

Quarterly Letter – Fourth Quarter of 2024

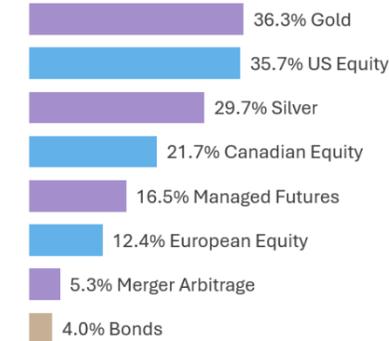
Investment returns in 2024 were excellent. Equity market indices, Canadian bonds, and a variety of alternative investments all had positive returns in 2024. Even more, all three equity indices in this chart hit an all-time high in 2024. This marks a reversal of fortunes compared to 2022 when equities and bonds were both down. Notice that **alternatives** performed well in 2024 **AND** outperformed traditional asset classes in 2022.

As a reminder, gold, silver and managed futures are good diversifiers in an investment portfolio because their returns typically aren't related to bonds and equities. Merger arbitrage is a good diversifier for bonds because both asset classes have fairly stable return profiles, but Merger Arbitrage returns have historically been higher than bonds.

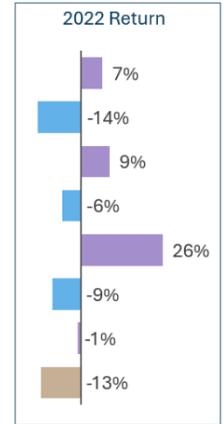
For the rest of the financial markets update, we wanted to share a few stories from 2024 based on numbers, both big and small. Join us as we take these stories **from numbers to value**.

2024 Returns for Select Investments

(in Canadian Dollars)



S&P 500 (US); TSX Composite (Canada); EURO STOXX 50 (Europe); Vanguard Aggregate Canada Bond Index. Data from YCharts.



20% The total return of the Canadian stock market in 2024 (measured by the TSX Composite Index)

40 Years of Canadian Stock Market Returns



This marks the second year in a row with above average returns. Historically, the average annual return has hovered around 8 or 9%. But that doesn't mean you should expect the average return every year. The average does a good job of explaining long-term experience, but it does an awful job of conveying the year-to-year experience of the average investor (let alone the day-to-day).

Case in point, in 23 out of the past 40 years, the return was either better than 20% or negative. That's a wild ride that's only smoothed out by consistent investing and diversification.

From numbers to value: Stock market fluctuations tend to smooth out over time. As an investor, you can either focus on the day-to-day variations or the long-term upslope.

You decide.



BEKALOW-CAP

30% The loss sustained by stocks that were recommended in online articles last year.

We randomly selected 3 articles written around the first week of 2024. Then, we tracked the performance of the recommended stocks over the course of 2024. On average, they lost 30%.

There are at least six very good reasons to not make an investment decision based on an online article or post. By far the best reason is that the author doesn't know you, so any recommendation they make isn't necessarily suitable for you.

The next best reason, and the one we want to focus on here, is that nobody who writes an article recommending stock XYZ is going to buy XYZ after the article is published. The best money managers don't share their secrets because it eliminates their advantage.

On the other hand, if you made a bad investment, you might have incentive to write an article promoting the stock in the hopes that readers believe your (false) narrative and buy the stock. Enticing more buyers makes the price go up so you can sell. True "pump and dump" schemes are rare, but a few cases in the cryptocurrency space did pop up in 2024.

From numbers to value: Don't take advice strictly from an article (don't tell Dave).

66.67% The new capital gains inclusion rate. Or is it?

The short answer is that we aren't totally sure yet. The situation isn't crystal clear.

- The Liberal government proposed that the inclusion rate for some capital gains be increased to 66.66% from 50%. The change was introduced as a Ways and Means motion, but the NDP's support for the Liberals was revoked before the increase was passed into law. Now that parliament is prorogued until March 24th, it would need to be re-introduced as a new motion, then passed through the House and Senate. The odds are stacked against that happening before the tax filing deadline.

Another layer of complexity is that it's not even clear who the government will be when parliament resumes in March. The Conservatives have criticized the increase in the past, so it may never be re-introduced.

- BUT there's a further twist. The CRA's general practice is to administer proposed legislation even if it hasn't been fully passed into law. Following precedent, their latest guidance (on Jan 7th) says they will collect capital gains tax according to the higher rate. There's still some time for them to change their mind. So, for now, we're monitoring any developments.

From numbers to value: Even though 2024 is over, the tax rules aren't necessarily set in stone yet. Those who those staying on the good side of the CRA will probably opt to follow their guidance, even if it means pay the higher rate and get a rebate if the CRA backtracks.

1.438 The number of Canadian dollars you needed to buy one US dollar at the end of 2024.

The exchange rate has been steadily weakening since mid-2021 (notice the cost of a US dollar in the **brown line** trending up). Except for a handful of weeks in 2016, the exchange rate hasn't been this weak since early 2003. If you traveled to the US in December, you could probably feel the difference. As usual, we have no crystal ball about what happens next.

Even if you don't travel to the US, your investments are affected by the weakening Canadian dollar, and it was good news in 2024.

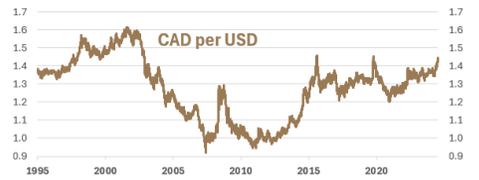
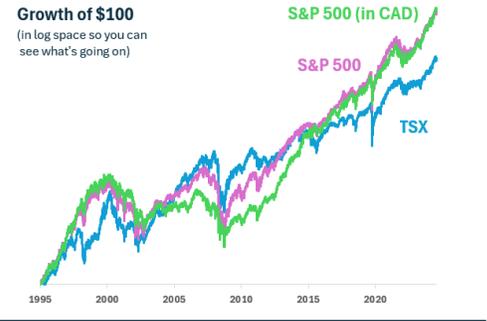
You hold a diversified portfolio which includes investments in US equities. These investments are denominated in US dollars, so when the US dollar appreciates, so does the value of those investments in Canadian dollar terms. To use 2024 as an example, the S&P 500 returned 25% and the value of the US dollar in Canadian terms appreciated by 8.5%. As a result, the return of the S&P 500 in Canadian dollars was almost 36%.

What does Currency mean for Canadian Investors?

Year	S&P 500 (in USD)	ΔFX	S&P 500 (in CAD)
1996	22.96%	0.55%	23.63%
1997	33.36%	4.51%	39.38%
1998	28.58%	7.42%	38.11%
1999	21.04%	-5.59%	14.27%
2000	-9.10%	3.24%	-6.16%
2001	-11.89%	6.26%	-6.37%
2002	-22.10%	-1.09%	-22.95%
2003	28.68%	!-18.02%!	5.49%
2004	10.88%	-6.90%	3.23%
2005	4.91%	-3.09%	1.67%
2006	15.79%	-0.24%	15.51%
2007	5.49%	!-15.16%!	-10.50%
2008	-37.00%	!24.02%!	-21.87%
2009	26.46%	!-13.86%!	8.94%
2010	15.06%	-5.32%	8.94%
2011	2.11%	2.31%	4.47%
2012	16.00%	-2.77%	12.79%
2013	32.39%	7.03%	41.70%
2014	13.69%	9.40%	24.38%
2015	1.38%	!19.10%!	20.75%
2016	11.96%	-2.94%	8.67%
2017	21.83%	-6.35%	14.09%
2018	-4.38%	8.40%	3.65%
2019	31.49%	-4.78%	25.20%
2020	18.40%	-1.92%	16.12%
2021	28.71%	-0.78%	27.70%
2022	-18.11%	7.25%	-12.17%
2023	26.29%	-2.24%	23.46%
2024	25.02%	8.56%	35.72%
2025	???	???	???

Indices from YCharts; FX from Thomson One

Growth of \$100
(in log space so you can see what's going on)



From numbers to value: Managing currency exposure is an important aspect of investing. Drawing on US investments to pay US expenses is one strategy that could make you more immune to currency changes.

5 The number of G20 countries with impending leadership changes as of the end of the year.

Here they are:

- Canada: Trudeau will likely face a vote of non-confidence when parliament resumes in March.
- United States: The new administration takes power on January 20th.
- Germany: Chancellor Olaf Scholz lost a vote of confidence in December.
- France: Prime Minister Michel Barnier resigned after a historic no-confidence vote in December.
- Korea: President Yoon Suk Yeol was impeached after attempting to declare martial law in December. He is currently barricaded in his home, resisting arrest.

From numbers to value: International relations will be in the spotlight in 2025, with likely trade negotiations between Canada and the US. The incoming US administration has often used rhetoric as a negotiating tactic. So, while Canadians do not appreciate recent suggestions that the US should annex Canada as the 51st state, we should also not take them too literally.

\$500 million

The amount of money that Meta (aka Facebook) reportedly spent calibrating the latest version of their AI language model.

For a tech company, calibrating an AI model is akin to a world-famous chef designing a new dish. They test variations for months until it's perfect. Meta and other tech giants have each spent tens or hundreds of millions building AI models. The cost to calibrate Meta's model came mostly from three things:

- They used 50,000 specialized computing chips to do the computations. At \$30,000 USD each, it's likely they spent \$1 billion for the chips. Only a portion of the chip's life is spent calibrating this model. After calibration, the model is released to users and the chips are used to run the model.
- The chips are power-hungry. Running at full capacity, Meta's 50,000 chips use as much power as 10,000 Canadian households.
- Finally, there's the cost to obtain and review the text and images used to calibrate the model. It's not clear where all the data came from and a few have started to wonder if there has been any copyright infringement. In November, a group of Canadian news outlets including the CBC sued OpenAI, the leading model developer, alleging that their content was used without permission. More lawsuits are ongoing, filed by the likes of The New York Times, comedian Sarah Silverman, visual media provider Getty Images, and Concord Music, who represents more than 125,000 artists and songwriters globally.

In an interesting twist, a Chinese company just published an AI model that performs nearly as well as Meta's and cost less than \$6 million to calibrate. That's just 1% of what Meta spent. Imagine if the chef could get lobster for 100 times cheaper. Would they keep charging the same price for dinner? Likely not.

From numbers to value: Now that there's evidence that it's getting easier to build a state-of-the-art model, we think competition in AI is going to increase in 2025. This could make it a challenge for the big tech companies to maintain their dominance and could also put pressure on their profit margins.

\$8 billion

The peak market value of "PEPE", a cryptocurrency named after a comic book frog that gained internet fame in the era of MySpace (c. 2004).

That sentence might seem nonsensical and unrelated to financial markets, but there are no typos. More than half a million different cryptocurrencies were launched in 2024. PEPE was just one of them. At its peak, the total value of the PEPE was more than Canadian Tire...the whole company. There is probably a joke about Canadian Tire money, but we'll leave it alone. In December, the situation went into the potty, when the market value of a cryptocurrency named "FARTCOIN" topped one billion dollars.

From numbers to value: These sorts of things don't happen when a bubble has just started inflating. They are more likely near the moment when the last clown blows their hot air into an overinflated balloon. We continue to view cryptocurrencies as much too speculative to be part of an investment portfolio.

\$6.5 trillion

The increase in the value of the top 10 US companies in 2024.

In total, the value of the companies in the S&P 500 index increased by a total of \$10 trillion in 2024, which means that more than half of the increase is attributable to only 2% of the companies. So far, the increase in company value hasn't been matched by an increase in company earnings.

From numbers to value: If the proof (of higher stock prices) is in the pudding (of higher earnings), then it seems that the pudding isn't here yet. We remain cautious about the equity market heading into the year.

Financial Planning Update

Aging in Place – In November, we hosted a webinar with Marnie Courage (an occupational therapist) and Michael Reimer (a home builder) to talk about aging in place. Their firms collaborate to renovate homes into accessible living spaces that allow their clients to continue to stay at home even if their health and mobility deteriorate. We had two big take-aways from their presentation:

1. Living spaces can be both accessible and beautiful.
2. Renovating your home to make it accessible does not decrease its value. Quite the opposite. As the population of Canada ages, accessible homes are becoming more desirable. We expect this trend to continue.

We will post a replay of the webinar to our website in the weeks to come.

Sincerely,

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