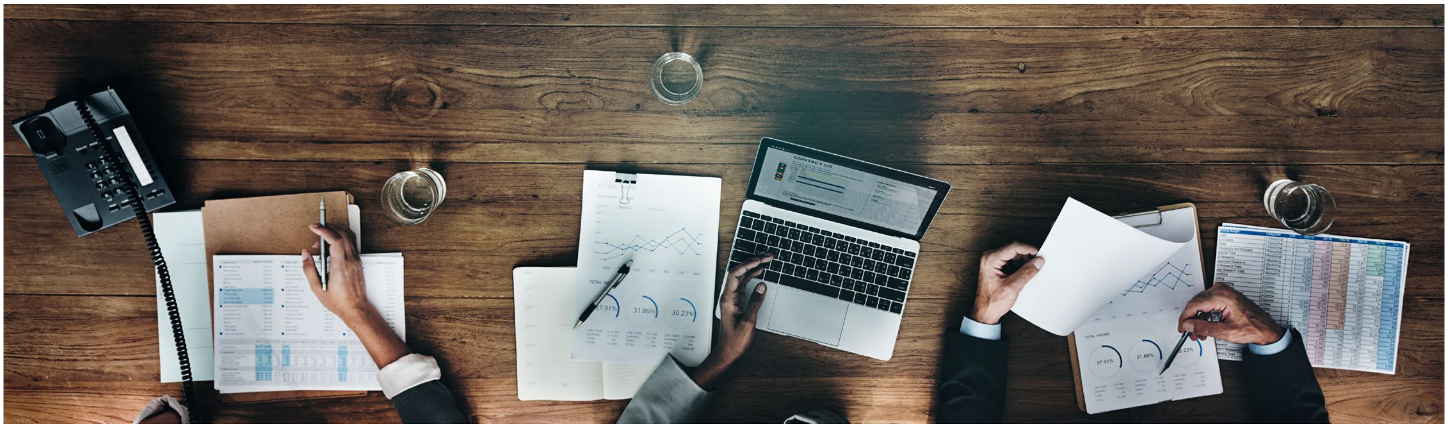
> *The risk of paying too high a price for* ***good-quality*** *stocks – while a real one – is not the chief hazard confronting the average buyer of securities. Observation over many years has taught us that the chief losses to investors come from the purchase of* ***low-quality*** *securities at times of favorable business conditions.*
>
> *-Benjamin Graham*

Lorne Steinberg,
MBA CFA
PRESIDENT

Risk and Reward

Dear Client,

Years ago, a client of mine asked if I could recommend a stock to buy for his newborn grandson, one that could be "put in a drawer and opened on his 21st birthday." Although I prefaced my recommendation with the usual disclaimer about the risks of buying a single stock, I knew that I had to choose a company with a great franchise, strong balance sheet, consistent free cash flow generation, and a long history of growing market share and earnings through good times and bad. I was not concerned whether my recommended stock would outperform the market in the short term. My sole focus was on suggesting an outstanding business, one that would continue to be an industry leader, and possess the financial resilience to survive under the worst circumstances.



LORNE STEINBERG WEALTH MANAGEMENT INC.
1000 DE LA GAUCHETIERE STREET O., SUITE 3310, MONTREAL, QUEBEC H3B 4W5 • P: (514) 876-9888, (866) 876-9888 I F: (514) 876-9994
34 KING STREET EAST, SUITE 701, TORONTO, ON. M5C 2X8 • P: (416) 485-4747 I F: (514) 876-9994
WWW.STEINBERGWEALTH.COM

Risk and Reward

This sparked a thought. Certain companies have not only managed to remain market leaders, but have also evolved over time, maintaining a dominant position in their respective industries. While these businesses seldom trade at bargain prices, they have rewarded shareholders over the long run, by consistently generating earnings and dividend growth, while holding up well during periods of market disruption. Conversely, some companies may appear "cheap" based on certain financial metrics, such price-to-earnings or book value, but may lack other important factors for consideration such as dominant market share, global presence and financial strength.

Financial metrics are straightforward to measure. However, other factors can be harder to assess. What value can we attribute to the brands of Kraft Heinz? Heinz Ketchup has been the dominant brand in its category for decades, boasting a global market share in excess of 50%. The same holds true for Kraft Singles, Philadelphia Cream Cheese and Kraft Dinner. To safeguard its market position, the company spends over $500 million annually in advertising and marketing. Consider the daunting challenge a new entrant would face having to compete with that level of marketing budget, not to mention the brand awareness that can take decades to establish. These brands carry immense value, as consumers are willing to pay a premium for their preferred brands and are less inclined to switch to cheaper alternatives, even during economic downturns.

Alphabet is another example. Its shares currently trade at a multiple of 20 times earnings. However, the company is spending over $40 billion annually on research and development (R&D), fueling its innovation in areas such as AI. Although R&D is expensed on the financial statement, it is actually a long-term investment that can yield substantial returns in the years ahead. We focus on companies that have the capacity and foresight to intelligently allocate capital, in order to maintain their market position and protect the brand.

To summarize, while it is difficult to place a value on certain quality attributes, many companies have built significant value that is not reflected in their financial statements. Over the past fifteen years, we have experienced the global financial crisis, a pandemic, and escalating geopolitical instability. Unsurprisingly, markets have been volatile, leaving many investors concerned about their financial future. Yet, throughout this period, earnings of the world's top-tier businesses have consistently outpaced inflation, leading to increased dividends and, ultimately, higher share prices.

LORNE STEINBERG WEALTH MANAGEMENT INC.
1000 DE LA GAUCHETIERE STREET O., SUITE 3310, MONTREAL, QUEBEC H3B 4W5 • P: (514) 876-9888, (866) 876-9888 I F: (514) 876-9994
34 KING STREET EAST, SUITE 701, TORONTO, ON. M5C 2X8 • P: (416) 485-4747 I F: (514) 876-9994
WWW.STEINBERGWEALTH.COM

RECENT ACTIVITY

Brookfield

Brookfield Corp (BN) is a diversified global alternative asset management company with a focus on real estate, renewable power, infrastructure, and private equity. As effectively the holding company for all of the various Brookfield entities, its primary asset is its 75% ownership of Brookfield Asset Management, an institutional investment firm with $800 billion of assets under management, in areas such as real estate, infrastructure and other less liquid assets. They have sizeable stakes in other publicly-listed entities, such as Brookfield Renewables (which focuses on the development, ownership, and operation of renewable power assets, such as hydroelectric, wind, solar, and storage facilities), Brookfield Infrastructure (an investor in infrastructure assets, such as energy, transportation, and data infrastructure) and Brookfield Business Partners (a private equity firm that invests in businesses across a range of industries).

In assessing the value of each of their businesses, the share price today is trading at a significant discount to its net asset value (NAV). Such is not lost on management (whose significant share ownership makes them very aligned with shareholders) who are aggressively buying back shares given their view of how compellingly valued this stock is today.

Johnson & Johnson

Founded in 1886, Johnson & Johnson (JNJ) consists of 3 businesses: Pharmaceuticals, Medical Devices and Consumer Health. While probably best known for its iconic consumer brands (including Johnson's Baby Shampoo, Listerine, Tylenol and Neutrogena to name a few), the bulk of the earnings are driven by the pharmaceuticals (68%) and medical technology (20%) divisions. In addition to the aforementioned brands, JNJ commands leading market positions in several medical technology markets such as knee and hip replacements and advanced wound care. The company has been able to maintain its growth by spending 15% of revenues on research & development, which has resulted in a healthy pipeline of innovative new drugs and medical devices.

In terms of financial strength, the company is one of only two S&P 500 companies (the other being Microsoft, which we also own) with a balance sheet strong enough to command a AAA credit rating. All of the above has resulted in JNJ being able to generate over 60 years of consecutive annual dividend increases. Far from resting on their laurels, they are looking to streamline their operations, and recently spun out 8% of their consumer health business, named Kenvue, with a view to further selling down their stake over time, thus providing considerable optionality in how they decide to deploy these funds for the benefits of shareholders.

CVS Health

CVS Health is one of the largest integrated pharmacy services providers in the U.S. In addition to the retail division, which comprises almost 9,000 stores, its Caremark division is the largest pharmacy benefits manager, while Aetna (acquired in 2018) is a major provider of healthcare insurance and managed services. Given their physical footprint, as well as several targeted acquisitions, CVS is well placed to take advantage of the trend to reduce healthcare costs by driving a larger portion of primary care towards pharmacies and clinics. As expected, store traffic has returned to pre-pandemic levels, which has put pressure on earnings in the short term. That being said, despite such headwinds, sales and profits may well reach record levels in 2024, a factor that seems completely lost on the market. With the stock now trading on a mere 8x prospective earnings, we are being presented with a compelling opportunity to add to our position, and we have done just that.

LORNE STEINBERG WEALTH MANAGEMENT INC.
1000 DE LA GAUCHETIERE STREET O., SUITE 3310, MONTREAL, QUEBEC H3B 4W5 • P: (514) 876-9888, (866) 876-9888 I F: (514) 876-9994
34 KING STREET EAST, SUITE 701, TORONTO, ON. M5C 2X8 • P: (416) 485-4747 I F: (514) 876-9994
WWW.STEINBERGWEALTH.COM

High Yield Bonds

A review of the high yield bond market and our high yield fund is available here: High Yield Quarterly.

Final Thoughts

There has not been a lot of positive news thus far in 2023. The war in Ukraine is in its 17th month with no end in sight, while tensions between China and the west remain elevated. At the same time, inflation has proven to be more resilient than forecast, resulting in ongoing interest rate increases. Yet despite all of this, corporate profits have held up well, as have share prices. The most vocal economists at the beginning of the year, who promised a "hard landing," and deep recession by the summer of 2023, have all but disappeared.

The quote at the beginning of this letter was written by Benjamin Graham in the 1950s. He made the observation that many of the world's highest quality businesses, though often more expensive than their competitors, in terms of valuation, have delivered superior returns over the long-term. In other words, paradoxically, taking less risk has often led to greater reward. This is a lesson worth remembering.

I recently had a phone call with the client who had asked me to recommend the stock for his grandson, who is now approaching his 21st birthday. The stock was Allstate. Over that period, Allstate has delivered an annualized return over 8%. While an investment in Allstate has certainly not been a topic of conversation at cocktail parties, the company remains the best property/casualty insurance company in North America, with an outstanding track record of creating value for shareholders.

If a client were to ask me the same question today, Allstate remains one of the companies I would recommend for the next twenty-one years.

Sincerely,

Lorne Steinberg
President

LORNE STEINBERG WEALTH MANAGEMENT INC.
1000 DE LA GAUCHETIERE STREET O., SUITE 3310, MONTREAL, QUEBEC H3B 4W5 • P: (514) 876-9888, (866) 876-9888 I F: (514) 876-9994
34 KING STREET EAST, SUITE 701, TORONTO, ON. M5C 2X8 • P: (416) 485-4747 I F: (514) 876-9994
WWW.STEINBERGWEALTH.COM