2023 Q3 Commentary

"A Lesson From Tennis"

Picture a tennis court in the afternoon sun with players engaging in a fierce match of serves, volleys and smashes. Now, imagine that this court isn't just a haven for forehands and backhands but a lesson on how to win the game of investing.

Much like a reversal of fortunes during a match, after an optimistic start to the third quarter, bonds posted significant losses as yields rose sharply in Canada and the United States. This drove down both the bond markets and North American stock markets. By September 30th, the TSX had given up almost all its year-to-date returns.

During a difficult match (or a challenging time in the markets), we are reminded to stick to some simple lessons to improve our odds of success:

IN TENNIS

- Avoid Making Big Swings
- Keep Hitting the Ball over the Net
- Work on your Stamina
- Be Strategic & Tactical

IN INVESTING

- Control Risk
- Be Consistent
- Take a Long-Term Approach
- Have a Plan But be Flexible

We will briefly cover each of these concepts over the next few pages to show how these lessons can applied across both fields.

Control Risk

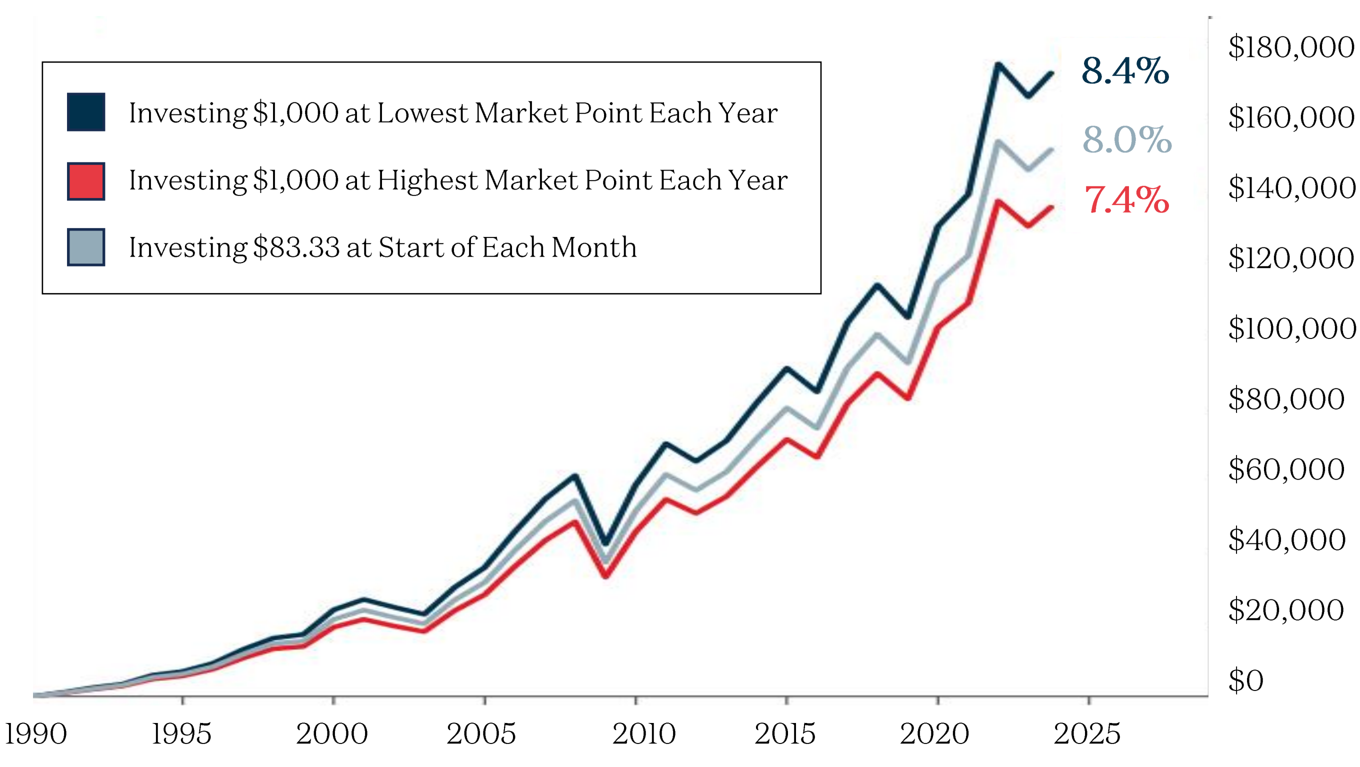
A big swing favours power over accuracy, which means a higher chance of missing the shot. Finding that right balance is crucial in the heat of the match. A similar situation happens when investors' emotions lead them to make large bets during tense periods. These outsized bets may lead to outsized losses, which further compound negative emotions and bad decisions. Instead, we prefer to control risks by altogether avoiding big swings, whether that's concentration in individual investments, sectors, themes, or market timing.

Market timing is the idea that you can predict the future direction of investments and position yourself accordingly to benefit. Make no mistake, attempting to time the markets is a fool's errand.

National Bank compared an individual who invested $1,000 into the S&P/TSX Index Composite each year at the bottom of the market (a perfect timer) vs an individual who invests the same amount monthly over the same period. As the research shows, over the long term, the difference between perfect timing and dollar cost averaging is quite small.

The message is simple: since no one can time the best day to invest every year for 33 consecutive years, the next best thing from a rate of return perspective is to simply continue to save every month.

Investing $1,000 Per Year into S&P/TSX Index from Jan 1990 to Sep 2023[1]



1. Source: National Bank Investments Myths & Realities As of September 30,2023. CIO Office (data via Refinitiv). *Annualized money-weighted rate of return.

Consistency

A game of tennis can be won by limiting unforced errors and constantly returning the ball over the net. Consistently keeping the ball in play will increase the chance of your opponent making an error. The same is true of investing; being consistent in the application of your investment strategy can put you in a favourable position. Would it shock you to learn that most professional money managers lack this consistency?

The premise of “active” management is that with enough skill, an investment manager should consistently outperform their benchmark. For example, a Canadian Equity manager who buys and sells individual Canadian stocks should strive to beat the TSX Composite Index net of investment fees. So, how many managers are skilled enough to achieve this goal?

The short answer is very few.

For the last 20 years, S&P DJI has published the results in a semi-annual report called SPIVA. The most recent mid-year 2023 report revealed that the vast majority (roughly 95%[2]) of professional Canadian Equity Fund managers were unable to beat their benchmarks over the last 5-year and 10-year periods.

While no two SPIVA Scorecards are the same, a certain theme is evident. Actively managed funds historically underperformed their benchmarks over both short and long-term periods, and when an active manager has outperformed their benchmark over a set time period, they usually fail to do so over the next period. Until the SPIVA scores materially improve, we prefer to save our clients the extra fees of “active” management in highly efficient large-cap markets (i.e TSX Composite, S&P500). The cost savings are then used for our private market exposure which diversifies our portfolios and helps get the ball consistently back over the net.

Percentage of Funds that Underperform their Benchmark

Fund Category	Comparison Index	5 Year	10 Year
Canadian Equity	S&P / TSX Composite Index	94.5%	94.6%
U.S. Equity	S&P 500 (CAD)	95.8%	94.8%
Global Equity	S&P Developed LargeMidCap (CAD)	96.1%	96.6%

1. Myths & Realities: Fact checking and perspective on common investment beliefs – Sept 30, 2023: S&P TSX Total Return from Jan 2002 – Sept 30 2023
2. S&P Dow Jones Indices LLC, Fundata. Data as of Jun 30 2023. CIFSC categories are used. Financial information provided by Fundata Canada Inc. Past performance is no guarantee of future results. Table is provided for illustrative purposes

Stamina

Winning in tennis often requires a long-term focus, stamina, and perseverance. Similarly, successful investing typically involves a long-term perspective and the ability to stay committed despite periods of volatility and uncertainty.

The chart below illustrates the probability of stock market returns being positive or negative over a given period.

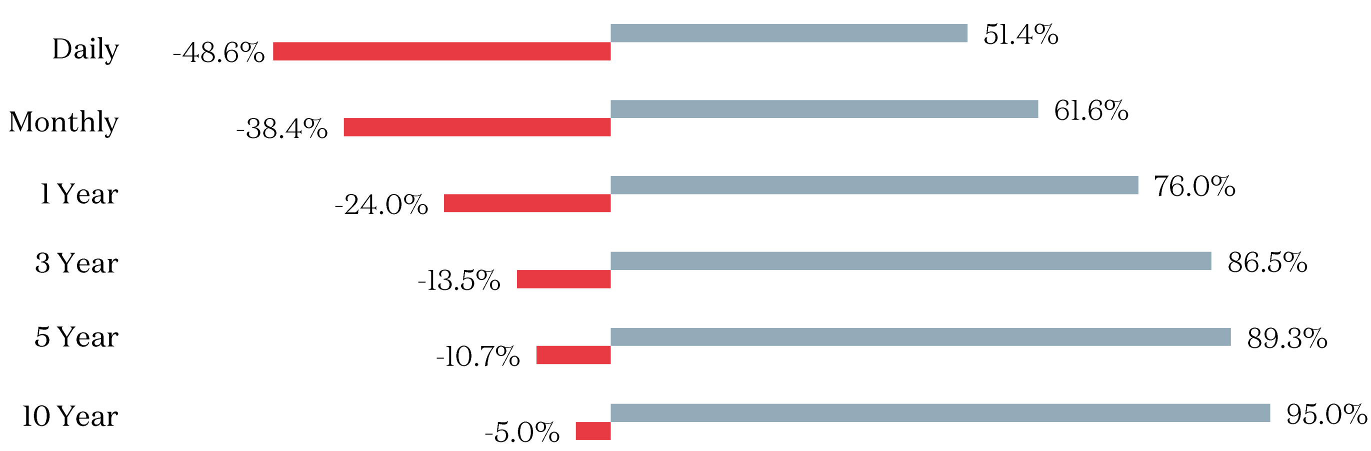
If an investor looks at the odds of positive returns on the S&P 500 over any given day, the chances are roughly 50-50. But extend the time horizon a year and the odds of positive returns increase to 76%. At 5 years the odds are almost 90% and over a 10-year period the odds of positive returns on the S&P 500 are 95%.

The lesson is simple: if the investor has the stamina, they should expect predominantly positive returns as their time horizon increases.

"The biggest mistake investors make generally is their confusing time and return. The shorter the time horizon, the worse the returns - by far. You have to go into it thinking it's a long-term time horizon..."

- Satish Rai
Former Chief Investment Officer, Ontario Municipal Employees' Retirement System (OMERS)

Percentage of Negative vs Positive Returns on S&P 500 over 50 Years*



	10 Years	5 Years	3 Years	1 Year	Monthly	Daily
Positive	95.0%	89.3%	86.5%	76.0%	61.6%	51.4%
Negative	-5.0%	-10.7%	-13.5%	-24.0%	-38.4%	-48.6%

Source: Bloomberg, Manulife Investment Management, Capital Markets Strategy.
*As of March 31, 2023. Price index before 1988. Total return index after due to availability of data

Strategy

Strategic vs Tactical Allocation

Tennis players need to have a game plan before starting a match. Investing is no different, the portfolio manager should determine the best long-term game plan (strategic asset allocation) but also be open to adapt to changing market conditions and new information (tactical asset allocation).

In an environment of "higher for longer" interest rates, we needed to make some changes at the margin. As we explained in the **control risk** section, large outsized swings are not in our DNA. Here is a list of small adjustments we made to the Westmount Wealth models in 2023:

>Increased Allocation

Private Credit

Private credit is a direct loan to a business looking to expand or fund day-to-day operations. In our case, we invest primarily in loans to U.S. mid-market companies, with operating profits in the 10M-250M range. With ongoing stress in U.S. regional banks, private lenders are well positioned as regional banks have pulled back. This type of lending involves applying a credit spread (risk premium) above a floating benchmark rate, such as the Secured Overnight Financing Rate (SOFR). The recent movement in SOFR plus healthy credit spreads have resulted in attractive interest payments.

$100T

Estimate of new infrastructure needed by 2050 according to the International Energy Agency (IEA)[1]

Private Infrastructure

Infrastructure assets have the potential to diversify returns and provide stable cash flows. Assets like power plants and toll roads are often funded through long-term inflation-linked contracts. This helps insulate them from economic cycles and the effects of inflation. Infrastructure investments can also be attractive due to their monopolistic pricing power. As a results certain types of infrastructure assets tend to be less sensitive to economic slowdowns as the demand for their services will not wane regardless of the state of the economy.

1. Blackrock, "Adding structure to your portfolio with infrastructure," June 2023

Strategy Con't

>Decreased Allocation

Private Real Estate

This is an oversimplification, but higher interest rates often lead to lower real estate prices. If the cost of capital (borrowing rates) increase faster than your net operating income (rent), then real estate values typically adjust downward. This is why we have traditionally focused on properties that not only have the ability to increase rent but are also in demand due to a lack of supply (i.e. industrial warehouses). Given the challenging environment for real estate, we have reduced our exposure to this asset class.

Private Mortgages

When investing in mortgages, we prefer variable (floating) rate yields on first position mortgages with low loan-to-values. We feel we are being compensated properly for the risk we're taking. There is still high demand for private mortgage financing from Canadian homeowners and property developers. While we see no immediate cause for alarm in the 3,000+ mortgages in which we are invested, we are reducing our exposure on a preventative basis as we anticipate further stresses on borrowers.

>Added Exposure

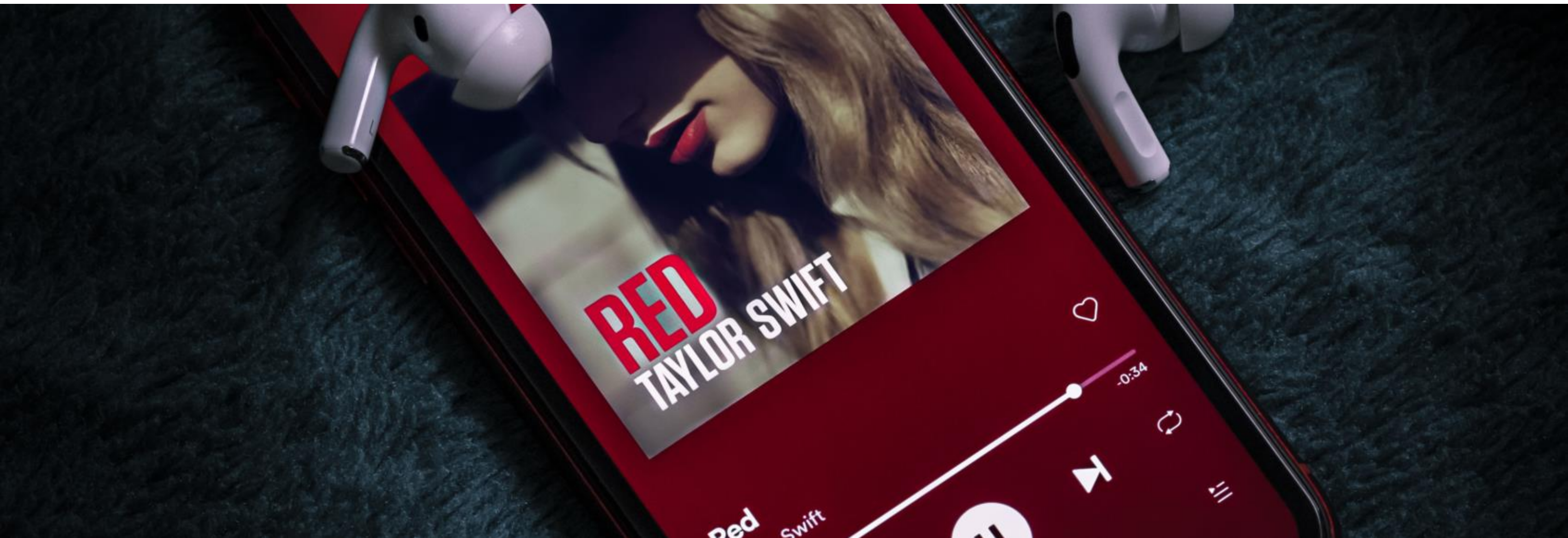
Music Royalties

Music royalties are a source of recurring income for those who own the intellectual property (IP) rights of a song. Royalty income can come from many sources including streaming revenue, digital downloads and synchronization licensing – when a copyrighted song is used in video games, movies and TV shows. These recurring payments are desirable to investors looking for a source of income as well as an asset that is less sensitive to economic cycles. People don't stop listening to music if the economy dips into a recession.

$700M

Amount of money Morgan Stanley is planning to invest in buying Music Royaties[1]

1. Kobalt Music - https://www.kobaltmusic.com/press/kobalt-partners-with-morgan-stanley-tactical-value-to-invest-more-than-usd700-million-in-music-copyrights/



The Bottom Line

Stock markets peaked in late 2021 and have not yet recovered. The same is true for most bond indices, which have been under significant pressure due to higher interest rates.

Canadian investors have also watched as real estate values have started to drop in response to high borrowing costs and a lack of affordability. This is the time where our emotions can lead us to make bad decisions due to exhaustion and lack of clarity.

Our investment philosophy emphasizes the importance of volatility-reducing, pension-style investing with a focus on income. Our private Westmount funds have been doing exactly as planned by adding to return and lowering overall volatility. Both our private funds are in positive territory for 2022, 2023 (year-to-date) and since inception (Dec 2021). Furthermore, we are proud to share that our Westmount Alternative Income Fund was recently nominated for 1-year performance for private debt funds in the Canadian Hedge Funds Awards.

Like a match of tennis, focus on what you can control, and ignore what you can't. Limit big risks and compounding errors. Be consistent in your approach. Have the stamina to stay in the game long-term. Adjust your strategy in small but meaningful ways to match your opponent's intensity.

As always, we are here to coach you through it all.

Returns from Dec 1, 2021 to Sep 30, 2023

Canadian Stocks S&P/TSX Comp. Index	-4.51%[1]
US Stocks S&P 500 (USD) Index	0.51%[2]
International Stocks MSCI EAFE (CAD) Index	-5.13%[3]
Canadian Bonds FTSE Canada Bond Index	-16.76%[4]
US Bonds Bloomberg US Agg Bond Index (USD)	-14.36%[5]

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1.2.3.4 Bloomberg price return from Dec 1, 2021 to Sept 30, 2023 - 5. Bloomberg total return from Dec 1, 2021 to Sept 30, 2023

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