Market Update

February 2022

An Important Note: Two stories from nature that teach us a few things about investing:

1. Extremes lead to extremes.

California has been devastated by wildfires for a decade. Back to back, year after year. Long-term droughts turned forests into dry tinder.

So everyone was elated when 2017 brought one of the wettest winters California had seen in recent memory. It was epic. Parts of Lake Tahoe received more than 65 feet of snow in a few months. The six-year drought was declared over.

But the fires just got worse. The wettest year in memory was followed by "the deadliest and most destructive wildfire season on record." And those two things were actually related.

Record rain in 2017 meant a surge of vegetation growth. It was called a "super bloom", and it caused even desert towns to be covered in green.

That seemed great, but it had a hidden risk: A dry 2018 summer turned that record vegetation into a record amount of dry kindling to fuel new fires.

So record rain led to record fire.

That's not intuitive, but there's a long history of this verified by looking at tree rings, which inscribe both heavy rainfall and subsequent fire scars. The two go hand in hand. "A wet year reduces fires while increasing vegetation growth, but then the increased vegetation dries out in subsequent dry years, thereby increasing the fire fuel," the NOAA writes.

The point is that extreme events in one direction increase the odds of extreme events in the other.

Extremes do not simply continue or repeat but trigger forces in the opposite direction. It is the same in the stock market and in business.

2. Small changes compounded for long periods of time are indistinguishable from magic.

The most astounding force in the universe may be evolution, that force that guided single-cell organisms into a human who can read this article on a phone. The thing that's responsible for 20/20 vision and flying birds and immune systems. Nothing else in science can blow your mind more than what evolution has accomplished.

Biologist Leslie Orgel used to say, "evolution is cleverer than you are" because whenever a critic says, "evolution could never do that" they usually just lacked imagination.

It's also easy to underestimate because of basic math.

Evolution's superpower is not just selecting favorable traits. That part is so tedious, and if it's all you focus on you'll be skeptical and confused. Most species' change in any millennia is so trivial it's unnoticeable. The real magic of evolution is that it's been selecting traits for 3.8 billion years.

The time, not the little changes, is what moves the needle. Take minuscule changes and compound them by 3.8 billion years and you get results that are indistinguishable from magic.

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That's the real lesson from evolution: If you have a big number as the exponent you do not need extraordinary change to deliver extraordinary results. It's not intuitive, but it's so powerful. "The greatest shortcoming of the human race is our inability to understand the exponential function," physicist Albert Bartlett used to say.

And isn't it the same in investing?

Howard Marks once talked about an investor whose annual results were never ranked in the top quartile, but over a 14-year period he was in the top 4% of all investors. If he keeps those mediocre returns up for another 10 years he may be in the top 1% of his peers – one of the greatest of his generation despite being unmentionable in any given year.

So much focus in investing is on what people can do right now, this year, maybe next year. "What are the best returns I can earn?" seems like such an intuitive question to ask. But like evolution, that's not where the magic happens.

If you understand the math behind compounding you realize the most important question is not "How can I earn the highest returns?" It's, "What are the best returns I can sustain for the longest period of time?"

That's not to say good returns don't matter. Of course they do. Just that they matter less than how long your returns can be earned for. "Excellent for a few years" is not nearly as powerful as "pretty good for a long time." And few things can beat, "average for a very long time." Average returns for an above-average period of time leads to extreme returns.

And as we all know, the only thing that matters is where you are in the long run.

Market Update – February 2022

February was a mixed month with bond and preferred prices falling, and equity markets recovering slightly. The stand out this month was small cap companies (companies worth $10 billion or less as opposed to the large cap companies we are more familiar with) which gained the most.

February was another difficult month as political, social and military issues became the focus while company successes and earnings were largely ignored. While this focus is understandable (it is more immediate, there are issues of life and death, and it sells), history has shown that it has less of an effect on one's portfolio than earnings – over the medium and long term.

In the short term we do expect market volatility to remain elevated. The main concerns - supply chain disruptions, inflation, increases in interest rates - all still remain – and now we have protests in Ottawa and a war in Europe.

So where do we stand today? At all times there are books and articles written about how the market is going to fall (where real concerns are turned into prophecy) while at the same time there are books and articles written about how the market is going to rise (where real positives are turned into prophecy). Similarly, today, you can choose from either column:

All is true. This is the crazy and wonderful world we live in. But I do not believe in prophecy.

And so, as always, the focus remains, and must remain, on the long term. One should invest in strong companies that can weather the inevitable storms and prove profitable. One should invest for the long term and ignore short term fluctuations. Focus on your life, your plan, your goals. At the end of the day that is all that truly matters.

Looking forward we are concerned but neutral in the short term, and positive in the medium and long term. We continue to invest new funds and monitor our positions closely.

Have a great month and let us know if there is anything we can do for you,

- Meir

Index	Month	Year to Date
Bonds FTSE Canada Universe Bond Index - CAD	-0.80%	-4.20%
Canadian Equity - S&P/TSX 60 Index - CAD	1.00%	-0.50%
US Equity – S&P 500 - USD	0.70%	-7.50%
International – MSCI EAFE Index - USD	-1.90%	-6.80%
Emerging Markets - MSCI Emerging Markets Index - CAD	-1.20%	-3.40%
Real Estate - Dow Jones® Global Real Estate Index - USD	-0.40%	-8.70%
S&P/TSX Preferred Share Index - CAD	-2.10%	-2.40%

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[1] Bonds FTSE Canada Universe Bond Index - CAD
Canadian Equity - S&P/TSX 60 Index - CAD
US Equity – S&P 500 - USD
International – MSCI EAFE Index - USD
Emerging Markets - MSCI Emerging Markets Index - CAD
Real Estate - Dow Jones® Global Real Estate Index - USD
S&P/TSX Preferred Share Index - CAD