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THE ROAD NOT TAKEN

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By Brahm Satov

In my 20's, I lived in Hawaii for about 5 years, and left a short while before my dad passed which was in 1999. I made some great friends and most days were filled with sunshine and adventure. Sometimes I wonder what my life would have been like had I stayed. It is not just the year around great weather that makes me wonder, but the culture, connection to nature, beautiful waters, and lifestyle that also makes me question my decision. I returned to Hawaii, I believe it was the winter of 2018, with my wife, kids, and in-laws, it felt like I had returned home. We rented a house in Lani Kai on the quieter side of the island, away from Waikiki Beach, and it was probably our best vacation ever. I have to admit, that sometimes in the heart of Toronto winters when I look outside and it is bitterly cold, I question whether I made the right decision. However, sometimes life happens. After my dad passed it was really up to my sister and I, to help my mom and get her back on her feet. Staying in Canada allowed me to spend time with my mom, my sister and her better half and her family, to marry my wonderful wife and get to know her family, have two amazing kids, and spend time with my friends here, as well as work at a job that I thoroughly enjoy! Yes, I made the right choice but I sometimes wonder about, "the road not taken".

I tip my hat to Robert Frost for the title, and for being the author of one of my favorite poems. When it comes to the equity markets I feel like I have also embarked upon the road not taken. In other words, whereas most choose to stay invested and hope the markets recover, I think it makes far more sense to change the portfolio allocation to become far more defensive when the likeliness of correction is high. Whilst this strategy worked out well in 2022, with the NASDAQ down more than 30%, the S&P down by almost 20% and I read that the average Canadian investor was down over 15%. Given that last year both the stock and bond markets fell together. So far this year the markets have started to bounce back, and some may be wondering if the downturn is over. Is it time to reconsider this defensive strategy.

Although it may feel like they have, stock markets have not returned to their old highs prior to the 2022 downturn, so if you moved to the sidelines before that downturn, although you may have missed much of the bounce back this year, you are likely still ahead. Something else to consider, is that economic growth globally has been slowing and in some places like Germany, already in recession. Additionally, much of the appreciation of the stock markets has been due to just eight stocks heading considerably higher. This is referred to as market breadth, as I mentioned in my previous newsletter, when market breadth is negative, few stocks are rising, this is generally not a positive sign. It is better when most stocks are rising higher pushing markets higher, not when it is just a few rising by a lot. Also it remains my opinion that the correction in 2022 was due to rising rates. As rates go higher, the discount rate rises and the discounted projected cashflow of companies falls in value. Some may be thinking that the downturn is over, and that we are on the road to recovery, and as much as I'd like that to be true: In the past, to get out of a downturn something would need to happen to trigger the improvement. In other words, historically, central banks would need to stimulate the economy either through lower interest rates or other stimulative measures to help reinvigorate the economy. This has not yet happened, if anything central banks in much of the world are still hawkish and looking to raise rates even higher. Moreover, a delay between many of the leading economic indicators turning negative and an oncoming recession is normal. Often it can take a year or more. Also of significance, the unprecedented amount of stimulus injected to fight the Covid induced slowdown, created a massive liquidity bubble that in my opinion is still affecting the markets. Further, we still have many investors that are investing in the stock markets that are less sophisticated, I hope that is not offensive, but I believe it to be true. Take a look at Bitcoin, many have invested in it, but have no idea what it's value is. I consider all crypto currency to be an indicator of how foolish the markets are at any given point in time, and given the recent runup in Bitcoin… And let us not forget what the bond market is still saying, that we will see a recession ahead, and keep in mind the bond market is far larger than the stock market and when in the past we had an inverted yield curve like this one, persistent and pervasive, a recession followed each and every time.

Whilst it is normal to see bear market rallies (a brief period of optimism that drives prices up temporarily before bearish sentiment takes hold once again, pushing prices even lower) and sometimes they can even reach or even pierce old highs. Higher rates puts downward pressure on the markets, this is especially true for the technology sector, (as the technology sector has more expected cash flows in the future, in other words a higher discount rate will generally affect companies with larger future forecasted cash flows to a greater degree). However, the expectation for lower rates ahead, can be expected to see the reverse and for the tech sector to rally more than others. As we have seen recently. Although these rallies can be meaningful, you never know when they will end. Nonetheless, if we do see a recession, which I still think it highly likely, especially a severe recession, it would be reasonable to expect a considerable downturn in most sectors, including technology. Currently GIC rates are around 5%, and given that long time stock market returns are only about a couple of percent higher than that, coupled with the much higher than normal probability of a selloff, I continue to believe GIC's offer a better risk adjusted return at this time.

Although most would agree that it is easier to stay invested, maintain your holdings no matter what. If a downturn turns out to be a significant one, it could take years to come back to break even. Keep in mind China's Shanghai index has not made a new high since 2007, that is more than sixteen years since an investor who invested then at the high has still not recovered, and for Japan, for those that invested in the Nikkei in 1989, it has still not made a new high, it has been well over 30 years. Some refer to lowering exposure to risk and changing ones investments as timing the market. This has taken on a negative connotation, and some have suggested that this market timing is tough. I would postulate that it just makes sense to lower exposure to risk when the likeliness of a downturn is high and raise it when the likeliness is low. Although it may be a more difficult at times, I am proud that I have chosen the road not taken.

Thank you for taking the time to read this, please feel free to e-mail me any feedback or comments.

Sincerely,

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GIC - For more information about this product, please contact your Investment Advisor.

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