

Portfolio Commentary

Second Quarter, 2015

Was that really 15 years?

Hard to believe, but it was fully a decade and a half ago that we launched Dixon Mitchell Investment Counsel, just as tech stocks were melting down and mere weeks before Nortel would begin its fateful demise. If we thought we had seen the worst of trouble in our first few months, though, we would soon be relieved of any solace when, barely a year later, passenger planes slammed into the World Trade Center, setting off one of the most harrowing geopolitical periods in modern history. Since then, the US has fought the longest war in its history, entrenched governments have toppled, and adversaries of the west have employed tactics that until now could have scarcely been envisaged in the most dystopian imagination.

These daunting social conditions were mirrored in economics, with a near collapse of the global financial system in 2008 and an accompanying stock market crash that would make the bursting of the tech bubble feel like a petty nuisance. Just as the terrorist attacks in the US were answered with a comprehensive military response, so too did the financial crisis summon the fiscal and monetary “big guns”, as numerous stimulus programs were launched (known commonly by acronyms like “TARP” and “CARS”) and central bankers let loose with *quantitative easing*, a formidable bond buying scheme designed to encourage business activity and capital expenditure by forcing down long term interest rates. When the calendar finally closed on the first 10 years of the new millennium, investors looked back on a roller coaster period to find that major stock markets had generated no return. Though commentators were quick to label this stanza “the lost decade” and several observers made the case that equity markets were irreparably broken, those who succumbed to this dire narrative were about to sit out one of the greatest bull markets in history.

For all the trials and challenges of the past 15 years, it is significant that none could suppress the restless power of human ingenuity. In fact, the short time of Dixon Mitchell’s existence has coincided with a remarkable burst of innovation, with advancements not only pushing the boundaries of science and technology, but changing the way we lead our everyday lives. The late economist Joseph Schumpeter once said that a vibrant capitalist economy is one characterized by a high rate of “creative destruction”. In other words, when the market for ideas and inspiration is functioning well, incumbent enterprises are continually under threat from new technologies, improved processes, and visionary entrepreneurs. By this measure, the past 15 years would have to be regarded as prosperous, with a healthy list of businesses and industries having faced competitive incursions, sometimes existential:

- Video rental stores – even the once venerable Blockbuster met its end during our tenure
- Print publishing – the E-reader has significantly undermined this centuries-old business
- Camera manufacturing – high quality smartphone photography has severely undercut sales in this former growth industry; readily available GPS mapping on phones and car navigation systems has done the same to the road atlas
- Travel agencies – being able to book a vacation or check into a flight on a laptop or even a phone has marginalized this once essential service
- Fixed telephony – when’s the last time you heard Telus or Bell crowing about their great land-line offering?
- Utilities – as the cost of solar plunges and its efficiency increases, it is rapidly approaching “grid parity” in several locales; combined with the expected production of household power storage units, this progression will likely require electricity providers to reassess the durability of their current ratepayer bases
- Hotels and taxis – reaction to upstarts Airbnb and Uber has ranged from rankled to riotous
- Tobacco – how bright is the future for tobacco producers, as smokers increasingly switch to safer E-cigarettes?
- Postal service – the falloff in letter writing has required drastic (and often controversial) service cuts at Canada Post and other national carriers
- Personal computers – once dominant, PC’s have been meaningfully supplanted by tablets and other high powered portable devices; Microsoft now targets cloud computing for its future growth, while Intel has shifted its focus to making chips for the mobile market and the “internet of things”

Speaking of tablets, to get a sense of how quickly our lives are changing and how recently we’ve adopted many of the items we now can’t imagine doing without, consider this: *when the 2010 Winter Olympics concluded in Vancouver, the iPad had not yet been released to stores. So, if you recall checking hockey scores or medal counts on your tablet, that’s just your memory playing tricks!*

Economic dynamism has also been reflected in market indices, with several former cornerstones of the economy no longer up to inclusion. Emblematic of this changing of the guard are Eastman Kodak and The NY Times, which were recently replaced in the S&P 500 by a network technology company and Netflix. Though the list of advances that leapt onto the scene during our corporate life could fill volumes, it’s nonetheless worth also mentioning:

- Skype, Wikipedia, youTube, Paypal, Facebook (*and virtually all social media*)

- Streaming video
- USB drives that allow one to carry a library of data inside a shirt pocket
- Plasma and then LCD TV's
- Hybrid and electric cars that not only work, but which are coveted by consumers
- 3D printing
- Energy extraction technologies that almost instantly flipped the "peak oil" storyline to one of North American self-sufficiency
- Scientific and medical breakthroughs ranging from embryonic stem cell therapy, to the mapping of the human genome, to the completion of the Large Hadron Collider, which recently enabled the first observation of the Higgs boson, or "God particle"

As we look ahead to the next decade and beyond, we see no shortage of pending progress – in fact, the US Patent & Trademark office received double the number of patent applications in 2014 as it did in our first year of business. A few of the developments that could flow from this torrent of creative activity in the years to come include:

Internet everywhere – several companies are racing to develop the means to provide continuous Wi-Fi service to every square inch of the globe, from the tiniest mountain village to the most desolate African desert.

Driverless cars – development of this technology is well underway and it is widely expected that some form of self-driving car and/or long haul truck will appear on roads in the foreseeable future.

Organ printing – human cell tissue has now been 3D printed, paving the way to the eventual printing of entire organs.

Telepathy – with the recent breakthrough in "thought controlled" prosthetics, scientists have suggested that the door has been opened to some form of telepathic communication technology.

We list these accomplishments and aspirations not simply to fill space or to put added shine on a tumultuous decade and a half, but as a reminder that the spirit and initiative behind such advancements is persistently burning beneath the surface, even when market and economic news is at its most discouraging. In the long run, this virtuous force of progress and the growth it generates are the fundamental reasons to own stocks and participate in the marvel of free markets.

So does this mean we will speculate on emerging technologies or hopeful inventions directly in your portfolio going forward? No, because for each compelling idea that completes the journey to marketable success there will be countless costly failures along the way and much risk capital consumed; as stewards of your financial and retirement assets, that level of risk taking is several de-

grees beyond both our mandate and our tolerance. At the same time, though, we are heartened by today's breakneck pace of innovation, knowing that it is this very same drive to question, enhance, and create that compels CN to make its trains run a little more efficiently each year, Apple to produce the next indispensable item that we don't yet know we need, and J&J to find new ways to improve our health and beat complex ailments.

So, when you read about the mess in Greece this summer or listen to latest seer calling for an imminent "market correction", remember two things: first, your portfolio has likely already survived and thrived through just about the worst the world has to dish out; and second, no matter what happens with stock prices in the short term, insatiable entrepreneurs and talented corporate managers will keep innovating and improving, helping to grow the true underlying value of both corporate North America and the equities in your account.

Thanks for entrusting us with your assets during our first 15 years – we look forward to the next 15!