- FINANCIAL LETTER -

FOURTH QUARTER 2024

2024 Retrospective

Stock markets generally continued their strong upward trend in 2024, driven largely by hopes that artificial intelligence would generate significant profits for companies involved in the field, particularly the "Magnificent Seven" (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla). Optimism about potential interest rate cuts and expectations that Trump would reduce corporate taxes and regulations also (temporarily) boosted the market. However, toward the end of the year and into early 2025, markets adjusted their expectations and now anticipate that inflation will be more persistent, fueled in part by Trump's inflationary policies. Excessive government debt has also led to rising interest rates across many markets. The 10-year U.S. Treasury yield is now at 4.7% compared to 3.6% in mid-September. In Canada, the 10-year rate is at 3.5% versus 2.9% in September. This caused stock markets to decline by more than 4% from their recent peak in early December and pushed bonds (Core Canadian Bond Universe) down by approximately 3.5% over the same period.

Much of the stock market gains over the past two years have been driven by the rising price-to-earnings (P/E) multiples of certain mega-cap companies. For example, Apple's P/E ratio increased from 22x in December 2022 to 40x now. Tesla's P/E ratio went from 30.6x in December 2022 to 102x today. The Nasdaq Technology Index rose 29% in 2024 after gaining 44.6% in 2023. Speculative sectors like Bitcoin, junk bonds (non-investment grade as rated by credit agencies), and "meme stocks" promoted by online influencers surged in 2024, reminiscent of 2021 when most investors seemed to forget that risk exists. Other publicly traded companies experienced more normal growth rates in 2024. Including dividends, the S&P 500 returned 25% in USD (after 26% in 2023), while the equal-weighted S&P 500 returned 11.4%, and the Dow Jones Industrial Average gained 15%. The Canadian stock market posted a 21.7% return. The Canadian dollar's significant depreciation in 2024 boosted the returns of U.S. assets in Canadian dollars, adding about 8.6%.

Geopolitical issues, including trade tensions (let's call it Trump/Xi/Putin) and rising national debt levels, worsened in 2024, weakening the global economy. This environment doesn't prevent us from investing in the stock market but does increase the risk premium, leading us to require a greater margin of safety in our investments (a lower price for expected future profits and a more conservative estimate of those profits). Furthermore, the rapid advances in artificial intelligence (AI) in 2024 signal both positive transformations and significant disruptions in various economic sectors, making future profit estimations more challenging. This requires us to approach the situation with greater humility.

Outlook

In 2025, a trade war looms between the United States and the rest of the world, including Canada. The 25% tariffs announced by the Trump administration against Canada could plunge the country into a deep recession. The last U.S. trade war lasted about a year with Canada and two years with China (where certain high tariffs remain). For now, it is reasonable to expect Trump to exert significant pressure on the Canadian economy to extract concessions, suggesting a negative impact for a certain period. The precise consequences remain unclear as negotiations unfold in real-time and exchange rates adjust accordingly. However, Canadian exporters to the U.S. and domestic companies tied to consumer spending are likely to face challenges for some time.

American consumers, who represent about 68% of the U.S. economy, would also suffer if tariffs against China, Canada, Mexico, and Europe are implemented as announced. U.S. supply chains and manufacturers could be affected until the trade war and negotiations are resolved. Since nothing is decided yet, it is difficult to determine whether current stock prices in affected sectors adequately reflect this risk. Importantly, this trade war is likely to be temporary. If stock prices for certain of our companies drop significantly in the coming months, it could present buying opportunities for us, long-term investors.

No one can predict the systemic shocks that might result from geopolitical, natural, or financial crises. Given historically high stock market levels and government debt, older individuals should consider reducing their exposure to equities. As Warren Buffett once said, if someone cannot withstand a 50% drop in their stock portfolio, they should avoid the stock market (or at least reduce their exposure to a tolerable level). With 10-year U.S. Treasury yields at 4.7%, lower risk options are becoming increasingly attractive.

For investors with a longer time horizon and the ability to tolerate market declines, we believe there are currently high-quality companies trading at reasonable levels. These companies can form a diversified portfolio capable of delivering good returns over a 10-year or longer horizon. In our view, certain sectors offering essential products or services with sustained growth potential for at least the next decade are available at reasonable prices because short-term prospects currently appear less clear. Our focus is to select companies within these sectors that stand out due to durable competitive advantages and trustworthy management teams. The essential principles for managing uncertainty remain diversification, quality, and gradual progress.

Our investments

"Simplicity is the ultimate sophistication."

-Leonardo da Vinci

"Invest at the point of maximum pessimism".

-Sir John Templeton

Stock Transactions

During the quarter, we completed the full sale of **Atkins Réalis** (SNC-Lavalin) at a price of approximately $69.30. We had purchased this stock in 2019 at an average cost in the low $20s, when the news surrounding the company was dire, but we believed in its turnaround potential. Following Trump's election and the resulting stock market surge, we reduced our holdings in some stocks we considered overvalued, such as **Apollo Group** (+86% in CAD in 2024) and **Brookfield Corp** (+56%

in 2024). We also fully sold **Houlihan Lokey** at approximately $182 USD (with an exchange rate of about $0.71 CAD), a stock we had acquired in July 2022 at an average cost of around $75.50 USD (at an exchange rate of about $0.76 CAD). This generated an internal annualized rate of return exceeding 50% over two years and four months. In hindsight, it's easy to regret not having purchased more.

We have reduced equity exposure in some accounts with shorter investment horizons. Our purchases last quarter focused on a small-cap stock, which we will reveal once we complete our position. Additionally, we increased our holdings in the healthcare sector.

Fixed Income

We plan to extend the maturities of our bond holdings, particularly for our USD-denominated portfolio, which currently has a very short average maturity.

Reflections on Investment Mistakes

Every year, I review a list of my mistakes and successes, and I am often surprised by the sheer number of mistakes I've made while still achieving good returns. The key is not the number of mistakes but their relative significance (weight). The critical objective is to avoid major errors. It's essential to learn the right lessons from mistakes, which requires absolute honesty and experience. Moreover, one must not be paralyzed by past errors and must remain optimistic. Defining what constitutes a mistake is equally important. There are errors of commission and errors of omission. Errors of omission often stem from regretting a lack of conviction (or insufficient research) to purchase a stock that later performed exceptionally well. Regarding errors of commission, a drop in the price of a stock we purchased or held does not necessarily qualify as a mistake. It is considered a mistake only if, in our view, the price decline was due to valid reasons we failed to assess properly. If the price fell for reasons we deem temporary or because of a passing trend diverting funds elsewhere, we do not regard the price drop as a mistake. Over 30 years of investing, we have witnessed countless situations where a company faced severe difficulties, its stock price hit rock bottom, the news was dreadful, the situation seemed unsolvable, and no one paid attention anymore. Yet, 4-5 years later, the stock doubled or tripled.

Here are the returns on our model equity portfolio as of December 31, 2024:

As of December 31, 2024 (annualized for periods over 1 year):

	1 yr	3 yrs	5 yrs	10 yrs
Préfontaine Portfolio	25.2%	17.7%	17.3%	14.7%
Benchmark index	21.7%	8.7%	11.9%	10.7%
Difference	3.5%	9.0%	5.4%	4.0%

Returns before fees, including dividends. Fees vary according to the size of each portfolio. As an indication, our average fee as of December 31, 2024, for the total portfolio of all clients is 0.73% annually. Comparable index (total return -TR i.e. including dividends and in CAD) adjusted each year according to the allocation of the Préfontaine Portfolio; as of December 31, 2024, 53.7% S&P500 Equal-Weight TR, 38.4% S&P TSX TR and 7.9% MSCI Europe TR. The Préfontaine Portfolio is an actual portfolio made up of all Stéphane Préfontaine's personal and corporate accounts and those of the Fondation Préfontaine-Hushion over the entire reference period.

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