May 6, 2024

Navigating Market Storms and Harnessing the AI Wave – May 2024

By Pedro Ribeiro, CIM®, FCSI® – Portfolio Manager and Cross-border Advisor

Last month, I mentioned that market fluctuations are as predictable as the tides — a fact as shocking as the sun rising in the east. April proved to be a turbulent month for equity investors, with major U.S. indices taking a tumble. The Dow Jones, NASDAQ, and S&P 500 all experienced over 4% drawdowns, with the Dow Jones leading the retreat at nearly 5% down.

Closer to home, the S&P/TSX couldn't entirely escape the downdraft, giving back 1.82%. I'm not one to revel in misfortune, but there's a silver lining here: our model portfolios weathered the storm better than the broader market indices owing to our diversified and disciplined approach.

Fluctuations in the market are to be expected and we'll undoubtedly encounter further choppy waters in the months ahead. But that's why we've built our portfolios with a focus on resilience and long-term growth potential. When the waters turn rough, it's comforting to know that we've charted a course designed to navigate the inevitable storms. Sorry about the boating analogies, but for those that know me, you know about my passion for boating and boating season has finally arrived in Ontario.

Capitalizing on the AI Megatrend: A Wealth Management Outlook

We're always looking ahead to emerging trends that could impact your financial future. One area that's rapidly evolving is artificial intelligence (AI) and we're excited about the potential benefits this cutting-edge technology could bring to society and your investment portfolios.

You've likely already experienced AI in action through digital assistants like Siri or Alexa that can understand and respond to voice commands. But AI's capabilities extend far beyond that. Through machine learning, AI systems can analyze vast troves of data, identify patterns, and make highly accurate predictions in ways that surpass human abilities.

In the healthcare field, AI is helping doctors detect diseases earlier through advanced image analysis. It's also being used to develop personalized treatment plans and discover new drug therapies. Imagine a world where cancer, Alzheimer's, and other devastating illnesses are cured—that's the immense promise AI holds.

For businesses, AI can streamline operations, enhance customer service, and uncover new revenue opportunities through data-driven insights. Companies at the forefront of AI innovation could see their revenues and profits increase in the coming years as they fully utilize AI technologies.

Even climate change could be tackled more effectively with AI modeling future scenarios and optimizing energy systems. The possibilities are staggering when you combine AI's computational power with the boundless ingenuity of the human mind.

Of course, with any transformative technology, there are valid concerns around privacy, job displacement, and the ethical development of AI systems. But we're confident that responsible governance and ongoing advancements will ensure AI becomes a great catalyst of human progress and prosperity.

As your financial stewards, we have been actively monitoring AI-related investment opportunities that could generate attractive returns aligned with your goals and values. We'll keep you updated on new investments making their way into our model portfolios. In the meantime, here are some examples of how some of our holdings are developing and using AI technologies:

Tesla:

- Autopilot and self-driving capabilities in Tesla vehicles rely heavily on AI systems for perception, prediction, and path planning.
- Tesla is developing humanoid robots called Optimus that will use AI, computer vision, and machine learning to perform tasks.
- Elon Musk recently launched a new AI company called xAI to develop "truth-seeking" AI models.

Microsoft:

- Microsoft has invested over $13 billion in OpenAI, the company behind ChatGPT, to further AI research and product development.
- Azure AI services like Computer Vision, Cognitive Services, and Bot Services use AI models for image/video analysis, natural language processing, and conversational AI.
- Microsoft 365 products like Word, PowerPoint, and Outlook leverage AI for smart writing suggestions, data visualization, and automated insights.
- Microsoft is integrating AI models like ChatGPT into products like Bing search, Office apps, and cloud services.
- The company has an AI research division exploring areas like large language models, multi-modal AI, and AI ethics/safety.
- Customers like BMW, Siemens, and Volvo Penta have expressed how they are leveraging Microsoft’s cloud and AI technologies to revolutionize their manufacturing processes.

Google:

- Google has been a pioneer in AI research through its Google Brain team and the acquisition of DeepMind.
- AI powers many of Google's products like Google Search, Google Assistant, Google Translate, Gmail spam filters, and Google Photos.

- Google Cloud offers pre-trained AI models and services for computer vision, natural language, conversational AI, and more through its Cloud AI platform.
- Autonomous vehicle company Waymo, owned by Google parent Alphabet, uses AI and machine learning for self-driving capabilities.
- Google is investing heavily in large language models, generative AI models for text/images/audio/video, and AI hardware like TPUs.

These tech giants are racing to advance AI capabilities across a wide range of applications from autonomous systems and robotics to productivity software, cloud services, and consumer products. Their AI research and product development efforts are shaping the future of this transformative technology.

Sources :

1. https://www.thestreet.com/technology/grok-elon-musk-ai
2. https://www.investors.com/news/technology/artificial-intelligence-how-microsoft-and- google-beat-apple-and-amazon-in-generative-ai/
3. https://www.youtube.com/watch?v=5R0s3dkWF1M
4. https://fortune.com/2023/07/12/elon-musk-ai-startup-xai-deepmind-microsoft-executives/
5. https://www.linkedin.com/pulse/amazon-tesla-facebook-microsoft-google-apple-smart-payroll-lewis

Portfolio Changes

Marnoa Moderate:

- Purchased Tesla (TSLA)

Marnoa Growth:

- Purchased Tesla (TSLA)

Company Snapshots

Written by Christopher De Sousa, CIM® | Associate Portfolio Manager | www.marnoa.ca

Cintas

Cintas is a leading provider of corporate identity uniforms, first aid and safety products, and cleaning services and supplies. Cintas serves over 1 million businesses of all types and sizes primarily in the U.S., as well as Canada and Latin America. We see a large runway for growth at Cintas considering there are over 16 million business in North America that could be utilizing the company's products and services. Cintas enjoys a regional and local monopoly, fortified by unique competitive advantages such as technology and economies of scale derived from route density. These advantages present significant challenges for competitors, primarily mom-and-pop shops, to replicate or compete effectively.

In the latest quarter, Cintas reported sales and earnings growth of 10% and 22%, respectively. Sales growth benefited from strong volume growth, new business wins, and further penetration and cross-selling among the existing customer base. Building strong relationships and earning the trust of a customer enables Cintas to not only sell uniforms to that business, but also allows the sales rep to cross-sell restroom supplies, entrance mats, and cleaning services. We think entering new markets and further partnering with its existing customer base will continue to be instrumental to the company's ability to grow organic revenue growth in the mid-to high-single digits and double-digit earnings growth over the next five years.

Cintas earned an operating profit margin of 21.6%, an improvement from 20.6% in the same quarter a year ago. Margin performance widened from a combination of technology-driven operational savings and efficiencies across each business segment. We believe that as Cintas expands the existing route and service network, operating costs including fuel expenses should decrease as a percentage of revenue per delivery route. We expect to see continuing operating leverage through scale and greater route density, leading to higher margin revenue per delivery route over time. Cintas currently serves over 11,500 local delivery routes across 330 cities.

Cintas is a boring business with exceptional fundamentals and stellar management execution. Cintas has grown sales and profits in 52 of the last 54 years—the only exception being the Great Recession.

Costco Wholesale

Costco Wholesale opened its first membership warehouse in 1983 in Seattle, Washington. Costco is now the world's third-largest retailer, behind Walmart and Amazon, and operates 874 warehouses worldwide with revenues exceeding $240 billion. Costco offers its members low prices on a limited selection of national brands, selected private labels, and in-house brands (i.e., Kirkland) across a wide range of categories while generating high sales volumes and rapid inventory turnover. There are over 73.4 million paid household members (grew 7.8% y/y in the latest quarter) and 132 million cardholders (+7.3% y/y). In Canada and the U.S., the membership renewal rate is 92.9%—a record high.

Costco has two membership classes: Gold Star ($60) and Executive ($120). Executive members represent ~46% of paid members and ~73% of global sales and growing each quarter. As many of you know, the rise of online shopping has led to fewer people visiting physical stores. However, Costco stands as an exception. High volumes of customers continue to visit Costco warehouses week in and week out. Retail foot traffic in the U.S. (+4.3%) and globally (+5.3%) remains strong and some of the best we are seeing in the retail industry. In the latest quarter, Costco reported sales and earnings growth of 5.7% and 18.8%, respectively.

Costco is experiencing a recovery in the discretionary merchandise category. Sales of big-ticket items such as appliances are growing over 20% whereas the industry is flat. This is promising as discretionary items carry higher margins, and in turn, would have an outsized impact on the company's profits. Costco's e-commerce business, which represents just ~6% of total sales, has been a standout performer, rising 18.2%. Costco Logistics set a record by delivering over a million packages, an increase of 28%. We believe Costco's e-commerce business is still in its early stages, with a long runway for growth.

Costco operates a simple yet effective business model: set prices at a level that encourages bulk buying while simultaneously generating a consistent flow of membership revenues. Costco purchases most of its goods directly from manufacturers, often selling these items before its required to pay for them. Each Costco warehouse carries fewer than 4,000 SKUs, a number significantly lower than other retailers such as Walmart and Target. This focused approach and quick inventory turnover gives Costco greater bargaining power over suppliers, enabling it to negotiate lower prices due to its large and frequent purchasing volumes.

Costco has managed to gain a significant market share over time attributable to its superior value proposition and the loyalty of its customers. We think Costco has a large opportunity set to expand its warehouse base internationally. We see China being a large opportunity as Costco only operates six warehouses, compared to its largest competitor (Sam's Club) at 48 stores. In addition, Costco could be raising membership prices sooner rather than later. This would lead to an immediate bump to net profits. Historically, Costco has raised membership prices every five years. The previous price hike was in 2017.

Like Cintas, we think Costco is a boring business with exceptional fundamentals and stellar management execution.

As always, please do not hesitate to reach out, should you have any questions or wish to discuss any matter in further detail. We're here to help you pursue your financial goals with confidence.

Yours truly,

Pedro Ribeiro, CIM®, FCSI®
Portfolio Manager
519.707.0049

OUR TEAM

PORTFOLIO MANAGEMENT	WEALTH MANAGEMENT	CLIENT MANAGEMENT
Pedro Ribeiro, CIM®, FCSI® Portfolio Manager RIA – Raymond James USA 519-707-0049	**Tracy Andrade, CFP®** Associate Wealth Advisor 519-707-0050	**Marci Paquete** Client Care Specialist 519-707-0051
Christopher De Sousa, CIM® Associate Portfolio Manager 519-707-0053	**Paul Thomas, CFP®, FMA®, CIM®, FCSI®** Financial Planner 519-707-0055	**Suzanne Ribeiro** Client Service Coordinator 519-707-0054

Performance as of April 30, 2024

Gross performance results as of April 30, 2024 for our discretionary model portfolios are as follows:

	Performance Summary (%) as of April 30, 2024								
Portfolio Mandate	3 months	6 months	9 months	Year-to-date	2023	2022	2021	2020	2019
Marnoa Strategic Allocation	2.43	11.46	6.28	3.17	10.54	-12.70	12.38	18.01	15.78
Marnoa Conservative	0.67	4.55	2.87	1.26	5.69	-12.05	10.86	9.90	19.86
Marnoa Moderate	3.54	9.50	10.01	4.73	12.35	-13.55	12.92	20.79	25.52
Marnoa Growth	6.56	15.22	15.73	8.78	19.28	-17.26	15.00	29.74	28.70

The returns above are gross of fees. Individual performance may vary based on cash flows and fees. Performance figures for periods greater than 1-year are annualized. The performance data quoted represents past performance. Past performance is no guarantee of future results.

Disclaimer

This commentary has been prepared by Marnoa Private Wealth and expresses the opinions of the author and not necessarily those of Raymond James Ltd. (RJL). Statistics, factual data and other information are from sources RJL believes to be reliable, but their accuracy cannot be guaranteed. No recommendation of any product or service would be made without a thorough review of an individual's financial goals and risk tolerance.

The returns presented are gross of fees. Individual performance may vary based on cash flows and fees. Performance figures for periods greater than 1-year are annualized. The performance data quoted represents past performance. Past performance is no guarantee of future results. The above performance data is current as of April 30, 2024.

Inception date is January 1, 2019 for Marnoa Strategic Allocation, Marnoa Conservative, Marnoa Moderate, and Marnoa Growth.

Generally, mandates with higher returns entail higher levels of risk. Investors should consult with their advisor prior to making an investment decision to help ensure their investments are suitable for their particular situation.

Past performance is not necessarily indicative of future results. Statistics, factual data and other information are from sources believed to be reliable, but accuracy cannot be guaranteed. It is furnished on the basis and understanding that Raymond James Ltd. and Marnoa Private Wealth are under no liability whatsoever in respect thereof. This report is for information purposes only and is not to be construed as an offer or solicitation for the sale or purchase of securities. Raymond James is a Member Canadian Investor Protection Fund.