VALUE CONTRARIAN
ASSET MANAGEMENT

May 19, 2016

25 Years of Ben's Investment Secrets

(condensed in five pages)

Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily understandable business whose earnings are virtually certain to be materially higher five, 10 and 20 years from now … It's better to buy a great business for a fair price, than a fair business for a great price.

Warren Buffett

The key to investing is not assessing how much an industry is going to affect society or how much it will grow, but rather determining the competitive advantage of any given company and above all, the durability of that advantage. The products or services that have wide, sustainable moats around them are the ones that deliver rewards to investors (what leads to excess returns is buying these businesses at a discount).

Warren Buffett

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Our Investment Philosophy:

At VCAM, we want to buy assets/companies whose price underestimates the value of the underlying assets or earnings (value investing) or their future potential (growth at a reasonable price). In either case, we are looking for a situation where the market is wrong. In essence, our job is to calculate what a company is worth and see if we can buy it at or below that price.

If history is our guide, equities will outperform bonds over the long-run, even if they are certain to be more volatile. Our investment success is more likely to lie in discipline, consistency and minimization of errors, rather than in bold strokes or hitting that sensational home run.

In order to produce superior long-term returns, an investor has to be a "contrarian" – doing things different from the crowd. This involves seeing value in assets/ companies that others have not yet recognized and that is not yet reflected in the share price.

Emotion is one of the greatest enemies an investor faces. "**Fear**" makes it hard to remain optimistic about stocks whose prices are plummeting, while "**Greed**" makes it hard to refrain from buying overvalued assets everyone else wishes to own.

The notion that in the short-term most assets are priced "right", and the markets are "efficient", is based on the belief of investors being rational and objective. But in real life, these last two human traits are rarely seen. Inefficiencies and mispricing's often occur in the stock market as a result of human behavior and emotions.

Investment Criteria:

Our broad objective is to achieve long-term capital appreciation through investments in common shares and other equity securities in mostly North American publicly-traded companies. Specifically, when available, we prefer to buy good businesses with shareholder friendly management.

Definition – What's a Good Business?

These are companies with a high return on equity (ROE), need little capital to grow and return shareholder capital through a combination of dividend increases and share buybacks. Being a superior business means that these companies drown in free cash flow because they possess a durable competitive advantage – also known as a protective moat. Most importantly, **time** is your friend in a good business because the business in continually increasing in value. In a bad business, time is your enemy.

Avoid the Crowds:

At VCAM, we will not be pressured by investment manias or the risky practices of our less disciplined industry peers. Merely because everyone else is engaging in a particular business/investing activity, does not mean we also must follow the herd over the cliff. Yet, it often takes years before the crowd realizes it was mistaken.

Investment Restrictions:

The manager will not engage in short selling or purchase securities on margin (unless written consent is provided). The manager will not purchase physical real-estate, physical gold or buy, sell or write put or call options.

The majority of a client portfolio will contain individual names not exceeding 5% of the portfolio's total value. No single equity name should exceed 10% of a client's total portfolio, unless the security was transferred in or through price appreciation.

Investment Timeline:

Investing in the stock market requires both time and patience. Portfolios will be managed on the basis of investors having a time horizon covering a five to seven year period. Historically, equities outperform fixed-income over the long-term. However, over the short-term (1-3 years), the stock market can be a volatile and nasty neighbourhood, as the 2007-2008 financial crisis period demonstrated. Negative investment returns are thus possible in a given year or period of time.

Clients should always consult their own tax advisor regarding their individual financial/tax situation.

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Understanding Risk

"Most people who want to avoid risk actually mean they want to <u>avoid loss</u>."

Most investors say they can tolerate some risk (the caveat they fail to admit is) so long as they do not experience a loss of capital or down years!

Investors wrongly equate <u>volatility</u> (or bear markets) with increased investment risk. Rather, excessive valuations or disruptive technological (secular) changes are what really create investment risk.

Investors often fail to understand that an investment that guarantees return of capital at maturity (bonds) is not truly "risk free". It is superficially risk-free.

Let us understand the term "risk-free" beyond the traditional definition – no loss of capital. In other words, even if ones original capital is guaranteed at maturity, what are the other hiding risks an investor may encounter?

1) The risk of holding <u>overpriced assets</u> (stocks, bonds or real-estate).
2) The risk of being <u>over concentrated</u> in one type of investment or asset class.
3) <u>Purchasing-power/inflation risk</u>. Put all your money in a piggy bank or money-market fund (or even a GIC today) and investors run the risk that inflation will outpace any asset growth.
4) <u>Investment-rate risk</u>. Rising interest rates <u>act as gravity</u> to stocks. The tiniest change in rates alters the value of every financial asset. With interest rates currently hovering near zero, investors who chase higher yielding and longer maturity securities run the risk that inflation and eventually <u>rising rates</u> will crush the value of their investment.
5) <u>Shortfall risk</u>. This is the possibility that an investor will not have sufficient funds to retire comfortably. Many investors assume this risk when they are <u>too conservative</u> and avoid or underweight, for example, equities. Conversely, investors often become <u>too aggressive</u> with equities when the sun shines, the economy is strong and the stock market is booming and overvalued (think 2005-2007).

Bottom line: If your temperament can't accept a capital loss or a year of negative returns, then you should not be a stock market investor. Understanding the meaning and significance of the various types of investment **"risk"** is indeed crucial to your long-term financial health.

Ben Horwood

Value Contrarian Fund
May 19, 2016

Next purchase date Value Contrarian Fund: May 30, 2016 (call today: 514-398-0808)

Your comments are always welcome via e-mail (benh@valuecontrarian.com) or LinkedIn.

Please note: The timing of Ben's market comments will only be sent when something of value should be shared.