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INVESTMENT COMMENTARY: WINTER 2021

"The stock market is a giant distraction to the business of investing."

– John C. Bogle

As it was for many aspects of life, this past year on financial markets was both unusual and extraordinary. Who would have predicted during last March's stomach-churning selloff that 2020 would turn out to be a strong year for stocks?

With much drama and angst, the total return for the S&P/TSX Composite Index as at December 31, 2020, was 5.6% while abroad, the S&P 500 and MSCI World Index closed the year with gains of 16.2% and 14.4% respectively in Canadian dollars.

Typically, market declines of the magnitude witnessed early last year usually take several months to unfold. For instance, during the financial crisis of 2008, it took nine months for global markets to finally hit bottom in March 2009. Similarly, the implosion of the "Nifty Fifty" stock market darlings in the early 1970's, took 23 months to unfold.

This time around, barley one month separated the peak from the trough, during which time many global equity benchmarks dropped over 35%. And, within that relatively short period, 85% of the total decline came in just 11 trading days in March. Fears spilled over into the bond market as well, where even the highest quality issues saw liquidity seemingly dry up overnight.

Then, POOF, as quickly as it happened, it was over. By stepping in and buying almost every issue in sight, the Bank of Canada created liquidity in the bond market while extraordinary monetary stimulus unleashed by global central banks propped up asset valuations.

These advances were underpinned by an excitement for investing not seen in decades, as people of all ages jumped into the market to ride its wild moves. To top things off, the market for initial public offerings thrived with many new issues surging on their market debut. Witness the day one price action of so-called unicorns Door Dash and Airbnb – the founder of the latter left speechless on live television by the price surge.

We are pleased that portfolios managed by Commodari Antinori Group handled this unprecedented period well. True to form, our drawdown at the stock markets nadir in mid-March was less severe and, given a late year rally in many of our holdings, performance overall was quite robust.

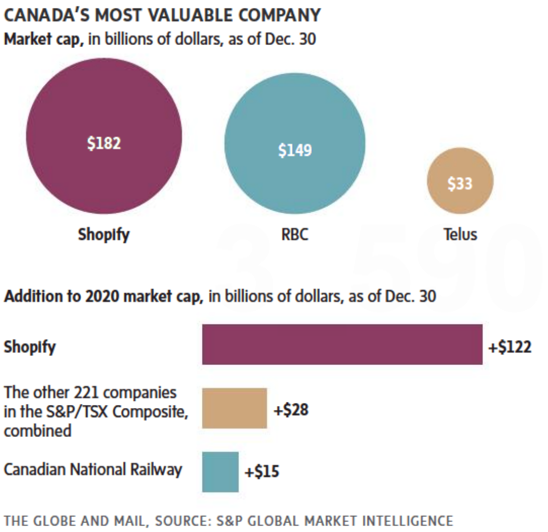
EQUITY INEQUITY

Despite the robust rally last year, a look beneath the surface reveals that the health of global stock markets is not as hearty as it appears at first glance. This holds true for many markets including Canada but especially the United States.

First though, a look at our home market. O Canada, hewers of wood and drawers of water, eh! Once again, the performance of our domestic index, the S&P/TSX, lagged its global brethren. Scorned by investors, stalwarts such the banks, telecoms, and pipelines participated little in last year's gains – many, finishing the year with negative year-over-year returns.

A striking contrast of just how large the divide lies can be seen by comparing Royal Bank of Canada and Shopify. In their most recent quarterly reports, the former posted a profit of $3.2 **billion** and the latter $60 **million**. Nonetheless, in 2020, Shopify was up 178% compared to RBC's anemic 1.79% and thus displaced RBC as Canada's most valuable company.

The graphic below highlights the absolute dominance of Shopify over the rest of the S&P/TSX.



As you can see, in 2020 the market capitalization of the index grew by $150 billion with Shopify accounting for $122 billion or 81% of that amount. The remaining 221 constituents ***combined*** contributed a mere $28 billion or 19%. Excluding Shopify, the return of the S&P/TSX Composite Index would have been -2.5%.

The underlying health of the U S stock market as represented by the S&P 500 is not any better. By weight, the top **five** stocks account for 22% of the index and, together, they delivered a return of 25% while the remaining **495** components - accounting for 78% of the index's weight - returned -9.0%.[1]

So, why not just own the top performers and forget the rest? Borrowing a phrase made famous by Ron Popeil, "just set it, and forget it!" After all, in many areas of life, doing more of what works usually delivers good results.

Of course, this statement makes lots of sense when grounded in logic. The problem arises when actions are motivated not by logic, but rather, emotion - anger, envy, fear, etc. In such cases, results could fall short of expectations; think a lover's quarrel, a bar fight and, need we say it, the Nifty Fifty!

Today, over ten years into a bull market with only a few hiccups along the way, many professional money managers are in the hot seat. Rather than face criticism and withdrawals from disillusioned clients, they succumb to pressure and "give the people what they want". Void these checks and balances the inequity noted above deepens: the big get even bigger while the rest are ignored. And a self-feeding mechanism is created.

Of course, while adapting our approach to changing times, we ***always*** stay true to our time-tested, market-proven principles. It remains our firm belief at Commodari Antinori Group that when it comes to equity investing, owning a diversified portfolio of 25 - 30 reasonably priced businesses is the best ticket to minimizing risk and to consistently making money over time.

THE ONLY GAME IN TOWN

Indulge us for a moment as we recount a true story from the past. There once was a very smart man - in fact one of the smartest in history. He owned a stock at $200 in March that he subsequently sold in June at around $600 and then bought back again in July/August at between $900 and $1,000. By September, that said stock was trading again at $200. Ouch! Could the stock be Tesla or perhaps Yahoo back in 2000? Neither!

The gentleman in question was Sir Isaac Newton, the year was 1720 and the stock in question was the South Sea Company. Despite his vast intellect, he could not escape the draw of arguably, the greatest momentum stock of the era. Of course, the stock subsequently collapsed and, sadly, Sir Isaac Newton lost the equivalent of more than $3 million today.

Currently, spurred by low-cost discount trading and "investor-tainment", momentum is alive and well and driving a large portion of the stock market's recent gains.

Zero commissions and fractional share ownership have led to an explosion on new account openings at online brokerage houses such as Schwab, eTrade, and Robinhood. Upwards of 13 million new accounts have been opened[2].

With restrictions and lockdowns put in place to "flatten the COVID curve" everyday pleasures ranging from working out to watching sports on TV were temporarily halted. People had time on their hands. The stock market became for many the "only game in town"; a diversion … entertainment. Any wonder then why retail trading activity surged?

Much, if not all, of this activity was and continues to be speculative. A mention on Reddit or the announcement that a company will soon split its stock is enough to blast its share price into orbit - even though a stock split creates no economic benefit for the company.

In one case, the Securities & Exchange Commission (SEC) in the United States felt compelled to act to prevent a fleecing of incredibly ***willing*** online traders. In May 2020, Hertz Rental Car was forced to file for Chapter 11 bankruptcy protection and yet, the company's share price took on new life gaining several hundred-fold over a few weeks. Incredible but true! This odd turn of events encouraged the bankrupt company to attempt a stock issuance – after-all, it had willing buyers. Alas, the SEC kiboshed this offering.

We would all be wise to remember that investing is not a game or a form of entertainment. When momentum falters: look out below – Sir Isaac Newton, prior to trading, should have consulted his notes on his Laws of Gravity.

FOLLOW *YOUR* PATH

In many areas of life, when confronted with a problem or issue, we consider our personal experiences and observations; we read up on the subject; consult friends and family; and look to experts. We determine alternatives and then we act. This decision-making framework generally works fine - a well-reasoned and sound consensus on the subject at hand coalesces and the right course of action is evident.

In the investment arena however, consensus is often dangerous, and the right course of action becomes clear only in hindsight - it is less apparent as you are going through the cauldron. Opinions are plentiful - from the barber to the economist. The latter typically generate reams of back-tested data to back up their opinion. Then, they are invited to squawk on the financial channels on cable television: point, counterpoint, drama … confusion.

What is an investor to do? Our belief is that the best way forward is to forget the talking heads, tune out the chatter, and most importantly, avoid impulsive actions. Instead, apply a rational framework to define and follow your path.

This journey begins and ends by knowing yourself and the specifics of your situation. When will you need some or all of your capital back? How much income do you need each year from your portfolio? What amount of stock exposure will make you sleep well at night? The answers to these questions – which may evolve over time – will, through thick and thin, keep you on track.

PORTFOLIO DEVELOPMENTS

Our investment philosophy is to make concentrated commitments of capital in a limited number of companies that have superior long-term economic prospects and sell at what we believe are attractive prices.

The table below shows the stock price performance of our fifteen largest holdings at the end of 2020:

Source: BMO Retail Information Systems **Holdings**	**% of Equity 31-Dec-19**	**Price Change[1]**	**% of Equity 31-Dec-20**
Toronto-Dominion Bank	*4.2%*	*-1.2%*	*5.2%*
Ishares Capped Energy Index	*-*	*-37.2%*	*4.8%*
Walt Disney	*-*	*22.9%*	*4.4%*
Facebook	*4.6%*	*30.5%*	*4.1%*
Unitedhealth Group	*-*	*17.0%*	*4.1%*
Berkshire Hathaway	*4.5%*	*0.4%*	*4.0%*
Alphabet Cl. C	*4.6%*	*28.5%*	*4.0%*
Carmax	*5.3%*	*5.7%*	*3.9%*
Arista Networks	*-*	*40.1%*	*3.9%*
Jacobs Engineering Group	*4.2%*	*19.0%*	*3.9%*
Nutrien	*3.4%*	*-1.5%*	*3.4%*
Ritchie Bros Auctioneers	*3.7%*	*58.8%*	*3.4%*
Power Corp. / Great-West Lifeco	*4.3%*	*-12.6%*	*3.4%*
Charles Schwab	*-*	*9.3%*	*3.2%*
Vivendi	*0.8%*	*9.1%*	*3.1%*
	39.41%		*58.76%*

As you know from our video communications to you this past year, we were quite busy in 2020 especially during stock markets most tumultuous period back in March. Stakes in several new businesses were acquired, among them Arista Networks, UnitedHealth Group, Wayfair and Walt Disney.

Despite sharing wonderful growth prospects, these new additions are all vastly different when it comes to their lines of business. Arista Networks is a U S based computer networking company that designs and sells multilayer network switches to deliver software-defined networking solutions for large datacenter, cloud computing, and high-performance computing environments. UnitedHealth Group is an American for-profit managed health care company offering health care products and insurance services while Wayfair is an e-commerce company that sells furniture and home-goods online. As for Walt Disney, they are a media and theme parks juggernaut whose studio and broadcasting assets include Marvel, Lucasfilm, 20th Century Fox, ESPN and ABC, all of which are poised to catapult Disney to the top of the home streaming market via Disney+.

While several of our businesses experience stellar results in 2020, some, like Rolls Royce, had a much harder go at it. Despite the dramatic decline in its share price we did not dramatically subtract or add to our position. With a 70% to 80% drop in flying hours - by no fault of their own - the reality is that the civil aviation industry is seeing a disruption that is unprecedented in scale and it is likely that it is going to take multiple years before we see more normalized levels of flying. Notwithstanding, the question before us now is whether or not, based on the current share price, Rolls Royce has any upside potential. Because we believe the business model remains intact and the challenges that Rolls faces are being tackled by management appropriately, we believe they do.

CONCLUDING THOUGHTS

Financial assets, especially stocks, continue to move forward. *Can* this continue? *Will* this continue? Is it time to liquidate our stock holdings? Experts are, as always, mixed: some bullish others bearish. What should an investor do *now* to protect gains generated over many years? These are timely questions with no simple answers.

An allocation to stocks must not be whimsical and transient, driven by emotion. It must be the outcome of a rational framework like we discussed above. Then, unless your circumstances have materially changed, you must follow your path and stick within the range of your equity allocation. The market has humbled many investors who decided to take a breather until "things settle down" - just missing a few good days is enough to take a big bite out of positive returns.

Think of it this way: you determine that alpine skiing is one way for you to enjoy nature and thus, over the years, you invest time and effort to become proficient at this sport. You buy a season's pass at Tremblant.

Most days, conditions are favorable: the sun is shining, there is little precipitation, and the visibility is excellent. Thus, the trails you tackle include black diamond and double black diamond runs like *The Flying Mile*, *Vertige* and *Zig Zag*. Other days, conditions turn less favorable: it is overcast, the mountain has the snow guns going and visibility is poor. You stick to intermediate trails like *Beauvalon*, *Fuddle Duddle* and *Sissy Schuss*. You don't leave the mountain!

Same with stocks - just shift the trails you tackle. Thanks for your confidence and see you on the chair lift!

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"The Commodari Antinori Group of BMO Nesbitt Burns offers a boutique private client wealth management experience. We work exclusively with high-net-worth individuals and their families and build for them unique portfolios — no pooled funds or other proprietary products."

Let's connect

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[1] *Bloomberg Markets, S&P 500 Index, Movers, 06/30/2020*

[2] *Quartz, "How the Retail Trading Boom is Shaking Up the U S Stock Market", 06/23/2020*