

July 24, 2024

Dear clients,

*It ain't what you don't know that gets you into trouble.
It's what you know for sure that just ain't so.*
- Mark Twain (attributed)

*Doubt is not a pleasant condition,
But certainty is absurd.*
- Voltaire

Yogi Berra once said, "It is difficult to make predictions, especially about the future." Or did he? Quoteinvestigator.com attributes this quirky phrase to a Danish proverb. So it seems even the past is difficult to predict.

The future is harder. If you had "Trump nearly assassinated because sloped roofs are too dangerous for Secret Service personnel" on your bingo card, congratulations! But I bet you didn't.

Yet we routinely ask our leaders and professionals for their expectations of what will happen. Often these opinions coalesce into a "consensus opinion" because there is safety in numbers when they're inevitably wrong. Some are correct of course, and if they do it more than once, they are lauded for their special powers. But such brilliance never lasts forever, because *time and chance happen to them all* (Ecclesiastes 9:11).

In the investment realm, company strategists and news pundits are paid to create these predictions and publish them to us. These are the talking heads you see on TV, in newspapers and websites, and on your favourite blogs and YouTube channels. Most of the time their predictions are worth what you pay for them.

Investment managers in the trenches of the market take a much different approach, because acting on bold predictions is a sure way to lose sums of money. Our approach is never to be certain of anything, but rather to invest according to the balance of probabilities. This means diversification, discipline, conservatism, and a long-term view.

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“The science is settled”

What are the markets certain of these days?

- 1) Interest rates are coming down and staying down, because inflation is more or less defeated.
- 2) Artificial intelligence (AI) will impact the world profoundly and immediately, as much as the internet and smartphones did.
- 3) The energy transition, away from fossil fuels and towards electric and renewables, is within reach.

Here are my thoughts on these convictions:

- 1) A very smart analyst named Lyn Alden Schwartz published an article last week proposing that we are entering an era of fiscal policy dominance. Her point was that monetary policy (interest rate and money supply adjustments) are no longer effective in taming economic activity, thanks to years of profligate deficits. In other words, governments are showing no desire to stop spending, so until they do, we will have inflation. And the more debt our economies are asked to absorb, the higher the rate of interest we will need to be paid to hold it.

Rates will come down in the short term, but the long-term direction of interest rates is more likely flat to higher because of government spending.

- 2) We've heard Elon Musk's warnings that AI could mean the destruction of civilization. I think he's seen too many Terminator movies. But isn't it the next big thing at least? Certainly a few companies like NVIDIA are in a position to benefit from the adoption of this new technology, but it seems to me that all companies stand to benefit to some degree. However, I suspect it will take years to play out, maybe decades. In the meantime, the Magnificent 7 stocks are stretched and ripe for a decline. I much prefer to invest in undervalued companies with less downside potential.
- 3) The great benefit of fossil fuels is that they are a reliable source of energy. Neither solar nor wind are reliable, as they are both subject to weather, and storage is a challenge. The International Energy Agency says oil demand will peak in 2030, but wind and solar are not capable of replacing it. The only viable alternatives seem to be natural gas and nuclear. Electricity demand is rapidly increasing thanks to electric cars and data centers, and now artificial intelligence – but infrastructure is not currently able to handle such an increased load, and nuclear facilities take up to eight years to build. Midstream natural gas and electrical infrastructure companies strike me as reasonable investments over the next five to 10 years. Oil companies too should remain very profitable because environmental concerns are keeping a lid on oil supply, while demand continues to rise.

The recent quarter

In Canada, all market sectors were negative over the three months to June 30 except Materials and Consumer Staples. Your Canadian equity portfolio has a generous helping of Materials stocks, including gold, silver, and fertilizer companies, resulting in strong outperformance compared with the S&P/TSX

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Composite Index. Our one Canadian technology company, Celestica, had a strong quarter as well, riding on the Artificial Intelligence tailwind.

In the United States, Technology and Communication Services led all sectors. April and June were strong for any company related to AI, but in May the forgotten companies had a recovery. Your U.S. portfolio lagged the S&P 500 Index during the quarter, but we avoided significant risk in the overvalued Technology sector. Instead, we are focused on gold and silver companies, agriculture, and energy. It feels like the market is waiting for its stop, then it will jump off the Technology train. We shall see.

Positioning

I have focused on investing in “real stuff” because I feel inflation is a real threat that is not going away. This is a conservative position that will underperform when the market is strong, but should do much better if the market reverses itself. The most likely and imminent catalyst for this is a “coming back to earth” for the Magnificent 7 stocks related to AI. At time of writing, cracks are forming. But your investments are performing well in the midst of it, like they were designed to do.

As Warren Buffett likes to say, the first rule of investing is not to lose. And the second rule is, never forget the first rule!

New reports

You may have noticed a new format to your Portfolio Review I send monthly by email. I’ve tried to make it easier to read, while providing more information about the sectors of the economy driving market performance. You’ll need a password to get in to the encrypted email – if you can’t remember, simply hit the “Forgot Password” button. If you have suggestions for future reports, please let me know.

Best regards,



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