Market Casualties and Lessons to Learn

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Despite the recent market rebound in January, let's review what has happened to the market last year and see if we can all learn from these events and how we reacted to them.

All these stories that I am about to divulge to you are only to try to help all of us not make the same type of mistakes in the future. I will never provide any names of individuals as their utmost privacy is assured.

Bitcoin and Cannabis Sectors

Approximately two years ago private investors were obsessing about both bitcoin and cannabis stocks. Some investors decided to completely avoid traditional dividend paying stocks to concentrate solely on the faster moving bitcoin and cannabis sectors. One investor actually addressed me as an out of touch 1950's investor who had no idea about the current market. I told him several times that gambling your hard earned capital was not a great long term strategy. We all remember what happened to Nortel where many investors were still buying the stock at $120 per share only to see their shares fall to zero.

The Bitcoin NYSE index has fallen by almost 74% yr/yr as of January 11, 2019. Year to date the index is still off by over 3%.

The Horizons Canadian cannabis ETF, HMMJ, registered a 1 year performance as of January 11, 2019 of minus 13.4%. Last year's performance was down almost 20% after a 90% rise in 2017. Year to date 2019 has seen this index rise almost 26%.

The very high sector price volatility of the aforementioned groups does not make professional institutional investors have much confidence in the long term outlook.

The lesson we can learn from this performance is to always sufficiently diversify your holdings and only to have a very small token position, under 1% of your equity holdings, in these types of investments.

North American Financial 15 Split Corp. Common shares FFN

Many investors over the last several years have invested heavily into this financial ETF. The marketing documentation surrounding this investment implies that the underlying investments are in high quality Canadian and US financial stocks, thereby indicating the overall risk is low.

Over a year ago this ETF had a dividend yield of over 12%, while their underlying investments in bank and insurance stocks were only yielding in the range of 4%. I was informed by several private investors that this was a great investment with little downside. My initial reaction was very skeptical. How could this ETF yield three times the bank stocks when financial stocks were their only investment holdings in the ETF?

After doing some research, this FFN ETF is using leverage to improve its overall returns. Once again we all know that leverage, borrowing to invest, only provides strong performance when the markets are rising and produces much worse numbers when markets are falling.

Last year this ETF fell over 42%, while the Canadian financial ETF, XFN fell by only 10%. Year to date this ETF has sharply outperformed the bank etf, XFN by rising over 24% compared to the XFN's rise of almost 4%.

The lesson to learn with this type of investment is to never trust all the marketing hype and do your own research. Be skeptical of an investment that indicates their dividend yield is many times higher than the underlying assets the fund is invested in.

There is really no need to take on additional risk. We should focus on a risk adjusted rate of return whereby you as an investor really need to determine in advance what type of risk you are assuming before you invest in these types of securities. Do not invest in securities that use leverage. Invest directly in bank common shares.

<u>Fully invested in stocks at all times</u>

This subject I have addressed many times in the past. Active asset mix strategies do work in a volatile market no matter what your adviser tries to tell you otherwise.

Several investors I know who do not have defined benefit pensions rely exclusively on their dividends to maintain their standard of living. One individual I know was fully invested in stocks during the last economic recession. It took him seven years to breakeven on his capital even though he was still getting his dividends. In my opinion this is not a good strategy to follow. In an economic recession many companies cut their dividends. In addition why expose yourself to undue stress by seeing your investments collapse in value in a market downturn? This stress could result in a heart attack for distraught investors.

The lesson to learn here is to manage your overall asset mix actively and to adjust your stock exposure when market valuations are just too high relative to historical averages. Having a cash surplus to use when markets correct to more attractive valuations is a key strategy to follow.

<u>Active Asset Mix Strategies that are not working</u>

The dictionary's definition of an idiot is someone who continues to pursue something that does not work. Goggle Search's definition of an idiot comes up with Trump!

There are many day traders who rarely invest for the long term by only trying to profit on intraday price volatility. I am not an advocate of this strategy.

Recently I asked one individual I know how much cash he had as a percentage of his total holdings. He said that he had virtually no cash as he was fully invested in securities that had fallen in value. He was hesitant to sell any of them until he broke even.

Normally this individual is 100% cash by the end of each day. Now he is 100% invested in stocks.

There are two lessons to learn in this case. Equity markets really do not care what your book value of your securities is. If you have invested in a stock that has gone down in price, there is no guaranty it will ever recover to what you originally paid for it.

Secondly it is imperative to manage your asset mix in a beneficial manner. Going from 100% cash to 100% invested could be a recipe for disaster. Manage your asset mix actively but conservatively.