Lionridge
CAPITAL MANAGEMENT INC.

DISCIPLINE, DILIGENCE, EXCELLENCE

## Quarterly Portfolio Manager Commentary — Fall, 2012

### THE BEST OFFENCE IS A GOOD DEFENCE

As you've probably heard me explain before, the key to successful investing is to always be defensive – I can do a better job at growing your money if I don't lose it in the first place. The case for defensive investing is particularly compelling at this time. In past commentaries I've expressed concerns about potential economic issues, and these seem to be far from resolved. In fact, the IMF recently came out with a cautious reduction in its forecast for global growth, stating that the advanced economies are at risk of recession.

It is interesting that in the face of such obvious negative news, the equity markets have risen quite sharply in recent months. This is a reaction to continued fiscal stimulus programs (including the recently announced QE3 in the U.S.), despite evidence that they don't seem to be working. It's possible that there's a certain segment of the market that believes QE3 is going to work eventually, but I suspect that there's a larger segment of the market that's driving up prices only because they believe that that these programs will cause speculative rallies that they don't want to be left out of.

This skepticism over near term economic problems does not keep me from avoiding the market, it just heightens the importance of focusing on companies that I believe can withstand such problems and prosper over the long run. It also magnifies the importance of investing in stocks only at a price that provides a margin of safety. I recently sold some positions because their price had run up to a degree that there was no longer a sufficient margin of safety. I also keep looking for new opportunities and recently added a new one, detailed further below.

Results continue to be good. Over the last 12 months Lionridge's Total Equity Portfolio kept up with the benchmark*, beating it slightly. During that same period it beat the TSX by 5.0%.** Since inception of the Total Equity Portfolio in March of last year, it has beat the benchmark by 7.5% on an annualized basis and beat the TSX by 13.1% on an annualized basis.

The key to good long term results in times like these is to go into them with a well-defined investment approach and stick with it in a disciplined manner. This is what I do for you.

At your service,

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

**Investment Highlight – American International Group ("AIG")**

- At the epicenter of the financial meltdown of 2009, AIG has been a reviled stock during the last few years.
- One of the world's largest insurers, an aggressive and incompetent move into (seemingly) lucrative derivatives trading brought this company down. It was kept alive by government intervention, which was deemed necessary in order to stabilize the global financial system.
- As a result of this intervention, the U.S. Treasury became the largest shareholder. More recently, as the company has been stabilized the Treasury has been gradually exiting its position.
- The company has been restructured by competent management that was brought in to replace the former leadership. It has shed its risky derivative business and other non-core assets and is well into a turnaround that includes tightening up its underwriting practices to improve profitability.
- I have recently initiated a position in AIG as it provides compelling value. At current prices its trading at less than 60% of its tangible book value.
- Theoretically, if the company were liquidated today, you would receive over $1.60 for every $1.00 invested. This provides both the upside potential and the margin of safety that I look for in an investment.
- I'm confident in management's ability to run the company, and as the market eventually regains confidence in AIG I expect this investment should do very well.

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*Benchmark: 45% TSX Total Return; 35% S&P500 Total Return (Cdn $); 20% MSCI EAFE (Cdn $)