



2020 Investment Surprises: Interest Rates, Canadian Home Prices, FAANGMs, Tesla, Robinhood, IPOs and So Much More!

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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 for today's show. Welcome back, Marcelo. It's been a little bit of time since you've been on the show.

Marcelo: Yeah, I know. I miss it every time, but it's always a good day when I'm back.

Keith: So this is our first recording for 2021. Before we get into the episode subject matter, how were your holidays? What did you do?

Marcelo: It was a weird holiday, of course. Everybody knows. We can't see people, so it was a lot of Zoom calls, but we tried to make it special with my wife here. You know, we cooked special meals, enjoyed some nice wine. I got to do some reading and enjoy some nice movies. We did a Star Wars marathon—all nine movies, actually 10-11 movies. So it was a lot of fun.

Keith: Wow. I had the family up. As you say, it is a very different time. We have a small cottage up in St. Donat and were fortunate enough to be able to get outside. We did get some snow, so that was very nice. One of the activities that we did a lot actually for the first time was we resumed playing chess.

Marcelo: Oh, so no Catan? Settlers? Settlers of Catan?

Keith: Settlers of Catan. Yeah. That's what I'm into.

Marcelo: Yeah.



Keith: Yeah, so we didn't do that, but this is back to Queen's Gambit, the Netflix show that kind of got you enthused about chess. So I started off the holidays being able to beat my kids—adults—and I ended the holidays losing to them all.

Marcelo: Did you lose any money?

Keith: Nope, no money.

Marcelo: Okay, good.

Keith: But it's a wonderful game, and I was surprised because they're in their early 20s, mid-20s, and they're playing a lot with their friends.

Marcelo: I heard that before, that board games and more interactive play are going up amongst young people.

Keith: Yeah, for sure. So listen, onto the show, and for our listeners, what we have decided to do for 2021 is structure our month with two shows. One show would have a guest, and the other show will be speaking to either with Marcelo or Ruben or myself, maybe even Lawrence, but we'll be speaking about current events. We'll be speaking about issues that are going on in the investment business, the planning business. We might be sharing some insights and stories in terms of what we're seeing with clients, but we'll try our very best to make it topical and informative. Today's show is going to focus on what we thought were the surprises for 2020. Marcelo has got three surprise topics, and then I've got a few at the end. We'll be talking about interest rate levels, how low they are. We'll talk about what that means for investors. We'll talk about FANG stocks, technology stocks, some of these big growth stories. We'll talk about some of the gambling and the speculation that might be going on in the market as well. So Marcelo, when we think about 2020, for you, what were some of your top surprises for the year?

Marcelo: Yeah, it was an extraordinary year. I think back to when the pandemic started and how quickly the world changed in two to three days. I think it was the middle of March. We were normally going to the office, and after two or three days, we were back home, locked in, trying to figure out how to work from home. But on the investing side, I think I have three things. So the first one for me—and this one has been a trend for a while—the levels that we've seen in 2020 really surprised me. And I guess it goes hand in hand



with the economic situation, but it's interest rates being at low record levels. And I'm sure you can relate to this, Keith, because you were a bond trader, right? But last time I checked when I was doing the research for this show, the 10-year yield in the U.S. was at 0.92%. Germany was -0.57%. Canada was at 0.70%. So it's the first time in my investing career that I've seen 10-year yields being below 1%. I have never seen negative yields before, so this is completely new to me. You look at more of what really affects Canadians day to day, the five-year posted mortgage rate fixed in Canada right now is 1.69%, but I even saw as low as 0.99% throughout the year. So to me, it's the first surprise, and it's crazy because I think it affects savers. If you're a borrower right now, there's never been a time in history that borrowing is this cheap.

Keith: You're absolutely right, Marcelo. At one point, I think in March, 10-year U.S. Treasuries, which you're alluding to, were somewhere in the vicinity of 0.01%. As of today, they've popped up just over 1%. Now, could you have predicted this a year ago? Absolutely not. You needed to be able to predict this pandemic or this almost complete 40% drop in GDP to then be able to say the governments around the world are then going to react by lowering interest rates. It was almost a byproduct of the circumstance that we have found ourselves in. But that interest rate for financial people, as you very well know, is critical. It's not just for home buyers. It's for everybody who evaluates the price of securities. That interest rate affects so many different asset prices. We'll talk about this because some asset prices appear to be almost out of control on the upside. A lot of people are commenting that it's the interest rates that are driving some of that anyway. So what do you think about a five-year mortgage rate at call it 1.5% or 1.7%, Marcelo?

Marcelo: I'm going to talk about this in my next two surprises, but I think it's directly affected the way people behave when they're buying a house. All of a sudden, if you can afford a house at \$500,000 and at a posted rate of, let's say, 2.50%, you could only do so much. Now at interest rates being this low and your monthly payment going down, you're obviously going to tell yourself, "Maybe I can afford a bigger house." So I think it's definitely had an impact on the housing market and the way people behave towards buying a house.

Keith: Talk to us about housing prices. I know you've got that. I'm jumping the gun here. You got that as your third point, but what went on with housing prices in Canada last year?



Marcelo: I'm going to jump right away to number three here. We'll go back to number two after, but I was listening to a podcast on The Front Burner. It's a CBC podcast on May of 2020, and they had an expert on real estate and they had Frances Donald, who was the chief economist at Manulife. And all these people, they were talking about the pandemic, how badly it was going to affect the housing market with all this new environment of the pandemic for the simple reason that now if you had people losing jobs and not being able to pay a mortgage, if you're a business owner and you're not being able to carry on your business, how were you going to be able to pay your mortgage, right? So they were predicting that the housing market was going to collapse in the sense that obviously you can't pay your mortgage, you have to sell your house, the bank has to repossess, and that depresses the prices. But fast forward to the end of 2020, I'm going to read you the numbers here, and you tell me. Just in the West Island of Montreal, they were up 15% from October 2019 to October 2020. Canada as a whole from December 2019 to December 2020 was up 13.8%. Now if we keep going through the specific provinces, Quebec was up 23.3%, Ontario was up 17.8%, Alberta 7.1%, and BC was up 9%. This is crazy.

Keith: It is actually amazing. I think part and parcel interest rates went down, but also people's attitudes changed maybe emotionally and maybe just through what they wanted. Discretionary spending was diverted from other things into things like, "I would like to have more of a home. I would like to have a home with a backyard. If it means me paying a few hundred dollars, maybe even a thousand dollars more a month for the access of that home, I will do it." \$1,000 gives you \$200,000 more purchasing power on a mortgage. So people are thinking more cashflow-based and also diverting some of the spending into more of this feeling of being secure and safe in your home and having more space. So it's probably a combination of both, but you're absolutely right. Nobody would have necessarily thought that homes would be up 15%. In fact, you take an environment like the pandemic where there's so many individuals that are affected by this, there's so many businesses that are struggling. Here we are in January, you ask Canadians to tally your net worth, and between a home and then add the investment portfolio, which depending on the types of investments that you're in, you might be up 5%, you might be up 10%, you might be up a lot more than that depending on the risk you took, but who would have ever thought that in an environment where you had a pandemic, your net worth, your balance sheet would go up 20%?



Marcelo: To me, the implication here is, and I think this has been recorded as the wealth effect that home prices have created in Canada, and the last time I looked at the debt levels in Canada, every Canadian had debt of about \$1.76 for every dollar they earn. So that means that what happens is if your house was worth \$500,000 and now it's worth \$800,000, you feel wealthier. So you at this low level of interest rates, you tend to feel, "Oh, maybe I can spend on that renovation. Maybe I can spend on that item that I want." Now we can include travel in there because it's not available, but I think that creates an effect that people feel more wealthy than what they are without having materialized that wealth in the house, and that creates even more debt. So what's worrisome for me is that if we end up getting a recession later on, let's say 2022 or 2023, this could have a really bad effect on the economy at large.

Keith: Oh, absolutely. This is what economists worry about, which is inflated asset prices and the ramifications of that later on when things change or have a little bit more challenge involved. Those are two great points, Marcelo, interest rates and home prices, right? Some major surprises and some major shocks for 2020. What was your other one that you wanted to put forward to the listeners?

Marcelo: The other one is not going to be a surprise for people. It's the rise of the FAANGs. And now the FAANGs used to be a four-letter acronym, and now it's a six-letter acronym. So that's F-A-N-G-M.

Keith: Hang on, Marcelo. Hang on. What is a FAANG?

Marcelo: So the FAANG is the acronym for the four stocks, being Facebook, Amazon, Netflix, and Google. Now there's six letters in there, so it's Facebook, Amazon, Apple, Netflix, Google, and Microsoft.

Keith: How do you pronounce the new name now?

Marcelo: Oh my God, it's a FAANGM, I think. That's my lame attempt at it. So that was surprising to me. We've seen these companies do well in the past. I think nobody can deny the rise of Amazon, Netflix, and the effect they've had on the way people consume and the way people behave. Nobody can deny that. But typically, the S&P 500, which is typically a gauge on the U.S. economy and the 500 largest companies that the market has, these companies became 24% of the proportion of the whole index. So this to me was crazy. It was surprising. I never thought this could happen. I definitely thought that these



companies could do well, but I never thought we could see this magnitude of a performance.

Keith: Yeah, I guess you're referring to the fact that if we were to go before the pandemic, we would not have thought that this could have occurred. People can now maybe justify it or think the story through because of all the closed economies we have and the reliance on technology. Do you have some returns? What did the S&P 500 do with FAANGs and without FAANGs?

Marcelo: So this is the interesting thing because if these companies did become 25% of the whole index, we have to look at the returns with and without, right? So if we look at the returns from December 31st, 2019 to December 31st, 2020, with the whole index of the S&P 500 completely, the returns were 18.3%. If we exclude those six companies, the FAANGs as we call them, if we exclude those, the return was 10.01%. So that's an 8.2% difference.

Keith: Yeah, this speaks to the idea that even though the market with these FAANG stocks was elevated, when you start taking them out, you start seeing a very different market. And that's the S&P 500. We could all look at other markets. Of course, U.S. small value companies would have had a sort of close to 0% return, which is very different than the S&P. It's a very different set of companies. You take the Canadian stock market, you take out Shopify's performance, you will have a very different result than if you include Shopify's performance.

Marcelo: Yes.

Keith: And so this is what you're speaking to. And that's a great point, and it did surprise people. If you would have gone back in time and said, "I can predict," or somebody can predict, "we're going to go through this massive thing called a pandemic and the stock market will go down 38% in the month of March, or March 24th we'll hit an all-time low," what do you think would happen on a go-forward basis? Very few people would be able to figure out and say, "Okay, we think this will happen."

Marcelo: And like you said, these companies are capturing the zeitgeist of the moment. They're capturing people's imaginations, and it's tough to have a diversified portfolio and something that would be, quote-unquote, "boring" when you're seeing these insane returns going on in the market. So that was surprising to me.



Keith: Yeah, you know what I'll say in their defense though? What I think happened for the first time in history, everybody sat back and said, "You know what? Hang on a second. We can actually work from home. This technology stuff actually works, and we're able to buy things, have things delivered to our house. We're able to work. We don't actually have to drive into the office anymore. We can collaborate with our colleagues." And in an information-based world, that I think was the big realization that occurred probably somewhere in the summer. And I think that's just wonderful and fascinating.

Marcelo: Absolutely. All right. So those are my three, Keith. Now, what about you? Tell me what surprised you the most in 2020.

Keith: I'm going to continue on a couple of these concepts here, but my three were more on valuations and trading and investments. So my number one thing would be that I haven't seen this in many years. I'd have to go back to 1999. People who speculated, people who chased, people who bought momentum stocks, people who gambled did better than people that took a kind of more boring diversified approach. And usually it doesn't work that way because the gamblers get burnt. And 2020 was a year that—trust me, I'm not endorsing gambling here, you know that, Marcelo—you take the likes of just taking money and adding it to anything that's going up, that was the winning trade. You have firms like Robinhood, firms that almost enticed and encouraged herd mentality and trading and buying. These firms were prominent in 2020, and I didn't think we'd see this. I almost thought, going back to 1999, gone are the days of the day trader. Now, I don't think we have day traders because people aren't flipping stocks around all day long, but we definitely have herd mentality and we definitely have speculation. We have things I don't think I would have ever seen for a while. We've got individuals who feel that a stock will go up, and instead of buying the stock, they're buying call options. These are novice investors speculating on call options. I just read a report yesterday that leveraged exchange-traded funds, which essentially is taking leverage and making a bet on the direction of a market, have skyrocketed in terms of their usage. That, to me, is a dangerous thing that's happening. It was a huge movement last year in 2020.

Marcelo: I think I told you this at the beginning. We mentioned Robinhood in one of our earlier podcasts, and there's for sure a lot of psychology going on in this gambling behavior, but the way these apps are made, Keith, I'm telling you, have you looked at "The Social Dilemma" on Netflix?



Keith: Yes, I have seen it. It's a good movie and everybody should watch it.

Marcelo: So it's essentially the same logic they apply to these social networks in creating these dopamine shots in your brain. So you become addicted, which is what slot machines are based on. So it creates a small reward, and it's infrequent, so you keep coming back to the app. I think they've integrated this stuff into apps like Robinhood, and people not only have the rush of making money now, but you also have this addictive effect of being in a game where you get quick rewards. It's infrequent, and sometimes you get it and sometimes you don't, so people become addicted. So that's what's scary about all this. It's how this will affect the future generation of investors. And I will tell you something. I think there is a positive to this because it is exposing some people who have never been exposed to the stock market into how a trade is done and how stock markets work, but I think the negatives outweigh the positives here, and it's scary as to what that could mean in the future.

Keith: Yeah, and I don't think that many people truly—Robinhood is an interesting app. You get to trade or buy stocks for free. Now if you ask anybody, what does that usually mean? There's a saying, nothing's for free out there.

Marcelo: You're absolutely right. Nothing is for free, and they've been found to have crossed the lines. Essentially, what they do is they sell the trade volume. They sell the volume to an organization that pays them the money. They negotiated very outrageous deals that favored Robinhood, and in turn, the other groups had to lower best execution prices. So they were actually found guilty.

Keith: Yeah.

Marcelo: It means people could be leaving money on the table with their trades, right?

Keith: A little bit. Now, they argue that they made more money on the commissions, but at the end of the day, it's a bit of a smoke and mirrors type of environment. And I guess we're saying that in this particular point, what surprised me is that those who chased momentum, those who piled in, on paper, their returns are better up to date. Now the trick is actually, are they going to get out? Because often speculation, when you win in speculation, you try it again. It's like going to the gambling machine. You almost continue until



you lose. It's human nature. And this is, I believe, one of the challenges that's facing a lot of investors right now. So yeah, that would be my number one surprise, is how much that came back, this idea of chasing and speculating. And my number two, I got two things I want to talk a little bit about: Tesla and the valuations, and also the IPO market. So those are my last two. They're somewhat interrelated. Tesla is probably one of the most controversial investment stories. You speak to people who drive Tesla cars, they absolutely adore them. They love them. You speak to people who invest in Tesla, they adore, they love, they believe in Elon Musk. They're just, they got t-shirts, they run around. If they've added a lot of money into their accounts for their return, they're happy. The security is up 750%. As of last night, I believe Elon Musk became the richest—and I don't say wealthiest, because wealthy is a broader term that involves happiness and family and a lot of other things—but he is the richest man in the world right now. And at the same time, you have industry analysts saying that is a complete bubble and it is completely unsustainable. The metrics do not work, and the vision, while we all can see it, understand it, it feels good, it just will not be able to produce the amount of cars in the next five to ten years to justify these valuations when all the competition is going to come in and all the pressure is going to come in.

Marcelo: Yeah, I think that's the issue. And like I was telling you off mic, but my view on this is that we have a hard time as human beings also—we have a hard time separating the narrative and how amazing, because nobody can take anything away from Elon Musk and what he's done. He's a true visionary in the way he views the world and what he wants to do. Now you separate that and you look at purely the valuation and the investment, and what's going on with Tesla is completely bananas. When you look at the numbers—we covered some of those in that previous episode—update them for now, which is till the end of December, Tesla sold about 400,000 cars in 2020, Toyota sold 10.7 million. If you look at the market cap, which is the number of shares times the price of Tesla compared to the rest of the car companies, which is called the nifty nine, which includes Toyota, Ford, GM, and all these companies, Tesla is worth more than all these companies combined. And the issue here is that you're not only paying for an extremely overpriced asset, but all these companies that Tesla's competing against, Tesla doesn't have any first-mover capabilities anymore. All these companies are investing heavy amounts of money into electric cars. So will the expectations come through in the future? Nobody wants to predict. We're not in the business of predicting, but I see it extremely hard.



Keith: Elon Musk probably, if you go back two years ago, remember there was a controversy with the SEC and he tweeted out that he was going to take the company private. If he would have done that back then, he would have had so much more wealth. So even he didn't necessarily have—guts is not the right word, because he's a pretty gutsy guy—but I don't think he had the conviction even two years ago. I don't think he could see how successful this was going to become two years ago. Otherwise, he would have forced that company private.

Marcelo: Because he could see it. The electric car industry, it's a whole podcast or you can even write a book about the whole industry, but if somebody could do it, it's Elon Musk, but it's not a slam dunk that he could do it.

Keith: Absolutely. Look, there's a perfect example, and it fits into the IPO story a little, but there's a company called QuantumScape. And QuantumScape is led and has an alliance with Volkswagen, which is a major car company, and Bill Gates. And they're trying to build a battery that will be a different type of battery than what is in the Tesla. That stock just skyrocketed, had a huge upsurge in the fourth quarter of 2020. Now, if that stock price is correct, that means trouble for Tesla in the future, or else that stock has to collapse. So both of those stories just can't be true.

Marcelo: So you're saying they're contradicting?

Keith: You're saying they're contradicting, and they're heavy competitors. People in the market are just chasing after all these incredible stories, these incredible concepts. They're paying huge prices for them. And the reality is, when you typically pay astronomical prices, your future returns aren't great.

Marcelo: I think about me buying a house at ten times its value. The likelihood of me making money in the future is, it's going to be hard.

Keith: You're absolutely right. I look at these valuations, and I was around as an investment advisor in '99 and 2000, and there's a very different market. That was an internet-based market, but we had something back then, Marcelo, called the Four Horsemen. Have you heard of the Four Horsemen?

Marcelo: I know it's a biblical story in the apocalypse, but...

Keith: So there's always these names, right? There were the FAANGs today. Back then in the year 2000, it was the Four Horsemen.



Marcelo: Right.

Keith: Microsoft, Dell, Cisco, and Intel. And everybody back then said the Four Horsemen, these are winners. You can't lose with these stocks, and they're major names. Everybody needs them. So think about it. Intel, everybody was using computer chips, and Intel had the monopoly. Microsoft, Dell, Cisco was doing all the telecommunication. These were enormous names. So if you bought those stocks at the high of the market in 2000, two out of them, Cisco and Intel, 20 years later, are still 30% below those levels.

Marcelo: Oh my God. That's not good.

Keith: Even if you bought a company back then like Microsoft, which has done extremely well in the last four or five years, you then, at the price that you paid, had to wait 16 years to get back in the money. These are enormous time periods. If you bought Amazon—and everybody knows the success of Amazon through the pandemic and through actually what they do, and they're a beautiful company from an execution perspective—but Amazon in the year 2000 was somewhere around a \$100 stock. Four years later, it was a \$7 stock. People forget that happened. Today's generation of individuals that are chasing securities didn't live through that. And the narrative is so incredible in terms of we're in this new world, and we may have shifted into a new world. We may have shifted into a world that now relies more on technology, but do the prices make sense? The Tesla valuations for me, and some of these big names, is a big piece. The IPOs were the last surprise. I look at some of the IPOs, it was the biggest year we've seen, really, I think since 2000. I saw a report this week that if you looked at the IPO performance up until 2017, IPOs had produced negative results. So all of a sudden, we're in 2020. You buy an IPO and you're up 100% day one.

Marcelo: Oh my God. Yeah. Those are the times.

Keith: And in particular, there's a lot of discussion around Airbnb and DoorDash. And there was a wonderful article written in the Globe and Mail by Tom Bradley. And I read it, and I said, he's making a great point. One of these stocks needs the economy to shut down and stay shut to really thrive and blossom, and that's DoorDash. And Airbnb is about travel and doing the opposite and opening up the economy. And they both boomed. And it's hard for both to boom because the economy has got to do one or the other, kind of muddle through maybe, but at the end of the day, one will happen. So for me,



that was huge, Marcelo, this whole rush to get into IPOs. And we haven't seen this in many years.

Marcelo: I think 2020 was the all-time record of the number of IPOs. What we saw in the markets and how they bounced back after the March dip, it's for sure a lot of people pushed for the IPOs because they wanted to cash in. I have no doubt about that.

Keith: For sure. It's momentum. It's chasing. It's absolutely chasing. So those are my three surprises that I wanted to add in for a review of 2020. So we've covered six today. What is your takeaway?

Marcelo: The one takeaway for me is, if you're an empowered investor and you've been listening to the show and you're doing all the right things with your investments, you're diversifying, you're making sure you're investing in the proper vehicles to make sure you have financial security, I think this feels somehow like you're in a race and somebody's driving a Ferrari, which is a high-octane, top-of-the-line speed car, and you're driving a Toyota Corolla, which is reliable, good value. So if you're that investor, I think you're feeling like you're driving in the Toyota, but I think you know what can happen with a Ferrari, right? It goes extremely fast, but it can crash easily. You can die, and it's high risk. So that's my takeaway, that you feel like you're in the Toyota right now, but over the long term, that's the right thing to do. It's the proper thing to do, and it's the hard thing to do because you're seeing all these things flying through your window. But if you stay the course, you'll be happy in the long term.

Keith: I think that's great. And I would add to the Toyota, maybe it's a Volvo or...

Marcelo: Yes. You get the point, right?

Keith: Yeah. Broaden out the narrative a little bit. I completely agree. And my takeaway would be valuations do matter. When you're keeping the course, staying the course, building a diversified portfolio, stay on top of your valuations because if you're chasing valuations, when you buy valuations that are very high, you typically get really poor results thereafter. When you buy companies with very low valuations, you tend to get higher expected returns, and that has worked for many cycles. So I would encourage listeners to grasp onto that as well. So, Marcelo, great show. Thank you so much for returning.



You'll be with us for the quarter as we do these sort of monthly updates, and then we'll interchange with a guest. So thank you so much. We'll see you in our next episode.

Marcelo: Looking forward to it. Bye.

Keith: And so, on behalf of Marcelo, myself, and all of us here at Tulett, Matthews & Associates, we'd love to extend our best wishes to all of our clients, our friends, our family, and all of the listeners the very best for a healthy...

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