ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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A Message from Our President and CEO

It's been a while since I've had the opportunity to connect with all of you. The last year has been a challenging time for everyone. At the beginning of 2020, I wrote an article for this newsletter about how Odlum Brown had nearly 100 years of experience and learning under our belt. Well, since then, I can assure you it feels like we've gained another hundred!

However, in spite of the challenges we have all faced over the last year, it does feel like there is light at the end of the tunnel. I don't know about you, but what I am really looking forward to is seeing people again. I can't wait to see all of my colleagues and our clients again in person and feel the buzz of activity in the office. That "buzz" in both my professional and personal lives is what I've missed the most.

When I look back on this past year, there have certainly been some dark times. But there has been a lot of hope, too. Collectively, as a community, we came together to be good neighbours and support one another. We recognized the commitment and courage of our health care workers and other frontline heroes. We saw what innovation and industry can accomplish when people work together toward a common goal.

At Odlum Brown, we also had a lot of bright spots. I have been immensely proud of our team's creativity and resilience, and how we've taken care of each other and our clients.

We **continued to support our communities** throughout the year, remaining committed to our community partners across BC and nationally, and supporting their many reimagined events and initiatives. If you follow us on social media, you will have seen the many wonderful organizations we sponsor and support in so many different ways.

During the **holidays**, we continued safely with our annual Giving Tree initiative to deliver gifts and food hampers to families at local non-profit child care centres. In lieu of our annual holiday cocktail party, we made a special donation to local food banks. We even held our children's holiday card competition, a favourite among the youngest members of the Odlum Brown family. To share our holiday spirit, we then created our first ever holiday video, showcasing for clients and friends how we kept our traditions alive.

In February, we reimagined another tradition, our **Annual Address**. This virtual event was attended by close to 2,000 of our clients and friends, with another 3,000 of you watching the presentations later on our website. Many of you told us that you actually felt closer to our firm through this virtual platform, or that this was the first time you were able to attend the Annual Address because it was more convenient being online. We look forward to carrying some of these lessons into future years.

In **other milestones**, our Vancouver office gained a brand new floor; we prepared all of our workplaces for the safe return of team members; and we launched several innovative technology solutions as part of our continual focus on enhancing the service we provide.

In short, we kept moving forward.

We also once again achieved recognition both as one of **Canada's Most Admired™ Corporate Cultures and one of Canada's Best Managed Companies** – our 22nd consecutive year as a Best Managed company. These awards are always meaningful, but they felt a little extra special this year. The recognition of our culture during a year when our team was physically separated proved to us that our treasured Odlum Brown culture lives beyond the four walls of our offices. Being named one of Canada's Best Managed Companies for the 22nd year in 2021 was an acknowledgement that the way we run our business is not only effective in good times, but is also well-designed to see us through challenging ones.

The biggest highlight, though, has been how we've continued to **strengthen our relationships with clients** – those we've served for a long time, and those who just joined us this year. Many of our advisors have shared with me that conversations with clients have often been more personal than business over the past year. You want to know how we're doing, and we want to know how you're doing. That's something special. More than anything, the

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trust you have placed in Odlum Brown amid a time of tremendous uncertainty means the world to us.

I want to end by sharing some words from author and inspirational speaker Simon Sinek. I think they capture the heart of what we need to do – not just right now, but always: "Take care of yourself. Take care of each other."

Thank you, be well, and all of us at Odlum Brown look forward to seeing you all soon!

DEBRA HEWSON
President and Chief Executive Officer

Hedging Inflation Risks

In May, I attended the Mauldin Economics Strategic Investment Conference. It was the second time I've attended the virtual event, and it was a fantastic opportunity to hear perspectives on the outlook for the economy and markets from some of the brightest minds in the industry. The most discussed and debated topic was the threat of higher inflation, and there were strong and convincing arguments made on both sides.

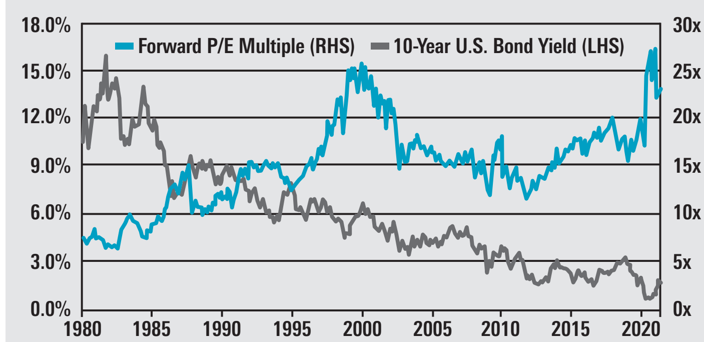
Any doubt that inflation would accelerate in the near term was firmly put to rest toward the end of the conference, when the United States reported a blockbuster 0.8% increase in the Consumer Price Index (CPI) for April. That was four times the 0.2% consensus expectation, and it brought the year-over-year change to 4.2%, the highest rate of inflation since September 2008.

Some believe that massive government deficits and central bank money printing will lead to a sustained period of higher inflation, while others argue that higher inflation will prove to be a transitory phenomenon. We believe that growth and inflation will moderate once economies are fully open, but also appreciate that there is a risk to that view.

Understanding the future course of inflation is important for investors because it influences the purchasing power of our savings, the level of interest rates, corporate profit margins and asset valuations. While interest rates tend to move in the same direction as inflation, it's much tougher to generalize about the influence of inflation on corporate profits and asset valuations. There are many nuances and exceptions to the theoretical rules that need to be explored.

For perspective, let's start by looking at the long-term relationship between bond yields and stock valuation multiples. The yield on the 10-year U.S. Treasury bond peaked at around 16% in the early 1980s and steadily declined over the last few decades as inflation decreased. Indeed, inflation fell so far that concerns about higher prices eventually morphed into fear about outright deflation in the wake of the COVID-19 pandemic, with 10-year yields reaching a low of 0.5% in July 2020. As interest rates dropped over the last four decades, valuation multiples went in the opposite direction; the forward price-earnings (P/E) multiple for the S&P 500 Index increased more than fourfold from a low of 6x (when bond yields were 16%) to more than 25x recently. The expansion in valuation multiples has greatly enhanced investors' stock market returns, which, without changes in valuation multiples, are driven by a company's earnings growth and dividends.

S&P 500 FORWARD P/E VS U.S. 10-YEAR BOND YIELD



Source: Bloomberg, Odlum Brown

Just as stock valuation multiples have risen with the decline in inflation and interest rates, bond valuations, real estate and other financial assets have been similarly buoyed. In fact, the inverse relationship between interest rates and stock valuations is similar to the relationship between mortgage rates and home prices. When rates are low, buyers can afford a larger mortgage and are therefore willing to pay more for a home.

The worry, of course, is that a sustained period of higher inflation and interest rates will cause valuation multiples for most asset classes to go in the opposite direction. Indeed, that is what recently happened for the S&P 500 Index: the forward P/E multiple dropped from more than 25x to roughly 23x as bond yields rose from 0.5% to 1.6%.

Nonetheless, the S&P 500 has powered higher despite the retrenchment in the valuation multiple. That is because the economy is booming and corporate earnings are growing faster than valuation multiples are contracting. That is one of the important nuances about the effects of inflation and interest rates on stock prices. Inflation is cyclical and normally a consequence of stronger economic growth, which tends to have a positive influence on corporate profits.

Determining which stocks will be positively or negatively influenced by stronger economic growth and higher inflation is definitely more art than science. Some businesses handle inflation better than others and are able to pass increased costs on to customers. That's why we focus our investments on the best businesses with

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sustainable competitive advantages and pricing power. When it comes to thinking about inflation, interest rates and stock valuations, it's also important to consider the exceptions to the general rules and trends.

The P/E multiple for the S&P 500 declined from over 25x at the turn of the century to a low of about 11x in late 2011 despite an ongoing trend to lower interest rates. Theory and reality were not in sync over this period because investor sentiment swung from euphoric to pessimistic extremes. In the late 1990s/early 2000s, many of the technology and other large companies that dominated the index were unjustifiably expensive relative to both their earnings potential and interest rates. Once the bubble burst, the sentiment and valuation pendulum swung to an undervalued extreme despite the positive influence of lower interest rates.

In Canadian dollar terms, the S&P 500 Total Return Index declined by 34% in the 2000s. Still, there were plenty of stocks that benefited from an expanding economy and lower interest rates during that period. The Odlum Brown Model Portfolio[1] owned many of those businesses and achieved a return of 245% in the 2000s.

The starting level of valuations had a huge influence on which stocks did well in the 2000s. Those that started the decade neglected and cheap ultimately far outpaced those that were initially popular and pricey.

The point we are trying to make is that markets are dynamic and influenced by many factors. It is the interaction of all these factors that ultimately determines individual stock performance.

While we worry about the possibility of higher inflation, we spend most of our time thinking about the relative competitive positions, growth prospects and valuations of the businesses we own and recommend. Moreover, we think about the health of these businesses and the state of the economy three to five years ahead.

Over that horizon, we believe the inflationary supply and demand imbalances caused by the pandemic will fade, and that the deflationary influence of deteriorating demographics, excessive debt and technology advancements will keep prices in check.

Businesses with higher, but still reasonable, valuations and higher growth prospects will likely do best if growth and inflation abate as we expect. On the other hand, lower-priced, slower-growing businesses stand to be the market leaders if robust economic growth is sustained and higher inflation persists. We are hedging our bets and protecting portfolios from the risk of higher inflation by owning both types of stocks.

MURRAY LEITH, CFA
Executive Vice President and Director, Investment Research
@murrayleith

[1] 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.

Critical Illness Insurance for Your Long-Term Care

"Critical illness insurance gives you financial independence when you need it most. You need insurance not only because you are going to die, but because you are going to live." – Dr. Marius Barnard

World-renowned heart surgeon Dr. Marius Barnard often witnessed the financial and emotional strain his patients faced after surviving serious illnesses and how, in many cases, they struggled to pay bills as they recovered and resumed their lives. He went on to help develop critical illness insurance.

As your life progresses, you appreciate the value of having plans in place if health challenges arise. Critical illness (CI) insurance offers you and your loved ones the financial help to ease the stress associated with life-altering illnesses. A lesser-known aspect of CI insurance is that some policies can do double-duty, protecting you upon a critical illness and the need for long-term care. We'll look closer at CI policy features and benefits to explore how this coverage works.

Availability – While typically available between ages 18 to 60, CI coverage is most affordable for applicants who are in their early 50s or younger.

Benefits – Policies can cover many medical conditions (see below). If you meet policy conditions, your CI benefit amount is paid to you as a tax-free lump-sum payment. Some policies may offer further coverage if you are diagnosed with a second illness after receiving a benefit for the first.

Use of Benefits – You do not need to repay the funds, whatever your health outcome, and are free to use the benefit amount in any way. For example, you may wish to use the funds to:

- Pay for medical costs such as prescriptions and equipment
- Replace lost income
- Pay mortgages or debts
- Hire a nurse or caregiver to help you out at home
- Find the best health care available – anywhere
- Arrange a life-affirming trip or time with loved ones

Coverage Periods – You can enjoy permanent coverage for your entire lifetime or coverage for a specific period, such as 10 or 20 years, or to age 65 or 75. Premiums on permanent policies can be structured to be paid over your lifetime or for a fixed number of years.

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Return of Premium on Death – This optional feature on a CI policy offers a tax-free payment to your estate or named beneficiary if you die without making a claim.

Return of Premium on Surrender or Expiry – Available on permanent plans, this optional feature returns 100% of eligible premiums paid if the policy has been in force for the required period of time.

Optional Coverage for Long-Term Care – While each company's products vary, CI policies may offer options such as:

Benefit type	Paid as	General criteria	Activities of daily living
Loss of Independent Existence Benefit	Tax-free lump-sum	A total inability to perform, by yourself, at least two of the six activities of daily living for a continuous period of at least 90 days, with no reasonable chance of recovery.	• Bathing • Bladder and bowel continence • Dressing • Feeding • Toileting • Transferring
LivingCare® Benefit or Care Benefit	Tax-free monthly benefit	Requiring substantial assistance with at least two of the six activities of daily living, or substantial supervision because of cognitive impairment (such as Alzheimer's disease), and satisfy a 90-day waiting period.	

Whether you are concerned about physical or financial changes if you were to face a critical illness or lose your independence due to illness, a CI insurance policy can help complete your financial plan to protect your wealth for yourself or future generations.

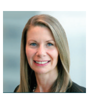
If you would like more information on critical illness insurance, please ask your Odlum Brown Investment Advisor or Portfolio Manager for our additional critical illness articles, or contact us through your advisor.

While each insurance company's products vary, critical illnesses may include:

- Heart Attack
- Stroke
- Coronary Artery Bypass Surgery
- Aortic Surgery
- Heart Valve Replacement or Repair
- Cancer (life-threatening)
- Major Organ Failure (on transplant waiting list)
- Kidney Failure
- Major Organ Transplant
- Motor Neuron Disease
- Coma
- Acquired Brain Injury
- Bacterial Meningitis
- Severe Burns
- Loss of Limbs
- Dementia, including Alzheimer's Disease
- Parkinson's Disease and specified atypical Parkinsonian disorders
- Multiple Sclerosis
- Deafness
- Loss of Speech
- Blindness
- Paralysis
- Benign Brain Tumor
- Occupational HIV Infection
- Aplastic Anemia

Illnesses that may be covered for a *partial* benefit could include:

- Coronary Angioplasty
- Gastrointestinal Stromal Tumors
- Early Prostate Cancer
- Early Thyroid Cancer (Stage T1)
- Early Chronic Lymphocytic Leukemia (Rai Stage 0)
- Superficial (Stage 1) Malignant Melanoma
- Ductal Breast Cancer in Situ
- Grade 1 Neuroendocrine Tumors (Carcinoid)



DEBBIE STUART, CLU, CHS
Estate and Insurance Planner
Odlum Brown Financial Services Limited

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