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

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Happy anniversary! Many happy returns!

September 15, 2018 was the 10-year anniversary of the bankruptcy of Lehman Brothers - the largest bankruptcy in world history. Its demise marked the heart of the 2008-09 subprime mortgage induced stock market collapse. How times have changed. Ten years later and the U.S. “bull market” run is now the longest bull market run in history. From high-tech stocks, to crypto-currencies, to cannabis stocks, investors’ main concern today seems to be how to wring out a few more drops of gains before the proverbial other shoe drops once again. Forgotten are the fears of yesteryear in which preservation of capital was the mindset of most. Will we go through another 2008-09 type of market? Probably not. Will we experience a normal 10-15% drop in the markets at some time in the foreseeable future? Probably. Have investors the wherewithal to withstand another historically probable downturn? That remains to be seen.

In the meantime, in honour of this infamous 10-year anniversary, I think it is only appropriate to review some of the lessons I learned before, during, immediately afterwards and in the years following the 2008-09 market, as follows:

1. **Common shares or “stock” investing involve risk to capital.** We used to refer to so-called “conservative” stocks as “widow & orphan” stocks because they were stable businesses whose stock didn’t fluctuate much, so you could buy and hold them for even your most conservative clients. They were the epitome of “steady as she goes” - not a source for big returns but also not a source for much anguish. In the 2008-09 market even our beloved Canadian “blue-chip” bank stocks dropped in value by 50% while many of the US “blue-chip” bank stocks dropped by 90% or more and cut their cherished dividends. So much for no anguish.
2. **Cash means cash.** As the credit markets dried up in mid-2008 to financing, many companies which had raised money to use for equipment or inventory purchases, for R&D, or for other expansion plans, had placed these funds in short-term (30, 60, 90 and 120 day) commercial paper to eke out better yield on their money than merely sitting in cash in their bank accounts. As the financial woes in the economy increased, much of this so-called “liquid” commercial paper was frozen and repapered as mid and longer-term bonds, effectively killing the short-term plans of many Canadian companies. Seeking a few extra percentage points over liquidity needed in the short-term is a good example of “missing the forest for the trees”.
3. **Common sense can trump the “experts”.** As investors, we have to rely on third party information and often we look to the “experts” to guide our decision-making. In 2007, Lehman Brothers Inc. bonds were “rated” “AA” – as good a rating as most provinces and many countries, which have the power of taxation to fund their expenses. Many pools of subprime mortgage debt were rated “AAA”. When mortgages started to fail, these highly-rated debt instruments literally collapsed like a stack of cards despite all the promises of “high quality”.

4. **"KISS" method still works best.** The main problem with the subprime mortgage market was that few people (even the rating agencies – see above) actually understood what it was that was happening, where the risks were, how bad the lending criteria had become, and how much fuel (i.e. leverage) had been added to the entire financial system. In early 2008, I asked a commercial mortgage lender at one of the big banks to explain to me how "B" and "CCC+" (i.e. "junk") rated mortgage debt sold to investors could become "A" rated debt or better (i.e. investment grade) once pooled and repackaged. I am not the smartest guy on the planet, but I am not the dumbest either and I could not wrap my head around what he was saying – and he is really smart and really believed what he was saying. Peter Lynch, famed portfolio manager from *Fidelity,* always recommends buying what you know.
5. **Long-term investing means long-term investing.** In 1998, people who bought homes in Toronto saw their home values crushed in the following two years and it took 10-years to merely break even. Fast-forward another 10 years and those same people were labelled investing "geniuses" as their original investment had doubled. People who invested in stocks in 2007 saw their investments crushed in 2008-09. Those looking to make a "quick buck" in the markets had their hopes dashed. Many panicky people sold or reduced their stock exposure near the bottom of the market in early 2009 as it was a really terrifying time. Those who had the wherewithal to stay invested in a diversified portfolio recovered their "paper losses" in many cases in less than a year. Those that didn't, and instead panicked, sold at "fire-sale" prices which would be almost impossible to recover.
6. **Should've, could've and would've.** An investor with cash and steel-resolve could have purchased many high-quality companies, such as the Canadian bank stocks, when they were on virtual "liquidation" sale at 50% down in value by early 2009. At those beaten-down prices, the dividend yields were extraordinary – CIBC at 8% or Bank of Montreal at 10%. Not only was such an investor able to lock-in gigantic yields, but as the stocks rebounded in the ensuing months the capital invested doubled giving them a true "double-double". Warren Buffett's advice, "you should be buyin' when others are cryin'!" aptly describes what we "should've" done as many a tear was shed.

Bottom line

Anniversaries are a time for reflection. Investors have to be honest with themselves and their needs. When is the money to be invested needed? Is it a short-term need or a longer-term need? How "long" is long-term? Do you need income to be generated from the investment or is capital growth the main objective? Do you have sources for alternative financing if a need arises and the investment is either not liquid or priced for liquidation? Are you willing to focus on your longer-term goals in the face of panic-stricken times? Asking a few of these questions and investing in things one can understand are life-long lessons for the prudent investor!

Global benchmarks
As at September 30, 2018 (Canadian $ Returns)

Asset class	1 year	3 years	5 years
S&P/TSX Composite T/R (Canada)	5.9%	9.7%	7.8%
S&P 500 TR - US$	17.9%	17.3%	13.9%
NASDAQ Composite - US$	23.9%	20.3%	16.4%
MSCI Europe Index Price Return	0.3%	3.6%	5.5%
MSCI Emerging Markets	0.2%	8.6%	5.8%
China S.E Shanghai A Price Return	-15.6%	-6.1%	7.7%
MSCI World Index Price Return	13.0%	10.2%	12.1%

Asset class	1 year	3 years	5 years
30-year U.S. T-Bond - US$	-3.9%	0.3%	4.6%
10-year U.S. T-Bond - US$	-3.6%	-0.8%	1.5%
Long GOC Bond (2048)	3.5%	0.2%	4.7%
10-year GOC Bond	-0.6%	-0.6%	2.8%
5-year GOC Bond	-2.3%	-1.2%	1.1%
3-month CDN T-bill	1.1%	0.7%	0.7%
US$/CDN$ (1.2904)	3.5%	-1.1%	4.6%

Source: RBC Capital Markets Quantitative Research

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