DM PORTFOLIO COMMENTARY
1st Quarter 2025

Beyond communicating our views on the investment landscape and the tack that our team is taking within our various portfolios, the act of writing a commentary provides an opportunity to organize our thoughts and ensure that they remain consistent, both with contemporary conditions and our dual mandate of risk management and return generation. A summary of this year's first quarter, however, has been rendered largely irrelevant by the dramatic events taking place in the opening days of Q2 and this note would serve little purpose if it didn't address these developments. Never have we written, re-written, scrapped, and restarted a letter as many times as we have done this one and we apologize in advance for the likelihood that much of what we say below will be made obsolete by a random tweet or an off-the-cuff policy change made in the days that follow!

Risk, realized

Prior to the US election and in the weeks leading up to inauguration, Donald Trump repeated both his affection for tariffs and his plan to deport millions of undocumented and, presumably, low wage foreign workers. The expected economic damage that such policies would impart, however, was tempered by concomitant plans to cut taxes and slash regulation, and especially by the widely held belief that the most undesirable parts of the platform were more bluster and gamesmanship than true intent. As such, stocks set these risks aside and rallied sharply through Christmas.

The market's sanguine mood was undoubtedly buoyed by memories of the first Trump administration which, despite its unconventional and often chaotic way, only tinkered at the fringes of the economy and wound up presiding over a 67% cumulative rise in the S&P 500. The key difference between then and now that markets might have missed, however, is that the untested Trump surrounded himself with seasoned professionals from business, government, and the military – individuals who almost certainly steered him away from his worst instincts and helped dampen White House unpredictability and accompanying economic volatility.

The second time around, however, the now streetwise president-elect corrected his earlier "mistake" and immediately stuffed key cabinet posts with inexperienced, unqualified, and/or sympathetic *(sycophantic?)* staffers, ones who wouldn't impede or even temper his avalanche of mostly destabilizing executive orders. When this barrage of edicts was followed by a tariff regime that, if fully implemented as first proposed, would blow through the rates levied by the maligned Smoot-Hawley Tariff Act of 1930, many investors, businesspeople, and campaign contributors were undoubtedly left muttering, *"I voted for what I thought he would do, not for what he said he would do."* With a decline of more than 4% in the first quarter, followed by an even larger drop in the opening days of April, the US stock market was undoubtedly feeling the same way.

Play it as it lies

If markets dislike conventional uncertainty, it's not surprising that they detest "stroke-of-the-pen" uncertainty, the kind that comes in capricious waves and which is more a function of one person's quotidian mood than of run of the mill imbalances that build and correct in the broad economy. Much like in golf, though, where a player must make the best of wherever their ball comes to rest, regardless of what better fate they might feel they deserve, we now find ourselves forced to manage around what is, rather than what we wish would be.

As we detailed in our final commentary of 2024, this attunement to conditions meant making significant changes to our US equity mandates, taking profit in stocks which had enjoyed the full benefit of recent market ebullience and shifting capital to companies whose share prices have remained tethered to, or even underperformed, the recent results of their underlying businesses. So far this year, these adjustments have been well rewarded, with the DM US Equity Fund outperforming the S&P 500 Total Return Index by about 4% in the first quarter and gaining even more against the market in the turbulent first trading days of April.

It's been a tougher go for us in Canada to start 2025, not because tariff uncertainty has torpedoed our market, but rather because the gold sector has dominated performance and we have only minor exposure to this group. In March, gold broke through $3000 per ounce for the first time on the way to posting its best quarter since 2016, as tumult in the US drove capital to the "safe haven" commodity. In sympathy, the precious metals sub-sector posted a big gain in the year's first three months and outperformed the market's next best sector by a factor of nearly five.

Resource stocks, and gold miners in particular, don't provide a good match with our investment philosophy, however, which is grounded on consistent cash flow generation, effective redeployment of capital, and earnings visibility. Mining companies have a spotty record on all three of these counts: their earnings tend to move in wide cycles, regularly dipping into the negative; they're voracious consumers of capital and rarely complete projects on budget; and they are <u>always</u> "price-takers", with no ability to differentiate their output from others in the industry. And so, during the sporadic periods when the stars align for this sector, DM Canadian Equity will inevitably cede some of its long-term outperformance.

Why not just sit it out?

When stocks, or groups of stocks, are making parabolic new highs, the most dangerous words in investing are said to be, "it's different this time". Of course, this counsel is meant to warn that mature economies can only grow so fast, innovations can only be adopted so quickly, and equity valuations can only become so stretched. But these words can also be useful in reverse. The financial crisis of 2008 and accompanying Great Recession were unlike any economic event that any of us had experienced first-hand, and the covid epidemic and concurrent market crash were *definitely* extreme events, both financially and socially. As it happened, though, the only investors whose fortunes were permanently hurt during those periods were the ones who decided that it *was* "different this time" and abandoned their long-term portfolios in favour of perceived safety.

This market feels different because its downfall has seemingly been brought about by one person and a single set of decisions. In fact, unlike past declines when leverage, or inflation, or geopolitical turmoil were the catalysts, uncertainty itself is now the variable. In other words, stocks aren't currently reacting to fundamentals per se, they're reacting to the realization that fundamentals are suddenly unknowable and to the real possibility that companies will pull back from planning, investing, and building until conditions clarify.

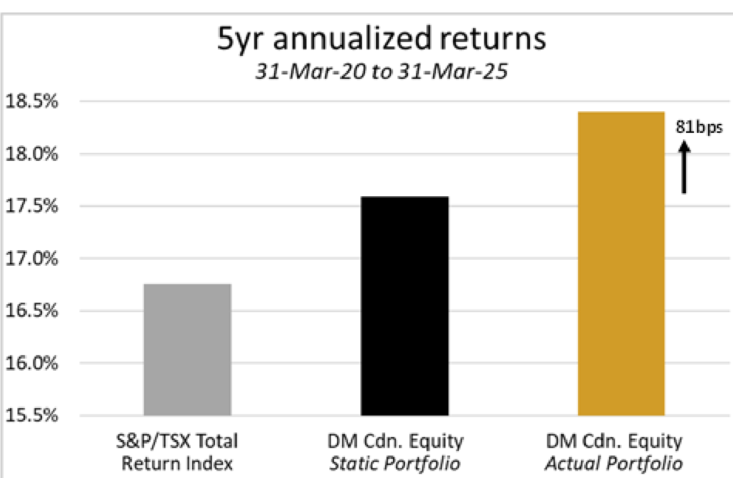
Much like the covid decline, however, a rapid plunge such as the one we're now experiencing can also create rare asymmetric opportunities. This is when great companies, ones whose products and services will account for meaningful parts of our expenditure regardless of economic conditions, can be bought at steep discounts. During covid, we re-underwrote each of our equity mandates and shifted capital to names which we felt had been excessively punished in the downfall and those which we believed could best weather the upside-down economic backdrop. In the ensuing five years, the DM Canadian Equity and DM US Equity portfolios significantly outperformed both their benchmarks and how they would have done had we left them unchanged through the period (see charts below).

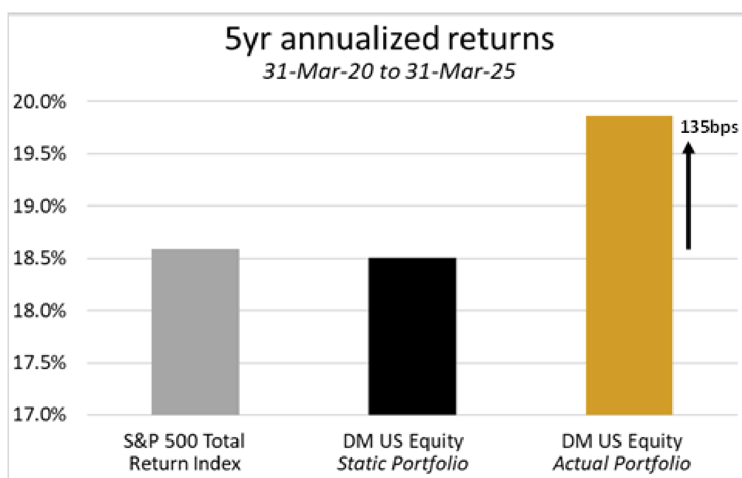
Today, our equity teams are performing the same deep analytical work that they did half a decade ago in anticipation of similar opportunities for return generation and risk management.

Investing is risky; not investing is riskier

As we've written in the past, if stocks provided a smooth return path, they wouldn't offer the promise of anything more than a savings account yield. It's *because* they're prone to dropping without notice and by meaningful amounts that they're priced to reward those with the time horizon and resolve to hang on through thick and thin.

Though it's hard to resist the natural urge to try and sidestep periodic declines, no one has yet displayed a repeatable knack for identifying either imminent market drops or the optimal moments at which to reinvest. And even with perfect information about future economic events, markets often don't behave as expected. If we told you in December that Trump's promised tariffs would be levied on Canada at even greater rates than forecast, that our federal government would be prorogued in the midst of this economic crisis, and that our economy would dip to within a hair's breadth of recession, getting your investment funds out of Canada would have probably been your priority. As it happens,





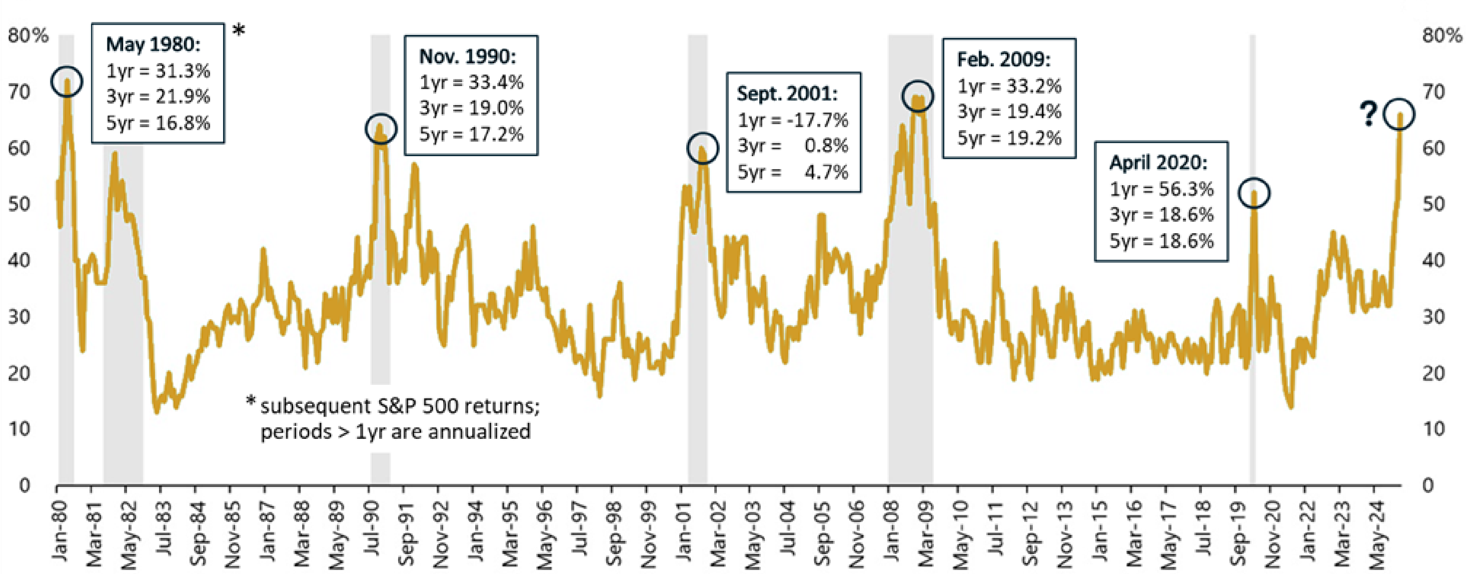
though, the TSX has outperformed the S&P 500 by a wide margin so far this year, *even in US dollar terms*.

Not surprisingly, sentiment toward just about everything – *the market, the economy, the state of politics and global accord* – has plunged to or below historic lows. Even though such general gloom makes us want to seek safety, this natural instinct is almost always in conflict with our financial best interest. The chart below shows the percentage of respondents since 1980 who think employment conditions will worsen over the coming 12 months. As you can see, when pessimism has been as high as it is now *(and this survey was taken before the April tariff announcement),* it has almost always marked an excellent entry point for equity investment.

When we further compare current events with the Great Financial Crisis and covid crash, key differences become apparent. In 2008, a massive bubble in US housing and credit markets was popping, a process which unfortunately had to run its course before green shoots could appear. Likewise, during the pandemic, central bankers and finance ministers could only mitigate the economic fallout and had to wait for science to catch up with the disease. Today, however, most of the economic damage that has been wrought so far could be undone with a phone call, or a press conference or, more likely, a business-positive tweet.

Such a development would undoubtedly ignite a market surge, but even if it doesn't come to pass, hiding on the sidelines might not provide the immunity expected. If the announced tariff regime, or some form of it, becomes an economic fixture, it will almost certainly cause the declining path of inflation to reverse (if it hasn't already). Against such a backdrop, the purchasing power of cash and interest-bearing investments will erode and, presumably, assets which have historically provided inflation protection (such as stocks) will gain favour. So, much like the investor who thought they were making a prudent risk management move by shifting to GIC's when short term rates popped above 5% a couple of years ago – *only to later find out that they would have earned nearly four times as much by sticking with stocks* – someone abandoning their long-term investment plan today introduces the risk of a similar setback.

12 Month Economic Expectations: *more unemployment*



Source: *University of Michigan*