

The ABC Perspective

Volume 34, No.1

January 2023



Navigating A Sea Of Opportunity: Our 2023 Investment Outlook

Reflecting on the past year, it is clear that financial markets were tumultuous for all investors. In fact, the investment terrain presented numerous challenges and a level of volatility that made navigating markets a formidable task. Investors were deeply fixated on the unrelenting monetary tightening of central banks in their battle against elevated inflation.

Compounding these negative pressures were significant geopolitical events, an unusually strong US dollar, and the expectation of an impending worldwide economic slowdown. These events, by extension, meaningfully impacted financial psychology with a maelstrom of negativity overhanging the marketplace. As a result of the significant market decline of 2022, share prices and stock multiples experienced a meaningful de-risking and various segments of the market appear to be very mispriced, being overlooked by anxious investors focused solely on the negative newsflow.

Reviewing the macroeconomic landscape, we see numerous reasons for optimism. To the surprise of many, the North American economy, unemployment, and corporate earnings have demonstrated remarkable resilience in the face of extraordinary monetary and geopolitical circumstances. In this regard, we believe the glass is half full rather than half

empty. For instance, despite the inflationary pressures of 2022, the present flow of data suggests inflation has peaked and is now in deceleration. This ebbing of inflation has been led by declines in energy, commodities, apparel, and car prices. For example, gasoline prices peaked in June of 2022, with wholesale prices plummeting more than 50%. Furthermore, the housing market downturn, induced by higher interest rates, has resulted in a steep drop in the price of lumber, which has fallen over two-thirds during the past year. This point is particularly relevant, as shelter comprises over 30% of the consumer price index, a key barometer of inflation. Additionally, the resolution of global supply chain challenges, now back toward a state of normalcy, is a major positive in inflation deceleration.

We believe that the present abatement in inflation should instill confidence in investors that global monetary authorities are making progress in addressing the 2022 price pressures. Any perceived success should precipitate an eventual pivot in central bank monetary policy. Consequently, declining interest rates, we believe, would propel common stocks multiples upward and provide a significant tailwind for equity prices. In our view, it is not a matter of if interest rates will decline, but rather when and to what degree. Additionally, with lower cost of capital, it would not be surprising to see

proactive companies engage in accretive merger and acquisition activity and go-private transactions, as they opportunistically capitalize on the market malaise.

Looking over past market cycles, our analysis suggests that the secular bull market in equities, which began in the mid-2010s, is still intact. Secular bull markets tend to produce above-average investment returns over extended periods of time, which spanning multiple business cycles and marked by a general upward trend. It is not unusual for these longer-term trends to be interrupted by shorter-term cyclical bear markets. We believe the current market weakness represents a cyclical bear market within a larger secular bull market trend.

More importantly, we believe that we are presently on the verge of a Cambrian explosion of innovation that will dramatically alter our lives and elongate the secular bull market in equities for years to come. In particular, we see artificial intelligence (AI) as the principal agent of technological advancement and the overarching theme in the next leg upward for common stocks. In this regard, AI, technology has the potential to reshape the world, boost productivity, and elevate corporate profits. For instance, AI will power self-driving cars, robotics, virtual/augmented reality, simulations, genomic sequencing,

and new drug discoveries. Our portfolios are well positioned to take advantage of secular themes in technology, including AI, via core holdings such as Apple, Microsoft, Amazon, Alphabet, NVIDIA, and Thermo Fisher Scientific.

In summation, despite the overwhelming pessimism that characterized 2022, we remain resolute in our “new value” investment conviction and are navigating the current tumultuous markets with a longer-term perspective and discipline. Looking ahead to 2023, we are confident in a significant stock market comeback with improving economic and corporate fundamentals providing a host of investment opportunities.

A handwritten signature in black ink that reads "Tom." with a period at the end. The signature is written in a cursive, slightly slanted style.

Featured ABC Common Stock Holdings

Zoetis is the global leader in animal healthcare. The company produces medications, vaccines, genetic tests, and diagnostic products for companion animals and livestock. Zoetis boasts a highly diversified portfolio, featuring over 300 product lines for eight distinct animal species, and conducts business in over 100 countries worldwide. We are exceptionally bullish on the pet care industry, as key secular growth trends including proliferating pet ownership and the increased humanization of pets are driving sales of pet products and services. With a projected compounded annual growth rate of over 8%, the pet care sector is expected to reach a market size of \$275 billion by 2030, a rate of expansion significantly outpacing U.S. GDP. Furthermore, animal health is expected to emerge as the industry’s largest segment, overtaking food and treats. We believe Zoetis is well positioned to capitalize on this shift. Our bullish outlook is supported by Zoetis’ introduction of novel products and services and their investments in research and development. For example, Zoetis has been a pioneer in the development of monoclonal antibody therapies to treat osteoarthritis pain in dogs and cats. The company has brought to market Librela and Solensia, the first injectable therapies for pain associated with osteoarthritis in dogs and cats. Additionally, Zoetis is successfully driving growth in revenue and earnings by leveraging direct sales channels to their advantage. These factors, combined with Zoetis’ exemplary management, underpin our optimistic view of the company’s prospects within an ever-expanding pet care industry.

NVIDIA is at the forefront of computer graphics and artificial intelligence based solutions. Under the leadership of visionary founder and CEO, Jensen Huang, the company emerged as a major player in the industry in the year 1999 with the invention of the graphics processing unit (GPU). This technological breakthrough not only propelled the growth of the PC gaming industry, but revolutionized modern computer graphics and parallel computing. Today, NVIDIA’s GPU’s are optimized for the complex computational demands of AI algorithms, making them ideal for use in data centres, where efficiency and speed are of the utmost importance. In a world increasingly reliant on data, the demand for AI solutions is growing at an exponential pace. We see AI having the potential to become one of the greatest advancements in human history and NVIDIA is leading the charge in its development and application. The company is well positioned to capitalize on a massive total addressable market, which we believe, could eventually exceed \$1 trillion. NVIDIA continues to push the boundaries of technology and innovation with new product offerings including Ada Lovelace RTX graphics, Hopper AI computing, Orin for autonomous vehicles and robotics, and NVIDIA Omniverse. Moreover, NVIDIA is not only growing organically but also expanding through strategic acquisitions and partnerships, all while returning value to shareholders via stock buybacks and a dividend. NVIDIA is a quintessential ABC Funds’ “new value” stock selection and a core holding in all three ABC Funds.