The Popularity and Risks in Special Purpose Acquisition Companies (SPACs)

By the Curmudgeon

Introduction:

The ongoing all asset mania, courtesy of the Fed and global central banks, is like the energy bunny that keeps on ticking without ever needing a recharge. Using stronger language, it is like *an orgy of lemmings that never ends*.

For sure, the dumb money has become the smart money. Investors with a sense of risk have been severely penalized such that all the lessons they learned over decades no longer apply.

In this week's column, we examine even more signs of excessive speculation. We then look at popularity and risks in Special Purpose Acquisition Companies (SPACs). Finally, we argue once again that Wall Street triumphs while Main Street suffers.

The Mania Continues Unchecked:

Here are a few more signs of euphoric speculation in financial markets from **Bank of America Global Research:**

- Bitcoin up +65% YTD; Crypto-currencies surpassed $1 trillion in market value, despite significant regulatory risk ahead.

- Largest week of equity inflows ever…$58.1bn (Figure 1a.), hearty $13.1bn into bonds, $0.8bn out of gold, $10.6bn out of cash.

- Flows to know: record week of tech inflows at $5.4bn (Figure 1b.), 2nd largest for U.S. large caps ($25.1bn), 3rd largest into U.S. small caps ($5.6bn), big inflow to munis ($2.3bn), MBS ($1.4bn), TIPs ($1.4bn), bank loans ($1.0bn - Chart 7), 1st outflow from gold in 2 months.

- U.S. junk bond yields below 4% (Figure 2.), 1st time ever, despite issuance annualizing $575bn YTD (up 33% from 2020).

- U.S. microcaps up 27% YTD outpacing small cap +16% and large cap +5% YTD.

- U.S. call option volume has doubled since the pandemic (Figure 3.), driven again by retail investors as 20% of total option volume now comes from orders of 10 contracts or fewer.

- BofA private clients cash drawdown was the largest since September 2019 (Figure 4.). Compare that with the huge cash increase when COVID-19 panic selling drove markets lower in March 2020. The bank's private clients have allocated 63.1% to stocks, which is a new record high.

Charts – Courtesy of Bank of America Global Research:

Figure 1a. Largest week of global equity inflows ever

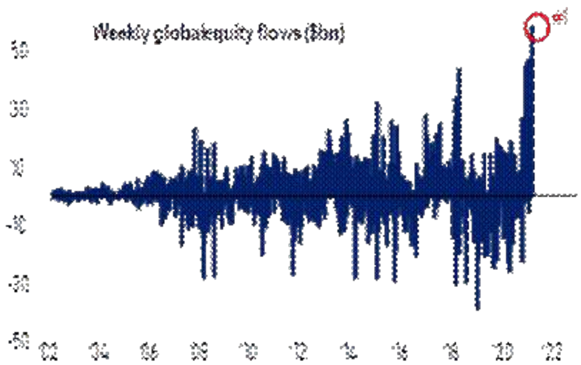


Figure 1b. Another week of record tech stock inflows

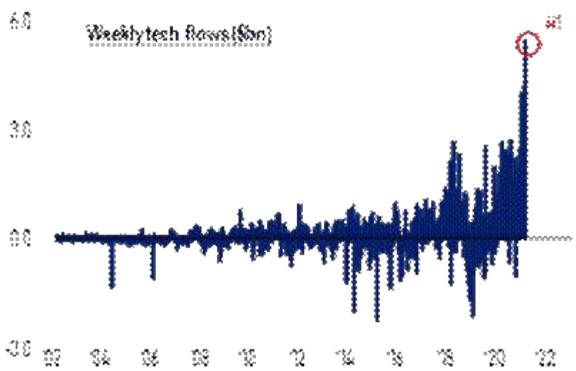


Figure 2. Bubbly, bubbly junk bond yields below 4%

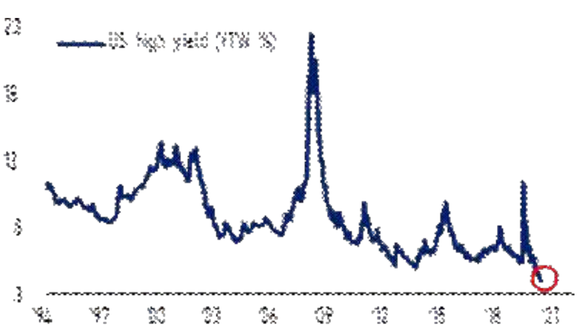


Figure 3. U.S. call option volume has doubled since the pandemic

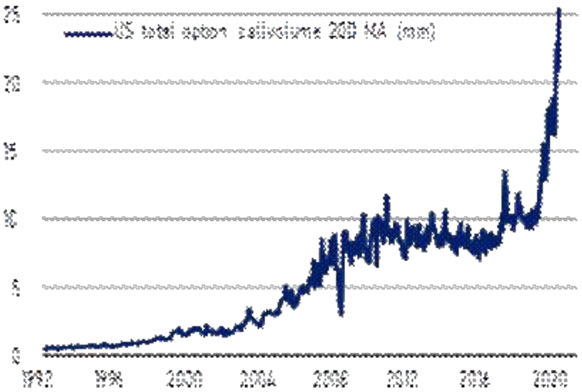
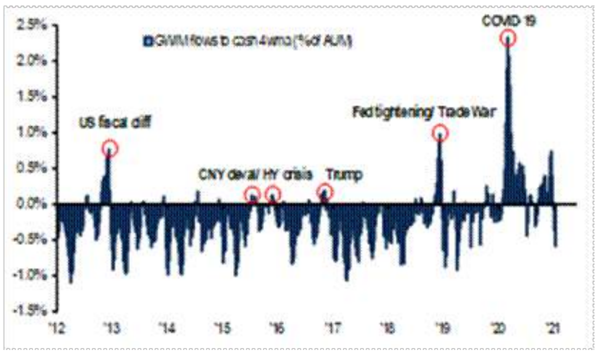


Figure 4. BofA Private client cash drawdown was largest since 2019



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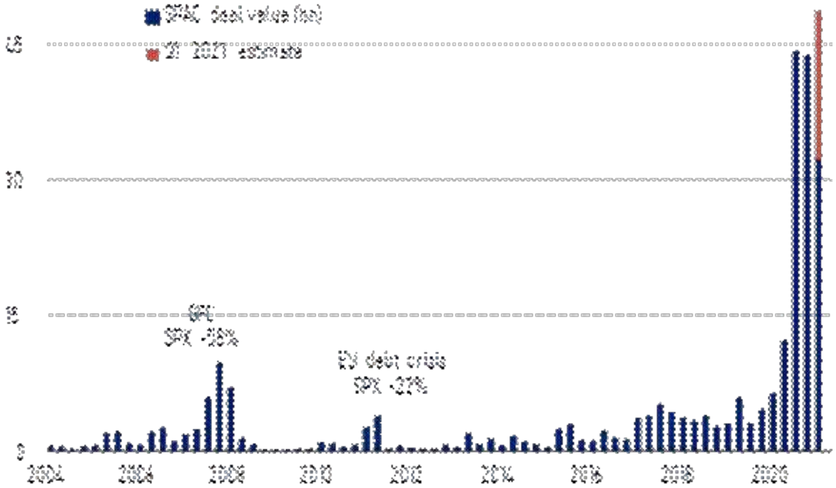
The Rise of SPACs:

Another sign of investor desperation for returns is the popularity of **Special Purpose Acquisition Companies (SPACs)**, one of the fastest-growing segments of the equity market. SPACs involve the creation of a publicly listed company for the sole purpose of raising capital to search for and then purchase a private company.

These "blank check" companies have two years to complete an acquisition or they must return their funds to investors. Once an acquisition is completed, the SPAC shares are redeemed, and investors receive shares in the newly-public acquired company. SPACs generally offer private companies a faster process, better fee terms, and easier marketing and regulatory requirements compared to traditional initial public offerings (IPOs).

In 2020, SPACs raised $106 billion in funds, five times the prior peak ($19 billion in 2007) and more than the total from the past ten years. Recent market volatility was no deterrent to new SPACs: the number of SPAC offerings in January alone exceeded the last six years combined, with 2021 on pace to set a new record (see SPAC chart below).

SPAC deals on pace for the strongest quarter in history



Source: BofA Research Investment Committee, Bloomberg; Q1 2021 estimated using January and February 2021 deal value.

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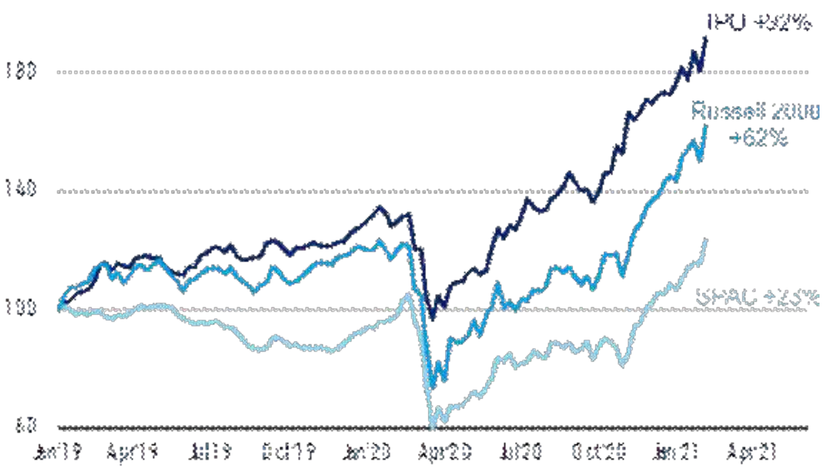
Individual investors are increasingly becoming more involved, representing 40% of all trading in SPACs, compa
20% of
retail investor activity in S&P 500 and Russell 2000 stocks, according to BoA data.

Since early 2019, the 30 largest SPACs have significantly lagged the 30 largest traditional IPOs and small stocks
in this chart:

Returns of the 30 largest post-merger SPACs, 30 largest IPOs, and the Russell 2000



The above noted under performance is probably due to the unique risks of SPACs. For example, early SPAC inv
idea what the
ultimate acquisition target will be. They have the option to redeem SPAC shares for a return of principal prior to
acquisition,
but still bear credit risk and the opportunity cost during the pre-acquisition period.

One study found that the hidden fees and costs are so large that for every $10 raised in a SPAC IPO, less than $7
by the time
the average SPAC acquires a target. Sponsors are also allowed to negotiate side deals with large or influential inv
offering more

favorable terms without disclosing them to the rest of the SPAC investors.

The desperation of investors to chase blank-check companies may serve as a contrarian indicator. After prior pe
issuance in 2007
and 2011, the S&P 500 fell 58% and 22%, according to BoA.

Rajeev Das, CFA, Portfolio Manager and Principal at **Bulldog Investors LLC**, had this to say: "The SPAC struc
structural
safeguards to investors. I am quite happy to keep investing in the space as long as the safeguards remain in place
more for a
SPAC than the cash held in the trust account. And we never stay in a SPAC post business combination as an inve
right to
redeem shares for the per share cash value of the trust account. So our strategy provides solid downside protecti
investors, while
allowing them to participate in significant upside."

"While SPAC issuance has reached record levels, the number of private companies that now see SPACS as a via
public has
also increased."

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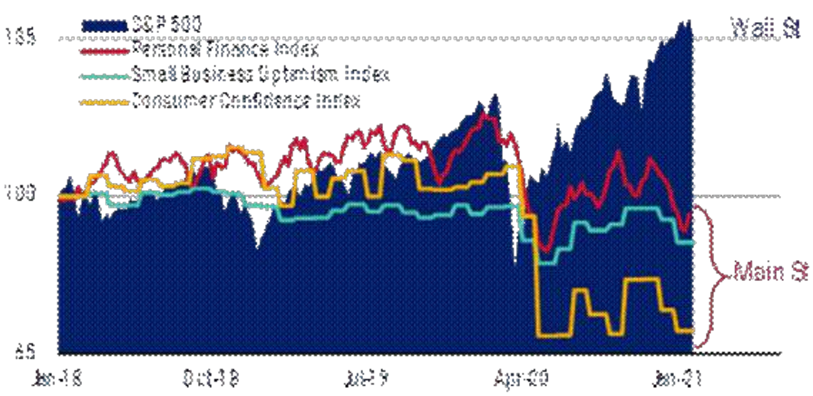
Conclusions -Wall Street Wins; Main Street Loses:

The loud and clear message here is one which we have repeated in numerous Curmudgeon/ Sperandeo blog posts: U.S. stocks (Wall Street orgy) continue to make record highs while the real economy (Main Street) suffers and languishes in despair.

That's shown in this chart (courtesy of BoA Global Research):



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Stay calm, be well and till next time……………………………………...

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Curmudgeon *is a retired investment professional. He has been involved in financial markets since 1968 (yes, he cut his teeth on the 1968-1974 bear market), became an SEC Registered Investment Advisor in 1995, and received the Chartered Financial Analyst designation from AIMR (now CFA Institute) in 1996. He managed hedged equity and alternative (non-correlated) investment accounts for clients from 1992-2005.*

Victor Sperandeo *is a historian, economist and financial innovator who has re-invented himself and the companies he's owned (since 1971) to profit in the ever changing and arcane world of markets, economies and government policies. Victor started his Wall Street career in 1966 and began trading for a living in 1968. As President and CEO of Alpha Financial Technologies LLC, Sperandeo oversees the firm's research and development platform, which is used to create innovative solutions for different futures markets, risk parameters and other factors.*