HILBERRY GROUP
WEALTH MANAGEMENT

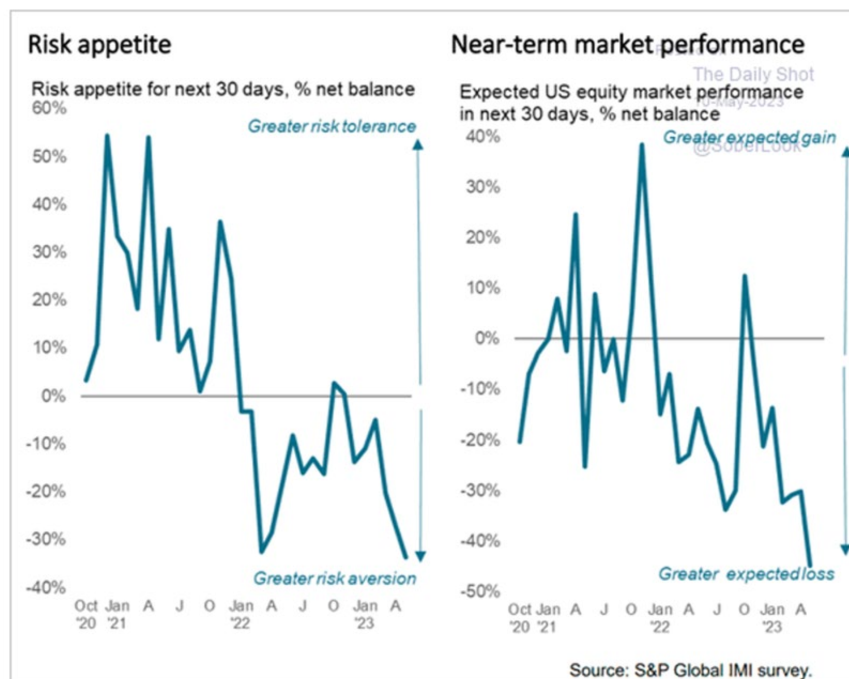
December 20, 2023

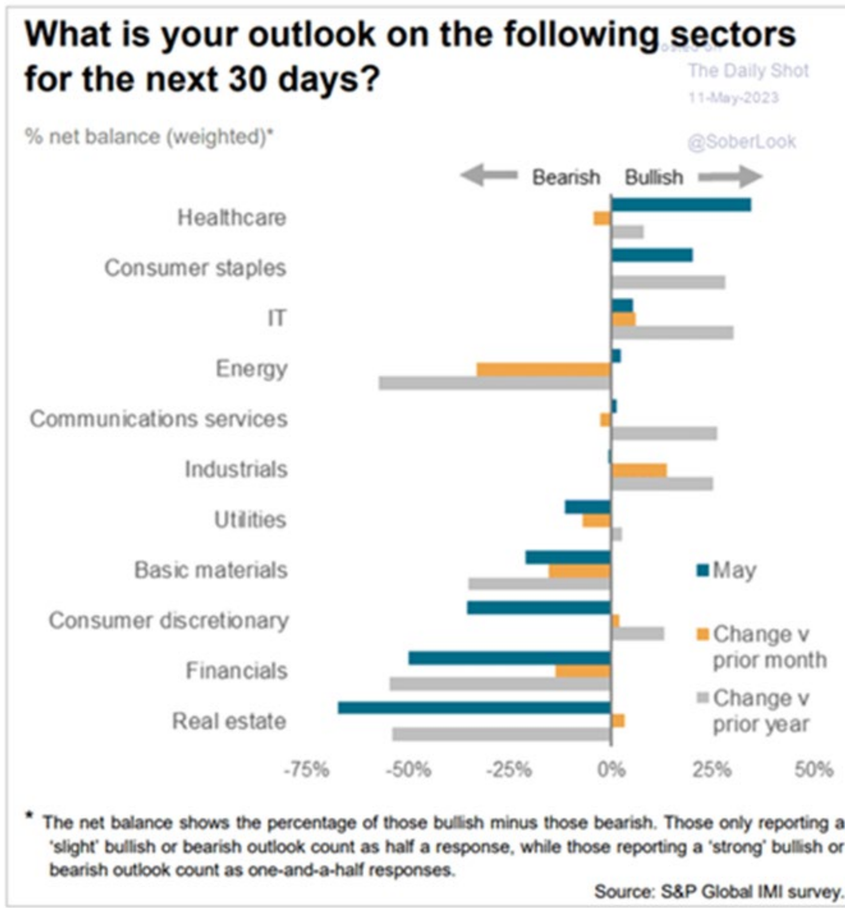
The year ahead.

We decided to give our readers the last weekend off. It was the calm before the storm. As today's will be our last posting for 2023, we're handing out a special bonus, piling on second helpings for your holiday. Enjoy your extra servings of data! A nice year-end rally is desert.

Back to future - late Spring and Summer of 2023…

We provided the next two charts in our May 12, 2023 Weekend Reading.

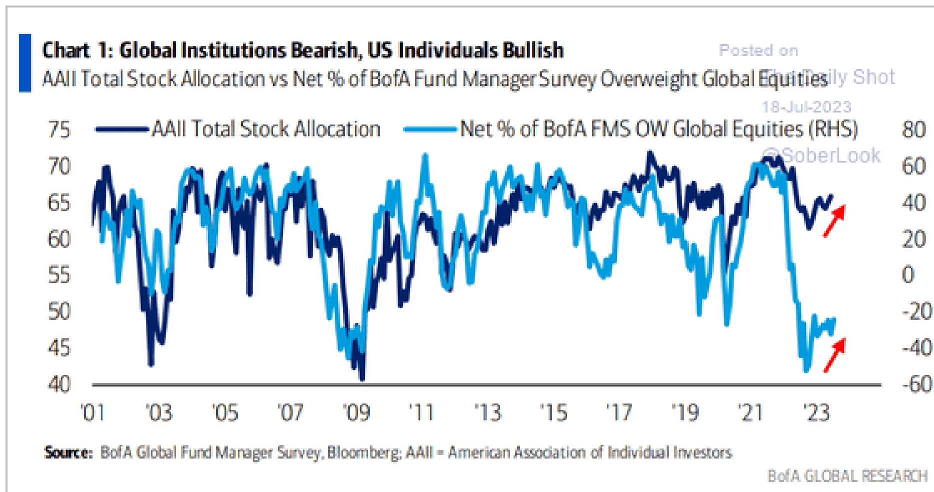




We took the bearish tone in chart 1 and the desire to own 'defensive' pharmaceuticals in chart #2 as a contrarian signal not to reduce risk. This next chart from July 18 told us the Big Money was nervous….

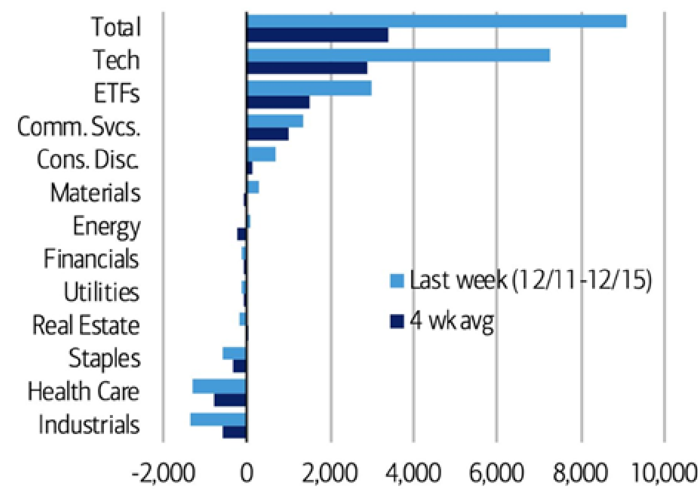
And the next confirmed it…

Equities: According to BofA's fund manager survey, the disparity in sentiment between institutional and retail investors has reached unprecedented levels.



Source: BofA Global Research

Over the summer we advised keeping the hand away from the SELL button. The date of the 2nd chart Friday July 21 to Dec 20, 2023 the S&P gained +5% . The S&P500 did the typical seasonal flop into October, hitting lows in the 3rd week -7.8% from July. For Big Money that's not enough to bother dealing with. At our seminars held the 3rd week of October, we advised we were buying into that decline. From those lows the S&P500 is up 13.6%. Remaining invested from July onwards has been profitable. Being contrarian added further value. This brings us to year's end. With Big Money's mid-summer desire for safety in mind, where did the money go? Hint: May's focus on Healthcare was not a short-term win.



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Healthcare saw net selling while – you guessed it – Tech saw the biggest inflow. Big Money surveys are useful…as contrarian indicators.

Ex the Magnificent 7, 2023 was boring.

For a large-cap, dividend focus, we believe appropriate benchmarks are the **Canadian Select Dividend Index** and the **Dow Jones Industrials Average**. We provide the S&P500 for perspective. The following table provides periodic total returns Jan 1, 2019 through to Nov 30, 2023 and year-to-date as of Friday Dec 15, 2023.

Index	1-Jan-19 30-Nov-23	1-Jan-20 30-Nov-23	1-Jan-21 30-Nov-23	1-Jan-22 30-Nov-23	1-Jan-23 30-Nov-23	1-Jan-23 15-Dec-23
Cdn Dividend Index TR	51.79%	24.42%	24.44%	-6.01%	2.27%	5.21%
Dow Industrials TR $CDN	53.46%	32.03%	25.12%	6.22%	8.89%	13.39%
SP500 TR $CDN	97.37%	57.99%	35.62%	6.21%	21.28%	23.59%
SP/TSX Comp TR	64.36%	33.76%	26.67%	1.26%	7.54%	8.91%

Source: NBF, Hilberry, Refinitiv. Notes: Index returns are synthetic, excluding real-world trading spreads, fees, assume FOREX at a theoretical market mid-point, and assume all dividends are reinvested without cost.

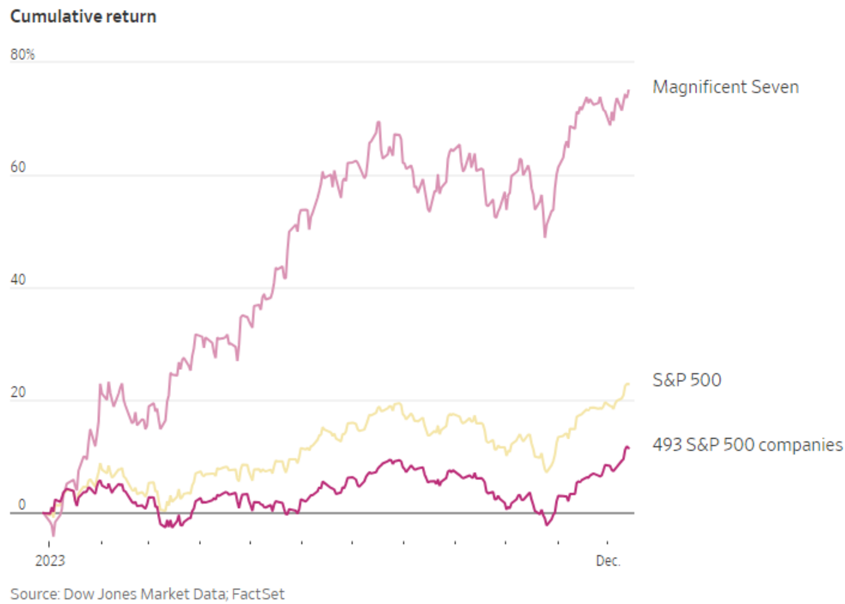
A 50/50 blend of TSX Cdn Dividend Index and the Dow Industrials generated a total return of 5.6% in $CDN. A 50/50 blend of the S&P500 and the TSX Composite (the TSX includes Shopify) delivered +17.1% year to date. Large cap dividend-payers were left behind on both sides of the border.

What about longer-term? How have large cap/dividend payers faired? We draw reader's attention to the difference between the Dow Industrials and S&P500 total returns. Both are focused on large to mega-large cap US companies. Jan/2019-to-Nov/2023, how did the S&P's 97% beat the Dow's 53% return by over 81%?

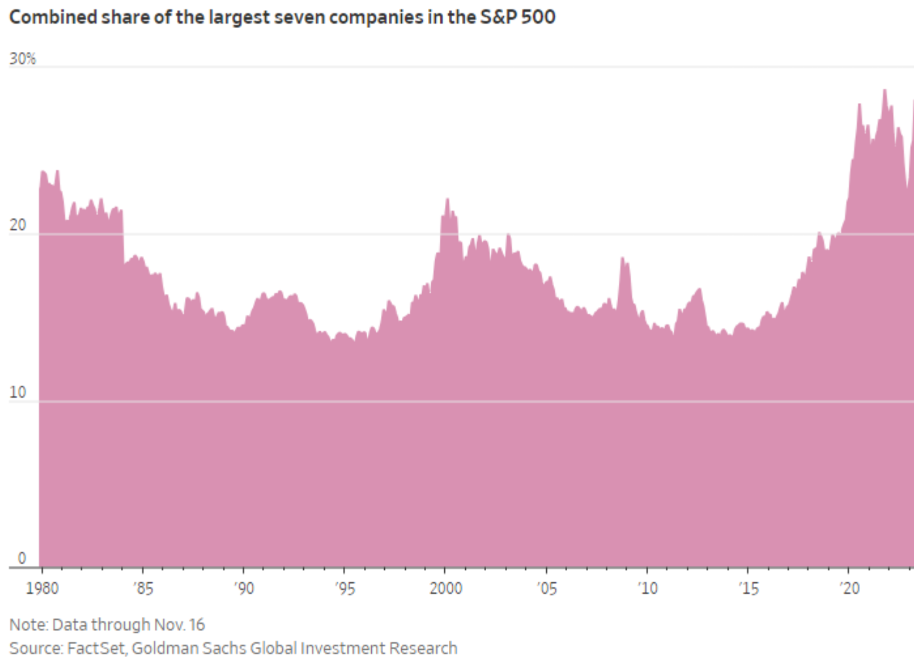
Since the COVID-19 lockdowns (and stimulus cheques) turned the Western economies upside down, the S&P500 has been dominated by E-commerce and social media stocks. The top 7 companies by market cap in the S&P500, dubbed the 'Magnificent Seven', are **Alphabet** (Google's parent), **Amazon**, **Apple**, **Meta** (formerly Facebook), **Microsoft**, **Nvidia** and **Tesla**. As of Dec 17th, these seven names totaled 30% of the SP500 market value.

The Wall Street Journal explains:

***'It's the Magnificant Seven's Market. The Other Stocks Are Just Living In it'*. Wall Street Journal, Dec 17, 2023**



The current concentration in the top seven names is the highest since 1980.



https://www.wsj.com/finance/stocks/its-the-magnificent-sevens-market-the-other-stocks-are-just-living-in-it-5d212f95

The article notes that the 75% jump in price for this group, led by AI-darling Nvidia's 241% surge, trounces the more pedestrian, but still excellent, +12% for the remaining 493 names. The Dow Industrials holds 30 names including Apple and Microsoft. Year-to-date the Dow was up roughly the same as the 493 'others', telling you how concentrated these 7 companies are in the S&P500. We don't know how, or when it ends. We suspect it may not end well for investors. We see value elsewhere. Where?

The Magnificent Seven trade at 41 X earnings. That's the average. The S&P500, including the Magnificent 7, trades at 19X earnings. The S&P500 at equal-weight (each constituent is worth 1/500th) drops to 15 X earnings or 6.7% earnings yield (inverse of P/E) being reasonably higher than the current 10-year Treasury Bond yield. Dow Industrials technology constituent, **Cisco Systems (CSCO-US-$50.24)** trades at 12.9 X 2024 EPS. There are companies to be had at reasonable prices. If the Magnificent 7 'corrected', the S&P500 could decline while other names within it could do okay.

DISCLAIMER: I hold Cisco Systems personally, for family members and for client accounts over which we have trading authority. We have traded in the security within the past 30-days.

Why don't we own the Magnificent 7?

We've held Apple and Microsoft in the past. We bought them when their prices were depressed, and their dividends looked appealing. Yes, that happens. As the prices took off, we trimmed, eventually selling down to zero. While we made great returns, we should have kept some. Why don't we buy them or the other Seven now?

Back to basics. Our goal is replacing our client's active employment, business, or professional income over which they sweated and worried, with investment income. There are risks to any endeavor business or skill set. If they've arrived at the point of having a retirement nest egg, they've proven themselves capable of managing those risks. If a Hilberry client is going to retire, they are going to give up doing what they're good at and getting paid for. Our belief is the retirement income sources they are counting on should be less risky than the income they've been generating. Where will that investment income come from? How dependable is it? How risky are the generators of that income? Will the income grow and if so, by how much? How confident are we in predicting that income into the future? How will it be taxed? Do we have histories to compare in past difficult times, or is it all champaign wishes and caviar dreams? This isn't a game of 'beating the index'.

Investors are paid to worry. The more you're paid, the more worried you should be. In our experience client risk-tolerance is 100% on the way up and 0% on the way down. Pursuing a volatile growth strategy, even if brilliantly executed, can create more stress than the career or business the client gave up. We don't think that makes sense. Betting on Nvidia's future could bring tremendous wealth. If the 12-month upside has been 300%, what's the potential downside? If $100 becomes $300 in a hurry, it can become $100 again in a hurry. If that happens what about that income thing?

What about younger investors with more time?

The same issues apply. It's hard to listen to your friend's brag about the $100 stock they bought becoming $300. History says such gains are extraordinary and are often followed by a 'correction' (of the excess). You won't hear about their $300 stock becoming $100 again. Investors tend to do more of what's working and less of that hasn't been. On the way up they often invest smaller amounts at $100 and larger amounts at $300. After all, 'everyone knows' the story at $300. Investor psychology has a way of turning a $100-$300-$100 = 0% round-trim into significant losses. We caution against clients committing too much of their capital to the shining stars and popular sectors (see the Big Money polls above). Successful investing is a game of patient compounding and survival, not spectacular gains (and losses).

Our strategy is to own a diversified portfolio of income-generating stocks with proven track records of paying growing dividends. One constituent of our Canadian dividend portfolio, **Telus Corporation (T-TSX-$23.76)** as an example. The company's 20-year average dividend growth rate has been 11.9% per year. The 10-year dividend growth has been 8%. Today's investor paying $23.76, receives $1.50 annual dividend equating to a 6.3% yield on cost. If we assume a lower-than-historical 7% growth rate, in 5 years the dividend yield on today's price would be 8.85%. In ten years, the cash yield on today's price could be 12.42%. Would you want to sell a stock paying 12.4% on cost at the same price or less than you paid? Not much. Rising dividends often beget rising prices – but not always. If in 10 years you decided to do nothing you could, ho-hum, spend your boring 12.4% and-growing income. History says prices often follow income upward, but there's no guarantees. Dec/2003 to Dec/2023, Telus Corp. price growth has averaged a boring 6.8% per year. With all dividends reinvested, the avg annual total return has been 8%. $10,000 invested on Dec 19, 2003 is now worth $46,807. This year's dividend income would be $2,964 and growing. Younger investors take note: You don't have to shoot the lights out to do very well…but it can be boring.

DISCLAIMER: I own Telus personally, hold it for family members and for client accounts over which we have trading authority. We have traded in the security within the past 60po60 days. Dividends are not guaranteed and may be cut or eliminate by Boards of Directors without notice.

Has our approach worked?

Our goal is to trim when prices are high and buy when prices are low, flowing money from stocks at a premium to those at a discount, building the income stream at a faster rate than the raw dividend income growth rate. Has that worked?

Dec/2018 to Dec/2023 our blended CDN/US portfolio income has increased 87.6% for an annual compound dividend growth rate of 13.5% per year. An investor drawing income since Dec/2018 has 87% more to spend. Clients not spending all their portfolio income accelerates the residual income growth for future years. Our portfolio income growth rate has been well above the rate of inflation. As the income is coming from cash dividends, market prices don't affect the income paid per share.

The income is great…but what about that market price thing?

With cash income up 87% it's no surprise the market value of the portfolio has increased. That total return increase has been 53% - equal to or above our benchmarks. Over the 5-year period this works to an annual average total return of 8.95% per year. The portfolio 8.95% market price growth is below the portfolio 13.5% dividend growth rate. As the dividend income has increased faster than prices, this tells us investors have yet to get serious about bidding up the prices of the stocks we own. We think this will happen. We don't know when. Our 10-year (Dec 31, 2012 to Dec 15, 2023), blended portfolio average annual time-weighted net return has been 10.37%, closer to the actual dividend growth rate.

Before we leave the AI-powered Magnificent Seven and dovetailing into our following energy comments…

AI Is Ravenous for Energy. Can It Be Satisfied? Wall Street Journal Dec 15, 2023

'The revolution in artificial intelligence may soon require more electricity than all electric vehicles combined. Every company betting that artificial intelligence will transform how we work and live has a big—and growing—problem: AI is inherently ravenous for electricity.

Some experts project that global electricity consumption for AI systems could soon require adding the equivalent of a small country's worth of power generation to our planet. That demand comes as the world is trying to electrify as much as possible and decarbonize how that power is generated in the face of climate change.

Since 2010, power consumption for data centers has remained nearly flat, as a proportion of global electricity production, at about 1% of that figure, according to the International Energy Agency. But the rapid adoption of AI could represent a sea change in how much electricity is required to run the internet—specifically, the data centers that comprise the cloud, and make possible all the digital services we rely on.

This means the AI industry is poised to run the equivalent of a planetary-scale experiment, according to experts both outside and inside the industry. This has some of them wringing their hands, while energy suppliers are practically salivating at the expected increase in demand.

(Requires subscription)

https://www.wsj.com/tech/ai/ai-energy-consumption-fc79d94f

The above tells us energy is where it's at. Forget the gold mines (AI) , invest in shovels (energy). This supports our focus on boring old power generators in Canada and US.

'Geopolitical Briefing: The geopolitical outlook for 2024' – NBF Economics and Strategy Dec 15, 2023

'Heading into the New Year, the world will be grappling with a number of geopolitical issues. These include the current conflicts in Ukraine and the Middle East and upcoming elections in the United States, Taiwan, India, and Mexico. The ongoing rivalry between the United States and China, growing government intervention in the economy, mounting debt, and higher interest rates add to these challenges.'

The attached report along with selected research from the Economics and Strategy Group can be accessed by clicking this link:'

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=9fa51588-4508-4fe8-af81-2b927102cb5a&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

The NBF Geopolitical report lays out a helpful series of risks but provides no guidance other than 'be careful out there'.

Here's our take. We see opportunity – carefully:

The litany of risks tells us a targeted approach to investing is required (stock picking vs indexing). On indexing, when peace dominates, inflation is falling, interest rates are low, everyone is making money. We will again review recent financial history.

Responding to the 2007 Credit Crunch, 2008 to 2020 the US Federal Reserve initiated Quantitative Easing (QE) in 4 series. QE enabled the Fed to buy bonds in the open market. Buying bonds bids up their price, driving the yields down. Congress gives the Fed money (prints it). The Fed uses that money to buy bonds. Note that the money itself and bonds bought are offset so the actual amount of loose money in the system doesn't change explaining our view that QE would not be directly and immediately inflationary. We advised that over time QE would lead to inflation.

QE1-2008, QE2-2010 & QE3-2012 suppressed short and long term rates below the rate of inflation. We didn't think it could last. Responding to the COVID-19 pandemic the Fed rolled out QE4 in March/2020. We didn't think it could last either. The upshot was the US Fed maintained 90-day T-bill rates at or below 0.2% from 2008 to 2015, allowed the rate to 'soar' to 2.4% in Jun/2019 (we saw that as recessionary, which it was) then pushed the rate back down close to zero % March/2020 holding that stance until Feb/2022.

From Jun/2008 through to Jun/2022 QE held US Federal 2-year bond yields below 2.5%, suppressing commercial bank financing and mortgage rates. For most of that period, borrowing rates were below inflation, punishing bond investors (lenders) rewarding floating rate borrowers, think real estate investors, equity investors and re-electing politicians who advocated free money. Voters liked what they heard.

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It wasn't all good though. The extremely low yields played heck with the liabilities of pension funds required by regulation to project future income on current assets invested at current yields – regardless of actual returns being earned. This prudently conservative approach is a serious challenge when a deposit stream that was estimated to earn 5-6% in bond interest is forced to project earning 2%. That annual 4% per year difference (on paper) over the expected life span of future pension recipients can add up to a significant *'pension-fund deficit'*. The workers depositing into the plan and the plan sponsor (corporation or government) must add more money into the plan to bring it back onside. That takes money out of both group's pockets. For industries on the edge of survival, like BC's Forest industry in the mid-2000s, that pension deficit can push them over the edge.

The 2008-2020 rising tidal waves of stimulus lifted all boats. In that environment, why analyze anything? Let others do the brain work. Just buy the S&P500 and hug yourself for being both smarter than those fancy pants analysts, and cheaper. Or better yet, tell a story of long-term growth you can sell to an investment community desperate for returns. Que the birth of the FAANG stocks sporting 100 P/E multiples and the current AI hype.

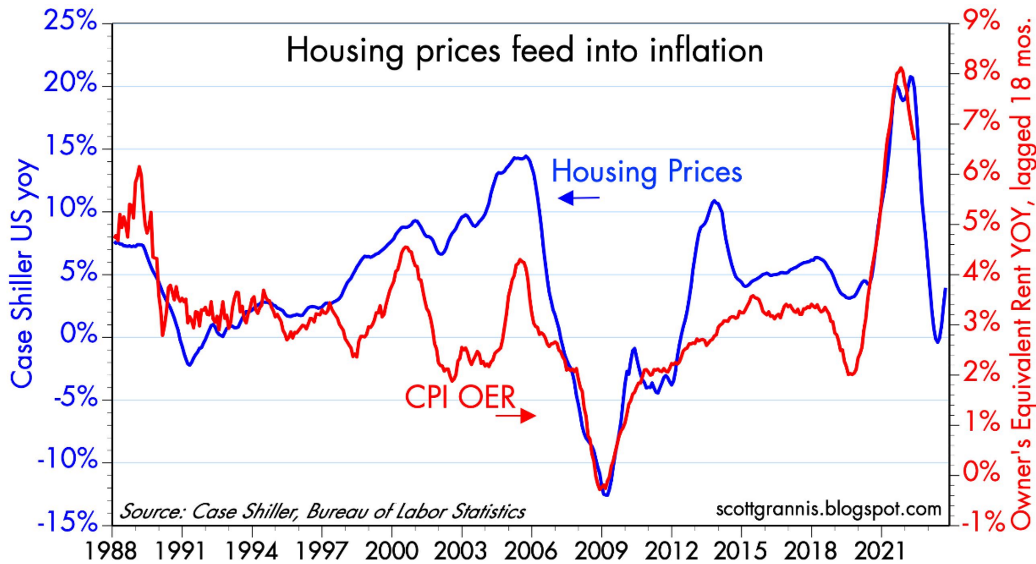
QE has since been scaled back but the debt pile-on isn't done. COVID-19 stimulus followed by further climate action infrastructure stimulus has piled on the debt. The money supply (monetary policy - controlled by central bankers) - has thankfully been contracting - see Scott Grannis below - but government spending (fiscal policy) has yet to be reigned in.

The bond market, freed from the Fed's QE shackles, has demanded much higher rates, much faster than many had anticipated. The 10-year bond yield hit a low of 0.6% in July/2020. It hit 5% in Oct/2023. Suddenly money isn't free anymore. This rising rate has inflicted pain on all long-growth strategies. One of the analysts interviewed in the Magnificent 7 article above advises owning that group to 'grow past inflation'. A tidy idea. Unfortunately, the multiple applied to that growth stream must contract. It remains to be seen which will dominate. We suspect some of that pain has yet to be felt.

On the political front, many of the West's current political leaders were elected prior to this yield runup. It's unfamiliar territory for them. For most of their adult life, and all their political careers, interest rates haven't been a thing to worry about. That may be about to change.

Near term direction for lending rates is down. In the very short-term…

'CPI less Shelter is only 1.4%' – Scott Grannis December 12, 2023



https://scottgrannis.blogspot.com/2023/12/cpi-less-shelter-is-only-14.html

We think bond yields will fall, but not to previous lows. There are scenarios we're examining that have rates higher, some a lot higher. Thankfully we don't see those playing out yet. We think bond yields 10-30 years are about right, while short term yields will fall.

Moving on to the environment.

'COP28: Underwhelming or Historic? We Think Modestly Incremental' NBF ESG Research Dec 13, 2023

COP28 Wrap up. Commentary from NBF ESG Research desk

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=482fe305-d004-45d9-b6fa-fffda3c7e895&mime=pdf&co=nbf&id=josh.ochman@nbc.ca&source=mail

Speaking of power, here in BC…

'Drought conditions force BC Hydro to rely on power purchases' – Globe & Mail Dec 18, 2023

The article notes the much-protested and now completed Site C dam yet to come on-line could bring BC back into a power surplus. We direct readers to the article's passing comments on how BC Hydro deals with unexpected costs – like buying power.

'To date, BC Hydro has acquired a net 10,000 gigawatt hours of electricity this year from imports. In the first half of the fiscal year, Hydro added $463-million to one of its deferral accounts "primarily due to higher net system imports," according to the utility's quarterly financial reports. BC Hydro uses deferral accounts, which track costs incurred that have not yet been recovered from ratepayers, to smooth rates'.

A ’deferral account’, defers the unexpected cost incurred by the Crown corporation from electricity rate paying consumers (voters). How is this done? By borrowing the amount otherwise to be passed on to consumers. BC’s Energy Minister thought it was a great idea.

‘At the same time that climate change is hammering hydroelectric power producers, inflationary pressures have governments seeking rate relief from their major utilities. In B.C., where the New Democratic Party government will face an election in 2024, Energy Minister Josie Osborne applauded BC Hydro for seeking a rate hike next spring that would be well below the rate of inflation.

“It’s more important than ever for us to keep the cost of clean energy down,” she said in a statement in October.’

That *cost-below-inflation-borrow-the-difference* thing again.

Q: if we need more electrical power, how is keeping the existing supply cost to the consumer well below the cost of production going to induce more power coming on stream?

A: It can’t. When something can’t happen, it won’t.

This means, as we’ve been advising for some time, costs for basic energy, which means everything, are likely to be higher than in the past. Inflation could fall but be sticky. If inflation isn’t going away, neither are the costs of borrowing. There is no free lunch. Again, this is why we like electrical power producers. We also like conventional hydrocarbon producers. Some good one’s are here in BC.

‘Oil, Gas & Consumable Fuels: Accelerating Towards LNG; How Off-Take Could Impact the Western Canadian Economy’ – NBF Industry Note Dec 12, 2023

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=2be0ba36-d6bd-42e9-8e50-34486e7dbfed&mime=pdf&co=nbf&id=josh.ochman@nbc.ca&source=mail

‘Things You Don’t See in A Recession’ – Ryan Detrick Dec 6, 2023

We’ve been saying a US Recession is yesterday’s worry. Mr. Detrick provides perspectives.

https://www.carsongroup.com/insights/blog/things-you-dont-see-in-a-recession/

Staying with our bull market in optimism…some stats on the US economy.

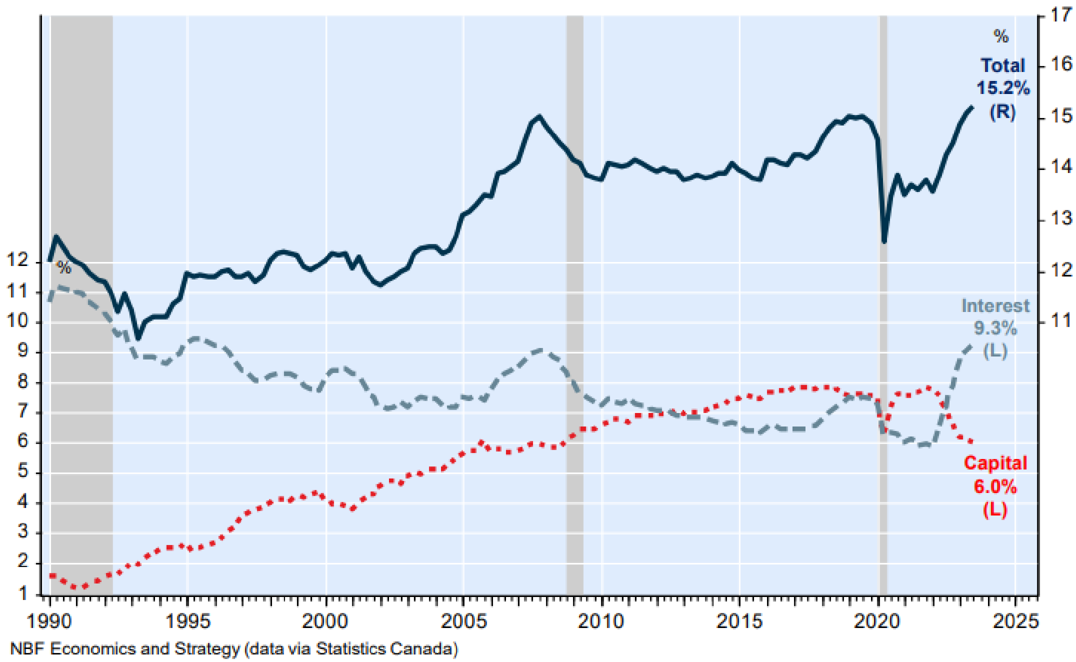
‘Animal Spirits: Dunking on Doomers’ – Ben Carlson Dec 13, 2023

https://awealthofcommonsense.com/2023/12/animal-spirits-dunking-on-doomers/

North of the border, headlines are equally glum. This week NBF featured Canadian’s record debt payments vs disposable income (15.2%) and the portion of those payments going to interest (9.3%) vs loan principle (6)%.

The story head-line is…

'Canada: Households facing record debt service burden' – NBF HotCharts



The current portion of payment to income is marginally above the previous spikes in 2007, prior to Great Financial Crisis and 2019, pre-COVID 19 Recession. As rates declined into the 2020 bottom the proportion of payment going to interest declined and capital paydown increased…to record levels in the other direction. While the current payment vs income % is at a marginal new high, the percentage of payment going to interest vs capital is back to the 1990-2007 ranges. Is this a good thing? No. Is it a disaster? No.

With the previous spikes in payments in mind, some interpret the recent spike to predict a made-in-Canada recession. We don't dismiss a potential Canadian slowdown. As we've noted recently, Canadian markets (banks in particular) have already priced one in. Unless the US leads further (see above), Canada is unlikely to experience a deep recession on our own. As the price discount is already in, we think it's time to look across the valley. A significant decline in rates has yet to be priced into risk assets (i.e. UP). We think that's what happens next. See the above comments from Scott Grannis on the near-term direction for interest rates (lower).

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=e29f6438-b82c-455b-99fc-be0599f90010&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Whew! We made it to year end and the end of our Reading for this year.

Have a Happy Holiday!

Steve & Anna Hilberry

FOR THE RECORD December 20, 2023

DOW INDUSTRIALS:	37,260
S&P 500:	4,714
S&P/TSX COMP:	20,671
WTI:	$74.12
LOONIE IN $USD:	$0.7490 $US

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