RBC Wealth Management
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Every three months we stop the clock, so to speak, and take score. Some quarters, I'd rather not. Our returns have been atrocious. The S&P 500 had the worst first 6 months since 1970, down 20% (in US$), including dividends. Investment grade bonds, as measured by the IShares Core US Aggregate Bond Exchange Traded Fund, had its worst start of the year ever, down 11% (in US$). The Canadian Broad Bond Composite lost 12.2%

Bonds are traditionally thought of as an offset to falling stock prices. If stock prices fall because of a weak economy, bond prices can be expected to rise as interest rates fall. The first half of 2022 has been different. Central banks kept interest rates too low for too long, so inflation has been running away. The Bank of Canada and the US Federal Reserve are now jacking up interest rates to catch up. Unemployment is still very low, but the stock market is squeezed by rising interest rates now and, the fear of a recession later.

So, what are we to do? You won't be surprised that my short answer is nothing much. Rising bond yields hurt our rate of return in the short term, but higher yields shouldn't remain a problem if our investing time horizon is longer than the term to maturity of the bond. Our bonds and bank deposits will mature regularly over the next 5 years and will be reinvested at the rate prevailing at that time. The TINA (There Is No Alternative) stock market has been replaced by TAGA (There Are Good Alternatives). It is strangely gratifying (and there has been very little about my investments that has been gratifying lately) to renew a deposit that has been paying 2% for years with one that will pay more than twice as much for the next few years.

If central banks are unable to tame inflation without precipitating a recession our stocks may fall farther. We'll see. Hopefully we haven't invested money in stocks that will need to be spent in the next couple of years if prices remain depressed (otherwise, we will use rallies to raise more cash). It seems to me that individual investors have a big advantage, the luxury of time. Professional investors are vulnerable to career risk, the fear of missing out and, the tyranny of the indices. Individual investors should be able to do little other than to wait. We haven't borrowed excessively to buy stocks. We haven't invested in wasting assets like options that can expire worthless. We haven't invested in companies that are perennially losing money or in companies which depend on a newfangled something or other. I believe that the great majority of the companies that we are invested in would survive a bad recession. Most will continue to pay dividends, and many would increase their dividends, as a number have even during these awful last few months.

The usual definition of a stock market correction is a decline of 10% and the Canadian stock market, which has been helped by rising oil prices, was down 9.9% in the first 6 months, including dividends. The S&P 500 met the definition of a bear market by falling 20% in US$, including dividends. The technology heavy NASDAQ was down 29.5%. My preferred definitions are that a stock market correction is when other people's stocks go down and a bear market is when my stocks go down. For me the seriousness of the current investing situation was brought home this spring when I bought some shares in an old favourite, Walt Disney, at what I thought was a good price, only to see it plunge 20% or so more. Recognizing that we are in a bear market, I resolved to proceed with caution and to be careful not to underestimate how bad or how long a bear market can be. We intend, as I like to say, to stay calm and to carry on consistently rebalancing portfolios to our targets, but slowly.

Warren Buffett says that there are 3 rules of investing; 1) Don't lose money. 2) Don't forget rule #1 and 3) He can never seem to remember rule number 3. When Buffett says don't lose money, he doesn't mean don't buy a stock at $100 because it might go to $50. He means don't buy a stock in a company that might go out of business or a stock that might go down 95%, because that is a loss which cannot be recovered.

I feel terribly about the slide in the market value of our portfolios in the last six months. It is easy to see now that a year ago there was a speculative investment mania afoot. That mania is over now. I believe that this year's decline is but an interim fluctuation in the market value and, that at some point, a recovery is likely. I have often said that the cheaper my favourite stocks get, the happier I should be because I can buy more. The reality is of course that I feel miserable, yet I do trust in our investment process. I hope that you will continue to allow me and our team to worry about your investments for you and that you have a chance to enjoy some fine summer weather.

Sincerely,

George Stedman, CFA

Senior Portfolio Manager
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