Dr. Patrick O'Brien's

February 2023 Client Note

Dr. Patrick O'Brien, (DVM), CIM
Senior Wealth Advisor
604 467-5321
patrick.obrien@rbc.com
www.patrick-obrien.ca

Celine McKay
Senior Associate
604 467-3173
celine.mckay@rbc.com

Tanner Hassell, BBA, CFP, CIM
Associate Advisor
604 467-3259
tanner.hassell@rbc.com

Brooklyn Nikiforuk, BBA
Associate
778 306-9913
brooklyn.nikiforuk@rbc.com

#200 – 11980 227Th Street
Maple Ridge, BC V2X 6J2

Dear Friends and Clients,

Three steps forward, one step back… and now forward again

Last year was a difficult one in the markets. Not just the stock and bond market, but almost everything declined in value, especially after interest rates began to rise in March 2022. Please reach out to me with your questions.

First, a little history…

Interest rates rose sharply, but briefly in 2018 causing a decline in the market. In 2019, interest rates started falling and bottomed with the onset of the pandemic. Since 2019, the cost of borrowing money has been very low. So low, that people of many stripes borrowed a lot and went on a spending spree to buy assets – homes, stocks, bonds, furniture, commodities of all kinds. This borrowed money and the gains they generated (more buyers than sellers) drew more people in - the fear of missing out (FOMO). Over that three years, our companies did fine operationally, but their share prices soared, even our conservative companies based on human needs. Many portfolios eclipsed a 50% gain over those three years ending in 2021.

The borrowed money, aided by supply constraints from covid lockdowns and the Russian invasion of Ukraine, caused prices for fuel, food etc. to increase quickly. To counter this, the Bank of Canada and central banks almost everywhere began increasing interest rates to cool demand and bring inflation back to the ~2% target. Inflation peaked last June at more than 8%. The interest rate increases to calm that inflation have been the most rapid ever and drew comparisons with the 1980s.

Rapid increases to short term interest rates made the borrowers who drove up the asset prices rethink their strategy and have been selling their assets over the last year or so and paying back debt. Consumers are doing the same.

This sets up a hopeful "relief" year and if history can be believed, then we have a high probability of a double digit gain in the Toronto stock exchange this year. History does rhyme, but can't be relied upon to repeat.

The Tugboat Company on the Fraser River:

So what does this all mean with our companies and portfolios last year, and more importantly, going forward? Consider a tug boat company moving logs, gravel, ships etc. on the Fraser River and Howe Sound. They have a good business, gradually increasing revenues and dividends for the last 30 years. The years 2019 to date were unspectacular from a revenue and profit perspective, just business as usual. However, a year ago, a prospective purchaser came by and offered $10 million for the company. The owners marvelled at the offer, but didn't take it as the business was their source of income, same as us. The buyer just came by again last week, but this time was offering just $8 million. His offer was rebuffed again for the same reasons, but the query was posed, "We had a good year last year, so why are you offering us 20% less?"

The answer was that the cost of borrowing has almost quadrupled and the buyer could no longer afford the company at $10 million.

This is what happened to our portfolio of companies last year. Profits good, dividends up – but, share prices down from 1 year ago because the borrowed money premium, built up since 2019, left the market.
I expect, but can't be sure, that we will see a good year in 2023 – profits stable or up, dividends up, and share prices recovering. Why? Because the companies that we invest in are tied to basic human need so whether the economy goes up or down, people can't do without the products/services they provide. No one will be surprised if there is a recession in 2023, so almost any headline less of that should move the markets up. The negative talk and fear based reality is always easier to believe than the idea that things will actually get better.

So what to do?

Not very much actually, except to call me and let's discuss the strategy, your needs, and your financial plan. Almost all of my clients live on the dividends that their investments produce (so they eat the eggs not the chickens).
Crystallizing losses to reduce future and recent past capital gains is almost always a good idea independent of market conditions. Trying to sell out strategically and then buy back in can create tax liabilities in non-registered accounts and doesn't work except by luck. The research on that is pretty clear.

So here we are as we start 2023 – three steps forward since 2019, one step back, stepping forward again now as January was a first good month for the year of the rabbit.

Please do call me about any concerns or financial planning needs you may have. I look forward to the discussion – phone, video conference or in person are available.
If you are planning an RSP contribution, February is the last available month for a deduction on 2022 taxes.

Regards,

Dr. Patrick O'Brien, DVM, Wealth Advisor and Senior Portfolio Manager

Celine McKay, Senior Associate

Tanner Hassell, BBA, CFP, CIM, Associate Advisor

Brooklyn Nikiforuk, BBA, Associate