LIONRIDGE

Quarterly Report

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Jelly Beans, Broccoli and Investing

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Dear Clients,

Imagine you put a bowl of jelly beans in front of a young child. They're bright, shiny, and colourful. The child anticipates the delicious sweetness with eagerness. Just before the child is ready to grab a handful to stuff into his face, however, the bowl of jelly beans turns into a bowl of steamed broccoli.

How would that child react? Not well, I'd imagine. I'm sure a tantrum would ensue. For that matter, most adults would not act much differently. If you leave a bowl of jelly beans out on a counter in a house full of people (young or old), they're not going to last very long. Leave out the bowl of broccoli and you can be pretty confident that it will remain untouched.

We know that jelly beans are bad for you; they can cause weight gain, diabetes and rotting teeth. Broccoli on the other hand is very good for you. In the long term this fine vegetable can contribute to good health and longevity. It does not give us that instant gratification of the sugar rush we so desire, however.

I think there is an analogy which applies to the world of investing. There are a lot of investment options that appeal to our base attractions. Some people enjoy the rush of excitement they get from investing in high-flying, high-priced glamour stocks. Many enjoy the instant gratification from investments offering high current yields, the sustainability of which can be suspect. These are the jelly beans of the investment world, and they can leave you financially ill.

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Value investments, which I look for, can be considered the broccoli of the investing world. They're good for your financial health, contributing robust portfolio growth. Nobody is excited about them, however. They tend to get ignored on the buffet table.

My approach to managing your portfolios is akin to avoiding jelly beans and loading up on broccoli. When there's not enough broccoli to be had, I'm happy to leave room on the plate (i.e. cash), waiting patiently to load up on more veggies when they show up.

I opened with the hypothetical (though unlikely) scenario of the bowl of jelly beans turning into broccoli. Unlike the crestfallen child whose bowl of sugar has turned into a pile of green roughage, I'm quite thrilled when this happens in the investment arena. Some recent additions to Lionridge's Total Equity Portfolio, as well as our clients' fixed income allocations, are a case in point.

Over the last few years, a lot of companies took advantage of investors' appetite for yield by issuing "rate reset" preferred shares. The initial dividend yields looked very attractive, and investors gobbled these up. What was overlooked was the fact that the dividend rate on these pref shares reset every five years, with the reset rates fluctuating with market interest rates. When people suddenly realized that the dividends were going to be lowered on these issues, they sold off in the markets and the price of these pref shares dropped significantly.

Given the drop in the dividend rates, it is logical that the price of these shares would drop to a certain degree. However, the market overreacted and some of these issues have turned into broccoli. I generally don't like preferred shares. These securities are typically targeted to retail investors for their attractive dividend yields. Unlike common shares, however, pref shares don't share in the growth of the companies and therefore don't provide the type of wealth compounding I look for in equity investments. This current situation, however, has provided some special opportunities.

After analyzing several scenarios, I've identified some such shares where the risk of losses is low and the potential upside is quite high – i.e. the odds of investment success are tilted in your favour with the type of margin of safety that helps to protect your capital. For the fixed income portfolio I've added issues by high-quality insurance companies such as Sun Life and Great West Life. For the Total Equity Portfolio I've purchased preferred share issues by TransCanada Corp and Fortis Inc, two solid companies, at prices that I believe have the potential to provide equity-like returns with lower risk.

The advantages of my value approach can be seen in the numbers. Since inception** a little more than five years ago to June 30, 2016, the Lionridge Total Equity Portfolio has achieved an average, annualized return of 12.2%***. This compares well to our Benchmark's* average return of 9.1% per annum (and that of the TSX which has seen an average return in that period of only 3.0% per annum). Broccoli really is better for you than jelly beans! ■

At Your Service,

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

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*Benchmark: 45% TSX Total Return; 35% S&P 500 Total Return (Cdn $); 20% MSCI EAFE (Cdn $).

**The inception date of the Total Equity Portfolio was March 30, 2011.

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