Looking back at 2020

The COVID-19 pandemic, and the related public health response, has impacted everybody in different ways. Across numerous media platforms there is no shortage of analysis and opinion evaluating how the pandemic has changed our lives, along with predictions about how it will continue to shape our lives in the future. With this in mind we will limit our COVID-19 discussion to investing and the markets.

What investing lessons have we learned from the COVID-19 pandemic?

2020 has not taught us much we did not already know about investing and markets, rather the market moves in 2020 served as stark reminders of lessons we had already learned, specifically;

1) ***In the short-term pretty much anything can happen in the markets – both positively and negatively.*** Market history is littered with drastic moves both up and down. While 2020 was certainly a dramatic example of this phenomenon, we have seen markets move significantly in the past and will, no doubt, see it again in the future. The list of potential triggers for a significant short-term market decline is lengthy. Terrorist attacks, cyber-attacks, banking crises, pandemics, natural disasters, commodity shocks, etc., could all lead to significant short-term downside in the market. All this serves to reinforce what is perhaps the most important investment lesson - investors should not have short-term spending and liquidity needs exposed to the equity markets – ever.

2) ***The economy and the stock market are not the same thing.*** The employment numbers throughout 2020 were pretty dire and overall economic activity was depressed compared to prior years and expectations. Logic would suggest that lower than expected economic activity and higher than expected unemployment would translate into lower equity market values; however, this has not been the case. In the long-run, economic growth and market performance are correlated, but if the suppressed economic activity is expected to be short-term and there are other factors supporting valuations, then it is very possible for the equity markets and the economy to become de-coupled for quite some time.

2020 Market Review

As many clients are likely aware, post a historic sell-off in March, equity markets recovered strongly over the remaining nine months to finish the year in positive territory.

On the year the Canadian market[1] rose 5.6%, while the U.S.[2] and International markets[3] rose 16.5% and 6.5% respectively, all in Canadian dollar terms. It is worth noting that the market gains for 2020 are heavily concentrated in a handful of stocks and sectors. Below is the breakdown of returns by sector in both Canada and the U.S.

Canada		
Sector	**Weight**	**2020 Return**
Technology	10.3	80.7%
Materials	13.7	21.2%
Consumer Discretionary	3.9	17.1%
Industrials	12.5	17.0%
Utilities	5.1	15.3%
Consumer Staples	3.5	4.3%
Financials	30.2	1.6%
Communication Services	4.9	-3.7%
Real Estate	3.1	-8.7%
Health Care	1.1	-23.0%
Energy	11.2	-26.6%
Overall - TSX Composite		**5.6%**

Source: RBC Capital Markets

United States (US$)		
Sector	**Weight**	**2020 Return**
Technology	27.6	43.9%
Consumer Discretionary	12.7	33.3%
Communication Services	10.8	23.6%
Materials	2.6	20.7%
Health Care	13.5	13.4%
Industrials	8.4	11.1%
Consumer Staples	6.5	10.7%
Utilities	2.8	0.5%
Financials	10.4	-1.7%
Real Estate	2.4	-2.2%
Energy	2.3	-33.7%
Overall - S&P 500		**18.4%**

Source: JP Morgan Research

There are a few key takeaways from the information above.

- The composition of the Canadian and U.S. markets is very different. This has been the case for decades, but it is worth remembering that broad market exposure in the U.S. has a significant tilt towards Technology, while in Canada it

[1] S&P/TSX Composite
[2] S&P 500 (C$)
[3] MSCI EAFE (C$)

remains significantly biased towards Financials, Energy and Materials. There is nothing right or wrong about this, simply something that investors need to be aware of when making allocation decisions. We would also highlight that for sector classification purposes Amazon is included in Consumer Discretionary, while Facebook and Google (Alphabet) are included in Communication Services, meaning the exposure to 'Technology' in the S&P 500 is actually much higher than the 28% indicated above.

- Depending on their sector allocations, investors could have done spectacularly well in 2020, or very poorly. Had an investor concluded at the start of the year that Energy, Real Estate and Financials were good value and concentrated their investments in those sectors that investor would be facing significant losses. Conversely, had an investor concluded that expensive Technology stocks would become even more expensive as the world shifted more online during the pandemic, that investor would be up 40% or more. We would argue that neither extreme would have been the correct conclusion and, therefore, diversified our investments across all sectors. The reality that a handful of stocks, in a specific sector, can so drastically drive performance simply reinforces the importance of having a broadly diversified portfolio.

Finally on fixed income, as we have noted in the past, bond rates remain exceptionally low by historical standards. The 10 year Government of Canada Bond rate finished the year at 0.67%. In practical terms this means that if an investor bought a 10 year Government Canada Bond on January 1st and held it to maturity in 10 years, the expected return is 0.67% annually. Rates have remained lower for longer than we have expected. However, this does not impact our overall conclusion that, given the current yield, it is hard to see how bonds protect and grow purchasing power over the long-term.

What are your goals with the capital you have invested?

Shifting gears from COVID and 2020, we wanted to touch briefly on a topic that comes up often in client discussions, but we have not discussed recently in client reports, and that is investment goals.

It goes without saying that the purpose of investing is to achieve some predetermined goal or goals. At Cypress we have typically defined the primary goals of investing as:

- Protecting and growing the purchasing power of the capital over an investor's contemplated holding period.
- Ensuring the investor has access to the purchasing power of the capital when needed.

For many Cypress clients these goals are the only relevant considerations.

The most likely path to achieving the above goals is to allocate a significant portion of your assets to equities, keep near-term liquidity set aside in an asset not subject to the volatility of the equity market, and not let the short-term volatility of the markets drive decisions. We have discussed this process at length in the past and will, no doubt, revisit in the future.

However, there may be other goals that supersede these goals or secondary goals that may also influence how a portfolio is constructed. Some of these goals may be at cross-purposes, so it is important to have a clear understanding of priorities.

Beyond protecting and growing purchasing power.

Highlighted below are some examples of other goals and considerations that may drive investment decisions.

- *Preserving capital* **–** An investor may not need to grow their capital to reach their goals, rather they simply want to preserve the value of what they currently have. Perhaps the anxiety and stress of seeing the portfolio go up and down with the market simply isn't worth it. Preserving capital and preserving purchasing power are not the same things. Preserving capital is simple, while preserving purchasing power is not as straightforward.

- *Investing to reflect your values or beliefs* – In recent years there has been a significant increase in demand for investment services and products that reflect an investor's beliefs or values. Most of these investments fall under the umbrella of Environmental, Sustainability and Governance (ESG). Internally at Cypress we have been doing considerable work to understand the risk and rewards of ESG investing and have recently launched an ESG fund. We expect ESG to become a larger part of the investing landscape as investors expect portfolios to be tailored to their specific values and Cypress is certainly in a position to provide this tailored service where appropriate.
- *Beating a pre-determined benchmark* – Every quarter in our quarterly letter we quote the returns of various equity indices (S&P 500, TSX, EAFE). For some investors their goal is to simply 'beat' one of these pre-determined benchmarks over a given period, success is therefore entirely relative to benchmark performance. Negative overall returns could, in fact, achieve the desired goal if the benchmark returns are even more negative.
- *Maximizing potential returns* – It is possible that an investor simply wants to maximize their return over a given time period. Doing so typically involves taking concentrated positions in sectors and stocks and, therefore, has a wide range of potential outcomes. Increasing upside potential invariably increases downside potential as well. Diversification is about giving up the upside, in exchange for limiting the downside.
- *Entertainment* – Some investors look to their portfolio as a form of entertainment. This is sometimes termed 'fun-money'. Stock trading may be entertaining, but numerous studies show that it is not typically a profitable investment strategy and therefore a very expensive form of entertainment.

Many of these goals may work against the primary goal of protecting and growing purchasing power. A focus on preserving capital may not protect purchasing power in the long-term, while looking to maximize performance will drastically increase the range of potential outcomes. Focusing on a specific benchmark may lead to too little or too much being allocated to a specific sector, while focusing on ESG may limit the range of potential investments. We highlight these differences not to suggest they are right or wrong, or good or bad, simply that they are different from what is typically our primary goal. Understanding and prioritizing goals allow investors to get more comfortable with their portfolio allocation and performance.

Strategy and outlook

While 2020 was undoubtedly an eventful year, and 2021 may prove to be as well, it does not impact our overall strategy and outlook. Given valuations across asset classes, having a significant allocation to equities remains the most likely path to protecting and growing the purchasing power of capital over the medium and long-term. There may be opportunities to tilt portfolios to sectors and geographies where valuations look relatively more attractive, but being broadly diversified remains of paramount importance.

As always, if you need to give us an update on your circumstances, or if you are unsure if the portfolio reflects your current circumstances, do not hesitate to contact us.

Finally, we would like to acknowledge the hard work that the Cypress administrative and operations staff has done to keep up the high level of service that clients have come to expect. The disruptions caused by COVID-19 have been numerous and Cypress staff has done a remarkable job keeping the business running as seamlessly as possible.

CYPRESS CAPITAL MANAGEMENT LTD.

Please see our website www.cypresscap.com for our most current disclosure document.