



GOLD INVESTMENT
PORTFOLIO MANAGER

Investment Letter

Q4-22 Investment Letter (No. 62)

January 25, 2023

OVERVIEW

Dear Clients and Friends,

We are pleased to provide this quarterly report for the period ended December 31, 2022. This report will be divided into three sections: (1) What's New, (2) Market Recap, and (3) Commentary.

WHAT'S NEW

2023 REVIEWS

GIM would like to remind you of its obligations to conduct annual "Know Your Client" ("KYC") reviews. Investment reviews are a great way for us to update you on your account and for you to keep us informed on your personal and financial circumstances so we can best serve you. You may receive communication from our admin department shortly to schedule a review with one of our portfolio managers. If you wish to speak with someone or have a change in your circumstances, please do not hesitate to contact our office anytime.

2023 INVESTMENT SEASON

The TFSA limit for 2023 is \$6,500; you can deposit up to \$88,000 (\$176,000 per couple) if you have never contributed to a TFSA provided you have been over 18 years of age since 2009. RRSP limits for 2022 and 2023 are \$29,210 and \$30,780, respectively; You may be able to contribute up to 18% of your earned income for the prior year up to the annual limit. You are encouraged to check your contribution room with Canada Revenue Agency prior to making a contribution. The deadline for RRSP contributions for the 2023 tax year is March 1, 2023. Other great ways to invest include pre-authorized contributions (PACs), RESPs, RDSPs and open/taxable accounts. Feel free to visit [GIM's investment blog](#) for more information.

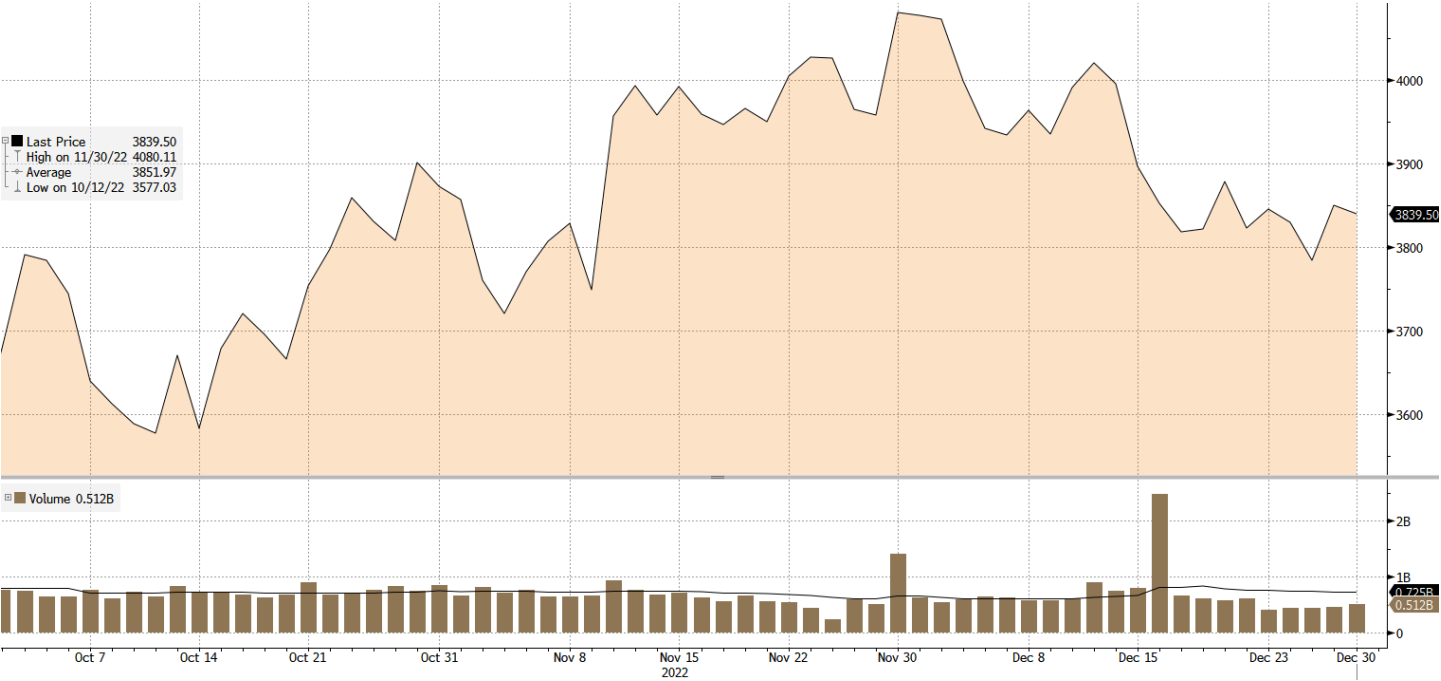
RRSP CONTRIBUTION RECEIPTS

For all clients making RRSP contributions, in response to demand Credential Qtrade Securities (Aviso Wealth) will be generating RRSP contribution receipts more frequently. Contribution receipts for March 2, 2022 to December 31, 2022 are available online and were mailed out the week of January 11, 2023. Receipts for contributions falling between January 1, 2023 to March 1, 2023 will be available online and mailed bi-weekly.

All tax documents are expected to be available by March 23, 2023. If you do not see any tax documents issued in 2023 in Credential's online portal or you have not received anything by mail, then you may not have tax documents for your account(s) for the 2022 tax year. If you have any questions regarding tax documents for your accounts, online login information, document delivery preferences or your mailing address, please do not hesitate to [contact us](#).

MARKET RECAP

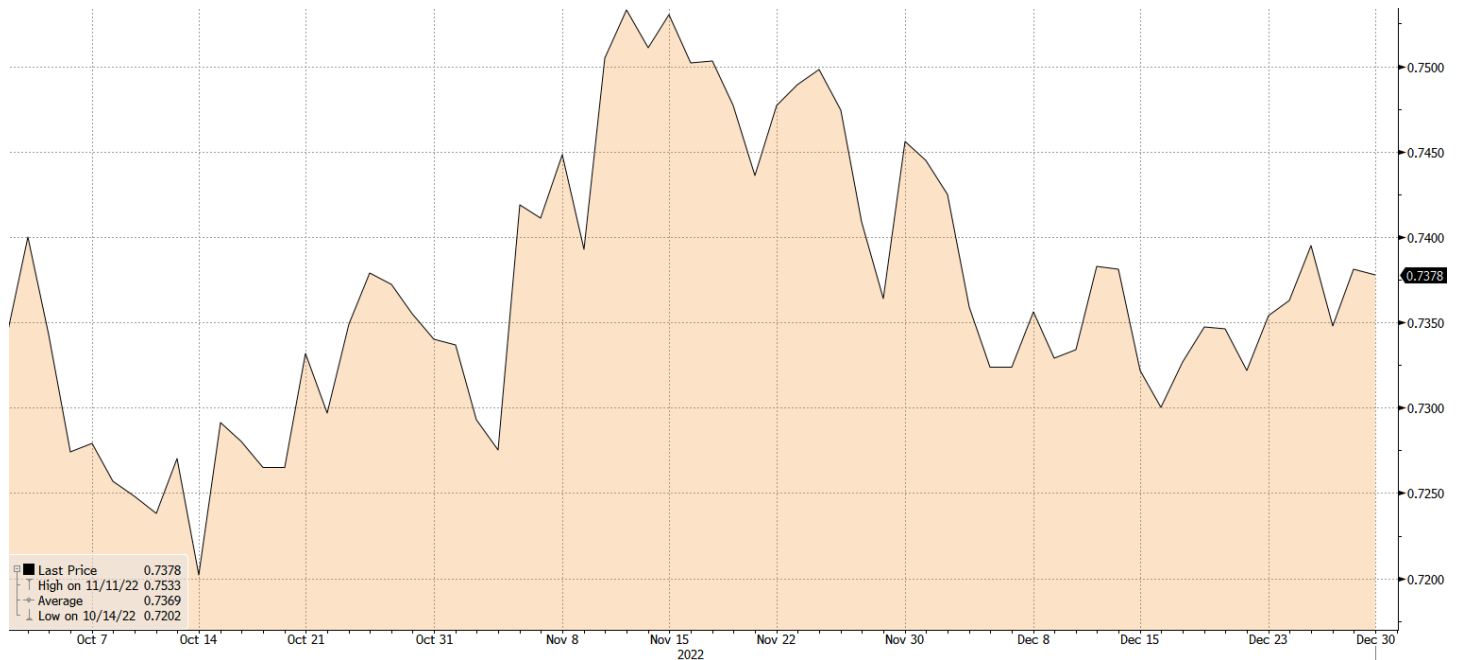
The S&P 500 Index (in USD) increased 6.36% for the three-month period ending December 31, 2022. The Index hit a high of 4,080.11 on November 30, 2022 and a low of 3,577.03 on October 12, 2022.



The S&P/TSX Composite Index increased 4.10% in the final quarter of 2022. The Index reached a high of 20,525.45 on December 1, 2022 compared to its low of 18,206.28 on October 12, 2022.



The Canadian Dollar quoted in USD (CADUSD) declined 1.74% during the fourth quarter of 2022. CAD/USD closed at a low of 0.7202 on October 14, 2022, after it reached a high of 0.7533 on November 11, 2022.



COMMENTARY

Globalization slowdown and the most valuable company in the world.

There is no shortage of topics for this quarter's newsletter, from inflation to the economy, to the war in Ukraine. Our business often requires us to drill down into the details of a particular security and get into the minutiae. However, to be a truly effective asset manager one must also understand geopolitical strategy. This is a topic that is usually difficult to make into an investment case. But for those who can identify the trends early there can be significant investment rewards.

The topic we want to focus on in particular is the re-onshoring of strategic industries. The past 30 to 40 years has seen manufacturing and refining of resources and industries move "offshore" from developed markets to international and emerging markets. We believe this trend will reverse for certain industry sectors.

Part 1. Backdrop. The world benefited from a "peace dividend" after the breakup of the former Soviet Union and the opening up of China's low-cost manufacturing economy. Cheap resources and raw materials from the ex-Soviet blocs and emerging markets, 30 years of falling interest rates in developed countries and extremely low labor costs in countries such as China all contributed to a massive migration of manufacturing from high labor-cost, developed countries such as Japan and the U.S. to emerging markets and third world countries. Labor was an order of magnitude cheaper and regulatory and environmental standards were much lower in the lesser developed parts of the world.

Part 2. And then 2020 to 2022 happened along. Here's a few of the highlights – or lowlights – as the case may be.

The Covid pandemic caused snarling of supply chains worldwide. Goods destined for developed markets failed to get there in a timely manner. This was just the appetizer.

When the war in Ukraine started in February 2022, the world realized that freedom isn't really free. Strong and effective militaries are the price democracies need to pay for our freedoms. In the words of Winston Churchill *"We sleep soundly in our beds because rough men stand ready in the night to visit violence on those who would do us harm."*¹ Appeasement is too often insufficient to keep bad state actors in check; a lesson that needs re-learning as the Ukraine is experiencing trench warfare and artillery duels like WWI and WWII.

The year 2022 also saw Xi Jinping re-elected for a third term of as General Secretary of the Chinese Communist Party at the 20th

¹ www.goodreads.com/quotes/

Party Congress in October. This makes him the *de facto* ruler of China. Perhaps not coincidentally, the period leading up to Xi's re-election also saw a peaking of China's self-proclaimed *wolf-warrior diplomacy* "characterized by the use of confrontational rhetoric by Chinese diplomats, coercive behavior, as well their increased willingness to rebuff criticism of the government and its policies and court controversy in interviews and on social media."² This diplomatic style has caused very real tensions with China's neighbors from physical battles with Indian soldiers – resulting in deaths and injuries³ – to regularly encroaching on Taiwan's air and sea space with its military.

Japan's Minister of Economy, Trade, and Industry Yasutoshi Nishimura eloquently framed the problem with bad state actors in early January 2023.⁴

Japan's economy chief said that democratic powers had made a mistake more than two decades ago in assuming that deepening economic interdependence, by bringing China and then Russia into the World Trade Organization, would "unquestionably bring about a peaceful world" following the end of the Cold War.

Rather than prosperity helping to build peace however, it only ended up increasing geopolitical risks, Nishimura said. Authoritarian governments used economic growth and technological advancement to boost their power.

"The free trade system ended up increasing the legitimacy of authoritarian regimes," he said. "The illusion we embraced ended up amplifying the threat of hegemonic powers."

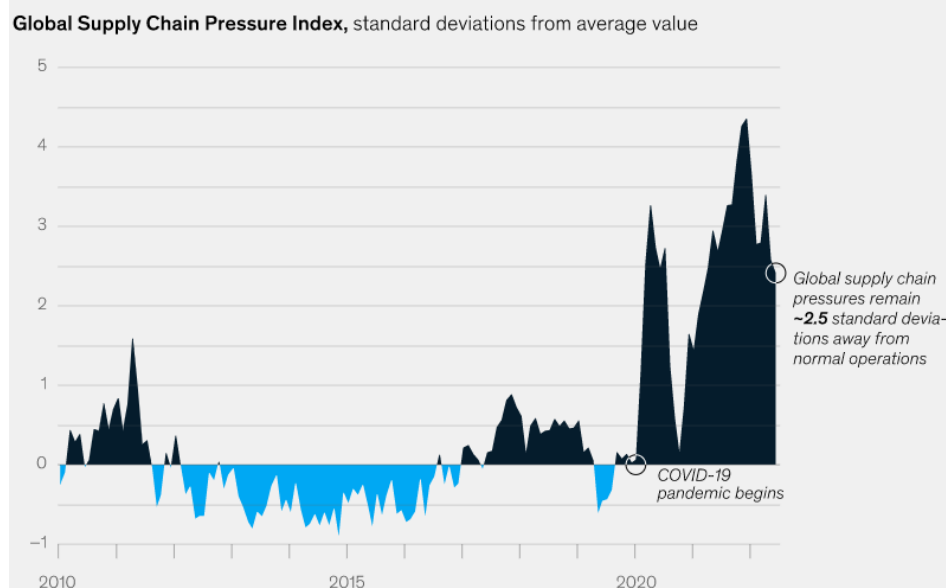
Part 3. Globalization will decline. Western countries did eventually run out of patience and there are economic consequences, the main one being ***we will swap out cheap goods in long supply chains for expensive goods that are secure.***

Western Europe is divesting its use of Russian natural gas. They have or are switching to gas or liquified natural gas from Scandinavia, the Middle East and the U.S. The Europeans are re-opening mothballed generating plants that were shut down when cheaper Russian gas was imported. This is clearly a trade-off of a more reliable supply of energy but at a much more expensive cost.

The main supply chain thesis we want to discuss are semiconductors as this has a direct impact on some of our investments in technology. Semiconductors are the computer chips that are in our appliances, smart phones, cars, jets and pretty much everything else. They are a key part in almost every consumer or industrial product. In a 2022 presentation to an institutional investor, we said that an economic reason Japan attacked Pearl Harbor in WWII was over the oil embargo by the U.S. We believe semiconductors will be the oil of the 21st Century, as we think they are that important.

Chart 1 – Importance of chips

Semiconductor shortages have been a key aspect of global supply chain pressures over the past 18 months.



Source: McKinsey & Company

² en.wikipedia.org/wiki/Wolf_warrior_diplomacy#

³ www.bbc.com/news/world-asia-53062484

⁴ time.com/6245021/japan-g7-economic-coercion-china/

“The chips are down: The United States makes 12 percent of the world’s semiconductors, compared with 37 percent in the 1990s, according to US government statistics. Many US firms are dependent on chips made abroad, and the fragility of those supply chains has been laid bare over the past 18 months. Moreover, McKinsey research estimates that worldwide demand will keep growing, with semiconductors poised to become a \$1 trillion industry by the end of the decade.” Source: McKinsey & Company

Enter Taiwan Semiconductor Manufacturing Company (“TSM”). TSM produces over 90% of the world’s advanced semiconductor chips and Taiwan is a staunch ally of the U.S. China manufactures many industrial products, but it does not have plants that produce high-end chips and, until 2022, imported the required finished goods from TSM in Taiwan. The final piece to this situation is that the U.S. and Europe do not currently produce much of these advanced chips, it is done in Taiwan which has a belligerent China right across the Taiwan Strait.

In late 2022 the U.S. passed the US\$280 billion Chips Act, which aims to bring production of semi-conductor chips onto U.S. soil and concurrently President Biden has banned the sale of advanced computer chips and the equipment to make them to China.^{5,6}

The table below show TSM’s business is skewed to high-end and North American sales, namely the U.S. While China is only 10-11% of revenue, we strongly suspect that this business consists of sales of the high-end chips that China does not have the capacity to make. This will include chips used by the Chinese state for its advanced government and military applications. TSM’s sales to China will be in decline going forward.

Table 1 – Taiwan Semiconductor Manufacturing

Net Revenue by Platform	2022	2021
High Performance Computing	41%	37%
Smartphone	39%	44%
Internet of Things	9%	8%
Automotive	5%	4%
Digital Consumer Electronics	3%	4%
Others	3%	3%

Net Revenue by Geography	2022	2021
North America	68%	65%
China	11%	10%
Asia Pacific	11%	14%
EMEA	5%	6%
Japan	5%	5%

Source: TSM 4Q2022 Report, Jan 12, 2023

Part 4. Summary. The strategy behind advanced technology is based on U.S. industrial policy being re-gearred towards self-sufficiency instead of cheaper but more fragile international supply chains. Domestic producers of goods and services in certain sectors, such as technology, will be favored over foreign suppliers.⁷ We do not believe this is necessarily protectionist. Rather it is aimed at maintaining the lead in industrial technology and countering the belligerency of hostile states.

- China does not produce advanced chips needed by leading industrial (including military), commercial, and consumer applications. The chips that are used in today’s smart phones and smart bombs come from Taiwan. China does make the lower end chips, but these are several generations behind the latest.
- It has become clear in the past decade that the ability to manufacture the latest chips is not easy and takes particular skill. TSM is first amongst equals in the very few companies that possesses this ability. China, furthermore, does not produce the advanced machinery needed to make semiconductors, which is a separate skill set unto itself. The suppliers of over 50% of the advanced equipment needed are American and European.⁷
- In investing terminology, we would say that TSM has a *high moat* business or a *high barrier to entry*, which is excellent from an investor viewpoint. This makes it very difficult for competitors to enter the sector and take market share away.

⁵ www.mckinsey.com/industries/public-and-social-sector/our-insights/the-chips-and-science-act-heres-whats-in-it

⁶ www.vox.com/world/2022/11/5/23440525/biden-administration-semiconductor-export-ban-china

⁷ [Geopolitical Briefing](#), National Bank Financial, 17JAN2023

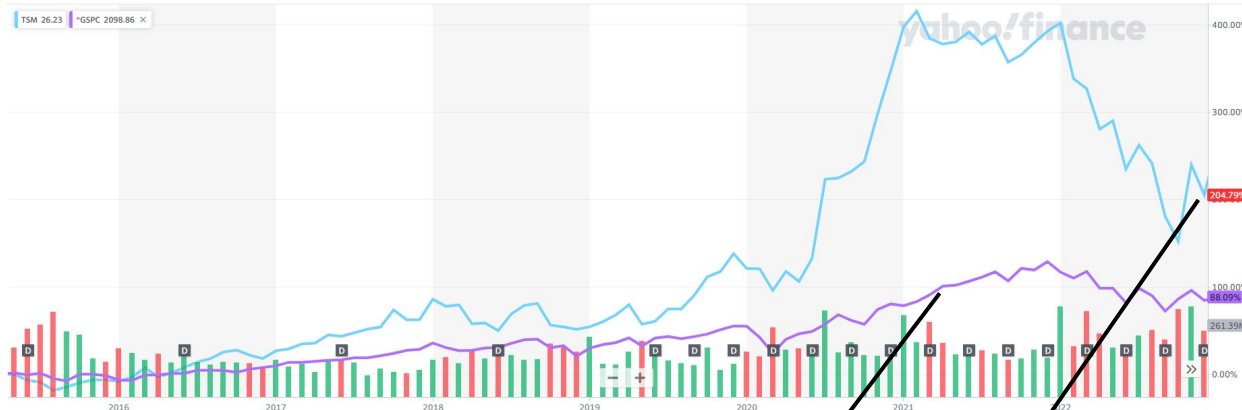
- Taiwan Semiconductor Manufacturing has already announced plans to build its first fabrication plants on U.S. soil due in part to the Chips Act.
- The ban on sales of the machines needed to make advanced chips plus the ban on sales of completed advanced chips are *strategic* moves by the United States to cap the hegemonic behavior of China.

Part 5. Conclusion. Understanding geopolitics is important. There is currently an active attempt to reduce globalization in select industries. In this case it means favoring manufacturing capacity of chips by the U.S. government. The main rationale is not economic – it is strategic. It aims to keep the U.S. ahead of all other countries in terms of economic and military strength.

We believe the most valuable public company in the world right now is Taiwan Semiconductor Manufacturing Company if viewed through a strategic lens. TSM is not the biggest by market capitalization or the most profitable; nor does it have the name recognition of other blue-chip companies. But TSM makes over 90% of the world's advanced microchips, including what is probably used in advanced U.S. military systems, and it is across the Taiwan Strait from a bellicose China. Taiwan itself is a staunch U.S. ally, so convincing TSM to set up manufacturing on U.S. soil was probably not difficult, despite the higher costs of operating in America versus Asia. However, the strengthened quality of the supply chain by moving onshore is regarded as a good trade-off.

We are pleased to say we have been buying TSM for some clients since 2016 as international politics have become more openly played in the past few years. As we stated at the start of this newsletter, strategy is something that portfolio managers need to understand as there will likely be an investment consequence.

Chart 2 – Jan 4, 2016 to Jan 19, 2023: \$1.00 S&P500 price return \$1.88 vs. TSM \$2.05



Source: Yahoo Finance Jan 4, 2016-Jan 19, 2023

S&P500 since 2016 TSM since 2016

Despite the pullback from its high point in 2021 we continued to add TSM as it still fits our criteria: Valuation is reasonable relative to earnings, we like its dividend history (there was a 10% dividend hike in 2021), its strong balance sheet and its unique expertise in making high-end semiconductor and computer chips making it an ultra-high barrier to entry business.

Please note this discussion is not a specific recommendation of TSM for your account. It will depend on your risk tolerance and other suitability factors which are covered during your annual (or more frequent) review.

To our clients, the key remains to think long term and stay invested according to your level of risk. We leave with a saying from legendary investor, Sir John Templeton. ***“The best time to invest is when you have money.”***

Thank you for entrusting us with your investments. As always, we welcome your questions and comments. You can [contact](#) GIM by telephone: 1.888.436.9955, fax: 1.866.541.7947 or email: invest@gold-im.com

Yours truly,

GOLD INVESTMENT MANAGEMENT LTD.

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