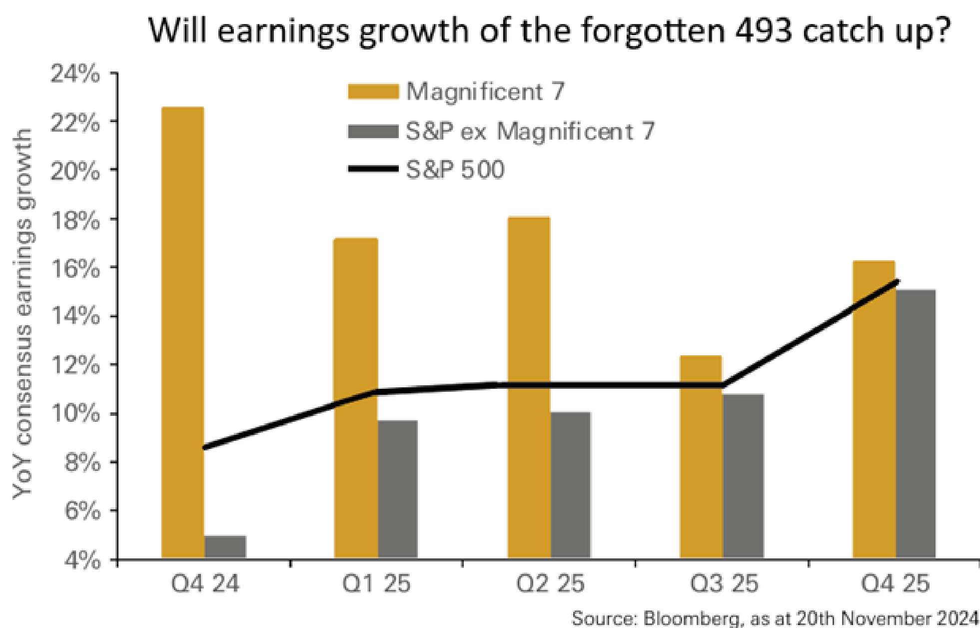
DM PORTFOLIO COMMENTARY
4th Quarter 2024

American Exceptionalism

If you've recently been following US politics – *or much of contemporary Americana for that matter* – these might not be the first two words that spring to mind; if we're talking about business acumen, innovation, and entrepreneurial spirit, however, they are absolutely the right descriptor. In 2024, as has been the case for some time, the US economy outpaced the rest and simultaneously seemed to be the incubator for most of the important technological developments which will likely drive tomorrow's growth.

Not surprisingly, the S&P 500 also lapped most of its global peers during the period and returned more than 20% for the second straight calendar year, a feat which hadn't been achieved in nearly three decades. Even though these gains followed a bear market in 2022, such prodigious performance can nonetheless evoke feelings of trepidation, nervousness that prices might have decoupled from value and that a reckoning is imminent *(to be sure, when "Fartcoin" rockets to a $1.5bn valuation, it's difficult to deny that there is at least some excess among us!)*.

At the same time, though, many of the impressive leaps in share price have been matched by similarly robust improvements in fundamentals, meaning that the market's leaders have not necessarily become as expensive as their stock performance might imply. This is exemplified by the now idiomatic "Magnificent 7" group of companies, which accounted for more than half of the S&P's 2024 return but, as the chart below highlights, also posted the earnings growth to back it up.



Source: Bloomberg, as at 20th November 2024.

If consensus estimates are to be believed, however, this graphic also suggests that the remaining S&P members should begin to make a more meaningful contribution to broad earnings growth in early 2025 and may even catch up to the Mag-7 by year end. With the forward price/earnings ratio of the equal weight S&P 500 now five turns lower than that of the generic index, this sets up a potentially interesting backdrop for the quarters to come.

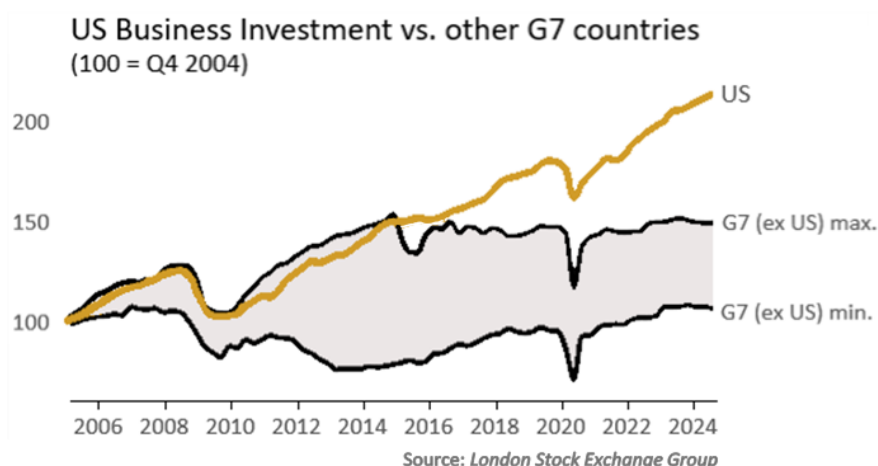
Following this line of thinking, we undertook an atypically large block of trades in DM US Equity in the final days of 2024, which included trimming names that had excelled on both price and profit growth, and repositioning this capital to other holdings which hadn't performed as well but which are now meaningfully cheaper than their faster growing portfolio mates:

Trims / Sells	Action	Return since start of 2023	Current Forward P/E
Amazon.com	Trim	175%	39.5
Apple Inc.	Trim	97%	34.3
JP Morgan	Trim	87%	14.2
Carlisle Cos.	Trim	75%	18.4
Booking Holdings	Sell	158%	25.4
Average:		**119%**	**26.3**

Adds	Action	Return since start of 2023	Current Forward P/E
TopBuild Corp.	Add	116%	15.5
HCA Holdings Inc.	Add	30%	12.9
Intercontinental Exchange	Add	53%	23.4
Roper Technologies	Add	26%	27.5
Thermo Fisher Scientific	Add	-3%	23.2
Average:		**44%**	**20.5**

In making these changes, our goal was to both crystallize some of the outsized profits accumulated over the past two years in DM US Equity and to put the mandate on a sounder footing, especially if the ascent of recent market frontrunners takes a pause in the new year. Though we may be giving up some growth potential in the near term, we've also cut valuation by nearly a quarter (see right column in each table), which feels like a prudent tradeoff from a risk management perspective.

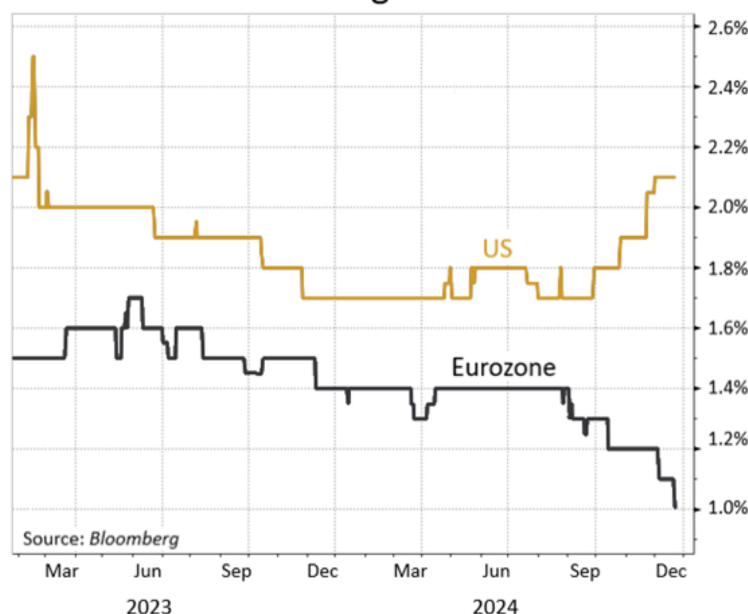
Speaking of risk management, most major non-US equity markets are now trading at historic valuation discounts to the S&P 500 and so the temptation to venture beyond North American shores is strong. In fact, many DM Investment Committee hours have been recently devoted to discussing and (often vigorously) debating this topic. In the end, however, we decided that most other markets are cheap for a reason and that capital allocated to them risked being trapped in a morass of mediocrity.



Source: *London Stock Exchange Group*

One of the many reasons that the US economy is better positioned than its peers, and that its companies tend to generate superior earnings growth to those situated elsewhere, is the vastly larger amount that gets invested by American businesses (see chart to left). This discipline leads to higher productivity, more of the innovation we mentioned above and, ultimately, compounding shareholder wealth.

To see how this plays out on an aggregate scale, the chart below shows how economist predictions for 2025 GDP growth in the US and the Eurozone have evolved in recent quarters which, as you can see, are now headed in strikingly divergent directions. So, while German and French and Swiss stocks look like relative bargains right now, this deep discount may not actually be great enough to compensate for the lethargy of these economies and the poor prospects for their underlying businesses.



When asked in December why the US economy is so much more dynamic than the others, Amazon founder Jeff Bezos answered simply, "We have the best capital system in the world – by far. In America, you can raise $50 million of seed capital to do something that only has a 10% chance of working … *that's crazy!*" It is crazy and it's also an economic superpower, one that can't be legislated for or coaxed out of financiers and risk takers. And, as long as it exists, the world's most important and successful innovators will continue to be seeded and thrive overwhelmingly in the US.

Speaking of exceptionalism … or a lack thereof

Of course, all of this brings us to Canada, where we're now enjoying our own version of political pantomime. And, just like Europe, Japan, and China, our equity market is now historically inexpensive relative to its southern big brother but, also like those regions, we're plagued by our share of economic ills (all of which are of course compounded by the President-elect's looming promise to erect a towering tariff wall in front of everything we send over the border).

While we won't predict who or what will prevail in Ottawa, we're cautiously optimistic that "tariff reality" might be somewhat less painful than "tariff threat". One of the key reasons for this is that much of what we sell to the US is inputs to downstream value-added activities. Our biggest export by value is crude oil in bitumen form, but several refineries in the US are configured to only handle this type of feedstock so it's not unreasonable to assume that they'd push back forcefully against a sudden jump in commodity prices. Same with potash, lumber, and aluminum: it's hard to imagine that farmers, homebuilders, and car makers wouldn't have something to say about a super spike in the cost of materials fundamental to what they do.

Regardless of how the pending trade skirmish plays out, Canada is our backyard and where we can truly use our boots-on-the-ground research approach to our advantage, getting to know management teams well and limiting holdings to companies which we believe are exceptional, irrespective of where they're domiciled. To that end, both DM Canadian Equity and DM Small Cap have far exceeded their benchmarks over the past half-decade and have been boosted lately by takeovers, with five of the stocks owned in these mandates getting acquired in the past 18 months at an average price premium of 52%.

Rather than dwell on unpredictable economic and political winds over which we have no influence, we'll continue to search for kernels such as these, while avoiding the chaff as best we can.

As we close the book on 2024, it feels like the year ahead could be one of the most interesting we've encountered. How will markets react to the redux presidency? Will stocks cheer the prospect of deregulation and tax cuts, or will they quake if monster tariffs and mass deportations are actually put into effect? Will a small group of mega-cap companies continue to dominate US market performance, or will the "other 493" stocks finally get their turn in the sun? Will Canada catch a bid if we find ourselves with a more pro-business government in Ottawa, or will the loonie and the TSX fall further behind their American analogues?

Unfortunately, we find ourselves with far more questions than answers as we enter the new year, which is why we've taken deliberate steps to manage risk and reduce valuations in our core equity mandates. As the nature of federal administrations, both south and north of the border, begins to be fleshed out, we may make additional portfolio changes to either take advantage of emergent opportunities or to sidestep perceived peril. Regardless, we expect that 2025 will keep us on our toes.

(oh, and for anyone who feels that time is galloping past, we're now a quarter of the way through the "new" century!)

Happy new year from the DM team!