GOLD INVESTMENT
PORTFOLIO MANAGER

Investment Letter

Q1-24 Investment Letter (No. 67)

April 22, 2024

OVERVIEW

Dear Clients and Friends,

We are pleased to provide this quarterly report for the period ended March 31, 2024. This report will be divided into three sections: (1) What's New, (2) Market Recap and (3) Commentary.

WHAT'S NEW

AVISO CORRESPONDENT PARTNERS - NAME CHANGE

On April 1, 2024, Aviso's two dealers - Credential Qtrade Securities Inc. and Credential Asset Management Inc. - merged to form Aviso Financial Inc., a dual-registered dealer regulated by the Canadian Investment Regulatory Organization. As a result, any clients who held accounts with Credential Qtrade Securities Inc. will now be custodied by Aviso Correspondent Partners, a division of Aviso Financial Inc. A concise recap provided by Aviso can be viewed by following this link: https://www.aviso.ca/en/news-media/legal-and-trade-name-change

Although this is a new name, it is the same trusted partnership, and your account has not changed. Gold Investment Management's role has not changed, and we continue to act as your Portfolio Manager. You will notice the new Aviso logo on your documents:

The client portal, formerly known as Credential Online, is now known as Aviso Online. The login screen can be accessed by following this link: https://online.aviso.ca/login.aspx, or by being redirected from the old login page. We encourage clients to update any bookmarks to the new URL.

NEW GIM QUICK REFERENCE GUIDE

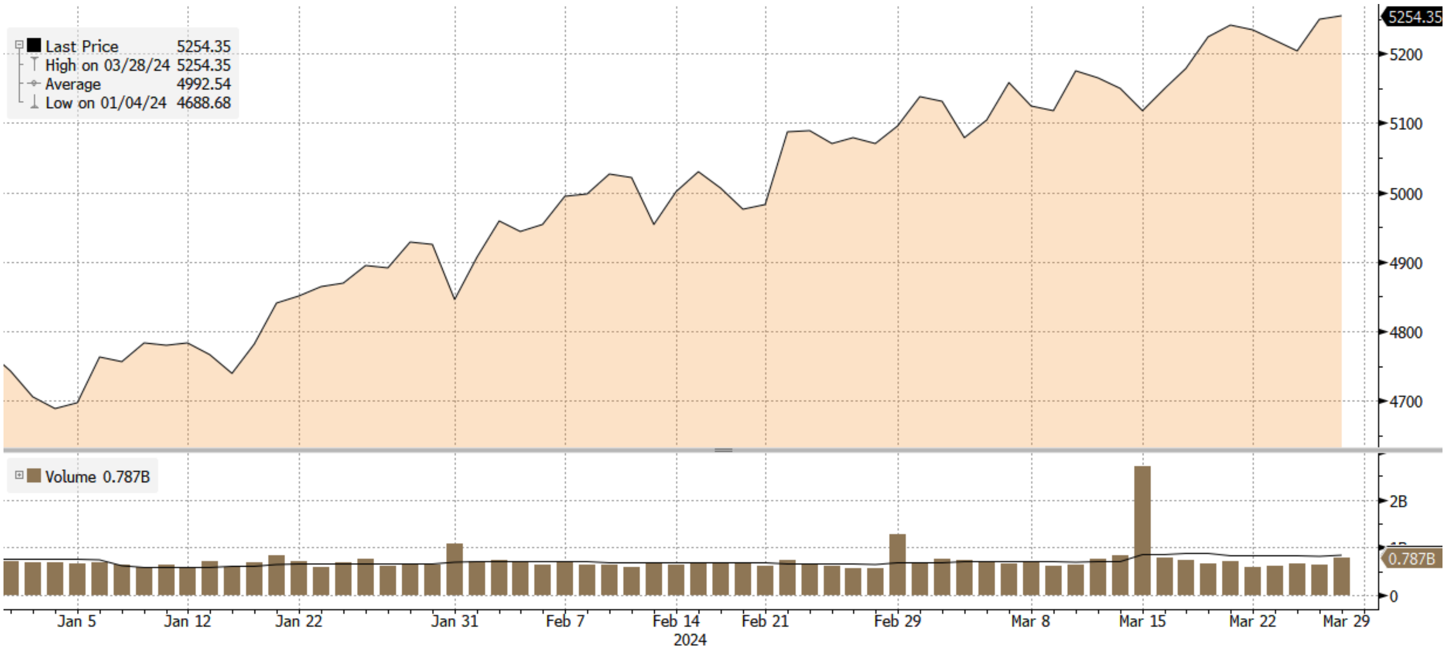
In light of the recent name change for Aviso Financial Inc. we have updated our GIM Quick Reference Guide. Please follow the link to bookmark, download, or print a new copy. The document contains quick information about how to contact us and make a deposit or withdrawal.

BUDGET 2024

Do you have questions about Budget 2024 including the increase to the capital gains inclusion rate? Don't hesitate to contact us – we can answer your questions and conduct your 2024 account review as well.

MARKET RECAP

The S&P 500 Index (in USD) gained 10.73% in the three-month period ending March 31, 2024.



The S&P/TSX Composite Index grew 6.04% in the first quarter of 2024.

The Canadian Dollar quoted in USD (CADUSD) decreased by 2.09% for the first three months of 2024.

COMMENTARY

The North American Decade

Production of goods has left North America for low-cost countries in the past 30+ years. Whether it is production of clothing and socks in Bangladesh and Honduras or the manufacturing of tools and machinery in China, this has been a worldwide trend for all industrialized countries. The trade-off to lower cost goods was long transportation costs and, as we found out during COVID, a higher risk of the supply chains failing.

Regular readers of our newsletter will know we have been saying there will be a very large boost to the re-industrialization, or re-onshoring, of the North American economy in the next 10+ years. Costs may be higher, but the big benefits are supply chain risk will be lower, transportation distances shortened, and political risk diminished.

We think the re-onshoring of industrial production is going to be a major structural change to the North American economy. We believe all our clients need to be aware of this. So, we are going to do a deeper dive into our rationale and explain how we positioned investments for this trend.

Please bear with us as this topic requires some explanation. Instead of covering a few topics, this newsletter will only discuss re-onshoring due to its length.

Part 1- Trade Barriers

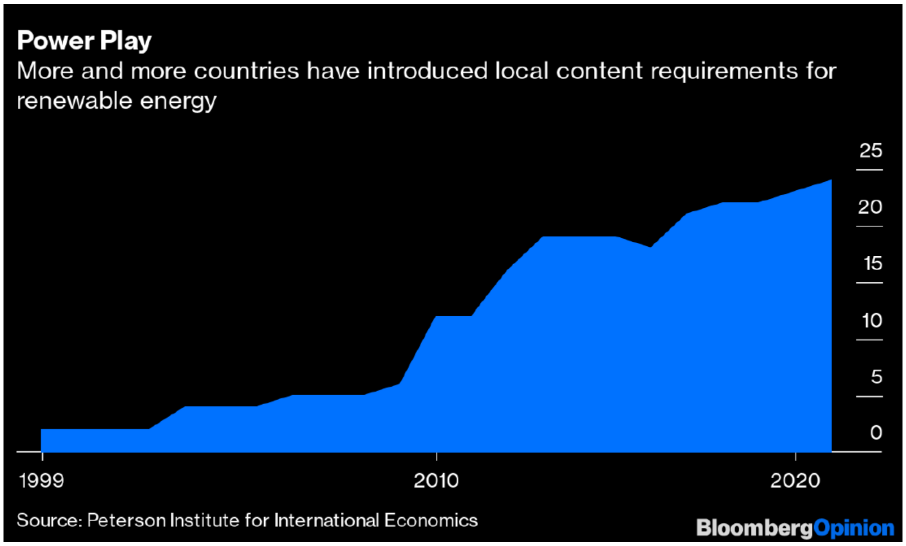
There is one additional imperative to boost re-onshoring, this being domestic protectionism. We think of protectionist behavior as being done through non-tariff and tariff barriers.

<u>Non-tariff barriers:</u> Let us use a real example of something topical, renewable energy.

China produces the vast majority of solar panels and lithium used for converting sunlight to electricity. China produces 80% of the world's solar panels and related products and it consumes about 40% of the world's supply of lithium, a key mineral in making electric vehicle (EV) batteries.[1] The response from countries that import Lithium-based batteries and solar panels has been to require more domestic content. This is a way to "ban a technology without outlawing it".[2]

[1] *https://interestingengineering.com/innovation/china-becomes-solar-energy-superpower-dominates-80-of-supply-chain*
https://www.wired.com/story/china-lithium-mining-production
[2] *<u>Your Local Solar Plant May Hold Back Net Zero</u>, David Fickling, Bloomberg, March 5, 2023*

Chart 1 – Rising Local Content Requirements for Renewable Energy



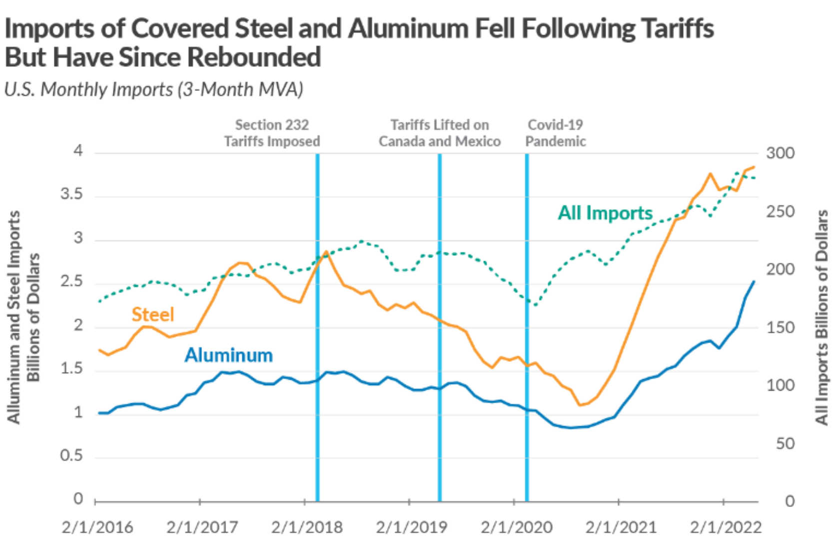
Source: Your Local Solar Plant May Hold Back Net Zero, David Fickling, Bloomberg, March 5, 2023

The result is that costs for the end users, namely consumers, go up from these policies. The irony is not lost on us. We want cheap stuff from emerging countries, but we will selectively ban their imports when it suits us. In the case of renewable energy products, a non-tariff barrier of requiring more domestic content is implemented.

Tariff barriers: Steel has always been a good example when it comes to the U.S. imposing tariffs. Tariffs are duties or taxes that are to be paid when a product is imported.

Low-cost producers like China have built up massive production infrastructures which still need to be constantly running in order to be profitable. The blast furnace for making steel is designed to stay running all the time, whether the price of finished metal is $1.00 or $100,000. When steel prices are low China is often accused of "dumping" it at a low price in developed markets like the U.S.A., which typically sparks a tariff response from the Americans. The next chart shows former President Trump imposing tariffs on steel imports in 2018, with a subsequent decline in the value of imports. Steel imports then rose dramatically after the tariffs were lifted in 2019 and the U.S. exited the COVID pandemic. [3]

Chart 2 – Steel Tariffs Caused Import Declines in 2018

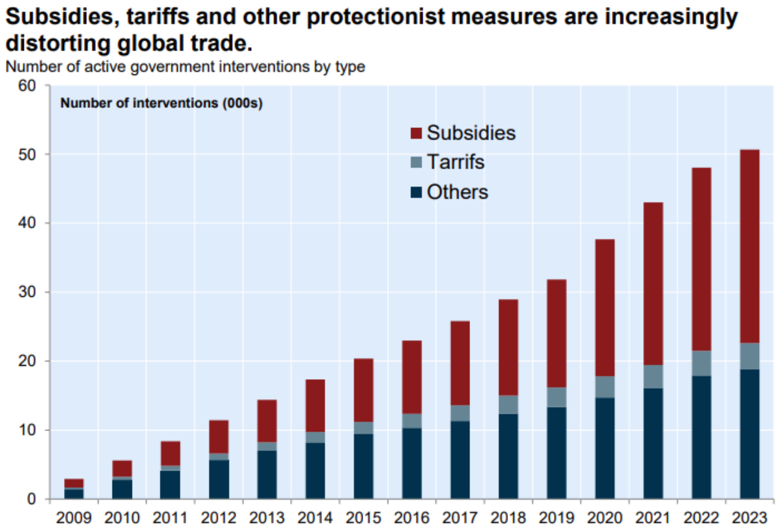


Source: https://taxfoundation.org/research/all/federal/section-232-tariffs-steel-aluminum/

[3] *https://www.reuters.com/markets/commodities/us-impose-tariffs-tin-mill-steel-canada-china-germany-commerce-dept-2023-08-17/*

Conclusion: The distortions caused by government subsidies, tariffs and other barriers has risen dramatically over the past 10 years and there is no indication it will stop. For American companies, this will create a push to decouple from China and transition to countries where trade barriers are lower – namely Canada and, more importantly, Mexico. These 3 countries renewed their free trade agreement in 2018.

Chart 3 – Barriers to Free Trade Rising Globally



Source: Geopolitical Briefing, National Bank Financial, November 17, 2023

Part 2 – Mosaic Theory

Analysts are supposed to be trained to take different pieces of information and put together a final picture with an investment conclusion. This with a Chartered Financial Analyst (CFA) Level 1 topic for investment analysts called *mosaic theory*, which is what we will now do.

There are additional items that favor re-industrializing North America. We will now fold in comments we made in previous newsletters.

- Canada, the U.S. and Mexico have USMCA, the successor to the NAFTA free trade agreement between the 3 countries. Goods made in any country will be exportable to the other countries with minimum trade barriers.

- Geopolitical tensions between China-U.S.A. The U.S. administration has come to the realization that China is going to be a global competitor for power. A couple of examples: (i) There are tensions over China's threat to take over Taiwan by invasion. (ii) Blatant espionage by the Chinese government – for example the spy balloon incident in 2023 where a balloon from China with a payload of 2 or 3 school buses was shot down and studied by the U.S.[4]

- With increased geopolitical tensions with China, there are added economic & military concerns:
  - The supply of strategic finished goods (semiconductor chips) from Taiwan. Taiwan Semiconductor Manufacturing Company makes over 90% of the world's advanced chips and many pieces of U.S. military or industrial hardware now require computer chips.[5] *In our opinion, semiconductors are now a strategic asset, and the U.S. will do whatever it takes to maintain a secure supply*.
  - The poor balance of trade the U.S. has with China. The U.S. goods & services trade deficit with China was US$367 billion in 2022.[6] This means that the U.S. buys way more product than it sells.

- China has not only threatened Taiwan with invasion, it has active disputes with the Philippines and India. In the Philippines there is a dispute over territory and fishing and mineral rights in the West Philippine Sea. On the Indian border there is actually a war between the Indian and Chinese armies, except both sides have agreed to not use guns – truth is really stranger than fiction sometimes.[7] In the face of China's disputes with its neighbors, a mistake could erupt into a real war which will affect supply chains to North America.

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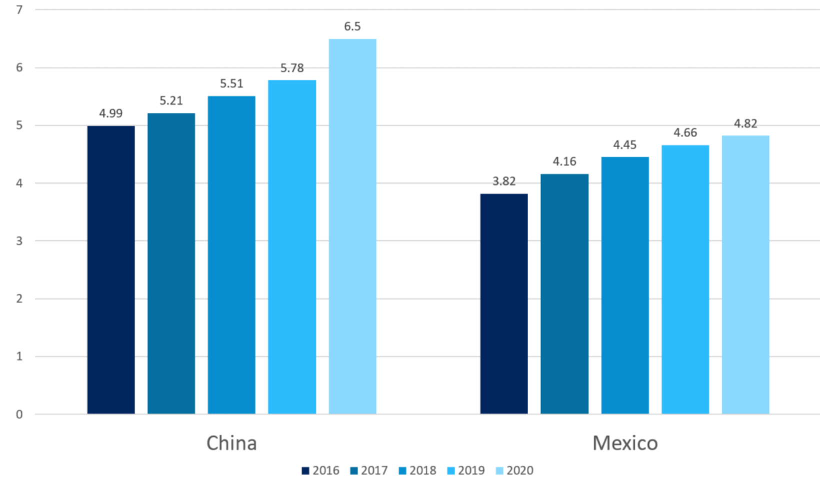
[4] *https://en.wikipedia.org/wiki/2023_Chinese_balloon_incident*
[5] *https://www.forbes.com/sites/katharinabuchholz/2023/01/13/advanced-microchip-production-relies-on-taiwan/*
[6] *https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china*
[7] *https://fsi.gov.ph/philippines-china-relations-beyond-the-territoral-disputes/ ; https://en.wikipedia.org/wiki/Sino-Indian_border_dispute*

- Long transportation networks from Asia to North America proved to be fragile during global events like COVID. In case of a military confrontation or economic sanctions, long supply chains will be at extraordinary risk.

- The median (average) age in Mexico is around 29 years and China's is 37 years. Mexican workers also earn less than their Chinese counterparts.

Chart 4 – Manufacturing Labor Costs Per Hour (in U.S.$)



Source: https://mexcentrix.com/manufacturing-in-mexico-vs-china/

- We are aware of the problems facing Mexico. Here are a few: [8]
    - Half the population lives in a narrow strip of land that encompasses Mexico City, the capital, and is less than 20% of all of Mexico's land. The problem is that northern Mexico is hot and arid with little water and the south of Mexico is tropical rainforest. The north badly needs infrastructure development, and the south will require environmental protection for its rainforests.
    - Poverty is still an issue and there are ongoing problems with crime and cartels.
    - Taxes and red-tape bureaucracy are well-known problems for private businesses. This causes distortions in the labor force, in health-and-safety as many people work informally, which also leads to less corporate taxes collected.

However, we believe the problems will gradually decline as Mexico's middle class increases from re-onshoring of industrial production. For example, we think young people will choose a job building cars and owning a home with security for their family instead of the dangers of joining a gang because there are no alternatives.

Conclusion: Mexico will become of strategic importance for U.S. manufacturing. Mexico has a younger workforce that costs less than a major exporter like China, it operates under a free trade agreement, supply lines are shorter, many southern U.S. states have Spanish as a second language, and Mexico is not threatening its neighbors like China has with India, Taiwan and the Philippines.

Part 3 – Where We Are Investing

Here are a few actual examples of re-onshoring (or near-shoring) in North America.

1. 50 electric vehicle battery plants will open in North America (2 in Canada) in the next 5-10 years.
2. Telsa, Mattel, and Unilever announced plant investments in northern Mexico.
3. Foxconn (a Taiwanese semiconductor maker) is developing sites in Mexico.
4. There have been over 50 greenfield opportunities and upgrades of solar projects announced within last 2 years in North America.[9]
5. We mentioned earlier that semiconductors are considered a strategic asset, critical for the function of the U.S. military and economy. Under the 2022 Chips & Science Act ("Chips Act"), Taiwan Semiconductor Manufacturing Company has received US$6.6 billion to set up over US$65 billion of manufacturing capacity in Arizona, with construction started in 2021.[10]
6. After the Chips Act, in 2022 Brookfield Infrastructure took 49% interest in a semiconductor manufacturing facility with Intel.[11]

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[8] *https://www.youtube.com/watch?v=YzgMePQvSdc*
http://www.geo-ref.net/ph/mex.htm
https://www.economist.com/the-americas/2022/03/19/why-mexicos-economy-underperforms

[9] *Focus On Nearshoring, Scotia Capital, November 2023.*

[10] *https://www.investopedia.com/tmsc-gets-usd6-6-billion-in-chips-act-funding-stock-rises-8628158#*

[11] *https://bip.brookfield.com/press-releases/bip/brookfield-infrastructure-signs-definitive-agreement-intel*

There are multiple ways to position for the re-onshoring trend. There are telecom and technology services – data centers, technology plants, and telecommunications companies. There is construction and building materials. There are opportunities in logistics and transportation.

We have deliberately positioned our clients in the areas of transportation and technology. For transportation we have loaded up on railroad stocks. In technology we have focused on semiconductors.

i. Transportation/logistics: For clients in equity portfolios where it is suitable, we have purchased all the Class 1 North American railroads. Railroads are the lifeblood of North America. Goods and services must travel east-west and north-south. Trucking and air cargo are competitive options for long haul, but they are more expensive and have limited capacity. Waterways are cheaper than railroads for transportation, but there is only the Gulf of St. Lawrence and the Mississippi River. With more industrial production across Canada, the U.S. and Mexico, all railroads will benefit from the added demand for transportation.

   We formerly owned Kansas City Southern ("KSU") in client portfolios. *KSU is the only U.S. railroad to have a line that goes to Mexico*. KSU was purchased by CP Rail in December 2021 in US$31 billion merger.[12] We believe the railroads have been positioning themselves to benefit from re-onshoring and it was the genesis of the CP/KSU merger. KSU shareholders had their shares taken out at a premium to the pre-merger announcement price and, best of all, we also owned CP Rail at the same time. When the dust settled, we were able to roll most of the KSU shares and all of the CP shares into the merged CPKC Railroad. We think there will be further upside to owning CPKC Rail and it is a likely candidate for a "forever holding".

ii. Semiconductors: For accounts where it is suitable, we focus on Taiwan Semiconductor Manufacturing Company ("TSM"), Applied Materials, Inc. ("AMAT") and Hoya Corporation in Japan ("HOCPY"). We also hold other semiconductor companies for institutional clients.

   The main theme is that these are the companies that are involved in the actual production of semiconductor chips. It bears saying: it is the *manufacturing* component of semiconductors that is of *strategic* importance to the U.S.A. The U.S. is arguably the largest advanced economy in the world and its military and economy absolutely requires the ability to manufacture advanced chips. Semiconductor companies like NVIDIA Corporation may be excellent companies, but it is a chip design house with no manufacturing capacity – it is TSM which has been contracted to make NVIDIA's chips.[13]

   For clients with Exchange Traded Funds (ETFs) in their portfolio, where suitable we have been reducing emerging and international markets exposure and adding the iShares Semiconductor ETF ("SOXX") as the top 15 holdings include TSM and AMAT. [14]

Part 4 – Summary

We believe our Class 1 railroads are virtually "forever holds". They stand to benefit from the re-onshoring of industrial manufacturing in Canada, the U.S.A. and Mexico. Mexico at this point seems to have the biggest tailwind as it has a younger and lower paid workforce than China, the current manufacturer to the world.

Our semiconductor holdings are more cyclical, but this is a sector that has performed very well over the long term. There have been multiple announcements of new manufacturing facilities being constructed in the U.S. and Mexico and these are going to permanently create high value-added products with good jobs in the North American economy.

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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.

[12] *https://www.freightwaves.com/news/canadian-pacific-and-kansas-city-southern-officially-merge#*
[13] *https://www.cnbc.com/2023/05/25/tsmc-asml-two-critical-chip-firms-rally-after-nvidias-earnings.html*
[14] *https://www.ishares.com/us/products/239705/ishares-phlx-semiconductor-etf*

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