

# During Uncertain Times: The Importance of Diversification

Volatility made a comeback to start 2025, fueled by the introduction of DeepSeek and U.S. President Trump's decision to unleash a trade war, adding new concerns for the markets.

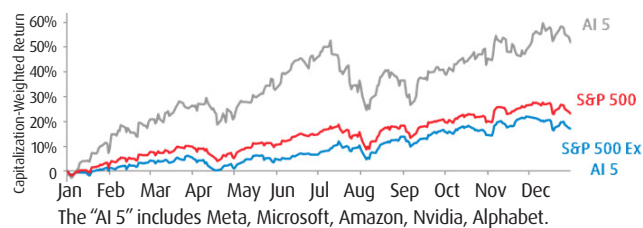
At the end of January, China's DeepSeek claimed to have developed top-tier AI for just US\$6 million—a fraction of other players' costs without relying on Nvidia's expensive chips. While this figure has since been disputed, it has shaken market assumptions about the dominance of certain U.S. AI players. A week later, the U.S. unleashed a trade war with its closest allies.

These two events serve as reminders of why diversification remains one of the investors' best allies:

**Sector Dominance & Rotation** — The AI boom has fuelled market optimism in recent years. The capitalization-weighted return of the top five U.S. AI companies relative to the S&P 500 in

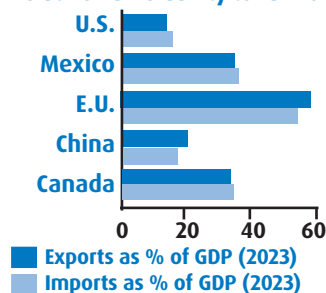
2024 alone (chart) highlights how a handful of names have come to represent a disproportionate share of the benchmark. DeepSeek's announcement may have unsettled markets, but consider that innovation inherently requires disruption—a concept often described in Schumpeter's *Creative Destruction* theory. This may also encourage constructive sector rotation into non-tech areas, some of which have been overlooked amid the intense focus on technology, with a greater focus on earnings growth and strong fundamentals as drivers of stock prices. It may also be a reminder that companies, sectors, geographies and even asset classes can fall in and out of favour over time.

2024 Capitalization-Weighted Returns, Top AI Stocks vs. S&P 500<sup>1</sup>



**A Changing Geopolitical Landscape** — Trump's tariff stance has reshaped geopolitics and tested diplomatic relations, underscoring Canada's vulnerability to trade disruptions. Canada remains heavily reliant on the U.S. as its primary export market. In 2023, Canada's total exports reached C\$965 billion and the U.S. was the destination for 77 percent of exports—no other nation accounted for more than 5 percent. Canada's imports totalled C\$978 billion, with 44 percent from the U.S. Just as diversification is essential in portfolio management, it is equally critical in trade. Overreliance on a single partner carries significant risk if conditions change. At the time of writing, as the tariff situation continues to evolve, we remain focused on assessing the potential impact on investments, recognizing that the scope, magnitude, duration and potential economic implications can shift over time.

Relative Vulnerability to Tariffs<sup>2</sup>



## The Continuing Importance of Diversification

A core principle in our approach as advisors has always been the importance of diversification. This principle is more critical than ever in today's environment, which is heavily tilted toward uncertainty. While we can never predict the future with certainty, a well-diversified portfolio can help to dampen volatility and, perhaps most importantly, prepare us to navigate a range of possible outcomes.

1. Nesbitt Burns Portfolio Advisory Team; 2. <https://www.scotiabank.com/ca/en/about/economics/economics-publications/post.other-publications.canada-and-us-economics-.canada-and-us-decks.trade-stats-january-31-2025-.html>



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