



mutual gains

ISSUE NO. 226 March / April 2025

THE VALUATION CHASM COULD BE CLOSING

The AI story has been going on for quite a while and the longer it goes on the more pain it will eventually inflict. I've touched on this topic a lot over the past several months.

What is bound to happen is a "valuation reset". It could come from 1 or a multiple of triggers, making investors in these very richly priced companies to move on to companies that offer much better value; companies that are significantly cheaper.

The valuation between "growth" and "value" companies is historically at all time wide margins. "Growth" are companies that are growing their earnings faster than most others. "Value" are simply companies that are cheap relative to their stable yet slower growing earnings.

A valuation reset can come swiftly, by a sharp drop in the price of growth companies. This happened in 2022 when in the first 6 months "the market" was down over 20%. Exuberance did come back

WE WILL LISTEN CAREFULLY
TO WHAT YOU ARE SAYING
AND BE ATTENTIVE TO YOUR DESIRES
AS WELL AS YOUR FEARS
SO TOGETHER WE CAN BUILD
AND ENJOY
A HARMONIOUS
AND RESPONSIVE RELATIONSHIP
IN ATTAINING YOUR LIFE'S DREAMS
AND THROUGH THAT
WE WILL BE ATTAINING OURS.

THE VALUATION CHASM COULD BE CLOSING 1

THE PENT UP VALUE IS OUTSIDE THE USA 2

WHAT CRYPTO CURRENCY IS 2

HOW TO ELIMINATE PROBATE FEES ON CASH 3

CHANGING YOUR RENTAL PROPERTY'S USE 3

HOW TO USE THE ENVELOPE SYSTEM 3

LIFE GEMS—ADVISOR STREAM 3

HHHMMM... 4

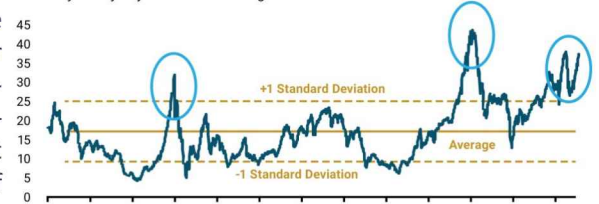
in this case. It often doesn't. The more telling is the aftermath of the 2000 tech bubble. Many companies today (25 years later) are just getting back to those peak 2000 prices with even more still well below those.

A flashing risk sign signaling that the divergence could end sooner rather than later is how fast smaller investors have ramped up their buying of growth companies (which ironically today are companies that from a "market capitalization" perspective are the largest in the world, yet historically large companies grow their earnings slower).

History has been highly consistent in showing that when the smallest of investors are piling in, the party is nearing or coming to an end. (Speculative bubbles were biggest in 1929, 2000 and the last few years; the bubble bursts only on the high priced companies.)

Despite all of the negative news and the feelings Trump is creating, there are still a lot of positive tailwinds in place which is keeping the party going. However, when valuations are as excessive as they are and everyone is "all in", it doesn't take much to end the mania and usher in a rapid and / or significant

The Cyclically Adjusted P/E Ratio is Very High
Shiller Cyclically Adjusted Price/Earnings



Source: Robert Shiller, Picton Mahoney Asset Management Research, Jan 1900 to Dec 2024.

(Continued on page 2)

decline in the highest priced (and most bought into) companies.

We allocate the total sum of most of our clients' portfolios between 3 different portfolio management firms, 2 of which are in Toronto and 1 in Salt Lake City. None of these will chase a market narrative or pile into a theme. They all operate as "business people buying businesses". This means a thorough digging into and analysis of any 1 business, which takes many many hours. Ultimately, the question becomes, "If we could buy the whole business, at what price would we be comfortable doing that?". This is very different than what most people do, which includes many professional investors who are trying to save face (and their jobs) by not willing to look wrong today, or different than their peers.

THE PENT-UP VALUE IS OUTSIDE THE USA

While the US market, led by the "Magnificent 7" (or Mag7 which include Nvidia, Microsoft, Alphabet/Google, Meta/Facebook, Tesla, Apple & Amazon), has become ever more expensive, companies outside of the US could be setting up for a reversion to equilibrium from their relatively bargain state (relative to US companies).

The foundational measure of pricing a business is current earnings and how those earnings are expected to grow over 3 to 5 years. The recent past (January & February) has seen the estimates for US company earnings being cut whereas in Europe, the expectation is that earnings will be increasing from their current levels. When earnings grow, the share prices of companies experiencing this, will eventually rise to follow.



Here is an example for illustration of how this plays out for those investors who don't simply buy what everyone else is buying. The blue line is the stock price. The earnings/share are the numbers floating above that line. As you can see, the earnings were \$3.38/share for this business; however, 5 years later they were \$7.46/share. That is an earnings growth rate of 19%/year. The ending share price (blue line) however is only a bit higher than at the beginning of this chart's time period. Over a long term basis, if the earnings are growing at a specific rate, the share price will eventually increase to match that rate of growth. Likewise, the market will eventually fully appreciate the strength and value of this business and the company's share price will move more strongly upward.

Upside is very important in investing. Equally important though is keeping risk low. You can have both by owning a company whose share price doesn't fully reflect its growing earnings. Increasing (and pent up) value is safety built right in. This isn't to say, during an emotional and uncertain event (e.g. Covid or a war), that the share price of companies like these will not fall as far as any other. They generally do. However, the earnings vs share price discrepancy is a strong foundation that will bring the share price quickly back up to closer where it should be.

The optimism of the Mag7 has so many investors completely oblivious to the value that has been building in so many companies around the world, and to the increasing risk of owning companies which the market deems can do no wrong. Eventually, the Mag7 and many other companies like it will lose their shine. We are starting to see signs of that today.

WHAT CRYPTO CURRENCY IS AND WHAT IT ISN'T

I continually come across people who have bought a relatively small amount of Bitcoin or some other crypto currency. Those who bought it along with most others don't really know what it is.

Bitcoin, the 1st crypto currency came to be in 2009. 16 years later, despite being called a currency, it doesn't act like one. Rather it has become a form of investment that people speculate on, with many people buying on lows and selling when it has gone sharply. Most who bought it though keep holding it, expecting that its price (value?) will be much much higher in the long run.

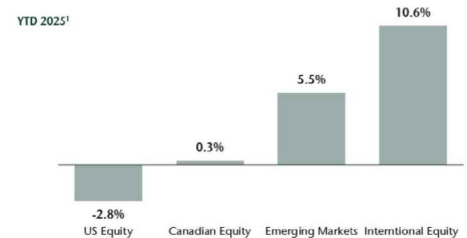
It fluctuates too wildly to be used as a currency or mode of exchange. If the price is low, you aren't going to spend it on daily needs. That would be selling low. As well, if the price is high, you are probably selling all you hold, replacing it for traditional cash which you will use to pay for the things you normally spend your money on.

Despite that, crypto currency's biggest challenge as a cash alternative is they have to compete with stable currencies (eg US\$, Euro, etc.). However, in some parts of the world, crypto has started to be used as an actual currency. In places like Venezuela, Nigeria and El Salvador, Bitcoin is being used to buy everyday goods. However, that is happening mostly because "stablecoins" have been implemented by those

(Continued on page 3)



EQUITY MARKET PERFORMANCE



governments. The price of these stablecoins is tethered to the value of the country's currency. This works so well in those countries because crypto currency is used electronically, which helps with countries that have a poor banking infrastructure (eg few ATM's).

Until governments create or back crypto currencies, including guaranteeing them, they will continue to be something that people speculate on rather than actually use. This is further confirmed by the fact that there are 13,000 to 18,000+ active crypto currencies (and that since 2013, at least 12,383 crypto currencies are now worthless).

HOW TO ELIMINATE PROBATE FEES ON CASH

Probate fees are basically provincial government tax imposed on the death of one of its residents. This can be avoided though but only if a beneficiary is named on the asset. This is most commonly done with "registered" plans like a RRSP/RRIF, TFSA, etc.

If you hold money in a GIC or any other bank deposit, paying probate fees is inevitable, but it doesn't have to be. The way to avoid the 1.4% probate fee on any bank deposits is to move that money to a guaranteed deposit at a life insurance company.

The reason why this works is that life insurance deposits are considered an "annuity" which is a "life insurance contract". They work exactly like a bank deposit until the owner of the deposit dies. With any life insurance company deposit, the money goes directly to those you have named as the beneficiaries. Any money held at a bank has to go through probate, which costs 1.4% of those assets.

We have saved our clients thousands of dollars by moving money from bank GIC's and savings accounts to life insurance company GIA's (the life insurance company equivalent to a bank GIC). If you want to get away from paying many thousands of dollars in probate fees on a large amount of GIC's currently held by you or an aging parent, with the same level of guarantee*, this is the way to do it.

* Canadian life insurance GIA's are guaranteed up to \$100,000 which is the same coverage as with a bank GIC. You can also get a guarantee along with better tax efficiency and growth potential with a life co. segregated fund, while also eliminating probate fees.

CHANGING A RENTAL PROPERTY TO YOUR PRINCIPAL RESIDENCE

We all know that when you sell something that has gone up in value, you are going to pay tax on the capital gain. However, you don't necessarily have to sell something you own to trigger a capital gain. If you own a rental property and decide to kick your tenants out so that you can live in it yourself, you will also trigger a capital gain and, if the property has gone up in value since you bought it, tax to pay. This is called a "change of use". However, you can delay the tax on the capital gain for up to 4 years.

This scenario could come into play if you own your own home and a rental property; you decide to sell your home (for tax free gains) and then move into your rental property. Also, if you own a rental property and really have no principal residence that you own, you move into your rental property as your principal residence. Both of these scenarios will trigger capital gains.

The tax on this capital gain would have to be paid no later than 4 years after the "change of use". This could mean that you have tax to pay, yet you haven't actually freed up any cash to pay it. That could be the case in the 2nd scenario which could mean having to increase (or add) a mortgage to that property so as to create cash to pay the tax. With the 1st scenario, hopefully you would have freed up cash from the sale of your home, and set aside funds you now need to pay any tax owing.

HOW TO USE THE ENVELOPE SYSTEM

Financial "Budgeting" takes a lot of time. Because of that, it often doesn't get done. I completely get it. The last thing we want to do when not working is to have another personal task to do. Getting a handle on your expenses, particularly if your income seems to barely meet your monthly living needs, is imperative. If you don't, you'll either slowly dig yourself into a debt hole or, years later you'll find that all of your money seemed to flow like sand through your fingers; finding yourself in your 50's or 60's, in regret.

The simplest and easiest way to correct this problem is to use the "Envelope System" for all of your costs that aren't automatically coming out of your bank account on a monthly basis. When income comes into your bank account from your employment, you withdraw a pre-determined amount of cash for each category of non-fixed spending you have. This would mean an envelope for each of the following: 1) Food, 2) Clothing, 3) Entertainment (includes dinner out) and 4) Hobbies for each person in the family. You may have other categories (or want to break these into separate envelopes for individuals) but those are generally the big main categories of discretionary expenses.

As the month goes by, you see that your "Grocery Envelope" is empty before the next incoming dollars comes in. You could take from another envelope, but that would mean that other category would have less available. This requires you to develop a skill of balancing out what is needed versus what is wanted.

Although travel is a very large discretionary expense, that shouldn't have a physical envelope. You wouldn't want thousands of dollars accumulating in an envelope. For that, you should have a "Virtual Envelope", which would be an account you add to on a monthly basis so as to meet that expense when it comes time to pay for it. That of course will only have a certain amount of money in it when it comes time to take your trip. Again, you'll have to work within the limits of what has been saved, or decide if it is worth it to sacrifice money from your "Entertainment Envelope" to beef up your trip. Alternatively, you could move the saved dollars to fund more entertainment throughout the year.

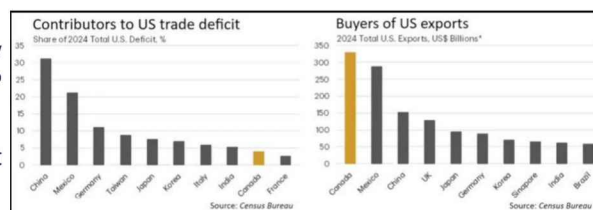
TECH GEMS— AdvisorStream

Do you ever see a headline for an article that you want to read, only to find that you need a subscription to access it? I have come across this

many times. There is a service that I have subscribed to whereby I can share “subscriber only” articles from some of the largest global publications. These include The Wall Street Journal, Barrons, Forbes, Globe & Mail, National Post, Financial Post, The Economist and many others. The best way to ensure you have access to any articles I may share from a wide variety of media sources (and see my comments on those), you’ll need to connect with our office via [Facebook](#), [LinkedIn](#) or [X \(pka Twitter\)](#). If I see an article that is missing the point, I’ll definitely make my thoughts known, as well.

HHHMMM...

- The Magnificent Seven has been responsible for the bulk of the S&P 500’s gains over the past 2 years. With profit growth slowing and valuations stretched, investors have been increasingly looking to the other 493 companies for outperformance.
- Historically, in any given year, the broad equity market can go down from a peak by –14%. This is normal and thus, volatility like this presents buying opportunities. Panic selling in such cases must be avoided.
- Chase Bank (USA) looked at times when funds were transferred from bank accounts to investment portfolios during 2024 and laid that number over the highs of the market. They found that, 1) people tended to transfer more funds to their portfolios AFTER a period of strong market returns (i.e. they “buy high”), 2) periods of high market volatility often spurred elevated rates of movements to and from cash and 3) male investors seemed to be much more triggered by market events and recent returns (emotion) than their female counterparts.
- Today, the smaller the company, the cheaper it is. Historically that has been flipped around, where smaller companies are more expensive because they generally grow faster (earnings) than larger companies. Aubrey Hearn, CI Global Asset Management, Feb 2025
- Small-cap companies are likely to be unaffected by tariffs and therefore stand to benefit competitively, as their operations typically are domestically based, enabling them to avoid the threat of protectionist economic policies.
- Each year our investment team members meet with hundreds of management teams and attend dozens of conferences, site tours and factory visits. We talk to suppliers, customers, industry experts and competitors. And we comb through financial statements, shareholder letters and investor decks, all to build a mosaic of information that eventually leads to an (investment) idea (that could potentially be added to our clients’ portfolios).
- Tariffs generally have little effect on smaller US companies because they are usually focused on the US market. Most of our client portfolios have a relatively minimal allocation in these.
- Trump metal tariff in 2018 raised the cost per American sold car by \$700. Current tariffs will add \$2,100 / car (and that is just tariffs on metal).



- BMO now anticipates the Bank of Canada will implement six consecutive quarter-point interest rate cuts, bringing the policy rate down to 1.5% by October. It is currently at 3%.
- It costs the US government 3.69 cents to make a penny and because very few people reuse pennies, giving them to others as currency, the government has to spend \$85 million dollars each year making pennies.
- In BC, a \$100 donation results in a \$20 tax credit, but a \$1000 donation results in a \$406 tax credit. Wondering how much of a credit you could get for the donations you have or are planning to make? Check out <https://www.canadahelps.org/en/tax-time/>. Because of the low savings on smaller annual donations, it can be better to use the donations you’ve made over 5 years (max) and deduct them all in 1 year.
- Canadian credit card debt has increased from ~\$60 billion to over \$100 billion in 4 years.
- The last time the Liberals made what they called a personal income tax cut, in 2016, they slightly reduced one bracket’s tax rate while simultaneously eliminating income-splitting for couples so that the vast majority of middle-income families actually paid more tax than before. #Smoke&Mirrors
- You can delay OAS to get the maximum amount. This can be the best thing to do if you expect to live past age 85 and don’t need the extra money. If you are over 75 and both members of a couple delayed receiving OAS until age 70, the total OAS would be \$25,600/year.
- MAID deaths accounted for 4.1% of all deaths in Canada in 2022, an increase from 3.3% in 2021, 2.5% in 2020, and 2% in 2019. BC was the highest province at 6.6% in 2022.
- Demographic shifts will have massive implications for Asia's future. The rapidly rising life expectancies and reduced birth rates of the populations of China, Japan and South Korea will place great burdens on the next generation. The gender gap is caused by selective abortion and infanticide in East and South Asia; these have created a deficit of tens of millions of girls, giving rise to prostitution, sex trafficking, wife-buying and abduction.
- There's a #bookstore renaissance both in the US and the UK. The #BarnesandNoble chain is expanding again: 57 new stores last year. The Guardian recently wrote that bookstores were cool again, that #millennials and #GenZ enjoyed spending time there and preferred asking for recommendations from humans rather than #algorithms. I've found out that #musiconCD is making a comeback also.

Chris