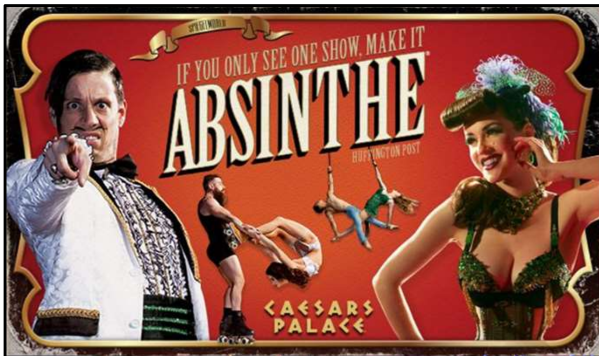
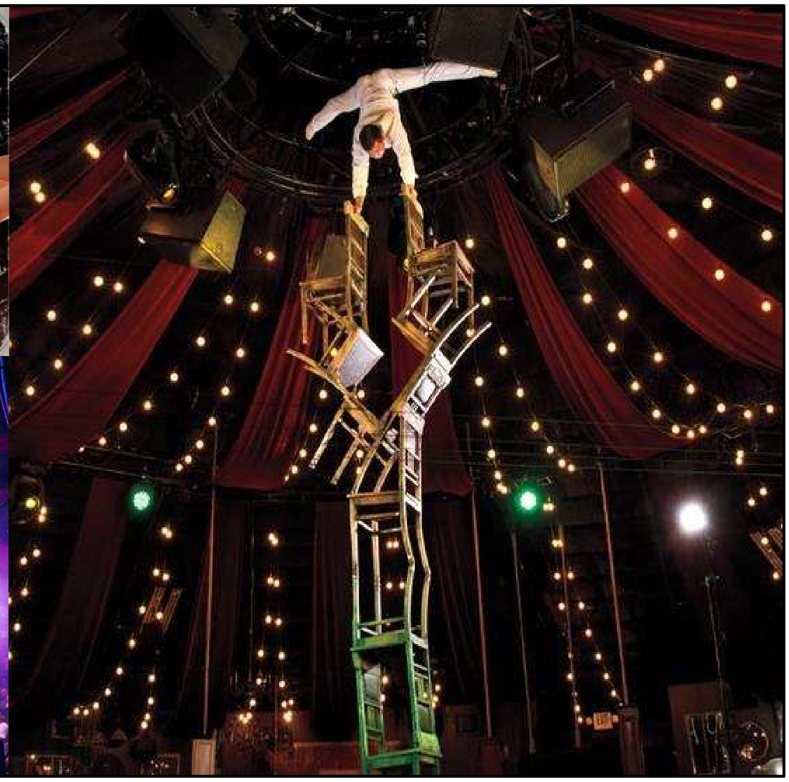
Good afternoon/evening.

I’m delighted to see new and familiar faces and be here to talk about the outlook for the economy and markets. But before I do, I want to share a story and say a few words about the psychology of investing and the dangers of forecasting.

My wife and I went to Las Vegas before Christmas with two other couples to see Garth Brooks, and boy was that a great concert.



We also got front-row seats to another show called Absinthe at Caesars Palace, which *The New York Times* describes as “Cirque du Soleil channeled through the Rocky Horror Picture Show.” The *Exploring Las Vegas* website said the layout for the theater was specifically designed to help audience members feel like they’re in on the circus action by allowing them to get up close and personal with the performers.

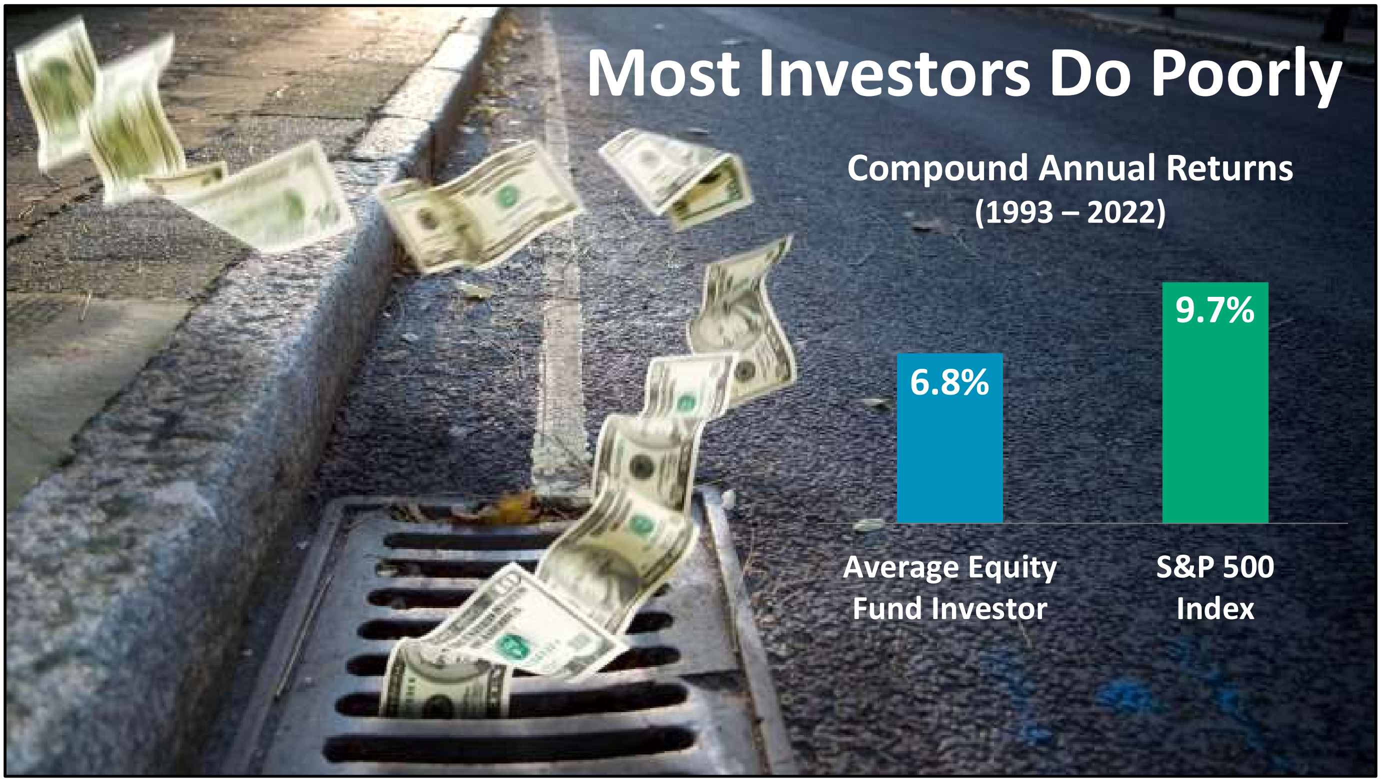
We thought we were in for a real treat, with our front-row seats literally within spitting distance of the tiny nine-foot stage in the center of the theater. But those front-row seats came with risks. The opening act included death-defying gymnastics on chairs that we feared would crash on our laps. Another performer dirty danced out of a bathtub full of water, which got us wet. But the real shocker came when the up-until-then hilariously inappropriate MC goaded Tricia and I on stage for a dance-off against another couple.

The moral of the story is unexpected things can happen when you are too close to the action.

I don't gamble when I'm in Las Vegas because I'm not interested in playing games where the odds are stacked against the player. Many people feel similarly about the stock market, especially given the extreme volatility over the last number of years. That's a shame because, unlike gambling, the stock market's odds are tilted to the investor's advantage.

Source: Bloomberg

The stock market isn't a zero-sum game with finite resources. It's a winner's game because the stock market pie grows over time as the economy expands and corporate profits increase. The point is illustrated in the chart that shows the rising trend in both the price and earnings for the S&P 500 Index over a 50-year period.

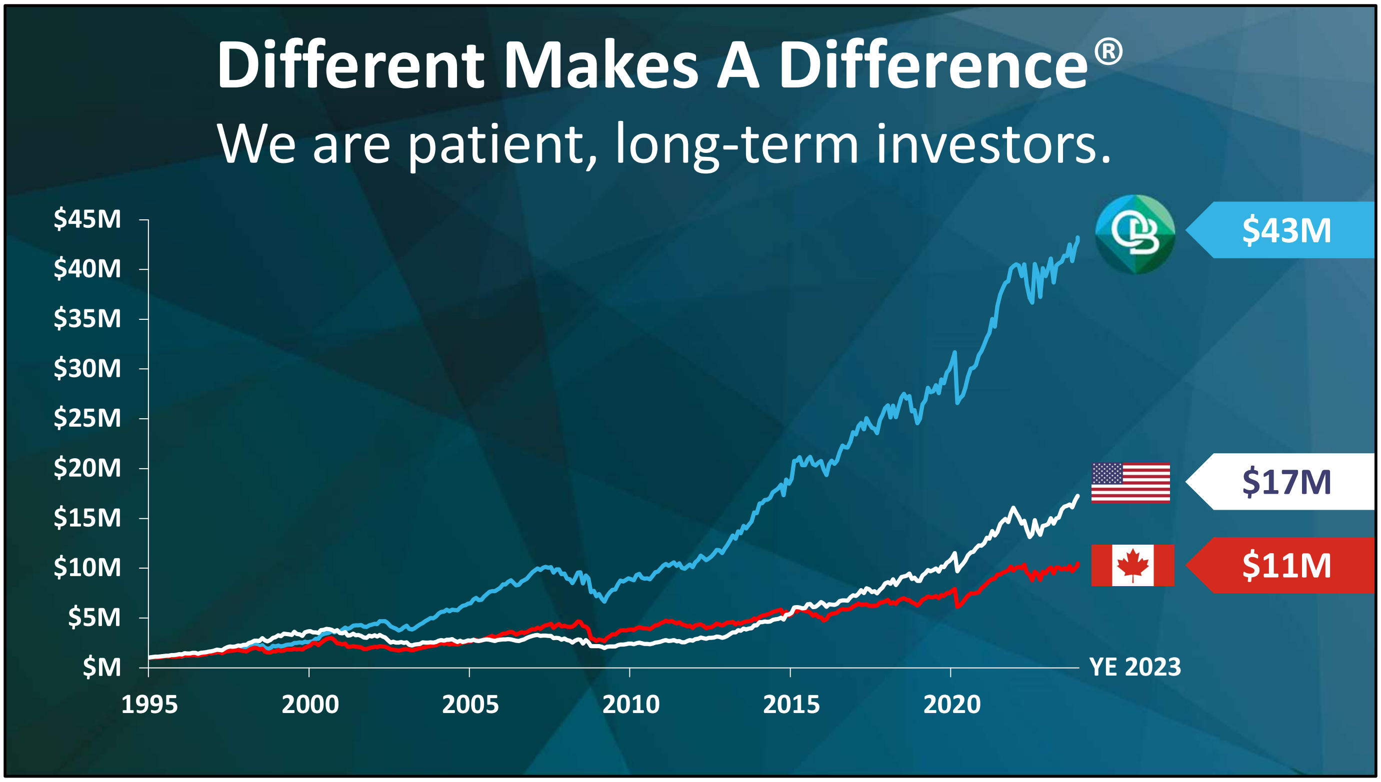


Source: Dalbar Inc.

Unfortunately, humans are not emotionally wired to be good investors. Our natural biases, including loss aversion, anchoring and herding, cause us to make mistakes that undermine our investment performance. Dalbar Inc. has studied our shortcomings for decades and quantified the cost. According to their calculations, the average U.S. equity mutual fund investor achieved a compound annual rate of return of 6.8% over the last 30 years, significantly less than the 9.7% annualized return for the S&P 500 Index. That nearly three percentage point difference is very costly over time, with the average investor turning $1 million dollars into $7.2 million over 30 years, much less than the $15.9 million they would have if they bought and held an index fund.

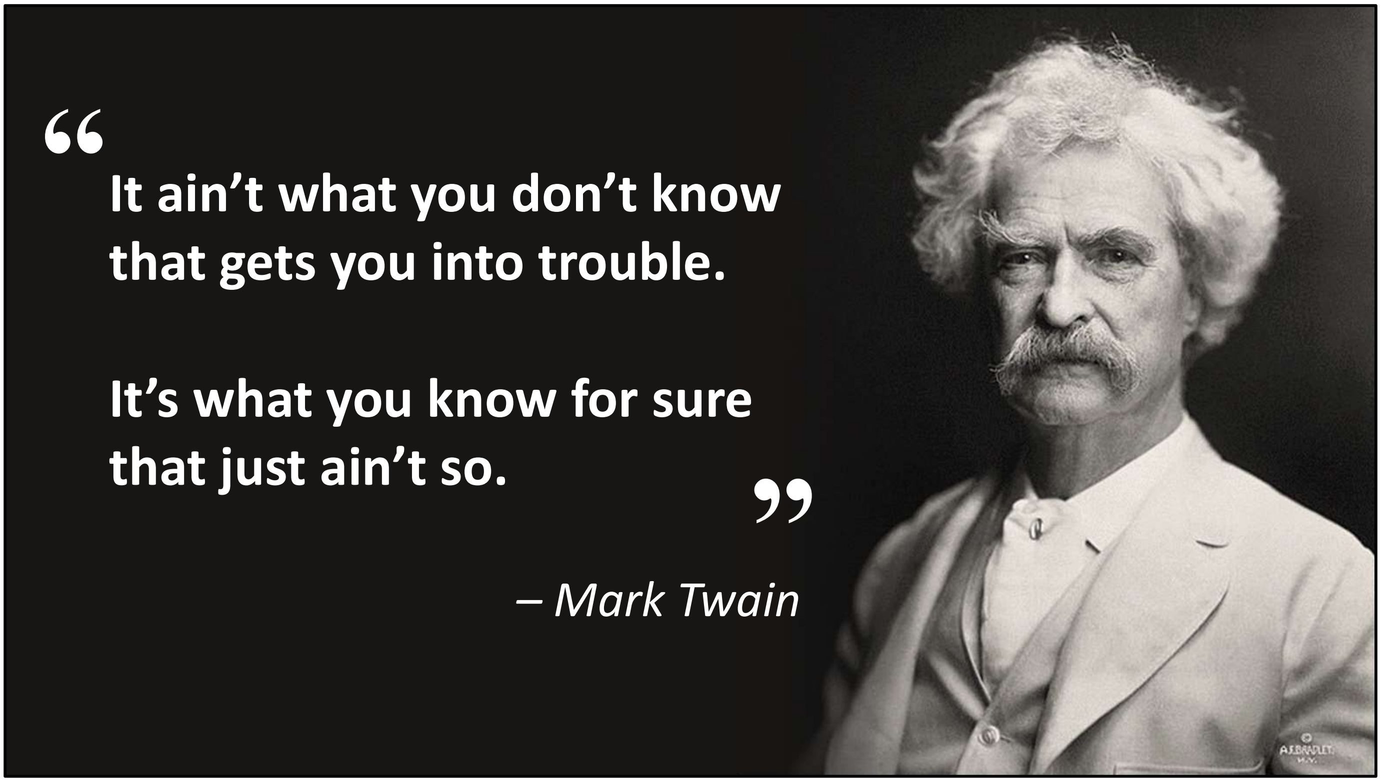
You may have heard that Warren Buffett's right-hand man at Berkshire Hathaway, Charlie Munger, passed away before Christmas, a month shy of his 100th birthday.

He was an incredibly wise man, and he will be dearly missed. He often said the best strategy is to own great companies and "sit on your ass." My version is "sit on your assets!" Our patient, long-term approach is much like Charlie's; he didn't believe in forecasts and jumping in and out of the market, and neither do we.



Source: Bloomberg, Odlum Brown

The track record for our Research Department's hypothetical, all-stock Model Portfolio was built by owning good businesses through the inevitable ups and downs. As you can see in the chart, we've done quite a bit better than the benchmarks over the long run.

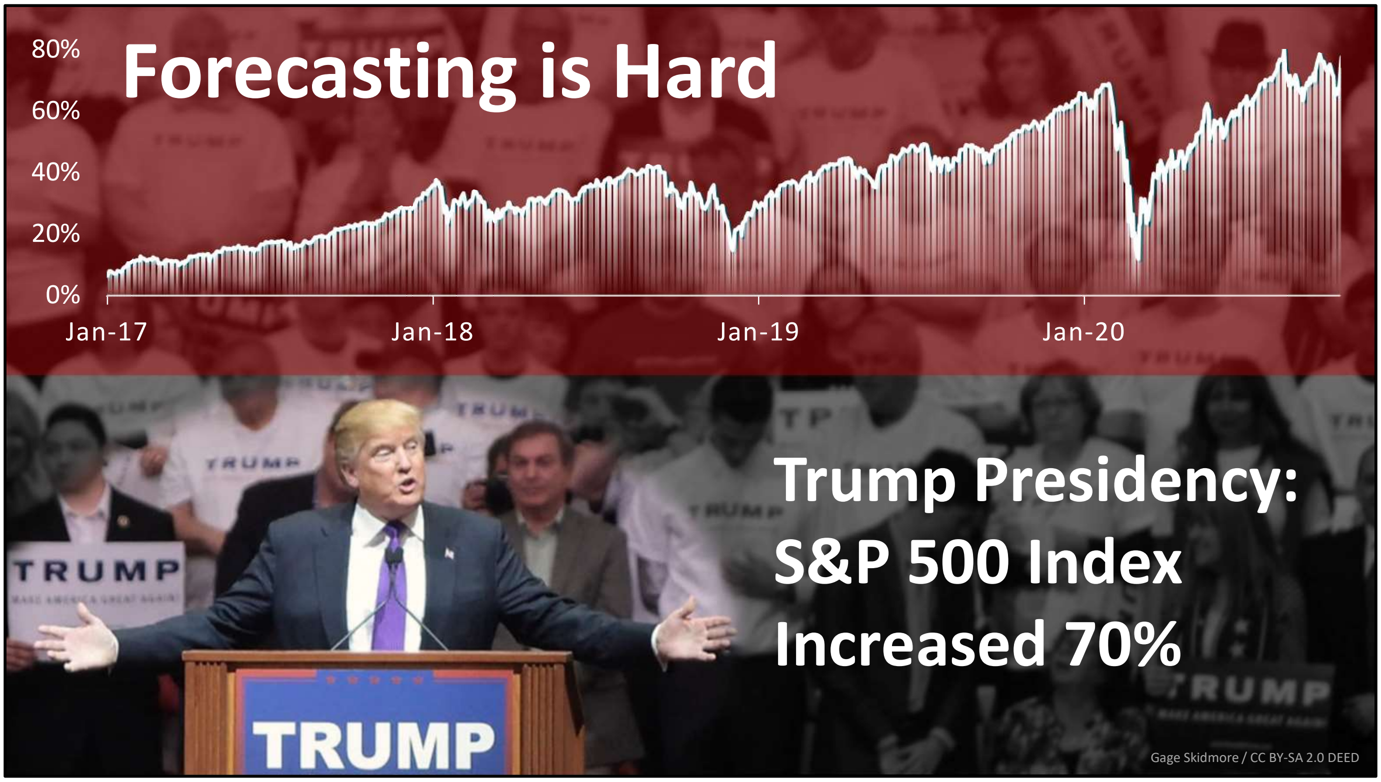


Mark Twain is credited with saying “It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.” It’s wisdom worthy of reflection.

Investors naturally believe that forecasting matters because the media and our industry bombard us with predictions and advice. We are told we should sell stocks and buy bonds because a recession is coming. We should buy gold because global conflicts are intensifying. Some pundits tell us we should sell dividend-paying stocks because interest rates are rising, while others tell us we should buy the same stocks because central banks will lower interest rates this year.

There is a lot of conflicting advice, and it’s confusing.

I’m sure you are interested in our outlook, and I’m happy to share our thoughts on the economy, interest rates, home prices and exchange rates. But you should also know that forecasting is fraught will peril. Predictions are often wrong, and even when they are right, markets don’t always behave as expected.



Source: Bloomberg
Photo credit: Gage Skidmore / CC BY-SA 2.0 DEED

Consider the 2016 U.S. presidential election. We, and almost everyone else, thought Hillary Clinton would be the next President of the United States. There was also a nearly universal belief that if Trump won, it would be bad for business and the markets.

Not only did Trump win, but U.S. stocks returned 24% in his first year in office and 70% over his four-year term.

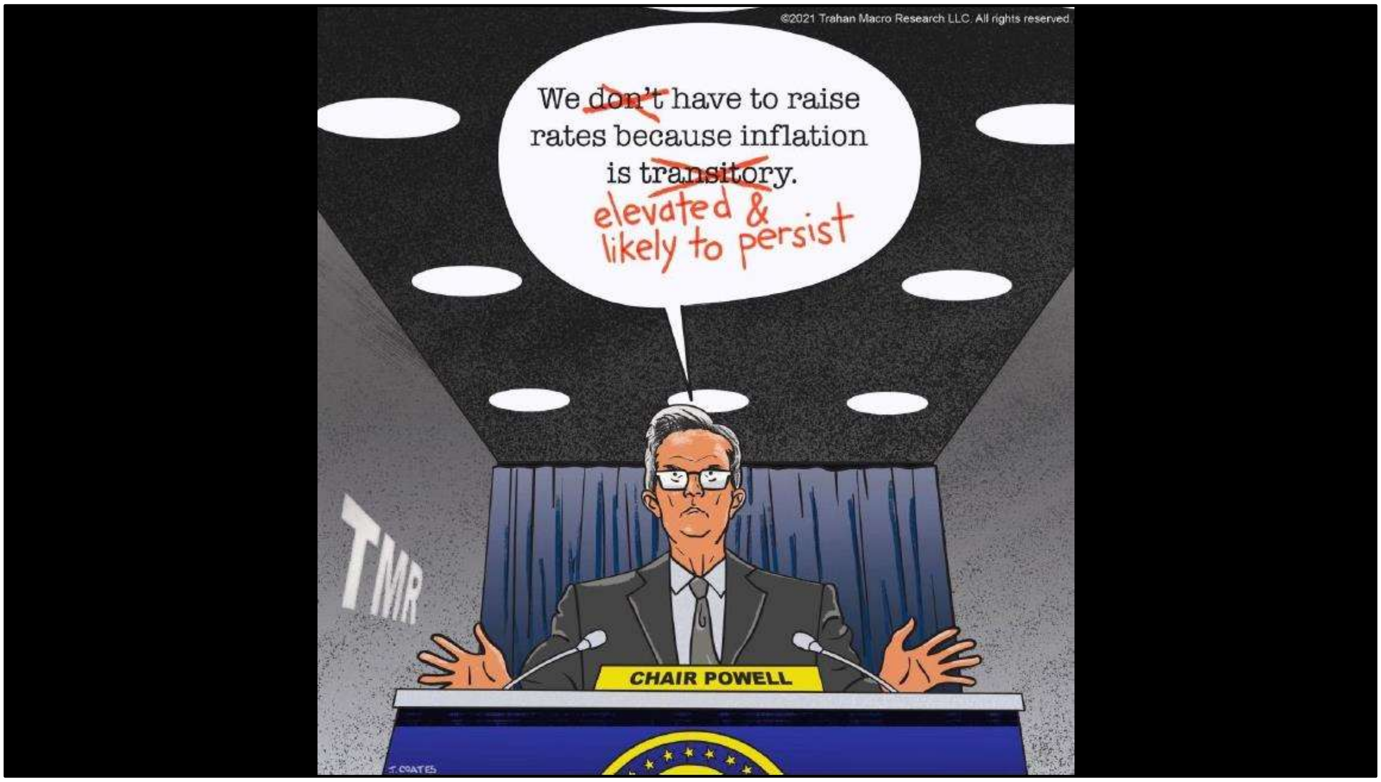
Source: Bloomberg

Predictions about the recent pandemic's impact were similarly dismal. In March 2020, when the world locked down and people started working from home, we and most others thought we were in for a long and grueling recession that would be hard on stocks.

It ended up being the shortest recession on record – only two months. Canadian stocks returned 42% in a year and 66% over a two-year period. Thankfully, we didn't advise clients to liquidate their equity portfolios.

Last fall, the drumbeat on the business news networks was that interest rates will stay higher for longer. This fear was fueled, in part, by remarks made by Jerome Powell, the Chair of the U.S. Federal Reserve (Fed) and other members of the institution's Federal Open Market Committee (FOMC).

The Fed's policy has a huge influence on domestic and international interest rates, so it's understandable that everyone listens when Mr. Powell and other committee members speak.



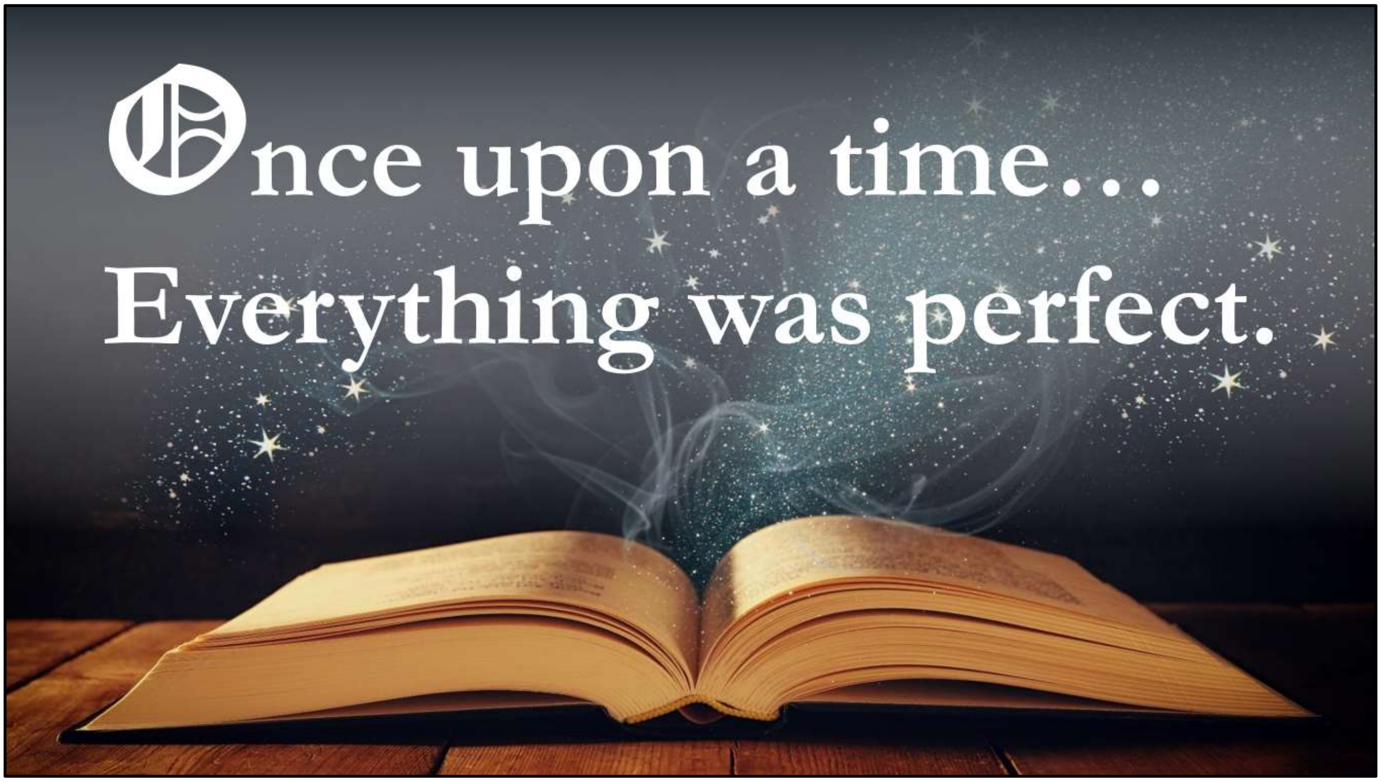
Still, one might want to consider the Fed's record on forecasting. Two years ago, U.S. consumer price inflation had already taken flight and was rising at more than a 7% annual rate, and yet the Fed kept the bottom end of its Federal Funds Rate (FFR) anchored at zero, where it had been since the early days of the pandemic. Mr. Powell told investors that inflation was a transitory phenomenon, and they believed him. The futures markets were discounting an expectation that the FFR would be no higher than 1.5% by the end of last year.

In March 2022, the Fed finally acknowledged that inflation wasn't merely temporary and raised rates by a quarter of one percent. At that point, the Fed and investors believed the inflation battle would be won without having to increase interest rates beyond 3.0%.

As we all know, that proved to be wishful thinking.

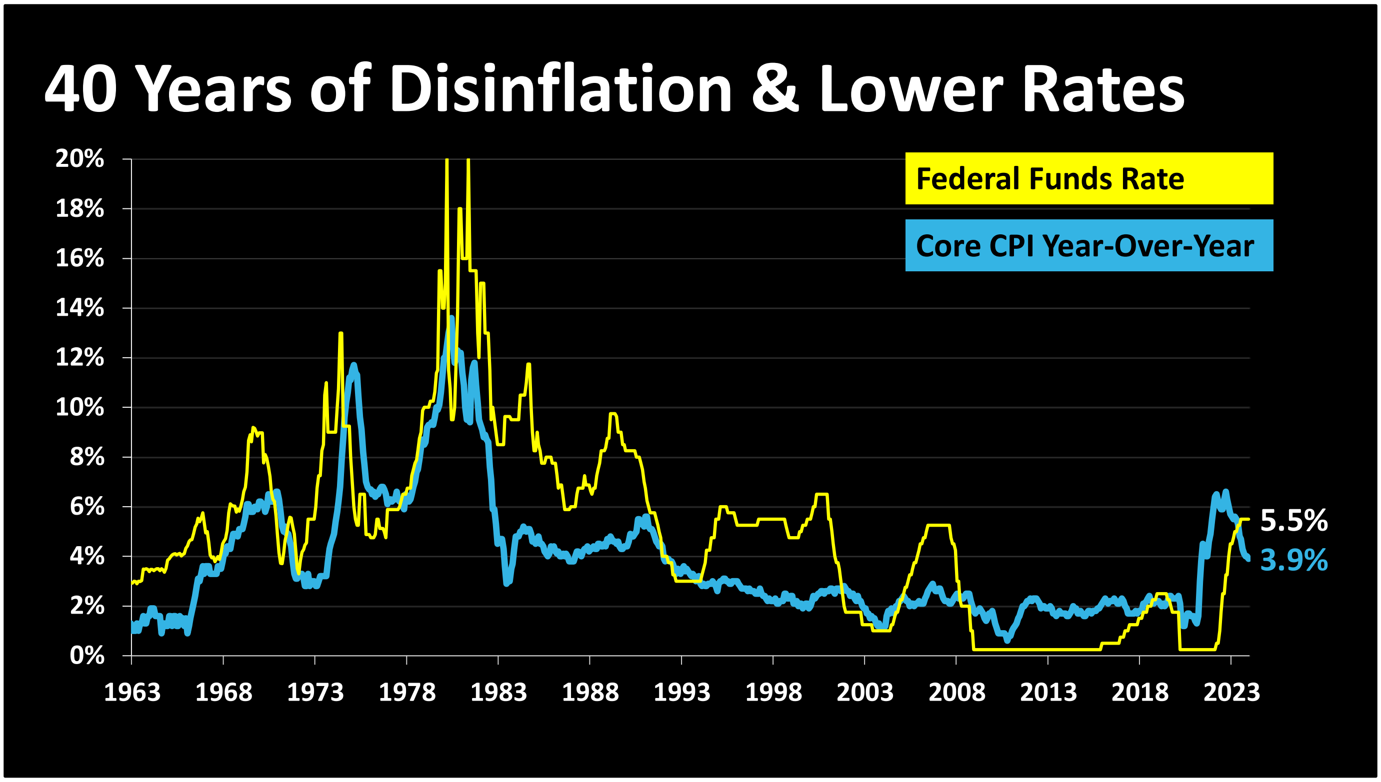
With the economy more resilient and inflation more persistent than expected, the Fed and the Bank of Canada increased interest rates at the fastest and most aggressive pace since the early 1980s. The FFR is currently 5.5% and the comparable bank rate in Canada is 5.0%.

For most of last year, investors worried that rates would rise further.



But since late last October, investors have bought into the idea of a "Goldilocks" scenario whereby economic growth slows without a recession, inflation recedes to the 2% target and central banks start cutting short-term interest rates this year. With that optimism, the yields on long-term bonds have dropped meaningfully, which has had a positive influence on bond and stock prices.

Before I talk about asset class returns and strategy, I think it's useful to have a long-term perspective on inflation and interest rates. And when we talk about interest rates, we need to differentiate between short-term rates, which are set by central banks, and longer-term bond yields, which the market determines based on several factors, including inflation expectations and the anticipated future path of short-term interest rates.

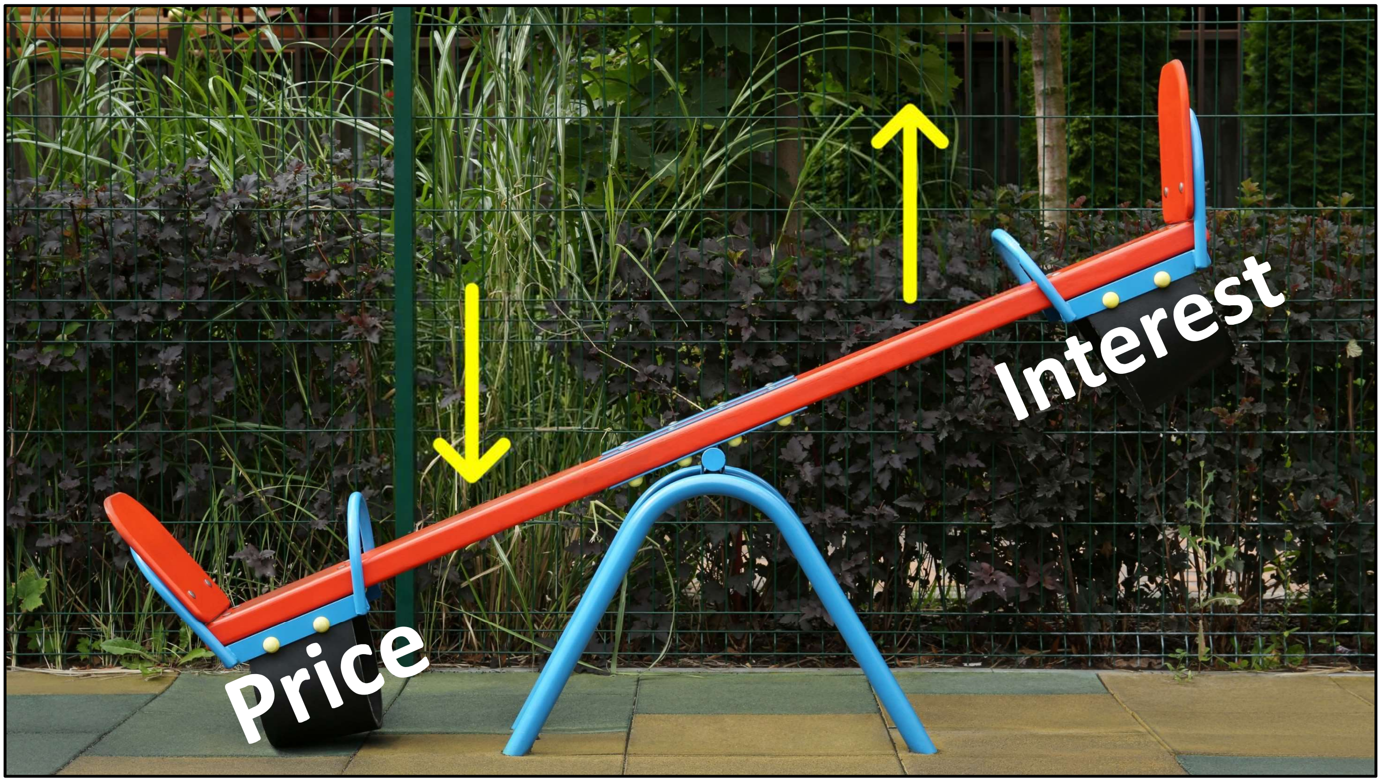


Source: Bloomberg

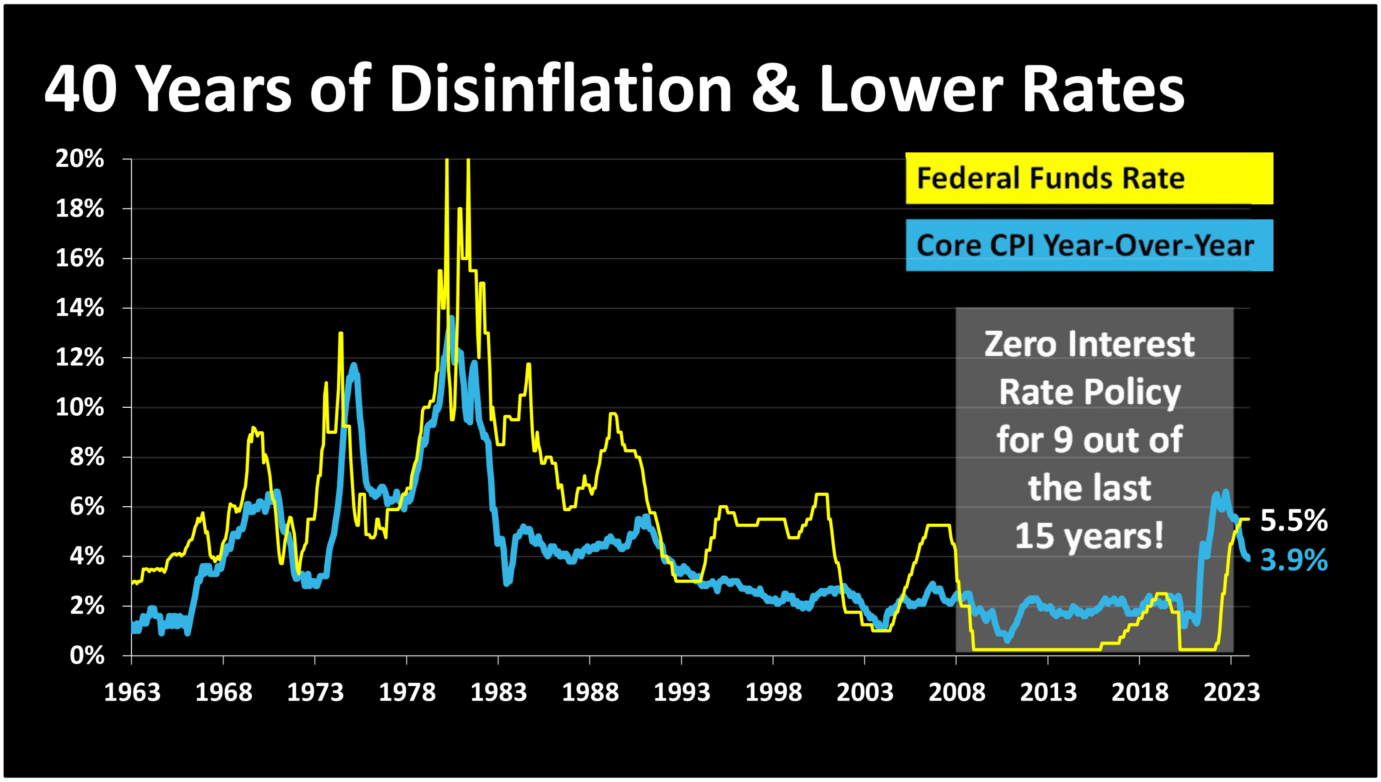
This chart shows a 60-year history of U.S. price inflation (blue line) and the Fed Funds Rate (in yellow). I'm highlighting U.S. data because I have a longer history; the Canadian data paints a similar picture.

I'm also using core inflation, without the more volatile food and energy components, because it does a better job of highlighting the long-term trends.

Note how inflation generally rose through the '60s and '70s and peaked in the early 1980s at close to 14%. At that time, the Fed, under the leadership of Paul Volcker, increased interest rates to 20% to break inflation. It worked, but there was an enormous cost to the economy and asset prices. There were back-to-back recessions in 1980 and 1981, and stock, bond and real estate values crashed.



Think of interest rates and asset prices as being on the opposite end of a teeter-totter; when interest rates go up, asset values go down.



Source: Bloomberg

After the peak in inflation, we had 40 wonderful years of disinflation. That's 40 years of lower and lower inflation. And as inflation dropped, so did interest rates.

In fact, with growth sluggish and inflation benign in the wake of the 2008 Global Financial Crisis, the Federal Reserve, the Bank of Canada and other central banks made it their job to stimulate growth with cheap and easy monetary policies.

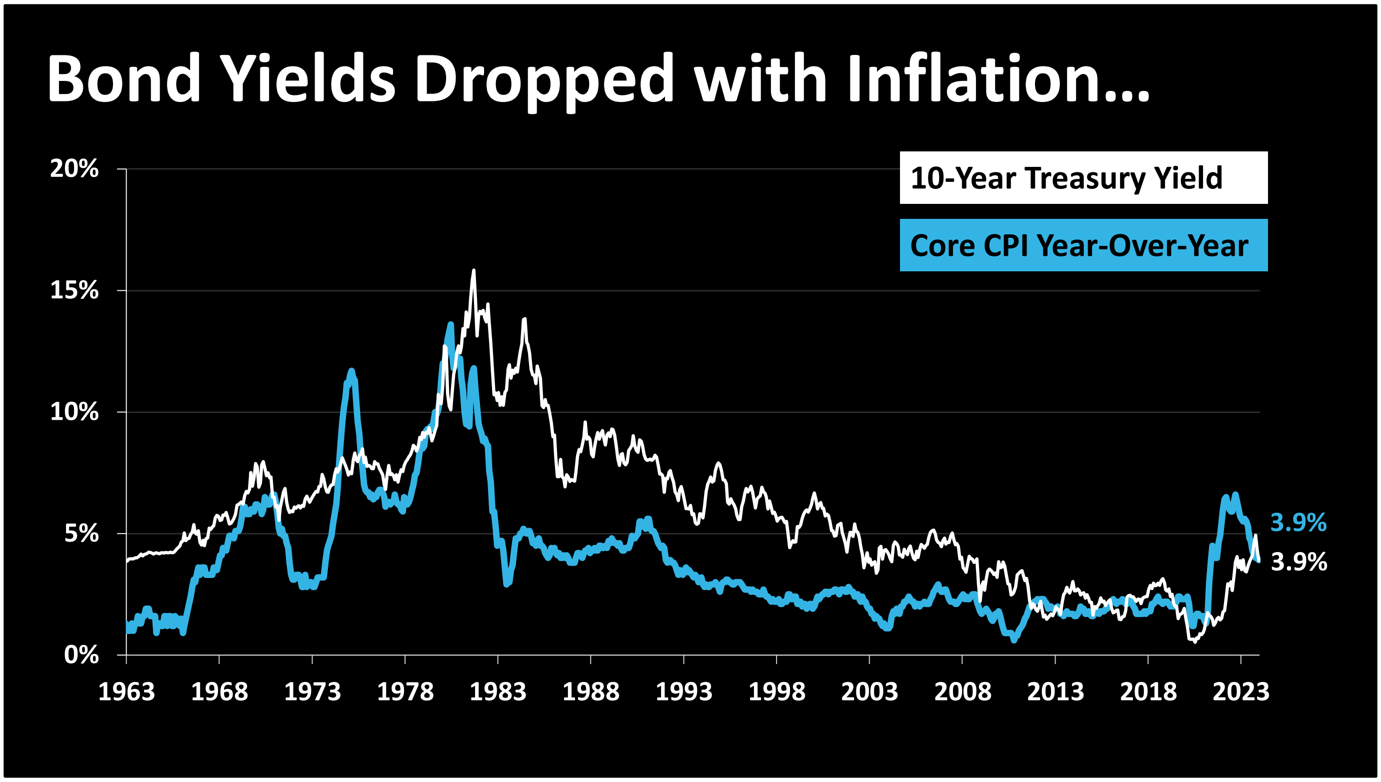
For nine of the last 15 years, the Fed had a zero-interest-rate policy. And they printed money, too. The Bank of Canada's monetary policy was similarly aggressive.

Those ultra-low interest rates had a huge positive influence on economic growth, asset values and wealth creation.

It also caused society to become addicted to low interest rates.

Unfortunately, the party ended in 2022. Those aggressive policies, and unprecedented government handouts during the pandemic, finally caught up with us and fuelled the highest inflation since the early 1980s. That, in turn, caused the Fed, and the Bank of Canada, to slam on the economic brakes and aggressively raise interest rates.

The good news is that inflation is coming down. In the U.S., the core annual inflation rate has receded from more than 6% to less than 4% (3.9%). In Canada, core inflation is 3.4%, down from a peak of 5.5%.



Source: Bloomberg

This next chart is a slight variation of the last. Core inflation is the same, in blue, but the white line is the yield on the 10-year U.S. Treasury Bond instead of the short-term Fed Funds Rate. Stock prices are more influenced by long-term interest rates than short-term rates.

Note how far the 10-year interest rate fell, from 16% in the early 1980s to a pandemic low of 0.52% in 2020.

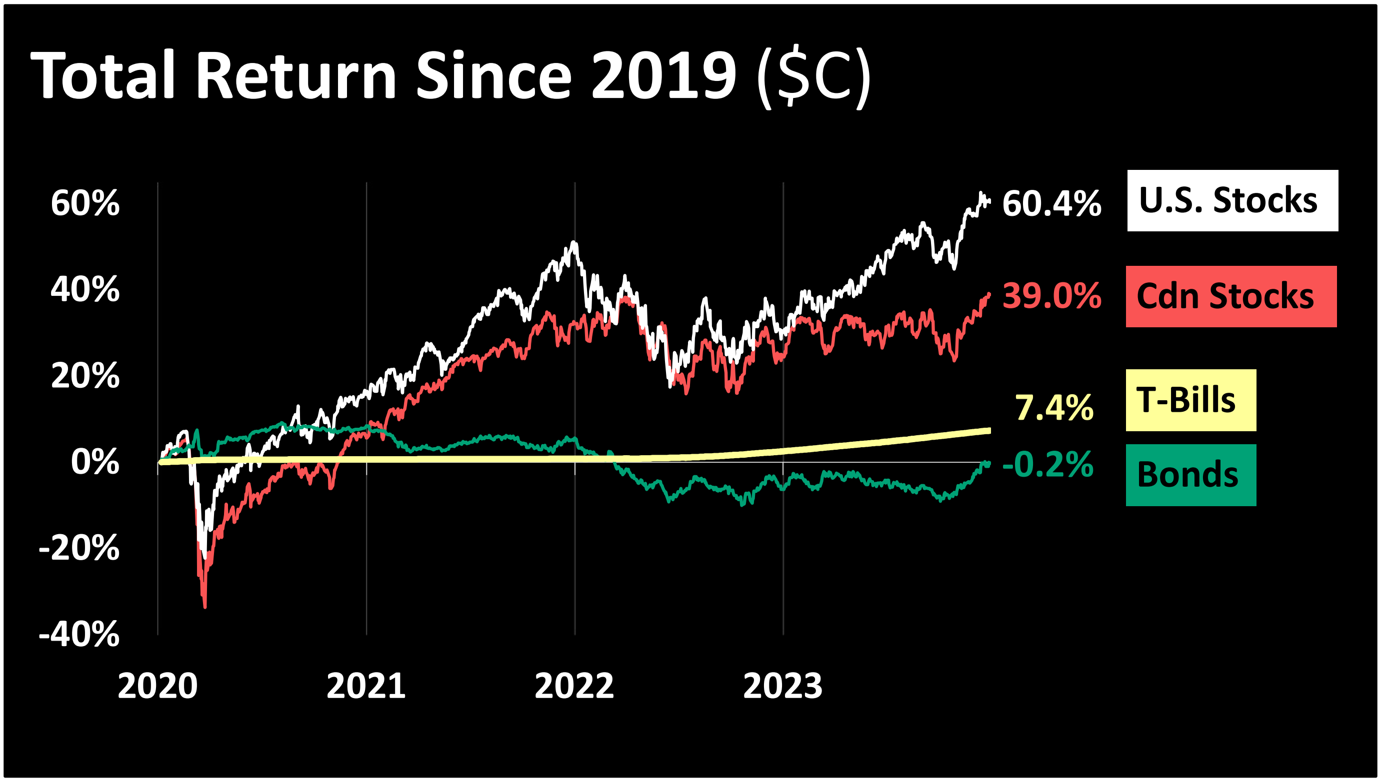
Today, short-term interest rates are at a 20-year high, while long-term bond yields are near their levels prior to the 2008 Global Financial Crisis.

Bonds have suffered the most from rising rates because they are the asset class most sensitive to changes in interest rates.

Shares of good Canadian dividend-payers – banks, telcos, utilities and pipelines – also sold off sharply in the face of higher interest rates. That's understandable since dividends are less attractive when bond yields are higher. But we think the selling was overdone given the stocks didn't rise as much as expected when interest rates went down.

It's also a little perplexing that growth stocks, like Apple and Microsoft, have held up so well. In theory, the valuations of companies with more of their potential profits weighted further into the future should also be sensitive to changes in interest rates.

The reason for the inconsistency is there are other factors that affect stock prices. While higher interest rates weighed on valuations in 2022, excitement around artificial intelligence had an overwhelmingly positive influence on the big technology stocks in 2023.



Source: Bloomberg

This chart highlights the performance of stocks, bonds and T-bills since the end of 2019, before COVID-19 descended upon the world, and through to the end of 2023. U.S. stocks returned 60%, significantly more than the 39% gain from Canadian stocks. Bonds did better than stocks and T-bills in the initial stages of the pandemic, as one would expect, but they have grossly underperformed as interest rates have risen. Over the four-year period, T-bills returned 7.4%, and bonds were roughly flat with a 0.2% loss.

It might seem counterintuitive for bonds to perform poorly when interest rates increase, so let me explain. Imagine I bought a 10-year government bond a year ago that paid 2% annual interest. Now imagine interest rates go up and the government is issuing bonds with a 4% interest rate. If I wanted to sell my 2% bond, nobody would buy it at par when they can buy a new bond with a higher interest rate. They would want a discount, and that is why bond prices go down when interest rates go up.

T-bills don't have the same interest rate risk because their maturities are short. A maturing three- or six-month T-bill gets rolled into a new T-bill with a higher interest rate, which is why the return from T-bills has steadily risen as central banks increased interest rates.

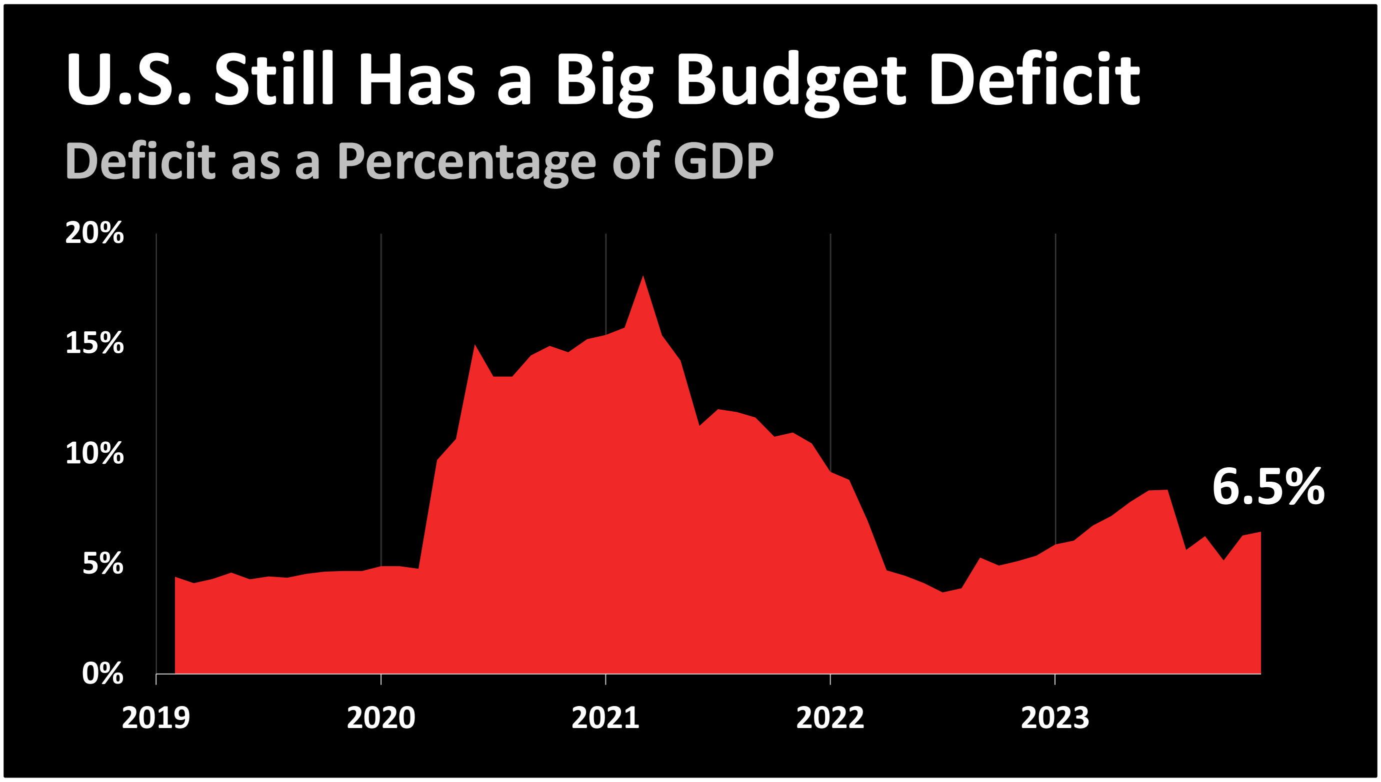
Our all-stock Model Portfolio is up about 44% over the four-year period. That is certainly respectable, but it's 6.0 percentage points less than what you would expect from 50/50 mix of Canadian and U.S. stocks. The underperformance is entirely due to our conservative posture in the early days of the pandemic. Contrary to our long-standing advice not to time the market, we maintained an unusual cash buffer when the world locked down, fearing a long and grueling recession. It was a better-safe-than-sorry posture, and it proved to be unnecessary.

Over the long term, we have no doubt that the usual relationships between risk and return will prevail, such that stocks will do better than bonds, and bonds will do better than T-bills and other short-term fixed income instruments like GICs and Money Market Funds. But what happens over the next year or two will depend on what happens to the economy, inflation, monetary policy and interest rates, so I'll address those factors before we talk about the outlook for markets.

Most of the time, central bank tightening cycles cause recessions, yet we haven't had one. Investors forget that it can take up to two years before higher interest rates impact the economy. It's been 23 months since the first rate increases in the U.S. and Canada, so a recession could still be around the corner.

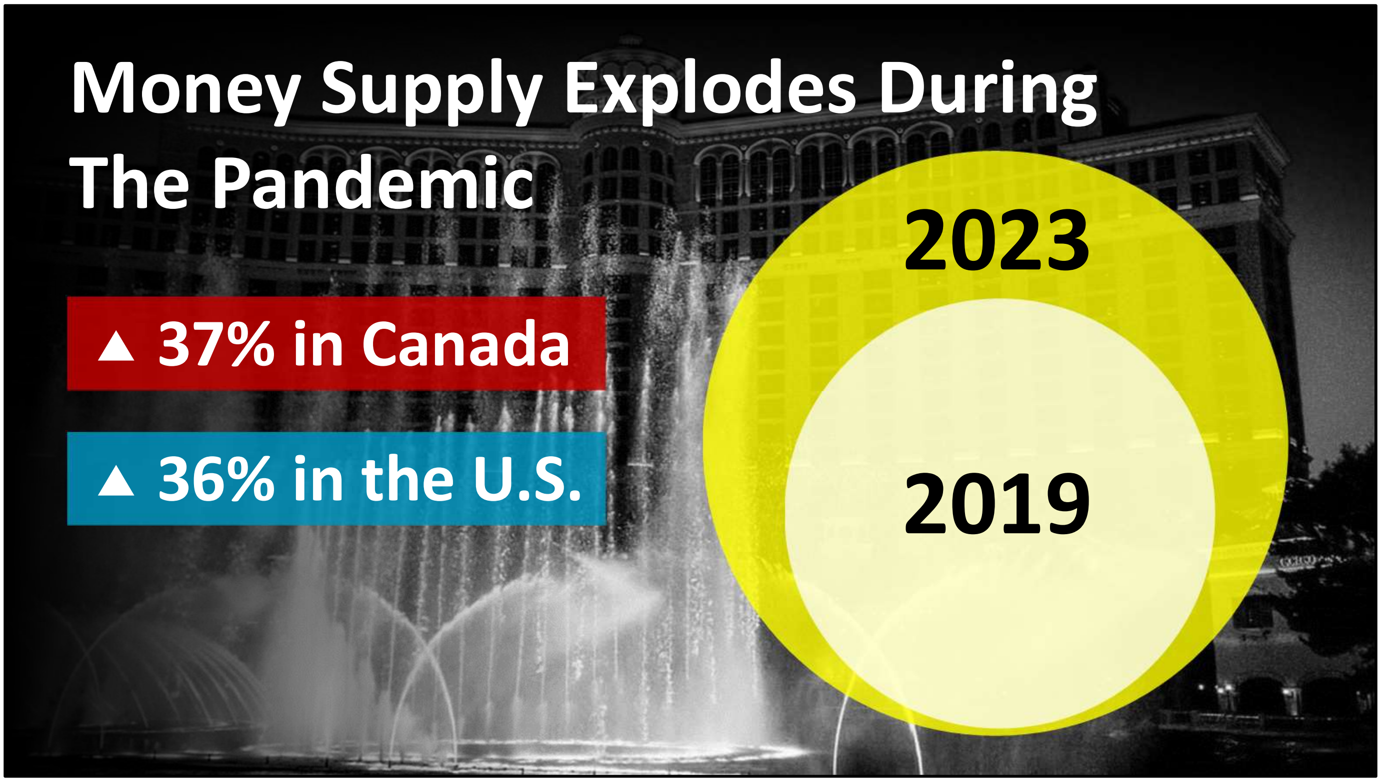
There are a few reasons why the North American economy, and the U.S. in particular, has been more resilient than expected.

First, consumers saved a lot of money during the pandemic, in part because they weren't spending while they were locked in their homes and because governments distributed a lot of money. Consumers also paid down their credit card debt while locked down. Those savings are being spent now, and credit card balances are up, so consumer spending will probably slow in time.



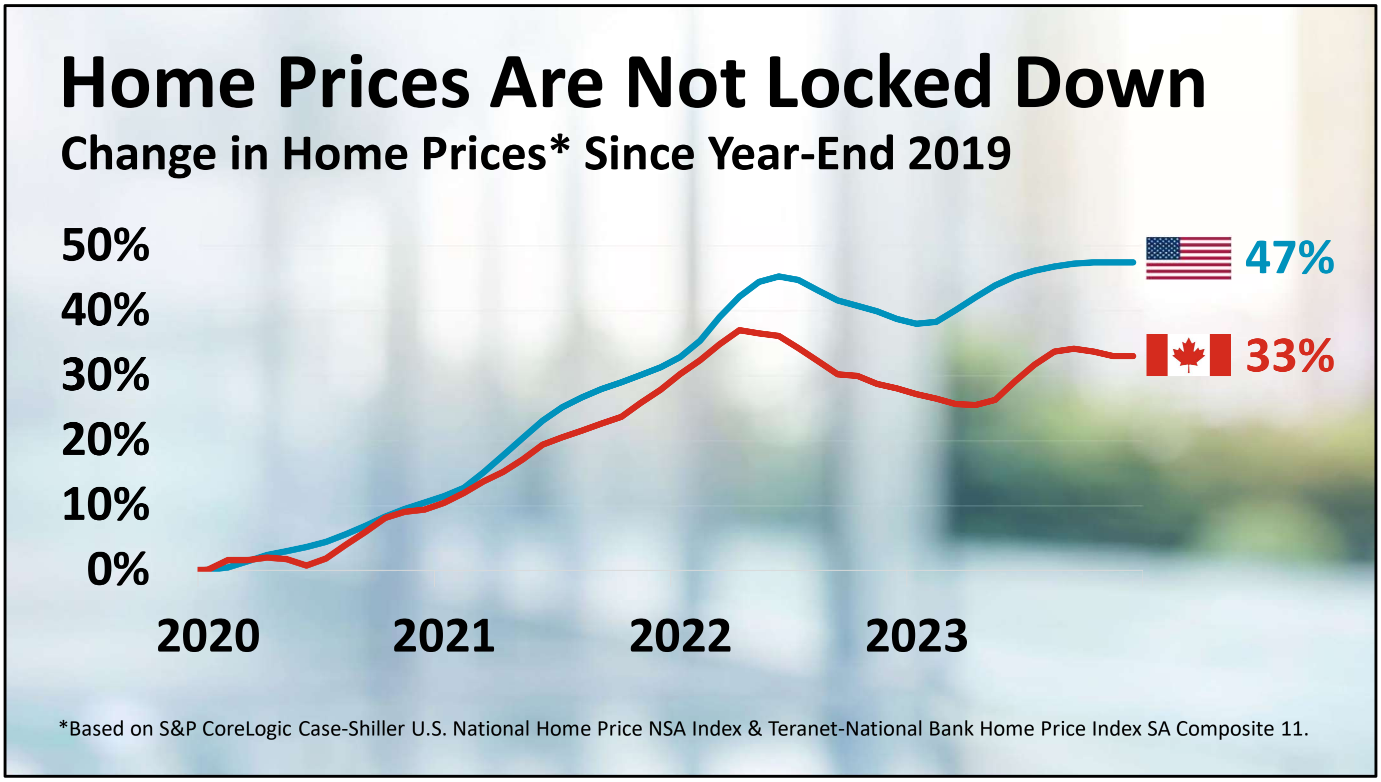
Source: Bloomberg, Odlum Brown Limited

Government deficits exploded during the pandemic, and although the U.S. deficit has come down a lot from its peak, it's still running at more than 6% of GDP. Canada's deficit is much smaller. While debt is often met with negative emotions, government deficits contribute to economic growth, and the bigger deficit in the U.S. is one of the reasons its economy is stronger than ours.



Source: Federal Reserve, Bank of Canada

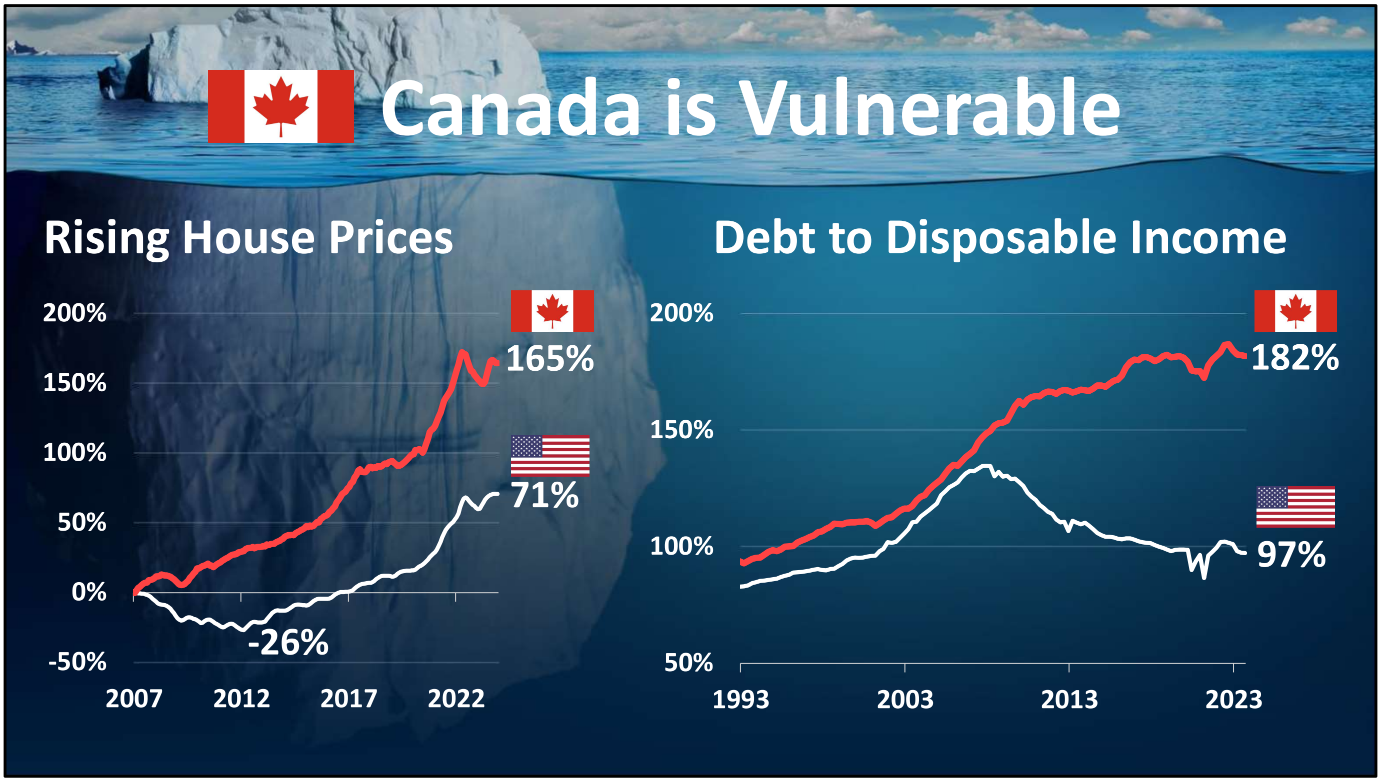
The Canadian and U.S. central banks increased the money supply of our two countries by more than 35% over the last four years. They did so by buying unprecedented amounts of government bonds, and this had a very positive influence on the economy and asset prices.



It's probably more than coincidental that average home prices are up 47% in the U.S. and 33% in Canada over the same period.

Given the huge gains in stock and housing prices over the last four years, people are a lot wealthier, and wealthier people tend to spend more money. We believe increased wealth is a big reason for the economy's resilience.

Now you might wonder why there is so much worry about Canadian home prices when they are not up as much as American home prices. Well, there are a number of reasons.



Source: Bloomberg, Odlum Brown

Relative to incomes and rents, Canadian homes are a lot more expensive than those in the U.S.

The chart on the left provides a longer-term perspective. American home prices dropped more than 25% in the aftermath of the Global Financial Crisis; ours kept going up. In fact, since the end of 2006, average home prices are up 165% in Canada versus 71% in the U.S.

The chart on the right illustrates household debt-to-income ratios for Canada and the U.S. After the crisis in 2008, Americans tightened their belts and reduced debt leverage considerably. Canadians kept borrowing and bidding up home prices.

We had a ring-side seat to the disaster south of the border, and we didn't really learn anything. Many Americans lost their homes because they couldn't afford the higher payments on variable-rate mortgages. Consequently, they locked in fixed 30-year mortgages when rates were very low. On the other hand, more than half of the mortgages Canadians took on during the pandemic were variable rate.

With considerably more debt and exposure to variable-rate mortgages, Canadians are a lot more sensitive to higher interest rates than Americans, and we believe that is a big reason why our economy is weaker. It also likely explains why the Canadian dollar is depressed despite relatively high oil prices.

We've become a country of real estate speculators. Since the turn of the century, residential real estate investment has more than doubled from less than 5% of our economy to about 10%. At the same time, investment in machinery, equipment, and research and development has fallen in half. We are not investing in our future.

I want to tell you another story that I hope will help me explain why we are more constructive regarding the long-term outlook than I was a few years ago. I heard it from Morgan Housel, the author of a great book titled *The Psychology of Money*.

It’s about small fish, and a study about their growth and longevity done by biologists from the University of Glasgow.

The biologists took two groups of identical baby fish and put one in abnormally cold water and the other in abnormally warm water. The fish living in cold water grew slower than usual, while the fish in the warm water grew faster than usual.

They only did that for a short period of time, about 4% of the fishes’ expected lives, and then they returned all the fish to regular temperature water. Both groups ultimately matured into normal, full-sized adults.

Then the magic happened.

Fish with slowed-down growth in their early days went on to live 30% longer than average. Those with artificially super-charged growth early on died 15% earlier.

The cause isn’t complicated. Super-charged growth can cause permanent tissue damage because it diverts resources away from maintenance and repair. Slowed-down growth does the opposite.

In similar fashion, central banks did tremendous damage to the foundation of our economy and our social fabric by trying to stimulate growth with artificially low interest rates for such a long time.

While the economy may have grown faster than it otherwise would have without ultra-low interest rates, there were several negative unintended consequences beyond inflation.

Ultra-low interest rates encouraged excessive speculation and an unhealthy buildup of debt. We have borrowed from the future, and we will pay for it in the form of slower growth. Ultra-low interest rates also promoted a misallocation of resources into unproductive activities, like real estate speculation, instead of much-needed investments in businesses and research and development. Low interest rates also fuelled inequality, as asset inflation disproportionately benefited people who owned assets and were already wealthy.

But there is a silver lining. The fight against inflation, and the associated normalization of interest rates at higher levels, has meaningful collateral benefits.

We stop fuelling the negative unintended consequences and we start building a stronger economic foundation for the future. To me, that is great news.

Another benefit is savers can now earn a decent rate of interest on fixed income securities.

We think putting the economy on a firmer foundation will involve short-term pain, and we believe a recession is likely. We don't think it will be particularly long or deep, but we think it will be worse in Canada for the reasons already discussed.

Whether growth merely slows, or if we have a recession, we have probably seen the highs in interest rates for this cycle. Central banks will likely lower interest rates this year as inflation moderates in the face of weaker growth. The pace and magnitude of those reductions will depend on how quickly inflation gets back to the 2% target.

However, given the inflation that we have experienced lately, we think it is very unlikely that interest rates will fall dramatically. We are not going back to ultra-low interest rates unless the economy gets ugly, and we don't see that happening.

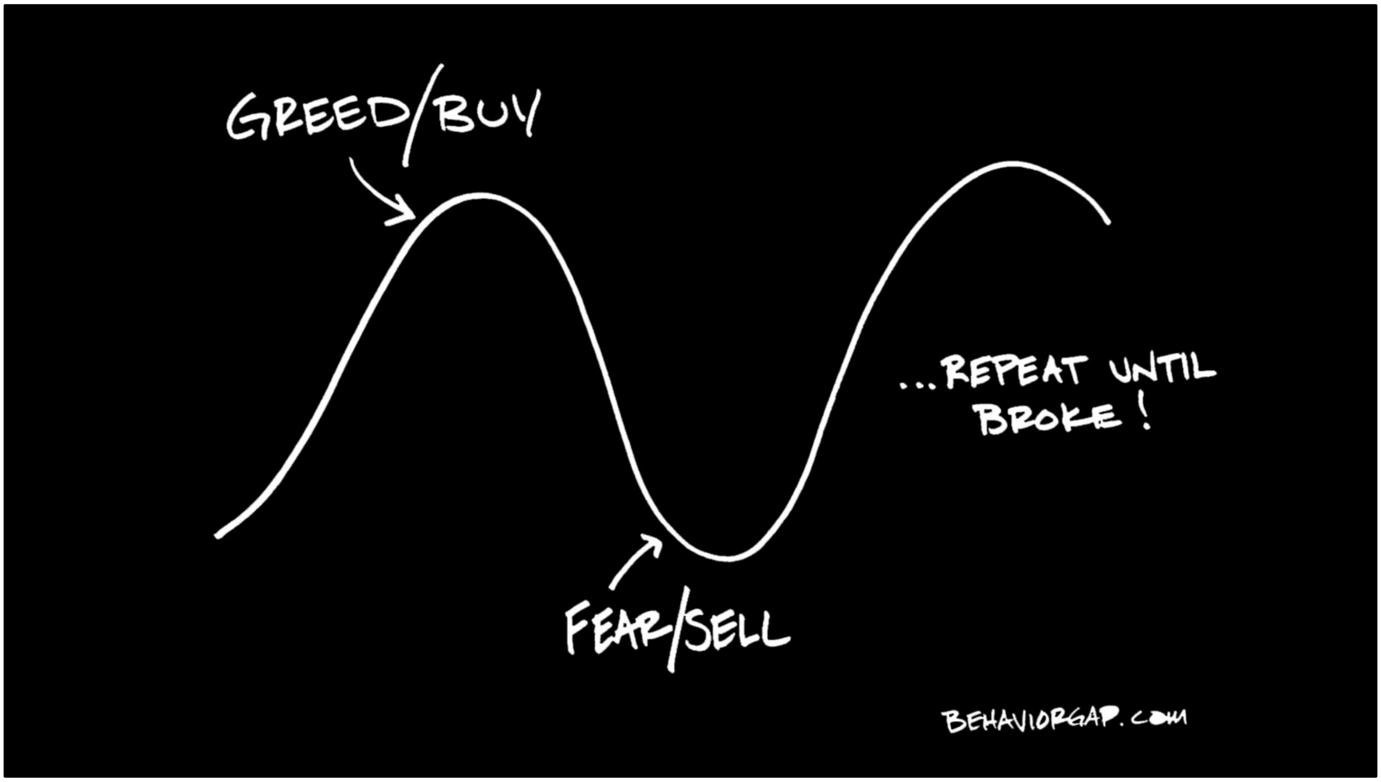
So, what does that mean for markets and how should you position your portfolio? Should you be doing anything differently?

Unfortunately, there isn't a one-size-fits-all answer. Everyone has different time horizons, objectives and risk tolerances.

Someone like me, who has a long investment horizon and is comfortable with volatility, is almost entirely invested in stocks. At the other extreme, a person with a much shorter time horizon and/or who doesn't want to lose sleep from the gyrations in the stock market may have a 30/70 split between stocks and fixed income.

What I can say is, if you are feeling uncomfortable about your asset mix, or your circumstances have changed, you should talk with your advisor.

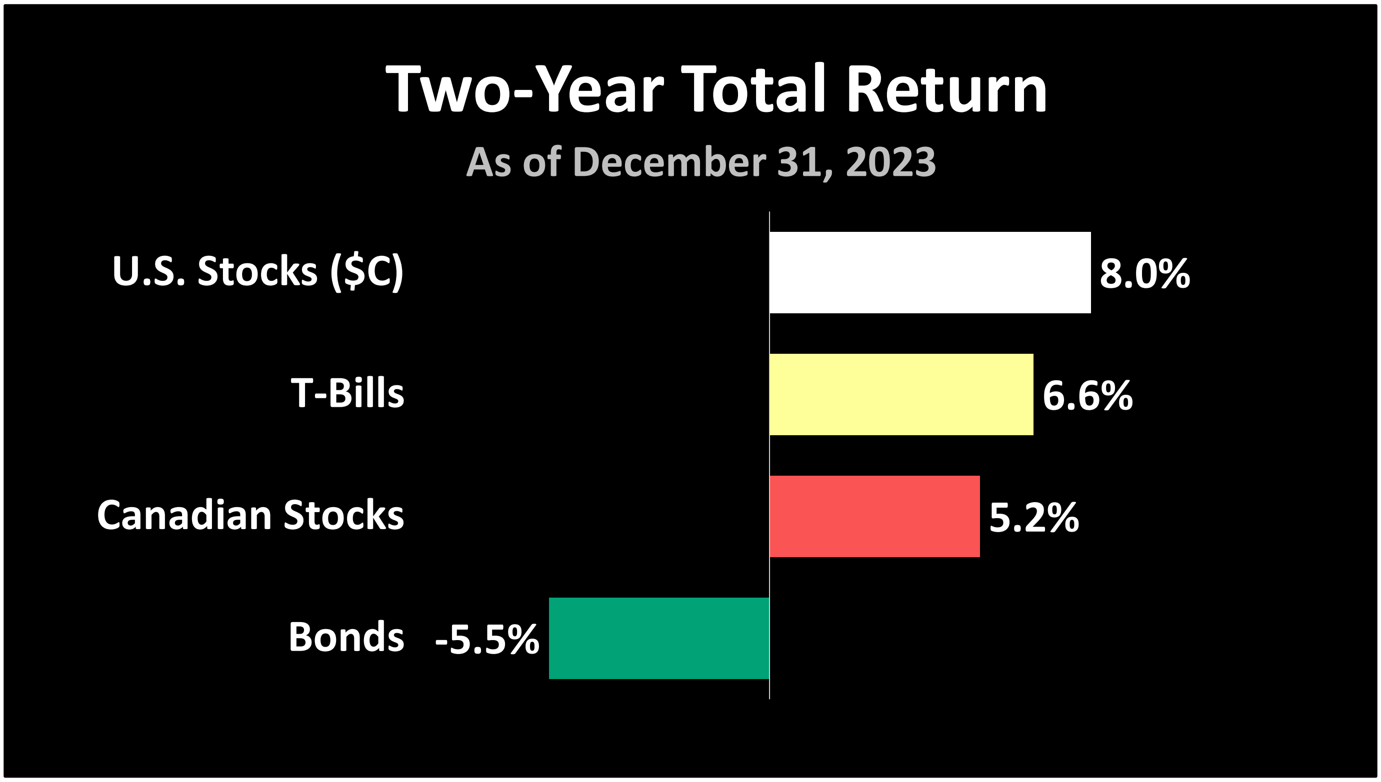
In aggregate, clients are generally staying the course and maintaining their long-term asset mix. Some have made a modest shift from stocks to fixed income, and that is perfectly rational given that interest rates are the best we've had in years.



Having said that, I wonder if unhelpful human emotions are causing some to make changes they may regret. I see fear causing some to be more defensive, and envy and greed motivating others to be more aggressive.

I'll speak to the downside of being too defensive now and address our caution about being too aggressive towards the end of the presentation.

Given the risk of recession, social unrest, polarized politics, wars and heightened geopolitical instability, some wonder if they would be better off in T-bills or other safe, short-term fixed income instruments like GICs or Money Market Funds. After all, they currently pay upwards of 5%.



Source: Bloomberg

Considering the relative performance of the asset classes over the last two years, one can understand the allure of playing it safe.

In Canadian-dollar terms, U.S. stocks are up just 8.0% over the last two years, and all the gain was accrued in the last two months of 2023. That is less than 4.0% compounded annually, and less than current rates on T-bills and GICs. Canadian stocks are up even less, and investors have lost money on bonds.

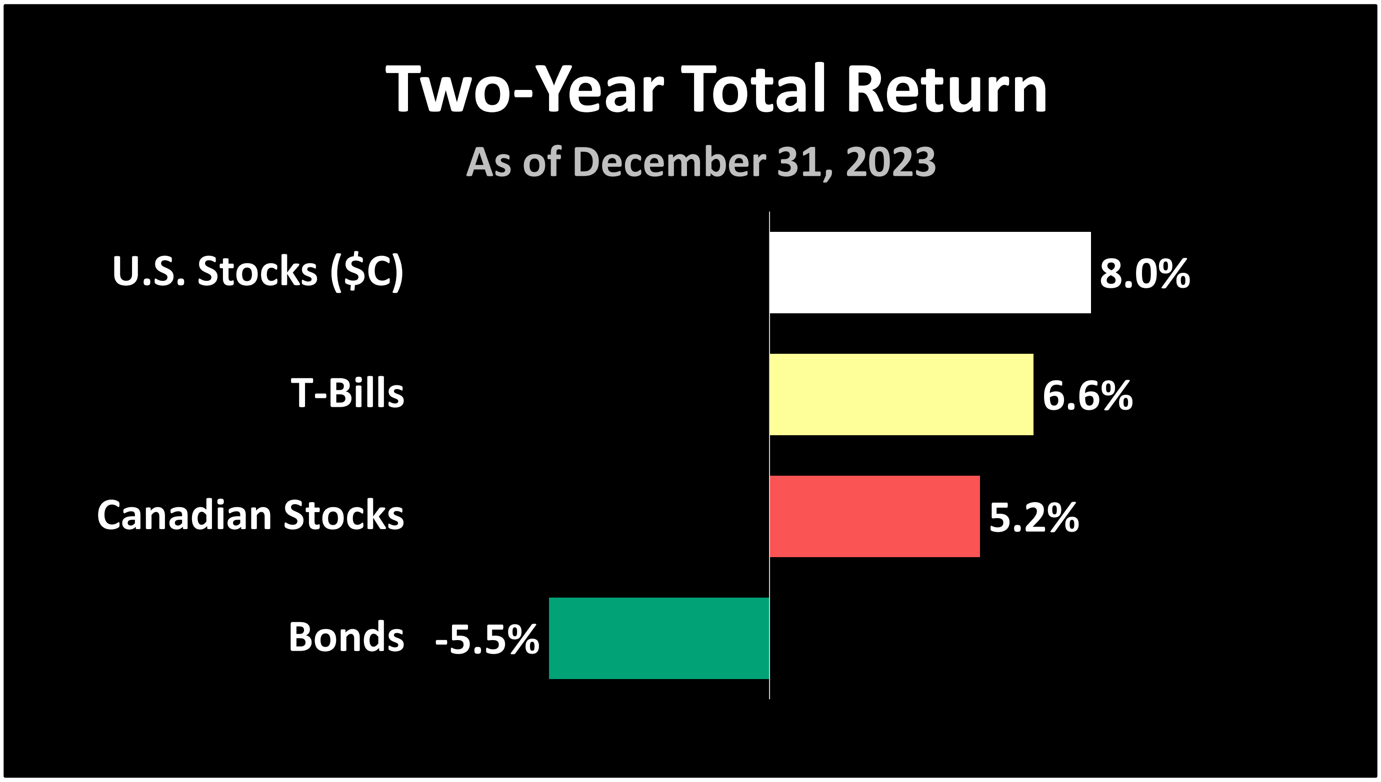
We always encourage clients to have ample short-term fixed income investments to meet expected expenses and planned big purchases over the next few years. Beyond that, though, there are two risks worth considering.

First, if inflation abates and the economy slows as we expect, the interest rate on those instruments is going to decline.

Second, there is a good chance that inflation and taxes will erode the purchasing power of short-term fixed income investments over time. That is certainly what has happened historically, and it's probable in the future, too.

Owning a laddered portfolio of bonds, from say one to five years, is also a good way to meet one's annual spending needs, and investors shouldn't let the recent poor performance dissuade them from owning bonds. Yields are at their highest level in over a decade, and capital gains are possible if we are right about the direction of the economy and interest rates. Remember, bond prices go up when interest rates go down.

Of course, cash and near-cash instruments may prove to be the best investments if inflation and interest rates surprise on the upside and/or if we have a deep economic recession. While we don't think either scenario is likely, both are possible.



Source: Bloomberg

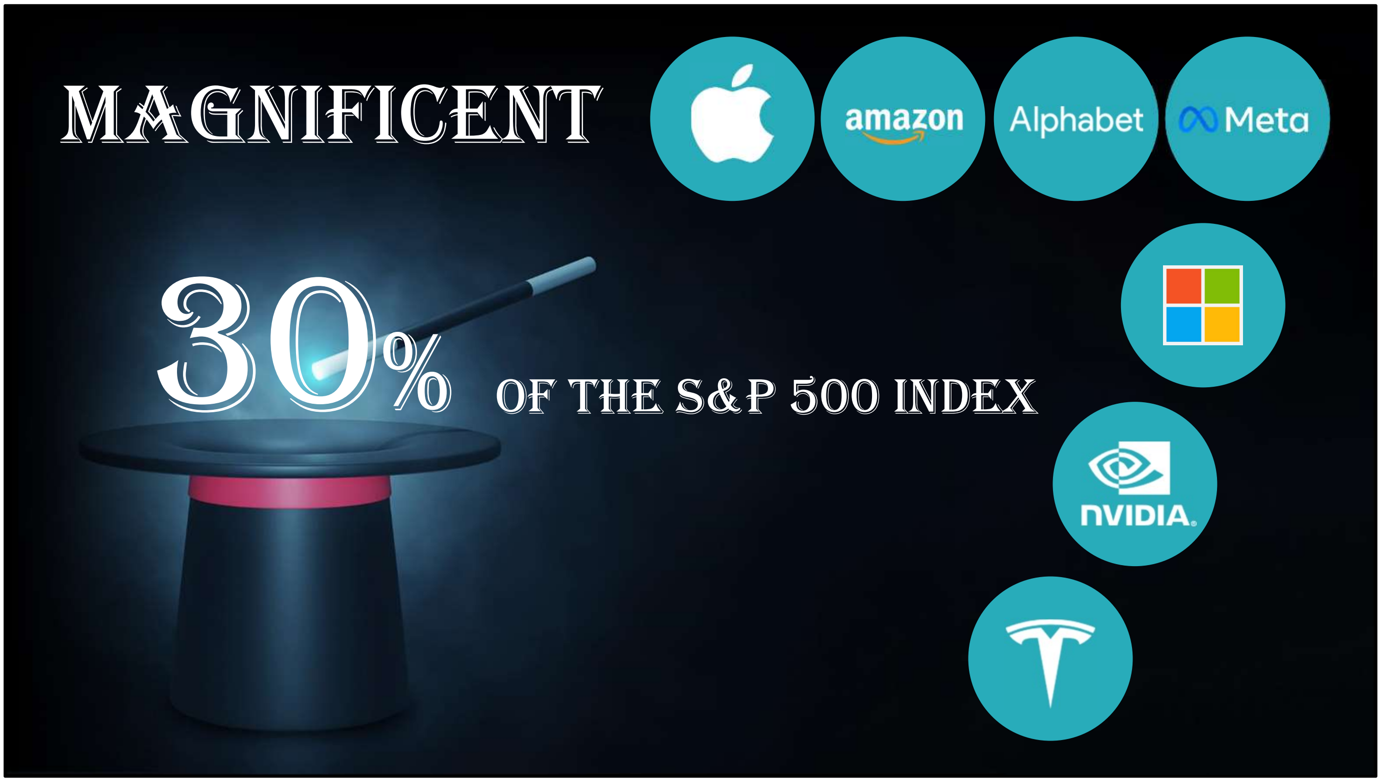
Over the long term, investments in businesses with pricing power and growth opportunities will likely do the best job of preserving and growing wealth. Real estate can be effective in that regard, too, because rents tend to rise with inflation. But given how high home prices are relative to rents and incomes in our country, we think stocks will do better.

In the short term, stock market performance will likely be more nuanced. Lower interest rates should have a positive influence on valuation multiples. But if interest rates go down because the economy is weak, corporate profits will probably deteriorate. That could be tough on some stocks, but not all.

Complicating matters further is that stock prices are forward looking. Stocks always bottom before the trough in the economy and rally well before the economy rebounds. The question is what is already discounted in the price? Some stocks are discounting a tough future, while others are not. GM's stock, for example, is so beaten up it might be anticipating the next two recessions. The popular technology stocks, on the other hand, seem to be discounting clear sailing ahead.

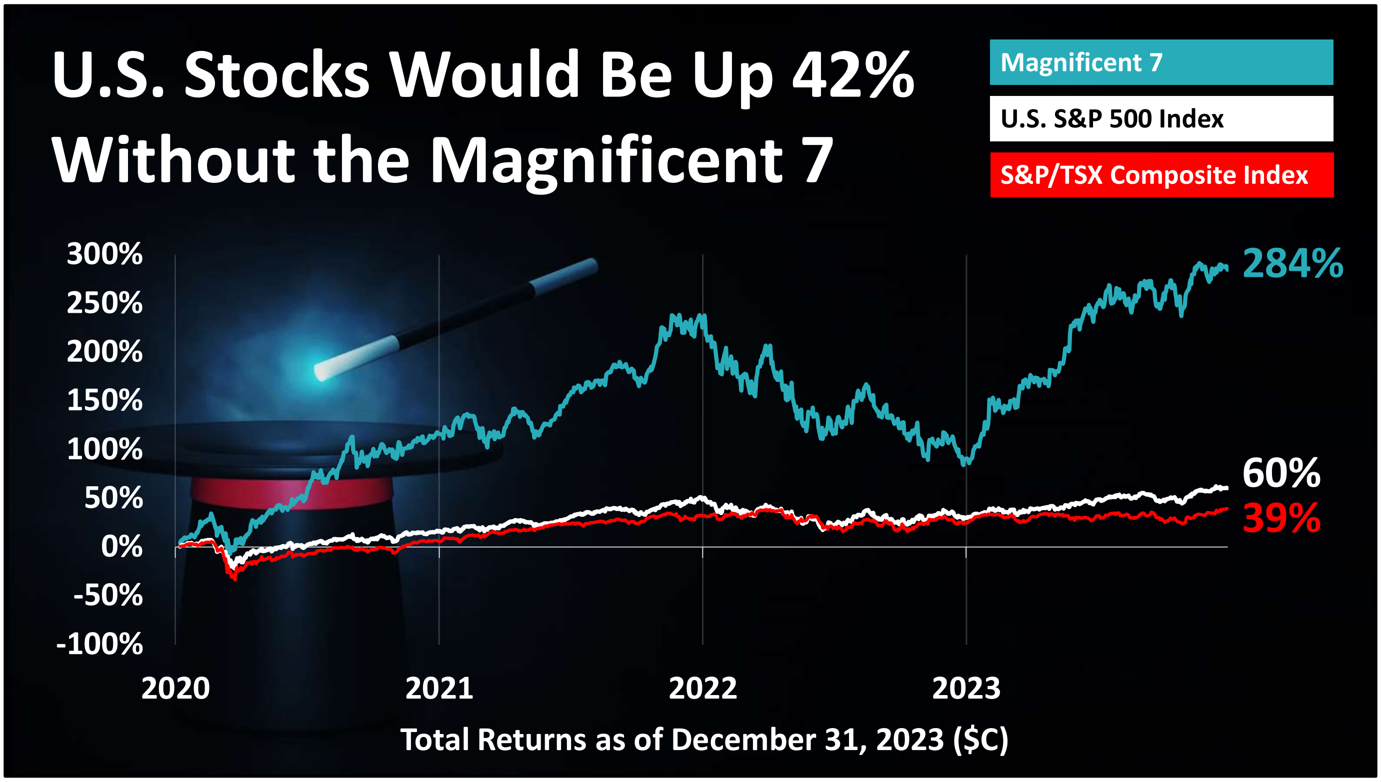
In other words, the shares of cyclical businesses like GM might have less risk and more long-term return potential than popular stocks that are near their highs.

Let me elaborate.



The U.S. market has performed a lot better than the Canadian market and our Model Portfolio in recent years, and that outperformance has been driven by seven very large companies commonly referred to as the “Magnificent Seven”: Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia and Tesla.

Collectively, they account for almost 30% of the market capitalization-weighted S&P 500 Index. As such, the performance of the seven stocks has an overwhelming influence on the overall benchmark.



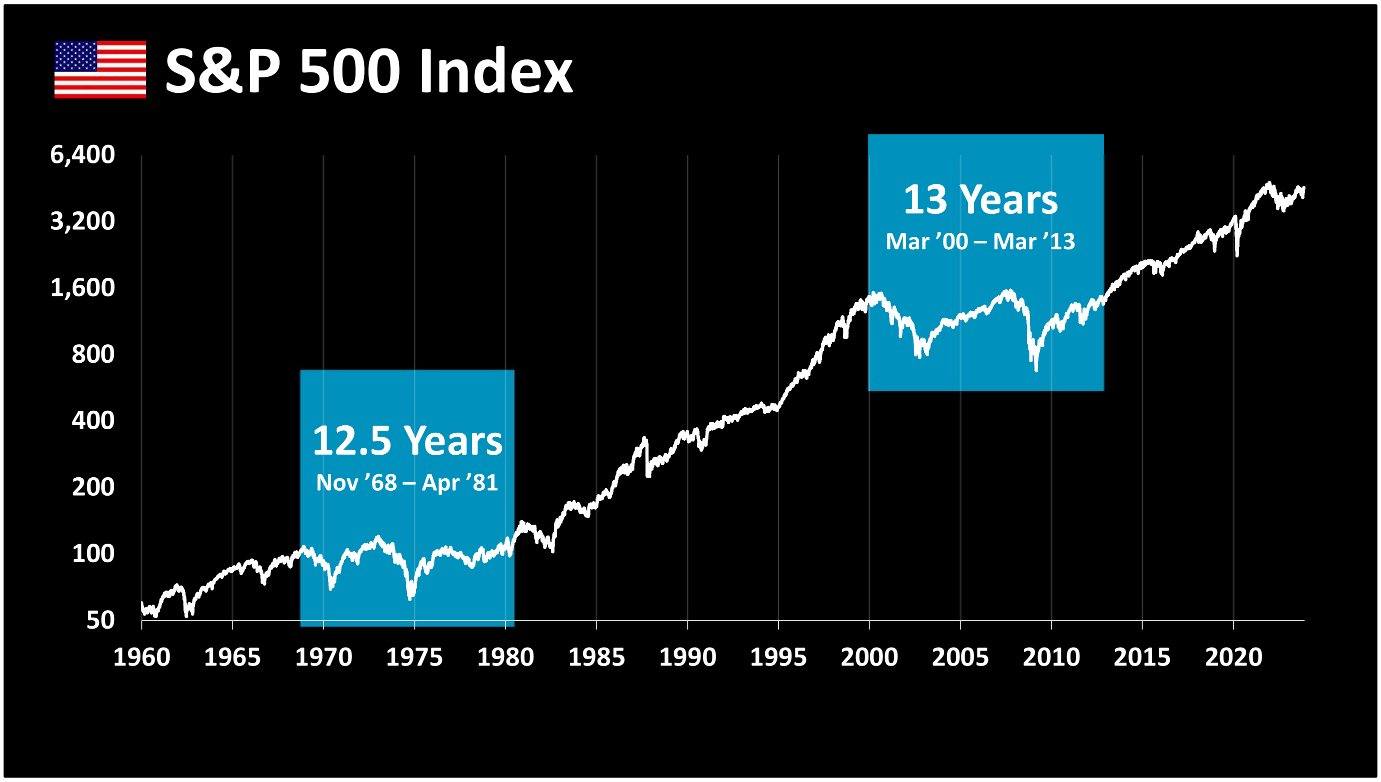
Source: Bloomberg

Over the last four years, the Bloomberg Magnificent Seven Total Return Index is up 284% in Canadian dollars, and those phenomenal gains are the reason the S&P 500 has done so much better than the Canadian market. Without the Magnificent Seven, the S&P 500 would be up 42% over the four-year period, not much more than the Canadian benchmark.

The Magnificent Seven stocks dropped a whopping 42% in 2022, and they could easily come under pressure if earnings disappoint in the face of economic weakness.

Nonetheless, given the awesome performance of those stocks over time, and their positive influence on the S&P 500 Index, some investors are envious. Understandably, they wonder why they should own Canadian stocks at all. Or follow our Model Portfolio, for that matter.

Why not just own a low-fee S&P 500 Index fund? I'll tell you why we don't think this is a good idea.



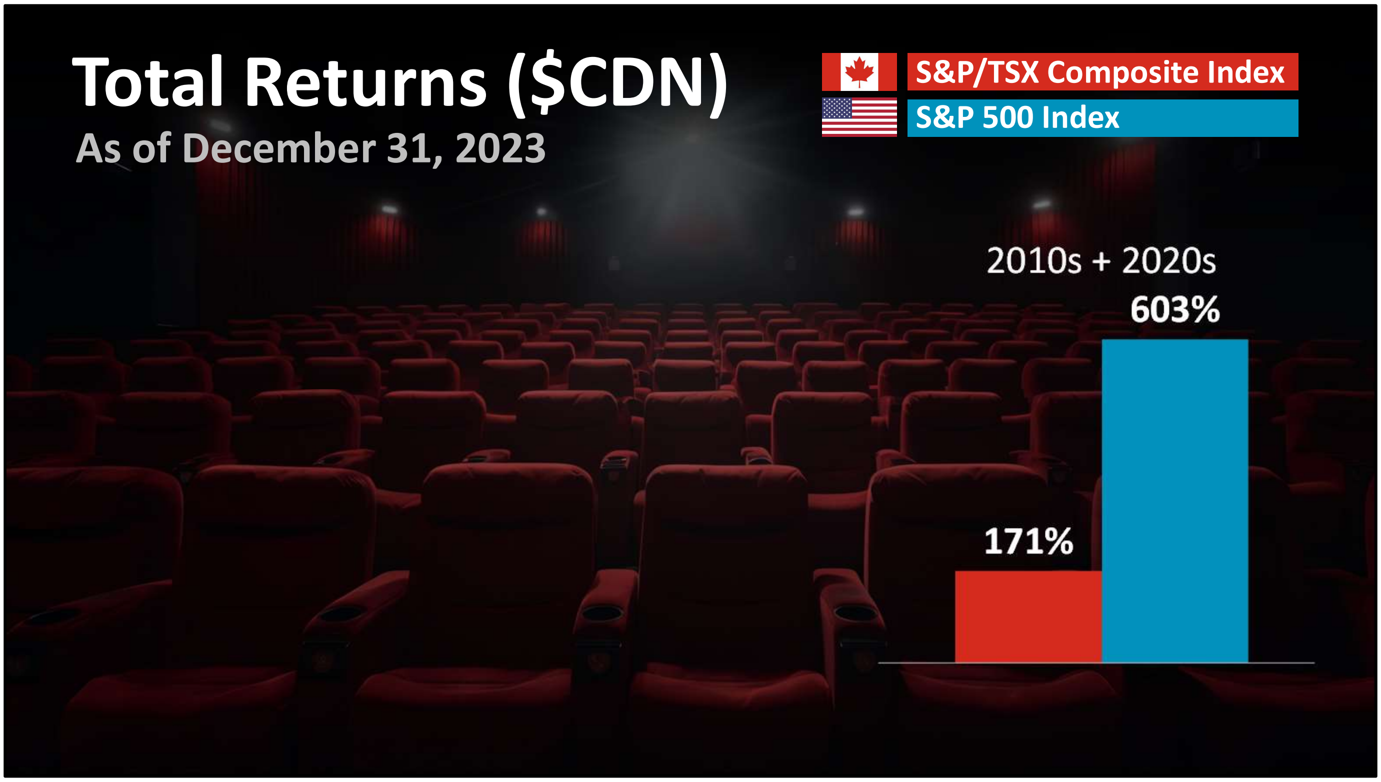
Source: Bloomberg

Two years ago at this event, I showed this 60-year chart of the S&P 500 Index. While the long-term gains are amazing, there were two long periods where U.S. stocks essentially went sideways before moving higher.

The first was a 12.5-year period from November 1968 to April 1981 and the second was a 13-year stretch from March 2000 to March 2013.

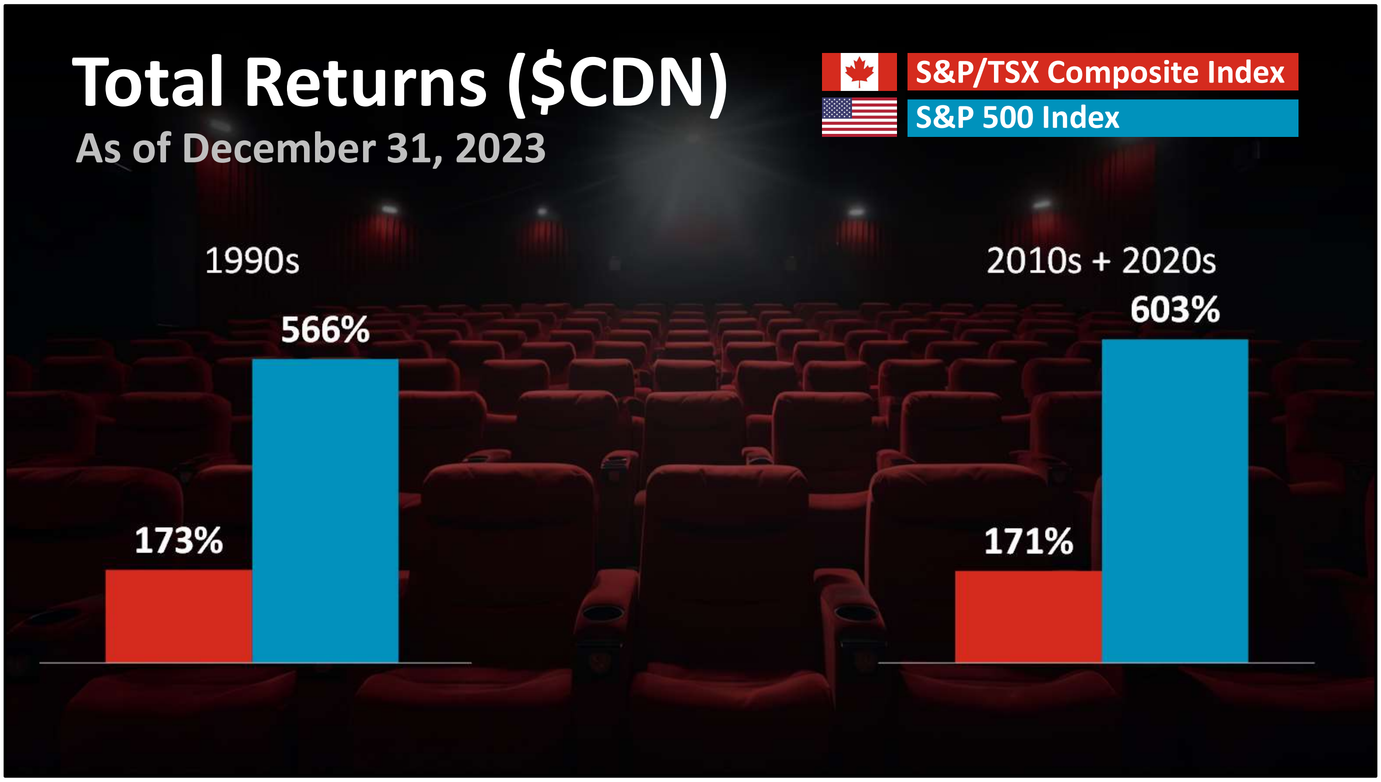
The one-two punches that undermined the market back in the 1970s were excessive valuations going in and surging inflation. In the 2000s and beyond, it was excessive valuations once again, then deflation fears following the Global Financial Crisis that held the market back. In both instances, the market was dominated by very large companies, much like it is today. In the early 1970s, it was the Nifty Fifty group of companies that included Coca-Cola, IBM and Polaroid, and at the turn of the century it was technology stocks.

If we get out of those front-row seats and step back for a broader perspective, some worrisome patterns emerge.



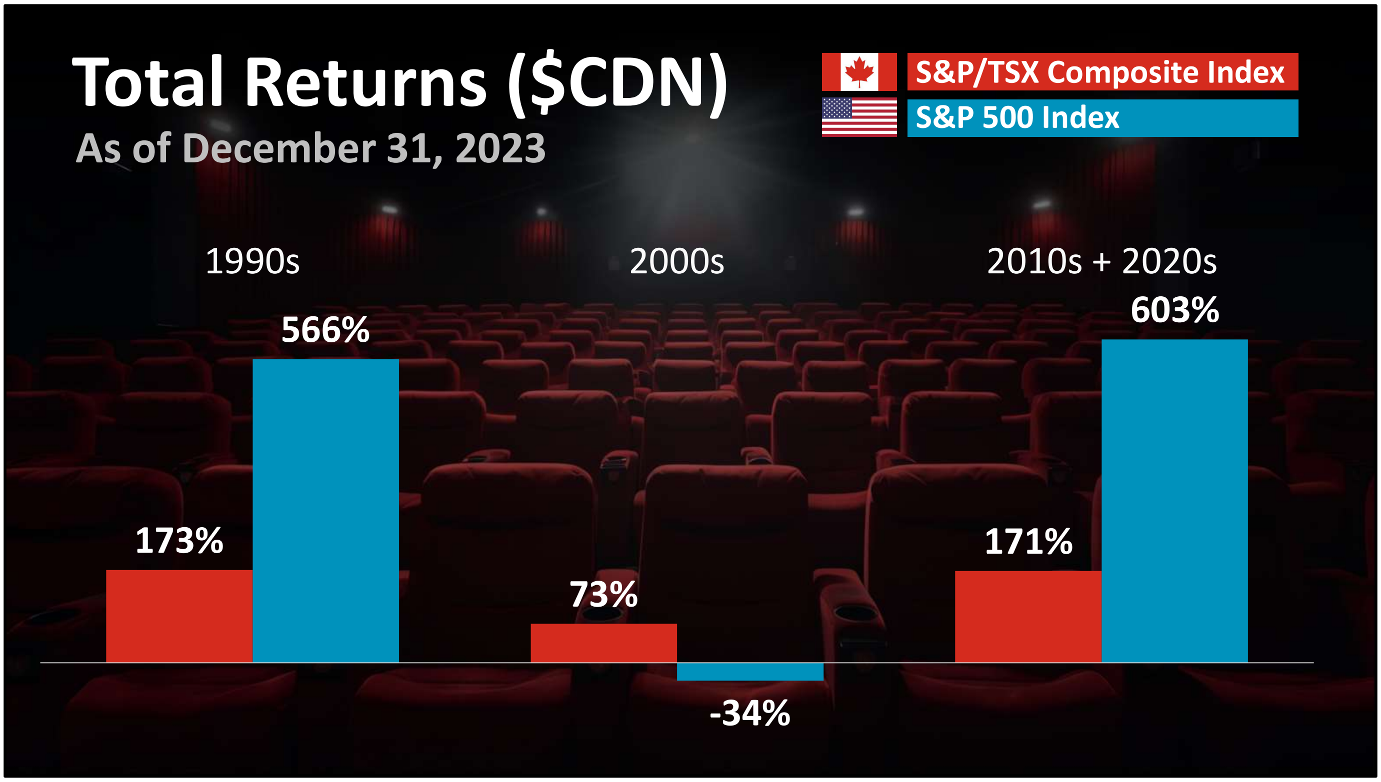
Source: Bloomberg, Odlum Brown

Over the last 14 years, from the end of 2009 to the end of last year, U.S. stocks produced a Canadian dollar return, including dividends, of more than 600%, substantially higher than Canadian stocks. No wonder investors love U.S. stocks!



Source: Bloomberg, Odlum Brown

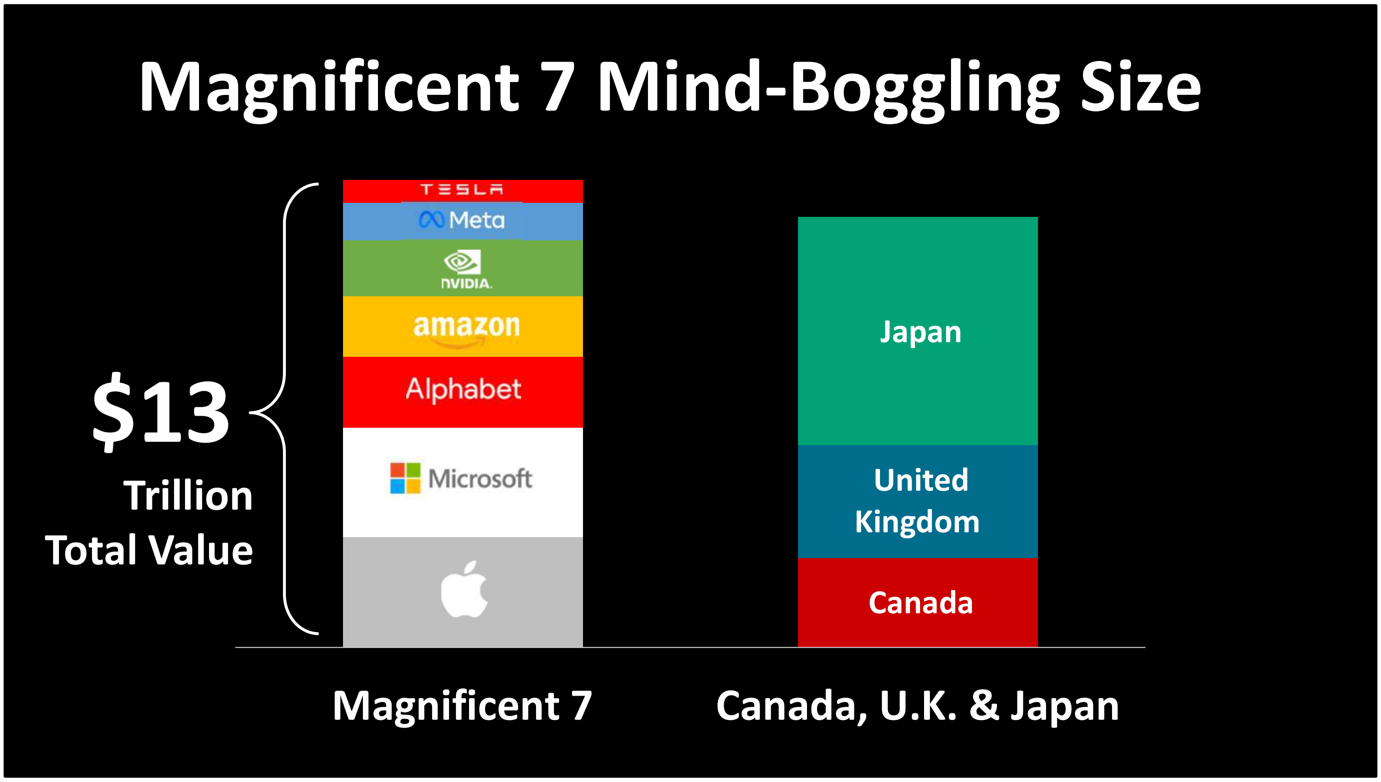
Consider the comparative performance in the 1990s. Once again, U.S. stocks trounced Canadian stocks. Those who were enticed by the superior U.S. returns in the 1990s were very disappointed.



Source: Bloomberg, Odlum Brown

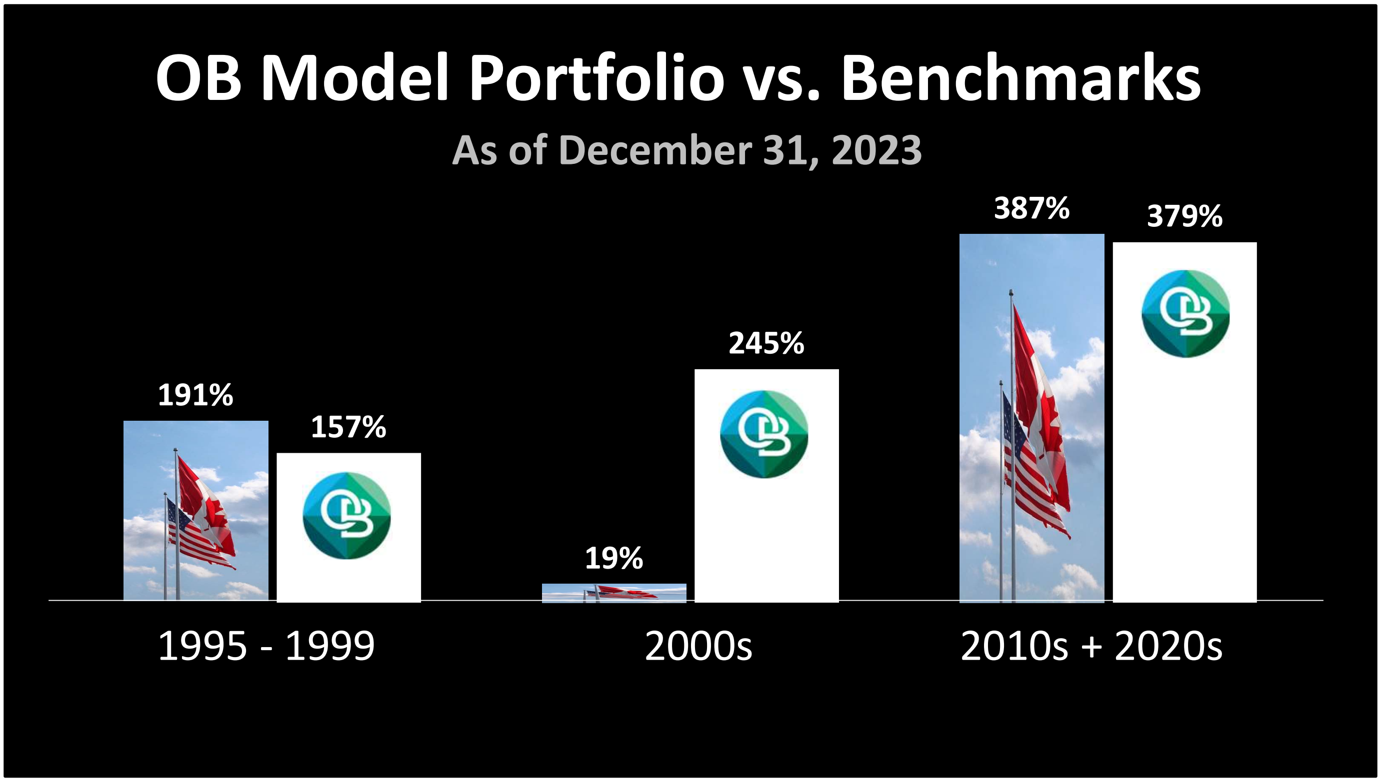
Look what happened in the 2000s. U.S. stocks lost one-third of their value. The Canadian market didn't do well either. That was because our technology darling, Nortel Networks, went bankrupt after accounting for one-third of the Canadian market at the peak of the mania.

At our Annual Address in 2000, Nortel's market capitalization was close to $200 billion, greater than 13 of Canada's biggest and best companies combined, and I rhetorically asked, "Which would be a better investment?"



Today, the Magnificent Seven are collectively worth about $13 trillion – that's more than the combined value of all the companies listed on the Canadian, U.K. and Japanese stock exchanges. So, I ask again, "Which would be a better investment?"

I'm not predicting that the S&P 500 Index will be down over the next 10 years, but I do think there is a good chance that it will underperform relative to some of the better-priced alternatives.



Source: Bloomberg, Odlum Brown

A lot of stocks did well in the 2000s, despite the poor performance of the main equity benchmarks. Our Model Portfolio did pretty well, simply by avoiding or underweighting the popular and pricey stocks. Beneath the surface, there were a lot of very attractively priced stocks. Our Model appreciated 245% in the 2000s versus just 19% for a 50/50 blend of U.S. and Canadian stocks.

But note the set-up for that market-beating performance. We didn't keep pace with the blended benchmark in the second half of the 1990s. Achieving good long-term returns requires patience, and sometimes that means under-performing in the short term. Being value conscious, we have struggled to keep pace with the market in recent years. Since the end of 2009, on the right, our Model has appreciated a tiny bit less than the overall market.

Given all the uncertainties in the world, we think it’s important to have a well-diversified portfolio. We still own four of the Magnificent Seven – Apple, Amazon, Alphabet and Microsoft – and they are truly wonderful businesses. But their magnificence is well appreciated by investors and is reflected in their premium valuation multiples. We still like them, but we don’t love them like we did 10 years ago when they were less popular and cheaper. Our combined exposure in our Model is about 12.5%, much less than the near 30% the Magnificent Seven represent in the S&P 500.

Frankly, we worry more about the Magnificent Seven than we do about Canadian dividend-paying stocks, which performed poorly in the face of higher interest rates. They are unpopular, and their dividend yields are lucrative relative to bond yields. Moreover, with the notable exception of the banks, many of the great dividend-paying businesses operate in less cyclical industries. That’s a characteristic that will likely render them more popular if/when the economy deteriorates.

Let me conclude by acknowledging that it’s been a tough couple of years. While interest rate relief is likely on the horizon, the economy may experience some turbulence in the near term.

We are more constructive regarding the long-term outlook than we have been in some time, with inflation coming down and reckless monetary policies in the rear view.

I want to remind you that successful investing is a marathon, not a sprint. It’s an endeavour where the odds are stacked in an investor’s favour.

It would be wonderful if we could correctly and consistently predict economic and market setbacks, but we can’t.

Our advice is to get out of the front-row seats and stop paying attention to the forecasts. Don’t let alarming headlines and scary forecasts spoil a sound long-term investment plan.

The odds of the economy being bigger and the companies we like being more valuable in the long run are a lot better than the probability that a short-term prediction will be right and profitable. Those who commit to owning shares of great companies through good times and bad invariably do better than those who try to time their participation in the market.

In honour of Charlie Munger, I'll end with a story he liked to tell about a schoolboy in Texas.

The teacher asked the class, "If there are nine sheep in the pen and one jumps out, how many are left?" Everybody got the answer right except the little boy, who said, "None of them are left."

The teacher said, "You don't understand arithmetic."

The boy replied, "No, teacher. You don't understand sheep."

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