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The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | July 2021 www.krygierwealthmanagement.ca

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Actions speak louder than words!

As a parent, there are few things that guide one's children learning more than how one acts. One can lecture, talk about appropriate behavior, rebuke or verbally give advice, but if one's actions are inconsistent with one's verbal message, it is a truism that one's actions are most likely to be followed. In the field of education too, if a teacher acts inconsistently with his or her message, the message will be lost on the students. I recall a class on "ethics", during the Ontario Bar exam preparation sessions in the mid-90s, which was taught by a practicing lawyer. He showed us multiple videos of lawyers who had been "disbarred" and thereby precluded from practicing law, usually after stealing from their law firm's "Trust Funds". How did they arrive in this situation? Too often it was a case of succumbing to alcohol and/or drug abuse which started innocently while dealing with the stresses from work, and which eventually culminated into fraud or theft when their personal finances suffered from their inability to function. This lawyer teaching us about acting ethically turned to us and asked, "Do you think this is a far-fetched scenario?" "In a typical day, I wake up at 5 a.m. to go to work. By noon I have had ten coffees. At lunch I have a martini or two. By 4 p.m. I take two Tylenol 3s (i.e. with codeine) for a headache, and when I come home I have a drink or two to wind down." I was never quite sure what we were supposed to learn about ethics from him…

It has become a given over the past several decades that whenever a financial crisis occurs, which seem to be every few years, the US Central Bank, the "Fed" – comes galloping to the rescue of Wall Street and investors everywhere – hooray! "Don't worry, we will lower interest rates to "stimulate" the economy." "Have no fear, we will buy our own governments' issued bonds to keep interest rates low (prices of bonds trade opposite of yields, so buying pressure pushes the price of the bonds up and conversely the yields down)." If the Fed's actions are not sufficient to meet the challenges of the latest crisis, other branches of government get involved, such as releasing the government's strategic oil reserves to increase the supply of oil on the market or to add to the reserves to reduce the supply on the market (ironically the government historically seems to add to their reserves (using tax payers' money incidentally) when prices are high, thereby exacerbating the prices to go even higher, and releasing reserves onto the market when prices are low, thereby ensuring the worst possible returns to the tax payer as they sell and push prices even lower). Other actions may include bailing out otherwise bankrupt companies rather than letting the market deal with business failures and allowing good businesses to flourish. Adam Smith (the father of modern economics) must be turning in his grave at the not-so-"invisible hand" which is interfering with market action. Despite Abraham Lincoln's admonition that the legitimate role of a government "Is to do for [society] that which they cannot do or not do so well for themselves in their individual capacity," government actions belie that logic and instead suggest that they know what's best for society.

The main debate amongst economists and market strategists today is whether we are heading into a longer-term inflationary environment, with elevated prices of oil, steel, lumber, fertilizer and other commodities to remain high, or are we just experiencing a short-term post-Covid pent-up demand “blip” in what has been a deflationary environment for the past 30 years? If one listens to the “language” coming out of the Fed, the story being told is one of “transient inflation”. The official mantra has been that we are simply seeing a reversion to the mean in demand, following the forced economic closures that put a dent in global supply chains of parts and products worldwide. This mantra of “transient inflation” is being repeated and reinforced by assurances regarding the Fed’s ability to control inflationary pressures should they persist – or in their words, we can “talk about talk”. Despite these nice words, which are clearly intended to give confidence to market players by reducing concerns over inflationary pressures, the stock market sold off and the yield curve “flattened” in response as a knee-jerk reaction against the recently popularized view that inflation is here to stay. Why? Because despite the talk of transient inflation, the actual projections about inflation published by the Fed (the “median dot projection”) showed that seven members of the Fed expect interest rate hikes by 2023 versus only 3 members with such an opinion earlier this year. Some market strategists suggested that, “The dots were inconsistent with the Fed’s economic forecast.” As for the markets’ collective confidence in the Fed and other Central Bankers to control inflation, beyond the nice words no action was taken. In response, market strategist Jared Dillian remarked, “I would categorize this as completely ineffectual.” He further remarked that even by addressing inflationary pressures, “the Fed is actually tacitly admitting that the inflation trade is not transitory.”

Bottom line

Whether one is a parent, an educator or a Central Banker, one’s actions are more impactful than one’s words. When the dog is baring its teeth while at the same time wagging its tail, the lack of consistency in the message leads to confusion. Central Bankers have been thrust into the limelight in recent years, as governments globally face increasing challenges from larger and larger fiscal deficits and moribund growth, despite “stimulative” efforts. While mild inflation signifies healthy growth in an economy and is to be welcomed, high levels of inflation can wreak havoc on an economy and ultimately on one’s ability to maintain one’s lifestyle. If we are in fact facing a new challenge of persistent inflation, we need effective leadership to act on a timely basis. Talk is cheap.

Global benchmarks
As at June 30, 2021 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	17.3%	33.9%	10.8%
S&P 500 TR - US$	15.3%	40.8%	18.7%
NASDAQ Composite - US$	12.5%	44.2%	24.5%
MSCI Europe Index Price Return	7.2%	20.6%	4.0%
MSCI Emerging Markets	3.6%	26.1%	6.7%
China S.E Shanghai A Price Return	1.8%	20.2%	6.9%
MSCI World Index Price Return	9.2%	25.1%	10.9%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	-8.9%	-13.4%	8.4%
10-year U.S. T-Bond - US$	-4.5%	-6.5%	6.0%
Long GOC Bond (2051)	-13.0%	-17.1%	3.9%
10-year GOC Bond	-5.3%	-6.3%	3.9%
5-year GOC Bond	-1.8%	-1.8%	3.2%
3-month CDN T-bill	0.0%	0.1%	1.1%
US$/CDN$ (1.2394)	-2.6%	-8.7%	-1.9%

Source: RBC Capital Markets Quantitative Research

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