GOLD INVESTMENT
PORTFOLIO MANAGER

Investment Letter

Q4-23 Investment Letter (No. 66)

January 30, 2024

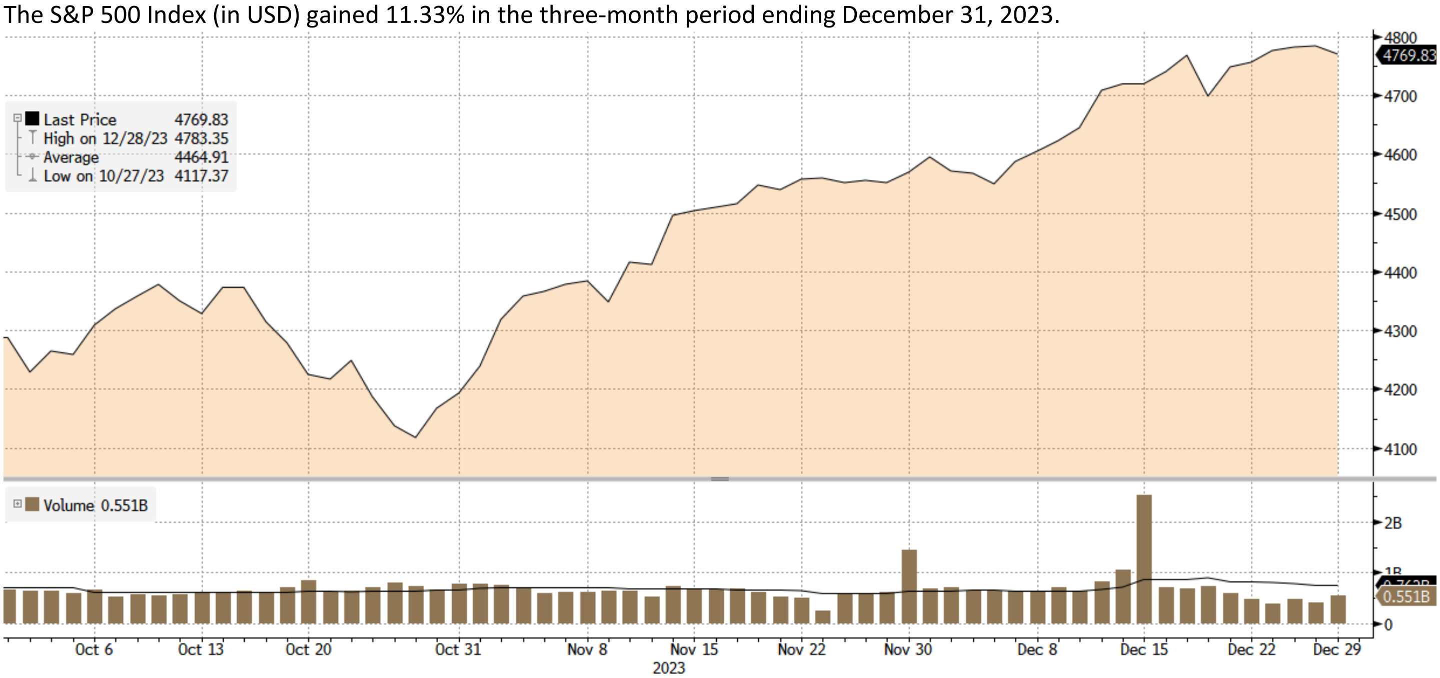
OVERVIEW

Dear Clients and Friends,

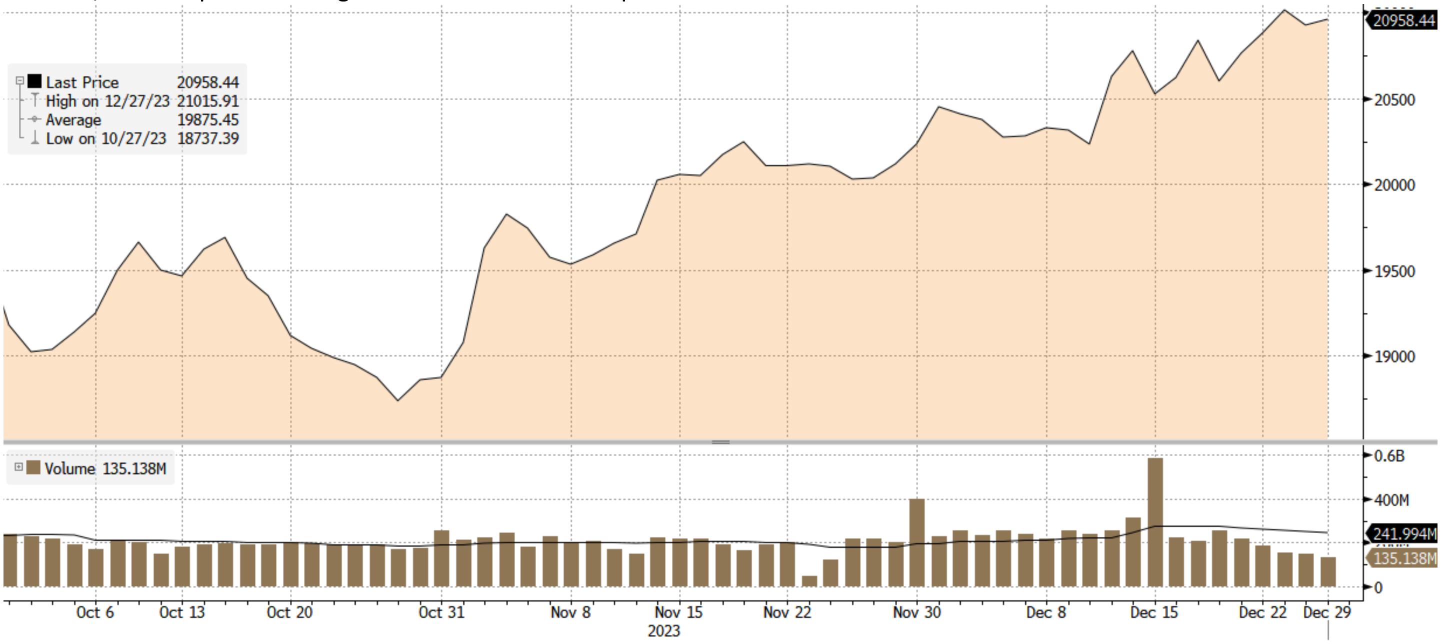
We are pleased to provide this quarterly report for the period ended December 31, 2023. This report will be divided into three sections: (1) Market Recap, (2) What's New and (3) Commentary.

MARKET RECAP

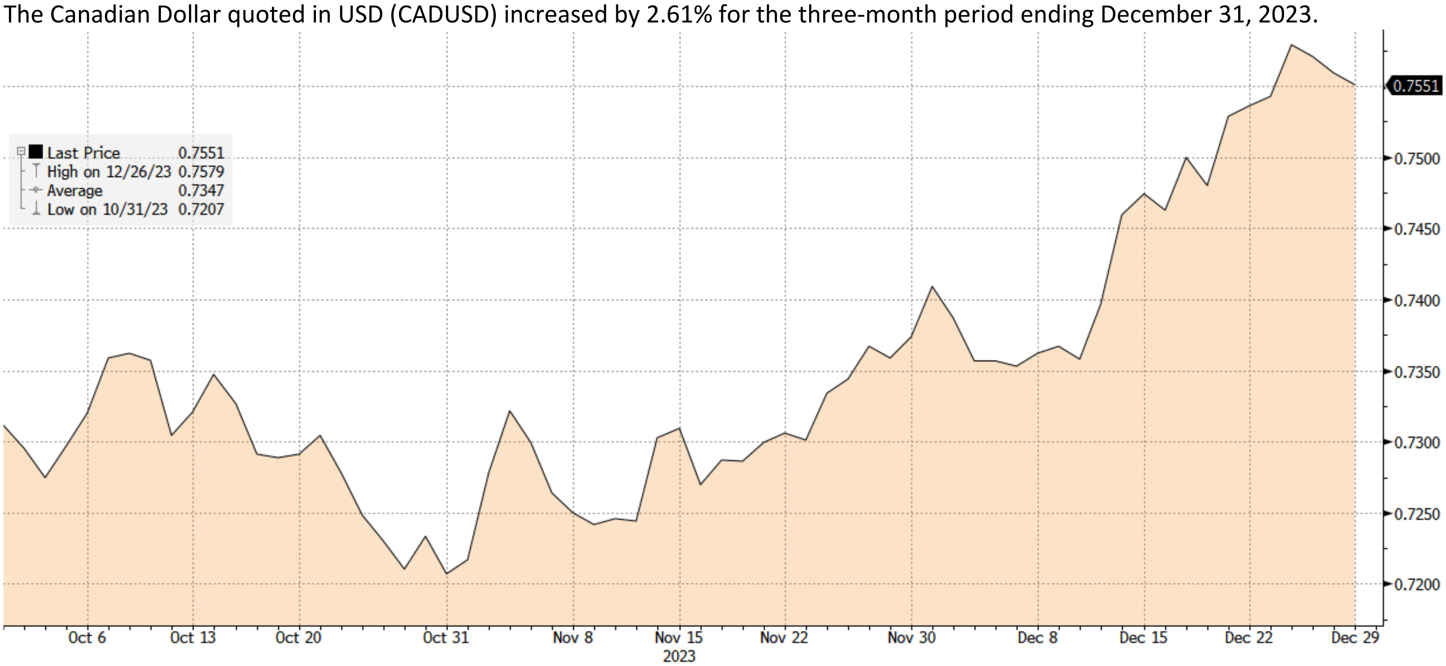
The S&P 500 Index (in USD) gained 11.33% in the three-month period ending December 31, 2023.



The S&P/TSX Composite Index grew 7.36% in the fourth quarter of 2023.



The Canadian Dollar quoted in USD (CADUSD) increased by 2.61% for the three-month period ending December 31, 2023.



WHAT'S NEW

2024 INVESTMENT SEASON

The TFSA limit for 2024 is $7,000; you can deposit up to $95,000 ($190,000 per couple) if you have never contributed to a TFSA provided you have been over 18 years of age since 2009. RRSP limits for 2023 and 2024 are $30,780 and $31,560, respectively; You may be able to contribute up to 18% of your earned income for the prior year up to the annual limit. The deadline for RRSP contributions for the 2024 tax year is February 29, 2024.

First Home Savings Accounts (FHSA) were introduced in 2023 to provide first time homebuyers an opportunity to save to buy a qualifying first home tax-free. The 2024 FHSA limit is $8,000. Carry-forward amounts do not start accumulating until the year you open a FHSA. If you opened a FHSA in 2023, you may have up to $16,000 of room.

You are encouraged to check your contribution room with Canada Revenue Agency prior to making any contributions. 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.

2024 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 TAX DOCUMENTS
All tax documents are expected to be available by March 25, 2024. If you do not see any tax documents issued in 2024 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 2023 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.

COMMENTARY

Part 1. Investors Buy Risk and Rent Returns

2022 and most of 2023 were bearish for both the stock and bond markets. It was not until October 31, 2023 that both asset classes managed a tremendous rally that allowed 2023 to finish in the positive.

To see this clearly we’ve broken out 2 charts, one for calendar 2022 and one for 2023. We’ve used the bond ETF, iShares Core Canadian Universe Bond Index (XBB.TO), to represent the Canadian bond index as that is an investible product available to all investors.

2022 was a bad year. What is truly amazing is that bonds have been far riskier than the stock markets. In 2022, XBB was down almost 14% while the Toronto Stock Exchange was down less than 9%, on price movement. The finance textbooks say that bonds are less risky than stocks but the opposite was true. *Investors in balanced mandates holding stocks and bonds needed to have their bond managers make the appropriate adjustments, or their bond performance would have been worse than their equities.*

Chart 1 – 2022: XBB bonds (Blue, -13.8%), TSX (Purple, -8.7%), S&P500 (Orange, -20%)

Source: Yahoo Finance, price movement

S&P500 divergence in 2023. The next chart shows all 3 assets for 2023. The excellent performance of the S&P500 in 2023 was actually due to only 7 stocks – Apple, Microsoft, Amazon, Nvidia, Alphabet (formerly Google), Meta (formerly Facebook) and Tesla. These names, dubbed the Magnificent 7, were up approximately 75% in 2023 and represent a gigantic 33% of the S&P500 index. If we exclude these 7 names, the rest of the S&P500 was up 12% to Dec. 18, 2023.[1] We have avoided most of these 7 names for clients as we have found the valuations too expensive for our liking; do not forget the S&P500 was down 20% in 2022, so the round-trip was basically about a +3.5% price return over 2 years.

[1] *https://www.dailymail.co.uk/yourmoney/savings/article-12877353/magnificent-seven-stocks-tech-ai-2023.html*

Chart 2: 2023: XBB bonds (Blue, +3.4%), TSX (Purple + 7.7%), S&P500 (Orange, +23.5%)

Source: Yahoo Finance, price movement

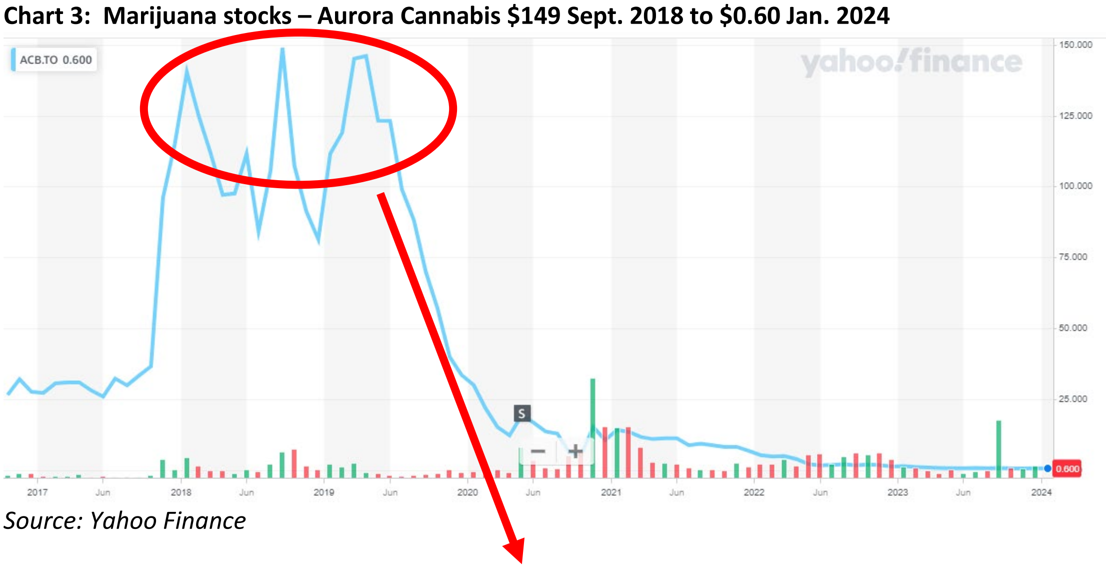
<u>Chasing prices means renting returns</u>. The very narrow leadership by the Magnificent 7 is exactly what we want to talk about. There is a huge element of something called price momentum in the Magnificent 7. Simply put, people are buying them because they are going up.

This was the topic of a Barron's article at the end of the year (emphasis ours).[2]

> *"After the different crises over the past 25 years, 2023 provided evidence of how investor behavior has changed after the market has overcome those episodes. We have come to believe that **many investors rent returns and own risks**. They play a winning hand for a year more, but they ultimately give back some or all of their gains to thoughtful investors who understand that investment success is not defined by a year or two of high gains but **years of consistent returns and managing risk**... gains appear as fact, even if they're unrealized, and risk doesn't exist – until it does."*

<u>Conclusion</u>. We saw the same price-chasing behavior for marijuana stocks a few years ago and cryptocurrency recently. Here's an illustration of what can happen.

Chart 3: Marijuana stocks – Aurora Cannabis $149 Sept. 2018 to $0.60 Jan. 2024



Source: Yahoo Finance

> **Classic price chasing example**. A double and triple top formed, to pull in the last marginal buyer based on "fear of missing out". Then once all the buyers are all-in, a spectacular price collapse of 99.6%. This is what <u>Barron's</u> means by "*gains appear as fact, even if they're unrealized, and risk doesn't exist – until it does*" [2]

[2] *"What went right for investors in 2023 can go wrong in 2024", Steven M. Sears, <u>Barron's</u>, Dec. 27, 2023*

Chasing prices, by default, means there is no consideration for the level of ***risk*** being taken. Here's the problem: today's buyers of the Magnificent 7 are relying on selling to the last marginal buyer before getting out. But no one is smart enough to sell at the peak. So instead of owning the returns and managing risk (renting risk, in Barron's words), such investors do the worst thing which is to rent the return (have paper gains for a short time) and buy the risk (ultimately losing money). We have told clients during annual reviews when trying to educate about risk ***it's not what you make, it's what you keep***.

Part 2. Interest Rates – Higher for Longer

Canadian inflation. The Canadian inflation rate for December was released on January 16, 2024. Headline inflation went up from 3.1% in November 2023 to 3.4% in December 2023. No, this is not a typo. Inflation went up even after all the interest rate increases since 2021.

The culprits for the higher inflation number were the usual suspects of mortgage costs (for homeowners), rental costs (for those that don't own homes), gasoline prices and food (grocery inflation 4.7% y/y).[3] The economics team at BMO also believes wage trends are now sticking at 4-5%. This makes the Bank of Canada's (BoC's) inflation target of 2% more difficult to achieve.

The markets had been hoping for an interest rate cut by the BoC until January 16, 2024. If interest rates go up (bond yields), then bond prices go down. Bonds yields were gradually declining until January 16, when the bond market realized interest rates will not likely be cut in the near future due to the problem of wrestling inflation down. BMO economists believe we may now see a rate cut some time in the second half of 2024, a figure we agree with. [3, 4]

U.S. inflation. The U.S. general inflation rate for December 2023 was up 3.4% and this was higher than consensus of 3.2% inflation. Like Canada, inflation remains sticky and hard to get down. Also like Canada, the U.S. central bank, the Federal Reserve (Fed), will need to see clear signs of falling inflation before an interest rate cut. BMO's economists also look to at least mid-2024 before interest rates fall.[4]

This time it's different. A recession is defined as 2 quarters of economic slowdown. Normally aggressively rising interest rates like we've seen will cause a severe recession, with high unemployment. When people lose their jobs, they stop spending money which slows down the economy, at which point interest rates can come down. This time is different. Firstly, we haven't seen a deep recession, if any at all. Secondly, this time there are lots of jobs as the economy has been quite resilient.

Table 1: Interest Rates Stay Higher for Longer in Canada and U.S.

CANADA	**Q1 24**	**Q2 24**	**Q3 24**	**Q4 24**	**Full 2024**	**Notes**
Real GDP (q/q)	0.0%	1.0%	1.5%	2.0%	0.5%	GDP less inflation
CPI (inflation) (y/y)	3.3%	3.1%	2.4%	2.4%	2.8%	
Unemployment	6.0%	6.3%	6.5%	6.5%	6.3%	Lots of jobs
BoC Overnight Rate	5.00%	4.92%	4.50%	4.17%	4.65%	2H2024 drop
U.S.A.	**Q1 24**	**Q2 24**	**Q3 24**	**Q4 24**	**Full 2024**	**Notes**
Real GDP (q/q)	0.6%	0.8%	1.3%	1.5%	1.5%	GDP less inflation
CPI (inflation) (y/y)	3.0%	3.0%	2.7%	2.6%	2.8%	
Unemployment	3.9%	4.1%	4.3%	4.3%	4.2%	Lots of jobs
Fed Funds Rate	5.38%	5.38%	5.04%	4.63%	5.1%	2H2024 drop

Source: BMO focus, Jan. 12, 2024

Conclusion. Relief from falling interest rates is not in the forecast for the short term. Interest rates will stay higher for longer. With over 3% general inflation and 4.7% grocery inflation, a GIC or bank deposit will not keep up with the cost of living.

A plain 1 year GIC at the Royal Bank is 4.90% and you will at a minimum forfeit your interest if you need to cash out early. Even if you get your interest, the interest is taxable and if you are at the 50% marginal tax rate you will only net 2.45%, not enough to keep up with the cost of living. If you hold that 1 year Royal Bank GIC in a tax-sheltered account (such as a RSP) the rate is only 4.00%.[5]

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[3] *BMO EconoFACTS, January 16, 2024*

[4] *BMO focus, 12JAN2024*

[5] *www.rbcroyalbank.com/investments/gic-rates.html www.rbcroyalbank.com/rates/rsp.html 17JAN2024*

We had to click through some fine print on RBC's website to find this out, but the point is there is no free lunch.

In conclusion, due to the need to raise interest rates to fight inflation, all investors and our clients will have to put up with interest rates being higher for longer than any of us would like. We need to be invested in the market to keep up with living expenses but that means we need to also tolerate volatility in our investments.

Part 3. Summary

Firstly, interest rates will stay higher for long to fight inflation which is proving to be sticky. Anyone with investments or retirement savings need to be invested in the markets in order to have the chance to keep up with the cost of living. The trade-off is there will be volatility, namely asset prices will bounce around. But the alternative of a GIC/deposit means your money will lose its purchasing power after inflation even if the bank statement looks unchanged.

Secondly, the failure to not consider the riskiness of an investment is what gets investors into trouble. Barron's final paragraph sums this up nicely.

> *"Few people are disciplined enough to sit tight in a well-curated portfolio of blue-chip stocks. Instead, they are hostages to their own emotional swings, and that inevitably hurts them."* [2]

Modern investment markets are the most democratic thing. The markets do not care about social status, wealth, politics, or occupation. Anyone can invest $100.00 or $100 million. The only thing the market cares about is if the right decisions over the long term have been made.

Investors that understand the prudence of taking the riskiness of an investment into consideration are the ones that will survive and do well through the up and down cycles. These types of investors will *rent risk* when there is opportunity and end up *owning returns*. We leave with a relevant quote from the strategist Sun Tzu who understood that warfare is all about understanding risk.

> *"Victorious warriors win first and then go to war, while defeated warriors go to war first and then seek to win."* – Sun Tzu [6]

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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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[6] *https://wealthygorilla.com/35-powerful-sun-tzu-quotes-art-war/#*

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