Wealth Management
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Mind the "shot across the bow"…

It's been over a year since the panic about the pandemic peaked…and things are looking up! Most of the developed world has already provided vaccines for a significant portion of their respective populations, and even in Canada we have started to vaccinate regularly, fulfilling the old adage of better late than never… Investors who stayed the course and held on to their investments continue to experience reasonable returns after what looked like the brink of Armageddon a year ago. In stark contrast to the peak fear, speculation by retail investors recently hit all-time peak levels earlier this year, symptomatic more of greed and a top in the markets than of fear and the depths of despair. For those on the lookout for the next "sure thing" there is no shortage of "investment" advice coming from not only the traditional sources (brokerage "sell-side" research, "expert" media personalities), but also from Sport Bar owners, first time investors, social media gurus, and other "aficionados". For those caught up in the excitement of the latest hot trend, focusing on the bigger picture is easy to ignore. There is an expression from the world of military which, based on the changing market leadership, ought not to be ignored. In battle, an attacking military ship would often give a warning to an enemy ship by literally shooting a cannon ball across the bow of the enemy ship. A ship's crew foolhardy enough to ignore that warning could find itself under siege with the threat of death and destruction not far behind. One might say, watching recent market action that "Mr. Market" has provided investors with a "shot across the bow" and likewise, only a foolhardy investor will ignore the telling signs.

I have been writing about a "changing of the guard" in the markets since the summer of 2020. The market is going through significant changes, almost cataclysmic in nature, and investors ought to pay attention. The problem however in trying to discern this "big picture" is the information-overload we receive about the markets. Access to a computer, laptop, tablet or even a smart phone (maybe a smart watch too?) allows access to minute-by-minute streaming of changes to the price of one's investments. When an investor stares at a screen all day, as market strategist Jared Dillian notes, "You sort of lose track of what the trend is." Dillian notes that one's daily routine can look something like, "bad day for value [stocks] yesterday. Good day for value the day before. Good day for bonds yesterday. Bad day for bonds the day before." Worse still, on a macro-level, the amount of time investors hold onto their investments has decreased to levels not seen since the "roaring '20s" (remember what happened at the end of that decade…). Prior to the 1930s, the holding time period for stocks was less than two years. From the 1930s to the late 1980s, the average hold time went as high as 10 years or more. Since the late 1980s however, the holding time period has gone back down to two years. So for all the talk about "buy and hold", that has not been the experience of the average investor. As Dillian points out, in order to be a successful investor, you need to "keep the larger trend in mind…[as] you don't make money by buying, you don't make money selling, you make money by waiting."

Did you ever think about borrowing to invest? Some may balk at the idea as too risky, but most are comfortable taking out a mortgage to buy a rental property. In fact, the returns on real estate are exceptional mostly because of the borrowing. If one puts down $1 million to buy a home outright and it appreciates to $2 million, one has made a 100% return (less expenses). However, if one puts down $250,000 to buy that $1 million home and borrows the rest, one has made a 700% profit (less expenses, including the cost of borrowing). Borrowing to buy stocks can be risky, or it can be conservative and comparable to buying a rental property. Borrowing to buy dividend-paying stocks, and using the income produced (dividends, etc.) to pay the cost of borrowing, is fairly conservative and the risks are akin to borrowing to buy a rental property. The cost of borrowing is tax deductible and the assets can be held to appreciate over time. On the other hand, borrowing to buy an asset in the hopes it will appreciate quickly can backfire and lead to large capital losses. For instance, if the rapid growth one expected doesn't occur, or not in the short-time frame one was expecting, then one is left holding onto a depreciating asset with ongoing carrying costs. Consider the levels of borrowing to invest in the stock markets (referred to as "margin" loans). Since 1999, there have been bursts of margin borrowing which have often been followed by market downturns. This makes sense, as if the assets one is holding don't produce sufficient income to cover the cost of the borrowing, then one is more likely to sell the investments in order to cut one's losses. Frighteningly, margin balances are up about 50% since February of 2020, when the markets began to react to the pandemic. Combined with the average short-time horizon for holding stocks, it is likely much of the margin borrowing is invested for short-term gains, a dangerous combination if stocks turn down.

The current poster child for "growth" investing is Tesla, the electric car manufacturer. After peaking near $900 per share in early 2021, (following a huge run up in price in 2020 which culminated in its being added to the S&P 500 stock market index), the stock is now down 26% from those highs. From March 1st to March 8th, the stock dropped over 20%, only to rebound by 20% the next day. There may have been other occasions in which one of the top 10 largest companies in the S&P 500 stock market index has been that volatile, but it is at the very least a very rare occurrence. Priced at a valuation representing several hundred dollars per dollar of actual earnings, it's hard to argue this stock is a bargain. In contrast, shares in "old guard", classic "value" stock, Exxon Mobil, one of the world's largest oil producers, having recently suffered the indignity of being kicked out of the S&P 500 index, and after dropping steadily in price since the mid-2000s, is currently up by almost 40% year-to-date. A changing of the guard indeed!

Bottom line

In the military and in investing there is nothing more important than focusing on one's long-term goals. Day-to-day minutiae ought to be ignored as it doesn't matter who wins the battles, it only matters who wins the war. When the generals send shots across the bow, or when value stocks start to outperform growth stocks, consider it a warning!

Global benchmarks
As at March 31, 2021 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	8.1%	44.2%	10.2%
S&P 500 TR - US$	6.2%	56.4%	16.8%
NASDAQ Composite - US$	2.8%	72.0%	23.3%
MSCI Europe Index Price Return	2.1%	26.8%	2.0%
MSCI Emerging Markets	0.6%	38.6%	3.1%
China S.E Shanghai A Price Return	-2.6%	20.8%	0.7%
MSCI World Index Price Return	3.1%	35.6%	9.9%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	-15.5%	-21.2%	5.8%
10-year U.S. T-Bond - US$	-7.2%	-8.9%	4.8%
Long GOC Bond (2051)	-16.1%	-13.6%	3.0%
10-year GOC Bond	-7.1%	-5.9%	3.3%
5-year GOC Bond	-2.1%	-0.8%	3.2%
3-month CDN T-bill	0.0%	0.2%	1.2%
US$/CDN$ (1.2558)	-1.4%	-10.7%	-0.8%

Source: RBC Capital Markets Quantitative Research

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