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COMMODARI ANTINORI GROUP / BMO NESBITT BURNS

INVESTMENT COMMENTARY: WINTER 2024

"The big money is not in the buying and selling, but in the waiting."

– Charles T. Munger (January 1, 1924 – November 28, 2023)

Equity markets, especially those in the United States, enjoyed a strong 2023 – to everyone's surprise. Following a weak 2022, the consensus on Bay and Wall Street was that the pain would continue for stocks in 2023. The narrative last January was that a recession was looming, unemployment inevitably would rise, consumers would stop spending, and stocks would fall, possibly precipitously.

Yet stocks defied interest rate hikes, wars, and collapsed banks to stage a rally that few forecasters, commentators, or gurus saw coming. What could possibly explain this defiance? Let's rewind to last March.

With a banking crisis unfolding in the United States and Europe – think Silicon Valley Bank, First Republic Bank, and Credit Suisse – global central bankers committed to protecting depositors and the financial system. Certainly, this intervention helped. It does not, however, fully explain the unexplainable.

The turnaround on stock markets coincided with the launch of Taylor Swift's Eras tour. It started with a whisper. As in the song Shake It Off, investors, once burdened with worries and doubts, found themselves swaying to the rhythm of resilience. They shrugged off the uncertainties that echoed in the market with a newfound confidence.

Reaching further into Swift's songbook, another anthem emerged – Fearless. As if this were their rallying cry, investors faced the market's typical uncertainties with courage and dare. Stocks, once predicted to stumble, stood tall and strong. This sentiment began to be felt in other asset classes as well, particularly in bonds.

Amid this financial symphony arose the theme of possibilities, akin to a Blank Space. The empty void of Wall Street's negative expectations was replaced with optimism and anticipation. Once cautious investors were now filling the market's blank space with dreams of growth and prosperity. No wonder the stocks of artificial intelligence companies flourished!

The enchantment reached a crescendo like the ballad Long Live. When all was said and done, as at December 31, 2023, the S&P 500 Index and the MSCI World Index posted total returns, in Canadian dollars, of 23.32% and 21.49% respectively, while in Toronto the S&P/TSX Composite Index gained 11.75%.

We are delighted to report that portfolios managed by the Commodari Antinori Group posted excellent results in 2023, in both relative and absolute terms. This was no easy task, since index returns were concentrated in very few stocks, as we will see in the next section. If you owned these stocks, you had cause for celebration.

A TALE OF TWO MARKETS

To quote Charles Dickens, for many portfolio managers, 2023 "was the best of times, it was the worst of times." The year gone by was a dichotomy for investors, a tale of disparities. The chart below tells the story:

Source: Dow Jones Market Data; FactSet

Seven stocks, colloquially known as the Magnificent Seven - Tesla, Nvidia, Meta, Alphabet, Microsoft, Apple, Amazon - powered the index's gains, accounting for nearly 80% of the overall upswing. In stark contrast, the remaining 493 stocks contributed insignificantly to the index's gains.

This market dynamic, and others before it (like the Nifty Fifty of the early 1970s) raises challenging questions for investment managers. Where do you cast your net? Among the highly favoured businesses of the period like the Magnificent Seven? Or does prudence dictate a more diversified strategy that encompasses the broader spectrum of often overlooked businesses acquired at fair prices?

Our approach is grounded in the latter. Even though we own only two of the Magnificent Seven, we outperformed the stock market last year. This is because the Commodari Antinori Group casts a wide net and strives to identify and invest in gems that are found beyond the select few. A wealth of patience, coupled with a willingness to periodically underperform, explains the long-run success of our clients' portfolios.

PAYING TRIBUTE TO A REMARKABLE PERSON

In the dynamic world of investments, where uncertainty and volatility are constants, finding a guiding light becomes imperative. We want to pay tribute to a luminary whose wisdom has left an indelible mark on us and the investment landscape. The late, great Charlie Munger, Vice Chairman of Berkshire Hathaway, was not just an investment guru but a sage whose principles resonated deeply with us and greatly influenced our investment framework.

A remarkable combination of intellectual rigour, common sense, and a keen understanding of human psychology characterized Munger's approach to investing. His partnership with Warren Buffett is legendary. Together, they formed one of the most successful duos in the history of business. Munger's principles provide us with invaluable insights.

One of Munger's enduring legacies is his emphasis on the importance of logic models. He believed that a diverse set of logic models from various disciplines was essential for sound investment decisions. For affluent business owners, this approach is particularly relevant. The business landscape is multifaceted and having a broad set of mental models allows for a more comprehensive understanding of the opportunities and risks that lie ahead. By integrating insights from different domains, we can better navigate the intricacies of life and business.

Munger was also a staunch advocate of the long-term approach to investing. In a world where short-termism often dominates, his unwavering commitment to holding investments for the long haul is a beacon of wisdom. This philosophy aligns seamlessly with our strategy for building wealth for ourselves and our clients. By identifying companies with enduring competitive advantages and solid fundamentals, we aim to create lasting value for our clients' portfolios over time. Munger's patient and disciplined approach serves as a reminder that true wealth is built steadily, not hastily.

Furthermore, the concept of the "circle of competence" is central to Munger's philosophy. He urged investors to focus on what they know and understand best. For business owners, this means leveraging industry expertise and insights gained from their enterprises. By staying within their circle of competence, investors can make more informed decisions and mitigate unnecessary risks. Munger's emphasis on self-awareness and humility in acknowledging the limits of one's knowledge is a guiding principle for prudent wealth management.

In the realm of risk management, Munger's emphasis on avoiding the "too hard" pile is similarly noteworthy. If an investment is too complex or difficult to understand, it is wise to pass on it. This principle is consistent with our commitment to transparency and clarity in our investment strategies. By avoiding overly complex instruments and focusing on what we can comprehend thoroughly, we strive to safeguard the interests of our clients.

The legacy of Charlie Munger is a source of inspiration and guidance for us as portfolio managers. In short, his principles of logic models, long-term investing, the circle of competence, and prudent risk management are pillars that support our commitment to creating enduring wealth for our valued clients.

BONDS … AT LAST MEANINGFUL INCOME + RETURNS

It has been many years since we have written about bonds. Readers have perhaps enjoyed this respite after our numerous back-to-back writings on this subject. We first wrote about the weak outlook for bond investments in the January 2010 edition of our Investment Commentary. In a section called Safety in Bonds – A Financial Mirage, we drew historical parallels to the inflationary period of 1965-1982. We highlighted the adverse effects of rising interest rates on bond investments, noting that bondholders during that period suffered negative real returns.

Subsequent installments of our Investment Commentary included sections called Bonds and the Managers Who Cried Wolf (January 2012); Bonds: Resist the Sirens Song (July 2012); and Bonds Again – Really?? (July 2013). Although our concerns had not yet materialized in the market, we continued to emphasize the potential risks associated with bonds.

Over this period, we addressed our subdued outlook for bonds by cutting duration for investment mandates requiring exposure to bonds, say for charities or for clients with less tolerance for stock market fluctuations. Without getting overly technical, duration in a bond portfolio is like a measure of sensitivity to interest rate changes. It helps you understand how much bond prices might move when interest rates go up or down. The higher the duration, the more a bond's price will change in response to interest rate shifts. So, it's a way of gauging how risky or stable bond investments are in different interest rate scenarios.

Having a short duration like we had spared our bond investments from deep pain when central banks aggressively started hiking interest rates in 2022. We endured a paper cut as opposed to the arterial bleeding that the FTSE Canada Bond Universe Index suffered.

Now, for the first time in nearly 15 years, we hold a positive outlook for bonds at Commodari Antinori Group. At current interest rates, bond prices finally offer a livable total return. Thus, our strategy, once focused on short-term bond laddering as a defensive measure against rising interest rates, now embraces modestly extending duration. This means our bond ladders will have a rung or two a little further out.

PORTFOLIO DEVELOPMENTS

As we noted earlier in this Investment Commentary, portfolios managed by Commodari Antinori Group posted very strong gains in 2023. This outcome highlights the strength of our philosophy and steadfast discipline. Navigating through uncertainty, overcoming occasional missteps, and addressing unforeseen challenges, our approach is not just sound but consistently successful.

The table below shows our top ten portfolio contributors and detractors in 2023. On the positive side of the ledger, we had a couple of two baggers, Rolls Royce and Meta, and two near doubles, Wayfair and SNC Lavalin. We are gratified by this exceptional performance however we recognize that this pace of share price appreciation is unsustainable. That said, while it is likely that we will trim these positions, we remain optimistic about the prospects of these businesses.

Source: BMO Retail Information Systems **Notable Contributors**	**Price Change[1]**	*Source: BMO Retail Information Systems* **Notable Detractors**	**Price Change[1]**
Rolls Royce Holdings PLC	*235.3%*	*Nutrien Ltd.*	*-24.8%*
Meta Platforms Inc.	*187.8%*	*Saputo*	*-20.2%*
Wayfair Inc.	*82.0%*	*Charles Schwab*	*-18.6%*
SNC Lavalin Group	*80.4%*	*Alibaba Group Holding*	*-15.0%*
Micron Technology	*64.7%*	*PayPal Holdings*	*-14.9%*
Alphabet Inc.[2]	*54.9%*	*Johnson & Johnson*	*-13.7%*
Capital One Financial Corp.	*38.3%*	*Enbridge*	*-10.4%*
Taiwan Semiconductor Mfg Co	*33.8%*	*Elevance Health*	*-10.1%*
Carmax Inc.	*22.5%*	*Air Canada*	*-4.1%*
Visa Inc.	*22.3%*	*Toronto-Dominion Bank*	*-3.3%*

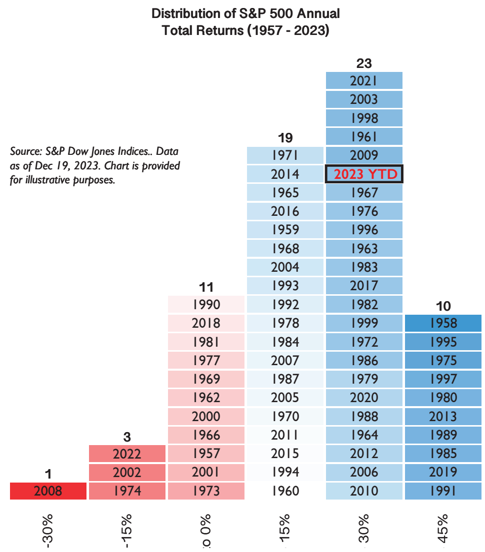
[1]Year to date price change as at December 31, 2023 in Canadian currency.

Over on the other side of the equation, while we wish to never have any portfolio detractors, we realize that is impossible. The reality is that in a portfolio of 30 – 35 businesses, one in four may be down at any given point in time. Our challenge then is to reassess these marked down businesses - has there been a fundamental deterioration in the company's prospects or, are the issues transitory? Should we sell or buy more? In the case of these businesses, with one or two exceptions, we are inclined to purchase more. Stay tuned for our next Investment Commentary to see if we part ways with any of these businesses.

A LOOK AHEAD

How will events play out in 2024? Will the long-called-for recession finally arrive? Has inflation truly been tamed? When will central banks cut interest rates? All we know with certainty is that we don't have the answers, and no one else does either.

This chart depicting the distribution of the annual returns of the S&P 500 Index between 1957 and 2023 is very informative and focuses attention on what really matters for long-run investment success: participation in the equity market, mastery over one's emotions, and a rational approach for buying and selling businesses.



As can be seen from the chart, gains have occurred 78% of the time, emphasizing the long-term upward trajectory of the market. Moreover, the data reveal that the market is six times more likely to experience gains of at least 15% than to incur losses of the same magnitude. This underscores the resilience and potential for growth in the market, even amid periods of uncertainty.

The Commodari Antinori Group owns a curated basket of businesses characterized by resiliency and bright prospects, acquired at reasonable prices. While we expect more muted stock market returns going forward, we remain confident that we will continue to prudently grow clients' capital at a reasonable rate in the many years ahead.

Thank you for your confidence and the privilege of working with you.

M. Antinori

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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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