A View From Here - February 2019

And the beat goes on....

Climbing the Wall of Confusion

The world of politics and economic sensibility seems to be in a in a place of turmoil. What is seen as real and fake has divided many in terms of personal value system and has seeped into the market fabric. Not that this is necessarily a bad thing, but rather just another sign of the times that needs to be navigated. In search of where we could be going, I look to an old axiom, which says 'As January goes in the stock market, so does the rest of the year'. According to the Stock Trader's Almanac, an advance in January has foretold an annual gain 87% of the time with only 9 major errors going back to 1950. The S&P 500 index was up 7.9% in January 2019, its best performance for the first month of the year since 1987 but most industry professionals I know do not trust the current environment fearing a retest of the December lows.

Reaching even further for something timely, brings us to the Super Bowl Indicator that says if the NFC division wins the big game, than the market will rise in the coming year. Unfortunately, the New England Patriots won, so maybe the professionals are right. It should be noted however, that this indicator is more tongue in cheek and has only been correct 50% of the time over the past 10 years. It is worth noting that earnings continue to be favorable and fear of recession, interest rate hikes, geopolitics and what people refer to as 'late cycle' volatility might be well baked into the market.

Our investment and retirement accounts also enjoyed a profitable month in January, so you will be happy at the sight of your month-end statements when they arrive shortly.

"When everyone thinks alike, everyone is likely to be wrong"

This is one of the first things I ever learned about the stock market. When you look at this from 30 thousand feet it makes a lot of sense because most of the well-known concerns are priced into the companies and sectors that these fears mostly affect, leaving them open to something else occurring entirely. We have learned the hard way to expect the unexpected. For example, our holdings in Colliers International consolidated in recent months despite strong earnings reports. This occurred mostly because investors fear a global recession and as such re-rate the business to reflect that fear. It is interesting to note, that earnings have been contrary to that view.

A glance backwards over the past two years, saw U.S. market indexes increase to all-time highs as the broader market stumbled downwards, especially in Canada. A lot of what makes up the stock market indexes has become dominated by Exchange Traded Funds (ETFs). Some estimate that this affects 85% of trading in shares that pretty much own a lot of the same companies (big name technology in particular), leaving the rest subject to higher volatility associated with lower trading volumes. Our long-term success has been based on owning over-looked businesses. When a company's valuation is too low, it often leads to some sort of activity from activists and/or strategic buyers. I believe that this sets us up for opportunity to profit when and if there is a reversion to the mean. This has occurred recently in one of our holdings in the past month which we detail below.

Still, even with these challenges and volatility, our long-term track record is hopefully an indication for future profit. There is a popular disclaimer in the world of investing which asserts that, 'past performance is not an indication of future returns'...True, but it tells you something.

...and the band played on.

Enter the Activists

We hold an investment in local news media provider, Lee Enterprises and throughout this tenure, the company maintained the highest margins (by at least two times) of its peers, but the shares remain the lowest in terms of valuation. While we remain excited about the prospects, most investors don't seem to care and its valuation relative to its peers, has remained the lowest in the industry.

As a nod to their operating efficiency, Warren Buffett and Berkshire Hathaway tapped Lee's management to help bring the profitability back to their own papers through a lucrative five-year contract that management believes could provide over $50 million in additional cash flow. Lee has reported the strongest operating metrics in its industry, and has been proactive in making small acquisitions (one in 2017 and one announced in January 2019) to augment and expand their business. Further, last month, their largest peer, Gannett Inc., received a takeover offer, which if plugged into Lee's valuation, would be worth closer to two and a half times Lee's current trading price - depending of course that you ask.

In January, U.S. hedge fund - Cannell Capital announced a 4.77% stake in the company and is challenging Lee's management, executive compensation and board of directors for not owning enough shares in the business or as they put it...lack of skin in the game. They see significant profit potential in an undervalued business.

I have been in close touch with both the senior management of Lee as well as the activist and at times feel like the conduit between the two. While, I do not necessarily agree with concerns regarding management compensation, especially given their performance in managing the company, the board's 'skin in the game' issue is real to me. It stands to reason that if the board directors own a lot of shares, they tend to make better decisions. Since we own a significant stake, I offered my services to Lee's board of directors.

Either way, depending on how passionate Cannell's team pushes Lee into action, (which they are taking very seriously), it draws another circle around the under-valued nature of the company - and another reason why I remain passionate about the potential for this investment for our accounts. Perhaps this is the catalyst that brings this undervalued investment to fruition. Stay tuned.

RRSP & TFSA Season

The deadline for RRSP contributions is fast approaching on March 1st, 2019 and I will be reaching out to determine if you would like to make any contributions. I remain convinced that the RRSP and TFSA (as well as a RESP for post-secondary education) are key pillars that we can use to secure the best financial plan. It is important to note that the difference between getting performance returns and not has a significant impact on future wealth. For our long-term clients - look at where we came from in the past three, five, and 10 years and you'll be surprised at the current value relative to that period. Despite anything professionals say about investing, performance is the most important thing.

Thanks for taking a look, and as always,

All Good Things,

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