# Quarterly Commentary

F/OMO • Q3 2022

CREWCIAL® PARTNERS

# F/OMO

Every party has a way of reaching its natural conclusion. When attendees are glued to their phones and the DJ can no longer get anyone out to the dance floor, the prom party is petering out. When the last remaining guests are having trouble keeping their eyes open and their martini glasses from spilling, the dinner party has run out of steam. It's easy to read those signs, and given the time and effort required to plan and conduct these parties, hosts are usually somewhat relieved when they end. They're certainly fun while they last, but parties can't go on forever—especially those in the investment world, although the end may only gain definition and clarity in hindsight.

The bull market that ran largely unabated from the ashes of the Great Financial Crisis until the fall of 2021 (with a pause for the pandemic retrenchment in early 2020) was one of the most celebrated parties in the history of the financial markets, and the host was determined to keep it going as long as possible, even when it became clear that it might not end well. The Federal Reserve started lowering interest rates in 2007 to jumpstart the economy, and kept them low until earlier this year, when inflation became too dangerous to ignore. The Fed has a dual mandate of maximum employment and stable inflation, and while the former was holding quite steady, the latter was experiencing pressure it hadn't felt in decades1. And so the Fed began to aggressively raise interest rates, risking recession in order to address its fear that if it didn't act, it would miss an opportunity to keep inflation from inflicting more serious and lasting harm on the economy.

The Fed adjusts interest rates through "open market operations," OMO, which carries more than a touch of irony given the hold that FOMO inflicts on the psyche of many investors. The fear of missing out is a well-known phenomenon across the social fabric of society, but it weaves through the investment community as well, leading to activity that may generate some level of success in the short term, but often leads to disappointment long term. As it turns out, the best opportunities are often not those investors believe they're missing, but those not noticed enough to be missed. As we dig through the rubble of a market that has run into one landmine after another in 2022, investors will be best served by avoiding those areas ripe for FOMO by focusing on areas where fundamentals and valuation matter most, and provide better protection against OMO, which is not only altering the interest-rate landscape, but possibly the broader investment landscape as well.

[1] Even though the Federal Reserve Act lists three distinct goals of monetary policy – maximum employment, stable prices, and moderate long-term interest rates – the Fed's mandate for monetary policy is commonly known as the "dual mandate" because high employment and stable prices create the conditions for interest rates to settle at moderate levels.

# Fed OMO

In a speech at an economic symposium in August 2021, Fed Chairman Jerome Powell acknowledged that recent inflation was a cause for concern but said that responding to (what he thought was likely to be) a temporary inflationary trend by tightening monetary policy could be "particularly harmful" for the economy, a mistake he was unwilling to make[2]. As the year went on, though, Powell was forced to change his tune, scaling back an enormous bond-buying program that began during the pandemic and instead conducting OMO to raise the federal funds rate[3]. The federal funds rate directly impacts rates used for lending, which in turn impacts unemployment, economic output, and—key to inflation—the costs of goods and services.

The worst-case scenario for the Fed is rising unemployment and runaway inflation, and as it considers adjustments in interest-rate levels, it can't help but operate from a place of hope and fear: hope that its actions will stabilize prices, and fear that its actions could push the economy into a deep recession. It is also forced to contend with the fear of inaction and the profound impact it could have on the long-term health of the economy. This fear is a particularly powerful motivator for the Fed, so in March of 2022, it voted to raise interest rates by 25 basis points, which was followed by 50 basis points in May, and an additional 75 basis points in June, July, and September. And if the fed funds futures market is a good predictor of activity going forward, the Fed is not done yet[4].

The process for OMO is fairly straightforward. Through the purchase and sale of securities in the open market, the Fed can control the supply of reserve balances to keep the federal funds rate around whatever level it's targeting. In recent years this was near zero, a level first targeted in 2008 through aggressive monetary policy during the financial crisis: "From the end of 2008 through October 2014, the Fed expanded its holdings of longer-term securities through open market purchases with the goal of putting downward pressure on longer-term interest rates and thus supporting economic activity and job creation by making financial conditions more accommodative. During the policy normalization process that commenced in December 2015, the Federal Reserve first used overnight reverse repurchase as a supplementary policy tool, as necessary, to help control the federal funds rate and keep it in the target range set by the FOMC. In September 2019, the Federal Reserve used term and overnight repurchase agreements to… mitigate the risk of money market pressures that could adversely affect policy implementation… [and] amid the COVID-related stress around March 2020, term and overnight repos played an important role in ensuring that the supply of reserves remained ample and supporting the smooth functioning of short-term US dollar funding markets."[5]

In other words, the Fed used a variety of tools in its toolkit to keep rates low. And with rates sitting around all-time lows, for a long time bonds were a relatively less attractive investment from an ex-ante total return perspective. With most investors choosing between bonds and stocks, it wasn't even much of a choice: earn miniscule or even negative real yields in the bond market, or take advantage of zero commission equity trading, like everyone else seemed to be doing. When everyone else is doing something different—or it seems like everyone else is doing something different—it can make for a very lonely feeling. Especially when it comes to making money.

---

2 "Why Fed's Powell still thinks high inflation is 'temporary'" Reuters, Aug 27, 2021

3 The federal funds rate is the rate that banks charge each other for overnight loans of reserves on deposit with the Federal Reserve. Lowering the fed funds rate effectively lowers the rate that banks charge for lending, spurring economic activity.

4 Fed funds futures are derivatives based on the fed funds rate. Futures pricing can be converted into market-based odds of future Fed announcements of changes in the fed funds rate target. As of publication, the market is currently expecting a fed funds rate of just over 4% at year-end 2023.

5 FederalReserve.org

# Investor FOMO

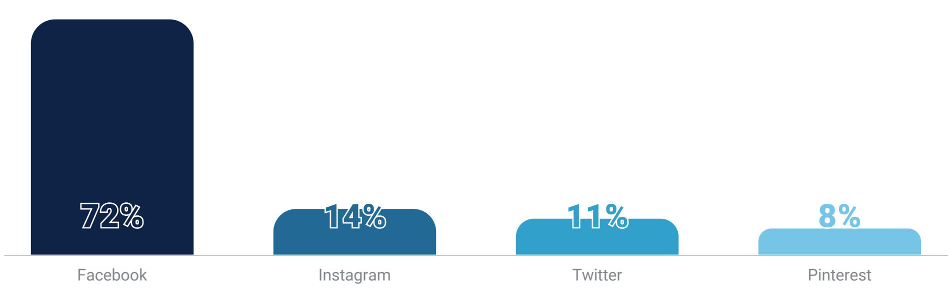
The fear of missing out has been with people since the beginning of time. Previous generations expressed FOMO through the phrase "keeping up with the Joneses" (which rolls off the tongue a lot more easily than the clumsy acronym KUWTJ). It may or may not be a rational fear, but it's a fear nonetheless.

By some accounts, the term FOMO was first officially coined in an op-ed published in 2004 in The Harbus, the magazine of Harvard Business School. Student Patrick McGinnis—who has taken full advantage of the cultural embrace of this term via his podcast FOMO Sapiens, in which he talks to leaders in business, entrepreneurship, politics, and culture—penned the piece as a comedic response to "helpful frameworks that allow HBS students to distill entire career's [sic] worth of work in a single catchphrase," citing Maslow's hierarchy of needs, Porter's five forces, and Shah's three Rs as inspiration. He attributed his fellow students' overscheduling, particularly early on, to this fear of missing out as they developed their position in the social structure of business school.

The position point is an important one. People tend to underinflate their own placement in the social order and overinflate the placement of others, a distortion intensified by an unprecedented level of access to information, especially through social media. This information not only warps reality, but is a constant reminder of one's incompleteness. Almost all lives experience ample joy and hardship, but social media is used mostly as a megaphone for the former, which doesn't help those who feel like they're on the outside looking in. This has significant social implications—the kind McGinnis was referring to in his article—but it also extends to other areas, like financial health and well-being. It's one thing for social status to feel compromised. When it seems like everyone else has found the next best way to make money, a deep sense of anxiety can set in. When that happens, bad decision-making usually follows, and when the means of accessibility make it easy to participate, the fear of missing out can overwhelm proper recognition of the risks of participation.

**SOCIAL MEDIA NETWORKS THAT CREATE THE MOST FOMO**

*Source: https://financesonline.com/fomo-statistics/*




6 "Social Theory at HBS: McGinnis' Two FOs" The Harbus, May 10, 2004

# The Personification of FOMO

Fewer than 100 cryptocurrencies existed around ten years ago. By earlier this year, this number was over 10,000[7]. The relatively frictionless nature of crypto creation makes it easy for skilled programmers to engineer a new blockchain and token. However, in order for it to have any value, it needs people to buy it. Given how much wealth has been earned by the earliest adopters of Bitcoin and Ethereum, crypto creators rely on FOMO to lure investors seduced by a possibility—no matter how remote—that the coin (or coin-based venture, such as NFTs) in which they are investing may be the next one to produce life-changing returns, even without fully understanding the landscape in which they are participating[8]. Many of these investors have no meaningful insights into where the current will ultimately lead the world's currency and payments system. They just don't want to miss the next wave.

There's certainly no shortage of wealthy people convincing the less well-off that inaction is a terrible strategy, including the corporate evangelist and MicroStrategy chairman Michael Saylor, who has told everyone who will listen—via conference audiences, cable television interviewers, and podcasters both mainstream and obscure—that not only will he keep buying Bitcoin, but he will never sell it, and investors should follow his lead[9]. When it drops, they should buy more, and when it rises, they should buy more. It's a truly confounding investment perspective—buy an asset, keep buying it, and never, ever sell it—that should crater his credibility, but within the crypto community it gives him an aura of invincibility.

Market participants victimized by FOMO may be more inclined to forgo the long and often arduous road to financial freedom. Every aspirational crypto investor has the same thought—"If I had just bought 100 bitcoin when it was pennies…"—but even those who have experienced success have staunchly resisted when given the opportunity to transfer the weightlessness of crypto into the solidity of cash. Glauber Contessoto, a video editor in LA, leveraged his entire life savings into a $250,000 bet on Dogecoin, a cryptocurrency created as a joke but given life by Elon Musk, who irresponsibly tweeted about it off and on over the course of a few months, elevating its value[10]. When Musk tweeted a painting of a dog barking at the moon on April 15, 2021, captioning it Doge barking at the moon, the coin skyrocketed in value, and a few days later Contessoto was a millionaire multiple times over on paper. So what did he do with his newfound wealth? Nothing. According to Contessoto, "If you could buy into Amazon when it was $10 a share, would you have sold when it hit $20 or when it hit $200? No, you wouldn't." Equating a trillion-dollar company with the potential value of a piece of code that's mainly derived its worth from tweets by Elon Musk is a byproduct of FOMO, and the unfortunate thing is that it works in two ways, stirring the capacity for buying, while paralyzing the capacity for selling.

Bored Ape Yacht Club, often simply called Bored Apes, is a non-fungible token (NFT) collection built on the Ethereum blockchain featuring profile pictures of cartoon apes generated by an algorithm. Despite their eye-watering price at the market's peak (since attenuated) and embrace by certain celebrities (e.g., Paris Hilton), both the collection's artistic merit and inherent value have been roundly questioned.

[7] "Number of cryptocurrencies worldwide from 2013 to February 2022" Statista

[8] SEC Investigating Bored Ape Creator Yuga Labs Over Securities Violations: Report (https://decrypt.co/111671/sec-bored-ape-nfts-apecoin-yuga-labs-securities)

[9] "Michael Saylor Suggests MicroStrategy Will Never Sell Its Bitcoin" Coindesk, May 10, 2022

[10] "He's a Dogecoin Millionaire. And He's Not Selling." New York Times, May 14, 2021

# The Root Cause (or a Root Cause)

It's unfair to chastise the Glauber Contessotos of the world for financial naiveite. Many investors like him are by-products of a system they feel has not operated fairly and in the best interests of all participants, favoring large and wealthy institutional investors at the expense of smaller investors with more to lose. Quite frankly, there's a deep lack of trust.

The Fed is technically not a part of the federal government, but it was created through an act of Congress and its chairperson is a presidential appointee, so it is closely connected in the minds of Americans, the majority of whom have a general distrust of government. According to a new survey by Partnership for Public Service and Freedman Consulting, more than half of Americans do not trust the federal government and don't think it helps people like them[11]. Amid this perceived level of institutional instability, people can feel a level of desperation to create a stable financial present and future. These tensions have been exacerbated and fed by popular culture and films such as Wolf of Wall Street, itself a reflection of the 80's "Greed is Good" ethos, which helped spawn such movements as Wall Street Bets—in essence, amateur high-risk gambling for those outside the financial establishment in an attempt to make some money, preferably at the expense of legacy financial institutions. COVID-19 and the resultant boredom, frustration, and enforced free time for many (especially younger generations, who have flitted from what seems like one crisis to the next) additionally helped fertilize the ground for these reactions and the prevailing negative sentiment.

In the US, policymakers fed the flame for a long time, providing gasoline to an equity market in which just over half of Americans now directly participate, down from 65% prior to the financial crisis in 2008[12]. Rather than manage the situation more thoughtfully throughout, the Fed can be perceived as lacking the forethought to understand how it could. Many view the investment world as rigged when monetary authorities engage in actions that negatively impact any modest wealth they may have accumulated; the roots of these suspicions grow deeper and stronger with each new crisis, when institutions that may have played a part in the economic and financial disfunction ultimately emerge bearing no responsibility[13]. This also leaves many people wondering when their chance to strike it rich will come, and that feeling leads to anxiety, restlessness, and resentment, a perfect combination for rash action and investment FOMO.



[11] "First look: Most Americans don't trust the government" Axios, March 22, 2022
[12] "Share of adults investing money in the stock market in the United States from 1999 to 2021" Statista
[13] Amid all of the corporate malfeasance that led to the Great Financial Crisis of 2008, only one Wall Street banker – Kareem Serageldin from Credit Suisse – went to jail.

# There Is Only One Shortcut, The Long Way

FOMO can be a powerful emotional driver for behavior, and depending on someone's character and inclinations, it can serve as a real benefit. For someone who has expressed hesitation at trying new things, that fear can be a motivator. It may expose new social opportunities and create a general mindset geared toward growth, not stagnation, providing an onramp for new experiences. With investing, however, FOMO can be problematic. It is often associated with things that have worked recently, sometimes spectacularly well, and introduces the idea that whatever is being missed out on should absolutely not be ignored anymore. Popularity, publicity, and existing name-recognition can drive capital in myriad directions in search of the next big thing—driven by anything from infamy or controversy[14] to newness or a more general sense of fear[15].

This is almost never a good strategy for investing. The only path—short cut or otherwise—towards a desirable destination converges on discipline, a deep respect for valuation, and a timeframe that extends not days or months but years. Responding to promotion and hype may provide an initial jolt of relief, but that is almost certain to fade in favor of the next FOMO opportunity, which will give way to another in a continuous chase for the next best thing. The best thing, of course, is taking a long-term approach and sticking to it through the various cycles that may be driven in part by Fed F/OMO, but will ultimately be most closely connected to how companies selling real goods and services are able to perform across these cycles. Good managers can identify these companies, and these are the managers we try to identify for client portfolios. As other investors focus on FOMO, such misunderstood and overlooked ideas become increasingly prevalent; our FOMO is the fear that we'll miss out on great managers, and we try to mitigate this by an exhaustive research process that's global in scope.

People will always seek shortcuts. Mapping software charts the quickest route between two locations. Meal-kit companies provide all the ingredients for a speedy home-cooked meal. And the reduction of common phrases to a few letters shortens the amount of time to write something. Investing, however, is different. There may be handy shortcuts for describing great investing, but there are no shortcuts for the process itself.


Under co-founder Adam Neumann's leadership, and after significant hype, WeWork gained mainstream media attention in 2019 with its failed initial public offering (IPO) following criticism over its governance, business model, and ability to turn a profit.


Perhaps unsurprising that a notable proponent of get-rich-quick schemes is now using apocalyptic language to promote crypto.

[14] WeWork founder bounces back with $1bn property project Flow (https://www.theguardian.com/business/2022/aug/16/adam-neumann-wework-founder-bounces-back-with-flow-a-1bn-property-project)

[15] Robert Kiyosaki Urges Investors to Get Into Crypto Now, Before Biggest Economic Crash in World History (https://news.bitcoin.com/robert-kiyosaki-urges-investors-to-get-into-crypto-now-before-biggest-economic-crash-in-world-history/)