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Market Comment:

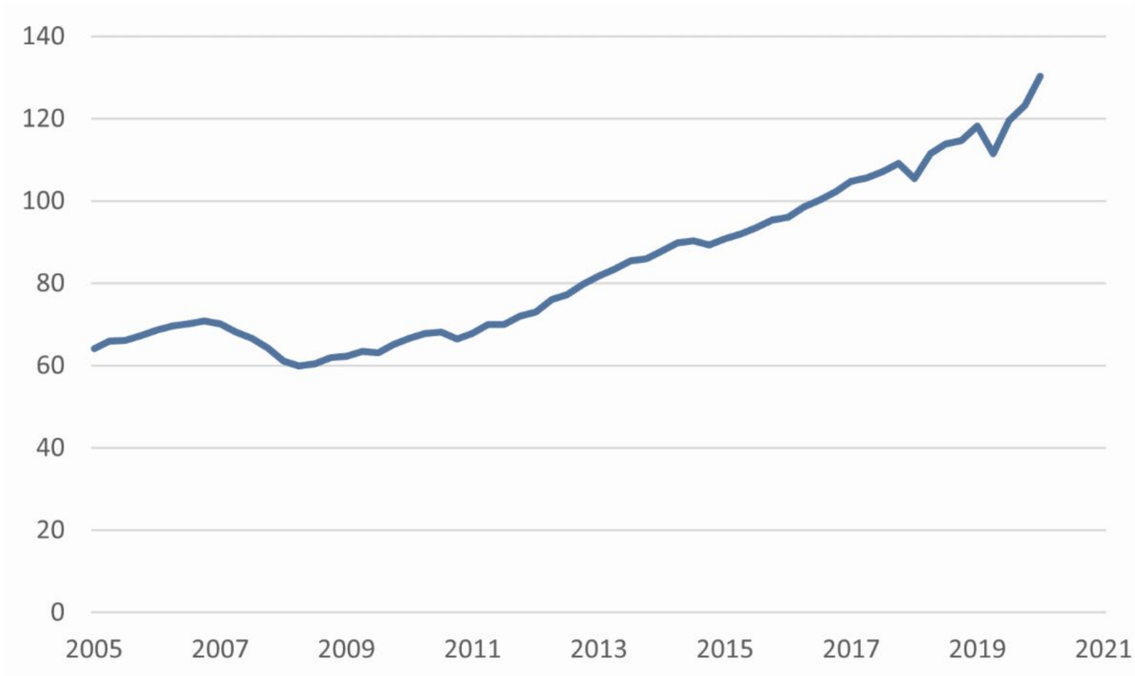
In 2013, two software engineers — as a joke — created a cryptocurrency based on a dog meme. As of last week that cryptocurrency, Dogecoin, had a market cap higher than Ford and Kraft. Your Hometown Deli, an unexceptional deli located in Paulsboro, NJ, does $20,000 in revenue in a good year. Its market cap? $100 million. GameStop Corporation, an unprofitable firm with declining revenue, continues to trade 3200% higher than one year ago. Based on these examples, of which there are dozens more, it is abundantly clear that this is an appropriate time to take a step back and clearly distinguish between investment and speculation.

Whether you are valuing bonds, stocks, real estate, or any other asset, most of investment management comes down to assessing the timing and magnitude of future cash flow along with determining an appropriate rate at which to discount those cash flows. For example, value and growth equity managers might debate how to quantify those metrics for certain companies, but ultimately their philosophes embrace the same fundamental belief: the value of an *investment* is the present value of the investment's future cash flows.

Speculation is different. Speculation implies that an asset's fundamental value matters less than whether there will be a greater fool willing to buy the asset from you later at a higher price. When speculating, there is no future revenue to wrangle with. No appropriate discount rate to apply. Just a belief that someone else will pay more. The Mississippi bubble, South Sea bubble, railroad bubble, dot-com bubble, and housing bubble were all built on speculation.

We should not be surprised to find abundant speculation in today's market. Whether it is blockchain, the successful COVID mRNA vaccine, computer chip technology, battery technology, or the private space race, we don't have to look far to see unusually rapid technological advancements in many sectors of the economy. Furthermore, due to a strong recovery in asset prices and large government transfer payments, the aggregate net worth of US households had increased to its highest level ever at the end of 2020 (Fig. 1). The combination of technological innovation and rapidly increasing wealth has been a catalyst for speculation going back to the seventeenth century, including the Dutch Tulip Mania.

Fig. 1: US household net worth has accelerated over the last year ($ trillions)



Source: Bloomberg, Federal Reserve, Mill Creek. Chart shows the aggregate net worth of households and nonprofit organizations. As of Q42020.

We're not luddites, but we do distinguish investment from speculation. Take cryptocurrencies, most of which are blockchain based, for example. We have modest exposure to crypto and blockchain-related companies in our public equity portfolios, our hedge fund program, and our private equity programs. These positions are *investments* correctly defined. We do not directly hold cryptocurrency, as it falls into the speculative category.

We also recognize that many investors want to participate in some speculative bets despite the risk involved. Perhaps British economist John Maynard Keynes said it best:

"The game of professional investment is intolerably boring and overexacting to anyone who is entirely exempt from the gambling instinct; whilst he who has it must pay to this propensity the appropriate toll."

Position sizing determines the toll.

Benchmark Performance

Benchmark Performance by Asset Class						
Benchmark Returns	One Week	Year to Date	1 Year	3 Years	5 Years	10 Years
Global Equities	-0.1%	9.4%	51.9%	13.3%	13.7%	9.4%
US Equities	0.0%	11.9%	57.9%	18.6%	17.4%	14.2%
International Equities	-0.4%	7.4%	46.0%	6.6%	8.9%	5.5%
Emerging Market Equities	0.3%	5.2%	54.8%	7.8%	12.5%	3.6%
US Taxable Bond Market	0.1%	-2.4%	-0.1%	5.3%	3.3%	3.4%
US Municipal Bond Market	0.0%	0.4%	4.9%	4.2%	2.7%	3.1%
Hedge Fund Index	-0.2%	2.3%	14.8%	3.6%	4.0%	1.4%
Diversified Commodities	2.2%	13.3%	45.6%	1.0%	2.4%	-6.0%
Gold	0.0%	-6.4%	2.7%	10.3%	7.6%	1.7%
Key Rates (as of stated date)	4/26/21	1/1/21	4/26/20	4/26/18	4/26/16	4/26/11
US 10-Year Treasury	1.6%	0.9%	0.6%	3.0%	1.9%	3.3%
Barclays Aggregate Bond Index	1.5%	1.1%	1.4%	3.3%	2.3%	2.9%
BBarc Muni 1-10Yr Blend (1-12) Index	0.6%	0.6%	1.6%	2.4%	1.3%	2.4%

Source: Bloomberg, Mill Creek. Returns for periods greater than one year are annualized.
Benchmark rates are yield-to-worst.

This week's contributor: Michael Crook, CAIA.

Indices Used: U.S. Large Cap equities: Russell 1000 Index, U.S. Small Cap Equities: Russell 2000 Index, International Developed Equities: MSCI EAFE Index, Emerging Market Equities: MSCI Emerging Markets Index, U.S. Bonds: Barclays Aggregate Bond Index, U.S. 10 Year Treasury Note: Bloomberg 10 Yr. Treasury Note, Municipal Bonds: Barclays Intermediate Municipal Bond Total Return Index, High Yield Bonds: Barclays U.S. High Yield Total Return Index, Oil: Bloomberg WTI Crude Sub-Index Total Return Index, Gold: Bloomberg Gold Sub-Index Total Return Index