

# CAPLAN CAPITAL MANAGEMENT, INC.

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## Investment Review and Outlook

Surprise! The stock market registered eye-popping gains in the second quarter, wiping out much of the paper losses when Covid-19 morphed into a pandemic. While the crisis is far from over, as evidenced by the rising number of cases across the country, investors are beginning to look beyond the economic damage caused by the pandemic and focusing on the shape of a recovery when the health crisis passes.

Many market professionals did not see a rally of this magnitude coming. The rally demonstrates the power of the coordinated stimulus actions by the Federal Reserve as well as the Federal Government. In past cycles, such expansive economic stimulus actions were prone to fuel consumer spending as well as commodity inflation. Yet in today's world, it appears the inflation is showing up in asset prices.

What gives? Our view is that the aging of the baby boom generation, in concert with the new era of super-low interest rates, is driving increased savings, as retirees struggle to find investment vehicles that can generate much needed income streams. Despite the strong recovery of stock prices, the average dividend yield of a basket of S&P 500 stocks is well above the yield of Treasury securities. This is a relatively new phenomenon in the financial markets, which could help support elevated stock valuations for years to come.

Even if higher valuations can be justified, investors must pay attention to potential risks on the horizon. The outcome of the presidential election in November presents a number of uncertainties. If there is a democratic sweep in November, have investors discounted a potential rise in corporate taxes as expected? With regard to the pandemic, the timing of a vaccine remains elusive. Moreover, will another wave of the virus in the Fall/Winter be manageable to the extent that the economy need not shut down once more?

Uncertainty remains at elevated levels. A watchful and discerning eye will be a required to navigate the markets in the second half and beyond.

## Cloud Computing on Cloud 9

The stock market recovery last quarter was broad-based, but was led primarily by technology stocks. In recent weeks there has been particular strength in stocks that have a presence in the "cloud computing" space. Cloud computing has been a major driver of technology spending as companies gravitate from the data center model (building the technology platform in house) to the cloud platform (outsourcing much of the data processing). Many cloud computing stocks have soared and are trading at extraordinary valuations. While not yet comparable to valuations during the dot.com boom/bust in the late 1990's and early 2000's, there are some signs of extreme froth.

The Wisdom Tree Cloud Computing exchange traded fund (**WCLD \$42.56**) is now up over 60% this year, far surpassing the performance of nearly every other major sector of the stock market. These stocks have a potentially bright future. But we are dubious of the valuations that the market is assigning at this juncture.

To illustrate, the average price-to-earnings ratio of the top 10 holdings of the fund is over 400 times, far in excess of the S&P 500 index's more modest ratio of 22 times. The average price-to-book-value of 30 times compares to the average S&P 500 index's more reasonable 3.3 times.

Over the coming years and decades, we believe that some of these companies may emerge as technology leaders as in the past. On the flip side, we believe that some of these companies could be hamstrung either by competition or newer technologies. The point is that if one is willing to pay an elevated price for a stock or fund, one should have reasonable visibility of the path to success before paying a relatively frothy price.

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