Wealth Management
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An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | January 2019 www.krygierwealthmanagement.ca

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Do you believe?

Remember when you were really little and adults would answer your "why?" questions with a flippant, "wait until you are older, then you will understand." While this is never a satisfying answer, there is an element of truth to the response. Last August, a month and a half before the cannabis legislation was approved in Canada, I received several calls from people desperate to buy a "pot stock" and it didn't matter which one. In turning down the requests, I was reminded of the same irrational desire to "buy at all costs" just before the peak of the energy market in 2007, and again just before the peak of the technology market in early 2000. Since the cannabis legislation was passed, the "pot" stocks are down on average over 50%! My answer to the curious "wanna-be" buyers could have been, "wait until you are older, then you will understand." Life experience is invaluable as guidance in times of high emotion, whether greed or fear.

Extreme periods of volatility, as well as year-ends, offer a time for introspection. As the philosopher George Santayana said, "those who cannot remember the past are condemned to repeat it". The following are some of the lessons and observations which I have personally learned, which I believe will make me a better investor going forward:

1. **What's in a name?** Remember when "sin stocks" was the label given to stocks in companies that sold alcohol, gambling, military and weapons? In Canada, the cannabis stocks have been lumped into the "health sector". Judging by the performance for this startup industry, investing in it has not been good for one's financial health.
2. **This downturn has been very painful.** For short-term investors this is true, which is why I stress with every client that if you need to encroach on your capital in five years or less you should never, ever invest that amount in stocks.
3. **This downturn is really different –** right? Wrong actually. Stocks can and will go down, and that has always been the case. In fact, drops of 20-30% are relatively common and drops of 50% or more are not uncommon. For long-term investors this is just one of the mental challenges of obtaining tax efficient, long-term inflation-beating returns.
4. **Why not sell everything** and sit out the volatility? While to do so would undoubtedly 'feel good' while market volatility continues, it can also result in financial ruin. If an investor was unlucky to have bought stocks in 1929, right before the most famous market crash, on paper he would have lost 38%! If instead he held onto that portfolio until 1939 and reinvested dividends, he would have had an annualized return of 7.76%, and by 1945 the annualized profit would have risen to 14.74%. Similar data arises if one uses the stock market crashes of the early '70s "Nifty Fifty", "Black Monday" of October 1987, "tech-wreck" of 2000, 9/11 twin towers attack, and more recently the 2008-09 subprime mortgage fiasco, from which it took less than a year to recover the "losses", for those who stood calm in the face of that storm. Stocks are long-term investments, and to think otherwise is naïve at best.

5. **Income focused investors have a different concern**. Not true. Rarely do market downturns make any impact on the income generated by one's securities, whether they be bonds, preferred shares or regular common shares (stocks). Financially solid companies will continue to pay the same interest or dividends through up or down markets. The corollary is that, in positive markets, income focused investors should not expect higher payouts from their investments, unless a company raises its dividends. Throughout the financial crisis of 2008-09, few companies dropped their dividends and, if one held a diversified basket of financially sound companies, there was little to no impact on an investors' regular income stream before, during or after that crisis.
6. **Investing in stocks is crazy.** Actually, it would be more accurate to say the stock market is crazy, not stocks, and the two are not synonymous. If you own stocks in a good company, then you actually own a piece of a good business. If the company sells good products, serves its customers well, and makes a steady profit, then its earnings will grow and over time its share price will reflect that growth. However, if there is a war, a terrorist attack, a drop in a speculative part of the market (like technology, crypto currency or cannabis), any shares from any company can crash short-term, and yet it makes no difference to their business! If I feel certain that a company will persevere over the next 5, 10 and 20 years, then I will buy its shares, and history shows I will profit handsomely over time.
7. **What returns do you expect in the coming year?** Nobody, nowhere, at any time can answer that question. It is impossible for anybody to anticipate what tomorrow will bring. However, with a high degree of certainty one can say that in a diversified basket of financially sound stocks one will make inflation-beating returns over time.
8. **Buying and holding is always the best strategy** – not so fast. That may be true of a diversified basket of stocks, but if a given sector or company has problems there may be a reason to sell. In 2000, if one bought and held Microsoft, Oracle, or other tech behemoths which survived the tech melt-down, it took 15 years just to get one's money back. Our strategy, when sensible, is to cut losses short to avoid large losses, and to redeploy the proceeds into stocks of other companies. This allows one to smooth out returns and reduce the overall volatility in a portfolio.

Bottom line

Watching market volatility is a challenge for short-term investors. However, despite the irrationality one sees, there is one rational thing history shows will ultimately win out. That is, over long-periods of time, the stock price of a company's shares will follow the direction of the company's earnings. A company that is able to continue to grow its earnings will over the long-term see its stock price appreciate. In that I believe and with that I invest.

Global benchmarks
As at December 31, 2018 (Canadian $ Returns)

Asset class	1 year	3 years	5 years
S&P/TSX Composite T/R (Canada)	-8.9%	6.4%	4.1%
S&P 500 TR - US$	-4.4%	9.3%	8.5%
NASDAQ Composite - US$	-3.9%	9.8%	9.7%
MSCI Europe Index Price Return	-10.3%	-1.3%	1.6%
MSCI Emerging Markets	-9.6%	6.2%	4.3%
China S.E Shanghai A Price Return	-22.7%	-13.1%	5.9%
MSCI World Index Price Return	-2.9%	3.7%	7.8%

Asset class	1 year	3 years	5 years
30-year U.S. T-Bond - US$	-2.6%	2.7%	6.4%
10-year U.S. T-Bond - US$	0.4%	1.1%	2.9%
Long GOC Bond (2048)	4.1%	1.6%	6.3%
10-year GOC Bond	3.0%	0.6%	4.0%
5-year GOC Bond	2.3%	0.2%	2.1%
3-month CDN T-bill	1.3%	0.8%	0.8%
US$/CDN$ (1.3637)	8.4%	-0.5%	5.1%

Source: RBC Capital Markets Quantitative Research

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