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The Triumph of Common Sense over Brilliance

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Dear Clients,

The end of 2015 saw a lot of volatility in the markets that is carrying over into this year. Although I never try to anticipate movements of the markets, I have repeatedly shared with you my view that markets have been pricey and the fact that I've responded by letting the cash position in the Total Equity Portfolio to gradually build to more than 30%.

Despite last year's volatility, this portfolio's Benchmark* managed positive returns in 2015. With this high cash position, I would have expected to have lagged behind its benchmark's performance. On the contrary, I managed to beat it by 4.4% ***. This was partially due to the performance of some of the stocks contained in the portfolio, but much of this outperformance was attributable to what I didn't invest your money in. My approach is centered on trying to build your wealth safely and that includes avoiding stocks in companies that are not overly sound or are overpriced (this is how I've outperformed my benchmark since inception**, with lower downside volatility).

Stock market prices are mainly driven by the moves of the professional investors managing huge pension funds and mutual funds. These pools of money are managed by teams of intelligent and experienced people, so I'm always fascinated by the way so many smart people can collectively make such bad decisions – supporting overpriced markets or shunning bargains when they appear. The problem is that their processes seem to be too heavy on technical brainpower and too light on common sense (often the result of exposure to short term pressures that they often endure).

> "I have never tried to forecast moves in energy prices, and my discipline compels me to avoid commodity-related companies unless the pricing becomes extremely attractive"

For example, the rapid rise in the price of shares of Valeant Pharmaceuticals attracted a lot of new buyers that pushed the price even higher before it crashed (at one point losing almost three-quarters of its market value). As the price of that stock went up it became among the highest-weighted stocks in the TSX index, and more and more investors consequently felt pressured to be in it for that sake alone.

A lot of brilliance was applied at major investment firms to justify the sky-high price and to come up with reasons as to why the climb would continue.

In my opinion, all that was needed to avoid the subsequent losses suffered by the shareholders of Valeant was a dose of common sense (backed up by a proper degree of fundamental analysis) and the discipline to ignore the crowds. Even at currently depressed prices, I'm not interested in this stock due to uncertainties inherent in its business model and the company's very high levels of debt.

Another sector I had avoided was energy-related stocks, which of course performed terribly due to the collapse in oil prices. I have never tried to forecast moves in energy prices, and my discipline compels me to avoid commodity-related companies unless the pricing becomes extremely attractive – i.e., I require a very wide margin of safety before investing in such stocks given their inherent volatility. Are we there yet with energy stocks? I don't know, but my analyst and I are currently looking into it.

Remember that the current market volatility is not a bad thing for you right now, because I'm holding a lot of cash in your accounts. During the fourth quarter, falling markets provided me an opportunity to increase a couple of holdings at very attractive prices. If markets fall further, I might soon have the opportunity to invest much more of the cash into stocks on terms very advantageous for you.

In my opinion, long term investment success requires three crucial elements. The first is having a well-defined philosophy. The second requirement is having the technical skills to practise proper investment analysis. The third requirement is the ability to be disciplined about it and to control one's emotions (this ability for me comes from knowledge and experience in the area of fundamental analysis). Applied with a good dose of common sense, these attributes are more powerful than a room full of brilliant people working with the wrong set of principles and incentives. These are the strengths that I put to work for you. ■

Yours truly,

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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