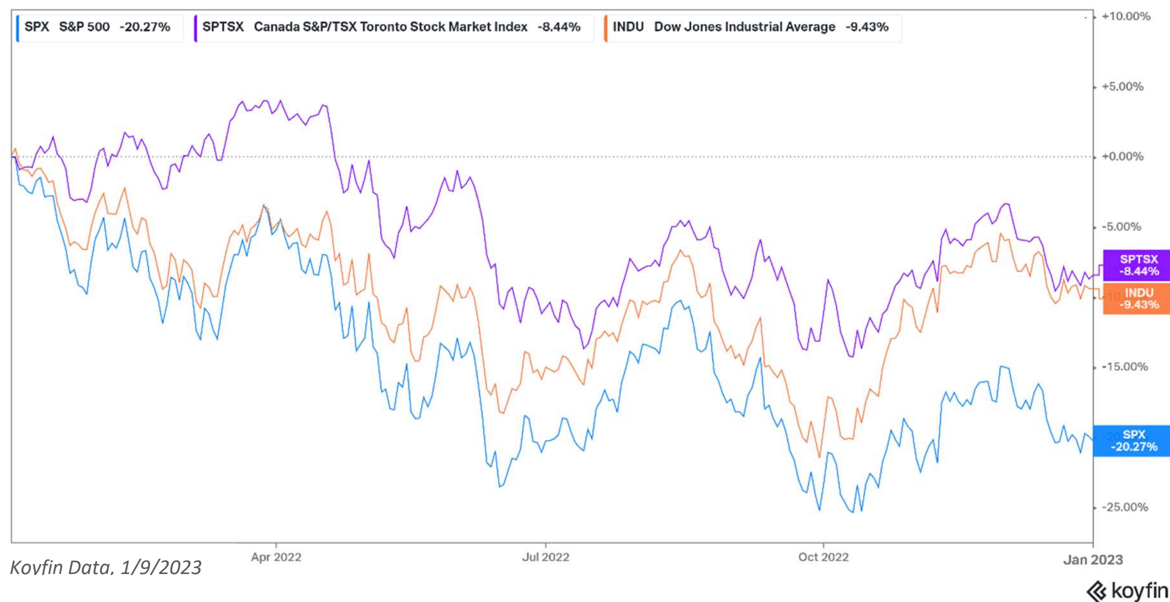
Lee Turner

Investment Quarterly
January 2023

Review

If 2020 was the year of "uncertainty" rearing its ugly head in the form of an unforeseen pandemic, 2022 was the year of "risk". High growth tech stocks and cryptocurrencies plummeted after years of high prices, inflation ran at decadal highs after record stimulus, interest rates rose at record speeds to address the inflation, and that is not to mention the world outside of financial markets where war, court rulings, and elections, all bucked expectations. In short, proverbial chickens came home to roost in financial markets as previously unheeded warnings about valuations, momentum, tech, energy, and debt came to fruition. For the year the S&P 500 had a total return of roughly -18% with the Dow Jones down 7% and the TSX composite index down 6%. On a price return, as in the chart below, the returns were obviously worse. While it was a tough year for common equities, it was a very rough year for bonds as the US Aggregate Bond Index (per S&P) fell 12% in 2022 and 11% in the Canadian market.



Koyfin Data, 1/9/2023

None of the issues highlighted above was unknown and yet, in financial markets, most had not adequately understood the risks nor understood the probable impacts. We were not immune. At the beginning of the year, we at Lee Turner thought we'd get significant increases in interest rates, with somewhere between four to six hikes of 0.25% each. We were right in direction, right in the appetite of central banks to move aggressively to fight inflation, and dramatically wrong in magnitude as the Bank of Canada went from 0.25% at the beginning of the year to 4.25%, by far the fastest tightening ever. Now, we should be critical of ourselves, but we are not geopolitical or intelligence analysts and did not see a ground war in Eastern Europe kicking off in February which kicked inflation up a notch (in honesty, neither did Ukrainian leadership). That said, a look back at the news and commentary in the preceding year highlighted that conflict was possible. Thankfully we were positioned to benefit from some of the turmoil caused by that disaster even while the speed of interest rate hikes caused price declines in other parts of the portfolios. And this gets to the other aspect of dealing with risk—if you can't predict its impact perfectly, you better figure out how to weather it.

Resilience is a key attribute of the way we endeavor to build portfolios, the kind of companies that we seek out, and the disposition we aim to instill in ourselves as investors. Perhaps more than any

Suite #790 - 999 West Hastings Street
Vancouver, BC V6C 2W2
Telephone: 604-689-3289

other quality as an investor, the ability to endure, the "capacity to suffer" as one famous financier put it, is crucial to building and keeping wealth in financial markets. To do that, we also need to find companies where that capacity is a function of the business model and (ideally) inculcated in the culture of those running it.

One facet of finding those companies is to look at the past. The average age of the top 20 companies in which we invest is about 80 years (and some of these came from spinoffs from older companies). On average, none of us at Lee Turner were alive when these companies first started making money. For the top 50, the average is about 60 years. While the age of the company alone does not mean it is a great investment, it does highlight that the company has endured various market environments, technological innovations, political administrations, and global events. But this resilience does not come for free. It is very unlikely that any of our companies will be the best performer in a given year, particularly when market conditions are sunny and "accommodative" as they have been in the past decade. As in the poem:

Good timber does not grow with ease:
The stronger wind, the stronger trees;
The further sky, the greater length;
The more the storm, the more the strength.
By sun and cold, by rain and snow,
In trees and men good timbers grow.

Where thickest lies the forest growth,
We find the patriarchs of both.
And they hold counsel with the stars
Whose broken branches show the scars
Of many winds and much of strife.
This is the common law of life.

Forecast

Unfortunately, we do not see a quick reprieve from market volatility. Economic data remains contradictory, with pockets of concern and sources of strength. Consumers spent strongly in the holiday season, employment numbers remain robust, even while housing, rents, lending activity and general sentiments show signs of stress. We like to use the analogy of a bouncing ball, with good news of slowing price increases signaling the end of inflation only for it to bounce aggressively back in short order. We believe that the leaders at the Federal Reserve and the Bank of Canada are likely aware of this fact, after looking over previous inflationary periods, and will be more likely to keep the pressure on fighting inflation even if it looks to be cooling. As a result, we expect that interest rates have not yet topped out and, barring a significant deterioration in economic data, we think they will likely remain high for a while. A "soft landing", or an end to inflation without a recession, is not out of the question but it remains a very tricky maneuver for central banks to land. As with the war in Ukraine or China's COVID surge amid reopening, there are so many economically sensitive factors entirely out of the control of Western politicians and technocrats, that the path to a smooth landing is very difficult to determine. However, of the two risks, rampant inflation or a recession, we think the central banks (particularly the Federal Reserve) have determined that the former is much more unpalatable than the latter.

Strategy

We remain primarily focused on the core areas of the common, preferred, and income trust markets, as we have been for a while. The bond market, while flirting with becoming attractive once again, has yet to reach prices that we think make it a wise investment for the long term. If rates continue to rise, there may yet be an opportunity to buy bonds, but we remain in "wait and see" for now. We'll continue to be on the look out for opportunities that seem favorable but, as highlighted earlier, our focus will continue to be putting resilience and durability front and center, seeking out companies and industries that are key to economy and capable of weathering future storms.

Suite #790 - 999 West Hastings Street
Vancouver, BC V6C 2W2
Telephone: 604-689-3289