Chairman's Council

The Pope Team
CIBC Wood Gundy
Pacific Business Centre - North Tower
Cooney Road, suite 606
Richmond, BC V6X 3M1

Tel: 604 270-6457 | 1 800 341-9909
www.thepopeteam.ca

April 2021

IS THIS MARKET PARTYING LIKE IT'S 1999?

If you have a spare $600,000 or so, perhaps you might be interested in buying an encrypted video of a cat? Yes, that happened! Believe it or not, we now have a new asset class called 'non-fungible tokens' (NFT) which are original memes that people have created. The cat video in question sold at auction for the equivalent of the average Canadian home (or 1.5 times the average U.S. home.)

For the computer programmers out there, perhaps it would be neat to be the 401st person or company to create a computer algorithm, which provides the ability to make transactions with a new cryptocurrency- that is backed by nothing tangible or central-bank like. It doesn't cost much to create the algorithm, and should people buy it, the portion of cryptocurrency you keep for yourselves can be worth a lot of 'coin'. Do not worry, the Pope Team is not suffering from Covid fatigue enough to invest here.

Unusual Times and Investor Psychology

This past year has been so different in many ways. Having said that, history is repeating itself in terms of how basic human nature works. Just a short one year back, fear ruled the day. Questions like "how bad were things going to get?... and how much more can markets drop?", occupied investors' minds.

About six months later, as markets were looking better, investor psychology shifted towards taking more risk. Many investors were house-bound and opened online trading accounts and began piling into new and exciting areas that are trendy and in demand in our Covid economy. Actual corporate earnings do not seem to matter when it comes to analyzing how an investment might perform. Just like the seasons, both the economy and with-it investor psychology, will always cycle.

Currently we see many speculative areas of the market that look over-valued to us. The only other time over our careers that we have seen this much over-valuation (or as Alan Greenspan once called it 'irrational exuberance') was during the internet and tech bubble, in the late 1990s. Around that time, I was interviewed by Jon Ferry for an article he was writing in BC Business magazine, regarding how things might transpire. Recently, I tried to dig up the article copy in our office. I was confident we would find a copy as I am a notorious packrat for business things acquired over the years. For example, I can't seem to bear to recycle away a very dumb device I bought over 30 years ago. It allowed me to advance in technology by typing information from business cards onto a machine with a tiny screen.

Surprisingly, we could not find any copy of the article. I phoned BC Business and a nice lady there looked through their microfiche archives. For a very reasonable $25, the company emailed me the article, which I attached above. I enjoyed re-reading it after all these years and I hope you enjoy reading what we were doing investment wise back then. It's a trip down memory lane for our longer-term clientele.

As things turned out, it was very good that we avoided getting caught up in the excitement, momentum, and exuberance - that eventually saw the tech heavy Nasdaq index fall by a whopping 80%. Meanwhile the industries these companies were in (internet, cell phones, etc.) went on to grow significantly. The lesson that was learned (but I don't think is being applied well today) is that while it is possible to accurately predict what new industries and growth areas are out there, be careful in terms of investing in stocks when they are both popular and pricey.

Supply and Demand 101

Capitalism and Darwinian theory (survival of the fittest) have a lot in common. Namely, any above average growth in demand for new and exciting things (that in-turn creates above average profit margins and fast growth) will attract new companies and incent existing companies in that space to invest in that growth. This results in an increase in supply of what people want to buy, which in-turn causes profit margins and company growth to come back towards a more normal level. That is the essence of capitalism which functions best when there is competition. Only monopolies (which are technically not allowed in the private sector) can avoid the inevitable competitive pressures and increase in supply that results when people want more of whatever fast-growing companies are providing. This basic economic truism is another reason to be careful when investing in high priced stocks in fast growing industries.

Cryptocurrencies, Renewable Energy, EVs, Marijuana and SPACs: "FOMO" Fear of missing out?

Now let's move on to cryptocurrencies. The most exciting and topical cryptocurrency is of course, 'Bitcoin'. Of late, it has been on a tear as many legitimate industry players begin accepting this form of currency. We also see a massive amount of advertising by companies in the intermediary business of conducting cryptocurrency transactions - to earn transaction fees. Also, common to see are business news networks ads promoting investors to buy a cryptocurrency ETF or mutual fund (where the companies providing same earn hefty management fees.)

The closest analogy we can think of to the 400 or so digital coins trading out there these days, is the dot-com stocks from the late 1990's. All a company had to do back then was announce they had a neat new website that would sell stuff, and suddenly their stock price took off. I would estimate that dot-com stocks, on average, went on to fall around 95%; however, one little dot-com stock that sold books online, by the name of Amazon, seems to be doing very well today! There will again be a few big winners out of the many companies that are trading at rich valuations today but getting that stock pick right is a risky bet.

Management and transaction fees are enticing more well-known and legitimate financial intermediary players, such as PayPal, into the cryptocurrency space. For the time being, if more people want to buy Bitcoin than sell it, prices indeed could go higher, or maybe much higher...or maybe not? 'Two maybes' in a row', is one too many maybes for us. But just maybe, Bitcoin is the new digital gold, or maybe it is indeed an inflation hedge, or maybe it is a good portfolio diversifier? Ok, ok, enough with my maybe joke.

Why would legitimate industry players accept Bitcoin and, in some cases, other forms of cryptocurrency? Reason number one as said above is transaction fees. Reason number two is that these companies can now use the cryptocurrency futures market to offset the price risk in terms of the time needed to obtain the cryptocurrency- and then exchange it for real currency.

With major central banks around the world soon launching their own form of digital cryptocurrencies fully backed by their strong and legitimate currencies, the main utility of today's cryptocurrencies will go away. This will leave the only prime reason to buy into this space (other than for those attracted to its secrecy benefits which concerns regulators) being the hope that existing cryptocurrencies can be sold for a higher price in future. I have no idea when and how this will end, but it's certainly possible some Bitcoin buyers will end up learning a tough lesson.

Let us look at a few of the other high-flying areas, that look richly valued:

Anything to do with electric vehicles certainly qualifies here as do the mining companies producing lithium and cobalt (which are needed to make electric vehicle batteries). Renewable energy stocks are also trading at lofty valuations as are many tech companies.

Another sign of speculation is the huge increase in 'special purpose acquisition companies' (SPAC's.) Here, millions of dollars are raised to invest in future into (initially unknown) companies. These SPAC's, on average, now trade 50% above their initial public offering (IPO) price - even though most have yet to invest in any company! There were 155 SPAC IPO'S in just the first month and a half of 2021 and most are focusing on new and exciting growth industries - as that's where the action is. Our contacts in the private equity space tell us it is a suitable time to be sellers of their private company holdings to SPAC's. Hence, those in the know are selling, not buying.

Occasionally, we look at a few smaller companies in the "in-favor" industries. Generally, it is because a client mentions they may be interested in buying it. We currently see many smaller companies that are losing money but trade at valuations that no outside deep pocketed investor would ever pay to buy the whole company. There has also been a huge up-tick in insider selling by major shareholders of smaller company stocks. So, here again, those in the know are 'selling'. My inbox these days is flooded by emails from promoters of small cap stocks. I hit the unsubscribe button, but they keep coming! Today's 'Wolves of Wall Street' (or Howe street, or whatever street) have computers of course, not just the old-fashioned telephone!

Marijuana stocks, which suffered massive stock price declines previously (since most of these companies have yet to figure out how to make any money), have gone up dramatically of late. Yet, most of these companies still lose a lot of money. The unregulated and untaxed black-market marijuana players refuse to give up this business without a good fight!

Tulips Anyone?

Back in the 1700s in Holland, there was a famous bubble of epic proportions when investors somehow thought tulip bulbs could be worth a fortune. One tulip bulb could trade for as much as the equivalent of a home back then (I am again reminded about that $600k cat video!).

People buying these bulbs, in the end, would have much preferred to own a house as of course, the bubble ended up bursting. As crazy as that situation might seem, the psychology behind bubbles and making fast easy money is inside all our brains. Our role as your financial advisors, and stewards of your hard-earned savings capital, is to resist these temptations - and always be very valuation conscious in terms of any asset we invest in.

The Social Media Soapbox

As to what is driving all the speculation these days, here is a clue. When the original stock markets in London and New York began, it was important to be in those cities where the action was and where information could be learned and disseminated. The informal and formal chatter that took place back then (and today) in key financial cities has been augmented significantly these days by social media. Social media chatter can spread information to exponentially more people and much faster than can financial players chatting in London or on Wall Street. The short squeezes involving GameStop and AMC are notable examples of how social media can spread an idea, which in-turn can create a lot of buying. For some, who buy in early and then sell fast enough, a good profit can be had. At the end of the day though, it is inevitable that all assets will eventually trade for their true value. It is our job, on your behalf, to play the long game and if something is trading higher than it's clearly worth, we don't buy it.

Finally, the good news

Do all these concerns mean that markets in general are overvalued? We do not think so, not yet anyway; however, the speculation and buoyant investor psychology we see right now certainly tells us that markets are no longer at an attractive low point, as was the case a year ago. A market bottom has never occurred when speculative investing is prevalent.

The good news is that companies with good, predictable and steady earnings -such as the banks, utilities, and rail companies, are not excessively valued. Low interest rates though may indeed result in almost everything becoming overvalued, perhaps in two- or three-years' time. If we see that happening, we have 'arrows in our quiver' investment wise to decrease risk. In the meantime, we absolutely promise to avoid buying into cat videos (we do like cats though!).

We very much appreciate your business and the trust you have put into our team. As always, please call us if we can do anything whatsoever.

Kind regards,
The Pope Team

Neil Pope, MBA
Portfolio Manager,
Investment Advisor
Tel: 604 207-8578
neil.pope@cibc.ca

Rick Aulik
Investment Advisor
604 207-8585
rick.aulik@cibc.ca

Susan Christie
Associate Investment Advisor
604 207-8570
susan.christie@cibc.ca

Cheryl Sy
Client Associate
604 207-8581
cheryl.sy@cibc.ca

Melanie Burns
Client Associate
604 207-8583
melanie.burns@cibc.ca

Phoebe Tagaca
Administrative Assistant
604 270-6457
phoebe.tagaca@cibc.ca

Disclaimers

This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. CIBC and CIBC World Markets Inc., their affiliates, directors, officers and employees may buy, sell, or hold a position in securities of a company mentioned herein, its affiliates or subsidiaries, and may also perform financial advisory services, investment banking or other services for, or have lending or other credit relationships with the same. CIBC World Markets Inc. and its representatives will receive sales commissions and/or a spread between bid and ask prices if you purchase, sell or hold the securities referred to above. © CIBC World Markets Inc. 2021.

CIBC Private Wealth Management consists of services provided by CIBC and certain of its subsidiaries, including CIBC Wood Gundy, a division of CIBC World Markets Inc.

"CIBC Private Wealth Management" is a registered trademark of CIBC, used under license. "Wood Gundy" is a registered trademark of CIBC World Markets Inc.

Clients are advised to seek advice regarding their circumstances from their personal tax and legal advisors.

If you are currently a CIBC Wood Gundy client, please contact your Investment Advisor.