

# Markets Made Simple

Chan and Brown Wealth Management



Wealth Management  
Dominion Securities

FOURTH QUARTER REPORT – DECEMBER 31<sup>ST</sup>, 2025

## ARTIFICIAL INTELLIGENCE

As a child I loved dreaming up new inventions. I had some ideas that I knew would revolutionize the world. Unfortunately, my 10-year-old brain was unable to carry my ideas to their logical conclusion. My idea of a glow-in-the-dark toilet so you could safely relieve yourself in the middle of the night without walking into the medicine cabinet did not consider that a \$1.50 night light would do the same thing without outlining your “business” in fluorescent green. Then there is the transparent fridge door that allows you time to contemplate your snack options without letting all the cold air escape. Apparently, I did not realize most people would prefer not to watch their leftovers decompose in real time while having dinner. Finally, there was my brilliant idea of a mug that changed color to indicate whether your coffee was too hot to drink...because just holding the hot cup would not tell you that.

Although my inventions were less disastrous than Google Glass or the Segway, they offered the investor market about the same utility as solar powered flashlights or motorcycle seatbelts. My little mind had big dreams but like Henri Giffard, the inventor of the hydrogen gas filled blimp, my ideas ultimately collapsed (or exploded) in failure.

History is filled with ideas that have completely changed the world. The 1800s gave us the telephone, the bicycle, and the automobile. The early 20th century brought us television and commercial flight, and the latter half delivered the internet, personal computers, and the World Wide Web with unlimited information, mostly used for Tik Tok memes. Today, we’re watching the next world-changing technology unfold, Artificial Intelligence. Although many have said that we would be better off focusing on increasing Common Sense rather than creating Artificial Intelligence, nevertheless, AI is here to stay.

Every major innovation creates winners and losers. For example, the creation of the internet resulted in a few big winners like Amazon that is up over 3000X from its IPO price...but a much longer list of losers such as 360 Networks, Nortel, and William Shatner’s favorite stock, Priceline.com, all worth less than your Christmas tree in January.

Predicting the future is difficult even in mature industries. Will people still be drinking Coca-Cola five years from now, or will everyone switch to something green, organic, and made from the bark of a Ramón tree? At least with established businesses we can lean on decades of data and financial results. With brand-new technology, there is no roadmap, just a blank page that you can fill in with your imagination, not unlike promises from our politicians. With AI, the questions seem endless. How will it be used day to day? How fast will it be adopted? Will it result in companies reducing their workforce? Will it create attractive robot servants to take care of your family, like in Gemma Chan’s TV show ‘Humans’?

Much like the ten-year-old me was convinced my inventions would change the world and turn me into the youngest billionaire in Surrey spending the rest of my life eating Nachos and playing Nintendo 64, many investors today are projecting endless possibilities for AI and considering what to name their super-yacht from all the money they will be making.

History shows that when a technology captures the public’s imagination, capital doesn’t just trickle in...it comes in like an atmospheric river. Valuations rise, excitement builds, and prices often reach levels that assume perfection and global domination. History is quickly forgotten as investors start telling themselves, “*This time really is different*”.

We’ve seen this before.

Take the automobile industry in the 1920s. As roads improved and cars became affordable, demand exploded. Hundreds of car companies emerged producing everything from very successful designs that continued to this day like the Ford F-series to spectacular failures like the Edsel, Studebaker, AMC Pacer and Delorian although the latter made a significant come back in the movie 'Back to the Future' despite needing 1.21 GIGAWatts of power to do its thing. The less practical designs continue to this day with the release in 2023 of the vehicle that looks like it was built from used refrigerator panels, the Tesla Cybertruck. The former DOGE Czar Mr. Musk predicted annual sales of 250,000 units but faced the harsh reality of actual sales well below that level, with only 16,000 units sold in 2025 not including the one Trump plans to buy.

Investors were right about cars as they completely changed the world. Horses were politely dismissed, walking was relegated to health-conscious seniors, and the world opened up in ways we could only have imagined. For investors in the automotive industry, the story was quite different. During the 1930s, car stocks collapsed with many losing 90% or more of their value and fading into history. Even industry leaders like Ford saw their shares fall by roughly 75%.

It turns out world changing innovation is not synonymous with being a great investment.

Warren Buffett summed it up in a 2012 interview:

*"[The automobile was] the most important invention, probably, of the first half of the 20th century. . . . If you had seen at the time of the first cars how this country would develop in connection with autos, you would have said, 'This is the place I must be.' But of the 2,000 companies, as of a few years ago, only three car companies survived. So autos had an enormous impact on America but the opposite direction on investors." (Time, January 23, 2012)*

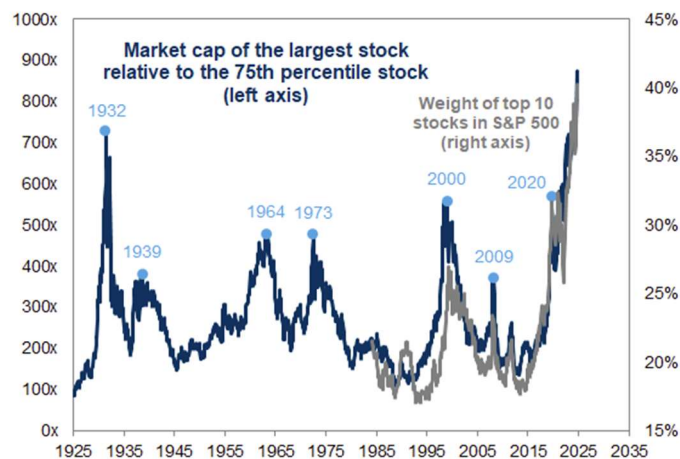
### So, What About AI today?

With any new technology, predicting the future is nearly impossible, especially when we don't yet understand all the trickle-down effects or the consequences it will have across industries and to our way of life. Every technological revolution creates massive opportunity...and equally massive risk.

Imagine being an investor in the 1920s with a list of 2,000 different car companies. Which one would you choose to put your money in? It would be like Indiana Jones in the 'Quest for the Holy Grail' where he ended up in a room with over 1000 different cups only one of which would give eternal life and the rest, instant death. The villain, American industrialist Walter Donovan chose...poorly.

We've seen many instances of huge peaks and massive collapse in the past several decades: internet stocks in 2000, cannabis companies in 2016, NFTs in 2020, Elias Pettersson in 2024 after he signed his \$92.8 million contract with the Canucks, reminding us that cycles change but human behaviour doesn't...now the sequel continues with AI.

In the markets today AI-related companies dominate leadership. The five largest stocks: Nvidia, Microsoft, Apple, Alphabet, and Amazon make up more than one-third of the S&P500. In other words, when you buy the index, you're buying AI with a side order of everything else.



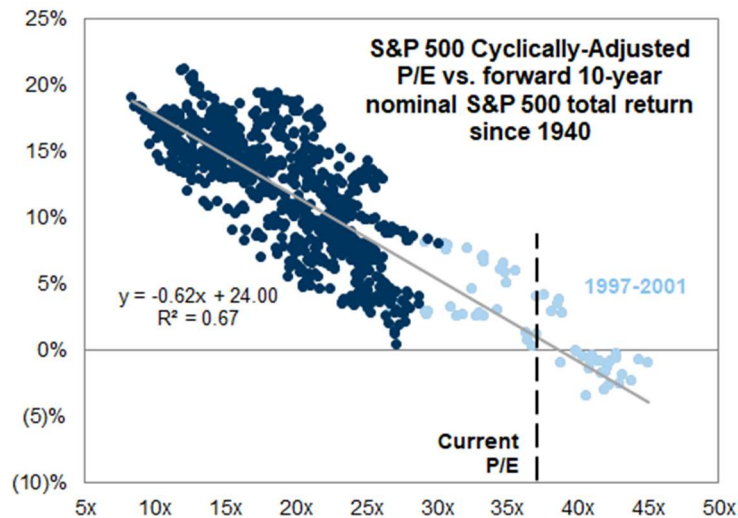
Source: Compustat, CRSP, Kenneth R. French, Goldman Sachs Global Investment Research

For the first time the top 10 companies account for nearly 40% of the index, a level of concentration that has never been seen before in history and not dissimilar to the scoring contribution of Connor McDavid for the Oilers.

In the past, when the S&P500 became highly concentrated in a few stocks, investors have received poor future returns which happened in 1932, 1964, 1973, 2000, 2009, and 2020<sup>1</sup>.

The “Magnificent (or Mag) 7” does not refer to the 1960’s western film starring Yul Brynner, Steve McQueen and Charles Bronson but to seven of the largest technology-focused companies in the United States starring Apple, Amazon and Nvidia, Alphabet, and Microsoft. In addition to these five biggest stocks in the S&P 500, the other two heavyweights are Tesla and Meta Platforms both of which rank amongst the ten largest companies in the index. *These seven “gunslingers” have “shot up” the most and contributed more than 50% of the returns for the S&P500 in the past four years.* As valuations continue to rise in an industry that is still unproven, risks are mounting. History reminds us that for every big winner there are plenty of investors left holding the bag...or burying the dead (stock).

The CAPE P/E ratio which was created by Nobel laureate Robert Shiller (who did not offer to transfer his prize) is designed to smooth earnings over a full decade and has wandered into heights not seen since Shaquille O’Neal was on the basketball court. History suggests that when CAPE gets this stretched, future returns tend to be less attractive than leftover Christmas fruitcake.



Source: Goldman Sachs Global Investment Research

Looking back to data from 1940, the metric has shown about 70% predictive power which translated is way better than “60% of the time...it works every time” – Brian Fantana from the Legend of Ron Burgundy. Today it is pointing to returns of roughly 2% per year over the next decade. In other words, expectations are high, but the math is not impressed.

Our strategy has always been to protect clients against the risks embedded in markets, especially the ones that look benign during periods of excitement but are extremely risky like backyard trampolines. After navigating record low interest rates in 2020, rampant speculation in 2021, high inflation in 2022, then high interest rates in 2023, recession fears in 2024 and a global trade war in 2025, the new threat for investors on the horizon is AI. It promises huge opportunities for some and Freedom 95 for other investors.

### The Outlook

After a year marked by a new US president, sweeping policy changes, a global trade war, and rising geopolitical risks, investors are asking a familiar question: “What do I do now?”

<sup>1</sup> <https://www.gspublishing.com/content/research/en/reports/2025/11/12/0c292cc7-ce42-4fba-a026-744231e9f4f4.html>

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In 2024, central banks pivoted from rate hikes to rate cuts. They then hit the pause button at the start of 2025 and have gone right back to cutting rates. That is generally good news for markets but it's bad news for anyone holding on to cash. Cash felt fantastic when it paid 5%. Yields are now dropping faster than the Vancouver Canucks playoff prospects and suddenly that 'safe' money doesn't feel so safe.

Inflation is leaving cash yields in the dust and markets are sprinting ahead while investors sitting on to that pile of idle money in savings accounts are getting more anxious than some politicians awaiting the full release of the Epstein files. The real question today is *'Where will that cash go?'*

### ***Options for Investors Today***

As rates fall, the outlook for cash has become slimmer than dieters on Ozempic. The fixed-income options available to investors today include:

**Cash:** Around 2%... if you're lucky. Most savings accounts are paying less than 1%.

**GICs:** One-year GICs are offering roughly 2.7%, down from the highs of 2024 when they paid an eye-popping 5%!

**Bonds:** One-year Government of Canada (GOC) bonds yield about 2.4%, five-year GOC bonds around 3%, and ten-year GOC bonds roughly 3.5%. Corporate bonds aren't much better, with the S&P Canada Investment Grade Corporate Bond Index yielding 3.6%.<sup>2</sup>

Over the past 12 months, we highlighted for readers that fixed-income opportunities are disappearing faster than free samples at Costco. We have been boosting our stake in high-quality government bonds while trimming our overweight in preferred shares after close to a 50% rally in the space over the past two years. At the same time, we've been stretching out the duration of our bond holdings as longer-term yields have finally started to rise.

### ***How About Equities?***

We can compare equities to fixed income by converting their earnings into a 'yield', similar to a bond yield. Think of it like estimating the profit or rental return on a real estate property.

Based on forecasted earnings for global stock markets next year, the earnings yield for various regions are:

**United States:** S&P500 – 4.5%

**Canada:** S&P/TSX – 6.0%

**Europe:** FTSE Developed Europe – 6.8%

As the S&P 500 has moved higher, valuations have also risen, making the US markets more expensive. We are finding the best opportunities in areas such as small and mid-cap US companies, which are providing us with earnings yields of 5.6-7.3%, while our holdings in Canada offer even more attractive yields of 6.0-8.4%<sup>3</sup>. In addition, we have found good value in international markets relative to their US counterparts.

Earnings yields on Canadian, international, and U.S. small and mid-cap stocks are still handily beating cash and fixed-income options but that is not the only advantage. Companies can grow earnings, bonds can't. Back in 1950, the S&P 500 earned \$2.37 per share. Today? \$225.27 per share—almost 100X more, providing investors with about a 6.2% growth in earnings per year for the past 75 years. Meanwhile most bonds continue to pay the same interest except for a small portion of the bond market that are floating. While our equities continue increasing their earnings, rates are expected to be moving in the opposite direction.

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<sup>2</sup> <https://www.spglobal.com/spdij/en/indices/fixed-income/sp-canada-investment-grade-corporate-bond-index/#overview>

<sup>3</sup> Morningstar Workstation

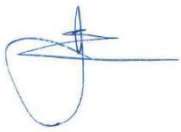
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The changes we made to portfolios earlier this year and over the past several years have served us well. Our overweight exposure to some of the top-performing markets this year such as the Canadian and International markets have helped drive returns. Our gold equities had a record year, nearly tripling from the start of the year and our energy exposure did quite well making material contribution to portfolio returns. One key factor going forward will be our ability to continue to adjust portfolios to adapt to the evolving economic landscape and market environment.

While exciting technologies may change the world, our goal is to make sure they do not significantly impair your retirement plans. The ten-year-old version of me would have “flushed” his life savings into the glow-in-the-dark toilets; the grown-up version would do a lot more research before taking that plunge.

As a final note, we want you to know that this entire newsletter was written by AI...or was it?

-Kind regards,



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