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The Krygier Report

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

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Been there, done that…!

With the great returns of 2021 a month past and long forgotten…some investors are waking up to the reality that negative volatility is still capable of rearing its ugly head (rarely does anyone complain about "positive" volatility). The NASDAQ heavily technology-laden stock market index is down 10% year-to-date, and the last time we saw this type of market turbulence it was the early 2020 "Corona" panic. Before that in late 2018 it was the U.S. Central Bank (the "Fed") threatening to drastically raise interest rates (before backtracking three weeks later). Well before that in 2008-09 it was the near-collapse of the over-leveraged financial system (THAT was frightening). In the mid-2000s it was oil prices hitting $140/bbl., and of course before that in '99-2000 was the massive dot-com bubble bursting. In between each of those drops in market value or "bear markets" there were many mini-drops along the way. Statistically, on average once every three years the capital markets have a drop of 10% or more in market valuations and despite that markets have created a lot of wealth over time. Having experienced a number of these moments of "high drama" in the past 25 years of advising (yes, the grey hair has been honestly earned), I cannot say I relish the thought of going through another one again, but at the same time I must say that the "edge" has come off the gut-wrenching feelings they can produce. A lot of lessons have been learned in the past quarter of a century, mistakes made and, yet, here we are once again having the opportunity to try and predict future events and plan around them, knowing full well that whatever we expect to happen may not in fact come through to fruition. Lacking the attribute of hindsight, the only perfect predictor of future events, we can still try to learn from the past in order to plan for whatever the future portends, with the confidence that we will persevere, just as we did through each of the past downturns.

Starting in the financial industry in late 1996, I caught the tail-end of the last high-tech boom, the birth of the internet. It was very exciting and the potential seemed unlimited. I would say that the stock market at that time could have been divided into three types of stocks. First, were the infamous "dot-coms", companies with nary a realistic business plan for making money but with bright-eyed high-tech nerds promising a better tomorrow. For the most part, the stocks in these companies ended up worthless. The second category were real companies, many of whom are still around today and are even better companies than they were back in 2000 – "mega-cap" companies like Microsoft, Apple and Cisco, to name but a few. While even great back then, their problem was that they suffered from a massive overvaluation in the market place – from over exuberant investors willing to pay any price for the exciting growth they represented. When that price bubble burst, so did their stock prices…and how! Microsoft, for instance, reached such a peak in value (over 80 times its actual earnings) that it took (no, this is not a misprint) 15 years to recover back to the price it touched in March 2000. A treasury bill would have given a better return during that period. The final category of stocks was "everything else" – including boring consumer stocks of brands everybody buys, old-fashioned industrial companies that manufacture "widgets", transportation companies that bring goods from producers to consumers, and of course miners and producers of the raw commodities needed to build "everything".

In 1999, retail investors outperformed many of the professionals. "Growth" oriented portfolio managers outperformed "value" managers by a wide margin. Famed investor Warren Buffett was "washed-up", while darling Nortel was driving the Canadian markets to all-time highs with its stratospheric growth. Mackenzie Financial, the mutual fund company, created the "perfect solution" to investing – the "Select Managers" fund. Mackenzie took five of its best performing portfolio managers – each with a different specialty, who would each contribute their 10 best ideas, into a tight 50 stock portfolio as a veritable "one-stop" shop on the road to wealth creation. The managers invested (if memory serves correctly) in Europe, the USA, global small companies, high tech, and global value-oriented stocks - seemingly well diversified. I bought the fund for a number of clients in early 1999 and figuratively patted myself on the back for the brilliant selection as the fund rocketed up over 50% during the year. However, as the NASDAQ market hit a peak in March 2000, so did this "well-diversified" fund, and as the high-tech bubble burst, so did the returns on this fund. At the end of 2000 the fund had essentially mimicked the NASDAQ index – straight up in 1999, and straight down in 2000 – an absolutely stunning turn of events. It turned out that four of the five managers (the one exception being the global "value" manager) had overloaded on high-tech exposure in their own "pool". As the luck of that sector ran out, and with no strategist overseeing the managers so did the fund. That fund was later disbanded to the mutual fund hall of shame, as have hundreds if not thousands of funds which didn't work out as planned and which have been swept under the rug, just in time for the next marketing strategy…

One month into 2022, twenty years ago "washed-up" Warren Buffett (through his Berkshire Hathaway company's stock) is up about 5% (and 37% in the past year), while the NASDAQ high-tech laden index is down 9% (and now is only up 12% in the past year). Today's dot-com parallels like Zoom and Peloton (never mind the "SPACs" and "Meme" stocks) are down more than 50% in the past year on their way to oblivion, and overpriced mega-stocks, like Amazon and Tesla, are down over 10% so far this year (with a lot more downside to come) as investors experience this decade's "OMG" moment of realizing that yes, there has to be a relationship between actual earnings and a company's stock valuation. Looking back over the past 25 years, an old cliché comes to mind, "Fool me once, shame on you; fool me twice, shame on me."

Bottom line

Time brings experience and the school of hard knocks is often the best teacher. The stock markets can be a source of wealth creation or a source of wealth destruction. The secret recipe for being on the successful side of investing is actually quite simple: adopt a longer-term view, avoid speculation, focus on good quality and reasonable valuations, and throw in a smattering of common sense and a dash of patience. Take all of that and in 25 years you too can write the story!

Global benchmarks
As at January 31, 2022 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	-0.4%	25.0%	14.1%
S&P 500 TR - **US$**	-5.2%	23.3%	20.7%
NASDAQ Composite - **US$**	-9.0%	8.9%	25.1%
MSCI Europe Index Price Return	-4.1%	9.5%	6.9%
MSCI Emerging Markets	-1.4%	-9.6%	3.7%
China S.E Shanghai A Price Return	-7.2%	-3.1%	9.9%
MSCI World Index Price Return	-4.8%	14.3%	13.4%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - **US$**	-4.4%	-4.5%	8.0%
10-year U.S. T-Bond - **US$**	-2.3%	-5.1%	3.9%
Long GOC Bond (2051)	-7.8%	-10.7%	1.7%
10-year GOC Bond	-2.8%	-6.1%	1.9%
5-year GOC Bond	-1.5%	-3.7%	1.6%
3-month CDN T-bill	0.0%	0.1%	0.8%
US$/CDN$ (1.2705)	0.6%	-0.6%	-1.1%

Source: RBC Capital Markets Quantitative Research

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