2021 Year in Review

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Keith: Welcome to The Empowered Investor. My name is Keith Matthews, and I'm joined by my co-host Marcelo Taboada. Marcelo, how are you today?

Marcelo: Very good, Keith. How were your holidays?

Keith: It was great, thank you. Boy, I wasn't sure you'd open up this way, but now that you did, I played a game that you've mentioned in previous episodes many moons ago. I played Settlers of Catan.

Marcelo: I'm so happy you did. Did you like it?

Keith: Yeah, I played with my whole family. It reminded me of the old board game called Risk that people used to play in the 70s and 80s, except it doesn't take six hours to play. You play it in an hour and a half. It's perfect. It's great for attention spans that are good for that couple of hours.

Marcelo: You know what I love about Catan? It really shows people's true colors.

Keith: What do you mean by that?

Marcelo: People's darkest side when you're trading and trying to get ahead in the game. But anyways, it's such a fun game. I did some of that as well. My New Year's Eve was online Catan and sushi with my siblings. So that was a good way to end the year, and the rivalries get really heated.

Keith: Yeah, you mentioned you were doing online. I'm amazed that a board game like that which sells just massive quantities. It's striking because you look at the board game and you go probably cost five or six bucks to produce the board, the cardboard, the pieces, and yet the margins are just massive. It's a wonderful profitable business that Catan.

Marcelo: It's completely exploded and the online game on the iPad is amazing. It costs like five dollars and everybody can play and the setup they have it goes even faster because it has a timer. So you got like a minute to play and do your trades but anyways that was my holidays. I'm happy. You enjoyed the game. So listen today we're talking about

Keith: So listen today we're talking about the 2021 year in review right? And in particular, we're going to cover off a 2021 asset class returns. We'll talk about the big topics the big investment topics of the year. Some surprises of 2021. And then we'll refer to a report talking about expected returns from this point on 10-year expected returns. So how about we start with how was the year? What asset classes. Produce the best returns and how did things evolve?

Marcelo: Yeah, it was an interesting year. It always is. We never have a boring year in the markets but the bond market was negative surprisingly so that came down 2.5%. Then you had really strong numbers in Canada and the US so 27% for the US 25% for Canada. International markets were strong but not as strong as the US and Canada so that came in about 10%. Emerging markets were negative at minus 1%. And then you had like REITs which is Real Estate Investment Trust came in at 31%. So that's probably the strongest asset class for the year.

Keith: So what you had is you had a real push forward in equity returns and 60/40 portfolios, 60% stocks, 40% bonds. If you divided your stocks up into three main regions—Canada, US, international—you would have had a gross return somewhere in the vicinity of 11%.

Marcelo: Yeah, which is amazing. Those are great returns for a 60/40 portfolio if you ask me.

Keith: 100%. So let's look at this in a little bit more detail. When I think back to last year, I think a lot of investors and listeners would look at the year and go, if I look at a chart of the TSX or the S&P, things just look like they're always going up, a few bumps here and there, but it looked pretty steady. And really, we know that it wasn't steady underneath. It's like the duck that swims across the pond. The duck on top of the water looks gentle but under the water, the duck's legs are paddling at a thousand miles an hour. There was a lot of turbulence. When you think of some of the big movements, some of the turbulence, what comes to mind for you?

Marcelo: There was a big rotation between value and growth. So we saw that happening in small versus large as well as opposed to 2020. Then we had industries that did well. Your usual suspects did really well—the FAANGs. So your Facebook, your Amazons did really well. And a lot of the things that benefited from the reopening from the pandemic did really well. So you have your financials, your industrials, energies, REITs did really well. And then you have something that did really poorly which is small-cap growth with low profits as opposed to the year before where like they did amazingly well with no profits surprisingly.

Keith: Yeah, absolutely. You highlighted all of the positive industries, the reopening industries that did well, but there's that one area that you referred to that had a really rough year. We're going to spend a little bit of time later on this one. A lot of times people were referring to them as the disruptive technologies. They were the darlings the year before. Everybody wanted to own those types of stocks. They were the stocks like the Pelotons, Lightspeed, Zoom, you name it.

Marcelo: Robinhood.

Keith: Robinhood didn't come out in 2020, remember it only came out in '21. But yeah, a lot of those technology and those lockdown companies had spectacular returns—battery companies like Plug. They had spectacular returns. And then in 2021 we saw massive negative returns in particular in the last six months. When I look back at last year, you had at the beginning of last year the first six months all the value stocks surging because of the reopening right after the vaccine. They took off for six months and growth slowed down. And then in the last six months large-cap technology growth continued, value was flat and small growth got destroyed. And I mean destroyed. You've got companies like Peloton, which is the bicycle company. At the top of the market in 2021 to where we're at today, it lost 79%, Marcelo.

Marcelo: Wow.

Keith: It's almost right back to where it was pre-pandemic.

Marcelo: Yeah, those are the stocks that were dominating the headlines.

Keith: Absolutely. You had one stock that did extremely well at the end of last year, this technology battery company QuantumScape, that lost 82% last year. You referred to Robinhood. That was the most talked about IPO and it did surge the first couple of days but from the top of where it was to where we're at now Robinhood is down—and that's the trading platform—Robinhood is down 71%.

Marcelo: Wow.

Keith: So you refer back to the duck gliding across the pond. You look at the Toronto Stock Exchange or the S&P 500 and it looks like it's just going up but you don't necessarily see all this turbulence underneath the market. It was a huge reversion that we saw last year. So the big winners of 2020, not all of them were big winners the year after. The industries that struggled—energy, which was in the dumps in 2020—had a huge bounce back in '21.

Marcelo: What's funny is like all these companies you're talking about—the Pelotons, the Robinhoods, Life is another one that's down 71% from the top—all those are great companies. It's not even a question of whether they're good or bad companies. It's just they've been hyped and the valuations are so crazy that just a little bit of reality check brings them back to earth which is completely insane.

Keith: Yeah, 100%. The two for me that come to mind and I'll say that Marcelo just because we and our company use it and everybody uses it—Zoom and DocuSign. So Zoom, the whole world uses Zoom but the top of the market for Zoom was in the fall of 2020 just after the vaccines came out. And ever since then it's lost up to 70% of its value.

Marcelo: Insane.

Keith: And it's a great company that everybody's using the services and the products.

Marcelo: Oh, we couldn't operate. Can you imagine a world now? In this virtual world, we pretty much operate on Zoom and DocuSign on a daily basis.

Keith: Yeah, and DocuSign, for those who may or may not be aware of it, is a digital signature application process that allows firms and service firms to send documents out on a secure basis so that people don't have to meet face to face because that's the way documents were signed five years ago—had to meet face to face. So it's revolutionized our business. It's been an incredible service, yet its stock is down 56%. It's exactly what you're talking about. All the hype that mentioned these companies would just grow forever, the sort of air in the balloon fizzled out a bit.

Marcelo: Yeah, absolutely. I sent you a quote this morning. Did you get to read it?

Keith: Oh, which quote did you send me?

Marcelo: I find that so remarkable too. So it was a quote by an investor called Jim Grant and I found it so relevant for what we're talking about. A lot of the times we think stocks eventually will be based on fundamentals and their value should reflect what they're valued. So I'm going to read the quote. It says, "To suppose that the value of a common stock is determined purely by a corporation's earnings discounted by the relevant interest rates and adjusted for the marginal tax rate is to forget that people have burned witches, gone to war on a whim, risen to the defense of Joseph Stalin, and believed Orson Welles when he told them over the radio that the Martians had landed." I love that quote because it shows how powerful a story and a narrative is.

Keith: Yeah, I'm just seeing your text, I'm looking at it right now. Now you know that Jim Grant is a Bond guy, right Marcelo?

Marcelo: No, I didn't know that.

Keith: Yeah, Jim Grant used to write the Grant Observer. And it was a very famous fixed income nerdy economic-based newsletter that Bond managers around the world used to read. That's a great story. So Marcelo, what are the other things? So that talks about one area highlight of the year for 2021. What are some of the other things that we want to point out that were a little unusual or needs a nice comment around?

Marcelo: We did two shows on inflation and I think it's on everybody's mind now because if you follow the news you obviously know that inflation is quite high now. And if you don't you've probably noticed it at the pump. You've probably noticed it at the supermarket where everything is more expensive. So we've gone from believing that inflation is going to be transitory versus more structural and more long-term. And we've seen even Jerome Powell from the Federal Reserve pivot and change his opinion on this. So I remember the first episode we did, Keith, we were discussing how hard it was to predict inflation and how differing the views were amongst the experts. And Jerome Powell was one of the ones who was pretty much saying that we shouldn't worry because inflation was probably transitory. And now he's shifting his views and saying, you know what, maybe we have something here that may be more structural in the long term. That was quite a surprise to me.

Keith: You're right. His pivot, the fact that he changed his mind, was definitely a surprise. And hence he got nicknamed the "Powell Pivot." But I think the story is inflation roared back. And now there's a lot of discussion that it might appear that it might be here a little longer than people thought originally. And there's all sorts of reasons for it. There's this massive amount of labor shortage. Firms are trying to find ways to fill gaps. Hospitals, medical systems are looking at trying to make sure people are there for jobs and positions. The latest statistic I saw in the U.S. had something like six or eight million workers have actually left the workplace. In other words, they either retired, they're taking time off, they're chilling out, they're disconnecting themselves, and that's a massive hole to fill. And that and supply shocks and a variety of other things are pushing inflation. So that's a big one. What are some of the other big ones for the year, Marcelo?

Marcelo: I don't even know if we can call it a surprise but house prices keep going through the roof in Canada. And I don't even know if it's surprising anymore but we're seeing like huge appreciation in this housing market still. 2021 was another great year for housing in Canada.

Keith: Yeah, so you're right. Houses are up anywhere from 20 to even 30% in smaller cities. And the irony is not the irony—smaller cities and cottage country went up the most.

Marcelo: Right.

Keith: Versus the large cities. That's definitely a big story for the year. And I think there's a lot of discussion. A lot of individuals are trying to figure out how do you fix this? Obviously if you're long home or you own a home or two homes or a rental property or a cottage you might be happy but there's a portion of the population that still don't own homes yet. The entire next generations are sitting back saying how do I make this work for me? It's a challenge.

Marcelo: I have a friend who pretty much describes what's going on. He's looking for a house in Santo Stache, living on the island of Montreal for people who are not familiar with it. So he told me that they put an offer on a house and it sold 100,000 over asking. And when he told me that I was like, this is insane. Before it used to be that you go to places that are farther from the island you would expect that they're cheaper than what they are in the actual city right? And now we're seeing all this huge price increases and bidding wars in the outer parts of Montreal. People are just going farther and it's getting there.

Keith: And it's not just Montreal. It's whether you're in the outskirts of Toronto, Vancouver, Calgary, it's the entire country. And a hundred thousand dollars—we did this analysis earlier in the year—a hundred thousand dollars is call it three or four hundred dollars in mortgage. So you're paying an extra three four hundred dollars that gives you a hundred thousand dollars with a pricing power. Which for some people they would say based on this pandemic that I'm living through, the money I'm saving by not going to dinners, by not doing this, by not having two cars, I can afford the 400 or I can afford 800. So I can afford to spend more in a mortgage. And that's the tricky part. Because if we do see some reversals in interest rates there's going to be pressure. If we see the pandemic over and more blue skies around the economy, people will maybe want to live downtown in Montreal and not have homes to worry about as much. Definitely not have cottages to worry about as much. I think that's a reversion. We're talking about reversion of stocks here and themes that we've seen in either value stocks or growth stocks—they revert back. We might very well see that in cottage country.

Marcelo: Yeah. You have a cottage, right? You see the prices around your cottage are probably going up insanely.

Keith: We've owned a cottage for 25 years. There's reasons why we owned a cottage at a very young age but we've seen cottage country and we've seen cottage country where people would say, "God, you go in a lake and there'd be out of 20 homes, six would be for sale. A third of the lake is for sale." Now if I talk to people up in the area where our cottage is, people are building cottages in the middle of the woods not even close to the lake because they feel like it's a place they can relax, have a barbecue, and take off their mask. And so contractors are just sitting back saying they've just never seen this before.

Marcelo: Wow. That scares me a bit because if we see a situation where we have high interest rates because the economy is hot and people have a lot of debt and they're overstretching themselves for properties, I don't think that's a good mix.

Keith: Every Canadian is following the real estate story now. And I think that whether it's government at the federal level, the provincial level, the municipal level, everybody's trying to find ways to see how they can release the pressure. And I just think there's so much pent-up need for that to be not fixed but provide solutions. So I think that we'll be following this for many years to come.

Marcelo: Yeah, 100%.

Keith: Marcelo, what about IPOs? That was a big theme in the last two years. What comments would you have around that?

Marcelo: In Canada, there were about $400 million in IPO fees in 2021, so about $9.2 billion were raised. So about 40 Canadian companies went public in 2021. And I tell you, like I looked at the performance—this is out of an article from the Globe and Mail. If you look at this cohort of IPOs and you compare it to the S&P/TSX adjusted for the day they went public, they underperformed the benchmark by 7.4%. So that means that as a group that IPO, those 40 companies that went public, ended up underperforming the benchmark, which in theory means that if you were just to own the index you would have outperformed that group of IPOs by 7.4%. So bad year overall.

Keith: And again, this fits into what we spoke about earlier, which is the return of small growth companies. And that same IPO theme is going on in the United States. As well, reported last week in the Wall Street Journal, 65% of companies have negative returns since their initial price. So again, it's a reversal. IPOs only went up in 2020. So two years ago was the year that just about—you just couldn't lose money at the end. You started the year off with a 30% correction and you ended the year off with frenzied speculation. And we spoke about this a year ago in our review, and I'd never seen this before. We had that much speculation that close to a correction. And so now last year it fizzled out. The IPOs just fizzled, especially in the last six months of the year.

Marcelo: You look at those stocks you mentioned at the beginning of the podcast and the behavior is so similar. They peak and then they start going down and a lot of people probably put money at the peak. And they put money when the stock is hot and everybody's talking about it and they're hearing about it from their friends. And then it ends up in disappointing. We have the numbers here from the ARK Innovation Fund. I find that story remarkable. Let's get into that.

Keith: Yes, let's do that for sure. But what you're alluding to, what you're referring to, is investors buying when things are really high. So in other words, they don't buy in advance of the stock lift. They buy after the narrative is out and everybody's in love with the stock. So what we're going to get into are things called money-weighted returns, which is you can have a return of a strategy which is X, but that doesn't mean that's what investors got in that strategy. What investors get is a function of when they put money into the strategy. Yeah, let's talk about the ARK. So first of all, who is Cathie Wood, Marcelo, and what are the ARK strategies?

Marcelo: So Cathie Wood is this superstar portfolio manager that started this fund called ARK and their fund is called ARK Innovations and it's a fund that invests in software companies and IT companies. It's a very different way of investing. They don't have a style or an investment philosophy. It's pretty much if we like the company and we think it's going to do well over a five-year period, we'll buy it without regard for the fundamentals. To me, it sounds a lot like she's just buying on gut feeling and just by her field of which companies will do well. And it did incredibly well in the last few years.

Keith: But hang on a second. She's also going to say I'm buying companies that have a specific technology which will disrupt an already existing industry which is not functioning very well, not very productive. And somehow this technology will really be a killer and have an incredible investment return.

Marcelo: That's why the fund is called ARK Innovations.

Keith: Yeah. So she's a big believer in Tesla. She's a big believer in a lot of these technology strategies. So really she's, like you said, she became a superstar. She manages a fund that trades as an exchange-traded fund. And in the world of money management, I guess in 2020—so again two years ago—she would be plastered on a lot of reviews. She would have been a hot commodity. She would have been like you got to get Cathie Wood to be on your interview. Somehow if you get her it's going to be great. So I know where you're going with this. How did it all work out last year?

Marcelo: So you were talking about the difference between time-weighted returns and money-weighted returns. And I think that's pretty simple. So if you hear that a fund, for example, Fund X returned 12% on the year. We can assume we're talking about the time-weighted returns. In other words, it doesn't include the money in and money out. So when we say that if a fund returned 12% it doesn't necessarily mean that the investors got 12%. And that's because you may come in at a different time period than when the year started. So we always see that Morningstar publishes this study called Mind the Gap every year when they try to aggregate the market and look at how the market did versus how the actual investors did based on when they put in the money. And for example, if the market goes down and you're panic selling or you're buying at the top, that's going to have an impact on the total return. So that's what we call money-weighted returns. So Morningstar tried to do something really cool with the Cathie Wood story. And I think the numbers are remarkable. If you look at the five-year return—the five-year return for the fund, Keith, was 41.3% over a five-year period. The money-weighted return for investors over that same period, five years, was 9.9%. So the gap is incredible.

Keith: Yeah. So what you're saying then is that the investors actually don't get the stated return because they haven't been in the fund all that time. They've been buying at the top end. So you're right. ARK lost 46% from the top of the market to where it's at today. And so a lot of people would say, yeah but look, it did extremely well in the last five years. And so this is where you now come in and say, okay, great. It did extremely well in five years but how many investors actually were invested in that strategy for five years or how many of them bought it really only in the last year and a half after all the big returns were done. And so that's what you're alluding to is most people were buying after the big run-up. And so hence their returns aren't that great.

Marcelo: Yeah, somebody might say okay maybe the since inception numbers are better and they're actually along the same line. So the since inception number, so that would be from October 30th, 2014, the investor return was close to 10%. The total return was close to 30%. So again it's a gap almost of 20%. So the five years is this small. And so is this inception. The good thing that Morningstar did to it is they added the cash flows. So they try to look at what cash flows went into the fund and when.

Keith: What you're talking about is an incredible story and it shows you how people jump in at the top. I will say something more. So it's not new. I remember in the 1990s Peter Lynch was a star manager of Fidelity and the same research came out and I don't have the exact numbers. That was the Magellan Fund, right?

Marcelo: Magellan Fund, that's right.

Keith: For a young guy, you got a pretty good memory, Marcelo. I know you're a history buff too. So you like to look back in time. So the Magellan Fund was this rocket ship that had these spectacular returns throughout the 1990s. And Peter Lynch was a stock picker and the average return was something I don't know like 20% but the average investor only got 10%. And it's why does it exist? It exists because people are buying into narratives and stories and buying at the top of the market. They look at what happened the year before they go wow look at those great big returns. Let me get some of that. They buy and then they don't get the great big returns. So what are the big numbers for Cathie Wood? So how much money did she have in her strategy in 2020?

Marcelo: It's crazy but let me take you a bit back from 2020. So in 2017, Keith, so that's quite a few years ago, the fund had 116 million of assets. So money invested into the fund. Okay. The return that year in 2017 was 87%. Amazing numbers, right? You can't deny that. Then you fast forward to 2021. As of November 30th the fund had 21.6 billion invested in it. So it had a remarkable jump and you start really seeing the numbers accumulate. So it went from 116 in 2017. In 2020 you'll have 6.7 billion and then it jumps to 21.6 billion. So from 2020 to 2021, a huge explosion in new assets.

Keith: So all of the people who are actually in the fund of the 21 billion, most of it came in the last year. Most of them bought at the top. Most of them have big negative returns. It's exactly the same thing as what's going on with a lot of people who are chasing individual stocks. So you ask people who bought Zoom, they didn't buy Zoom three years ago. They bought Zoom in the fall of 2020 after they saw it do extremely well. And they said this thing's going to go on forever. It's the same story for individual stocks too.

Marcelo: Yeah. When you talk about that 46% down from the top, I bet you that a lot of that 21 billion that went in, some of that caught the wave going down and a lot of people are seeing a lot of red.

Keith: All of it caught the wave. That's exactly what's happening. It's a pretty consistent story all the way through when you ask people, "Hey, when did you buy Lightspeed? When did you buy Peloton? When did you buy Dash?" When did you—people bought it when it just rocketed up and now they're stuck with these 70% losses on these positions. Now regardless, that's one of the big themes. Let's start wrapping up a little bit here. That's one of the big themes, Marcelo, that we've identified in 2021. We've got this year where for all intents and purposes it's a wonderful year to be an investor. If you stuck to diversified portfolios you are a very happy investor. If you diversified across Canada, US, international markets you are a very happy investor with regards to your returns. There's a lot of turbulence in the market so we've seen that. Marcelo, let's try to wrap up here. Let's think about 2021. Can you share with the listeners your takeaways? It's the things that you want individuals to try to consider and focus and do.

Marcelo: So my big takeaway from this year, Keith, is that if you were feeling like you were missing out in 2020 and even the first part of 2021, I think this year is a testimony of how important it is to have a well-established plan and to resist the temptation to fall into the narratives. And don't get me wrong. Some of the stories may as well end up returning a lot for investors, right? Not all of them are going to crash like the ones we're going to talk about but do you really want to take that risk with your assets and jeopardize your retirement? A lot of people would say no. I think our portfolios—I'm extremely happy with the way they're positioned. We were talking about this yesterday, you and I, off the mic and it may not be the most exciting, but I think we can agree on that, but they're doing the job they're supposed to do. It's a bit of a long-winded answer but that's my takeaway.

Keith: No, it's a good takeaway and it makes a lot of sense. And the only thing I'm going to add to that is a year ago a lot of individuals would say after 2020, "Oh, this is the new world we live in. You got to invest in disruptive technologies. They're going to take over the world." And I'm sitting back and I know a lot of others were sitting back saying, you know what? That's exactly what people said in 1999. Every time you have these big massive run-ups there's always a narrative to support the run-up. And what we're seeing right now is things do return back and things don't just go on forever. They simply do not. And history is almost repeating itself with some of these spectacular stories that are coming right back down again. So to your point, I think the investors and listeners stay diversified, stay the course, keep the portfolios low cost, build the portfolios around index strategies, understand your plans, and move forward and stay away from the narratives.

Marcelo: A hundred percent.

Keith: So listen, I think that's a pretty thorough review for 2021. One of the ones I know that we're going to bring up shortly is going to be on expected returns. So where are we today? Where are we going to go in the next decade? After strong markets like this expected returns are going to be lower and we're going to dedicate an entire show on that. So Marcelo, thank you so much for sharing your thoughts and your comments on today's show and to all of our listeners, have a great week and we'll see you in two weeks. Thank you.

Marcelo: Bye-bye.

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