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The Krygier Report

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

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Time to take stock!

As fear of yet another pandemic stirs the volatility pot, investors have to take stock of where they stand. Capital markets in 2019 turned in a much better performance than most pundits expected, yet concerns over "the other shoe to drop" remain. Note that markets have been led higher by an increasingly small number of large companies' stocks, reminiscent of past market peaks which resulted in a lot of disappointment and even loss of capital for those coming "late to the (investing) party." In 1999, Canadian investors following the passive "index" benchmark (or ETFs tracking the market index) would have discovered that only two stocks (no exaggeration!) comprised almost 30% of the entire Canadian stock market – hardly a diversification strategy, with one of those two (BCE i.e. Bell Canada Enterprises) rocketed higher on the back of its majority stake in the second of those two (Nortel…remember that name?) – effectively leaving 30% of the entire market hanging on the fortunes of one company – remember how that turned out?

Americans, and those investing in U.S. markets, during that '99-'00 "dot-com" craze, had a similar concentrated bet, via the Nasdaq technology-laden benchmark index. Even further back, in the early '70s, the investing "sure thing" was the famed "Nifty Fifty" blue-chip stocks which "could not lose" – except that anyone who bought into that phenomenon late in the game in fact did lose – a lot. Today? Well, by the end of 2019, of the 500 largest companies comprising the U.S. stock index (and the passive ETFs mimicking the index), a total of 5 stocks made up almost 20% of the entire market. The number one performer? Apple Inc., which was up over 80% in 2019, despite total global sales today standing at roughly 2015 levels, and both sales and cash flow from operating activities being down from 2018. After such a run-up in its stock price, the "market capitalization" of Apple's stock is valued at more than the entire U.S. energy sector. The fine print on the bottom of all financial marketing reminds us that "past returns are no indication of future returns." With that in mind, it is worth remembering the last time U.S. technology led markets higher. The NASDAQ index peaked in March 2000, after which time it collapsed, and it took until 2016 for it to reach those same levels. Consider that if you thought investing in passive Index ETFs is a good "buy and hold" strategy.

Note also the number of unprofitable companies which have seen their stock prices soar in recent years. Over time, a company's stock price should reflect the direction of its earnings – a company growing its earnings should see its stock price rise and the inverse is true for the stock prices of unprofitable companies. When a "disconnect" occurs between earnings and stock prices, it is often a warning sign that things are not as they should be – usually it indicates stocks are either under or overpriced. Consider that nearly 40% of listed companies in the U.S. reported losing money

in the past 12 months – the highest percentage of loss-makers since the late 1990s. Furthermore, of the largest 100 companies that reported losses, approximately 75% of them saw their share prices rise in the past 12 months. Of all the money-losing companies in the U.S., 41% of them saw their shares go up last year, most of which were in the biotech sector, with the second highest percentage coming from tech stocks. Clearly, valuations of many companies are stretched at best and expectations of "disruptors" and future growth are high. So where do we go from here?

I recently heard on the radio that consumer bankruptcies in Canada at the end of 2019 hit all-time highs. This news comes in the context of real estate prices and stock markets (i.e. investment assets) at or near all-time highs. How does the former make sense in the context of the latter? To answer this query, consider the most common asset for people – the vehicle they drive. According to the New York Federal Bank, car loans 90 days late are at 4.7%, the highest since 2011, and the average length of a loan is at a record high. The average price of a car is now about 60% of median income in the U.S. and incentives in December 2019 were a record amount of $4,600 per vehicle. Simply put, people are outspending their means, and lifestyle expectations are becoming increasingly unrealistic, as reflected by record debt levels. In the context of the U.S. Presidential race, it used to be that a main difference between Democrats and Republicans was their respective willingness to spend, but today it is almost impossible to find any politician of any political stripe who is willing to risk his or her political neck by promising to be fiscally prudent.

Bottom line

The stock markets have continued their rally into 2020, providing an opportunity for individuals to review their overall financial circumstances. Are you being realistic regarding your financial needs in the coming years? Are your assumptions for growth reasonable knowing asset prices are high? Is it time to rebalance your investment mix? Are your debt levels under control? What would an increase in interest rates do to your ability to service your debt? Is your portfolio too concentrated in one sector, geography, currency or asset class? How would a downturn in the housing or stock market impact your daily lifestyle? Time spent contemplating such questions is time well spent!

Global benchmarks
As at January 31, 2020 (Canadian $ Returns – except where noted)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	1.7%	15.0%	7.2%
S&P 500 TR - US$	0.0%	21.7%	14.5%
NASDAQ Composite - US$	2.0%	25.7%	17.7%
MSCI Europe Index Price Return	-0.7%	10.8%	5.6%
MSCI Emerging Markets	-2.9%	2.1%	5.9%
China S.E Shanghai A Price Return	0.2%	12.6%	-1.5%
MSCI World Index Price Return	1.2%	16.5%	9.9%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	9.0%	25.6	10.5%
10-year U.S. T-Bond - US$	4.0%	12.8%	5.3%
Long GOC Bond (2048)	7.3%	18.1%	9.4%
10-year GOC Bond	3.8%	7.2%	3.6%
5-year GOC Bond	2.1%	4.1%	1.8%
3-month CDN T-bill	0.1%	1.7%	1.2%
US$/CDN$ (1.3235)	1.9%	0.9%	0.5%

Source: RBC Capital Markets Quantitative Research

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