Investment Commentary
2023 – A Year In Review

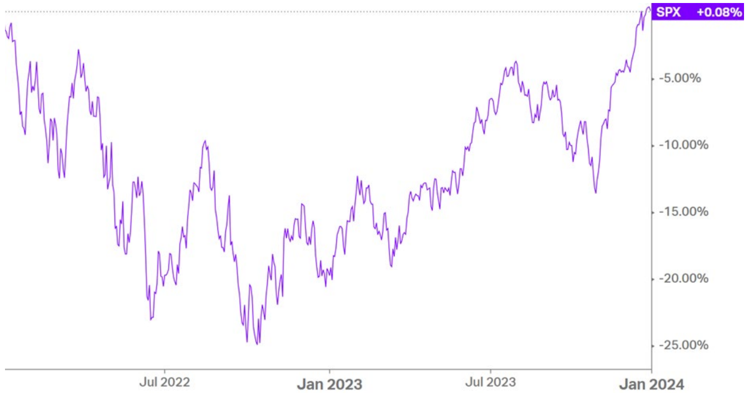
OUR FAMILY OFFICE

30 January 2024

2023 Review – The Markets

What do markets at all time highs really mean? The short answer… nothing!

Stock markets have had a roller-coaster ride over the past two years. The markets recovered in 2023 following a sharp decline in 2022. "The harder they fall, the faster they rise." – maybe too fast? After two years, markets have gone back to where they started, as illustrated in the chart below. Investors had many sleepless nights watching their portfolio values fluctuating, going back to where it was two years ago, after making a U-turn.



Source: Koyfin, S&P 500 through 2022 and 2023

The S&P 500 index ended 2023 ahead by about 25%, while NASDAQ gained 43%. With the markets at record highs again, stocks are now priced at a level suggesting an expectation that the Federal Reserve will engineer its dream "soft landing" economic outcome. A lot of the good news has already been priced into the market, including expectations for a soft landing, rapid rate cuts, and easing inflation, leaving little room for errors, if any.

In 1993's "16 Rules For Investment Success" Sir John Templeton wrote: "The four most expensive words in the English language are, '**This time it's different**'." The ones who believed so have paid a hefty price.

In 2023 there was a wave of excitement about Artificial Intelligence, and the so-called "Magnificent 7" (Microsoft, Alphabet, Nvidia, Apple, Amazon, Meta, and Tesla). We wrote about the Magnificent 7 last year and it is worth noting that the gains of these seven stocks contributed roughly 60% of the total gains of the S&P 500 Index for the year while the other 493 stocks contributed only 40% (see chart on page 6).

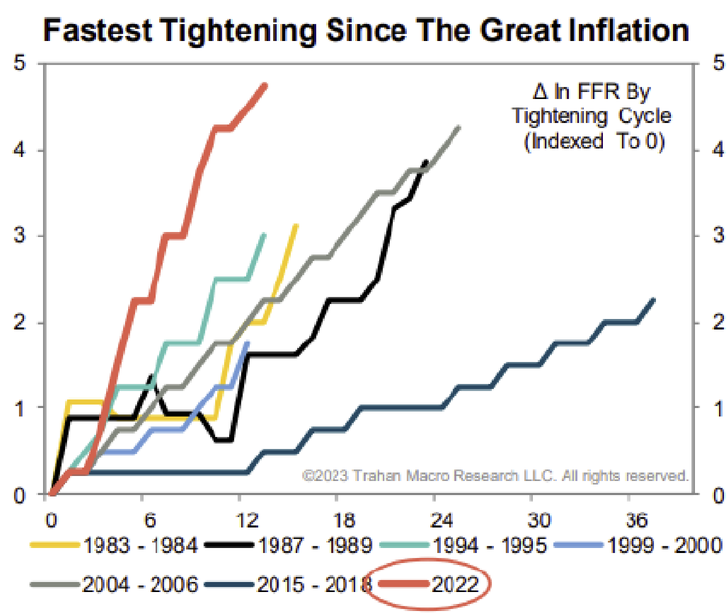
Were those stocks driven higher by improvement in their fundamentals? No, they were carried higher by the anticipation that their future earnings would go up dramatically and the Fed would cut rates aggressively in 2024 and beyond.

Rising long-term interest rates drove investor confidence down and extended the late summer decline, taking markets down 10%. Markets quickly reversed when October inflation data softened faster than expected leading markets to gain 14%. This was an "everything rally," where stocks across most sectors rallied together, leading to a strong finish to the year. All in all, the year showed investors that inflation and Fed policy are still the main drivers of asset prices.

2023 Review – Interest Rates and Inflation

Looking ahead to 2024, interest rates will be coming down, but how much and how fast is the question.

In 2023, inflation came down in most major economies around the world, following the most aggressive rate hikes in history. The cycle of interest rate hikes, while alleviating inflation pressure and curbing demand, has clearly had economic impacts. The real estate sector, which is particularly sensitive to interest rate fluctuations, cooled down. This was followed by slowdowns in real consumption and business investment. Some lagged effects of Fed tightening can take 12-18 months to materialize, so the impact of these hikes may not yet be fully felt.



Many pundits are forecasting rapid rate cuts in 2024 and beyond. Where markets are at right now is reflecting the expectation of five U.S. interest rate cuts in 2024 and another four in 2025. Some have cheered at that prospect and eagerly pushed stock markets higher.

If history is any indication, markets in fact go down when interest rates go down. We have shown the chart (See Page 7) before and we would like to stress the point again. The chart shows peaks in the 10-year Treasury yield have coincided with significant economic crisis or market turmoil. A material drawdown in global risk assets may be likely as rates peak in the current cycle. If aggressive rate cuts do transpire, it may be because the employment situation – and the economy - start to deteriorate rapidly. Neither scenario would do any favours for stock markets.

A few years ago we made a tactical decision that any asset class that produces income - be it mortgages, secured lending or bonds - were floating rate and very short duration. It has proved to be correct in that mortgage funds and lending strategies gained 7.5% in 2022, over 8.5% in 2023 and we expect over 9% in 2024. In anticipation of rates declining, we have recently made a new tactical call. We are adding to mortgages as the return on cash will no longer be as appealing as in the past year. Mortgages provide a steady return stream and good mortgage managers are able to control risks with their expertise.

2023 Review – Geopolitical Events

Geopolitical tensions have risen over the year and have become the single most important risk confronting the global economy, although almost always less appreciated than the economic risks by investors. Foreign challenges to US dominance – primarily from Russia, China, and Iran – have destabilized the world. Wars are now raging in two regions – Eastern Europe and the Middle East. An escalation of the conflict in the Middle East could push energy markets into uncharted territory. Recent attacks in the Red Sea have already disrupted shipping through the Suez Canal, which accounts for 30% of global container traffic, negatively affecting global supply chains.

More than 60 countries representing about 50% of the world's population (about 4 billion people) are heading to vote in 2024. It is not an election year. It is **the** election year. Markets do not like uncertainty.

Even your vocabulary has expanded in recent years: *de-globalization, de-dollarization, de-coupling, deepfake, polarization, politicization, woke, polycrisis, permacrisis* – each of them represent a new kind of challenge and increased risk and consequences.

In this era where social media lies are more believable and travel faster than the truth, misinformation (false information) and disinformation (created to mislead or cause harm) cause people's trust in news to decline and increase polarization further.

As we look ahead to 2024, we must guard against complacency. Interest rate moves, geopolitical risk, and concentrated market performance make it more difficult than ever to predict future performance.

As always, our approach has been building portfolios across a wide range of scenarios without banking on one particular outcome or another. Our All-Weather portfolios have been strategically positioned for the long term, without having to take market risk. Our clients' portfolios are managed to preserve wealth and grow steadily. Remember: you only need a steady 7% net return to double your portfolio every 10 years.

Our endowment-style portfolios focus on long term steady returns, so that multi-generational wealth is always preserved.

If you've made it this far in reading our commentary you will understand that we focus on risk. Our All-Weather Portfolios have been able to consistently outperform a traditional 60/40 (stock/bond) allocation on a risk adjusted basis. If you are interested in learning more about our investment philosophy and process, please feel free to reach out to us.

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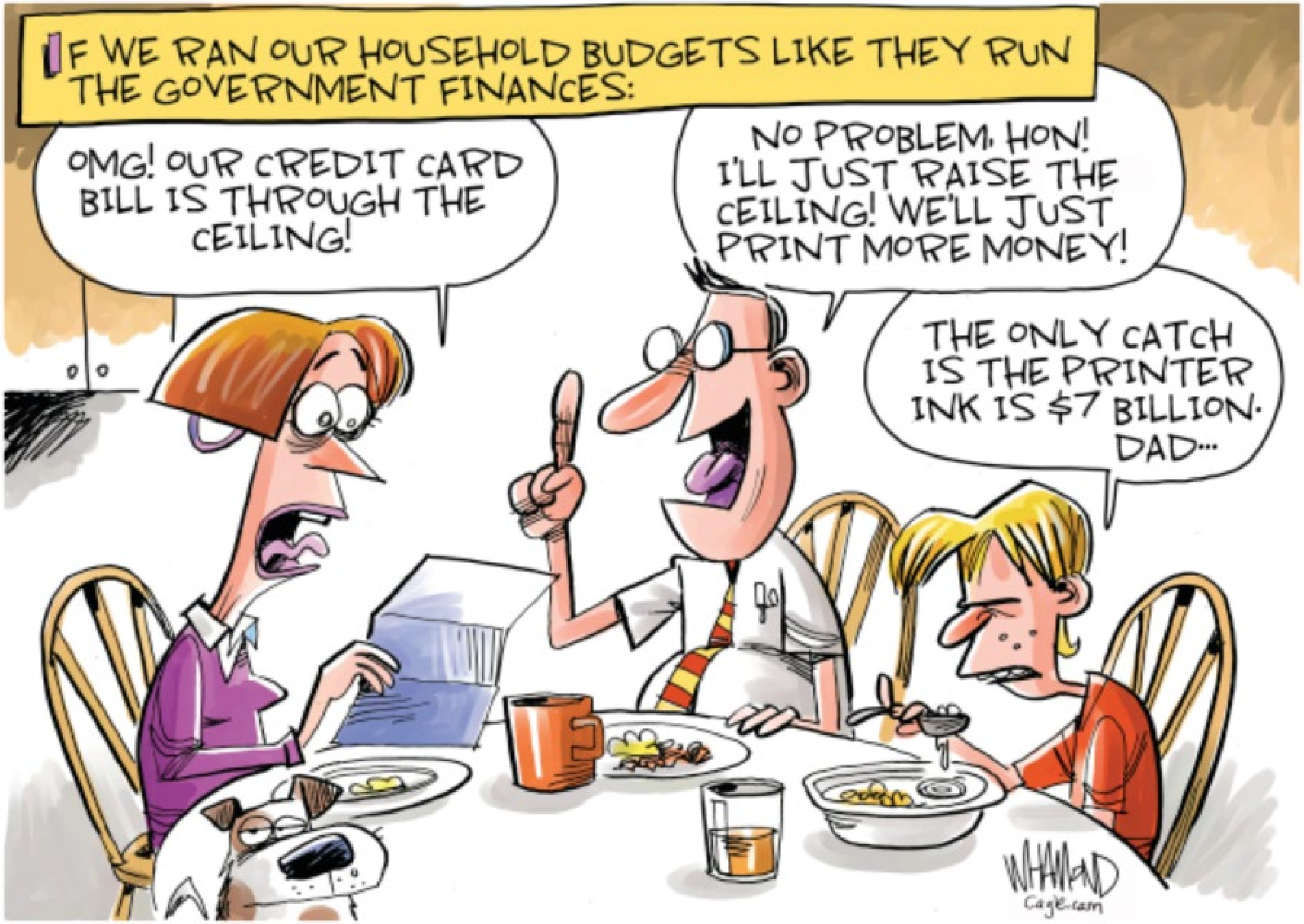

IF WE RAN OUR HOUSEHOLD BUDGETS LIKE THEY RUN THE GOVERNMENT FINANCES:
OMG! OUR CREDIT CARD BILL IS THROUGH THE CEILING!
NO PROBLEM, HON! I'LL JUST RAISE THE CEILING! WE'LL JUST PRINT MORE MONEY!
THE ONLY CATCH IS THE PRINTER INK IS $7 BILLION. DAD...
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2023 Review – Charts

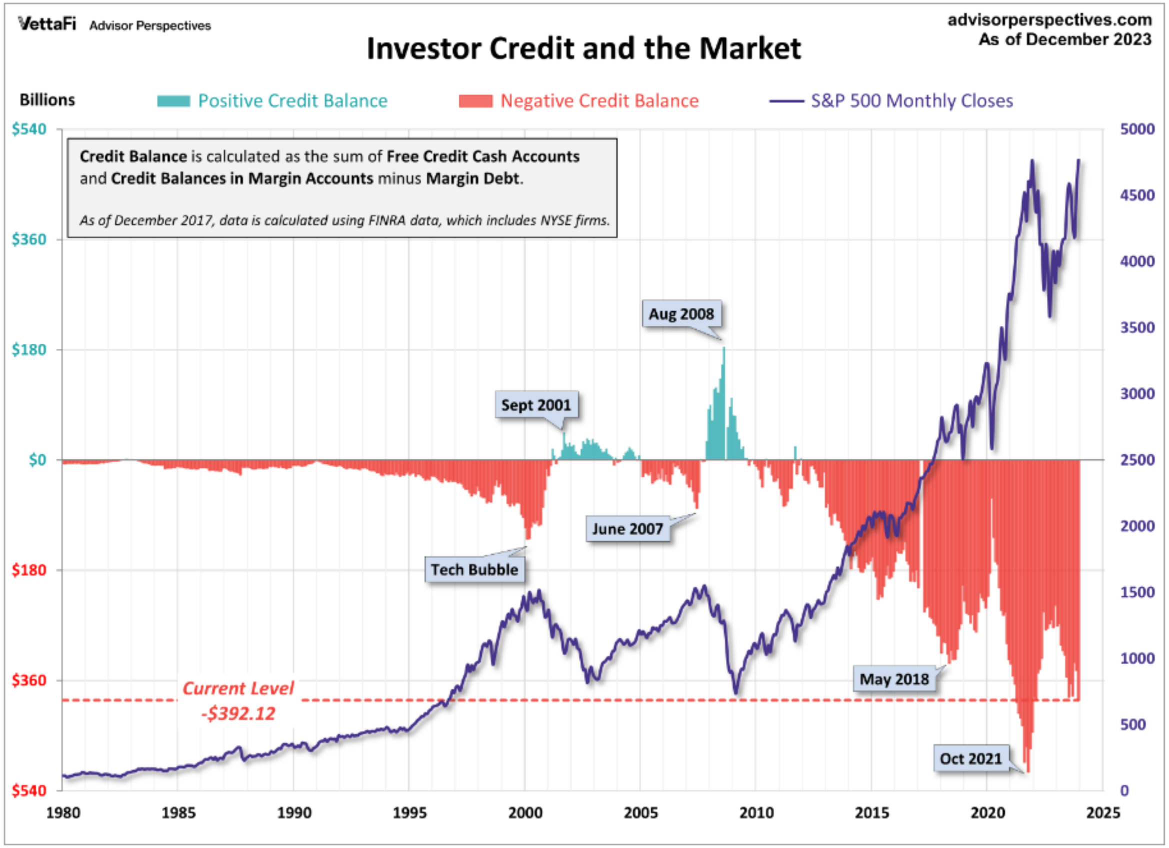
Source: Dow Jones Market Data; FactSet

- The above chart shows the 2023 cumulative return for the Magnificent Seven, for the S&P 500 as a whole and for the 493 remaining S&P companies.
- This small group of large growth companies has continued to be the driving factor behind market returns through 2023.
- The Magnificent 7 now make up nearly 30% of the market cap of the S&P 500.
- A market with such narrow breadth brings into question the sustainability of the S&P 500's recent rally.

2023 Review – Charts

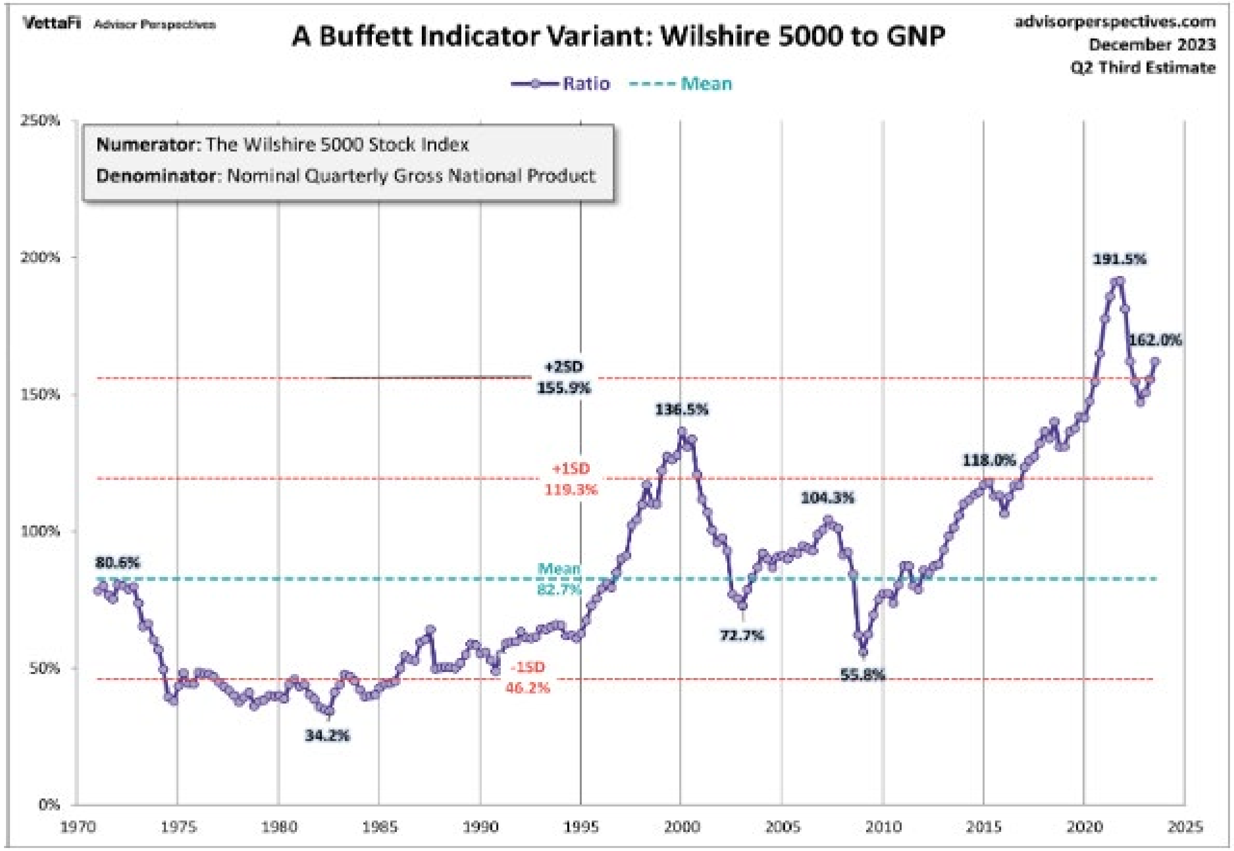
- The above chart shows the 10-year Treasury yield with significant market volatility events highlighted.
- Negative market events act as the catalyst for rates to come down quickly.
- Peaks in the 10-year yield have coincided with periods of market turmoil and if history is any indication a material drawdown in global risk assets may be likely as yields peak in the current cycle.
- Investors should be wary of what market event could drive rates down this cycle.

2023 Review – Charts



- Investor credit balances and margin debt overlayed with S&P 500 performance over the last 43 years. Investors have historically negative credit balances with the market at new highs.
- As markets fall, there is widespread selling of securities causing margin balances to turn positive since investors are required by their brokers to reduce their debt balances, often more than mitigating it.
- Preceding major recessions such as the Tech Bubble (2000) and the Financial Crisis (2007-2008), margin levels tend to peak with the market – making it a useful indicator to watch for future downturns.
- The indicator is trending towards the October 2021 low point, after which the S&P500 slipped into a bear market.

2023 Review – Charts



- The Wilshire 5000 Index, which is a broad-based stock index, divided by the GNP illustrates how risky the market still is relative to the last 50 years.
- This indicator of market valuation measures the market capitalization of public equities relative to Gross National Product in the United States.
- When public market valuations are high relative to GDP (100%+), as they are now, that is an indication that markets may be overvalued.
- As of December 2023 the Buffet Indicator is at its second highest peak since 1970.

Q4 – 2023 – Charts

Chart 1: Ten Year U.S. Treasury Yield (%)

Chart 2: Cdn & U.S. Bond Market Performance

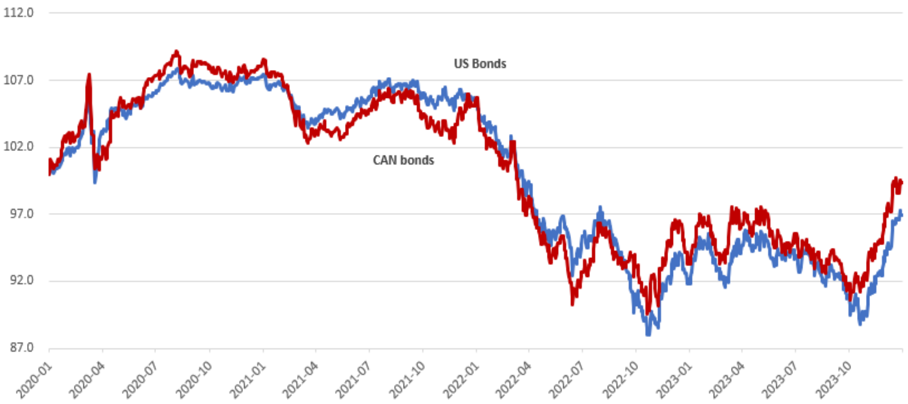


Table 1: Commodities (USD)

	Q4 2023	2023	2022
Commodities	-4.6%	-7.9%	16.1%
Agriculture	-0.7%	-8.3%	12.1%
Copper	3.3%	1.8%	-14.0%
Natural Gas	-24.1%	-62.6%	19.8%
Crude Oil	-20.8%	-10.3%	6.4%
Gold	11.0%	13.5%	-0.1%

Table 2: Summary of Global Equity Returns (Local Currency)

	Q4 2023	2023	2022
Canadian Large Cap: TSX Comp	8.1%	11.8%	-5.8%
US Large Cap: S&P 500	11.7%	26.3%	-18.1%
US Small Cap: Russell 2000	14.0%	16.9%	-20.4%
US REITs	18.0%	11.3%	-25.2%
International: MSCI EAFE	5.0%	16.8%	-6.5%
Japan: TOPIX	2.0%	28.3%	-2.5%
UK: FTSE 100	2.3%	7.9%	4.7%
Eurozone: Euro Stoxx 50	8.6%	23.2%	-8.8%
Emerging Markets: MSCI EM	7.9%	9.8%	-20.1%

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