2021 Year in Review

A warning sign
I missed the good part then I realised
I started looking and the bubble burst
I started looking for excuses

-Coldplay

I am almost certain that Chris Martin was not talking about the stock market when he wrote this song. None-the-less, the lyrics do a fine job describing the events of the past three years, the current macro economic backdrop and the eventual, yet common, reaction from investors. Investors must stand in awe of the economic pickle for which we are in today. Furthermore, wonder – how to confidently invest hard-earned savings in fixed income or stock market indices.

It is foolish to try and time markets and therefore we stick to our strategy of purchasing volatility when it is empirically cheap, selling it when it is expensive, and anchoring the portfolio with high quality, non-resource, dividend paying stocks. Knowing that we cannot "time" the stock market, we expose ourselves to this safe-heaven asset class to maximize the *compound annual return* of our capital over a cycle.

In our last letter we wrote about the "Minsky Moment"–

> "In the early 1970s, economist Hyman Minsky first developed his hypothesis of financial instability. He argued that financial crises are endemic in capitalism because periods of economic prosperity encouraged borrowers and lenders to be progressively reckless. Following a crisis, as confidence builds, people start to take on more and more risk; lending is done on less favourable terms; greater leverage is used in portfolios and on the balance sheets of businesses; speculative investments and schemes become more commonplace. As prices continue to rise, every fault of human psychology will work towards drawing in more investors until we reach a peak that ends up collapsing under its own weight with no causal factor."

The key message, in our opinion, is there is no single causal factor at the time when markets correct. Of course, few admit to this fact and instead use the benefit of hindsight to explain poor results. Just like the song says, "I started looking for excuses".

The All-Weather strategy has had a "not-great" year in 2021. We choose to say "not-great" because we reserve the word "bad" for years when investors lose money. Equity markets have had many "bad" years whereas the All-Weather strategy has generally been profitable, offering a continuous path to compounding one's wealth and providing investors with stable returns to live their desired lifestyle. Our approach helps investors avoid market drawdowns which have become increasingly frequent.

The famous comedian George Carlin has a sketch on how society has increasingly adopted "soft language" to describe circumstances where the audience is sensitive to "political correctness" – using words to hide the truth. It appears that investors have adopted a similar vocabulary to justify todays investments - junk bonds are called "high yield debt", unprofitable companies are called "long duration assets", high valuation stocks are called "growth companies", unregulated unsecured lending is called "private debt" and excessive central bank and government intervention is called "TINA" (There Is No Alternative).

The existing levels of debt, low interest rates, high valuations, and central bank intervention in financial markets lead us to believe the frequency and magnitude of market drawdowns will continue to rise.

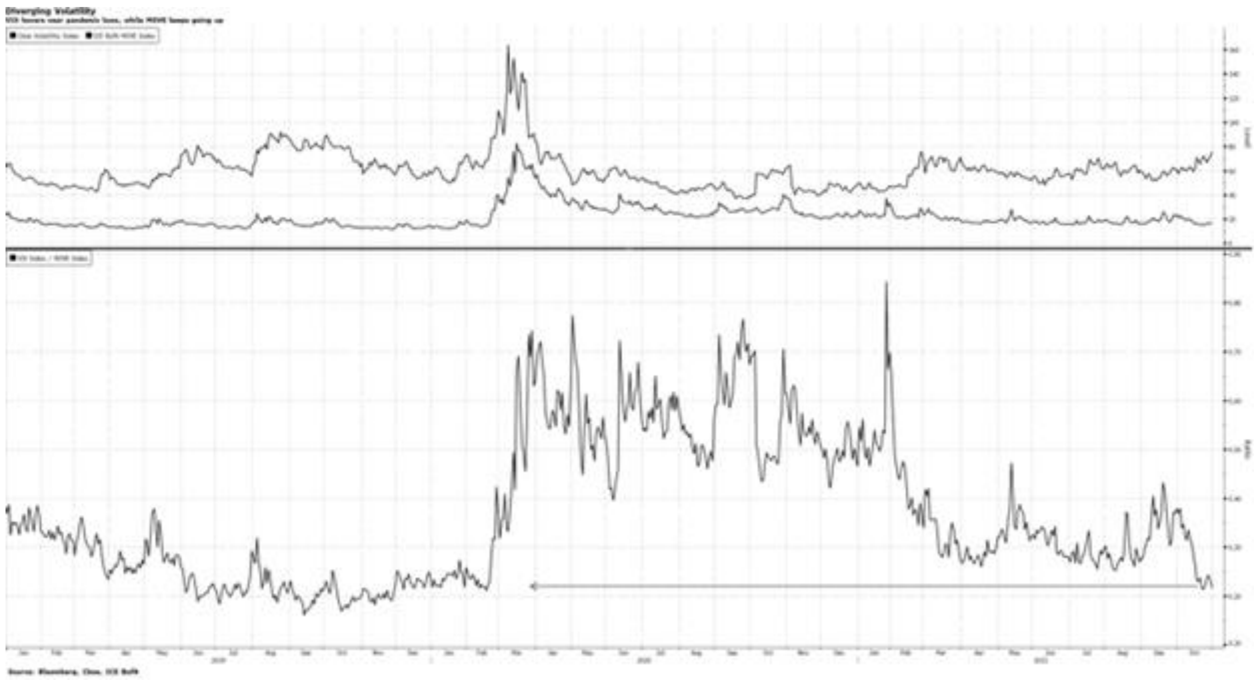
Often overlooked in the short term but evident over time is the math behind compounding returns. It is easy for investors to get carried away with short term performance, looking at individual years in isolation with little regard for the overall investment return.

The last 10 years of S&P/TSX Index returns, from December 2011 to September 2021, produces a compound annual return, dividends reinvested into the index, of 8.7%. However, for any individual year, returns almost never equaled 8.7%. The path investors experienced included several declines of over 10% including two periods of declines north of 25% (most recently a decline of 37.8% in March of 2020). There were of course several periods of 10% gains and the most recent 80%+ gain since March 2020's low. So how does an investor evaluate the advertised number of 8.7% in the context of this experience?

Most investors have foundational principals that help guide them towards opportunities. For us, it is the principle that fundamentals ultimately matter – despite price deviations that can persist longer than anyone predicts. Today, the influence of central banks and governments adds complexity to this relationship – which doesn't mean there is no relationship. We see these deviations as opportunities and exploit them by being patient.

We believe our equity portfolio offers investors excellent value today both on an absolute and relative basis. Over time, investors have been rewarded by owning strong ROE businesses, with stable and growing dividends at reasonable valuations.

Last 12 month metrics	P/E	P/CF	ROE	Dividend Yield
All-Weather Fund	15.0x	9.0x	16.5%	3.6%
S&P/TSX	19.5x	13.0x	12.6%	2.9%



The path you take to achieve investment returns is the most important. Anyone who is living off their hard-earned savings understands this point given that their lifestyle costs are generally less volatile than their portfolio! Therefore, we advocate for an approach that achieves one's investment goals to maintain their desired lifestyle, without exposing themselves to an undesirable investment path.

Today, the portfolio is positioned to take advantage of a rise in volatility, currently evident in the bond market, but absent in the equity markets. We believe the warning signs are clear and when the bubble bursts, we will have no excuses.

Sincerely,

Ryan Marr