The Krygier Report

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

Mark J. Krygier
Senior Portfolio Manager
& Wealth Advisor
416-733-5750
mark.krygier@rbc.com

Avital Pearlston
Associate Wealth Advisor
416-733-5751
avital.pearlston@rbc.com

Irene Hama
Associate
416-733-5752
irene.hama@rbc.com

It ain’t over ‘till it’s over…

Energy, inflation, interest rate increases…starting to sound familiar? Back in about 1997, I was working on the 39th floor of the gold Royal Bank Plaza building on Front St. in downtown Toronto. As rookie investment advisors, we were treated to a lecture by a senior advisor, “Al”, who only recently passed away in his ‘90s. The thrust of his lecture was to educate us on how to build a solid equity (stock) based portfolio for long-term growth. On a blackboard, Al took some chalk and drew two charts (for those that still remember an era before Power Point and Smart Boards). The first chart had an X and Y axis, and Al drew a line which went from the lower left to the upper right – this “pictorial” was to be descriptive of stock in a company whose earnings and profitability experienced “secular growth”, and whose profitability could be positively or negatively impacted by the competence of its management. The second chart also had an X and Y axis, but the line drawn was a series of “highs and lows”, or “mountains and valleys”, which in contrast to secular growth companies represented the cycles of stocks in commodity-based companies, as their profitability varied greatly and depended less on management skills than on fluctuating world-wide commodity prices. Al’s advice to us rookies was to build a portfolio of mostly “secular growth” companies’ stocks, to buy them when their valuation is reasonably low, and to hold them throughout the business cycles in order to enjoy their long-term growth, trimming or selling them only when valuations get too high or if something changes in the company’s business model. As for the cyclical commodity stocks (oil, gas, copper, iron ore, nickel, potash, gold, etc.), Al said that they should be purchased near the lows of their cycle (when their profits are terrible and valuations are high – unlike secular growth stocks) and sold near the tops of the cycles (when profits are great and valuations are low – again unlike secular growth stocks), and that they should not be held throughout a full business cycle. Having been fortunate to be investing in commodity stocks in our managed portfolios since June 2020, and having seen considerable capital gains since that time (in the face of increased overall market volatility and increasing negativity), is it time to sell them yet?

The last time the energy market peaked, after providing investors with outsized returns, was during the Beijing Summer Olympics in August 2008 when oil hit $US140/bbl (we ain’t seen nothin’ yet…). Earlier that spring, Jeff Rubin, the Chief Economist of CIBC, with oil at about $US100/bbl, put out a bold prediction that oil would hit $US200/bbl by the end of the year. A long-standing client of mine sent me an email shortly thereafter suggesting that we should be adding more oil exposure to our portfolio. As I started receiving more and more inquiries about investing in junior oil stocks something clicked in my mind – I had heard that urgent “need to buy” attitude once before. When was that? In January of 2000, two months before the peak in the high-tech “bubble” market, which when “pricked” – collapsed and took well over a decade to recover. In January of 2000, I was fielding calls from clients with a sudden “need” to buy more and more technology as the high returns from AOL, Yahoo, Netscape, Microsoft, et al. captivated the headlines day after day. So what happened to oil prices after the 2008 Summer Olympics? Al was 100% right – in the ensuing six months oil plummeted to the $80/bbl. range – a collapse of over 40%, and Rubin was no longer the Chief Economist of CIBC. So, that begs the question…are we there yet?

Most people today are incredulous at the prices of oil, housing, consumer products, and even food. Even investors can scarcely believe the increase in prices and what I am hearing is that, “it can’t possibly go any higher – can it?” Well, as famed baseball player and linguistic champion Yogi Berra used to say, “it ain’t over till it’s over.” When “Joe or Jane Public” is still arguing that prices can’t go higher, the mass psychology is clearly not yet at its bullish stage. It is said that famed banker J.P. Morgan sold his stock holdings before the 1929 stock market collapse after receiving stock advice from the shoe-shine boy. It is documented that hedge fund manager John Paulson bet against the U.S. housing market before the subprime collapse in 2008-09, in what became known as “the greatest trade ever”, making almost $4 billion as the markets tumbled. What were his clues to make such bold bets? Corporate finance “gurus” tried to sell him on a “no-lose” strategy to buy leveraged mortgage backed securities and his nanny tried to borrow $100,000 from him to buy her 5th rental property. The lesson Paulson derived and acted upon, much to his financial benefit, was when the last person available to buy is someone who should not be buying, prices have topped and are more likely to plummet. Are we there yet with commodities?

Economics 101 would tell you that “supply and demand” drives prices and nowhere is that more felt than in the commodity markets. Why did the prices of oil and other commodities get driven higher? Supplies were constrained as no new pipelines were allowed to be built. Environmental lobby groups in North America and Western Europe pressured governments to stop or reduce oil production. While demand was temporarily halted in the face of Covid induced government closures, the supply and demand relationship may have been at an equilibrium. However, as life returns more and more to “normal”, demand has increased while the supply continues to be constrained. What could change this situation? An end to the Russian invasion (Russia is a major supplier of many commodities, including oil), a peace-deal with Iran that allows Iranian oil to be sold on world markets (but which would allow Iran to fund its aggressive nuclear armament), a change in U.S. and Canadian government policy regarding domestic oil production (rather than importing “dirty” Russian oil). The cliché is that the cure to high prices is high prices. Something has to happen, but until then prices will likely continue to rise.

Bottom line

The key to figuring out when it is time to sell exposure to commodities may be when there are main-stream predictions for outlandish prices. Another sign may be when the generally non-interested investor is clamoring to buy what seems to be a “sure thing.” Over-confidence and panic buying is not yet apparent, but when it does, watch out below!!!

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

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	-1.3%	11.6%	11.0%
S&P 500 TR - **US$**	-12.9%	0.2%	13.8%
NASDAQ Composite - **US$**	-21.2%	-11.7%	15.1%
MSCI Europe Index Price Return	-12.1%	-4.6%	1.0%
MSCI Emerging Markets	-11.1%	-16.5%	-1.4%
China S.E Shanghai A Price Return	-18.1%	-9.4%	-1.0%
MSCI World Index Price Return	-12.0%	-0.5%	7.2%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - **US$**	-20.4%	-12.0%	0.9%
10-year U.S. T-Bond - **US$**	-11.5%	-9.7%	0.0%
Long GOC Bond (2051)	-21.4%	-12.8%	-4.7%
10-year GOC Bond	-11.1%	-8.8%	-1.7%
5-year GOC Bond	-6.0%	-6.5%	-.0.4%
3-month CDN T-bill	-0.1%	0.0%	0.6%
US$/CDN$ (1.2856)	1.8%	4.6%	-1.3%

Source: RBC Capital Markets Quantitative Research

For past copies of ***The Krygier Report*** visit **www.krygierwealthmanagement.ca.**

RBC Wealth Management
Dominion Securities