The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | October 2020 www.krygierwealthmanagement.ca

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Rear-view mirror driving? Don’t try it!

The dreaded second wave of the Covid-19 virus seems to have reared its ugly head. Cases of the disease have apparently surged here in Ontario and in several U.S. states. Israel, once one of the least impacted countries, recently imposed strict lock-down closures, as did the U.K., due to dramatically increased contagion rates. If that were not enough, there’s the matter of the impending fall U.S. Presidential election – perhaps the most polarizing U.S. election in memory. Concerns have arisen over a potential civil war over election discontent – no matter who wins. There are also concerns that governments will have to again force economic closures despite the Depression-like economic numbers it created the first time around and that health care systems will undoubtedly become overburdened even as the urgent search for a Covid vaccine continues. Finally, we are experiencing among the worst forest fire (west coast) and hurricane seasons (hitting the U.S. east coast) in history, to the point where the meteorologists are running out of names for the expected upcoming hurricanes (they traditionally alternate male and female names starting alphabetically with an “A”). Whew…it seems investors can’t get a break!

I was recently speaking to a client about some of these concerns when it occurred to me that we have been through all of this before – in fact, all of these concerns came to an absolute crescendo in the second and third week of March of this year – and yes, that was a mere 6 months ago even though it sure feels like a decade has passed since Covid started. Putting on my “reasonable man” hat, about which we spoke so much back in law school, in trying to decide how such a person would behave in a given scenario, I have to wonder if these concerns are really as complex or terrifying as they appear. Do I really believe that the medical system is as unprepared as it was in March should Covid numbers swell en mass? In the face of objectively falling morbidity rates, even as the numbers of infected people is rising – in some regions, do I really expect that the virus will have the same impact as it did initially? Furthermore, do I really believe that governments, which are still combating the negative impacts of the initial economic closure, have the wherewithal to impose such strict closures once again? If the answer to some or all of these questions is “no”, then I am not so sure we should be predicating our investment decisions for the coming year or years based on such concerns. To do so would seem to be trying to drive forward while staring in the proverbial rear-view mirror.

Everyone it seems wants to know what we can expect from the markets in the coming years. At the end of the day, markets are a reflection of the economy, but as a “leading” indicator the markets typically move in advance of economic change – for better or for worse. Short-term movements in the market can however be highly misleading and I strongly suggest that we are witnessing much of that phenomenon today. Anyone who looks beyond market performance numbers can see that something is askew. To August 31st, the S&P 500 (the standard benchmark for evaluating the performance of US stock-based portfolios) posted a sparkling year-to-date return of +9.7%, on the backs of a handful of mostly high-tech stocks.

The S&P, like most traditional market indices, uses a methodology of "market-weight" evaluation. Simply put, this means the largest companies have more of an impact on the movement of the "market" (i.e. the market benchmark) than do the smaller companies. Large or small refers to the "market cap" or "market capitalization", meaning the number of shares times that trade times the price of those shares. Microsoft and Apple are examples of high priced shares with lots and lots (millions?) of shares trading. In fact, Apple, which recently did a 4 for 1 "stock split", impacted the amount of technology exposure on the benchmark index due to this completely meaningless change, reflecting how bizarre a system that exists in the so-called objective "benchmark" index. [Note that I refer to the stock split as a meaningless change, since to my simple understanding of mathematics, holding 1 share worth $100 is exactly equal to 4 shares each worth $25, but I suppose somebody, somewhere might have an issue with this result.]

In contrast to the traditional S&P 500 "market-weighted" index, consider the returns of the S&P 500 "equal-weighted" index – which is surely a better measure of how the broader US economy, as measured by all of the listed companies, is faring. To the end of August this latter index posted a return of -2.3% - a massive discrepancy from the more popular reported market-weighted version and almost certainly more indicative of the general strength of the economy – weak and improving, but neither horrible nor terrific. Returning to the "reasonable man" methodology, I have to wonder what such a theoretical figure would adopt in having a portfolio of investments managed. Overweight a handful of overvalued companies or prudently trim gains to manage risk and avoid overconcentration within the portfolio? I think the answer is obviously the latter, and if so, to what are we comparing our actual portfolios to understand their relative success or failure? For those of us who remember the spectacular NASDAQ high-tech laden blow-up following the highs the NASDAQ made in March of 2000, this scenario is frighteningly reminiscent of what occurred at that time. Then too, energy, financial, industrial and good old-fashioned businesses were overlooked and performed poorly or were at best mediocre, until the tech "bubble" burst. Even amongst the tech companies which survived, the Microsoft's, et al, took 15 years to recover to the highs their stocks made during that "bubble". Those investors however who looked not at what "had worked", but instead at what "will likely work" in contrast had very strong portfolio performance in the following years.

Bottom line

Rearview gazing is rarely a successful strategy for reaching one's destination. Concern about Covid is definitely warranted, as is worrying about which party takes power in the U.S. due to its global impact, however forward-looking thinking is much more likely to provide a successful investing strategy going forward. Whether considering risks or in benchmarking – taking the reasonable approach is by definition the most prudent!

Global benchmarks
As at September 30, 2020 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	-3.1%	0.0%	4.3%
S&P 500 TR - US$	5.6%	15.1%	12.3%
NASDAQ Composite - US$	24.5%	39.6%	19.8%
MSCI Europe Index Price Return	-8.2%	-2.4%	-1.1%
MSCI Emerging Markets	-0.4%	8.7%	2.2%
China S.E Shanghai A Price Return	11.0%	17.4%	0.2%
MSCI World Index Price Return	2.9%	9.2%	8.1%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	24.4%	17.7%	13.2%
10-year U.S. T-Bond - US$	12.9%	10.8%	7.3%
Long GOC Bond (2048)	16.4%	11.2%	12.3%
10-year GOC Bond	11.6%	8.8%	6.6%
5-year GOC Bond	7.3%	6.3%	4.0%
3-month CDN T-bill	0.7%	1.2%	1.3%
US$/CDN$ (1.3319)	2.6%	0.6%	2.2%

Source: RBC Capital Markets Quantitative Research

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