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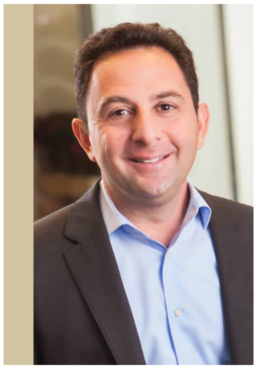
SPACs, NFTs AND GAMESTOP
WHAT THE HECK IS GOING ON?



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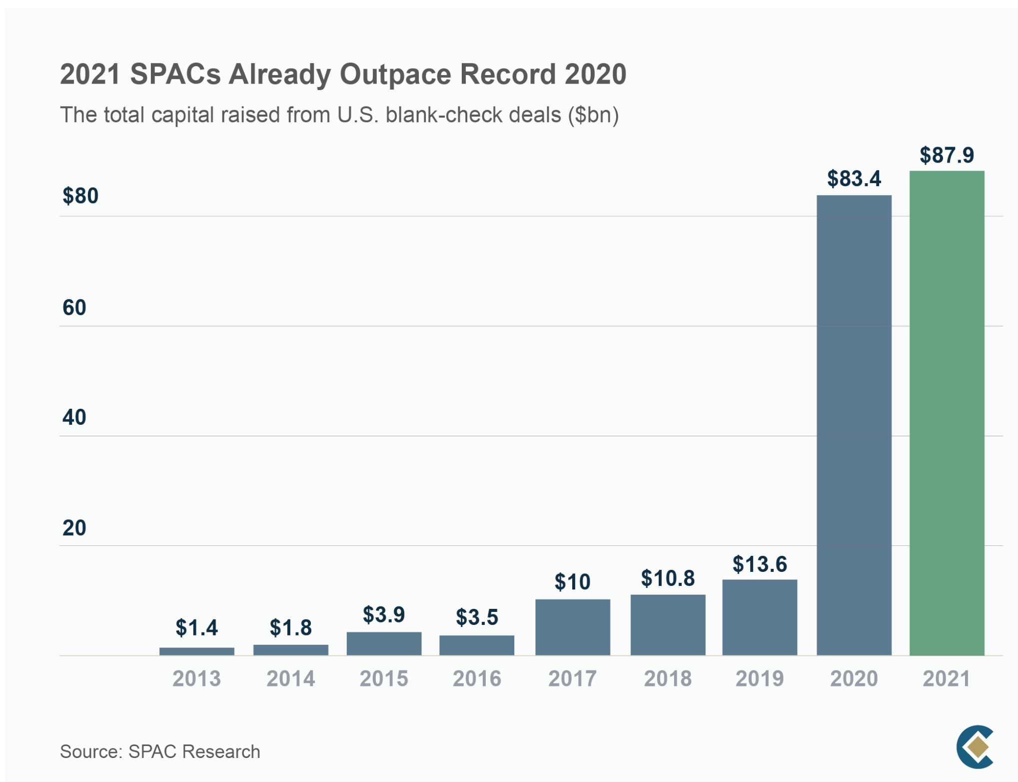
Spending 30 minutes watching financial news these days,[1] one can't help but wonder if they've landed in an alternative universe. For decades, the topics were generally stocks, bonds and real estate with a little bit of commodity talk and economics thrown into the conversation. Now, much of the time is spent on investments that didn't even exist (at least at scale) a few years ago, and the commentators use acronyms and verbal shorthand more than my teenagers do. Let's cover some of the hotter topics.

SPACs[2]

A SPAC is a Special Purpose Acquisition Company. It is basically a shell company used to purchase other companies. With the economy awash in cash, investors looking to get rich quick, and founders who are able to make a ton of money with relatively little work or risk, we are seeing a record number of SPACs enter the marketplace.



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Here's how a SPAC essentially works:

Step 1: Someone (the founder) forms a company that owns nothing and does nothing.

Step 2: The founder then raises money from investors. Sometimes the founder has a plan of what to buy ('hey, we are going to buy a company that makes rockets' or 'we are going to buy a small airline') and sometimes they don't ('I am so impressive, just give me your money and I'll figure out what to buy later').[3]

Step 3: The founder hires an investment banker to help them with an IPO (Initial Public Offering), allowing them to trade on public stock exchanges.

Step 4: Special note – I feel like this step should be flashing with a big red alert: The founder and management take a 5 to 20% stake in the company, practically or entirely for free, in exchange for raising the money and managing the company.

Step 5: The SPAC then buys its target companies. The end investors may or may not do well. The founder, it turns out, always gets super rich with almost no personal risk.

SPACs have been around a long time, and in and of themselves, nothing is wrong with them. Of late, though, the game has changed. Some wealthy individuals with high profiles have become fronts for SPACs, cranking them out one after the other.[4] And why not? Investors think they are getting into something at the ground floor and don't understand the economics of the deal. Further, there isn't enough history yet to know how these turn out, so there isn't a lot of evidence that, as a group, these investments will underperform. Spoiler alert: they most likely will, and the only people getting rich will be the promoters (sorry, I meant 'founders').

NFTs[5]

An NFT is a non-fungible token, which is a unit of data on a digital ledger called the blockchain. Basically, an NFT is simply a digital item like an image, video, video game, audio file or any other creative work[6] that is digitally stored in a way that ensures the purchaser owns the original. Non-fungible simply means 'one-of-a-kind, original and irreplaceable'.

In the last few months, we saw Kings of Leon, a rock band, collect $2 million for selling an NFT of their new album, LeBron James received $208,000 for

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an NFT video of a slam dunk and Christie's recently sold a digital collage by the artist Beeple Crap[7] for $69,346,250.[8]

Squarely in the 'You have got to be kidding me' category, Jack Dorsey, the founder of Twitter, recently sold an NFT of his first tweet for $2.9 million, someone sold a single red pixel for $900,000,[9] and earlier this month film director Alex Ramirez-Mallis sold a recording of one of his farts (I assume there is more than one) for $85.[10]

Skeptics of NFTs say most of these will be worthless. Sure, the guy that bought the NFT of the Kings of Leon album has the original, but anyone can still download the album for free or for a few dollars. They won't own the original, but who cares? Yes, someone owns the original video of the LeBron James' slam dunk, but there will be a thousand more videos to follow, and anyone can still go online and watch the video for free. Proponents of NFTs think those against it are out of touch and simply don't 'get it'. They say anyone can go to the Louvre and take a picture of the Mona Lisa, but it's not the same as owning the original.

So, will this be yet another bubble investment students read about in college in a few decades or a new frontier for investors and art collectors? I don't think it's an either/or but the reality, to quote the headline of the popular 2007 movie, is that 'There Will Be Blood'. Most of these NFTs will end up worthless, and countless people will likely learn very expensive lessons. Will some NFTs hold and grow their value over time? Most likely, yes. As with anything, an item is only worth what someone else will pay for it. From Beanie Babies to Norman Rockwell plates as well as 99% of art, most collectibles end up being worth far less in the future. The bottom line is there will likely be winners here, but it's a – shall we say – highly speculative environment.

GameStop, AMC, Reddit, Robinhood and the Death of the Little Guy

An inordinate amount of time has been spent discussing a small handful of stocks like GameStop and AMC, with politicians on both sides weighing in to somehow get this silliness to fit their respective narratives.

First, here's how this craziness started.

It all started on Reddit, which is a site where people can participate in forums on various topics. Basically, like nearly all social sites, it can be informative, entertaining, full of misinformation and generally toxic for the soul.[11] A user on this site, wallstreetbets, noticed that big hedge funds were betting against the company GameStop by shorting the stock (when you are 'long' a stock, you make money when the stock goes up; when you are 'short' a stock, you make money when the stock goes down). Rallying those in his forum, wallstreetbets encouraged everyone to buy GameStop. By buying GameStop, the price would be forced up, causing the hedge funds to lose a ton of money. This initially unfolded according to plan – the price of GameStop rocketed and the hedge funds lost money, eventually getting bailed out by another fund. The problem here is that these 'investors' which were nearly all retail investors, were left holding a company that likely doesn't have a promising future (if the fate of music stores and video stores is any indication of what to expect, a video game store doesn't seem like a smart money bet).[12] With no more foolish money to follow, the stock plummeted, with retail investors suffering more losses than anyone. The same story unfolded with AMC. Many of these traders use the free Robinhood app to trade. Overwhelmed and underprepared, Robinhood shut down trading in the stocks, further exacerbating the free fall. Who made money in all of this? The big guys that wallstreetbets and his legion of followers set out to punish. One example of a winner was Silver Lake (disclosure: Creative Planning utilizes this firm's offering with some high net worth clients where appropriate). Silver Lake sold their interest in AMC at the top of the market frenzy, surely never expecting to see such a run-up in such a short period of time.

Now, these stocks have simply turned into electronic roulette tables. Every day, thousands trade these stocks as they swing wildly from big losses to big gains and back again. The trading has little to nothing (closer to nothing) to do with fundamentals, and everything to do with gambling. Some will win, some will lose, but most retail investors will end up holding the bag. Buying stocks with real economic challenges to stick it to someone else usually ends up creating the opposite of the intended result.

So What the Heck is Going On?

The system is awash in money. From large corporate bailouts to private company loans to stimulus checks, money has flooded the system. And when money floods the system, it looks for places to go. In environments like this, most of the big money floods into income producing assets backed by real businesses and economic promise. This is why we see stocks, real estate, private equity and the like doing very well. The big money is betting on an economic recovery that will last for years and is moving toward assets most likely to be on the receiving end of that recovery. Ten years from now, this group will likely be full of winners. That's how investing (buying things that

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have a high probability of bringing money to you) generally works.

At the same time, there are always people trying to take a short cut to wealth and that type of money is flooding into stocks like GameStop and other assets like expensive SPACs and many NFTs. Ten years from now, this group will be mostly losers with a few winners. That's how speculating (investing in things that don't produce income but you think someone will pay more for in the future) generally works. Those few winners will also work their way into an investor's portfolio. The dotcom bubble burst, devastating many, but the winners worked their way into investors' portfolios with plenty of upside remaining. 99% of cryptocurrencies are now worthless, but Bitcoin has held up. And now Bitcoin is in nearly every investor's portfolio as it is owned by some S&P 500 companies like Tesla.

Knowledge is knowing that investing isn't new and speculation isn't new. Wisdom is understanding the difference.

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[1]Which is somewhere between 29 and 30 minutes more than necessary.
[2]Sounds like a kitchen utensil or sealant of some sort, but it's actually a way to increase your odds of losing money.
[3]Yes, this is a real thing.
[4]Recent SPAC founders include Jay-Z, Shaquille O'Neal, Serena Williams and Alex Rodriguez.
[5]No, this isn't shorthand for something your kids or grandkids text to their friends.
[6]Though we are about to really, really stretch the meaning of the term 'creative' shortly.
[7]I swear this is the real name.
[8]If you were taking a sip of any beverage while reading this sentence, I apologize for the clean-up that you will be undertaking after reading this letter.
[9]You can look at my red pixel here for free:
[10]The fact that I am writing about this in an investment newsletter may be the 7th sign of the Apocalypse.
[11]But I digress.
[12]As a guy who owned eight music stores in college, all of which were wiped out within months of music moving online, I can promise you I am intimately familiar with this issue.

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