## 2024 First quarter review

The strong equity markets we saw globally in late 2023 continued into the first quarter of 2024. Looking across geographies, for the quarter, the Canadian market was up 6.6%[1], the US market was up 13.0%[2], Developed Markets were up 8.1%[3] and Emerging Markets were up 5.1%[4]. While we have been following the equity markets long enough to never be surprised by the short-term moves in the markets; the first quarter of 2024 is nonetheless noteworthy since so few commentators predicted such a strong start to the year. This is yet another example of the futility of short-term market predictions.

Interest rates rose modestly during the quarter, with the benchmark 10-year Government of Canada yield finishing the quarter at 3.52%, compared to 3.29% at the start of year.

## The importance of the investment plan

To suggest that planning is an important component of long-term investment success is a truism and not particularly insightful. However, we thought it would be useful to discuss the importance of planning by breaking it down into separate components. First, the importance of establishing a reasonable plan, secondly the importance of sticking with the plan, and finally the potential cost of not sticking to the plan.

Perhaps surprisingly, establishing a reasonable investment plan is fairly straightforward. Depending on one's investment goals there are numerous strategies that can be implemented to meet those goals and we have identified several below. The hard part is not deviating from the strategy. Short-term losses, underperformance relative to an alternative strategy, and constant media negativity about the 'uncertainty in the world' can make sticking to an investment plan difficult. There is a quip we have heard about exercising and losing weight that applies to long-term investing. To the question, 'what is the best exercise to lose weight?', the answer is 'the exercise you will actually do.' Similarly with investing, 'what is the best long-term (within reason) investment plan?', the answer is 'the plan the investor is actually going to stick with'.

[1] S&P TSX Composite
[2] S&P 500 (C$)
[3] MSCI EAFE (C$)
[4] MSCI Emerging Markets (C$)

## *Establishing the plan*

Over the long-term, the primary goal of most investors should be to protect and grow the purchasing power of one's capital. Essentially forgoing purchasing goods and services today with the aim of being able to buy *more* goods and services in the future. Most assets that are expected to generate a cash flow or return in excess of inflation can meet this goal and there are many such investments.

| Assets that are 'good' long-term investment (depending on price) | Asset that are 'poor' long-term investment (regardless of price) |
|---|---|
| Stocks/Equities | Cash |
| Bonds | Currencies |
| Mortgage Funds | Commodities |
| Real Estate | Lottery Tickets |
| Education | |
| Private Equity | |

Within each of the investable asset classes there are numerous sub-categories. For example, equities can be separated by sector, geography, market capitalization or any of a dozen or more classifications. Similarly, bonds can be split out by credit quality, sector and type of issuer. JP Morgan produces a summary of returns for ten different asset classes which is included as an appendix to this letter (Appendix A, Page 6). The returns are summarized below. While, over the long-term, some investments have proven to be better than others, many have turned out to be reasonable investments.

| Asset Class | Annualised Return 2009-2023 |
|---|---:|
| | % |
| Large Cap Equites | 14.0 |
| Small Cap Equites | 11.3 |
| Real Estate Investment Trust | 10.9 |
| High Yield Bonds | 8.6 |
| Asset Allocation Portfolio (mix) | 8.1 |
| Developed Market Equities | 7.4 |
| Emerging Market Equities | 6.9 |
| Fixed Income | 2.7 |
| Cash | 0.8 |
| Commodities | - 0.2 |

Source: JP Morgan Guide to Markets

## *Sticking with the plan*

Based on the requirement of being expected to protect and grow the underlying purchasing power of capital, we see there are many asset classes that meet the criteria. Like exercise and weight loss, one could identify numerous exercise regimes that would lead to weight loss, the key is finding the regime that one will follow through on. Our experience has taught us that the follow through is the hard part, and we will discuss why.

Below we have summarised the best and worst years for the various asset classes mentioned above. Even the asset classes that performed the best over the long-term can have some very poor short-term periods. Conversely, and perhaps more importantly, the worst long-term investments can have some very strong years. In fact, in 2022 Commodities (which we do not even consider a legitimate investment) was the best performing asset class despite producing no return overall for the 15 years.

| Asset Class | Best Year (2009-2023) | Worst Year (2009–2023) |
|---|---|---|
| | % | % |
| Large Cap Equites | 32.4 | - 18.1 |
| Small Cap Equites | 38.8 | - 20.4 |
| Real Estate Investment Trust | 41.3 | - 24.9 |
| High Yield Bonds | 59.4 | - 12.7 |
| Asset Allocation Portfolio (mix) | 25.0 | - 13.9 |
| Developed Market Equities | 32.5 | - 14.0 |
| Emerging Market Equities | 79.0 | - 19.7 |
| Fixed Income | 8.7 | - 13.0 |
| Cash | 2.2 | - |
| Commodities | 16.1 | - 24.7 |

Source: JP Morgan Guide to Markets

Regardless of the strategy that one chooses, if the time period under consideration is long enough, at some point an alternative strategy is going to perform much better over the short-term. To demonstrate this, we will zoom in on Real Estate Investment Trust (REITs) versus Developed Market (DM) Equities. Though REITs have done better than DM Equities over the last 15 years, both have been 'reasonable' investment alternatives. However, if we look at the yearly returns, we see tremendous variation. We have highlighted a few periods of significant variation below. An asset class can lag by 20% one year, only to outperform by 30%+ the next year.

Calendar Year Return %

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **REITs** | 28.0 | 27.9 | 8.3 | 19.7 | 2.9 | 28.0 | 2.8 | 8.6 | 8.7 | -4.0 | 28.7 | -5.1 | 41.3 | -24.9 | 11.4 |
| **DM** | 32.5 | 8.2 | -11.7 | 17.9 | 23.3 | -4.5 | -0.4 | 1.5 | 25.6 | -13.4 | 22.7 | 8.3 | 11.8 | -14 | 18.9 |
| | -4.5 | 19.7 | 20 | 1.8 | -20.4 | 32.5 | 3.2 | 7.1 | -16.9 | 9.4 | 6.0 | -13.4 | 29.5 | -10.9 | -7.5 |

Source: JP Morgan Guide to Markets

REITs and DM Equites have very different performance drivers and the yearly variation in returns is not surprising, in fact it is to be expected. The purpose of the analysis is to demonstrate why it can be so difficult to stick with a plan that is underperforming in the short-term since an alternative plan may have recent performance that is significantly better. At the end of 2013 it would have been very tempting for an investor to sell down their REIT exposure and buy DM equities. This would have been a mistake.

If we look at different strategies within the equity and bond markets, we come to similar conclusions. Below we have pulled together the performance data for various exchange-traded funds that represent a range of different sectors and strategies. As can be seen, most of the strategies provided acceptable returns over the longer-term, but with significant yearly variation. The outliers to the downside are Bonds and Energy, both of which were starting from a point, in our view, of extreme valuations 10 years ago, but are currently valued more appropriately. To the upside US Growth, driven by a handful of technology names, has been the clear winner and there is much debate in the investment community whether this can, or will, continue. Even though US Growth has been the clear winner over the last 10 years, it was by far the worst performing strategy in 2022. Conversely, Global Energy, that has been a poor investment over 10 years, has been by far the best performing strategy over that last 3 years.

| Sector/Strategy | ETF Proxy | Cumulative Return % | | | |
|---|---|---|---|---|---|
| | | 1 year | 3 years | 5 years | 10 years |
| Canadian Dividend | XDV | 7.9 | 9.1 | 9.4 | 5.7 |
| Gold | CGL.C | 10.1 | 3.6 | 8.6 | 7.3 |
| Canadian REITs | XRE | 2.0 | 4.2 | 3.6 | 5.3 |
| Canadian Growth | XCG | 17.4 | 7.2 | 11.9 | 8.7 |
| Canadian Value | XCV | 9.5 | 14.5 | 11.4 | 7.2 |
| US Growth | IWF | 42.5 | 8.7 | 19.3 | 14.7 |
| Global Energy | IXC | 4.1 | 29.4 | 11.0 | 3.0 |
| Global Material | MXI | 14.5 | 6.3 | 12.3 | 6.3 |
| Total Equity Market | ACWI | 22.2 | 5.8 | 11.8 | 8.1 |
| Balanced Fund | XBAL | 12.8 | 3.7 | 7.2 | 5.5 |
| Canadian Bond | XBB | 6.6 | -2.9 | 1.2 | 2.4 |
| | | BEST | | WORST | |

| Sector | ETF Proxy | Calendar Year Return % 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Canadian Dividend | XDV | 21.3 | - 0.5 | 31.5 | - 8.6 | 7.9 |
| Gold | CGL.C | 12.2 | 21.3 | - 5.1 | 6.2 | 10.1 |
| Canadian REITs | XRE | 22.0 | - 13.6 | 34.2 | - 17.4 | 2.0 |
| Canadian Growth | XCG | 28.3 | 11.0 | 17.9 | - 11.0 | 17.4 |
| Canadian Value | XCV | 18.1 | - 3.5 | 34.1 | 2.1 | 9.5 |
| US Growth | IWF | 36.1 | 38.2 | 27.4 | - 29.3 | 42.5 |
| Global Energy | IXC | 12.3 | - 30.7 | 40.9 | 47.8 | 4.1 |
| Global Material | MXI | 22.1 | 22.2 | 15.4 | - 9.2 | 14.5 |
| Total Equity Market | ACWI | 26.7 | 16.4 | 18.4 | - 18.3 | 22.2 |
| Balanced Fund | XBAL | 15.2 | 10.6 | 11.1 | - 11.1 | 12.8 |
| Canadian Bond | XBB | 6.8 | 8.6 | - 2.7 | - 11.8 | 6.6 |
| | | BEST | | WORST | | |

Source: iShares.ca

Our plan at Cypress looks most like the 'Total Equity Market' with a tilt to Canadian equities. We know in the short-term, and even long-term, other strategies will outperform, but the knowledge of which strategies will only be gained in hindsight. We believe our strategy gives clients a very high probability for meeting their investment goals and has worked in the past and, we believe, will continue to work into the future. This high probability of success, combined with a demonstrable track record, hopefully gives clients the confidence to 'stick with the plan'.

## *The cost of not sticking with the plan.*

Studies that have looked at fund performance over the years, have shown there is a negative correlation between year-on-year fund performance, meaning a fund's outperformance one year is more likely predictive of underperformance the following year than continued outperformance. Based on these studies if investors were looking to make changes to a portfolio the rational action would be to sell out of strong performing assets and buy underperforming assets. Few investors have the discipline to implement this type of strategy, not to mention it being tax ineffective. It is far more likely that an investor will move money into the strategy or asset class that has the strongest recent performance.

Below we have summarized the returns that would have been earned if an investor moved all their capital into the asset class that had the *best* performance in the prior year. For example, in 2008 the best performing asset class was Fixed Income, so we have included the Fixed Income return for 2009, while in in 2009 the best performing asset class was Emerging Markets, so we have included Emerging Market returns in 2010 – and so on. Most investors have the good sense not to put all their assets in one asset class, but chasing performance is real, so this illustrates the extremes of performance chasing.

% Return for **best** performing asset class from prior year:

| 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Annualised |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FI | EM | REIT | REIT | REIT | SC | REIT | REIT | SC | EM | Cash | LC | SC | REIT | COM | |
| 5.9 | 19.2 | 8.3 | 19.7 | 2.9 | 4.9 | 2.8 | 8.6 | 14.6 | -14.2 | 2.2 | 18.4 | 14.8 | -24.9 | -7.9 | **4.2** |

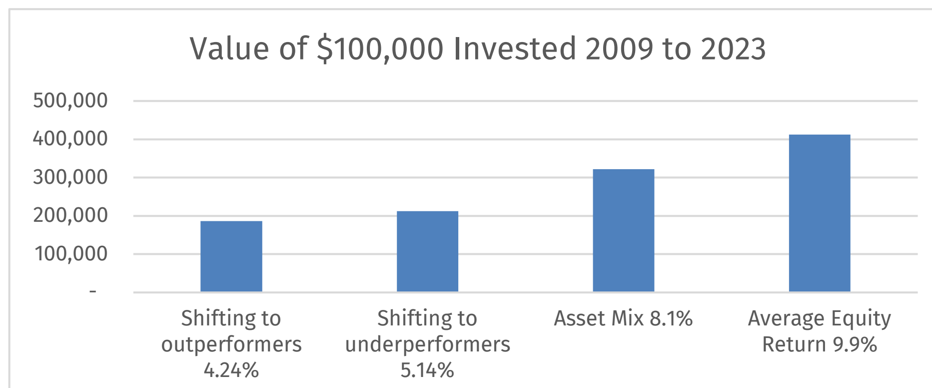
*FI = Fixed Income, EM = Emerging Market, SC = Small Capitalisation, LC = Large Market Capitalisation, COM = Commodities.*

For the sake of illustration, we have also looked at moving into the asset class that had the *worst* performance in the prior year. For the 15 years under consideration this was actually a better strategy than buying the best performing sector, but neither were anywhere near as good as a diversified basket of equities, which would be our preferred plan, or even a balanced portfolio (Asset Mix) that includes cash, fixed income and commodities.

% Return for **worst** performing asset class from prior year:

| 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Annualised |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EM | Cash | Cash | EM | COM | COM | COM | COM | Cash | Cash | EM | Cash | REIT | EM | REIT | |
| 79.0 | 0.1 | 0.1 | 18.6 | -9.5 | -17.0 | -24.7 | 11.8 | 0.8 | 1.8 | 18.9 | 2.2 | 41.3 | -19.7 | 11.4 | **5.1** |

*FI = Fixed Income, EM = Emerging Market, SC = Small Capitalisation, LC = Large Market Capitalisation, COM = Commodities.*



### *When to change the plan*

Reading the analysis above one might conclude that an investor should never change or update their investment plan. This is not true. The overall allocation should be updated to reflect changes in the investor's circumstances and changes in the relative and absolute return expectations of the various asset classes. For example, the return expectations for investment grade fixed income are higher now than they have been for most of the last two decades and we have been adjusting portfolios accordingly. Typically, these movements between sectors, geographies and asset classes are at the margins, taking portfolio weights up and down a few percentage points at most.

What one should conclude from the analysis above is that changes to the plan should not be made simply because a certain strategy has done well or poorly over a short period of time. Changes based on short-term performance often to lead to 'chasing performance', which is unlikely to end well in the long-term.

## Outlook

The strong start to 2024 for the equity markets means we should moderate our return expectations down slightly for equities over the short and medium-term. Overall, however, the relative and absolute valuation levels have not changed so much that we would be making any materials changes to what we have been doing for the past several quarters. Where appropriate we will continue to bring up the fixed income weight to reflect the real return potential in that asset class, but over the longer-term we expect a diversified basket of equities to remain the core of most investment plans.

**CYPRESS CAPITAL MANAGEMENT LTD.**

# Appendix A: Asset Class Returns

| 2009-2023 | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ann. | Vol. | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | YTD |
| Large Cap 14.0% | Small Cap 21.9% | EM Equity 79.0% | REITs 27.9% | REITs 8.3% | REITs 19.7% | Small Cap 38.8% | REITs 28.0% | REITs 2.8% | Small Cap 21.3% | EM Equity 37.8% | Cash 1.8% | Large Cap 31.5% | Small Cap 20.0% | REITs 41.3% | Comdty. 16.1% | Large Cap 26.3% | Large Cap 10.6% |
| Small Cap 11.3% | REITs 21.2% | High Yield 59.4% | Small Cap 26.9% | Fixed Income 7.8% | High Yield 19.6% | Large Cap 32.4% | Large Cap 13.7% | Large Cap 1.4% | High Yield 14.3% | DM Equity 25.6% | Fixed Income 0.0% | REITs 28.7% | EM Equity 18.7% | Large Cap 28.7% | Cash 1.5% | DM Equity 18.9% | DM Equity 5.8% |
| REITs 10.9% | EM Equity 20.3% | DM Equity 32.5% | EM Equity 19.2% | High Yield 3.1% | EM Equity 18.6% | DM Equity 23.3% | Fixed Income 6.0% | Fixed Income 0.5% | Large Cap 12.0% | Large Cap 21.8% | REITs -4.0% | Small Cap 25.5% | Large Cap 18.4% | Comdty. 27.1% | High Yield -12.7% | Small Cap 16.9% | Small Cap 5.2% |
| High Yield 8.6% | DM Equity 18.4% | REITs 28.0% | Comdty. 16.8% | Large Cap 2.1% | DM Equity 17.9% | Asset Alloc. 14.9% | Asset Alloc. 5.2% | Cash 0.0% | Comdty. 11.8% | Small Cap 14.6% | High Yield -4.1% | DM Equity 22.7% | Asset Alloc. 10.6% | Small Cap 14.8% | Fixed Income -13.0% | Asset Alloc. 14.1% | Asset Alloc. 4.2% |
| Asset Alloc. 8.1% | Comdty. 16.6% | Small Cap 27.2% | Large Cap 15.1% | Cash 0.1% | Small Cap 16.3% | High Yield 7.3% | Small Cap 4.9% | DM Equity -0.4% | EM Equity 11.6% | Asset Alloc. 14.6% | Large Cap -4.4% | Asset Alloc. 19.5% | DM Equity 8.3% | Asset Alloc. 13.5% | Asset Alloc. -13.9% | High Yield 14.0% | Comdty. 2.2% |
| DM Equity 7.4% | Large Cap 16.1% | Large Cap 26.5% | High Yield 14.8% | Asset Alloc. -0.7% | Large Cap 16.0% | REITs 2.9% | Cash 0.0% | Asset Alloc. -2.0% | REITs 8.6% | High Yield 10.4% | Asset Alloc. -5.8% | EM Equity 18.9% | Fixed Income 7.5% | DM Equity 11.8% | DM Equity -14.0% | REITs 11.4% | EM Equity 2.2% |
| EM Equity 6.9% | High Yield 11.5% | Asset Alloc. 25.0% | Asset Alloc. 13.3% | Small Cap -4.2% | Asset Alloc. 12.2% | Cash 0.0% | High Yield 0.0% | High Yield -2.7% | Asset Alloc. 8.3% | REITs 8.7% | Small Cap -11.0% | High Yield 12.6% | High Yield 7.0% | High Yield 1.0% | Large Cap -18.1% | EM Equity 10.3% | High Yield 2.1% |
| Fixed Income 2.7% | Asset Alloc. 11.5% | Comdty. 18.9% | DM Equity 8.2% | DM Equity -11.7% | Fixed Income 4.2% | Fixed Income -2.0% | EM Equity -1.8% | Small Cap -4.4% | Fixed Income 2.6% | Fixed Income 3.5% | Comdty. -11.2% | Fixed Income 8.7% | Cash 0.5% | Cash 0.0% | EM Equity -19.7% | Fixed Income 5.5% | Cash 1.3% |
| Cash 0.8% | Fixed Income 4.5% | Fixed Income 5.9% | Fixed Income 6.5% | Comdty. -13.3% | Cash 0.1% | EM Equity -2.3% | DM Equity -4.5% | EM Equity -14.6% | DM Equity 1.5% | Comdty. 1.7% | DM Equity -13.4% | Comdty. 7.7% | Comdty. -3.1% | Fixed Income -1.5% | Small Cap -20.4% | Cash 5.1% | Fixed Income -0.8% |
| Comdty. -0.2% | Cash 0.7% | Cash 0.1% | Cash 0.1% | EM Equity -18.2% | Comdty. -1.1% | Comdty. -9.5% | Comdty. -17.0% | Comdty. -24.7% | Cash 0.3% | Cash 0.8% | EM Equity -14.2% | Cash 2.2% | REITs -5.1% | EM Equity -2.2% | REITs -24.9% | Comdty. -7.9% | REITs -1.3% |

*Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.*

*Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg US Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2009 to 12/31/2023. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns.*

*Guide to the Markets – U.S. Data are as of March 31, 2024.*

J.P.Morgan
ASSET MANAGEMENT