July 16, 2022

Dear clients,

You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right. Similarly, in the world of securities, courage becomes the supreme virtue after adequate knowledge and a tested judgment are at hand.

– Dr. Benjamin Graham, The Intelligent Investor, 1949

Courage. It feels like investors need it now more than ever. Markets and the news media have not been reassuring. Yet we know these conditions are temporary. As an investor your best friends are a strong investment discipline and a long-term focus. Make rational, conservative decisions based on data and reasoning, not emotion. Focus on the years ahead, not the months.

From April through June, the Canadian stock market[1] lost -13.2%, the US stock market fell -16.4%, and even bonds fell -5.7%. Traders are selling stocks because of the concern that in the government's efforts to fight inflation, they will trigger a recession and company profits will suffer. Every new announcement featuring "higher than expected" inflation reinforces this fear.

Canadian CPI, our measure of inflation, is up +7.7% over the 12 months ending May 2022. Bank of Canada's overnight lending rate has been raised from 0.5% in March to 2.5% in July. It does appear that they intend to fight inflation by raising interest rates, no matter what this does to jobs and profits.

However, our regulators know that one of the main causes of inflation is the expectation of future inflation. That is, the more people expect prices to go up, the more likely they will make purchases now rather than later, which causes more inflation. This is likely a big reason why governments are talking and acting so aggressively towards it – the more serious they sound, the less they will actually have to raise rates. In other words, they are trying to "talk inflation down".

There is no way to know for sure what will happen to inflation and rates going forward, or the effect they will have on stocks. My approach is to remain invested in companies that have conservative balance sheets and undervalued prospects, which will hopefully do well over time whether we have a

[1] Performance figures are Total Return, with dividends and interest reinvested. Bonds based on iShares Core Canadian Universe Bond ETF (XBB), an ETF representative of Canada's bond market. Canadian Stocks based on S&P/TSX Composite Index, a Canadian equity benchmark representative of Canada's stock market. US Stocks based on S&P 500 Index, a US equity benchmark representative of the United States stock market.

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recession or not. Some of these companies have fallen recently, but I have kept them in the portfolios. Over the longer term I expect the market will recognize their undervaluation and bid prices up again.

At time of writing there are three US stocks in the portfolios that I consider "arbitrage" ideas: First Horizon Bank, Activision Blizzard, and VMWare. All three are in the process of being taken over by larger firms for higher prices, but there is uncertainty about whether the deal will go through. The spreads on these deals vary from 14% to 29%, but all look like they have an excellent chance of closing within the next 12 months. In times of uncertainty arbitrage is an attractive investment style, as these spreads should result in returns of 14-29% on those companies, whatever happens in the market.

Enjoy your summer, and if you have questions please don't hesitate to call anytime.

Best regards,

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