Wealth Management
Dominion Securities

George Stedman, CFA
Senior Portfolio Manager

RBC Dominion Securities Inc.
1501 McGIll College, Suite 2150
Montreal, QC, H3A 3M8
Tel: 514-840-7626
Fax: 514-840-7639
george.stedman@rbc.com
www.georgestedman.com

Tuesday, July 4, 2023

Second Quarter 2023

The Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla) have accounted for substantially all the gains in the S&P 500 so far this year. What they have in common is artificial intelligence, and massive market capitalizations. Therefore, they have a big influence on the capitalization weighted S&P500. It was up 14.2% in Canadian dollars (16.9% in U.S. dollars) in the first half of the year. Without the FANG+ technology stocks, it was up about 2% (4% in U.S.), similar to the Dow Jones Industrial Average which had a total return of 2.5% (4.9% in U.S. dollars) and the S&PTSX which had a total return of 5.7%.

Turning to valuation, the S&P 500 trades at 19.2 times earnings, but as Tom Lee, CFA, Head of Research at Fundstrat, likes to point out, the S&P500 without the FANG+ technology stocks trades at 16.4 times earnings, a "hardly demanding" valuation. Besides the promise of artificial intelligence, the other explanation for the stock market gains this year, Lee says, is that there has been no recession and there has been a huge decline in inflation. (Weakened Alpha, June 30, 2023)

At the beginning of my career, in the early 1980's, during the worst recession since the 1930's, the hardest cases I had to deal with were people who had retired on a fixed income, whether a pension, an annuity or bonds and whose lifestyle was ravaged by inflation which had escalated in the 1970's.

I remember meeting a new client who was in tears because of the emotional trauma caused by losing money on fixed income investments. I learned people had invested in stocks knowing that they were risky. What they hadn't expected was to lose what they considered to be their safe money, which was in fixed income investments. When interest rates went up, bond and preferred prices fell. When major companies like Dome Petroleum went bankrupt or, like Royal Trust, nearly bankrupt, the losses were traumatizing.
As an impressionable young man, the emotional pain of these new clients, who had been burned by fixed income investments purchased years before I met them, was seared into my brain. Essentially ever since then I have done two things to avoid losing money on fixed income instruments. I buy only fixed income securities with a credit rating of BBB or better, and I don't buy long term bonds. I generally

have a short-term ladder of maturities extending out only 5 years or so. That way about 20% of them mature every year and get reinvested at the prevailing rate. The interest rates average out over the years. The year 2022 was about my worst ever for returns because I lost money on stocks and bonds.

For example, in January 2022, I purchased just below par a Bell Canada bond with a coupon of 1.65% and a maturity date of August 16, 2027. It had roughly a 5-year term. Just a few months later, in June, after the Bank of Canada had raised interest rates faster than ever before, the yield to maturity of that 5-year Bell Canada Bond had increased from under 2% to over 5%. The yield had gone up 3% which over 5 years meant that the market price had fallen 12% in 5 months. I was having flashbacks to the early 1980's. The difference now is that Bell Canada is not in any danger of going bankrupt and that 5 years is within most people's investing time horizon. The bond could be held to maturity. The price history of the Bell Canada bond is illustrated below.

Bloomberg – July 4, 2023

When interest rates were fantastically low, after the Great Financial Crisis of 2008, Guaranteed Investment Certificates (GIC's) were among the least unappealing fixed income investments. Their yield was better than government bonds, yet they had the protection of Canada deposit insurance. Every GIC is a unique security which matures exactly on the anniversary of its purchase (in 1 to 5 years). Therefore, they have very poor liquidity, which is to say they are expensive to sell before they mature. The convention is that these pesky GICs are priced at 100% of their face value, plus accrued interest. In reality, they fluctuate every bit as much as bonds do, actually more. There is nothing to be gained by selling them before they mature as the market price will have declined because interest rates have gone up. It is better to patiently let them run off and replace them. It is quite satisfying to replace a GIC that was bought to yield 2% with a corporate bond that yields 5% to maturity or a government bond that yields 4%.

While our children are still young Kristin and I like to show them other places. We don't travel much but whenever we do, I am very happy to return to Canada. I hope you had a nice Canada Day and that you will have some nice summer weather. We are going on a short vacation. Elena and Margarita will be here to help you.

Sincerely,

George Stedman, CFA

Senior Portfolio Manager
Please visit us at www.georgestedman.com

This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. ® / ™ Trademark(s) of Royal Bank of Canada. Used under licence. © 2019 RBC Dominion Securities Inc. All rights reserved

RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. ® / ™ Trademark(s) of Royal Bank of Canada. Used under licence. Used under licence. © RBC Dominion Securities Inc. 2022. All rights reserved.