Lionridge
CAPITAL MANAGEMENT INC.

Quarterly Portfolio Manager Commentary — Summer, 2014

PROTECTING YOUR CAPITAL BY RESISTING TEMPTATION

Although I'm happy that Lionridge's Total Equity portfolio has made meaningful gains, when I look at the fundamentals of the markets right now I have trouble finding new opportunities to get excited about. The majority of the Total Equity portfolio is invested in high quality companies that I expect will generate satisfactory returns for you over a long term, however its cash allocation is still close to 30 percent as I patiently search and wait for the right opportunities.

The siren song of strong markets rings loudly in our ears, perpetuating continued momentum in stock prices and maintaining expensive valuations. As a long time student of market psychology, I continue to be fascinated by the ability of perfectly intelligent people to get caught up in the excitement and overlook the fundamentals. In the short term, markets are highly influenced by collective human emotion. Richly valued markets reflect people's bias towards optimism. The higher that market values rise, the more people throw caution to the wind by making investment decisions based on near term results as opposed to long term fundamentals. This is what helps drive bull markets.

I have responded by selling our positions in certain companies whose prices have risen beyond levels that are justified by their fundamentals, and have discussed previously that this is what has caused the cash position to build up (along with the accumulation of dividends). Although the Total Equity portfolio has performed well over the longer term as compared to our benchmark*, we have lagged the market's performance over the last 12 months. This lag is primarily the result of the drag caused by the cash position. The markets also currently appear to be favouring more speculative investments over the more conservative, higher quality companies that make up the Total Equity portfolio. This is not unexpected in a heated market.

I've consistently maintained that a primary pillar of my investment approach is protection of capital. Effective risk management is a key element to achieving superior long term investment returns, although this can sometimes result in short term under performance. Other than strong long term performance, how can we measure the effectiveness of a manager's risk management efforts?

One useful measure is the notion of maximum draw down. Over a period of time an investment portfolio will experience a number of peaks and troughs. Maximum drawdown measures the steepest percentage fall from a peak to a trough during the history of a portfolio, and therefore provides a useful comparison of the relative downside risk of a portfolio as compared to a benchmark. An associated measure is the number of months it took the portfolio to recover back to the previous peak level after experiencing a trough. These figures for Lionridge's Total Equity Portfolio, and those for comparative benchmarks, are as follows;

	Maximum Drawdown	# of Months to Recover
Lionridge Total Equity Portfolio**	(-5.1%)	3
Benchmark *	(-12.9%)	20
TSX	(-16.6%)	31

We can see from the above figures that my approach has exposed clients to far less downside volatility than our benchmark*. Also noteworthy is the fact that the Canadian market alone has experienced higher downside volatility than larger markets, and is part of the reason that I insist on significant non-Canadian exposure for my clients' equity investments.

I'm confident that new opportunities will eventually present themselves. They always have, and often in an environment where large cash cushion is envied. In the meantime I'll strive to do the right thing and avoid the temptations of the bull market. The stronger the bull, the deadlier its horns! Being cautiously skeptical to protect your capital, that's what I do for you.

At Your Service,

Hardev Bains, LLB, MBA, CFA,

President and Portfolio Manager

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