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The Krygier Report

An exclusive newsletter from Mark J. Krygier, Senior Portfolio Manager | December 2022 www.krygierwealthmanagement.ca

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Brains or bull?

As we enter the last month of 2022 we have the opportunity to reflect on what went right and what went wrong, or at least what went not "as right" as it could have been, over the course of the year. In a year of significant volatility and plenty of negative numbers, our clients' portfolios have actually fared very, very well. I am a big believer in what former newsletter writer and Portfolio Manager Dennis Gartman used to say, "Do more of what's working and less of what's not working." Therefore, our main investing themes from the start of 2022 have been "inflation is here to stay" and "avoid investing in overvalued companies." Investing in both of these themes has paid off in spades. Inflation as headline news became commonly accepted knowledge by mid-2022, after being "pooh poohed" by U.S. Fed Chairman Powell and most other Central Bankers for much of the previous two years. During that time period Central Banks globally, led by the "Fed," maintained artificially low-interest rates to try and induce growth in a moribund Covid-restricted economy until being forced in 2022 to raise interest rates at a faster pace than anyone has seen in over four decades – not a statistic for the faint of heart!

Inflation has historically crushed the stock prices of overvalued companies. *Facebook* (now "*Meta*" – reminiscent of Gertrude Stein's "A rose by any other name…") is currently down 67% so far in 2022. The Covid "posterchild" *Peloton* is down over 70%. The closed-end fund "*Greyscale Bitcoin Trust*" which gives "investors" the opportunity to invest in the financial world's "greatest thing since sliced bread" – Bitcoin – is down almost 75% (how do you spell P-O-N-Z-I ?). Oft-quoted portfolio manager (or according to Forbes magazine, "Star Stock Picker") Cathy Woods' flagship "disruptive" themed ETF is down over 60%. After achieving a return of over 150% in the 2020 apex of Covid, Woods' entire profit has been "washed away" as the value of her fund is down to pre-2020 levels – leaving most investors in her ETF wishing they had never got on the ARK…. Such "performance" reminds me of the old adage recently mentioned by famed distressed debt specialist and one of the truly brilliant people I have ever heard speak, Howard Marks of Oaktree Capital, "Never confuse brains and a bull market."

Speaking of Mr. Marks, his recent memo entitled "What Really Matters?" is worthy of review. One can access the full article on the Oaktree Capital website, and for those who are both interested in capital markets and enjoy reading beautifully written prose, I highly recommend his memos as "must" reading in the world of finance. Marks begins by listing all those things a serious investor has to learn to ignore: Short-term events, a "trading" mentality, short-term performance, volatility, and hyper-activity (excessive trading). In contrast, what should truly matter to a serious investor? "The performance of your holdings over the next five or ten years (or more) and how the value at the end of the period compares to the amount you invested and to your needs." Success, says Marks, comes more from hard work "to gain superior insight concerning the outlook for fundamentals over multi-year periods" than in focusing on the short run."

I showed this Howard Marks' article to a close relative, whose comment was, “Great article…really [it is] investing 101”, and I couldn’t agree more. Trying to figure out: “How bad will inflation get? How much will the Fed raise interest rates to fight it? Will those increases cause a recession? How bad and for how long [will be the recession]?” is a waste of one’s mental energy. Why? Because these events are hard to accurately predict on a regular basis. A better approach is to ignore them. Even if one would make significant changes to one’s investment approach in response to such predictions, it is really hard to make such changes and be consistently right. After five decades of successful investing, Marks concludes that “most investors are unable to improve their results by focusing on the short-term.” His reasoning? Short-term ups and downs are more influenced by swings in investor psychology than by actual changes in a company’s long-term business prospects. Since such swings in psychology matter more in the near term than actual changes to a company’s fundamentals, and worse that they are hard to predict, he concludes that “Most short-term trading is a waste of time..or worse.”

I have been asked on several occasions, “if you see a short-term opportunity, why don’t you just buy it and sell it shortly thereafter at a higher price?” Marks’ response: “Buying for a short-term trade equates to forgetting about your sport team’s chances of winning the championship and instead betting on who’s going to succeed in the next play, period, or inning.” That is nothing more than pure speculation or gambling. Similarly, believing that since I didn’t win the lottery for the past thirty years (or the horse race, or the slot machine, or…) means that somehow I am entitled to win the next “big one”? Where is that carved into stone? Finally, many investors hate the volatility in the markets because, deep down, they really believe that volatility means risk. In contrast, Marks defines risk “as the probability of a bad outcome, and volatility is, at best, an indicator of the presence of risk. But volatility is not risk.” Have you ever heard someone complain about a positive 15% return on an investment because it was “too risky”? Rarely, as only “negative” volatility brings out the risk discussion. In reality, only those investments which can experience negative volatility can also provide us with capital gains (positive volatility).

Bottom line

Planning a daily routine in the hopes of achieving a long healthy life means thinking about eating healthy, exercising sufficiently, getting enough sleep, and having healthy outlets for dealing with stress. When planning for financial health, the sound approach is to invest in good quality, avoid short-term fads, buy at a reasonable price, and stick with one’s investments unless the fundamentals change or a better opportunity comes along. Lasting physical and financial health starts with avoiding the “latest and the greatest” and instead focusing on long-term results!

Global benchmarks
As at November 30, 2022 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	-1.0%	2.0%	9.5%
S&P 500 TR - **US$**	-13.1%	-9.2%	10.9%
NASDAQ Composite - **US$**	-26.7%	-26.2%	9.8%
MSCI Europe Index Price Return	-12.2%	-7.5%	0.6%
MSCI Emerging Markets	-16.2%	-15.9%	-1.9%
China S.E Shanghai A Price Return	-17.6%	-16.7%	3.2%
MSCI World Index Price Return	-10.6%	-8.0%	6.2%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - **US$**	-29.6%	-31.2%	-8.2%
10-year U.S. T-Bond - **US$**	-14.9%	-15.3%	-3.8%
Long GOC Bond (2053)	-23.5%	-19.7%	-8.7%
10-year GOC Bond	-10.0%	-8.8%	-2.3%
5-year GOC Bond	-6.0%	-5.3%	-0.8%
3-month CDN T-bill	1.0%	1.0%	0.7%
US$/CDN$ (1.3409)	6.1%	5.0%	0.3%

Source: RBC Capital Markets Quantitative Research

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