ODLUM BROWN REPORT

07 2023

ODLUM BROWN
Investing for Generations®

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Don't Press Bets on America's Biggest and Best

COMPOUND ANNUAL RETURNS[1] (Including reinvested dividends, as of June 15, 2023)

	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	20 YEAR	INCEPTION[2]
Odlum Brown Model Portfolio*	5.4%	9.7%	13.2%	8.5%	11.7%	11.8%	13.9%
S&P/TSX Total Return Index	4.9%	5.6%	12.6%	7.4%	8.3%	8.4%	8.4%
S&P 500 Total Return Index ($CDN)	13.7%	21.2%	13.8%	11.8%	15.7%	9.9%	10.2%

[1] Except for YTD period. [2] December 15, 1994.

Investor sentiment and equity valuations, particularly in the United States, have improved meaningfully. From mid-June 2022 to mid-June 2023, the main Canadian and U.S. equity benchmarks appreciated by 5.6% and 21.2%, respectively. Over the same period, the Odlum Brown Model Portfolio* advanced 9.7%.

Not only have U.S. stocks outpaced Canadian stocks, and our Model, by a considerable margin this past year, but the same is true over longer horizons. Over the last 10 years, the S&P 500 Total Return Index ($CDN) has compounded at an impressive 15.7% annual rate, almost double the comparable 8.3% for the Canadian S&P/TSX Total Return Index and four percentage points better than the Model's 11.7% annual gain.

Investors naturally wish they owned more U.S. stocks, and some clients have understandably asked if a low-cost S&P 500 Exchange-Traded Fund (ETF) would be a better alternative to our Model, which has been roughly equally balanced between Canadian and U.S.-listed securities over the past decade.

It's a fair question and is reminiscent of client sentiment at the turn of the century. Then, as has been the case recently, U.S. stocks were doing much better than Canadian stocks. In fact, in Canadian dollar terms and including dividends, U.S. stocks compounded at a 20.9% annual rate in the 1990s versus 10.6% for Canadian stocks. While our Model had performed respectably since inception in December 1994, it wasn't keeping pace with the American market because it was heavily skewed toward Canadian stocks, which we felt offered much better value.

Being skeptical about U.S. stocks and positioning the Model in better-valued Canadian stocks yielded a huge payoff in the 2000s. Not only did the technology bubble burst, but the excessive valuations of the large growth stocks that dominated the S&P 500 Index deflated as many Canadian stocks recovered smartly from depressed levels.

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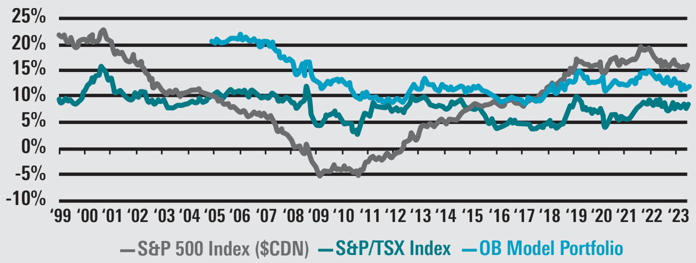
ROLLING 10-YEAR COMPOUND ANNUAL RETURNS*



* Returns include reinvested dividends; S&P 500 and S&P/TSX calculated at month end; OB Model calculated at mid-month.

While investors are regularly warned that past performance does not guarantee future performance, it's human nature to extrapolate trends. Those who expected U.S. stock outperformance to continue were massively disappointed. A decade later, at the end of 2009, the rolling 10-year annual return for the U.S. equity benchmark fell to -4.0%. A Canadian who bought an S&P 500 Index ETF would have lost 30% of their money in the 2000s, measured in Canadian dollars and before fees.

In the mid-2000s, as the China-fuelled commodity boom was accelerating and Canadian stocks were performing much better than U.S. equities, we started to shift considerable funds south of the border. The valuation multiples for America's leading companies were a fraction of what they were in the late 1990s, and we were confident that the stage was set for an impressive recovery.

As it turned out, we were right, but we were also early. The relative valuations of America's biggest and best continued to contract, despite generally growing their earnings at above-average rates. The downward pressure on valuation was so extreme that many of these companies traded at below-average multiples in the aftermath of the 2008-2009 Great Financial Crisis. That wasn't logical. These were companies with significant competitive advantages, above-average profits and growth runways, and superior capital structures. It was a trying time, and a reminder that sentiment and valuations swing like a pendulum, from one extreme to another.

Fortunately, the lesson learned from our premature enthusiasm for U.S. stocks inspired even more conviction for a grand recovery as the pendulum swung back from undervalued to fair value and ultimately to overvalued once again. We outlined our case in a lengthy July 2009 report titled "We've Seen This Play Before: It's a Story of Excessive Valuations, Subsequent Disappointment and Missed Opportunities." In the report, we quoted Arnold Van Den Berg from the August 30, 2006, issue of *Outstanding Investor Digest:*

> "From its 1973 peak to its 1981 low, Coca-Cola's stock went from $75 to $30.50. That's a 59% drop in the stock price. But the company wasn't exactly standing still during those eight years. During that time, Coca-Cola's sales went from $17.94 per share to $47.64 – which is an increase of 166%. Its earnings per share went from $1.80 to $3.62 – an increase of over 100%. And its dividend went from $0.90 to $2.32 – 158% increase. Meanwhile, its P/E [price-to-earnings multiple] went from 42 to 8 – which is a decline of 80%. Just think about that. The company's earnings per share rose 101% and its sales per share rose 166% – and yet, eight years later, its stock was 59% lower.
>
> Once a major company's stock has been pummelled, and then it goes sideways for years, and its sales and earnings continue to build up, eventually, the stock price has to shoot up – like a cork out of a bottle. That's exactly what happened with Coca-Cola's stock…"

Coca-Cola's share price didn't just pop. It exploded. From its low in 1981 to its high in 1998, its share price went up more than 67-fold.

Coca-Cola's story was not unique. A collection of stocks, which came to be known as the "Nifty Fifty," followed the same pattern: a long period of superior performance culminating in excessive valuation, followed by a lengthy period of disappointment and underperformance, which set the stage for another lengthy period of superior performance.

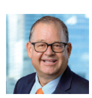
"Quality is paramount in our uncertain world, and for that reason we still have stakes in America's biggest and best. Still, we have scaled back our exposure in favour of businesses that offer a better long-term trade-off between price and growth."

In our 2009 report, we argued that the same pattern was unfolding again. After a decade of poor performance, we felt large-capitalization American stocks were poised to do very well, and history has proven our prediction correct. Those businesses have grown at above-average rates, with valuation multiples and dividends expanding considerably along the way.

Today's price-to-earnings multiples for America's largest growth companies are not as extreme as they were for the Nifty Fifty in the early 1970s, nor are they as lofty as they were at the turn of the century, but they are far from cheap. These companies are well loved by investors, and many are priced on the high side of reasonable. While the sentiment and valuation pendulum may still swing higher, we can say with confidence that the risk and reward proposition is nowhere near as attractive as it was five years ago or 10 years ago, or, even more so, when we issued our report in 2009.

Quality is paramount in our uncertain world, and for that reason we still have stakes in America's biggest and best. Still, we have scaled back our exposure in favour of businesses that offer a better long-term trade-off between price and growth. Making this shift to less fashionable stocks has contributed to our recent underperformance, and we are certainly feeling some déjà vu.

Patience was required when we favoured Canadian stocks in the late 1990s, and it proved necessary when we started making meaningful investments in America's biggest and best in the mid-2000s. But just as patience yielded rewards in those periods, we think a willingness to dial back exposure to popular American growth stocks and endure the possibility of underperforming in the near term will be a winning long-term strategy. With elevated valuations, the odds are not good that American growth stocks will be top performers over the next decade. We'd rather be selective than own a pricey S&P 500 ETF.



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* The Odlum Brown Model Portfolio was established on December 15, 1994, with a hypothetical investment of $250,000. The Model provides a basis with which to measure the quality of our advice. It also facilitates an understanding of how we believe individual security recommendations could be used within the context of a client portfolio. 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.

Preserving Digital Memories and Assets

It is increasingly common to store memories, such as digital photos, videos, messages and social media posts, online. However, without taking steps to preserve these invaluable digital memories, they could become inaccessible. Here are some recommended actions to prevent this unfortunate scenario:

Review the Legacy Settings for Your Online Accounts

To ensure that memories are handled the way you would like after your death or incapacity, take a few minutes to review and update the legacy settings for each of your online accounts. The Society of Trust and Estate Practitioners (STEP), a global professional body comprising lawyers, accountants, financial advisors and other expert practitioners in inheritance and succession planning, has created an online resource[1] to help with managing the legacy settings of the most commonly held digital accounts, including Facebook, Google, Apple, LinkedIn, Twitter and Instagram. Please check with each provider in case the settings have recently changed, and remember that you may have accounts with other digital providers not listed in the STEP resource, such as Microsoft, Dropbox or Evernote.

Secure Your Digital Assets

Preserving your online information includes ensuring that any digitally stored personal identifiable information and assets are secure. The Canadian website getcybersafe.gc.ca offers tips to keep your digital information from being compromised. It's also a good idea to back up your devices and personal data regularly. For physical back-up devices, consider using good encryption as well as a separate, secure location apart from the main device's location (for example, your safe deposit box). There are also online digital vaults to store your sensitive documents or photos. Just remember when setting up a physical or online vault to share the credentials with your loved ones or appoint them as your 'attorney' (for access while you are alive) or executor (for access following your death).

Leave Records for Your Family or Legal Representatives

In order to act effectively on your behalf if necessary, your family or legal representatives (such as your executor or attorney) will need to be aware of your digital accounts (including loyalty points, pre-loaded cards and online shopping accounts linked to your payment information). When listing your digital assets, balance the details you provide against the substantial harm that could arise if the information was used fraudulently by ensuring that passwords are not listed non-securely.

Our personal planning tool "Getting Organized – A Proactive Guide to Preparing for Illness, Injury or Death" includes ideas to prepare yourself, your loved ones and your legal representatives before a crisis happens, so that they can more effectively manage your financial and legal affairs. If you would like a copy of this handbook, contact us through your Odlum Brown Investment Advisor or Portfolio Manager.

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Odlum Brown Financial Services Limited

[1] https://memories.step.org/update-your-legacy-settings/

Odlum Brown in the Community

For 100 years, Odlum Brown has been committed to making a difference in our communities. We are proud to showcase the following summer events:

Thunderbird Show Park
Summer 2023
Langley, BC

We are thrilled to continue our partnership as a Premier Partner, and the official Investment Management Firm, of Thunderbird Show Park. Last month, we were proud to be the Title Sponsor of the Odlum Brown BC Open week of competition, which included the prestigious Longines FEI Jumping Nations Cup™.

On July 9, we look forward to returning as Title Sponsor of the Odlum Brown Grand Prix at this incredible venue, one of North America's top horse show facilities. **For more information, visit tbird.ca.**

Harmony Arts Festival
August 4 – 13, 2023
West Vancouver, BC

We are pleased to return as the Presenting Sponsor of the Harmony Arts Festival, a celebration of the arts in our community. The Festival is one of the North Shore's most popular community events, taking place in a spectacular setting along West Vancouver's waterfront.

With something for everyone, the Festival schedule includes visual art exhibits, dining experiences and free outdoor live performances. Most events are free to the public. **Visit harmonyarts.ca for more information.**

Help Us Make an Even Bigger Difference

At Odlum Brown, we love the communities where we live and work, and we're always looking for new ways to show our support.

In celebration of our 100th anniversary, we invite you to help us make an even bigger impact! Scan the QR code to help us choose a new community partner.

Here, you can share an organization that you see making a difference in your community and tell us what makes them outstanding. We will be selecting four organizations to receive special donations of $5,000 each from Odlum Brown.

We look forward to reading your suggestions and making new connections within our community!