ODLUM BROWN REPORT

01 2018

ODLUM BROWN
Investing for Generations®

INSIDE THIS ISSUE

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No Storm Clouds on the Horizon

The global economy strengthened in 2017, and stocks reacted positively. For the year through to December 15, 2017, the Odlum Brown Model Portfolio appreciated by 11.1%. Our significant foreign holdings, principally large U.S. companies, contributed meaningfully to our results. The main U.S. equity benchmark, the S&P 500 Index, produced a total return of 21.9% in 2017, or 16.3% in Canadian dollar terms after adjusting for the negative impact of the appreciation in the Canadian dollar. That was roughly double the 7.8% return from Canada's S&P/TSX Total Return Index over the same period. Our stock market was held back by the poor performance of resource stocks, whereas the U.S. equity averages benefited from the exceptional performance of technology stocks. Canada has less of what is doing well.

In many respects, 2017 was a mirror image of 2016. Many of the cyclical resource stocks that were among our top gainers in 2016 were among our worst performers in 2017. Conversely, high-growth businesses like Visa and Alphabet were at the top of the performance rankings in 2017 after being among the laggards the year before. As was the case in 2016, it paid to be diversified this past year.

COMPOUND ANNUAL RETURNS[1] (Including reinvested dividends, as of December 15, 2017)

	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	20 YEAR	INCEPTION[2]
Odlum Brown Model Portfolio*	11.1%	10.1%	12.1%	16.9%	10.7%	13.9%	15.2%
S&P/TSX Total Return Index	7.8%	8.5%	8.6%	8.7%	4.7%	7.1%	8.6%
S&P 500 Total Return Index ($CDN)	16.3%	16.0%	16.5%	22.3%	11.1%	6.7%	9.7%

[1] Except for YTD period. [2] December 15, 1994.

Some people are worried about the outlook, given that we are eight years into an economic expansion. They say that stocks are expensive and that we are overdue for a correction. We, on the other hand, are not particularly worried about the outlook, and will frame our reasoning by comparing our current thoughts to those we held 10 years ago, roughly a year before the Great Financial Crisis.

In 2007, monetary policy was a big negative. Central banks had slammed on the economic brakes by raising interest rates. Between 2004 and 2006, the U.S. Federal Reserve increased administered interest rates by 4.25 percentage points, from 1% to 5.25%. In the current cycle, the Fed is tapping on the brakes, having only increased interest rates from 0.25% to 1.50%.

Interest rates in general were much higher back in 2007. U.S. T-bills yielded 5.0% back then; today, they yield 1.3%. 10-year U.S. government bonds yielded 4.8% in 2007; today, they yield 2.4%.

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 Continued from page 1

> We're still living in a slow-growth world due to high debt levels and poor demographics, and consequently it's important to stay focused on higher-quality businesses.

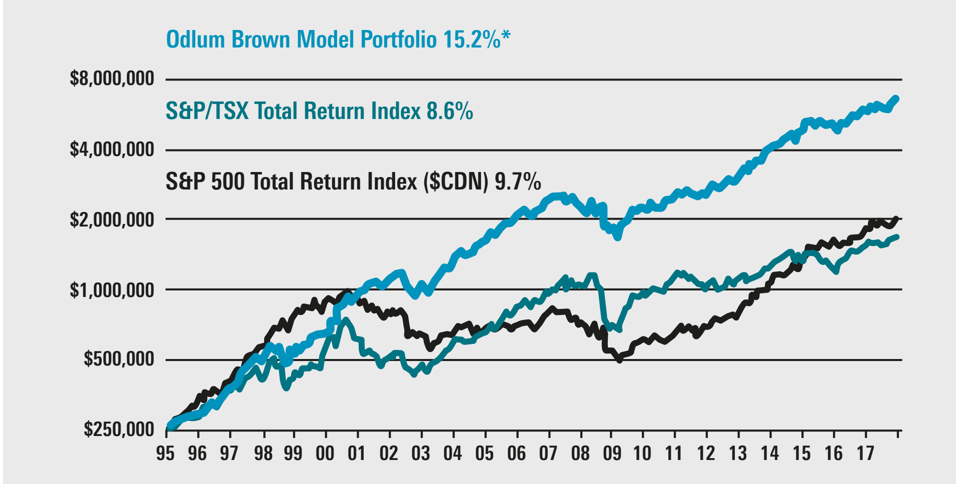
OB MODEL PORTFOLIO TOP 10 HOLDINGS

XPO Logistics (XPO)*	Industrials	4.4%
Brookfield Asset Management Inc. (BAM.A)[1]	Financials	3.6%
Visa (V)*	Info Tech	3.6%
Toronto-Dominion Bank (TD)	Financials	3.5%
Markel Corporation (MKL)*	Financials	3.4%
Alphabet (GOOG)*	Info Tech	3.1%
TRI Pointe Group (TPH)*	Cons. Discretionary	3.0%
Onex (ONEX)	Financials	2.9%
ING Groep N.V. (ING)*	Financials	2.9%
The Howard Hughes Corp. (HHC)*	Real Estate	2.9%

* Foreign listed. [1] Class A shares elect one-half of the company's Board of Directors.

SECTOR ALLOCATION	OB MODEL PORTFOLIO	S&P/TSX INDEX
Financials	29.7%	34.9%
Real Estate	4.5%	2.9%
Materials	6.1%	11.3%
Energy	7.6%	19.3%
Industrials	8.1%	9.6%
Consumer Discretionary	13.1%	5.5%
Info Tech	11.3%	3.3%
Consumer Staples	6.8%	3.7%
Telecom Services	3.5%	2.9%
Utilities	1.8%	4.8%
Health Care	5.1%	0.9%

OB MODEL PORTFOLIO VS NORTH AMERICAN INDICES



Oil was US$100 a barrel in 2007, which hurt consumers and businesses. Oil prices are roughly half that today.

The U.S. housing market was extremely frothy in 2007 and was a disaster waiting to happen. Lending standards were outrageously lax, and it was widely expected that a lot of homeowners were going to run into trouble when adjustable-rate mortgages reset to significantly higher interest rates. U.S. housing is more affordable today, and lending standards are prudent.

The banking industry was weak in 2007 because it was under-regulated and over-leveraged. Now, we'd argue that it is over-regulated and under-leveraged.

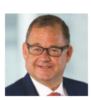
The one thing that does warrant caution today is the level of debt in the world. While debt levels were high in 2007, they are unfortunately higher today. Canada's debt-to-GDP ratio, for example, is now higher than that of the U.S., having risen from about 220% to almost 300%.

The good news, if there is good news, is that more of the debt is in government hands today, which is inherently more stable than debt held by consumers or corporations. We are also comforted by the fact that the banking sector is much better capitalized now than it was back then.

We are now a long eight years into the current economic expansion, and there is no doubt that there will be another cycle. However, we're not overly concerned about the economy in the near term, nor are we troubled by the level of stock valuations.

The U.S. stock market currently trades at about 19x expected earnings, only modestly higher than the 17x multiple a decade ago. Not only should valuations be higher when the economic outlook is better, they should be higher when interest rates are low. Stocks react to interest rates the same way house prices are influenced by mortgage rates. When mortgage rates were 15% in the early 1980s, stock valuations were very low; as rates have come down, valuations have gone up. With interest rates significantly lower today than 10 years ago, one could argue that much higher valuations may be justified.

We remain constructive regarding the economic outlook. It's been a long time since the Great Financial Crisis, and yet there aren't ominous storm clouds on the horizon. Valuations are reasonable, especially considering the low level of interest rates. We're still living in a slow-growth world due to high debt levels and poor demographics, and consequently it's important to stay focused on higher-quality businesses. They have the means to grow in a sluggish economic environment and are best equipped to ride out any economic surprises.



MURRAY LEITH, CFA
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@murrayleith

* Compound annual returns are from inception December 15, 1994 to December 15, 2017. The Odlum Brown Model Portfolio was established by the Research Department in December 1994, with a hypothetical investment of $250,000. These are gross figures before fees. Past performance is not indicative of future performance. Trades are made using the closing price on the day a change is announced.

Sound Investment Strategy Doesn't Change

The top of mind question at the beginning of a new year is always some version of, "How is the future going to be different than the past?" Our answer has always been, "Not different enough to change our investment strategy." We are sorry to disappoint, but that is our answer again in 2018.

While there are always nuances regarding the stocks and sectors that we favour at any particular point in time, we are always most focused on the two things that don't change: human nature and sound investment strategy. Because the two don't mix well, understanding and managing one's emotions is key to long-term investment success.

Human beings are not good investors because we are emotionally hardwired to do the wrong thing in the face of volatile markets. It is easy to say "buy low and sell high," but our emotions often cause us to do the opposite. We are more comfortable and confident buying stocks when the economy is doing well and stocks are rising, and we tend to panic and sell when the opposite is true.

These days, it is easy to get the feeling that you might be missing out on the next great thing, whether it be Bitcoin, marijuana stocks, artificial intelligence or electric vehicles. While it's always important to be mindful of new developments, our experience has taught us to think twice before embracing the popular stocks or evolving trends. Because change is often slow – evolutionary rather than revolutionary – it can be costly to chase the hot stocks or themes.

Investment success, and not letting your emotions get the best of you, comes from adhering to a few time-tested principles:

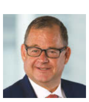
Have a Plan – Determine the long-term asset mix – stocks, bonds, real estate and cash – that makes sense for you relative to your goals and tolerance for risk. This mix can change slowly over time as your age and circumstances change, but it shouldn't change meaningfully year-to-year.

Know What You Own – The stock market can be bumpy, and the more familiar and comfortable you are with the businesses you own, the greater the chance you won't sell at the wrong time. It might seem exciting to buy Bitcoin when its price is rising rapidly, but ask yourself if you understand how it is valued and how you will react if and when its price drops dramatically. In our experience, when people don't fully understand the assets they own, they tend to panic in the face of poor performance.

Think Long Term – In this day and age, we are overwhelmed with advice on what is going to happen next week or next month. Everyone is trying to outsmart the other guy, and nobody is consistently good at it. Ignore the hype and think about where the economy and businesses are going to be in three to five years, or even longer term.

Don't Time the Market – Those who jump in and out of the market, trying to avoid the next recession or market correction, invariably do much worse than those who stay invested. This is because they spend too much time missing out. You might make a few good calls over a lifetime, but you will blow it enough times that you will significantly undermine your long-term returns. Those who accept volatility tend to do much better in the long run than those who try to anticipate it.

Have Reasonable Expectations – If you are going to invest in stocks, you are going to own some losers. It's the batting average that matters, and you will do very well over time if you simply have more winners than the alternative. The best year for the Odlum Brown Model Portfolio was the year 2000. We were up more than 40%, and yet we lost money on one-third of the stocks in the portfolio that year. You also have to expect corrections from time to time. We have a great 23-year track record, in large part because we remained invested during good times and bad.



MURRAY LEITH, CFA
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The Odlum Brown FWE Gala: Pitch for the Purse

Thursday, February 15
Fairmont Hotel Vancouver

We are pleased to return as the Title Sponsor of The Odlum Brown FWE Gala: Pitch for the Purse. Forum for Women Entrepreneurs (FWE) designed Pitch for the Purse to help women entrepreneurs access capital to grow their businesses. At this year's event, the audience will help award $25,000 to one of the three 2018 finalists.

Celebrity judges, a celebration of women entrepreneurs, leaders, mentors and serious fun are all in store. For ticket information or to learn about this year's finalists, visit fwe.ca/pitchforthepursegala.

Odlum Brown's 24th Annual Address

We are pleased to invite you and your guests to Odlum Brown's signature investment presentation series. Debra Hewson, Murray Leith and members of our research team will share our approach to growing and preserving clients' wealth for generations.

Debra Hewson
President and Chief Executive Officer

Murray Leith
Executive Vice President and Director, Investment Research

VICTORIA
Tuesday, February 13, 2 PM
Delta Victoria Ocean Pointe (Ballroom)
100 Harbour Road
RSVP to Monica at 250-952-7775 by February 6.

COURTENAY
Wednesday, February 14, 2 PM
Crown Isle Resort (Ballroom)
399 Clubhouse Drive
RSVP to Terina at 250-703-0637 by February 7.

KELOWNA
Thursday, February 15, 2 PM
Coast Capri Hotel (Ballroom)
1171 Harvey Avenue
RSVP to Lindsay at 250-861-5700 by February 8.

CHILLIWACK
Friday, February 16, 2 PM
Coast Chilliwack Hotel (Rosedale Room)
45920 First Avenue
RSVP to Taylor at 604-824-3376 by February 9.

SOUTH SURREY
Monday, February 19, 7 PM
Morgan Creek Golf Course
3500 Morgan Creek Way
RSVP to Maria at 604-844-5336 by February 12.

VANCOUVER
Tuesday, February 20, 2 PM
The Fairmont Waterfront (Waterfront Ballroom)
900 Canada Place Way
RSVP to Maria at 604-844-5336 by February 13.

New location! **LANGLEY**
Wednesday, February 21, 2 PM
Langley Events Centre (Banquet Hall)
7888 200 Street, Gate 2, Elevator at Gate 3
RSVP to Maria at 604-844-5336 by February 14.

WEST VANCOUVER
Thursday, February 22, 7 PM
Kay Meek Centre (Main Stage Theatre)
1700 Mathers Avenue
RSVP to Maria at 604-844-5336 by February 15.

RSVP early and electronically! Visit odlumbrown.com/rsvp to register online.

Space is limited.

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