

MONTHLY COMMENTARY | January 2022

"Lions and tigers, and bears, oh my!"

- Dorothy in The Wizard of Oz

It seems appropriate to begin with a refrain from the Wizard of Oz this month. Though public equities provide long-term investing success, this "yellow brick road" has many twists and turns to navigate, and January, as with the period between February and March 2020, provides good evidence of that fact.

Many pundits are referring to the recent pullback a variety of ways: the beginnings of a secular bear, a reversion to "value" investing, the "January barometer" of a difficult year caused by long-term supply chain disruptions, and/or the potential for another "tech wreck" similar to 2000 ... in short, all sorts of predilections and posturing. To top it off, Jeremy Grantham, noted perma-bear and co-founder of Boston-based asset manager GMO, came out warning of a super bubble in the US stock market and a subsequent 50% crash in market prices. Oh my!

Prior to the past decade, the last secular bull market ran from August 1982 to September 2000, with the S&P 500 index rising 1,364%, from 103.85 to 1,520.77 on the back of one of the greatest economic expansions in US history. Yet, during this remarkable period of appreciation, there were three major corrections: the well-known "Black Monday" October 1987 30% "crash" lasting three months, the early '90s recession resulting in a 19% pullback, and the 19% pullback in 1998.

At the end of the bull run, the subsequent secular bear market was triggered by the "tech wreck", which lasted thirteen years until the S&P 500 once again crossed its 1,520 price in March 2013. From there to the most recent high of 4,793 at the end of 2022 provided a gain of about 215% in the index. A significant rise for sure but dwarfed by the prior bull run, and during which there were three major pullbacks of 13% ending February 2016, 19% ending December 2018, and the now infamous 34% drop ending in March 2020.

So, with equity prices easing once again over the past month, many are thinking "Toto, I've a feeling we're not in Kansas anymore."

While true that markets have cycles, it is also statistically proven even the best investors cannot time markets – the inability to predict when a market is expensive (sell) or cheap (buy). It's one thing to look at history and see that recession's and bear markets have occurred with some frequency, and quite another to predict the precise timing of either event. And it's another thing entirely to devise a strategy that reacts to those predictions.

We readily admit there is some truth to the short-term value reversion. In January, the Russell 1000 (large capitalization) Growth Index underperformed the Russell 1000 Value Index by 6.2% - a sizeable differential. This huge one-month dispersion has affected the past year results, but over the past five years, the Growth Index has outperformed the Value Index by 11.8% - over ten years, the outperformance is 5.8%. In fact, over the past ten calendar years, the Russell 1000 Value Index has only outperformed growth twice – in the past twenty calendar years, value outperformed only 40% of the time.

We are confident that, looking to the next investing decade, there will be market volatility. China in particular, and Asia in general, will transition to the global "centre of gravity" while the US dollar likely loses its reserve currency status. We expect hydrocarbon growth to give way to renewables, and digital to fully replace analogue. These things are fairly easy to predict ... except for the timing, cause, magnitude, duration, location, and policy response (paraphrasing Morgan Housel).

We believe that markets are too complex and dynamic for anyone to reliably predict future price movements or, as suggested, style shifts. Our solution is to fill client portfolios with high-quality businesses which may not be immune to the nervous psychology of investors but, with credible, proven business plans and experienced management leadership, offer the best opportunity to be properly positioned throughout the uncertainties in the years to come. When investing for the long-term, high-quality stocks are an important ballast for an investment portfolio due to their financial stability and greater propensity for growth across varying macroeconomic environments.