A View From Here - December 2020

Climbing The Walls

"Value investing is at its core, the marriage of a contrarian streak and a calculator." - Seth Klarman

Moving In Cycles: Turning Value's Corner

Value investing is associated with the likes of Benjamin Graham and his well-known student, Warren Buffett, value investing has turned in better long-term results than any other type of investing I know of. One of the great success stories is Seth Klarman whose out of print book 'Margin of Safety' sells for thousands of dollars on the internet. I saw an interview where he stated, "Once you adopt a value-investment strategy, any other investment behavior starts to seem like gambling." I can attest to that view. Once it hit me, it become the centerpiece of our investment and retirement accounts. While not always in fashion, a value approach is not immune to the whims of general market challenges such as the bear markets. There is nowhere to hide in those circumstances but to prepare for the inevitable climb out of the doldrums. The past four years have had their own set of challenges as markets were led higher by a narrow band of high tech companies similar to the early 1970s (Nifty 50) and 1999-2000. If you were not invested within its parameters, you under-performed; badly. Markets (and life in general) move in cycles and it appears that we have entered a period of renewed enthusiasm for value investing. As such, our accounts have responded with most of them being close to or at new all-time high valuations. Who would have thought that back in March or even August for that matter?

Generally speaking, value investing focuses on companies trading at a discount to unrealized value, either in terms of assets or in comparison to peers. Constant revaluation helps to establish potential value parameters so that we do not prematurely sell a position before it reaches fruition. This investment strategy involves a contrarian streak in that you tend to focus on businesses that are not in popular sectors of the market. For example, it has been difficult in 2020 to find deep value in most things associated with technology. Back at the turn of the century after a powerful run, tech valuations collapsed, and it took 10 years to begin a new uptrend as companies such as Microsoft traded at fractions of previous highs. In fact, if you had purchased Microsoft at its peak valuation during that period, you would be barely profitable today. This speaks to the world of investing as it moves in cycles.

When an industry begins a rejuvenation, the hard part is to not sell just because it's waking up. Returns are created while one maintains conviction that potential value can still be recognized. One of the biggest misnomers in the investment industry is, that 'you can't go broke taking a profit.' Returns are made when value is constantly measured against an investment thesis, and if that thesis is still intact, then reason stands that you should continue to be invested. It often takes years for each investment to reach its potential and requires patience, constant revaluation to changing business environments and the conviction to believe. It's an obsessive, perfectionist type of thing that you either love or you don't. Due to its lack of popularity today, it is hard to find value-based investment managers as investors moved their assets to portfolios focused on what is currently popular. For the past four years in particular, this strategy has produced exceptional returns as more and more technology companies are added to stock market indexes. It's almost as if it were easy...almost.

I've often told clients that if you told someone of our long-term investment success, they wouldn't believe it. The run of performance from 2012 to 2016, was unprecedented with many accounts doubling in value. This led to an influx of new clients. However, since the start of 2017, our returns paled in comparison to major indexes and brought frustration for clients with some deciding to move to where the action is. As this occurred, the contrarian in me felt that we might be on the cusp of a better time. For now - that has been the correct assessment.

With the share price collapse of Lee Enterprises and Reitman's and it's subsequent CCAA filing, so did some client's tolerance. The cold comfort I took from this period, was that despite the weakness, we held fairly robust cash positions, and investments such as Constellation Software, FirstService and Colliers which provided the growth engines to keep accounts profitable. And that went on for over three years as it tested the resolve and patience, particularly, as it pertained to the newer clients who arrived with double-digit returns in mind. For what it is worth, I believe that there is a significantly better future for both Lee and Reitman's, even though it might be hard to see at present.

At or Approaching All-Time High

When the pandemic hit in early 2020, everything weakened with such force that rivaled the financial crises 10 years earlier, but at the time of writing, we have to marvel at the ascent from its lows. Talk about a "wall of worry". All of this is happening while the economy is in the doldrums, businesses are suffering, government debts are spiraling, earnings are lower, political unrest at levels like we've never seen before and a virus that is growing with fervor everyday. What gives? As I've said before and for what its worth, I see the current strength as a good sign for our future as markets take in all 'known' information and digest the possibilities. It's surprise, not consensus that will rue the day. Like surprise, there's a financial crisis that no one anticipated or surprise, there is a deadly virus that is affecting the entire world. When markets have a chance to digest all information associated with a popular concern, it adjusts accordingly. It is what it hasn't factored in which will change value.

Our patience and perseverance is now being rewarded as evidenced from your month-end statements or online access. The stock market's success over the past four years has been in the narrowest of ways as only a few handfuls of companies have been making market indexes go higher and we did not participate. Things, however, have changed in our favor and the recent rise has seen more widespread participation of public companies. The healthiest of market environments are the ones which see this type of circumstance.

I believe that our investment style has been re-invigorated and I'm excited to see where it leads us.

All Good Things and I hope we all stay safe,

Adam

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