SPAC, A NEW ERA?

The number of companies listed on US stock exchanges hit a high of 8,090 in 1996, just before the dot-com boom. The boom added companies to the market, but not as fast as mergers and acquisitions took them off the table. Regardless, by the time the Internet Bubble was ready to pop in 1999, there were still 7,229 stocks available for investors to choose from.

But when the bubble popped, the number of publicly traded companies declined and kept on falling right through the 2008 Financial Crisis. However, it may surprise members to learn that it didn't stop there, the numbers were in free fall and only bottomed out during 2012, at which point there were only 4,102 listed companies left on the market, half of what there had been at the peak.

Cutting investors choices in half was one downside of the declining number of stocks. Additionally, because many smaller companies were gobbled up by larger companies along the way, investors lost the chance to invest in many faster-growing small caps, as small companies got replaced with large caps. During 2018, Bloomberg hypothesized that the US stock market might be suffering from an unhealthy degree of industry concentration.

Enter of the SPAC - a new era, or is it?

2020 was the year of the special purpose acquisition company (SPAC) IPO and 2021 is probably going to be even better.

248 SPACs filed for IPO last year, going public with the sole intent of finding a hot private company to buy and then take public in a reverse merger.

This year in the first quarter there were nearly as many SPAC IPOs as last year; a mega trend has formed. *Why?* Well, the Wall Street Journal opinion pages summed up the one big reason for the building trend of listing an IPO via SPAC, the article explained the fact that a company that sponsors a SPAC for an IPO can and often does pocket a very sweet return on its investment, essentially for free. It also pointed out that individual investors who buy into a SPAC, on the other hand, lose an average of 12% of their investment within six months of the IPO. The article essentially denouncing the phenomenon as a ‘fad on Wall Street.’ Time will tell.

Why are SPAC's so popular?

The big benefit I see is the fact that it is faster to do than a traditional IPO, which can take up to six months to complete. Secondly, SPAC IPOs aren't subject to the same gag rules that forbid ‘normal’ IPOs from making projections about the future. When announcing an acquisition, SPACs routinely predict gigantic revenue growth, huge profits, and addressable markets that verge on too good to be true. These pie-in-the-sky statements help to drive investor excitement and drive SPAC valuations to the moon.

What it means to an investor; Be careful of the unchecked marketing hype!

Will all of these company’s produce stellar gains? No.
Most of the SPAC IPOs coming to market lately have been companies devoid of profit, or even revenue! Many will fail, I would also predict that in today's market many will turn out to be vastly overpriced, and as a result could easily result in their early investors losing money.

Equally, not all companies that go to market via usual IPO route turn out to be a good investment either. To make my point half of the companies on the S&P 500 are simply below average companies, and underperform the index every year.

My advice is that if you are not an industry professional or a seasoned investor you should invest in SPAC IPOs with far greater levels of caution.

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