OUR FAMILY PERSPECTIVES

INSIGHTS FROM CANADA'S LEADING FAMILY OFFICE

THE NEW CASINO…GOOD LUCK

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Robinhood, day traders and no trading fees have brought to the stock market a new kind of investor and right now, with the pandemic, they are mostly working from home, which means they have more time to trade stocks.

I am writing this brief article for those younger investors and for everyone else. I will share what I've learned over the last 49 years in the investment industry.

Let me start by quoting one of my favorites, Will Rogers. His advice on investing in the stock market is this.
"Don't gamble," he said. "Buy some good stock. Hold it till it goes up… And then sell it. If it doesn't go up, don't buy it." I hope you agree that there is as much wisdom as humour in this quote.

Younger investors today have never really experienced a sustained bear market or a recession, since many of them have only experienced the longest bull market in history, from March 2009 until March 2020. They don't know that stocks not only can go down, which happened last spring, but can actually stay down for a couple of years or more. They have never lived through an inflationary period and they believe that a Fed Funds Rate of 20% and mortgage rates of 18% are fiction or a myth.

They might even subscribe to this well-known expression in investing. To quote my mentor Sir John Templeton, "'this time is different' are amongst the costliest four words in market history". He also suggested the four most expensive words in the English language are "this time it's different."

I'm not sure how many of you have ever heard the name Benjamin Graham. His nickname is Mr. Market, and he is well known as the "Father of Value Investing". You probably are more familiar with Warren Buffett who is still going strong and has amassed billions of dollars through his patient approach to investing in growing companies, purchased at a reasonable price. Some think of him as a value investor which is more definitional than true in reality. In the last 70 years since Benjamin Graham taught at the Columbia Business School and published his book "The Intelligent Investor "and with Graham Dodd, "Security Analysis", it has become easier for most to invest in asset classes that are not just stocks and bonds. Today you have many more tools in your toolbox. You just have to understand what they are and how to use them.

Where am I going with this?

There is a far more important evaluation that must be completed before you make any investments, whether in the stock market or in any other of the numerous strategies available to you. It is paramount to understand the relationship between risk and return. When one goes to a Las Vegas casino to gamble, there is an expectation of taking significant risk of loss to make a substantial return. One could always limit their losses by gambling on a limited budget. Investing is really no different. One could take very little risk in an investment with a modest return expectation, like holding cash or investing in bonds. There is some symmetry in the greater the risk, the greater the expectation of a larger return and the lower the risk, the lower return. In my opinion, there are many non-traditional asset classes today available that have a much better risk/return profile for the future.

I'm talking about real estate, private credit, direct lending, private equity, absolute return strategies, SPAC strategies, mortgages, infrastructure and many more. If you think about real estate, you realize that it is probably one of the best investments that you have made over the last 10, 20 or even 50 years. It's the house that you live in. Most of us are very familiar with mortgages, but few have invested in the asset class.

When you look at your wealth or your investments, do you analyze them from the perspective of their potential returns only or do you consider drawdowns, the correlation to other investments in your portfolio, geographical diversification, their liquidity, fees, tax considerations, and the risk of loss? At our firm we look at all of these and analyze even prospective client portfolios.

I believe in playing defence to play offence. If you have never lost money, you are probably the best portfolio manager in the world. You must have a disciplined approach to your strategic asset allocation and understand that if you are only in the stock market, then you're missing out on most of the world of investing.

I often use the expression "if all you have is a hammer, everything looks like a nail. "We have a good weighting in equities, but it's not 60%, like a typical 60/40 model portfolio. It's less than half of that. A majority of the funds we manage are in anything but a stock and bond.

We like to have a view of the future. We have an opinion in our Capital Market Assumptions for the next five years. Almost every firm on Wall Street has Capital Market Assumptions and ours are very conservative. That gives us a view of expected returns of almost every asset class. But as important, is understanding the risk of those asset classes and that risk is a quantifiable number that's been around for 50 to 100 years. We know the volatility/standard deviation of every asset class and understand the relationship between risk and return. You'll find that most other asset classes have a better risk/return profile than the stock market. It's not just about the stock market, although Wall Street and the media would like you to think so.

With markets at record highs without the necessary fundamentals to support it, caution and defence are always recommended at times like now for the riskiest of asset classes.

Another individual that I like to quote is Bernard Baruch, who made millions of dollars in the stock market in the 1920's. Two of my favourites are "Nobody ever lost money taking a profit" and "I always made money by selling too soon."

So, what is my recommendation with markets at an all time high?

Build yourself an all-weather portfolio. Make sure that your investment portfolio includes a number of other asset classes that have a low correlation or no correlation to the stock market. This means if the market goes down, you have investments that can still go up. I'd like to say, that we serve very demanding clients. "When the market is up, they expect to be up and when the market is down, they expect to be up".

I have already mentioned many of those non-traditional asset classes, especially absolute return strategies. It's inevitable that the market will correct one day…unfortunately, we never know when that will start.

Something that has always resonated with me is the following expression, "It's important to know what you know and with humility, to know what you don't know. My greatest concern is not knowing that which I do not know or the unknown, unknowns".

Confident that we are at least halfway through this pandemic before our lives return to the new normal, I'd like to state the obvious...that the world has changed and we're not going back and that the stock market will be higher 10 years from now than it is today. I hope that we all stay healthy, have less stress in our lives and sleep better at night, knowing that we understand just a little more about the controllable risks in our lives.

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