of financial euphoria. Here are three trends to keep an eye on.

1. TREND: SOCIAL MEDIA

Social media platforms have created a digitalized investing environment in which investment news is at the (literal) fingertips of sophisticated and unsophisticated investors alike.

A pivotal point for social-media-using investors was in 2013, when the Securities and Exchange Commission (SEC) began allowing publicly traded companies to report news and earnings via social media platforms, resulting in an increased flow of information to investors. The impact of this ruling led to CEOs and other executives sharing business data through tweets and other real-time feeds. As with anything internet related, momentum picked up, quickly. Fast forward to today—we have the likes of Jack Dorsey and Elon Musk creating major market moves with a single tweet.

Social media platforms have also become a tool for the average retail investor. In the same way that friends use social media to share a snap of their breakfast, retail investors are using it to share and compare investment ideas, such as the latest trending meme stock.

Meme Stocks

Meme stocks—which gain a cultlike following online—are the perfect example of how social media influences modern-day investing. The first meme stock was GameStop (GME). In August 2020, an activist investor posted to Reddit explaining why GameStop could be a good bet. This was picked up by a Reddit user named Keith Gill, who posted a video laying out the case for how GME could soar from $5 to $50 because hedge funds would need to cover their positions in the event of a massive short squeeze. Reddit users started buying the stock, which exploded to nearly $500 amid a frenzy of short covering and panic buying. A lot of hedge funds were forced to shut down due to heavy losses. As a result, the meme-stock concept is also seen as taking from the rich Wall Street elites to reward small retail investors. Meme stocks, which also include AMC, Peloton, and BlackBerry, are not necessarily based on the companies' fundamentals or performance. Though there is a potential for outsized gains, meme investors may experience potentially bigger losses as the stocks become overvalued and prices plummet.

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Some might suggest that the meme-stock rally was fun while it lasted, but the implications for long-term investors and traders are profound. More than month-long slide in meme stocks erased a substantial portion of the gains of online Reddit traders' favorites. These meme stocks on average were down 27% in just a month. In addition, Robinhood stock has lost 57% in the last three months. Social media can make or break the trading in these names in a very short period.

Financial Influencers

We're all familiar with influential financial professionals who have made their careers in sharing expertise in personal finance and investing—think Jim Cramer, Dave Ramsey, Kevin O'Leary, and Suze Orman. As a whole, financial influencers have an important role in the financial world as they educate in an accessible, digestible fashion. Education and access are important factors when it comes to empowering the average investor. And with social media, these renowned financial professionals now have an even larger platform to spread their knowledge. The concern is with the commoditization and oversimplification of investment advice and how social media expedites the rapid-fire spread of uneducated recommendations and misinformation. With the growth of social media, we've seen a surge of financial influencers, many of whom lack experience and education in market dynamics and investment theory.

IMPACT ON INVESTORS AND THE CURRENT MARKET—JUST ENOUGH TO BE DANGEROUS?

The investment world is no longer held hostage by hedge funds and Wall Street. These are formative improvements to the retail investment world. But we'd be remiss if we ignored the negative impacts we've seen as a result of social-media-fueled investing.

Remember that we have a generation of new investors who don't have any historical context or understanding of the financial bubbles and consequent crashes of 2000 and 2008. The "ignorance" factor runs rampant across large investor groups who will likely have to learn the hard way though hopefully the lessons learned will not put them in harm's way.

Many of the tools being used today will not hold up in an inevitable bear market. It makes us wonder where these financial influencers will be when the tide turns.

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2. TREND: CRYPTOCURRENCY

Bitcoin and Ethereum, cryptocurrencies that were originally designed as an exchange of payment, are now treated more like financial assets as their early adopters/investors have become millionaires. Bitcoin gained even more traction after tech leader and billionaire Elon Musk posted on social media that Tesla will accept Bitcoin as a form of payment for its cars, while other prominent figures such as Tim Cook have disclosed they hold bitcoin as part of their asset allocation. Furthering its perceived legitimacy, the federal government approved the first Bitcoin-based exchange-traded fund in 2021, which allows retail investors to buy in to the crypto space more easily, and even within retirement accounts. From the beginning of 2020 until December 2021, Bitcoin market share increased sixfold, while Ethereum increased almost thirtyfold.

We're not sure whether the trend will continue with cryptocurrency, but it is clearly a volatile "asset class." The crypto market lost 47% of its value in a single week in May 2021 in reaction to China announcing a ban against cryptocurrencies and Elon Musk tweeting that Tesla would stop accepting Bitcoin payments. Further adding to the volatile nature of cryptocurrencies is the level at which supply is concentrated. The majority of the supply of these currencies is dispersed among a very few large investors. Approximately 2% of all Bitcoin accounts hold 95% of the available coins, according to Flipside, a crypto-analytics firm. In 2021, less than 20% of Bitcoin supply was actively traded as most of the supply is held in long-term accounts. That means trades do not have to be very large to shift prices dramatically.

The chart below shows the historical price of Bitcoin from November 2014 to the end of January 2022, illustrating the cryptocurrency's extreme surges and falls. No other traditional currency has lost half of its value over a couple of months.

Source: Coindesk

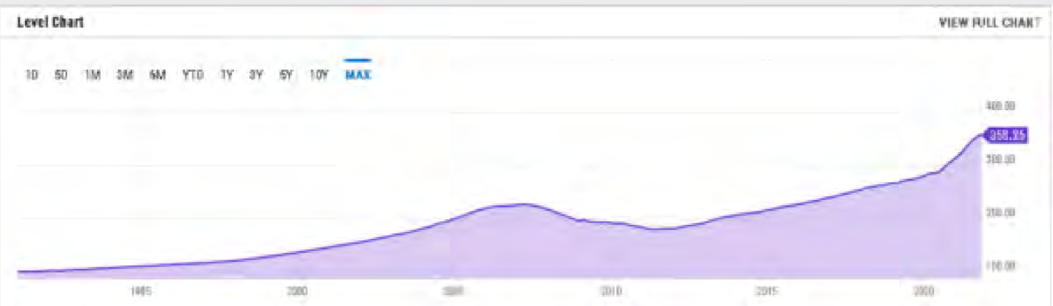
It's hard to predict where crypto is headed, but based on recent developments, it seems as though cryptocurrencies have significantly deviated from not only their intrinsic value, but also their original intent: a form of payment via utilization of blockchain technology. It is only a matter of time before a viral tweet or regulatory development sends crypto prices either much higher or lower from here. That being said, it is important to note that Summa is neither a bull nor bear as it relates to cryptocurrency as an asset class. We are simply providing observations of a euphoric dynamic around the crypto space and a framework for how to look at the topic in a historical context.

3. TREND: REAL ESTATE

Real estate is another area currently pushing the boundary of euphoric territory. Housing prices are surging to new records with no end in sight, fueled by historically low interest rates, but also by investors' and economists' beliefs that the housing market has a unique ability to support runaway prices. While this describes the current state of the U.S. housing market, it also sounds pretty similar to the 2004–2007 housing bubble, which contributed to the global financial crisis.

Generational demographics and a historically low interest rate environment continue to support housing prices but a change in either will dramatically impact the affordability index. Further, according to NAR, single-family home construction has lagged so dramatically, we are now facing a 5.5 million home deficit.

The average home price skyrocketed nearly 20% through the third quarter of 2021 compared to the year prior. It was the largest annual home price increase in the history of the U.S. House Price Index. The chart below shows the House Price Index over the last 30 years. Looking at the last two years, the uptick in price appreciation seems disproportionately high relative to the historical pace.



Source: Ycharts

Apart from these easily observed, quantitative signals, there are also less technical, more qualitative signs of over-optimism relating to the real estate sector. It seems we all know someone with an established career (maybe a full-time lawyer or corporate professional) who recently made a random pivot to get their real estate license, eager to ride the wave of a hot market. This type of hype is a categorical example of FOMO behavior. One doesn't have to look too far for clear signs of a market that needs to slow down before too many get hurt. Again, this is a movie most of us have seen before—and the beginning, middle, and end are highly predictable. But those who are not students of historical patterns may be vulnerable.

Some analysts are worried the real estate market won't be sustainable, as there won't be enough people to buy houses, contrasting the general refrain that there is an overabundance of demand. Falling fertility rates, an aging population, an uptick in multigenerational housing, and not enough immigrants are the main drivers of a declining population and new household formation. In addition, an uptick in interest rates or an increase in unemployment driven by a new variant of COVID and a prolonged pandemic could also dampen the real estate market. At this stage of the cycle, we support caution and believe it's best to dial down your expectations.

Whatever your holdings or passions in investing, a reliable financial advisor is priceless. We'll explain more in Part 3: How to Act from a Solid Foundation Instead of Fear or FOMO.