The Good, The Bad, and The Ugly

Edition #40

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RICHARDSON Wealth

GUSTAFSON & ASSOCIATES

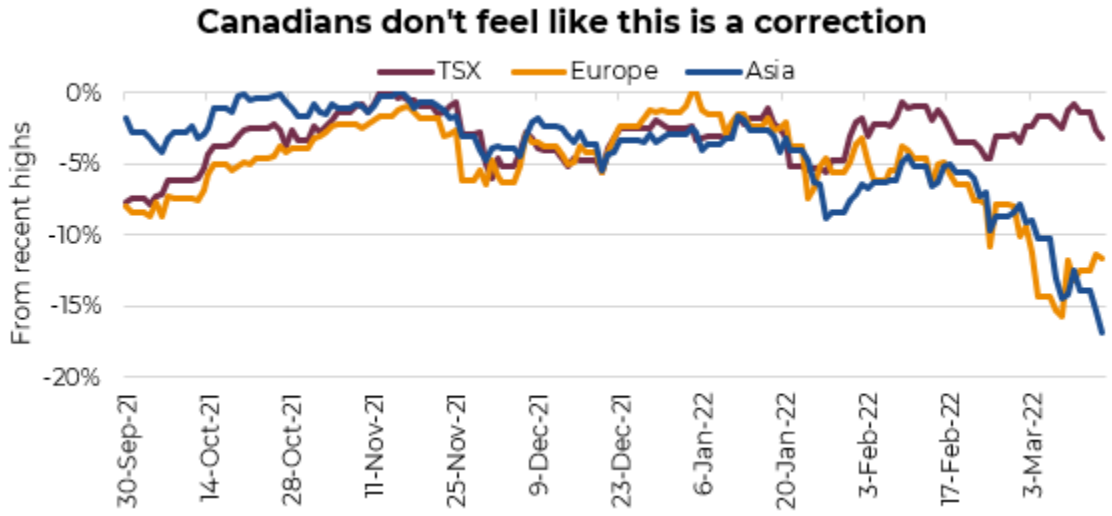
Hello my friends,

Lately I have had several strangers approach me recently to become clients. They are reciting the common refrain “It sure is great that the markets are up but my statement is down over 10% in the last 3 months. Can you give me a second opinion as I don’t think my advisor knows what they are doing?”. I am sure they are then wondering why I tilt my head and give them that puzzled, dog watching television, look. Their perception and statement is a mystery to me. It is one of those questions I can’t answer like why did we put a man on the moon before we figured out it was a good idea to put wheels on luggage? Or why did the author of the alphabet song not sue the writer of *twinkle twinkle little star* as they are the same tune. Or why did you just try singing these 2 songs? I digress.

All kidding aside, I can understand why they are assuming the stock markets are up. That is because we are blessed to live in a country that enjoys food and energy security (so far). As a result, we are relatively sheltered from many of the present global disasters and hardships. My heart goes out to people in the Ukraine today who may not know if they will see the sunrise.

We are indeed blessed in so many ways. I love unadulterated optimism; however, I love facts more. So here are the facts. Below I will throw in my 2 cents on this topic and if you have time, please email me with a penny for your thoughts. Is it just me or have you ever wondered where that extra penny goes to? Like the penny…the global economy has many unanswered questions. This breeds uncertainty that investors fleeing the stock market hate. As a result, stocks drop and return to their rightful owners: long term investors. For my younger readers, a penny was this coin that was made out of 94% steel that was worth 1 cent and took the government 2.06 cents to manufacture. Okay, enough with the dad jokes.

As you can see by the below the short-term performance, the world’s stock exchanges are indeed not “up”. In fact, at the start of the year the Nasdaq or tech-heavy stock exchange in the U.S. went into a bear market territory on March 24, 2022 (more than 20% drop) and so far, more than $9 trillion has been removed from global stock exchanges. So, it is understandable that Canadians feel that the stock markets are up because as I am writing this newsletter, Canada is the only major stock market that is up in 2022.



(Source: Bloomberg, Purpose Investments)

This Canadian rise is due namely to one sector represented by resource shares. In fact, resource shares are now the largest proportion on the Toronto stock exchange at 31% and have even surpassed the *banks* and insurance companies that are down as of April 18th, 2022. This is indeed amazing as only 12 months ago the analysts were saying that the world was “awash in oil” and oil was even trading at a negative futures price per barrel. It is amazing how fast investment news cycles and opinions can change.

Let’s dive deeper. Buckle up. Here comes the hide under your covers part of the newsletter.

Investors are fleeing the uncertainty of rising interest rates, inflation, oil shortages, potash shortages, rising commodity and food prices, Chinese government crackdowns on its tech companies, less global goods and food being produced in Ukraine and Russia, green countries that gave up their resource security now reconsidering their trade contracts with President Putin, a possible Russian oil embargo, record government debt, microchip shortages, supply chain disruptions, major covid lockdowns in China, record household debt, real estate bubbles and lack of house affordability, war, bitter partisan divisive elections, a pandemic, and lastly Will Smith’s slap heard around the world. Yeah, that latter point was silly. However, it is also puerile that most of these obstacles are short-term, but they are dominating the minds, emotions, and worse the actions of long-term investors going to the sidelines.

Quite simply, the world stock markets are in the grip of “unknowing”. However, the reality is that nothing has changed, and we have simply moved on to a different set of unknowables. What I do know is that the great companies of the world have already redirected capital and innovated to take advantage of the above unknowns. In time that increases their earnings and in turn their dividends and value of your stocks. Do you really think that the above speed bumps will impair the progress of $40 trillion of companies on the United States stock exchange who have $2.4 trillion cash on their balance sheets (in as recent as 2019 that was only $1.6 trillion)? I emphatically do not.

So, what does all this mean? It means that your statements will be down the first quarter. Short-term predictions are for fools. I do not have a clue when the stock market will rise again so your statement may also be down at the end of the year. So, the next question is: what am I going to do about it?

I am going to do exactly the same thing I did for my clients in the stock market drops of October 1997, July 1998, July 1999, March 2000, November 2002, October 2007, April 2020, April 2011, November 2015, January 2018, September 2018 and lastly February 2020. During these stock market drops I saw drops of 10% to 56% for a duration of 13 to 929 days depending on which correction you did not enjoy with me. This is not the first or the last stock market drop we will see together. Although my wrinkles may indicate otherwise, I would like to clarify that I actually was not a financial advisor during the 1901 stock market drop.

US Bear Markets: S&P 500 Composite		Bear Market	
Mkt Top	Mkt Bottom	Peak to Trough Decline, %	Duration in Months
Feb-2020	Mar-2020	-33.9	1
Oct-2007	Mar-2009	-56.8	17
Mar-2000	Oct-2002	-49.1	31
Jul-1998	Oct-1998	-19.2	3
Jul-1990	Oct-1990	-19.9	3
Aug-1987	Dec-1987	-33.5	3
Nov-1980	Aug-1982	-27.1	21
Sep-1976	Mar-1978	-19.4	18
Jan-1973	Oct-1974	-48.2	21
Nov-1968	May-1970	-36.1	18
Feb-1966	Oct-1966	-22.2	8
Dec-1961	Jun-1962	-28.0	6
Aug-1956	Oct-1957	-21.6	15
May-1946	Jun-1949	-29.6	36
Nov-1938	Apr-1942	-45.8	42
Mar-1937	Mar-1938	-54.5	13
Jul-1933	Mar-1935	-33.9	20
Sep-1932	Feb-1933	-40.6	6
Sep-1929	Jul-1932	-86.2	34
Jul-1919	Aug-1921	-35.1	25
Nov-1916	Dec-1917	-43.1	13
Nov-1909	Oct-1914	-37.5	58
Oct-1906	Nov-1907	-40.4	13
Jun-1901	Nov-1903	-31.4	29
Recession Related Avg		-40.5	21
Recession Related Median		-36.8	19
Non-recession Related Avg		-30.6	14
Non-recession Related Median		-30.7	10
Post WWII Avg		-31.8	14
Pre WWII Avg		-44.8	25
AVG		-37.2	19

Shaded rows denote recessions.

Source: 1832 Asset Mgmt

(Source: 1832 Asset Management)

I will continue to do the following:

(1) I will maintain the true safety of balanced portfolios diversified in different sectors:
A few seeks back, I have reduced but maintained my positions in resource shares which may or may not have more legs. I am not exiting the sector or suggesting you do as those shares my rise for 10 years or 10 seconds. No one knows. Your decision to exit any stock sector that you are too heavily weighted in should solely be based more on your financial plan and if you have enough money for retirement or the rest of your time on earth. If you do there is no reason to gamble at all by being too heavy in one sector. You only need to become wealthy once.

My apologies to my hard working, geologists, and all Albertans. However, since no one can predict the future, I will not be moving all of my clients hard earned assets into the investor stampede in to

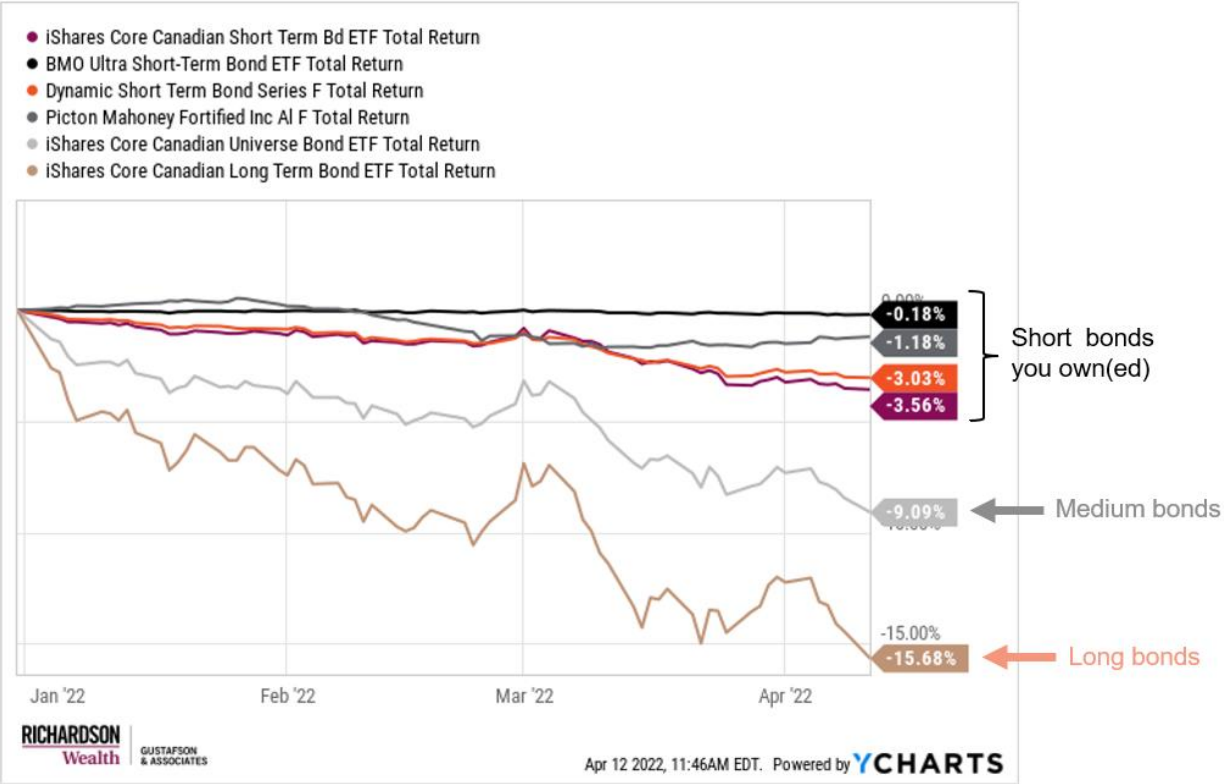
resource sector and only the Canadian stock exchange. For I know that if you have enough money in one sector to make a killing you also have enough there to get killed. Never forget that a sector will rise on the escalator and drop on an elevator. When that happens there will be no bell rung and no time to exit. Does this mean I may miss some growth? It sure could. However, it also means I will miss a potential blood bath someday.
Being human, many investors have performance chasing imbedded in their DNA. They may feel the rise of hot stocks will go forever and the laggard stocks will never perform again. Grown-up investors know that is a myth.

(2) I will turn off the television and only be controlled by the goals in your financial plan and our measured appetite for risk:
As a young advisor in my first market crash it hit me that I apparently was not in control of the universe, or the daily fluctuations of the stock market often caused by a bad news cycle. I can only control my actions and will practice rationality in the light of uncertainty and pick sound, long-term investments, not short-term flavors of the year. Your long-term financial plan, goals, and risk tolerance will be the foundation to all my decisions. I will choose investments I have crash tested with our software and use strategies that have made financial plans come true for decades. I will not follow the crowd using investments from the echo chamber or on fear-based headlines pontificating that "this time is different". Thinking we are living in tougher different times than past generations and stock markets borders on arrogance. Please remember that many of the financial idols on television and tweeter (twitter) are famous for being correct one time in a row.

Current events are irrelevant to the investment policy in a long-term financial plan. I will not go to cash with your money as short-term vacillations cannot be predicted or timed by anyone on the planet. Today's crisis quickly becomes yesterday's news. Ten years from now we likely will not remember today's fear inducing headlines.

(3) Bonds:
I will not dump the air bags for your portfolio and cease holding bonds. Memories are short; however, bonds are the exact reason that most of my clients did 2x the return of the Toronto Stock Exchange in the year 2020. It is what is protecting you now and the reason your portfolio has not dropped as much as global stocks.

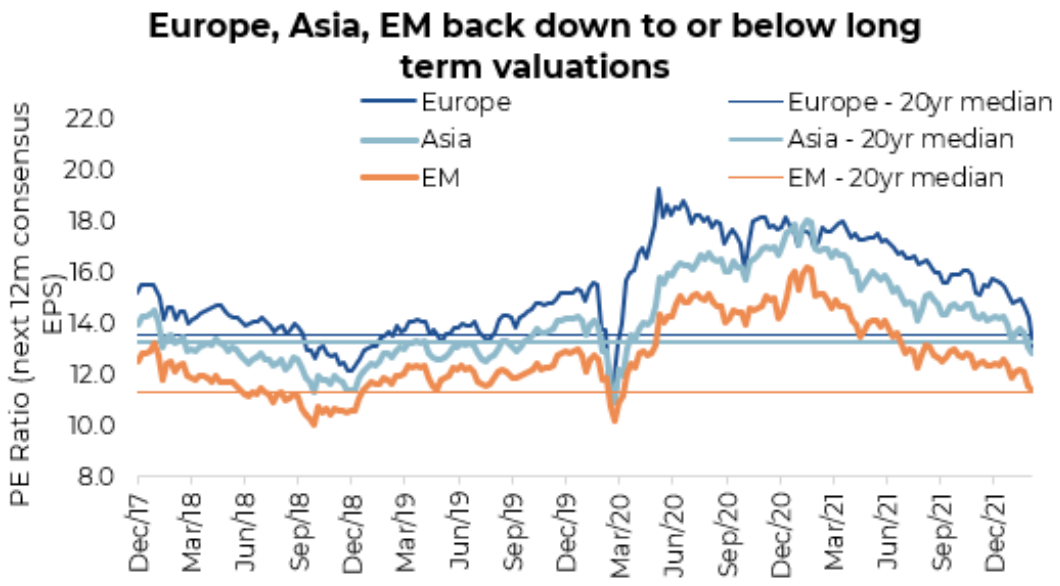
I will however continue to manage the duration of those bonds to reduce the potential damage to portfolios due to rising rates.
Here are the bond positions most of you own or recently held compared the measuring stick of the aggregate Canadian bond index (light grey) and Canadian long bonds (brown). At present we are meeting to look at what alternatives we will use next if rates rise high enough to do so. Trust me when I say no one is sitting on their hands in my office.



(Source: ycharts)

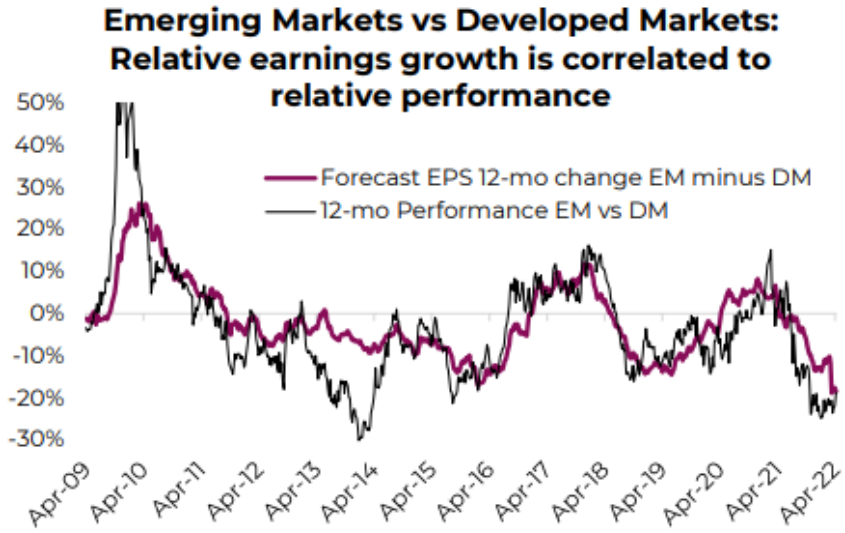
(4) Buy low:

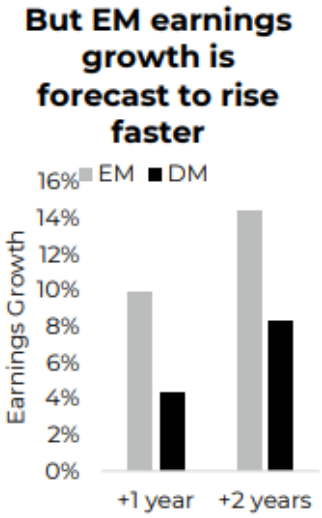
In part of your portfolio, I will buy cheaper investments with good cash flow. Right now, this is in Europe and Asia who just had a few tough years. As you can see these stocks are cheaper than other global stocks. This discipline is the toughest of all to honor as patience is required. If you buy low, it means you are not following the crowd so may have a wait to get rewarded. So that will likely mean you will not have big winnings in the short-term. Using this sound long-term strategy has caused my ability to be called in to question many times in my career by those few clients who watch their statements over the short-term. That has never made sense to me as their financial plan is not one quarter long. This happened when I bought healthcare stock decades ago. They did not grow for 5 years. They then doubled. It is indeed tempting to follow the crowd. That tingle that an investor feels when they seek quick money by following the crowd buying a hot stock is actually their common sense leaving their body, which may soon to be followed by their cash leaving their portfolio.



(Source: Bloomberg, Purpose Investments)

These areas are expected to have higher earning growths.



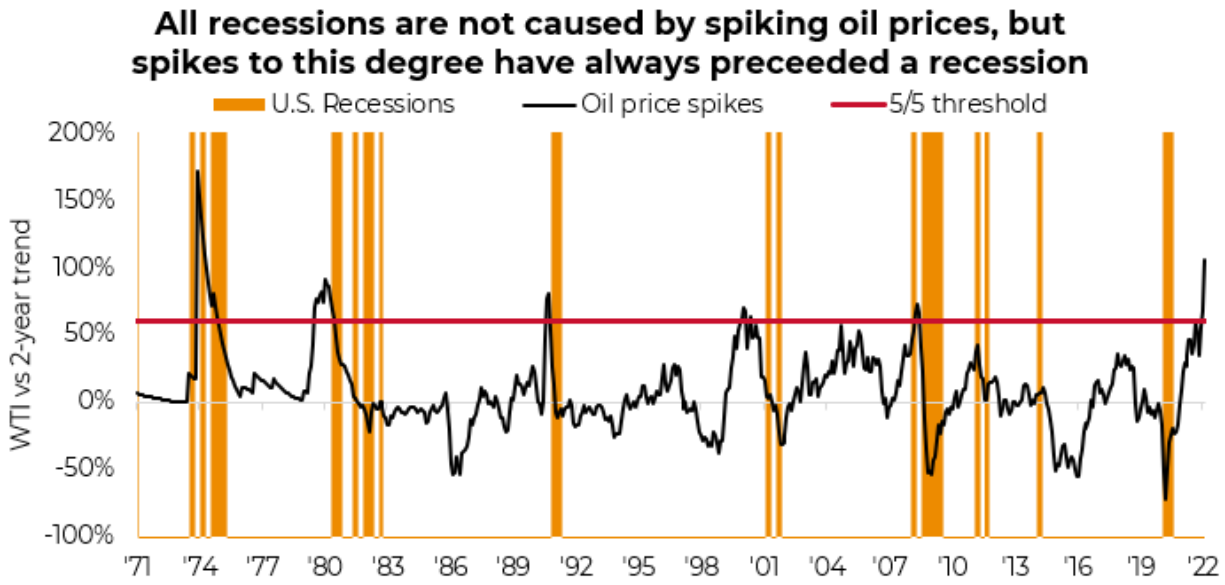


(Source: Bloomberg, Purpose Investments)

Now that I have spent the first few minutes reminding you of many facts you already know let's move on with the 40th edition of The Good, the Bad, and the Ugly. As always let's start with the bad news and finish with good news in case you are reading this before going to sleep or using it to put you to sleep.

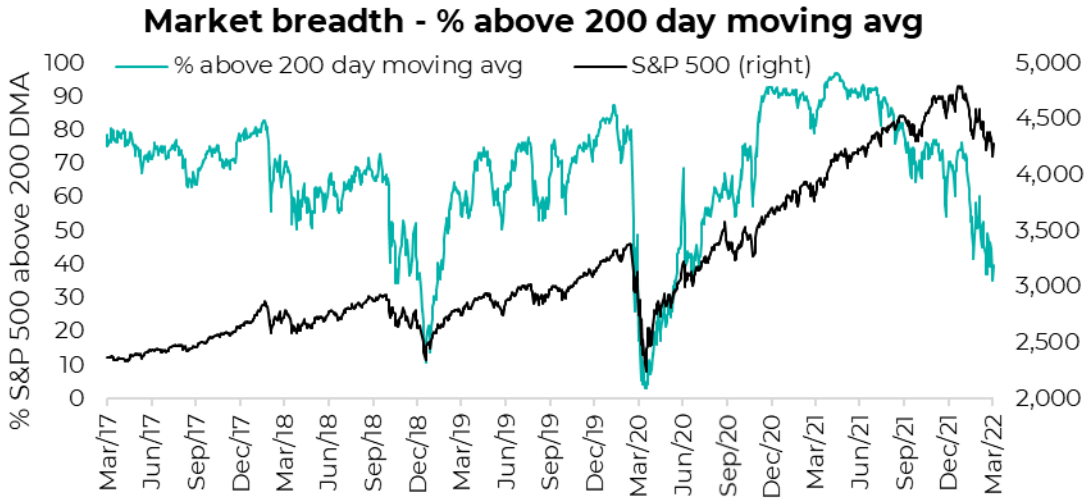
The Bad:

Western Canada and the Canadian stock market is basking in the sun of high oil prices. Whoop whoop!! However, oil prices this high have often been followed by a recession. As they say, “the cure for high oil prices is high oil prices”. When rising input costs (oil and gas) makes all the goods around us more expensive, consumers slow spending. This in turn can cause a recession. Perhaps governments will instead lower the tax on oil and gas and reduce the size of government instead? Yes, I know that on the inside I am a naïve farm boy from Tisdale Saskatchewan. A boy can only dream.



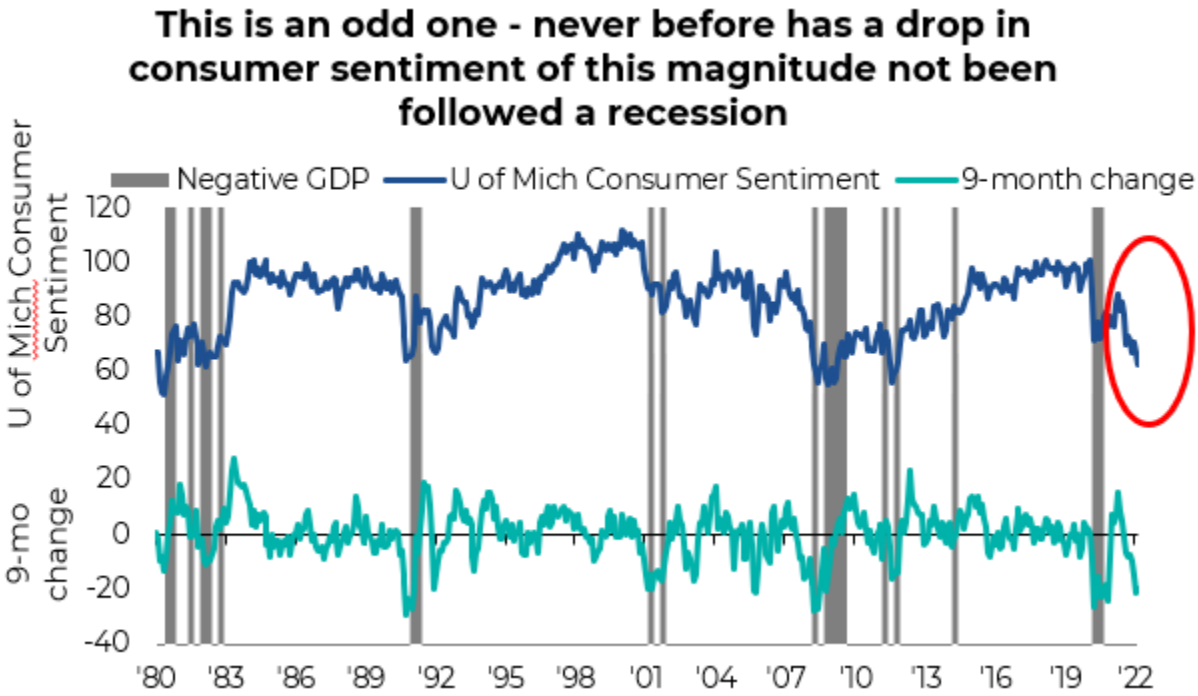
(Source: Bloomberg, FRED, Purpose Investments)

The number of stocks in the US that are trading below their 200-day moving average is increasing. This is often a bearish (downward stock market) signal.



(Source: Bloomberg, Purpose Investments)

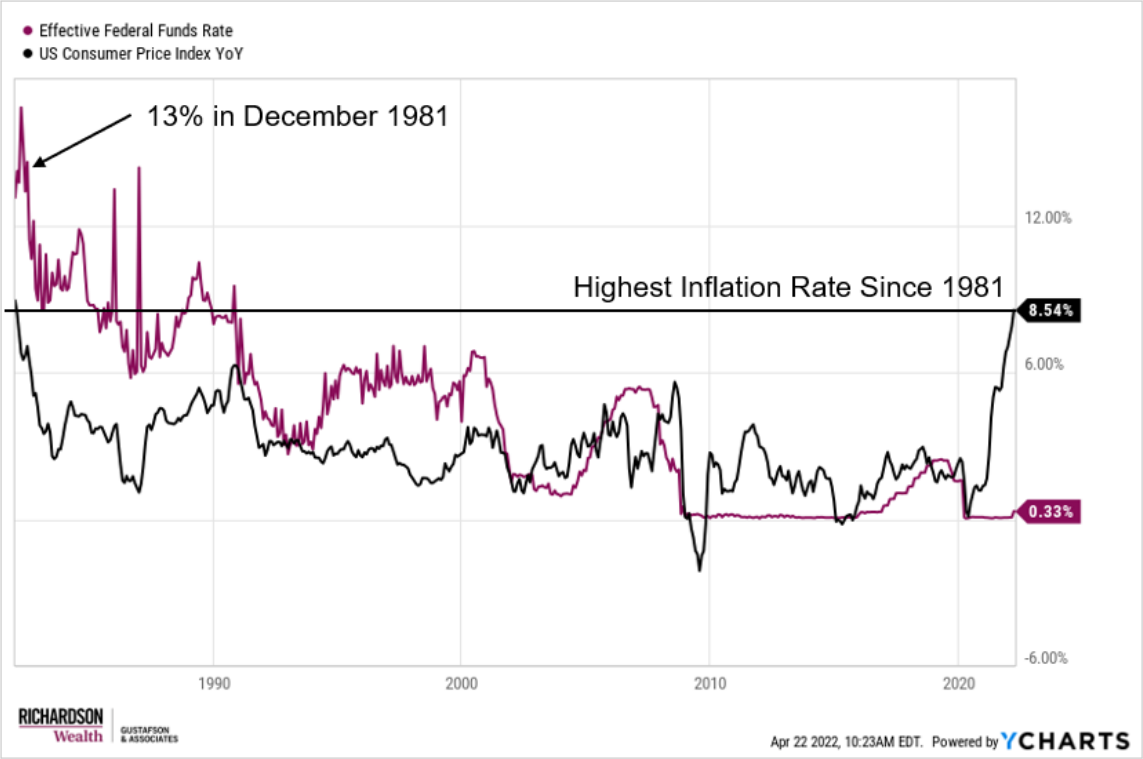
Consumer sentiment is starting to erode. This is often followed by a recession.



(Source: Bloomberg, Purpose Investments)

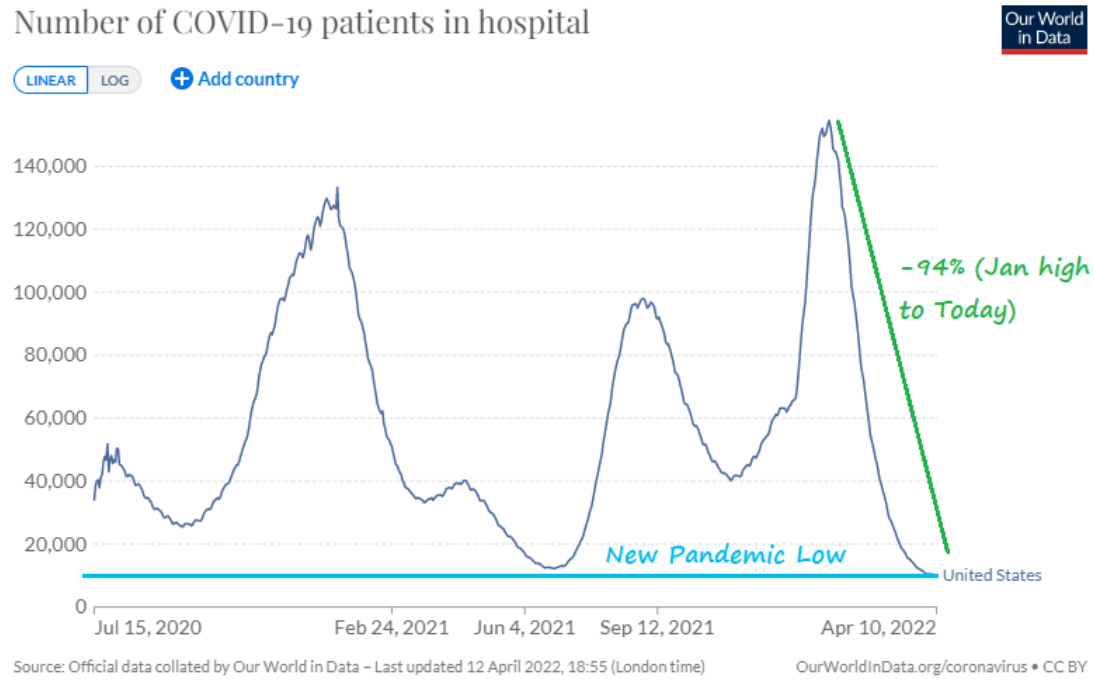
The Good:

All I hear about is how high interest rates are and how that means that stocks are going to drop. Whoa, let's pause again and look at that nasty thing called "facts" instead of fear. The last time inflation was this high in 1981 the federal reserve set their lending rate at 13%. Guess what? We were all doing just fine in 1981. Today, my industry is fidgeting with its worry beads over the fed funds rate rising by ½%?? Seriously? Is that really something to lose my last 2 hairs about? Fed Funds Futures and the bonds you hold have already priced-in a 50-basis points (0.5%) hike in May and another 50-bps hike in June. If that happens, it will bring the Fed Funds Rate up to 1.25%-1.50%... That is still incredibly easy fed policy given the inflation rate. The fed is clearly saying that they think that inflation is going to settle down when the global obstacles pass. I am not in the camp that feels all of the members of the Federal Reserve of the United States of America don't know what they are doing, so I will live by the adage of "don't fight the fed".



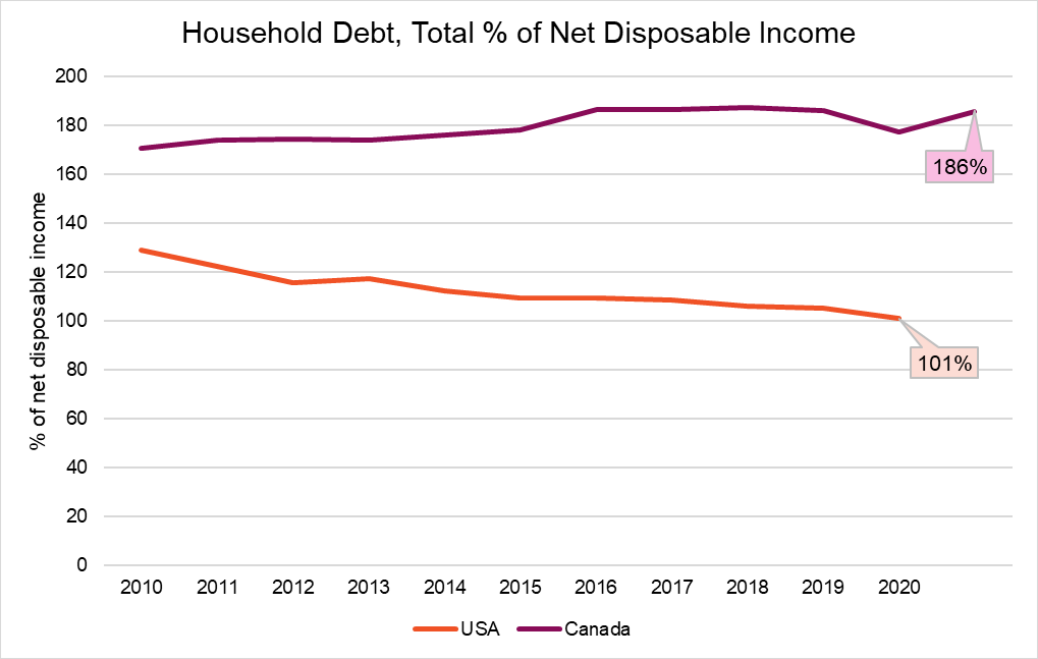
(Source: ycharts, Charlie Bilello – Compound Advisors)

In order to fix inflation caused by the shortage of goods we need to fix supply chain issues. Getting rid of Covid would be a good start. The largest economy and largest consumer in the world (the USA) appears to have almost done so.



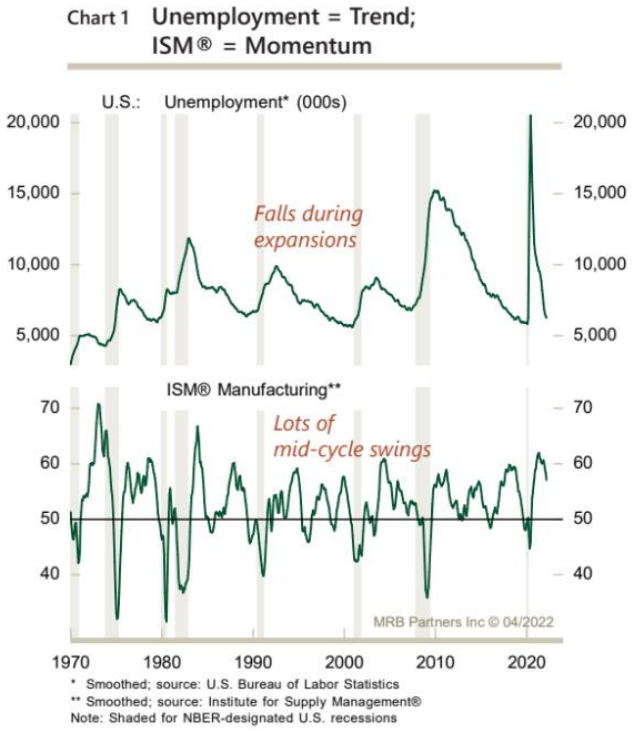
(Source: Our World in Data, Charlie Bilello – Compound Advisors)

At the same time the US consumer is very healthy and have got their financial houses in order and have essentially half the debt of Canadian households. Another reason all of your money is not invested in Canada whose households carry some of the highest debt on the planet.



(Source: OECD)

The US accounts for 45% of global consumption of goods and services. The balance sheets of their consumers are not only strong, but they are fully employed. US unemployment is in no way flashing a warning for a stock market crash or recession.

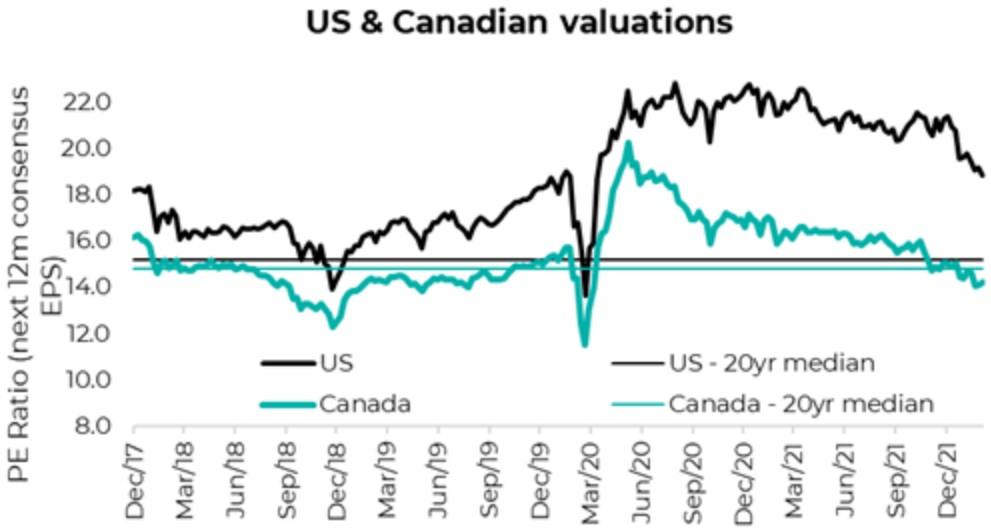


(Source: MRB Partners)

Investor sentiment outside of Canada hit a low which is typically a good a contrarian indicator. This is historically a “buy” signal, not a sell your stock signal. The fear greed index (which measures many leading indicators) is also flashing “extreme fear” at present which historically is a “buy” signal.

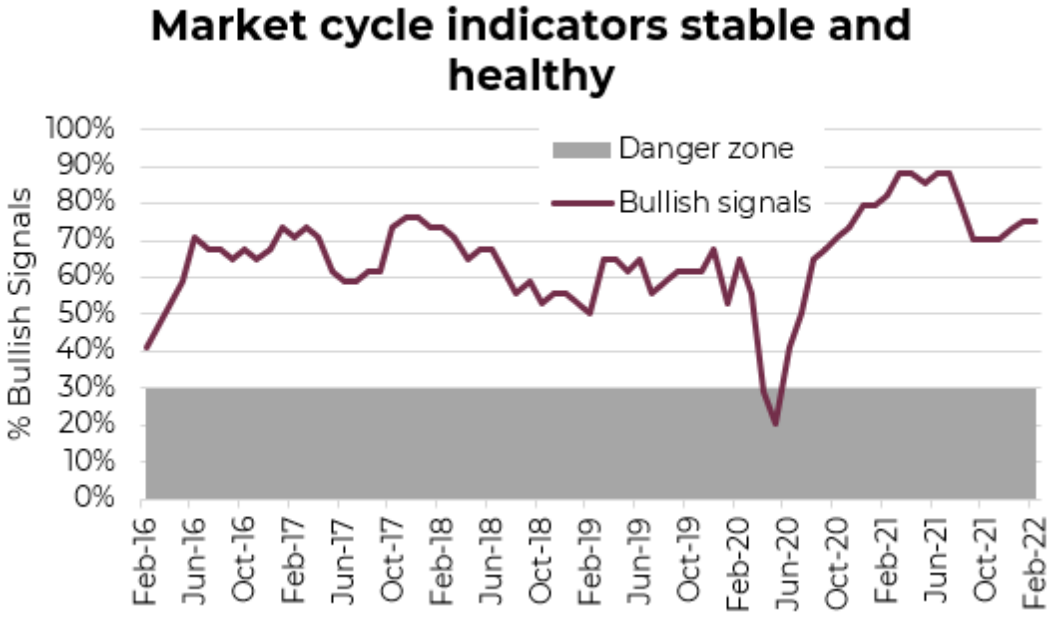
(Source: Bloomberg, Purpose Investments)

Stock valuations in North America have come down and are no longer as expensive as they were just 1 year ago. We buy cars on sale. So why do most investors today hate buying stocks on sale?



(Source: Bloomberg, Purpose Investments)

On top of that, a lot of the bullish signals my investment board follows are still very healthy.

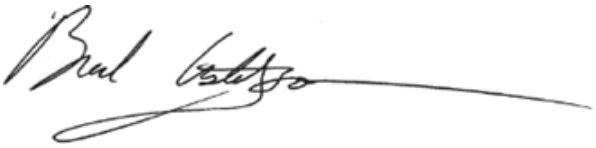


(Source: Bloomberg, Purpose Investments)

Every year we are faced with endless unknowns and are constantly barraged by the bad news over every aspect of media we are presented with. During such times it is only natural to feel that the easiest thing to do is sell. My best advice as always is that these short-term unknowns should only be considered noise and irrelevant to the investment policy of a long-term investor.

As always, it's a great day to be alive and invest!

Sincerely,



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