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The Archvest Advantage Q1 2021 Newsletter

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Q1 2021 in Review

There appears to be light ahead in the tunnel. Since the vaccines have been made available through the US, millions of Americans per day are getting vaccinated. About 40% of Americans have received at least one dose and about 25% of Americans are fully vaccinated. While a lot could still happen in the battle against COVID-19, it does appear that we are turning the corner. The sky is certainly looking bluer and the forecast is no longer cloudy with a chance of meatballs. We are cautiously optimistic as we continue to make our way through 2021.

While we do not expect a robust roaring 1920's style recovery, we do anticipate a positive trend in the global economy. The US gross domestic product (GDP) is forecasted to grow 5 to 6% this year. To give this number some perspective, since 2010, GDP has averaged 2.3% per year. In 2020, the markets appreciated while the economy declined. As the economy recovers, we are hopeful that the economic numbers catch up to the market, as the two may only diverge so far. As we ended the quarter, the equity markets ended up 6.2% for the S&P 500, up 8.3% for the Dow while the tech-lead NASDAQ ended up only 1.8%. The bond market decreased by 2.5% due to rising interest rates.

Robinhood – Prince of Thieves

According to English folklore, Robin Hood was a heroic outlaw that robbed the rich and gave to the poor. The modern trading application by the same name does exactly the opposite. Robinhood was created in 2013 with the idea of making investing fun and free for the masses. Since then, the platform has grown tremendously to over about $20 billion in assets. With no trading fee, how does Robinhood make money?

We will borrow from Tim Cook, CEO of Apple, Inc. on this one. When something is free, "you are no longer the customer. You are the product." Robinhood monetizes your data, selling order flow information to market makers and hedge funds. This may sound innocent as your order flow information does not contain your personal information, just how you trade. However, if this information is truly innocent, why would market makers and hedge funds pay for this data? Therefore, we must surmise that this data has monetary value. Hedge funds are notoriously secretive; they do not officially announce how this data is used but one can speculate that order flow provides them with insight into the market allowing them to make better speculative bets. In effect, this order flow data allows them to bet against you. To us, this sure sounds like stealing from the masses and giving it to the rich. Perhaps they should have named the app Sheriff of Nottingham, but it does not sound as cool and would reveal the true nature of how it makes money.

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Commission-free trading is now the norm vs. the exception. Traditional discount brokers have followed suit. Expect to hear more about order flow routing and best execution in the coming years. Robinhood was fined $65M by the Securities and Exchange Commission in 2020 for "misleading" investors about order flow and best execution. Brokers have a legal obligation to obtain the best price to execute your trades but when outside parties are paying the broker to execute trades, it creates a huge conflict of interest. Brokers are incentivized to route your order to the highest bidder. We do not believe that commission-free trading is best for investors and would rather pay a fee for trading to know that the fee structure is transparent and without conflict. Again, we don't think we've seen the end of possible disclosure lawsuits and more regulation on this.

What the SPAC?

You would think I'm coming up with some new lingo or catchphrase, but no, a SPAC is short for Special Purpose Acquisition Company. SPAC is simply a financial vehicle that is used to take a private company public. The initial public listing of a SPAC is to raise money with the intent of purchasing a private company. By purchasing a private company with a public entity, the private company becomes public. This process is sometimes referred to as a reverse initial public offering (IPO). Highly speculative companies like Nikola Motor Co., Draftkings, Opendoor, and Coinbase have become public in this manner. Even We Work is considering another bid at going public via a SPAC after almost imploding in 2019 while going public under traditional IPO avenues. So, what's the difference between becoming public via SPAC vs. IPO?

The SPAC starts with institutional investors and billionaires who raise money, likely not even knowing what company they will be merging with. Once this initial capital is raised, the SPAC goes through the IPO process, and the funds raised during the IPO are deposited into an interest-bearing account to be returned to investors in the event that the SPAC is liquidated, no merger occurs, or a private company is identified, merged and spun off as its own separate company. At the time of the spin-off, investors of the SPAC have the opportunity to get a return on their investment plus interest or can swap their shares of the merged company. The original SPAC sponsors who initially helped raise capital often get a 20% stake in the final merged company. In a traditional IPO, it's much more difficult for the sponsor (i.e. investment bank) to profit to such a degree. The SPAC, therefore, creates conflicts of interest that are not present in the traditional IPO. In addition, there is much more due diligence and scrutiny required in a traditional IPO versus SPAC offering, which protects investors. We are concerned that retail investors may be left yet again holding the bag as many unicorn tech companies look to go public and can easily deceive the public in this very loosely regulated SPAC structure.

Digital Currencies and Taxes

The IRS recently launched an initiative called Hidden Treasure to look for taxpayers who have

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failed to report digital currency earnings. There have been various John Doe lawsuits by the IRS against digital currency custodians to look for taxpayers that "may fail, or may have failed, to comply with one or more provisions of the internal revenue laws." If you have any digital currency transactions (earnings or losses), please remember to report them on your tax return and amend any necessary returns.

Meeting Again Soon

While we can't believe we have surpassed a year separated and under social distance circumstances and rules, we do look forward to meeting you in person again. We are hoping this can resume starting in the fall once everyone is fully vaccinated. Of course, we want to be sensitive to your health and level of comfort. When appropriate, we are happy to meet in the office, at your home, or even in your backyard. We will also continue to offer Zoom meetings as an alternative, but there is just something to be said about the art of conversation and seeing everyone in person. We trust you will continue to remain healthy and well and please don't hesitate to call us with any questions or even to just catch up.

As always, we greatly appreciate the confidence you have placed in us to work alongside you regarding your planning needs. Be sure to follow us on Facebook, LinkedIn and Twitter as well as our RSS feed to stay up to date on what we're reading and thinking.

THE Archvest Team