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# Steadyhand

## Let's Not Toss Valuations Out the Window

By Tom Bradley

There's a new acronym making the rounds. TINA refers to stocks and is short for "there is no alternative." You've got to buy them because nothing else is any good. Stock valuations may not be great (even poor in the eyes of some analysts, including myself), but the outlook for bonds is worse and cash earns nothing. So, stocks are it.

For me, this is the most difficult stage in the market cycle. When I hear TINA-like justifications for buying an asset, I get especially uncomfortable. It invariably means that valuations are poor and investors are stretching. I harken back to the technology boom in the late '90s and the commodity super cycle five years ago. Both were periods when valuations were tossed out the window.

My team and I are paid to invest our clients' money for the long-term but, at current prices, future returns look to be modest. Markets and valuations have risen and as a result, my expectation for stock market returns over the next five years has come down from double-digit in 2009 to 4 per cent to 6 per cent per year currently. This range is still well above the potential for bonds, but we have to remember that 4 to 6 per cent is uncertain, while the jolts and volatility that go with it are ever so certain.

Stocks should never be a default choice (i.e. TINA). If the valuation doesn't work, you're simply buying with the expectation that someone else will pay you a higher price at a future date. While this can work for long stretches of time, it becomes more challenging when markets hit a soft spot. It's then that you'll need to have a clear understanding of value, because a decision will be required. Do you hold on, buy more, or sell and take a hit? If you bought something based on the hope that it would go up, you're not left with much to lean on when it goes down.

With bonds and stocks looking expensive, the question needs to be asked – what about cash? Well, if I were going to write a sales brochure for GICs and short-term notes (no one has asked), it would emphasize the following points.

- Yield: less than inflation.
- Return pattern: opposite of bonds. Will be a hero when interest rates rise. A disappointment when rates fall.
- Upside potential: limited, but real yields (after inflation) could increase, either because yields go up and/or inflation goes down.
- Flexible: available at a moment's notice.
- Risk: highly manipulated by central banks.

The brochure isn't overly compelling, but at a time when cash is being dismissed out of hand, the asset class is actually more competitive than usual – bonds yields are also near zero and stocks offer low single-digit returns. It's not such a bad thing to have some cash set aside for a rainy day.

I say this without any divine insight as to what's ahead in the near term. I do know, however, we're participating (involuntarily) in a grand economic experiment. Debt continues to grow unabated. Interest rates are at crisis-like levels five years into an economic recovery. And central bankers are more focused on short-term growth than long-term stability.

Needless to say, the capital markets are confused. The bond market is telling us the world economy is fragile and can't sustain itself without free money. The stock market is more optimistic and is expecting continued revenue growth and improving profit margins. The technology sector is downright euphoric, with valuations rivaling the late 1990s.

As always, it's a time to be broadly diversified. In the Steadyhand Founders Fund, which I manage, there is a lighter than usual dose of stocks (all sizes, industries and geographies), a minimum allocation to bonds, and a healthy wad of cash under the mattress (18 per cent of the fund).

We want to own businesses at prices that make sense in the context of their long-term prospects. If we can't find enough of them, we do have an alternative. Unfortunately, I'm not creative enough to come up with an acronym for diversified, price-conscious, liquid and patient. Call it prepared.

*Tom Bradley is the President of Steadyhand. A version of this article was published on May 13, 2015, as a Special to the Globe and Mail.*