The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | May 2017

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The more things change the more they stay the same …

I recently met an old friend from Osgoode Hall Law School, which I attended in the late 80s, and he commented that I look exactly the same as I did 25 years ago, just greyer … I began my career in the financial industry in August 1996 as an Investment Advisor with RBC Dominion Securities, during what would be the last few years of the technology boom before its blow-up in 2000. While Canadians felt first the joy and then the pain through our darlings Nortel, JDS Uniphase and a few others, Americans too felt the tremendous highs and then the lows with the likes of Microsoft, Cisco, Lucent, Apple, Intel, etc. In addition to the tech leaders, there were the pharmaceutical giants like Pfizer, Merck, etc., all of which promised a better tomorrow, and together these sectors led the NASDAQ biotech and technology laden stock market index to all-time highs of 5000 in March of 2000. As **Krygier Wealth Management** rejoins RBC Dominion Securities in May 2017, after a 10-and-a-half year absence, certainly a little greyer and hopefully a little wiser, we find the NASDAQ benchmark index recently hitting new highs of 6000 – 17 years after completely crumbling in the years following that first high-water mark. So one has to wonder, what makes this market high so different from the previous "bubble"?

In the spring of 2001, after the collapse of Nortel and other tech giants, I found myself wondering about the rationale for such circumstances. How could it be that "the street" – all of the high-paid stock analysts, the news media experts, the "talking heads" on the financial stations, could have got it all wrong and where was a neophyte to investment advising supposed to turn for better guidance? It turns out an acquaintance of mine was next-door-neighbours with Jerry Javasky, then fund manager of Mackenzie's Ivy Canadian Fund, who in the year 2000, as the TSX and other markets collapsed under the sinking weight of the burst tech bubble, was named Canadian Fund Manager of the Year, having eked out a profit in a negative market. I asked my acquaintance to introduce me to Mr. Javasky and, as a result, I had the pleasure of sitting down with him over a coffee at his breakfast table on a Sunday morning. I asked him how he virtually avoided any exposure to Nortel which, together with BCE its parent company at the time, comprised almost 30% of the Canadian TSX stock market index, an almost unheard-of feat for an industry known for its closet-indexers. He answered very simply (I paraphrase from memory), "As an accountant by trade, I look at the financial statements of companies in which I invest. Normal reoccurring expenses are set off against revenue to produce net earnings. In contrast, "one-time" expenses are not set off against revenue and are merely a footnote in the financial statements. Nortel [the "Valeant" of its time] had a strategy to grow by acquisition, and each time it purchased a company it was a one-time expense so it duly noted it in its financial statements. The problem is that if you looked at the series of "one-time" purchases as its growth strategy, they should instead be included as reoccurring expenses and if you did so and set those expenses off against revenue, Nortel had not made net earnings in over 10 years." That was a lesson in common sense etched in my memory forever.

The most obvious difference between today's tech market and that of 2000s valuation is the real profitmaking from today's leaders. Apple, Alphabet (Google), Cisco, Microsoft, Facebook and most of the others are cash cows today with very stable business models, and most sport fairly reasonable valuations. In contrast, much of the "bubble" in 1999-2000 was from internet start-ups with not only no net profits to show, but with no realistic hope for ever making a net profit, which was reflected in sky-high valuations which inevitably crashed. In fact, today's leaders are rising in share value at least partially from President Trump's plan to "repatriate" much of the profits made globally by these American-based multi-nationals, by offering them low tax incentives to "show me the money" and bring back dollars that are otherwise collecting dust overseas, in the hopes that money is spent in America on building infrastructure and employing more Americans. Further proof of the maturity of these industries, and their consistent cash-generating capacity, is that unlike the 2000 era, most technology companies today pay regular quarterly dividends to their investors, and like more traditional industries like banking or industrials, they appear to want to keep raising their dividends commensurate with their rising profits. Interestingly despite "old school" companies appearing initially to benefit the most from the Trump administration plans for infrastructure rebuilding, the tech-laden NASDAQ index has outperformed the more traditional Dow Jones and S&P 500 so far in 2017 by almost double. At **Krygier Wealth Management of RBC Dominion Securities** we have been fortunate to establish positions in both the NASDAQ index as well as in several individual technology companies, in addition to the more traditional assortment of industries, and our investors are enjoying the rising trend which we believe still has some room to run.

Bottom line

As risk managers, we are always on the lookout for areas of risk we should avoid, or at ways of reducing risk, by diversifying by sector, geography, capitalization size, etc. We are also not afraid to take profits – despite by doing so we are often creating taxable gains – so as to not be greedy, and we are always trying to gain some historical perspective. While only hindsight has 20/20 vision, an investor has to look beyond the headlines to invest for long-term success!

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