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The Krygier Report

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

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“This” time IS different…

In 1999, three years after I joined RBC Dominion Securities as an Investment Advisor, I attended a client appreciation event hosted by RBC DS at the Sheraton Hotel in downtown Toronto. The featured speaker was Ed Kirschner of the investment firm Paine Webber, which was later bought out by Credit Suisse. At the time, RBC had exclusive Canadian access to the US research of Paine Webber, and Mr. Kirschner was ranked as the “Number 2” investment strategist amongst the myriad of US financial institutions, behind Libby Cohen, the Chief Investment Strategist of Goldman Sachs. The timing was great as stock markets were near all-time highs (peaking in March 2000). The event was absolutely packed with advisors and clients, and if memory serves there were 1,000 or more people with standing room only, everyone hoping to glean some ideas for investing in the coming years. The markets were flying higher on the backs of technology stocks. There were the blue-chip dominating companies like Microsoft and Apple, as well as the neophyte internet companies like AOL and Yahoo, mobile phone manufacturers like Research In Motion (i.e. Blackberry), Nokia and Erickson, plus all the “dot-coms”, like Pets.com, which promised a brighter and more profitable future with the increasing popularity of internet technology.

The thesis of Mr. Kirchner’s speech was that all boom and bust cycles throughout history were based on build-ups in inventory. A company, such as Ford Motor Company, would base their purchases of parts for their end-product based on past customer behavior as to how many parts (such as a bumper or windshield) they would need in the coming season. So for instance, if in the first quarter of each year Ford would historically sell 1,500 pick-up trucks of a certain model, they would order 1,500 bumpers (plus some extra for any mistakes) in order to build their trucks. They would have to transport the 1,500 bumpers, store them in a warehouse, pay workers to receive the delivery, record the inventory, and then to get it to the factory when the trucks were beginning to be assembled. In the event customers only wanted 1,400 trucks in the coming year, Ford would have to store the extra 100+ bumpers, and continue to pay electricity to heat and light the warehouse. Eventually, if the economy slowed down, they may have to lay off employees if they had to cut back on production due to the excess costs of storing the extra inventory. So what was the proposed solution to this inventory build-up, which Mr. Kirschner said exacerbated the boom and bust business cycle? The use of technology and “just-in-time” purchasing. No longer would Ford have to order their bumpers months in advance based on historical purchasing. Instead, they would wait to see actual customer orders, then they would send the message to the factories to order only that amount of parts and, “presto”, no more inventory build-up, no more boom and bust cycle (or at least very moderated) and we have the setting for a utopian cycle of growth that can go on forever! The presentation made for a good story, but, like many good stories – if it sounds too good to be true, then it’s too good to be true.

With hindsight it is easy to see the irony of this 1999 "just-in-time" presentation, as the market collapse in 2000 was precipitated by a massive inventory build-up in which sector? Would you believe…technology! The fears of "Y2K" – wherein the fear was that computer hardware and software would somehow implode once the year January 1, 2000 rolled into their systems, amongst other factors like the initial popularization of the internet, drove purchases of computers, software and internet related items to extremes, peaking in March 2000 with stocks at all-time highs and valuations at historical highs. The aftermath saw mass financial destruction as the "dot-coms" imploded, companies like AOL got bought out or faded into oblivion as their technologies quickly became stale-dated, and stalwarts like Microsoft, Cisco, etc. reached ludicrous valuations that collapsed and took as much as 15 years for their share prices to recover. John Chambers, the CEO of Cisco said (paraphrasing from memory) in the fall of 2000 that "never in the history of the industrial revolution has there ever been a slowdown in demand as has occurred in our (internet equipment) industry this year". In 1999, investors thought that they had found the magic elixir to financial success. Warren Buffett grossly underperformed the markets in the high-tech "bubble" of 1998-99. The average investor and certainly the DYI (do-it-yourself) investor at the newly formed discount brokers (version 1.0 vs. the Robinhood gamers, oops, investors of today) thought of Mr. Buffett as "washed-up" or "old-fashioned". He talked about investing in companies with "reasonable valuations", with "positive cash flow" and "ability to service debt", and a business plan which could prosper over time, in spite of the challenges of the boom and bust cycles which had existed forever, ideas which had made him such an icon amongst investors for decades. Fast forward two decades, and so far in 2021, Tesla's stock is down 11%, Amazon is down 1%, Netflix is down 7%, while shares in Buffett's company Berkshire Hathaway are up 24% and another famed value investor David Eichhorn's Greenlight Capital company's shares are up 26%.

Bottom line

Investors have to learn to read the "writing on the wall". Wanting to invest in an exciting idea like "cloud investing" or "artificial intelligence" or "block-chain" doesn't mean one can ignore common sense and prudent risk management. Even the best ideas like electric cars have to make sense from a financial point of view, otherwise they are doomed to failure, like so many "sure thing" ideas of the past. If one thinks that the "experts" at JP Morgan, Goldman Sachs "know" because they are now touting crypto-currencies or some area of technology, remember that in 2007 they too were the ones selling subprime mortgages to their clients, or as famed strategist Bob Farrell stated so eloquently, "when all the experts and forecasts agree – something else is going to happen."

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

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	14.4%	33.8%	10.5%
S&P 500 TR - US$	12.6%	40.3%	18.0%
NASDAQ Composite - US$	6.7%	44.9%	22.7%
MSCI Europe Index Price Return	5.9%	22.0%	3.7%
MSCI Emerging Markets	1.0%	29.6%	4.6%
China S.E Shanghai A Price Return	1.1%	24.4%	3.1%
MSCI World Index Price Return	4.8%	21.4%	9.8%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	-12.8%	-17.2%	7.1%
10-year U.S. T-Bond - US$	-5.7%	-7.7%	5.6%
Long GOC Bond (2051)	-16.8%	-18.1%	2.8%
10-year GOC Bond	-6.3%	-7.2%	3.9%
5-year GOC Bond	-1.6%	-1.3%	3.5%
3-month CDN T-bill	0.0%	0.1%	1.1%
US$/CDN$ (1.2062)	-5.2%	-12.4%	-2.4%

Source: RBC Capital Markets Quantitative Research

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