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Darren's take on things
July 2022

There is an old saying, **"you make money during Bull markets but earn it during Bear markets**". Bear markets are defined as a market drop in excess of 20%; they aren't much fun, but can be profitable and in this note I am going to explain how. As a preamble, a short history: The first half of 2022 is now on record as one the worst 6-month periods in history. Only six other times since 1926 (markets, not your account) have been worse than the past six months:

- Great Depression
- 1937 crash
- WWII
- 1970's hyperinflation bear market
- The dot.com bubble crash
- 2008 financial crisis

I am very pleased to report that for the first six months of 2022 our portfolios, although not immune to this volatility, are down only modestly. Not fun, but certainly nothing near the 20%, 30% and even 70% that much of the rest of the market is currently experiencing. Let's take the Russell 3000 as an example—it's a representative index of the entire U.S. stock market with more than 2,700 companies in it. Nearly 800 of those companies or around one-third of the total, are down 90% or worse from their all-time highs. One in five stocks are down 80% or worse from record highs!

Despite what the experts are saying, markets are telling us we may be in, or entering, a recession. These are the same experts that said inflation would be transitory, so I take their predictions with a grain of salt. Regardless, the economy is clearly slowing, but so far nothing like what caused the previous crashes above.

It's all a matter of perspective. No one likes losses, but the current market action is actually quite healthy, was very predictable and is normal. What's not normal is when nonsensical things like NFTs make people over-night millionaires. When you think about it, the entire world was locked down for 2 years and governments handed out trillions of dollars. What did they expect, rational behaviour?

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In my view, we are now suffering from three major policy mistakes. First, interest rates were kept too low for too long. Second, handing out too much money allowed consumers to accelerate current purchases, and hoard and speculate more in the past two years than they would have if no pandemic had ever occurred. And third, by shutting down many parts of the economy through lockdown mandates, government policy dismantled supply chains that took decades to create and perfect—and this won't be fixed overnight. I think markets and the economy are doing surprisingly well under the circumstances and I now hope for less government intervention to allow the economy to heal.

There is another market saying, "**high prices take care of high prices and low prices take care of low prices**". We are seeing this with expensive assets like oil, which was $130 a barrel and is now under $100 a barrel; real estate activity which became absurd has now cooled off. Both are coming down quite perceptibly and rationally. Things get too expensive, crash and eventually opportunistic investors step in and capitalize on the low prices in assets like stocks and real estate that are on sale, which is great news for all of us. The best results are born during bad markets, the challenge is knowing where the bottom is.

The market doubled 15 months after the March 2020 bottom, but who saw that coming and how could anyone know that was the bottom? The cause is always different, but every single bear market has one thing in common. Most observers wonder how much lower the market can go; it seems like the losses will never stop so most people wait and never act. The small number of investors that do act, do very nicely. The economic news will be terrible, other investors will be depressed. Pessimism becomes pervasive. We need a process or framework to navigate this and that's what Income Accelerator does.

How and why I say Income Accelerator is one of the best ways to capitalize on a Bear market:

When share prices drop, yields increase to a point where investors move in and buy. Using Bank of Nova Scotia shares with the "Gordon dividend model" as an indication of a market bottom:

- This past February, Bank of Nova Scotia shares were trading for $95 per share and paid a $4.00 dividend to yield 4.2%

- Today, Bank of Nova Scotia shares trade 20% lower at $75 per share while the dividend has increased 3% to $4.12 per share to yield 5.5%.
- The math of a 20% price drop of the shares and 3% increase in dividend translate to a 30% increase in yield

2008 was the worst year on record for Canadian banks and Bank of Nova Scotia shares (and all the banks) crashed. BNS was down 35% which caused its yield to increase from 3.56% to 5.82% which proved to be a historic buying opportunity. If BNS shares drop another $5 from where they are now, they would be at levels not seen since 2008. Would that be the bottom? I am not predicting what will happen, but after the 2008 experience, it took just a year for these investors to get back to even, but income was 19% higher than before the "crash". The point here is that patient investors were better off not in spite of, but because of the crash, which is why we say Income Accelerator is one of the best way to capitalize on a bear market.

You can't expect to earn good long-term returns without experiencing periods of short-term losses from time to time. We think that's acceptable, especially if short-term losses can actually benefit long-term income and that's exactly what we (again) expect to happen.

Sincerely,

Darren

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We understand that you've worked hard, saved and sacrificed. Which is why we have been committed to helping generations of families and business owners meet their goals since 1991.

Source: https://awealthofcommonsense.com/2022/07/the-worst-6-months-ever-for-financial-markets/

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Darren Luck is an Investment Advisor with CIBC Wood Gundy in Windsor. The views of Darren Luck do not necessarily reflect those of CIBC World Markets Inc.

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