ROCKEFELLER
ASSET MANAGEMENT

MONTHLY Market Review

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Crypto, Blockchain & Cannabis

Millennials' latest investment darlings; Rising odds of a market pullback

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The New Year started out with an Arctic outbreak that brought record low temperatures across much of the U.S. A "bomb cyclone" blasted the East Coast with a rare combination of snow, gusty wind, thunder and lightning. However, the stormy weather paled in comparison to the red hot stock market which continued to melt up with elevated optimism and exuberance. The S&P 500 Index's 5.6% gain was the best January in two decades. In the last few days of the month, however, equities experienced a mild pullback as the 10-year U.S. Treasury yield surged above 2.7%. Investors also woke up to the realization that Europe's economic strength made the region's bond yields look unjustifiably low – the German 5-year Bund yield finally moved into the *positive* territory for the first time since September 2015. Interestingly, in spite of the growing consensus that the U.S. economy would get a big boost from the Trump tax cuts, the U.S. dollar continued to be disrespected by the market, with the U.S. Dollar Index (DXY) losing 3.2% during the month. It did not help that U.S. Treasury Secretary Mnuchin appeared to endorse a weak dollar policy to help U.S. exports. There were also concerns about the rising U.S. deficit and the prospect of another government shutdown. The Greenback's pain turned out to be precious metals' gain, while crude oil prices also continued their upward march, with the Brent crude price climbing above $70 a barrel for the first time in three years. Lastly, just as Fed Chair Yellen wrapped up her final FOMC meeting, former Chair Greenspan, the man who coined the phrase "*irrational exuberance*" in 1996, stole the spotlight by warning that there are now two bubbles -- stocks and bonds.

Equity Markets Indices[1]	12/31/2017 Price	1/31/2018 Price	MTD Change	YTD Change
MSCI All Country World	513	542	5.6%	5.6%
S&P 500	2674	2824	5.6%	5.6%
MSCI EAFE	2051	2153	5.0%	5.0%
Russell 2000®[2]	1536	1575	2.6%	2.6%
NASDAQ	6903	7411	7.4%	7.4%
TOPIX	1818	1837	1.1%	1.1%
KOSPI	2467	2566	4.0%	4.0%
Emerging Markets	1158	1255	8.3%	8.3%
Fixed Income				
2-Year US Treasury Note	1.89%	2.14%	26	26
10-Year US Treasury Note	2.41%	2.71%	30	30
BarCap US Agg Corp Sprd	0.93%	0.86%	-7	-7
BarCap US Corp HY Sprd	3.43%	3.19%	-24	-24
Currencies				
Australian (AUD/$)	1.28	1.24	3.2%	3.2%
Brazil Real (Real/$)	3.31	3.19	3.9%	3.9%
British Pound ($/GBP)	1.35	1.42	5.0%	5.0%
Euro ($/Euro)	1.20	1.24	3.4%	3.4%
Japanese Yen (Yen/$)	113	109	3.2%	3.2%
Korean Won (KRW/$)	1067	1068	0.0%	0.0%
US Dollar Index (DXY)	92.12	89.13	3.4%	3.4%
Commodities				
Gold	1303	1345	3.2%	3.2%
Oil	60.4	64.7	7.1%	7.1%
Natural Gas, Henry Hub	2.95	3.00	1.4%	1.4%
Copper (cents/lb)	330	320	-3.2%	-3.2%
CRB Index	194	197	1.8%	1.8%
Baltic Dry Index	1366	1152	-15.7%	-15.7%

SOURCE: BLOOMBERG

Gone Bananas Over Pink Monkey

One morning in 1996, Pat Greene, a 55-year-old self-styled dealmaker, was having breakfast at a Walmart store in the outskirts of Houston. As he watched a store clerk setting up Cliffs Notes on a rack, a light bulb went off in his head – he would harness the power of the Internet, then a relatively new phenomenon, to sell study guides at lower prices than Cliffs Notes. He would name the website *PinkMonkey.com* as it was catchy and easy to spell.

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Mr. Greene went on to hire several writers in India to condense some widely read English literatures into 25 Monkey Notes. He was running a virtual company from the garage of his house that was also home to seven dogs, a squirrel, several cats and birds. The pony-tailed pipe-smoking founder was thinking big during those early days of dot-com exuberance. He executed a reverse merger by acquiring a listed, but revenue-less, Nevada corporation and renamed it PinkMonkey.com. On June 26, 1998, PinkMonkey.com started trading on the OTC Bulletin Board under the ticker PMKY.

On November 30, 1998, PinkMonkey.com issued a press release claiming that the company was "poised to become the Amazon.com of the educational study-aid market." The press release was like a lightning bolt that supercharged the stock – PMKY surged 251% that day, from $1.03 to $3.625. Two days later, it skyrocketed to as high as $17, briefly giving the firm a $250 million market capitalization. During this exhilarating stock run-up, the local phone company had halted service on PinkMonkey.com's sole phone line for two days as the system was unable to handle the tsunami of incoming calls. It seemed like some investors were actually trying to reach the company to do some fundamental research.

Those who actually did the fundamental work on PinkMonkey.com would have shorted the stock if they could. At the time of the press release, revenues were characterized by Mr. Greene as "nominal" – it had cumulative sales of $30. Industry leader Cliffs Notes, which had sales of $12 million for the fiscal year ending January 30, 1998, was just acquired by the publisher of the "For Dummies" self-help books for $14.2 million.

By year-end 1998, PMKY had drifted down to $3.18, which still gave it a $45 million market cap. The stock price finally fell below $1 a share in March 2000, when the dot-com bubble peaked out. In 2001, Mr. Greene settled a SEC lawsuit for $20,000. Today, if you punch up *pinkmonkey.com*, you would see a site boasting over 460 study guides, yet it appears to be barely maintained. PMKY last traded on January 9, 2018 -- 231 shares changed hands at $0.0001 per share.

Back to the Future

Those bubbly days when a mere press release on a company's internet strategy would generate outsized stock price appreciation have found their renaissance in blockchain and cryptocurrency. The once venerable Eastman Kodak, which was relisted in November 2013 at $26 a share on the Big Board after its bankruptcy re-organization, seized a Kodak moment this January with the announcement of KodakOne, a digital rights management system built on the blockchain technology and KodakCoin, its own digital currency. The news sent the stock soaring 119% from $3.10 to $6.80 on the day of the announcement. The frenzy continued on the following day, with the stock price up 57% to close at $10.70. More amazingly, Long Island Iced Tea, a beverage company, turbocharged its stock price this past December by renaming itself Long Blockchain Corp. The stock surged 500% in pre-market trading, and finished the day up 183% from $2.44 to $6.91. Similarly, U.K. penny stock Stapleton Capital more than doubled its share price upon renaming itself Blockchain Worldwide.

This phenomenon of publicly listed companies renaming themselves to capitalize on the blockchain craze has caught the attention of the U.S. Securities and Exchange Commission (SEC), which indicated that it would closely monitor and prohibit companies from misleading investors with gimmicky name changes. Various governments around the globe have also voiced the need for more oversight over cryptocurrency. South Korea banned the use of anonymous accounts for cryptocurrency trading and will start collecting taxes on cryptocurrency exchanges' profits. China is reportedly looking to ban its citizens from trading cryptocurrencies on exchanges outside of the country. Even Japan, which has been supportive of cryptocurrency development in the quest to become a global leader in this nascent field, was compelled to place cryptocurrency exchanges under closer scrutiny after Coincheck, one of Japan's leading exchanges, reported that hackers stole $530 million worth of a digital currency from its customers.

The regulatory threat appeared to have affected sentiment on cryptocurrencies, as various digital currencies have suffered sizeable declines of late. As of the end of January, Bitcoin fell below $10,000, down nearly 50% from its December peak of roughly $19,000; easy come, easy go.

Too Much of a Good Thing?

While the air appeared to be slowly leaking out of the cryptocurrency bubble, investors' enthusiasm for equities only got stronger for much of January. In mid-January, the Investor Intelligence Advisors Sentiment Survey's percentage of self-identified bullish advisors rose to 66.7%, the highest reading since early 1986, and those in the bearish camp declined to 12.7%, the lowest since early 1987. Various discount brokerage firms have reported a surge in new account openings and retail trading activity, with cryptocurrency, blockchain and cannabis related stocks being the standouts.

The record high U.S. household net worth, buoyed by the rising stock and housing markets, and the strong job market have also led American households to splurge, as consumer spending grew at a 3.8% annualized pace in the fourth quarter of 2017, and the saving rate in December 2017 plunged to 2.4%, the lowest in more than 12 years.

These phenomena are reminiscent of typical late cycle developments. While the overall macro narratives remained quite positive, much of the good news may have been discounted by investors. Indeed, market corrections have occurred during periods of strong economic and earnings growth. These corrections have been sharp, but were relatively short in duration and the market subsequently moved to new highs.

As a case in point, investors entered 1987 with much optimism as the Tax Reform Act of 1986 had lowered the top personal income tax rate from 50% to 38.5%, and the corporate tax rate was slashed from 46% to 34%. The S&P 500 Index gained a whopping 13% that January. This optimism was validated by accelerating economic growth. However, by the spring of 1987, continued decline in the U.S. dollar and rising inflation expectation prompted the Fed to tighten more aggressively. Interest rates started a rapid ascend and eventually resulted in the infamous Black Monday on October 19 – the Dow Jones Industrial Average crashed 22.6% in a single session. Amazingly, this market crash took place during a quarter where the U.S. real GDP growth actually accelerated to 6.8%.

This brief recount of 1987 is by no means a warning that a market crash is imminent. However, we suspect that the odds of a correction are on the rise due to the aforementioned sentiment extremes. Other warning signs include the sinking U.S. dollar and the rapid backup in sovereign bond yields. While one can argue that the former merely reflects stronger fundamentals in overseas markets and the latter confirms the global reflation, we would caution that these sharp movements often lead to higher volatility due to shifts in hedging and portfolio positioning. Inflation is another potential headwind; should incoming data deliver higher-than-expected inflation, the Fed may be compelled to take a more hawkish stance. The Trump Administration also appears to be ready to up the ante on trade issues. Lastly, one of China's largest conglomerates, the HNA Group, has been struggling with a severe liquidity crunch. The company has overextended itself after a $40 billion global acquisition spree in recent years. It is reportedly facing a $2.4 billion funding gap, and seven of its listed units have halted trading.

It's been more than 400 trading days since the S&P 500 Index last experienced a 5% pullback, which is unprecedented. Having been spoiled by this long stretch of steady appreciation, the next correction may take some getting used to.●

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[1] Index pricing information does not reflect dividend income, withholding taxes, commissions, or fees that would be incurred by an investor pursuing the index return.

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