A View From Here - February 2018

"With a torch in pocket and the wind at your heels, you climbed on the ladder and you know how it feels to get too high, too far, too soon - you saw the whole of the moon." - Mike Scott

Too High, Too Far, Too Soon...

Just as we were getting comfortable with markets increasing over 100 points a day, February threw us a round of volatility and massive intraday point swings that have been heard all over the world. Canada sits at levels just a stone's throw away from where it was at this time 10 years ago, as weakness in our core mining and resource companies resumed a round of consolidation that plagued most of 2017. When we look at this situation from 30,000 feet, we are more likely to see it as noise wrapped in blankets of fear. Fear of rising interest rates, geopolitical uncertainties, and a replay of 2008-2009. But maybe it has been just a little too good out there lately. The U.S. and Canadian economies are doing well and earnings have been good, so why the concern? Is it our precondition to worry mixed with the realization that there has been a lot of strength in the U.S. markets for some time, particularly the FAANG stocks (Facebook, Apple, Amazon, Netflix & Google)? I sense a degree of angst among investors who feel that they've missed out on the spectacular gains from all things blockchain and more specific to Canada, the marijuana companies. But could they handle the volatility? A look at investor reactions of the past week makes me wonder.

If you look at a chart of the S&P 500 or the Dow Jones Industrial Average for the past 3 months, it's not hard to see that they reached exponential levels that in the normal course of business needs to rest. The media as usual has had a heyday with the volatility fueling investor anxiety and leading to this likely temporary panic which resembles the thousands that have come before it. I do, however, believe that we have entered into a very speculative phase of the markets as things like crypto-currencies and FAANG companies, and more specific to Canada, marijuana companies, have been on a tear. This makes things a lot more mercurial.

The most important thing to realize in these situations is that we have to know what we own and why we own it. It's when you don't know your investment thesis, that investors are more prone to bad decision-making.

Comparing Then and Now: Technology 2000/2018

In the U.S., the top tier technology stalwarts known on Wall Street as the FAANGS (Facebook, Apple, Amazon, Netflix & Google) accounted for a great deal of the Dow Jones and S&P's increase. This is reminiscent of the technology boom in the late 1990's even though there are also differences. Mark Twain famously said; "history might not repeat itself, but it rhymes." With that in mind, let's take a look at then and now.

Technology stocks were strong in the 1990's, but so were the broader markets. As 1998 gave way into 1999, there was a shift out of traditional companies and into speculative companies that were on the technology bandwagon and, if you weren't participating, your portfolio suffered...kind of like it is right now. According to Smead Capital, growth clobbered the value index by 65.7% from late 1998 through March of 2000, while the S&P Index that was heavily weighted in technology companies rose 24%...similar to today. This historical extremity culminated in some of the strangest pricing we've ever seen among growth stocks. Some of the favorites from that era were eToys and Pets.com. They had very little in sales and were bleeding red ink, but with valuations well into the billions of dollars. Nortel peaked in 2000 at 33.5% of the entire capitalization of the Toronto Stock Exchange. At the same time, numerous solid non-tech companies were trading at multiples not seen for decades and many were offering generous dividends. But few cared.

The best comparison of 2000 and its similarities and differences begin with the most popular tech stocks. In the late 1990's it was Microsoft, Cisco and Intel who had the largest capitalizations and the most momentum. A sort of second tier group of companies was led by Sun Microsystems and Lucent Technologies. Today, the stock market has made the FAANGs the kingpins with other tech companies filling the tier, just behind them. The most profitable of today's glamour tech stocks sell at multiples similar to 1999, but Amazon is perhaps the most puzzling as some days it looks like Microsoft did in 1999 and other days, its money-losing divisions remind us of eToys. The two biggest differences between then and now is the effectiveness of the monopolies held by the FAANG companies and the dearth of IPO's of common stock in the current episode of technology financial euphoria. By 1998, the U.S. government was worried about Microsoft's monopoly in operating systems and software, but it seems that politicians today do not seem all that worried about how powerful and anti-competitive these popular technologies have become.

Tied to the power of Facebook, Google and Amazon is a lack of new public companies being brought to market and it appears that the market growth is being sucked into these monopolistic stalwarts which leave investors to pursue a narrow list of favorites. It all reminds us of the Nifty-Fifty, one decision stocks of the 1960s, most of which don't exist anymore. With the history of bubbles, from The South Sea Trading Company in the 1700s, Tulip mania in the 1800s, everything stock market in the roaring 1920s, The Nifty-Fifty in the 1960s, the technology boom in the late 1990s, guidelines suggest that this boom will likely be the impetus for the next bear market.

We have been fortunate and anyone who has been with our practice for five years or more has seen growth that well exceeds the returns of the TSX, Nasdaq, Dow Jones Industrial Average Index and pretty much any other market benchmark you can throw at it. But it has never been a smooth ride, and never wrapped in the comforting blanket we all wish it could be. But the bottom line in our long-term returns tells a very undeniable truth and while our long-term track record has been matched and/or exceeded by very few, the current environment remains a challenge. Markets are rewarding the easy things that we are all supposed to know work well, the popular tech companies that are so involved in our day to day lives, and the stoners who might have had it right at the planetarium taking in laser Floyd in the 1970s.

Thanks for taking a look, and as always,

All Good Things

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