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## Review

On June 5, the Bank of Canada jumped to the front of the line of developed countries' central banks and cut its interest rate. The cut was a modest 0.25% and the immediate signal taken by market participants was positive, but that enthusiasm quickly faded as the market trailed down over the remainder of the month. Admittedly, this cut came slightly earlier than our expectations, but our reasoning was sound because the inflation number, Canadian CPI at 2.9%, that was reported just three weeks later was ahead of expectations and stubbornly far higher than the "2% target."

For the quarter, the TSX Index was down 0.5%, but as for year to date, it was up 6.1%. In comparison the S&P 500 was up 4.3%, the Dow Jones Industrial Average fell 1.3% and the Nasdaq rose 8.3% over the quarter. The performance differential between the three US indexes is rather instructive about market dynamics. The average blue chips of the Dow Jones had a minor wobble over the quarter while having an overall okay year thus far. However, this wasn't the story. The story was that just three companies (Microsoft, Apple, and most of all, NVIDIA)—drove basically all of the broad markets' performance. Without these constituents, the S&P 500 would have been effectively flat for the year. Whether it is for Canada or the US, the story roughly is the same, the positive performance has been dominated by relatively few companies in just a few sectors. In Canada, the leaders were basic materials companies (particularly metals and mining companies) and consumer staples companies. Over at the bond market, as tracked by the FTSE Universe Index, it was up 0.8% over the quarter but still down 0.4% year to date. The preferred share index was up 2.3%, and a further 11.6% year to date (more on preferred shares in a moment).

*Koyfin data. July 7, 2024*

## Forecast

Overall, economic conditions remain challenging for the Bank of Canada. On one hand, employment is weakening, and job and economic growth are stagnating, but in the background, inflation is lurking. We maintain that the risks to upside inflation, and the resulting need for sustainably higher rates are not baked into most current forecasts and this is beginning to show in one market area: private asset funds. Such funds have historically argued that in exchange for limiting your liquidity (i.e. your ability to convert your investments to cash quickly) you could receive uncorrelated and strong investment returns. However, liquidity is a bit like the electrical grid; if we're all rational and frugal with our demand, then there is no problem but if we all experience a sudden, scorching stretch of weather and flip the switch on our AC at the same time, that capacity can reach its limit and lead to brown outs and eventually, crashes. So

far this year, private debt funds have shown signs of a brown out, with by our count, five large funds significantly curtailing investors' ability to withdraw funds. In exchange for no "market volatility", investors in these funds traded the daily price action for a lack of access to their funds and now, in some cases, those funds are indefinitely restricted. We know of no material failures in these funds (no outright blackouts, in other words) but the lights are beginning to flicker.

**Strategy**

Our core investment strategy has always been one of discipline, best described as "buy and hold". We are fully committed to this strategy, even though we know that it can at times present us with brief periods of doubts and challenges. Therefore, when the time comes for us to exercise our discipline - we stick with it; we remain calm and focused while re-examining our investment thesis and adjusting it if, and only if, necessary.

A recent demonstration of the effectiveness of our "buy and hold" strategy was on our preferred shares. These shares had presented us with some short-term under-performance, but held through to today, they have now rewarded us with very spirited out-performance. So, what happened? The most fundamental of explanations is that the entire preferred share market has witnessed an abundance of issues receiving a "call". Now, before we lead you into a technical and investments-based discussion of what constitutes a "call", let us divert you to some musical nostalgia, and share with you a side of our lives where our professional duties seldom vacate.

Flash back to 1980, when Blondie had a number one hit titled Call Me. Why would we find a 44-year-old song relatable today? Two reasons: first, this timeless Boomers' anthem had a very catchy and unforgettable refrain that goes: "Call me, call me on the line. Call me, call me any, anytime. Call me, call me". And second, those lyrics easily leapt to mind because of a recent flurry of preferred shares that received a "call", short for "call for full redemption". A "call", in the present investments' context, happens when issuers of preferred shares, from years ago, exercise their right today to cancel their shares by fully refunding to investors the shares' original issue price. That flurry of calls, thirteen issues worth about $3 billion dollars, came in just three months. Why this sudden spurt of call activity? The biggest reason issuers are calling their shares is that they do not want to continue paying the high dividend rates that were set for their shares years ago. While issuers are happily delivering calls to investors, what does getting a call mean for investors and their wealth being? Well, we suspect some investors might be quite ambivalent about being on the receiving end of a call. Because while the good news is that at the least, they will receive a full return of their capital and at the most, a sizable capital gain, the bad news is that they will face steep challenges to redeploy their capital with hopes of maintaining their previous level of dividend income.

We have no such mixed feelings at all. In fact, we are looking forward to receiving calls on our holdings because nearly all of them were acquired at lower prices than their original issue prices and therefore, we would be due sizeable capital gains upon their calls. And when we do get called, we will be more than up to the challenge of reinvesting our proceeds, no question. For now, given that our disciplined portfolios hold plenty of preferred shares and that we would profit handsomely when we do get called, you can understand why Call Me has held special meaning to us lately. Yes, we would just love to be on the receiving end of a call, or two, or more. We would! We are ready. And we are waiting, but not anxiously waiting. Our strategy is clear and simple, stay disciplined - relax and hold on to our preferred shares and enjoy our dividend income until the calls come in. Whoever, whenever - call us. Call us any, anytime. Call us.