Mott Liokossis Wealth Managment Group Newsletter

August 2024 Commentary

We apologize for the gap since our last letter, its simply due to a busy workload. To summarize the year-to-date July 31st, our *Hypothetical Equity Model*[1] stands at 17.11% vs. 13.99% for our *Global Equity Benchmark*[2]. The gap we enjoyed earlier in the year has closed quite a bit, which is typical during a short-term, event-driven correction. We tend to hold market leading stocks and those tend to get hit hardest with profit taking. After such a correction, these outcomes tend to reverse.

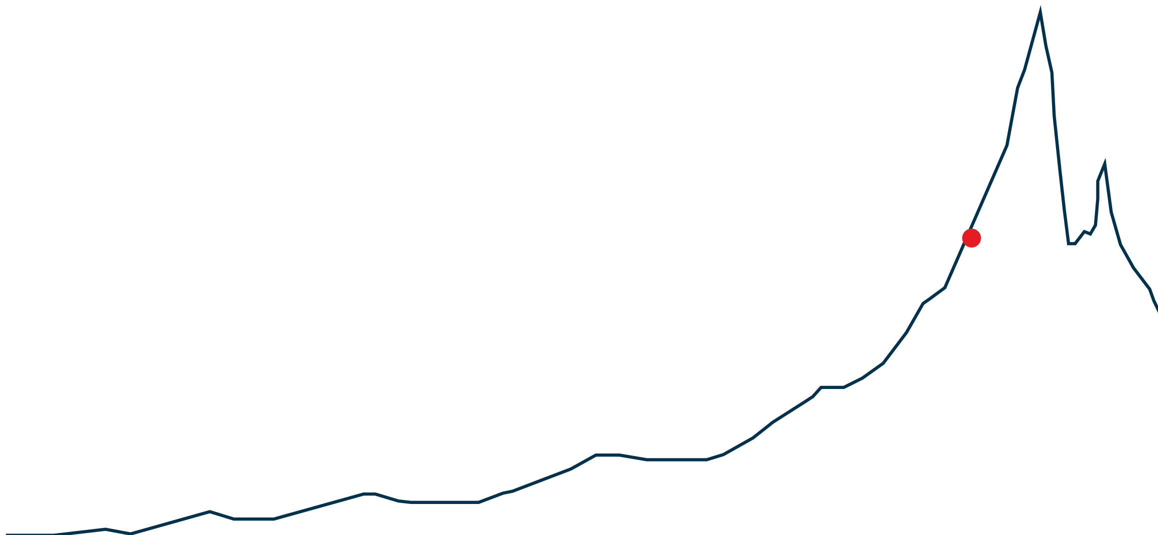
We are still working to bring our updated model to you. It will be a much simpler portfolio with lower costs and even better anticipated performance. We're working through a lot of grinding administrative processes as quickly as possible, but we are close.

Market Commentary

As they say on the nightly news, let's lead with the conclusion. Our 60,000-foot view has been unchanged for several years now. We are in the very last phase of a very long bull market in stocks. It has lasted decades and has been fueled by credit expansion. From here, we think the stock market – at least in the U.S. where we are most heavily invested - will roughly double* over the next eight years or so. Then we will get the crash everyone fears. We do not think there will be a major crash in U.S. stocks before then.

**How high we go may be impacted by how things play out in the short term, more on that near the end of the Market Commentary below*

Historically, when long term trends eventually end, this is what they usually look like:



1 If you are new to this newsletter, our reference to a 'hypothetical equity model' bears explaining. Because every client's portfolio is slightly different and customized, we track a 'hypothetical' model to represent our results. This model contains the same investments as the equity portion (i.e. the 'engine') of your portfolio. It excludes the bonds. Each trade is done at the same time and price as your portfolio.

Our Hypothetical Equity Model closely approximates the actual performance of your equities before fees. It gives us context, allowing for various types of analyses & comparisons.

2 Global stock market is represented by EWI785 World Stock Equal Weight Indext, Courtesy of SIA Charts

Without being too precise, we are currently at the pink dot. A long-term bull market picks up steam over years or decades. Over time as more and more investors pile in, the gains accelerate and then the graph goes vertical, which is unsustainable. It resolves with a sharp decline, a bounce and then a resumption of the decline until much lower levels are reached. You can see that there is a huge amount of vertical gain (returns) compressed into a short period of time (horizontal distance) at the very end, just before the peak. There are correspondingly huge losses in an even more compressed time frame right after the peak.

What should we conclude from this?

1. There is still a lot of money to be made in the next few years.
2. Our challenge will be timing our exit. We want to extract as much of whatever remains of this bull market by not getting out too early.
3. Conversely, we don't want to hang around too long past the peak.

If we are correct about what's coming, many fortunes will be destroyed and many more will be created. It will be a time of big risk and big opportunity, depending upon how you navigate it. More millionaires were created in the five years after the crash of 1929 than any such period in American history until the second term of President Ronald Reagan.

The key is you must sell early and be liquid before the crash. This will allow you to buy assets at ten or twenty cents on the dollar. So, while we have made a lot of money over the last decade, and we expect to make a lot more over the next eight years or so, that will be for naught if we don't get this last bit right.

The methodology we use in managing your portfolio will be critical.

We use a special approach based upon Relative Strength Analysis (RSA) in close collaboration with our partners at SIA Charts in Calgary, Alberta. If you look back at how this style of investing behaved during past major market crashes, e.g. the DotCom bubble of the early 2000s, the sub-prime crisis of 2008 or even the more short-lived Black Monday crash of October of 1987, a pattern emerges.

This pattern became clear and compelling to us in 2009, when we studied with practitioners who had applied these tools in real time during these crises. In each case, RSA signaled a move to cash well in advance of the crash. It was early but it was correct. It allowed investors to do exactly what we described above – be liquid going into the crash, stay whole and have dry powder to invest after the decline.

Before you get too excited, you need to imagine what living through one of those periods would have been like. Imagine selling your stocks and then watching the market climb 20% higher over the next six months while you sit in cash. We expect the next one to be something like this. Things may turn out very differently than what we think but there will be a next one at some point.

The risk for us as shepherds of your money is less about getting caught in the crash, and more about being early, enduring that last bit and trusting our instruments. The pressure to get back into stocks will be enormous. It will require true discipline to make and stick with that difficult trade. However, difficult trades are usually the best trades. Our pledge to you is that we will execute and guide you through it.

We're going to talk more and more about this end game, as we see it, in future letters. We want to beat a steady drum so that when the time arrives, you'll be completely ready. For now, that time is several years down the road. What about the here and now?

Political Change at a Critical Juncture

This time last year we were nearing the end of a two-plus year malaise where most stocks were not doing well. The start of this period of blah was early 2021, coinciding with implementation of a host of policies by the incoming Biden administration in the U.S. that were not market friendly. Early 2021 marked the end of relative global stability on the war front. It was also the end of surplus energy production in the U.S., which had ushered in lower energy prices, lower inflation, lower interest rates and a booming

economy, all of which resulted in a broad stock market surge. Our model piled up almost 50% between the start of 2019 and January 2021.

This time last year, our only guess as to what would end the then-current malaise would be a return to the economic policies of the previous Trump administration. Other than that, we were out of ideas. We predicted a second Trump administration would ignite a renewed acceleration in stocks and the economy. What we did not foresee was the extent to which the market (aka people, aka investors) had totally dismissed the possibility that Trump could ever get a second term. As the reality dawned during the Republican primaries that this might happen, investors, caught by surprise, quickly assessed their positions and began buying. Stocks turned decisively up in December. The type of stocks benefitting were U.S. domestically oriented businesses that would enjoy Trump's brand of hard bargaining with foreign trading partners. The market was surprised. We were surprised that the market was surprised, and the result was the blistering run we enjoyed from December to May.

Japan, then Europe, Then it's Our Turn

That surprise is now in the history books, investors have since looked ahead and what they are seeing is chaotic. The sharp correction we just endured emerged from Japan. The Yen has been under pressure for some time, so the Bank of Japan raised interest rates from roughly 0.10% to roughly 0.25%. Yes, you read that correctly. A 0.15% increase was enough to cause Japanese stocks to sell off by 13% in one day, among other bad days. How is this possible? It is due to something called the 'Yen Carry Trade'. Large institutional investors borrow in Yen at incredibly low interest rates, invest the money in the U.S. at much higher rates, pocket the difference and on top of that, make money on the USD/YEN currency exchange. It is easy money and irresistible – until the Bank of Japan unexpectedly raises rates. The people in these trades were highly leveraged so small losses were magnified, causing instant, massive losses. To cover those losses, and cover the margin on those investment loans, they had to sell other assets which included stocks holdings in Europe and North America. Voila! – you have a correction that hits home.

In previous letters we described how the empire recedes. Cash would flow out of the farthest reaches of emerging markets, then Japan was the next most vulnerable, then Europe. All

that money must go somewhere, it cannot vanish and that somewhere is the U.S. market. This Yen Carry Trade spook illustrated how vulnerable a position Japan is in, confirming our analysis. If we were guessing, we'd expect more intense volatility immediately ahead in September.

Political Fortunes that Determine our Fortunes

We have, again, waded into politics with trepidation but wade we must, because the purpose of this letter is to tell you what we see happening. We don't see the extraordinary events south of the border slowing down. From assassination attempts to the astonishing revolution in the Democratic presidential ticket with Biden stepping down, to cyberattacks, it has been remarkable. We don't see this as right vs. left, Republican vs. Democrat. Rather, this is a fight to the death between a long-tenured elite class of insiders and the rest of us. The entrenched political class of insiders does not want their very profitable apple cart upended by an outsider like Trump or Robert F Kennedy Jr. Will the next three months be the most bitterly

contested, chaotic final phase of any U.S. presidential election so far? Neither side can afford to lose. Nothing, including war, is off the table. It would not surprise us if the election were somehow interrupted or delayed. We have no idea how this will play out. Expect the unexpected between here and election night in November, and beyond. We cannot hazard a guess as to how things will play out or how that will affect markets, but we will make one prediction.

We see a Kamala Harris administration as, unsurprisingly, essentially a continuation of the policies of the Biden administration. We would expect spending and taxes to accelerate dramatically. To give you two examples of likely policies, current Secretary of the Treasury Janet Yellen has firstly proposed $3 Trillion (!) per year in additional spending to transition to sustainable energy. In addition, she has spoken openly about possibly taxing unrealized capital gains. What does that mean? Imagine you bought a house 40 years ago for $100,000 and it's now worth $1 million. You haven't sold it and don't plan to. This policy would have them value your house at fair market value and then assess capital gains taxes on the unrealized $900,000 gain. Very few people have the liquid funds to cover that big a tax bill so they will be forced to sell their homes and downsize. The ramifications can't be overstated.

*How does the short term affect the 60,000-foot big picture?

Remember, when we talk politics, we are talking about effects on your portfolio. This kind of taxing and spending will not be good. For us the next three months will be the most anticipated in our three plus decades in the investment business. It will not change the big picture we outlined at the beginning of this letter, but it could blunt the ultimate level we attain by the end of this bull market. Conversely, a Trump second term would probably make that final peak higher.

As usual, we stand ready to be completely wrong! Time will be the judge.

Integrated Tax Advice

One of the cornerstones of financial planning is capital preservation. In past years that involved considerations of how and where to hold assets, and from an investment management perspective, when to sell an equity and rebalance a portfolio. In our current punitive tax environment capital preservation has become synonymous with the term tax planning.

It is because of this stark reality that we have moved much further into providing tax planning as an integral part of our service commitment. We look forward to speaking with each and every one of our clients about their tax concerns, be that from making sure retirement funds don't fall prey to the current rate of high taxation, to helping prepare your enterprises for potential sale to a third party, to transitioning the business to the next generation.

People and businesses all have lifecycles. Financial planning directs that flexible and prudent tax reduction strategies are implemented for each stage of life. For individuals this might mean looking for opportunities to tax shelter some the growth in their net worth. For businesses this might include helping reorganize a company to transition to the next generation and making sure that when the founding

generation passes on that their life's work it goes to who they chose, be that family or charity, and not to a government incapable of any sort of fiscal discipline.

The recent changes to the taxation of capital gains have given many of us time to pause and consider just how much of our net worth a ravenous government intends to take. The claim that only .14% of Canadians will trigger a taxable capital gain in excess of $250,000 is pure sophistry. Anyone with an investment portfolio, a family cottage, an investment property or an incorporated business knows this firsthand.

We are told that only the much maligned "1%" will pay this new higher rate of tax, and they are just being asked to pay a "little bit more". In fact, most of us who consider ourselves to be part of the middle class will be affected by this measure. Canada, unlike our American cousins, does not impose an Estate Tax, but instead a taxpayer is "deemed to have disposed" of all capital assets at Fair Market Value the moment before death. Under the new rules these dispositions will give rise to an effective tax rate between 34-38%.

For business owners, the peril of double taxation at death is a real threat. Absent planning it is possible to lose 83% of the value of your enterprise to taxation. For us that is simply not morally justifiable.

For those who have saved, many in registered plans, the tax upon passing is likely to be 53.53%.

Taxation is simply too high in Canada. We resolve to take a vanguard position, to help our clients understand taxation, and together with their professional advisors, to implement prudent strategies to reduce them. To preserve the sacred capital that you have built through a life's work, and to see it passed on to whom you chose. For us, this is a call to action, we hope you share in our commitment.

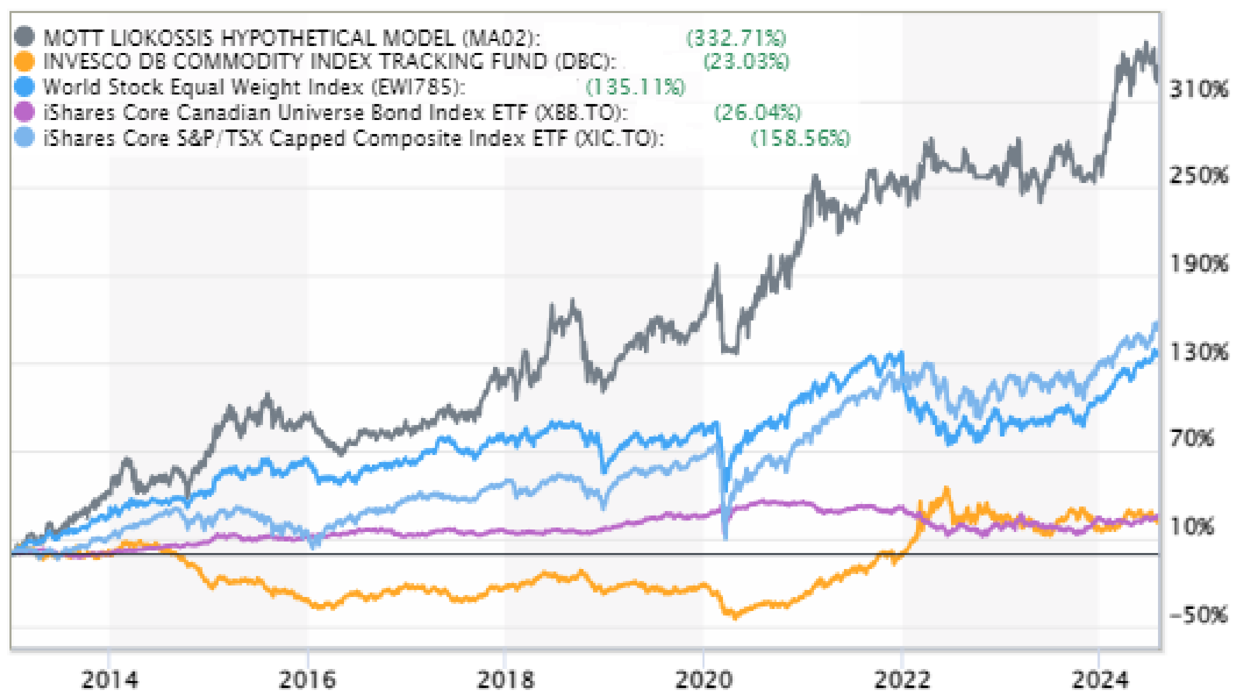
We look forward to our upcoming conversations.

Mott Liokossis Hypothetical Equity Model – Holdings at July 31, 2024

Weight	Equity Name	Symbol	Sector	Price	TTM Yield
5.95%	EMBRAER S.A. ADR	ERJ	Aerospace and Defense	$42.88	0.00%
5.47%	SEAGATE TECHNOLOGY PLC	STX	Computer Hardware	$141.07	1.98%
5.66%	D.R. HORTON INC	DHI	Construction	$248.43	0.46%
5.41%	NOVO NORDISK A/S ADR	NVO	Drugs	$183.12	0.75%
5.60%	TRANE TECHNOLOGIES PLC	TT	Manufacturing	$461.54	0.69%
6.26%	SAP SE ADS	SAP	Computer Software	$292.16	0.82%
39.07%	SIA ML GLOBAL TACTICAL POOL CLASS I	SWI220	Global Equity	$25.62	1.32%
5.84%	KKR & CO. INC	KKR	Financial Services	$170.45	0.39%
5.69%	HILTON WORLDWIDE HOLDINGS INC	HLT	Leisure	$296.39	0.20%
10.39%	BMO SIA FOCUSED CANADIAN EQUITY ETF	ZFC.TO	Canadian Equity	$42.96	0.50%
4.64%	CASH				

Mott Liokossis Hypothetical Equity Model – Percent Gain from Jan. 4, 2013 to Jul. 31, 2024

Growth Chart



Powered by SIACharts.com (Jul. 31, 2024)

Click here to access your online account and tax statements

Click here to learn more about the team

Click here to contact us

Blair Mott
FCSI, CIM®, FMA
Senior Wealth Advisor
& Portfolio Manager
519-646-2146
blair.mott@nbc.ca

Tony Liokossis
B.A., FCSI, CIM®
Senior Wealth Advisor
& Portfolio Manager
519-646-5728
tony.liokossis@nbc.ca

Stephanie Lindsay
HBA
Wealth Associate
519-646-2149
stephanie.lindsay@nbc.ca

Juliana Weese
Wealth Associate
519-646-2152
juliana.weese@nbc.ca

Bogue Clark
Wealth Associate
905-980-6331
bogue.clark@nbc.ca

© NATIONAL BANK FINANCIAL. All rights reserved 2024.

National Bank Financial - Wealth Management (NBFWM) is a division of National Bank Financial Inc. (NBF), as well as a trademark owned by National Bank of Canada (NBC) that is used under license by NBF. NBF is a member of the Canadian Investment Regulatory Organization (CIRO) and the Canadian Investor Protection Fund (CIPF), and is a wholly-owned subsidiary of NBC, a public company listed on the Toronto Stock Exchange (TSX: NA).

The information contained herein was obtained from sources we believe to be reliable, but is not guaranteed by us and may be incomplete. The opinions expressed are based on our analysis and interpretation of this information and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. The opinions expressed herein are those of the author and do not necessarily reflect those of National Bank Financial.

The securities or investment sectors mentioned herein are not suitable for all types of investors. Please consult your investment advisor to verify whether the securities or sectors suit your investor's profile as well as to obtain complete information, including the main risk factors, regarding those securities or sectors. This document is not a research analysis produced by the Research Department of National Bank Financial.