THOMLINSON
INVESTMENT COUNSEL

RAYMOND JAMES®

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Dear clients,

Of all the things I've learned this past year, the most significant is that emotions are a double-edged sword. In our personal lives, emotions are key to our personalities and desires, and giving them too little credence (or too much) can lead to all manner of dysfunction. But before we make important decisions, especially with our money, it's almost always best to leave our emotions out of it.

A critical part of my job as your financial advisor is helping you avoid emotional decision-making. At the same time I need to be taking advantage of the market's emotional ups and downs in order to provide healthy, consistent returns over time.

Emotions and investing

Warren Buffett, arguably history's most successful investor, once paraphrased his mentor Benjamin Graham this way: "In the short-run, the market is a voting machine. But in the long-run, it is a weighing machine." In other words, human emotion (or "sentiment") drives stock prices over shorter periods, but given enough time prices eventually reflect the true value of a company.

This can be frustrating. As financial analyst A. Gary Schilling once said, "The stock market can remain irrational a lot longer than you can remain solvent." You may own the most undervalued stock of the century, but if the market never bids the price up, you will never see that value realized. "Value" investors have suffered in this way for more than a decade, as sexy high-growth stocks vastly outperformed, even as they got more and more expensive.

Value investors must always be prepared to look wrong for extended periods of time. That is why famous Canadian investor Peter Cundill often quipped that the three crucial requirements for investing success are "Patience, patience, and more patience." I worked at Peter Cundill & Associates Ltd. in Vancouver as a summer student and for the first five years of my career. Peter sadly passed away in 2011 after a battle with Parkinson's disease at the age of 72.

Peter's value style is deeply ingrained in me. I prefer to buy stocks on sale because lower prices give investors what Benjamin Graham referred to as a "margin of safety". Over the course of 2021 I transitioned client portfolios to include more value-oriented investments. If you'll bear with me, I want to share a few examples of my thinking.

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Oil and oil stocks

Emergence from Covid was the major theme of 2021. A significant part of that theme was the supply and demand dynamics of oil and gas. In April 2020 the futures price of oil briefly went negative, due to uncertain demand as global Covid lockdowns kicked in. By early January 2021 the price was back up to US$50 per WTI barrel, but stocks were priced as if the commodity was selling for less than US$30. Normally, higher prices incentivize companies to increase production, which increases supply and drives prices down. However, with the market's emotional fixation on ESG (environmental, social, and governance) issues, "dirty" oil companies face significant headwinds – financially, logistically, and politically – if they choose to go that route. This acts to limit supply and should support oil prices at higher levels going forward. Commodities also tend to act as inflation hedges, which should serve as added downside protection in case inflation continues to run hot. I have selected the more conservative, underpriced oil and gas companies for your portfolios. Now, with oil trading above US$85, these businesses are almost literally gushing cash. The sector remains attractive.

Micron

Micron Technology, Inc. is one of three computer memory chip (DRAM) manufacturers globally, and is the only one that is US-based. (Samsung and SK Hynix are both domiciled in South Korea.) Because memory chips are interchangeable the business is seen as commodity-like, which suggests that profits rise and fall with global supply and demand dynamics. Similar to the oil story, in the past when DRAM prices rise, companies increase production but tend to over-do it, resulting in a supply glut and an inevitable collapse in prices. So markets have gotten used to seeing Micron and the others shoot themselves in the foot whenever conditions start to improve. Two elements of the story are different this time. First, demand for memory has never been stronger – Micron has 50% market share in automotive DRAM for example, which is a rapidly growing technology segment, particularly with electric vehicles. Second, leadership at these companies have finally "got religion" and have expressed their intention to only ramp up production in disciplined fashion going forward. The market, however, has not received this message, so when spot DRAM prices appear to soften, or there are rumours of spending on new supply, Micron's stock price falls. Fortunately this gives astute investors opportunities to purchase undervalued shares and wait for the robust earnings reports to prove the market wrong.

Changes (and lower fees) for smaller accounts

One of the artifacts from my previous Raymond James branch was that even smaller accounts were invested in a portfolio of stocks. This was impractical from a trading perspective, however, and I targeted the end of September to switch these smaller accounts' stocks over to professionally-managed mutual fund investments. (My background as a mutual fund analyst helped me find the funds that I believe would perform well over longer periods of time.) Unfortunately, several funds promptly fell in value mere weeks after the move. As a result, smaller accounts (less than $125,000) underperformed in 2021. I expect these funds to bounce back once the market starts rewarding their virtues again.

I also adjusted the fee schedule for smaller accounts so I am not charging clients for stock selection that I am not doing (the mutual fund managers will be doing it instead). Fees are now one-third lower for mutual fund holdings in smaller accounts. If you have questions about this please ask.

Final thoughts

On a personal note, 2021 was a challenging year. The good news is that business is healthy, the future looks bright, and I'm looking forward to helping more families with their financial decisions in 2022. If friends or co-workers happen to mention that they would appreciate a second opinion on their mutual fund portfolio I hope you will pass them my contact information.

Very best regards,

Bill