When Euphoria Turns to Phoria

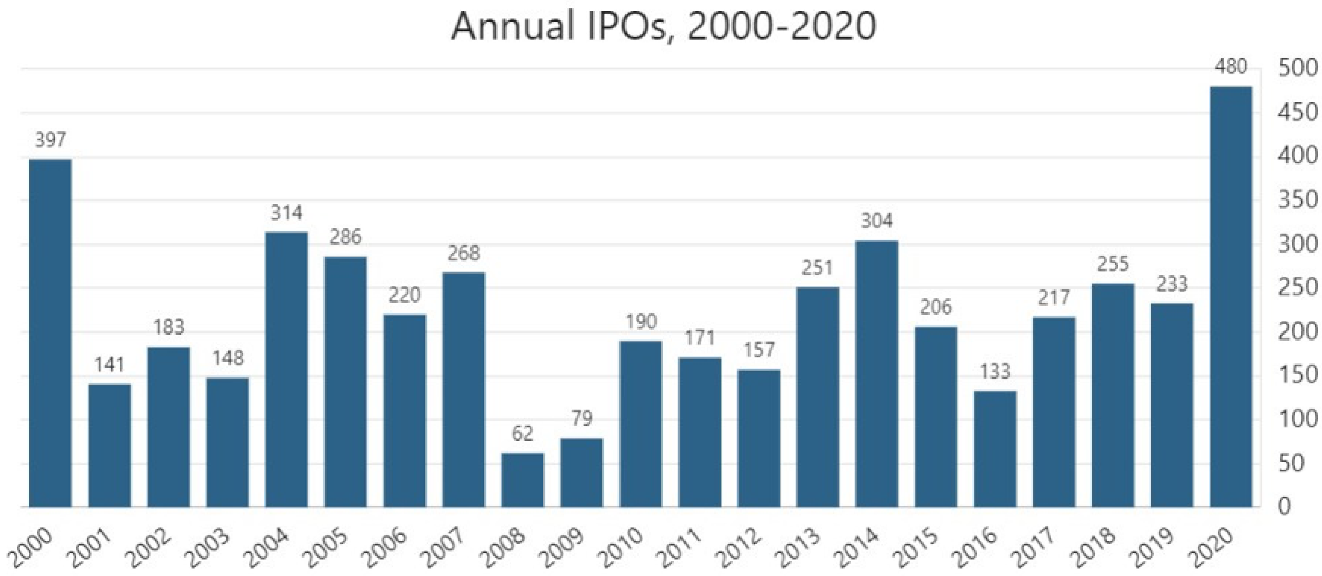
January 2021

Financial market tops always exhibit elevated valuations (check) typically combined with weak or deteriorating economic conditions (check) and a backdrop of investor complacency (check). But the greatest bubbles exhibit far more than such excess; they exude exuberance. Are the financial markets in a current state of euphoria with a commensurate risk of a market downturn? Various metrics strongly indicate as such.

Citi provides their own proprietary index: the Citi Panic / Euphoria Model. This index utilizes multiple sentiment and trading indications to assess investor mentality. “Euphoric” measures exceed 0.41 on their scale. The market rarely reaches such levels: over the last 20 years, it breached this level only five times. Three of those were but brief touches before receding in quick order.

But two times, the market was solidly deep within the “euphoric” area of the index: 1999 to 2000 and 2020 to 2021. At the height of the technology bubble, the index neared 1.50. What does the index indicate today? In January 2021, the index sits solidly at 1.80 having gone hyperbolic over the last several months.[1]

Another commonly accepted signal of extreme bullish sentiment is the increased acceptance of and demand for riskier assets; for example, initial public offerings (“IPOs”). During such times, companies oblige by increasing the number of IPOs to avail themselves of such demand in raising capital. The following chart demonstrates the number of IPOs in 2020 exceeded even that of the technology bubble.[2]



Curiously, of the 480 IPOs in 2020, fully 248 of them were Special Purpose Acquisition Companies (SPACs).[3] A SPAC is often called a "blank check" shell corporation because it pools investor funds together to finance an unknown acquisition within a future timeframe (generally two years).[4] Investing in a SPAC is like paying to sit at the chef's table in an unknown restaurant with an unnamed chef at some point in the future. Even the most fervent foodies would choke on the idea.

But not investors – not only were 248 SPACs debuted in 2020, but already to date in 2021, another 59 launched which tied the previous, pre- 2020 high set in 2019. And prior to 2019, SPACs averaged less than 17 per year during the previous ten-year period (2009 to 2018).[5] If the Citi Panic / Euphoria Model seeks corroboration, IPOs and SPACs provide it.

While "euphoria" is a state of intense excitement and happiness, "phoria" is a misalignment of the eyes which breaks binocular vision. Investors are moving from euphoria to phoria: unable to focus on sound investment principles and blind to economic dangers.

As long the Federal Reserve continues aggressive monetary expansion, investors may continue to fuel financial markets to loftier valuations and higher euphoria. However, many variables could work to undermine or overwhelm the Federal

Reserve’s efforts. If that happens, investor sentiment and demand may plummet, for their feelings are usually fickle. Financial markets will move accordingly.

Endnotes:

1. “A $13 Trillion Crisis-Era Debt Bill Comes Due for Big Economies” Bloomberg News. 04 January 2021
2. Citi Research.
3. Stock Analysis. 20 January 2021 https://stockanalysis.com/ipos/statistics/
4. Special-purpose acquisition company 20 January 2021 https://en.wikipedia.org/wiki/Special-purpose_acquisition_company
5. SPACInsider. 20 January 2021 https://spacinsider.com/stats/
6. Ibid.