



Dear Valued Investors,

As we bid farewell to 2023, it's time to reflect on the dynamic journey we experienced in the stock market this past year.

I am pleased to say that 2023 was one of those years that played out to near perfection. Heading into the year, we felt strongly that stocks were due for a nice rebound/recovery toward either the second half of 2023 or first half of 2024. Knowing that these things can never be timed perfectly, we nonetheless positioned the portfolios early in the year for a bull market. Notwithstanding, the first half of the year was far from smooth sailing but then we were treated with a robust market rally from November until year end.

Market Overview:

The global economy faced early headwinds in the year, including supply chain disruptions, inflation concerns, and geopolitical tensions. January inflation remained a significant focal point, impacting both consumer confidence and corporate decision-making.

With the Feds having initiated rate increases only nine months earlier in March 2022, it was premature to expect inflation to get back down to 2% in 2023. It generally takes 12-18 months before higher interest rates and tighter lending requirements make their full impact on the economy.

Over the course of the year though, central banks carefully navigated interest rate adjustments to balance growth with inflation containment. By July, the Feds had increased the fund rate by over 500 basis points. Not since the early 80's had consumers had to deal with such a rate shock. Auto sales declined. Home sales declined. Job growth, however, remained strong.

As luck would have it, both the US and Canadian economy did not go into a hard landing as many feared. High inflation did not persist as the US rate steadily dropped from 6.5% to 3.9%. Technology stocks which are supposed to underperform in a high interest rate, actually soared led by the magnificent 7 (Microsoft, Apple, Google, Meta, Amazon, Nvidia, and Tesla). And the Fed motto of "higher interest rates for longer" turned into a real dud as the yield on 10 year treasuries fell 25% from its October high of 5% to finish the year at 4%.

The grim outlook that the media and many economists had forecasted did not come to pass. The market proved its resiliency with many short sellers taking it on the chin, down over 20% with losses totaling over \$195 billion.



If there is one key takeaway/recommendation that I continue to preach for Frontwater clients, it is: “own high-quality companies and pay little attention to short term economic forecasts, recession fears and media reports that feed off doomsday scenarios.”

No doubt bear markets happen and so too recessions. But time and time again, these events are difficult to predict with any accuracy. That’s because companies make adjustments. Central bankers make adjustments. Governments make adjustments. Interest rate forecasts shift. Behavioral factors such as risk appetite and investor psychology shift. No one sits on their laurels.

Take the technology sector. Much of the earnings growth in 2023 actually came from cost cutting, not revenue growth. After sales declined post pandemic, tech companies like Meta and Amazon saw the light realizing they had massively over hired. Not only did these companies let go 10-20% of their workforce, but they also shelved many questionable pet projects in an effort to maximize shareholder value. Who could have predicted this kind of behaviour from technology’s leading top brass especially when “cost-cutting” had never been part of tech’s playbook.

For this reason, companies at the forefront of technological innovation shined for much of 2023 in spite of the rising interest rate environment. Strong earnings growth, robust balance sheets, and ongoing digital transformation trends fueled the outperformance of tech giants, making them cornerstone investments for many portfolios.

Looking Ahead:

As we enter 2024, uncertainties remain, but so do opportunities. Admittedly, we are not likely to see a repeat of last year’s tech sector’s performance. Still, a keen focus on technological advancements, sustainable solutions, and a disciplined investment strategy continues to be crucial. The year ahead promises to be filled with challenges, but for those prepared and strategic, it also presents a canvas for building resilient and rewarding portfolios.

One sector where we see opportunity is in the utilities and pipeline sector. Many of you know that utilities have a history of paying consistent dividends, making them attractive for income-focused investors seeking regular cash flow. Companies like Fortis, Emera, Enbridge, and TC Energy are currently paying juicy dividends with the latter two paying over 7%. When combined with a covered call option, investors can earn close to a 10% return in a flat market. Moreover, should interest rates come down further in 2024, those dividend yields become even more attractive. Like bees to honey, income oriented investors gravitate towards these type of high yield stocks in a low interest rate environment creating demand and pushing share prices higher.



At Frontwater, we remain committed to guiding you through these dynamic markets. Our team is ready to assist you in navigating the investment landscape and positioning your portfolio for success in the coming year.

Wishing you a prosperous and fulfilling 2024.

Regards,

A handwritten signature in black ink, appearing to read "Jeff Kaminker", is written in a cursive style.

Jeff Kaminker, President and Founder

Frontwater Capital