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The Krygier Report

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

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The best defence is a good offence!

The past 12 months have been marked by newsworthy political and economic upheaval globally. England's Brexit, China's tariffs, European negative interest rates, U.S. Democratic leadership race, Canadian Federal election, Iranian tanker attacks, Syrian war zone, Argentinian bankruptcy, and now with the start of U.S. Presidential impeachment proceedings, the list is literally endless. Volatility in the stock and bond markets has mirrored this upheaval - in both directions. While mostly quite strong so far in 2019, the uncertainty may impact investors thinking about the future. I recently read a book on self-defence, with the rather eye-catching title, "When violence is the answer," by Tim Larkin, a former military intelligence officer, and Navy Seal wanna-be. Larkin suffered an underwater diving accident while training to become one of America's elite soldiers, so he turned his knowledge into becoming a self-defence instructor. His book is the by-product of over 25 years of real-life experiences and stories he accumulated. While an interesting read, some of Larkin's guidance can also provide an investor with a mental framework for investing with confidence. The "battle fields" of the capital markets are often associated with extreme emotions and fears about the "what if" scenarios, so who better than a top-ranked self-defence instructor to turn to for some tried and true approaches for financial self-preservation. I will use a few headings from Larkin's book to try and glean a few kernels for investors.

Part 1: How to think about violence (or "violent markets")

a) **Chapter One: Violence is a tool:** Larkin makes the case that, in contrast to most people's thinking, violence is morally neutral. He illustrates his idea by presenting two alternative scenarios, the first involves a violent act occuring against an innocent victim. The second case replicates the first, but with one major difference – the victim is proactive when faced with a threat and preempts the attack by doing the identical violent action against the would-be attacker. Few would dispute the right to defend oneself and Larkin uses these parallel cases to make his point. For investors the analogy is obvious – what bothers investors the most? Volatility - and the consequent fluctuating capital value of their investments. I suggest, however, that volatility too is morally neutral. When markets are down 20%+, many investors are nervous, and a few even panic to the point of making irrational decisions. However, when markets are up 20%+ - where is the panic? Some do act irrationally and chase an already overbought market or hot stock, but few complain. The problem is that the only kind of investment that can grow in value beyond the rate of inflation is the kind that can also periodically go down – hence the cliché, "It's not timing the markets, it's time in the markets" that grows one's wealth.

b) **Chapter Two: Social Aggression Versus Asocial Violence**: Larkin distinguishes between "social aggression" – i.e. road rage or bar fight scenarios, versus "asocial violence" – mass shootings or sociopath attackers. The former types of violence are more common and fairly easy to avoid – walk away, don't escalate, and don't react with anger when confronted. The second type is much more rare but, unlike the first type, demands a proactive approach with an intent to attack and injure first, in order to avoid becoming a victim of extreme violence. For investors, the analogy is clear – a GIC (or CD in the US) does not fluctuate in value. However, ANY other type of investment – even government bonds, let alone stocks or real estate, fluctuate in value every single day! As noted above, to achieve a rate of return above the rate of inflation, one has to be willing to tolerate some level of fluctuation – in both directions – to try and attain that goal. However, for extreme negative volatility – like what occurred last December, in which uncharacteristically every single asset class had negative results for the month, one needs a well-thought out plan in advance to take advantage of the opportunities and conversely to avoid becoming a victim of one's own making by panicking. Such proactive strategies include holding "some" liquid cash to take advantage of oversold investments, not tying up money needed for a short-term expense in any instrument that can fluctuate, and finally, taking a deep breath and recognizing that the Chicken Little scenario is not upon us, and that this too shall pass.

Part 2: How to think about using violence

a) **Chapter Seven: Your brain is your deadliest weapon:** to Larkin, the fundamental idea of self-protection training is to accept the reality of violence and the reality of whatever situation in which one finds oneself. For many people, these are uncomfortable realities that their minds will not allow them to, "reconcile with their idealized vision of how the world should be." Most investors would like to see their investments do one thing – only grow in value and never suffer a "violent" drop in value at any time. Larkin's advice: "your brain is the tool that makes that reconciliation possible. It is your best asset." Investors need to create a well-thought out long-term plan of action, which includes a list of "what-to-do's" and perhaps more importantly a list of "what-not-to-do's" in times of volatility.

Bottom line

The lessons of self-defense extend well beyond physical protection. Investors would do well to heed the notions that volatility is a reality for those seeking decent long-term returns, that there is a distinction between day-to-day fluctuation versus extreme short-term volatility, and that a well-thought out plan can help prevent one from becoming a victim of one's own panicked reactions. As the old cop-show used to say, "Let's be careful out there."

Global benchmarks
As at September 30, 2019 (Canadian $ Returns)

Asset class	YTD	1 year	3 years
S&P/TSX Composite T/R (Canada)	19.1%	7.1%	7.4%
S&P 500 TR - US$	20.6%	4.3%	13.4%
NASDAQ Composite - US$	20.6%	-0.6%	14.6%
MSCI Europe Index Price Return	7.4%	-1.3%	3.9%
MSCI Emerging Markets	0.6%	-2.0%	3.8%
China S.E Shanghai A Price Return	8.9%	1.5%	-3.0%
MSCI World Index Price Return	12.3%	2.4%	8.4%

Asset class	YTD	1 year	3 years
30-year U.S. T-Bond - US$	22.6%	28.2%	4.2%
10-year U.S. T-Bond - US$	11.3%	15.8%	2.2%
Long GOC Bond (2048)	16.4%	23.1%	2.9%
10-year GOC Bond	6.8%	11.8%	1.1%
5-year GOC Bond	3.5%	6.2%	0.7%
3-month CDN T-bill	1.2%	1.7%	1.1%
US$/CDN$ (1.3239)	-2.9%	2.6%	0.3%

Source: RBC Capital Markets Quantitative Research

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