POSITIONING FOR THE NEXT BULL MARKET

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"I skate to where the puck is going to be, not to where it has been."

Wayne Gretzky

The intent of these quarterly letters is to provide you with the best investment advice I possibly can – under the current circumstances. In my attempt to ensure that you're receiving sound AND timeless advice, I try to distill for you as best I can, the wisdom of the world's greatest investors.

On the topic of advice, the following from portfolio manager Larry Sarbit seems to make a lot of sense; "Warren Buffett, Charlie Munger, and Benjamin Graham have figured prominently in our investment style. If you're going to copy someone's behavior and philosophy, you should pick one that has worked."

I believe, as I'm sure you do, that the value of a little bit of 'good advice' can be almost priceless when dealing with matters of finance and investing.

By following the proven philosophies of some of the world's greatest investors, I've been able to provide my clients with some timely advice in the past. Here are a few examples…

- In 2017 I warned investors of the importance of knowing the difference between investing and speculating. At the time, investor euphoria surrounding cannabis stocks was at an extreme. I recall three separate client meetings in one day that summer, where all three clients questioned why we didn't own cannabis stocks. A quick look at the financial statements for any of the 'dope' stocks revealed businesses that often had no assets, no profits, and in some cases no sales whatsoever! Meanwhile, would-be 'investors' were clamoring to hand their hard-earned savings over to these highly speculative companies – *forgetting the important distinction between gambling and actual investing!*

  Here is a recent headline from the Financial Post: *"Canadians have lost $131 billion investing in Cannabis".* Since the peak of investor euphoria the cannabis sector has lost close to 90% of its value, as per the Horizons Marijuana Life Sciences Index. (See my Dec 2017 quarterly client letter titled "Investing Versus Speculating").

- **After the 1st quarter of 2019 I reminded clients of the inverse relationship between price and value.** In early 2019 the stock market had been firing on all cylinders. Just since the previous December, the global stock market had gone up by ~20%, Canadian stocks were up almost 18%, and the U.S. market was up ~25%. As such, investors were full of optimism, pouring money into the markets – right when the risk of owning stocks had just gone way UP, not down (...this due to the inherent inverse relationship between current stock prices, and the underlying value received).

In that piece I referenced a quote from legendary investor Howard Marks; *"People should like something less when its price rises, but in investing they often like it more?"* (See "The Inverse Relationship Between Price and Value")

As we all know now, just one year later – in February/March of 2020 - investors witnessed one of the most rapid and severe market declines in its history…

- **In July 2020 I wrote that bear markets are always temporary and therefor it is a time to be buying stocks, NOT selling them!** (See "What Goes Down Must Come Back Up"). This advice came on the heels of that huge and rapid stock market drop referenced above (in March 2020), after the impact of COVID and the impending lockdowns began to hit North American markets. In just a little over one month, both the Canadian stock market (per the S&P/TSX Index) and the U.S. market (S&P500, in CAD) temporarily dropped on paper by more than 1/3rd!

  Of course, the key words here are 'temporary' and 'on paper'. No reasonably intelligent investor ever actually loses any money whatsoever during a market downturn – as long as they don't commit investing's *"cardinal sin"* of panic-selling at or near a market bottom.

  Just how temporary was the huge drop we witnessed during the 'COVID selloff' in early 2020? By August 2020 (just five months later!) the S&P500 was trading at new all-time highs, and the TSX also fully recovered before the end of the year. This was followed by an exceptionally good year for investors in 2021 (…at least, for those who exercised a modicum of patience, prudence, and dare I say, common sense - when markets nosedived in early 2020).

  As per Financial Advisor and author Nick Murray, *"The best predictor of the speed and trajectory of a market recovery is always the speed and depth of the preceding decline."*

To be clear, these missives are not to be construed as attempts to "time" the market. Also, I'm never one to participate in the futile AND completely unnecessary game of attempting to predict how the market will 'zig' or 'zag' next. According to Ned Davis, *"Today there are as many investment opinions as there are people. But as many a scorned investor can attest, predicting the future isn't easy. The good news is that it isn't necessary either. Once you stop trying so hard to be right about the future, you can start making money."*

To be sure, history has shown time and time again that market forecasts and outlooks are routinely proven to be 'wrong-footed', leading investors to be defensively positioned when they should have been more aggressive, and vice-a-versa. Inevitably 'the consensus' view (both among retail investors AND the so-called 'experts') is almost always proven to be dead-wrong, in due course. According to Warren Buffett, *"Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future."*

On a related note, I got a chuckle out of a recent interview I saw where a respected investment 'expert' shared his "outlook" for 2023. To paraphrase, he described how they try to identify where the biggest risks are, so that they can simply avoid them. If only it were that simple!

Of course, in the real world (…the one the rest of us live in!); if the "biggest" risks could somehow be identified in advance, then they clearly are not really a risk at all - let alone "the biggest" risks! The real 'big' risks (at least when it comes to relying on market forecasts) are those that simply cannot be known in advance (i.e. the 'punch' you don't see coming, because you can't see it coming).

To further emphasize this important point, there would be no risk of motor vehicle accidents ever again, if all road hazards and potential collisions could somehow been seen well enough in advance. In such a scenario, we'd simply avoid them. Of course, car accidents DO happen, and all of the real risks both on the road AND those that come with investing simply cannot be avoided entirely.

However, the reality of unforeseeable "risk" is not as much of a disadvantage as it may seem (…at least, in investing). Unpredictable events, both good and bad, happen all too frequently – resulting in extreme bouts of short-term market volatility. Volatility is what provides the savvy investor with opportunity; i.e. the opportunity to both buy great companies at obscenely low prices, and to sell them (or trim them) at unsustainably high prices.

According to Benjamin Graham, *"Price fluctuations have only one significant meaning for the true investor. They provide an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal."*

For our part, we seek to mitigate the inherent risk of the unknowable by ensuring that you have an appropriate asset mix and an overall investment plan in place – as based upon your time horizon, return objectives, current income needs (if any), etc. This approach focuses on that which is 'knowable'; your actual goals - and how best to achieve them. The result is a portfolio that is designed to weather all seasons. In a nutshell, the "biggest risks" obviously can't be known in advance, but we can be prepared.

Perhaps most important, while we can't control what the economy or the market will do next, we DO have complete control over how we react to whatever occurs. Buffett's most famous quote sums it best; *"Be fearful when others are greedy, and be greedy when others are fearful."*

What about the current circumstances?

To state the obvious, 2022 will not go down in history as a great year for investors. It was one of those very rare calendar years where both stocks AND bonds went down in value.

After a year like 2022, many investors (…looking for 'answers') tend to focus their attention on things like economic data, the financial "news", and worst of all – recent (past) investment results. All of these share one thing in common – they are all backwards looking.

Economic data, such as the unemployment rate, corporate profits, and GDP (Gross Domestic Product) – just to name a few – are lagging indicators. They measure data that, in essence, is always slightly behind reality. Granted, economic data can provide good information about the state of the economy. But by the time the data is made available it is of course, looking at the past, not pointing to the future (i.e. where the puck is going to be).

The financial news media is also backwards looking (…and this is where I believe far too many 'do-it-yourself' investors seek guidance). The media simply reports on events that have already occurred. While reporting the "news" (…at least, as they see it) may be their job, investors - who are faced with making decisions today, and with a view to the future - can't do anything about events that have occurred in the past. This is simply to state the obvious (…my apologies in advance); we can't go back in time.

And finally, basing today's investment decisions on results from the recent past is most likely the biggest detriment to your future success. This is what leads far too many to the "buy high, sell low – and repeat until broke" approach. This a classic example of 'performance chasing'. It's looking at where the puck has been, and then chasing after it. The problem is, by the time you get there, the puck (i.e. the results you're seeking) have long since moved on. As per famous investor Seth Klarman; *"The highest returns going forward are when you have the lowest returns looking backwards."*

Why should we be positioning today, for the next bull market?

At the beginning of this letter to you, I stated my intent: to provide you with the best advice I can under the current circumstances. This necessitates a view to the future, not looking backwards.

So to answer the question… *"Why should we be anticipating the next bull market?"* the answer is fairly simple: because that's where the puck is going! Every bull market is followed by a bear market… and every bear market is followed by a bull market. This is simply a reflection of the economic and market cycle.

While the economic data, the "news", and investment results from the recent past are all backward looking – the stock market is forward looking.

I titled my last quarterly client letter (written in October 2022) "What To Do In A Bear Market".

The crux of my message, of course, was to be opportunistic. In that piece I stated that the "smart money" recognizes that a bear market is when we should be buying stocks – not selling them. To sum it up best, I included the following quote from Buffett, *"Bear markets are where the real money is made – not lost."*

Since I wrote that letter, detailing what to do in a bear market (in summary, BUY STOCKS!), the financial news media and many investors somehow seem to be remiss of the fact that equities have already rallied significantly. Since the market lows of last October, global equities, including the Canadian and U.S. stock market had all rallied by as much as 16% to 18%!

In conclusion, once again, the world's greatest investor said it best…

"I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month — or a year — from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over."

- Warren Buffett

Scott Yates is a portfolio manager with Raymond James Ltd. Information provided is not a solicitation and although obtained from sources considered reliable, is not guaranteed. The view and opinions contained in the article are those of the author, not Raymond James Ltd. Raymond James Ltd. member of Canadian Investor Protection Fund.