A View From Here - April 2018

The Difference between Hot & Good

As mentioned before in this monthly note, a mentor once referred to financial advisory as "the business of disappointment." He went on to describe that view by saying that when things are going badly, we should make moves to prevent it from occurring, and when things are good, we should do even better. There's always someone doing better at any one particular period of time, but what really matters is long-term performance. There is a big difference between what is 'hot' and what is 'good' and when investment returns are achieved in speculative investments that are currently popular, many fear that they are missing out on once in a lifetime riches. In recent months, the things that have been working in the markets have become quite volatile and have been significantly weaker. This began to take shape in February and continued into early April, taking the prices of many of these exciting investment themes with them.

I often visualize 'hot' investments as piles of money on the dining room table of a house on fire. It seems to be a reasonable risk to go through the front door, grab some and run out. It might work a few times but ultimately you run the risk of the structure collapsing on you. In my experience, if there is an art to speculation (gambling?) in what is 'hot', it is to simply jump off the train before it hits the wall. Watching the recent plunge in all things Crypto-Currency and Marijuana as well the recent volatility in U.S. technology companies over the past two months reminds of us how there are no free rides. At some point, someone involved in the investment process has to know what valuations should be worth so they can better understand any set- backs, if that is what it truly is. That's not to say, that these investments won't re-engage the public's investment excitement, it is just that at this point, there is a lot of 'deer in the headlights' staring at the lower prices. Are we at the crossroads of further pullbacks or will they be saved by another round of speculation that takes them to a higher level? No one knows.

Since we are not chameleons who change colour constantly, we remain committed to what we see as 'deep value' investments and our portfolio of holdings have been performing very well over the past 7 months, despite a minor setback in March. But our real success has been achieved over the long-term, which includes a few periods where the shiny things are all the rage, and our holdings might look suspect. Most of our investments are generally underwhelming from an excitement perspective...until of course they work out and we remain thankful for the positions that continue to hold up our accounts while we wait for the others to catch the market's imagination.

Case Study of Patience and Return: Methanex

Methanex was an investment we held for 10 years through 2013. The Company is the world's largest producer of methanol, a base chemical for paints, polymers and adhesives as well as an additive to gasoline. When we initiated our position, the company had suffered through a 10 year hangover from a meteoric rise of $1/share to over $100 in the early 1990s when it was seen as the miracle additive to gasoline to help it burn cleaner. It turned out not to be as environmentally friendly as originally thought, and the share price collapsed.

When we purchased a position, it was overlooked and relatively forgotten, but the business was not only profitable but also very inexpensive. Management used a large portion of its free cash flow (money left over after paying expenses) and repurchased almost 40% of the shares over 5 years. That meant that the profits would be spread on fewer shares thereby enhancing its value. Throughout our investment tenure, the share price fluctuated from the low $20 range (which essentially was our average cost) to the $30 level, only to find its way back down. It did that enough times to create some frustrations among some of our clientele who felt that we should sell it when it gets to $30 and buy it back when it falls back.

I believed that one day, it would go through $30 and not look back and we would have missed out on

what we saw as its real potential. And after what probably felt like too many failed attempts and frustrations, the business valuation took a significant turn for the better and within a few short months found its way to over $70/share where we felt the valuation achieved its peak and we liquidated. We held those shares through all kinds of market fears and a full-blown financial crisis but ultimately, tripled our investment, while also receiving a pretty attractive dividend while we waited.

We were able to hold this investment because our work suggested that the potential was significantly more than its current valuation. Further, the market's concern that kept the company at a low valuation seemed to be a short term view. Tolerable and most importantly, this did not break our investment thesis. It's when the thesis changes that we should take action, and we did when the share price reflected what I believed was its peak value.

If there is an 'art' in being invested, it is to know as much as possible so we can make the proper decision. Our long-term returns have been achieved because of the deep knowledge and constant back testing against not only what we see for the company, its peers and overall market environment, but also what challenges that occur. It's what I do all day...everyday...all the time - until we liquidate.

The Things We Haven't Done

After coming home from a vacation last summer, I reached out to an oil and gas analyst at one of the companies we own for some clarity on its lackluster performance despite the strength in the business. He laughed and said; 'have you seen what is going on in the shares of oil companies?' In fact, so many of the value-based companies that I looked for in different industries have continued to weaken and has suggested to me that one of the best moves that we have made over the past year is what we didn't do.

We started two new positions over the past year, but one of the best things is not to do much at all. As such, we were uniquely quiet, as evidenced by the lower commission on a percentage basis that we all paid during the past 12 months. The recovery in some of our deep value investments culminating in October of 2017 took a small step backwards in March of 2018 but we have seen a 6-8% return for most accounts during this period, taking them within a few percentage points closer to all-time highs. This is also while the TSX index is down over 7% year-to-date, at the time of writing.

We have large cash positions with an eye for building investments that will create return for us over the long-term; however, there just hasn't been enough of an epiphany that purchasing new positions just because they are cheap is the best use of our capital. The epiphany to purchase is an important inflection point in taking a position in any investment, and if it's not there - not much should be done. As such we continue to add to the investments we hold that remain overlooked. At times, they look so weak that one must wonder what we see in them, but we have done the work and while they remain out of favor and the investment thesis remains intact, I believe we should remain committed.

I'd like to end this month's view with a quote by Charles Ellis who wrote the book ***"Winning the Loser's game"***

"Be patient and persistent. Good things come in spurts - usually when least expected - and fidgety investors fare badly."

Thanks for taking a look, and as always,

All Good Things

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