

ODLUM BROWN REPORT

07 2018



▶ Outgoing Chairman
J. Anthony (Tony) Hepburn is appointed **Chair Emeritus**.



▶ Vice President, Director,
Portfolio Manager **Ross Turnbull** is appointed **Chair**.



▶ Vice President, Director,
Investment Advisor **Andy Eisenbock** is appointed **Vice Chair**.



ODLUM BROWN
Investing for Generations®

Investing in Our Future

A message from Debra Hewson:

In a significant transition for our firm, I am pleased to announce the appointments of J. Anthony (Tony) Hepburn to Chair Emeritus, Ross Turnbull to Chair and Andy Eisenbock to Vice Chair of Odlum Brown Limited.

After 17 years as Chairman, J. Anthony (Tony) Hepburn will become Odlum Brown's first Chair Emeritus and will continue to serve his clients as a Portfolio Manager. In January, Tony will celebrate 50 years at Odlum Brown – and what a remarkable 50 years it has been! After joining the firm's Research Department in 1969, he became President and CEO in 1978, a role he held for 23 years before becoming Chairman in 2001. Throughout his tenure, Tony has been the unwavering face of our firm, guiding us through the rough spots and celebrating our successes.

Tony has influenced the Canadian investment community through his extensive volunteerism on numerous boards and advisory committees, both industry-related and philanthropic. He has received the Chancellor's Distinguished Service Award from Simon Fraser University and in 2008 was elected a Fellow (FCPA, FCA) of the Institute of Chartered Accountants of BC (now the Chartered Professional Accountants of British Columbia). Tony's inspirational leadership, stewardship and mentorship have ensured that Odlum Brown is well positioned for the future.

Incoming Chair Ross Turnbull is a Vice President, Director and Portfolio Manager who has been with Odlum Brown for 18 years. Prior to becoming a Portfolio Manager, he was an analyst on the firm's Equity Research team from 2000 to 2005.

Incoming Vice Chair Andy Eisenbock has been with Odlum Brown for 30 years. As well as his roles as Vice President, Director and Investment Advisor, he is an active member of the firm's Executive Committee.

On behalf of the firm, I am delighted to welcome Ross and Andy as Chair and Vice Chair. Over their careers, both have demonstrated an admirable commitment to their clients and to the success of Odlum Brown, and I look forward to working with them both in their new roles.

I would like to take this opportunity to thank each of you, our valued clients, for the trust and confidence you place in Odlum Brown. We are very fortunate to have such great clients – thank you for taking this journey with us.



DEBRA A. HEWSON
President and Chief Executive Officer

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Odlum Brown Limited



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Odlum Brown Community

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From our perspective, investor sentiment toward the various sectors and geographies is consistent with the risks and opportunities on the economic horizon. Views are neither extremely optimistic nor overly pessimistic. Without compelling reasons to be contrarian, we believe it is best to have a well-diversified portfolio and to expect reasonable returns.

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Tough to be Canadian

A decade ago, Canada was the envy of the world. The global economy was booming, led by China, and that was very good for commodity prices, the Canadian dollar and our stock market. Oil was US\$135 per barrel, the Canadian/U.S. exchange rate was near par and the Canadian equity benchmark, the S&P/TSX Composite Index, had risen 9% for the year through to its peak on June 18, 2008. U.S. equities were going in the other direction, with the S&P 500 Index down 9% over the same period.

Resource stocks were popular and expensive, so much so that the Energy and Materials sectors together accounted for more than half the capitalization of the Canadian stock benchmark. At the time, we didn't think it made sense to favour cyclical resource stocks. We were anticipating an economic slowdown due to the combination of significantly higher interest rates, crippling oil prices and weakness in the U.S. housing market. Despite the warning signs, investors threw caution to the wind.

Post Resource Mania Total Return 10 Years Since S&P/TSX Peak (June 18, 2008)	
United States	234%
OB Model Portfolio	184%
Japan	140%
Hong Kong	137%
India	119%
Korea	88%
Germany	85%
China	76%
U.K.	70%
France	65%
Canada	46%
Italy	0%
Russia	-13%
Brazil	-42%

Looking back, it's clear that was a mistake. Including reinvested dividends, the S&P/TSX Index has generated a total return of just 46% in the 10 years since the market peak in 2008. While not as poor as the returns from Italian, Russian and Brazilian stocks, an investor would have been better off owning Canadian bonds or stocks in any of the world's other major markets. U.S. stocks performed five times better than Canadian stocks over the period. The Odium Brown Model Portfolio has done well because we have consistently favoured blue chip American companies over Canadian resource firms.

The Canadian stock market has underperformed relative to its U.S. counterpart primarily because our market has too many companies in sectors that have performed poorly and not enough in sectors that have performed well.

The Energy and Materials sectors accounted for more than 50% of our market at the peak, and those sub-indices had total losses of 24% and 30%, respectively, over the subsequent 10-year period. The same sectors represented less than 20% of the American equity benchmark.

The top five U.S. sectors over the 10-year period – Consumer Discretionary, Technology, Health Care, Consumer Staples and Industrials – produced total returns ranging from 221% to 464%. That performance has contributed meaningfully to the S&P 500 Index return as those sectors collectively accounted for close to 60% of the index in 2008. That's almost four times the aggregate weight of the same sectors in the Canadian benchmark.

**Post Technology Mania Total Return
S&P 500 Peak (March 24, 2000) to
S&P/TSX Peak (June 18, 2008)**

Russia	724%
OB Model Portfolio*	229%
Brazil	168%
India	145%
Korea	76%
Canada	75%
China	59%
Hong Kong	19%
France	-2%
U.K.	-4%
Germany	-6%
Italy	-14%
United States	-30%
Japan	-46%

* OB Model performance since March 15, 2000.

There is more to the Canadian underperformance story than differences in the makeup of the indices. Canada has underperformed the United States in eight of 10 sectors since the peak in the resource mania. In fact, the return variances are so large that it would seem that negative investor sentiment has overridden economic considerations. Interestingly, we found similar evidence of widespread underperformance in the United States following the technology mania.

From the technology-driven peak in the S&P 500 Index on March 24, 2000, through to the resource-fuelled peak in the S&P/TSX Index on June 18, 2008, Canadian stocks did much better than U.S. stocks. Over the more than eight-year period, the U.S. equity benchmark dropped by 30% while the S&P/TSX Index returned 75%, including reinvested dividends. From a sector-by-sector perspective, Canada beat the U.S. in eight of 10 sectors. The Odlum Brown Model Portfolio performed considerably better than both benchmarks over the period primarily because we weren't hurt by the

collapse in technology stocks, which were a major drag on the performance of both indices. We also benefited from buying U.S. blue chip stocks after valuation multiples collapsed in the latter part of the period.

The lesson from history is not to be contrarian, but rather to consider whether conventional wisdom is consistent with economic fundamentals.

In late 1999/early 2000, the vast majority of the popular dot-com and technology companies didn't have the revenue, profits and prospects to justify sky-high valuations. Canadians were also paying ridiculous prices for blue chip American stocks like Johnson & Johnson and Coca-Cola with depressed 65-cent Canadian dollars, and that didn't make economic sense either. Similarly, it didn't make sense to love cyclical resource stocks in 2008 when the economic outlook was poor.

Given the performance bust that Canada has experienced over the last 10 years, it's tempting to wonder if Canadian stocks are due for a period of better relative performance. While we think that is quite possible over a three to five-year investment horizon, we are not sure if that will be the case over the next couple of years.

We think it is better to hedge one's investments by owning both Canadian and American stocks. The Odlum Brown Model Portfolio currently has 51% invested outside the country.

While resource stocks are generally unpopular and depressed, it's probably not a good idea to over-emphasize cyclical stocks nine years into an economic expansion. Most will likely provide great returns over the business cycle, but there could be pain during the next recession. Outside the resource sectors, it's hard to argue that valuations are any more compelling within Canada than they are elsewhere. Moreover, the Canadian market doesn't have the depth of opportunity that exists south of the border. High-quality growth companies like Visa, Amazon, Starbucks and Alphabet are hard to find in Canada.

From our perspective, investor sentiment toward the various sectors and geographies is consistent with the risks and opportunities on the economic horizon. Views are neither extremely optimistic nor overly pessimistic. Without compelling reasons to be contrarian, we believe it is best to have a well-diversified portfolio and to expect reasonable returns.



MURRAY LEITH, CFA

Executive Vice President and Director, Investment Research

[@murrayleith](#)

The Odlum Brown Model Portfolio is an all-equity portfolio that was established by the Odlum Brown Equity Research Department on December 15, 1994, with a hypothetical investment of \$250,000. It showcases how we believe individual security recommendations may be used within the context of a client portfolio. The Model also provides a basis with which to measure the quality of our advice and the effectiveness of our disciplined investment strategy. Trades are made using the closing price on the day a change is announced. Performance figures do not include any allowance for fees. Past performance is not indicative of future performance.



Summer is here!

Odlum Brown wishes all of our clients and friends a wonderful summer.

Please note that we do not publish the *Odlum Brown Report* in August. We look forward to sharing more market insight and timely topics with you in September.

In the meantime, stay up-to-date on our News and Events at odlumbrown.com.

Odlum Brown in the Community

We are committed to supporting initiatives that matter to our communities. This summer, we are excited to sponsor these upcoming events:



Harmony Arts Festival August 3 – 12, 2018 West Vancouver, BC

This summer marks our 17th year as Presenting Sponsor of the Harmony Arts Festival, one of the North Shore's best-loved community events. There is something for everyone at this annual celebration of the arts: visual art exhibits, an art market, free outdoor concerts and licensed beachside dining venues, along with drop-in art activities for both kids and adults. The Festival turns West Vancouver's stunning Ambleside waterfront and John Lawson Park into a lively outdoor spectacle. Most events are free to the public. [Visit **harmonyarts.ca** for more information.](http://harmonyarts.ca)

MJT Odlum Brown Classic – PGA of BC Junior Championship August 7 – 9, 2018 Surrey, BC

Odlum Brown is celebrating its 13th year as Tournament Partner of the MJT Odlum Brown Classic – PGA of BC Junior Championship. This 54-hole, Golf Canada-ranked tournament is part of Canada's most played junior golf tour, the Maple Leaf Junior Golf Tour (MJT), and is held in conjunction with the Professional Golfers' Association of British Columbia (PGA of BC). The MJT aims to develop champions, both in golf and in life. The MJT Odlum Brown Classic – PGA of BC Junior Championship takes place at Northview Golf & Country Club (6857 - 168 Street) in Surrey. Spectators are welcome. [Visit **maplejt.com** for more information.](http://maplejt.com)



Odlum Brown VanOpen August 11 – 19, 2018 West Vancouver, BC

Odlum Brown has proudly been the Title Partner of this world-class tennis tournament for 16 years. In partnership with Tennis Canada, the International Tennis Federation and the ATP Challenger Tour, the Odlum Brown VanOpen is the largest tennis tournament in Western Canada, bringing together high-level players from around the world. The



Odlum Brown VanOpen takes place at Hollyburn Country Club (950 Cross Creek Road) in West Vancouver. [Visit **vanopen.com** for ticket information and event details.](http://vanopen.com)

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