A View From Here - October 2020

We must strive to understand the implication of what's going on around us. When others are recklessly confident and buying aggressively, we should be highly cautious; when others are frightened into action or panic selling, we should become aggressive." - Howard Marks

Themes

Few things can frighten investors like October. While the weakest month of the year is actually September, it's in October when things have come apart in epic proportion. While there has been increased volatility in September this year, it was actually good for our accounts adding to a string of better months. But here we are in October - a month away from what looks to be an epic Presidential race, record Covid-19 cases and a self induced recession the world has entered...but still we see relatively strong international stock markets. I believe (and definitely hope) that the market's efficient viewpoint points to a satisfactory resolution of all things, because it tends to shoot first, then ask questions. I still believe the fact that the markets have not collapsed under the weight of all this uncertainty, is noteworthy for good reasons.

There is a view that as long as fiscal stimulus flows, the stock market remains one of the only choices for investors seeking a return on their assets. It's hard to believe as interest rates decrease ever so close to zero that there was ever a time when were above 5%, not to mention the early 1980s when they were 20%.

But that's the thing about stock markets - they tend to climb a wall of worry - even when things look impossibly bleak. There have been a number of questions about the presidential election and how it will affect the markets. I'd say that all of these things are priced in. Continuing with a theme from last month's note, I believe that markets on a macro level react to surprise not consensus. It's not as if the collective stock markets are on an island with headphones on, but rather digesting all the news which affects its participants.

Having said this, there are always times when 'themes' take over the valuations of market leaders. Looking backwards over the past 20 years we watched themes emerge in technology while companies such as Nortel made up 35% of the Toronto Index at the time, this was followed up by the theme of growth in China and India with its need for natural resources, when technology crashed in late 2000. At that time, the brokerage firm I worked for had laid off half of its resource analysts in favor of more technology specialists. It's not that the firms were backward in thinking, it was just that is what the clients demanded more of. Of course, a common occurrence, was that just as soon as there was no use for Resource analysts, commodities began to increase as demand to build China and India's infrastructure drove prices to all-time highs. However, this took a dramatic pause when the financial crisis took hold in 2008, and prices for Oil and Metals retreated, leaving investors worse for wear and most investors have been stuck in the headlights ever since.

It appears to me that when themes take hold, it requires at least a decade to remove them from investor psyche. Back in 2000 when technology stocks which were all the rage, prices of all things related to this new paradigm reached what would turn out to be unsustainable levels. And lead a decade long retreat. Even the mighty Microsoft traded down to almost 10% of its previous valuation by 2010 despite displaying continued double-digit growth in profitability during that time. Further, there was a call to remove the CEO because of poor stock performance.

This time is no different as technology has become all the rage. Last month, Exxon Mobil - once the largest company in the world was removed from the Dow Jones Industrial Index in favor of SalesForce.Com. It's the sign of the times - and speaks to themes.

One thing that might be in the early stages of emerging is the forgotten companies that are beginning to see a bit of light...That is the arena which we play in. A case in point is our investment in Leon's

Furniture. Purchased at 8.5x cash flow, the company has doubled its size since we initiated our position, increased its profit margins, took on over 450 million in debt that it has paid off and re-emerged into a net cash position of just under $100 million, yet trades a valuation of only 6x it's cash flow - despite record profits. All the while companies such as Amazon and Wayfair trade at much higher multiples because they are seen as the future...and while they might be - it doesn't mean its valuation will.

Microsoft?

While the world continues to appear upside down, I remain encouraged for the short term by the fact that markets, which are seen as an economic indicator - remain optimistic.

I like that...

Thanks for taking a look and, as always

All Good Things,

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