The Krygier Report

An exclusive newsletter from Mark J. Krygier, Vice President & Portfolio Manager | June 2018 www.krygierwealthmanagement.ca

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Wanna' bet?

Investors often wonder about buying into 'the latest and the greatest'. Remember **"**cryptocurrency" Bitcoin? Less than half a year ago its price was front-page news, and now it is hardly newsworthy. Currently, Bitcoin is trading below $US10,000 per unit of "something", after experiencing lows of just over $US2,300 and 'highs' of over $US25,000 in the past 12 months. Interestingly, throughout that time it was hard to find anyone that could really explain what it is that they were buying. More recently it has been the cannabis or 'pot' stocks which have again taken the limelight as multi-billion dollar takeovers in the industry have been announced. Do "investors" in these companies have any sense of how large this industry may become? Is there an understanding of when such companies will be net positive with their cash flow and profitability? Consider Elon Musk's leading electric car manufacturer Tesla. The company is burning through cash at an alarming rate, while delays in production on new models are only getting longer. Not surprisingly the stock price is down almost 30% since its high point last September and it could get much worse if the cash flow doesn't turn positive soon. Why are investors willing to give their hard-earned dollars to projects which may never become profitable? P.T. Barnum of Barnum & Bailey fame is said to have said that "There's a sucker born every minute." However, there has to be more to it, as that phrase at best acknowledges that for every gullible person there is a fraudster willing to take his or her money.

The reason people invest when rationally it may not make sense to do so, I believe, is because everybody likes to dream. They dream about getting rich, and doing so quickly, without any real effort. How else can you explain the lottery ticket phenomenon and its radio slogan, "Dream Bigger!"? Or the growth rate of government-sanctioned gambling institutions – which recommend that you, "know your limit, [BUT BE SURE to] play within it", a slogan promoted by the Ontario government's gaming commission. Having personally met gambling addicts who destroyed their lives, I am not convinced this is the most ethical source for government revenue. Do you think real estate or mortgage investing is without risks? Ask the many investors in syndicated mortgage investments for projects linked to Fortress Real Developments Inc., a Richmond Hill, Ontario based real-estate development company. In February of this year eight participants in Canada's syndicated mortgage market were sanctioned by the sector's chief regulator, as part of a $1.1 million settlement that saw several lose their mortgage broker licenses. While nothing is inherently wrong with syndicated mortgages, promises of high returns on so-called "risk-free" investments is clearly enticing to many. According to FSCO figures, the syndicated mortgage market grew from $3.7 billion to $6 billion in only two years, from 2014 to 2016. With consumer debt levels at all-time highs and property prices having soared on the back of exceedingly low interest rates, how many more hidden surprises are awaiting investors in these sectors?

Back in the 1990s, Enron, a "blue-chip" company, had a lot of investors excited over its rapidly rising stock price. In 1985, a merger between two natural gas companies formed Enron, initially as a gas pipeline company. In 1989 Enron started trading natural gas commodities and over the next 11 years it became the largest natural gas merchant in the U.K. and in North America. At its peak in August 2000 Enron was the 7th most valuable company in the United States. A year later, in October 2001, Enron reported its first quarterly loss in over four years, on charges of $1 billion. In November 2001 it acknowledged overstating earnings since 1997 by over $600 million, and on December 2, 2001 it filed for bankruptcy, in the face of numerous accounting fraud charges. Enron's auditor, accounting firm Arthur Anderson, admitted to shredding key documents relating to Enron's audit. The SEC (Securities Commission) was found complicit by the U.S. Senate in a "systemic and catastrophic failure of oversight." The credit rating agencies were found to be complicit in their failure to do due diligence, and the investment banks were found to also be at fault for allowing the company to receive positive research analysis. In the aftermath, legislative changes were made to enhance transparency and criminalize financial manipulation, while accounting standards were tightened to demand higher accountability. From the top of the organization and throughout the industry it was a picture of greed throughout.

There is a concept known as "casino mentality" in investing. Many novice investors view the financial markets as a veritable trip to Las Vegas, hoping to trade their way to riches. The problem arises with their lack of understanding of the markets in general and with the varied potential risks, combined with the greed that accompanies all get-rich-quick schemes. A few trading "wins" can only increase the motivation to place bigger "bets", until they fail and exit completely, disgusted with the "game" and convinced they have no business "playing" the markets. Even experienced investors can run into trouble when their greed overcomes their discipline. Education and discipline are the key factors in avoiding a casino mentality. A disciplined investor will spend the time to learn the basics of investing, watch position sizing, establish a sell discipline, and have a system of risk management. Without such an approach, an "investor" risks chasing the illusion of easy money, looking for markets or specific stocks to provide big paydays without working up a sweat to do so.

Bottom line

Financial markets offer many opportunities to build profits over time. The challenge is to reign in one's greed, recognize it takes time to build wealth and to avoid a casino mentality. A successful investor will take the time to learn some basic investing principles, to study the markets' history, and to create a disciplined approach to risk and money management. To do otherwise, as financial reporter Alan Farley notes, is "believing it's a casino that pays off in a random manner, ignores market structure and reality, providing a direct path to failure and washout."

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

Asset class	1 year	3 years	5 years
S&P/TSX Composite T/R (Canada)	7.7%	5.4%	8.0%
S&P 500 TR - US$	14.4%	11.0%	13.0%
NASDAQ Composite - US$	20.1%	13.6%	16.6%
MSCI Europe Index Price Return	-2.2%	1.8%	7.1%
MSCI Emerging Markets	7.0%	5.1%	6.8%
China S.E Shanghai A Price Return	1.4%	-12.3%	10.0%
MSCI World Index Price Return	5.1%	7.0%	12.2%

Asset class	1 year	3 years	5 years
30-year U.S. T-Bond - US$	-0.4%	1.7%	3.8%
10-year U.S. T-Bond - US$	-3.3%	0.0%	0.9%
Long GOC Bond (2048)	-2.3%	1.4%	3.8%
10-year GOC Bond	-5.4%	0.3%	2.2%
5-year GOC Bond	-3.1%	0.0%	1.4%
3-month CDN T-bill	0.8%	0.6%	0.7%
US$/CDN$ (1.2956)	-4.0%	1.3%	4.6%

Source: RBC Capital Markets Quantitative Research

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