LIONRIDGE
QUARTERLY REPORT

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# Looking for Walmart Prices in a Tiffany Market

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Dear Clients,

You know that my investment approach involves looking for stocks trading at attractive prices - the kind of deals you're more likely to find at your neighbourhood Walmart than a Tiffany store located on one of the high-priced shopping streets in a large city. This analogy came to me as I was contemplating the recent performance of Walmart, which has turned out to be an example of how our patient approach pays off.

When I first purchased its stock a few years ago, it was trading at a reasonable price. The shine was somewhat off of this company as it was no longer the high-flying growth story that it had been in earlier decades, and there were concerns about the encroachment of online shopping. I saw a company that was a category leader with a defensible competitive position, a great balance sheet and terrific inherent profitability.

In 2015, Walmart's stock price got hit hard when it announced lower profit forecasts resulting from higher anticipated costs. These costs related to strategic spending plans it had adopted. These decisions were designed to protect its market share and included higher investment in employee compensation, better store experiences and technology initiatives such as a mobile phone order placing platform where customers can place their orders remotely and have their parcels loaded into their vehicles at a store.

Unlike the knee-jerk reaction of the market, I chose to act rationally. I assessed the situation and decided it made much more sense to stick patiently with the position than to sell and take a loss. I liked that Walmart's management was acting very rationally and were willing to incur a short-term depression in earnings in order to make the investments that were necessary to protect and enhance the long-term franchise of the business.

Patience has paid off. As the market has recognized the effectiveness of Walmart's strategy, and has come to appreciate its key advantages and competitive strengths, the stock has risen over 25% in the last 12 months (not including dividends). Although the incursion of online shopping is real, Walmart's revenues have been stable and this company is well suited to withstand and adapt to this trend. This is a good example of how, using a defined and disciplined investment approach, a profitable outcome was achieved.

As to the overall market right now, we see a lot more

Tiffany prices than Walmart bargains. Our cash position in Lionridge's Total Equity Portfolio*** remains very high, and we will stubbornly stick with this until we find the right opportunities. We are regularly looking for them, as we'd prefer not to hold cash if we don't have to, but in these high-priced markets they are scarce (although not completely absent, as the majority of the Portfolio is still invested in stocks - stocks that we believe can give us a decent long-term return at their current prices).

> Nobody regrets paying for fire insurance just because their house never burns down - paying those premiums is the rational cost of risk protection.

As the market has continued to rise this cash has certainly caused the short-term performance of our Total Equity Portfolio to lag its benchmark*, but we view this as the price of protection. Nobody regrets paying for fire insurance just because their house never burns down - paying those premiums is the rational cost of risk protection. Our major objective is protection of your capital, as it's easier for me to grow your money if I avoid permanent losses. We make rational investment decisions designed to both grow and protect your wealth, and at certain times this can involve holding high cash levels. Our interests are aligned, as my own personal savings are invested in the Total Equity Portfolio.

When you buy fire insurance, you are not specifically predicting a fire. We are not specifically predicting a significant market correction, but it sure feels like people are playing with matches these days. ■

At your service,

Hardev Bains, LLB, MBA, CFA
President and Portfolio Manager

*Benchmark: 45% TSX Total Return; 35% S&P 500 Total Return (CAD$); 20% MSCI EAFE (CAD$).
**The inception date of the Total Equity Portfolio was March 30, 2011.
***The content of this report is intended for information purposes only and does not constitute an offer to buy or sell our products or services nor is it intended as investment and/or financial advice on any subject matter. Every effort has been made to ensure the accuracy of the contents of this report. Performance reports may be compiled utilizing information provided by third party sources. The opinions, estimates and projections contained in this document are those of the author as of the dates indicated and are subject to change. The performance returns are before the deduction of any fees and are not guaranteed. The Total Equity Portfolio returns are a composite of all client accounts invested in that mandate, calculated on a monthly weighted average basis. Individual client account returns will vary from the returns of the Total Equity Portfolio. Values change frequently and past performance may not be repeated. Lionridge utilizes a combination of broad market indices such as the S&P/TSX Composite Total Return index, the S&P 500 Total Return index (in CAD$) and the MSCI EAFE index (in CAD$) as the blended benchmark for comparison purposes. The blended benchmark is historically a general reflection of the nature of the securities held in the Lionridge Total Equity Portfolio Composite. The indices are unmanaged and do not incur management fees, transaction costs or other expenses associated with managed accounts. Further details about composite construction and investment returns are available upon request.

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