LIONRIDGE
QUARTERLY REPORT
winter | 2018

The More Things Change, The More They.....

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You know the rest of that line. As practitioners of fundamental value investing, we are looking for market inefficiencies that allow us to purchase shares of strong companies at advantageous prices. With the advancement of technology and the proliferation of information, one would question how such anomalies can exist. As a long-time student of investment psychology, I am confident that the reason for these continued inefficiencies lie in the non-changing realities of human behaviour. Humans have always been driven by the two great motivators, fear and greed, and I imagine they always will be. Over the long term markets are pretty efficient, but over short-term periods they can behave irrationally.

In the past I've discussed the current levels of speculation in marijuana stocks. I know marijuana is not yet legal in Canada, but the level of exuberance for crypto-currencies might be evidence that there is a lot of pot being passed around nonetheless. The level of speculative frenzy associated with these instruments make marijuana stocks look tame in comparison.

Currencies are a medium of exchange, not a store of value. The value of a medium of exchange like Bitcoin must eventually bear a rational correlation to other mediums of exchange - such as major international currencies. Based on this rationale, the rise in the market value of Bitcoin is divorced from economic reality.

To help you picture this, I use as an analogy the "Big Mac Index" that was regularly published in the Economist magazine. It showed the relative cost of a Big Mac in various countries, and was used as a way to illustrate the relative strengths or weaknesses of various currencies. In theory, the cost of a Big Mac in a given currency should be roughly the same in another country when exchanged for that country's currency. Some variation in price can be expected so as to account for different cost structures in other countries (e.g., for labour and raw materials), but on the whole prices should bear some reasonable degree of similarity. Significant differences would be indicative of currencies being either under or overvalued.

Since the end of 2010, inflation has been fairly benign. The cost of a Big Mac has appreciated only moderately. During that same period, the cost of a unit of Bitcoin has soared *over four million percent* (as at January 16, 2018). If you had enough Bitcoin to purchase a Big Mac in 2010, with that same amount of Bitcoin you could now purchase over forty thousand Big Macs.

This makes no logical sense, and it points to the high degree of speculation inherent in Bitcoin prices. For what reason could this medium of exchange appreciate so aggressively against conventional currencies? Is it that much more efficient to use? Are there things that people want to buy with it that cannot be purchased by conventional currencies?

If the latter is the reason, and the supply of Bitcoin is artificially limited, would we not see competing crypto-currencies come to the game to fill that same need? We are indeed seeing new crypto-currencies being launched, but I don't think this is happening to fulfill excess demand for an electronic medium of exchange. Rather, these new offerings appear to be coming from promoters trying to get rich quick by cashing in on this speculative demand driven by the greed of people who fear that they have missed out on supposed Bitcoin riches. I've watched videos where these promoters try to pass themselves off as visionary hybrids of Steve Jobs, Mahatma Gandhi and Oprah Winfrey.

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My understanding is that the underlying technology that facilitates crypto-currencies (known as blockchain) provides some very important advantages for efficiencies in commercial transactions, and is growing in its adoption. I have no reason to doubt the growth of the use of blockchain, nor to doubt the assertion that the use of crypto-currencies will expand. But the way the price of Bitcoin units have increased in value is divorced from economic logic, and the expectation that this trend will continue is the sort of wishful thinking that can end in a lot of tears. The recent volatility in the market price of units of Bitcoin should hopefully provide some kind of red flag.

Tying this into my study of investor psychology, this crypto-currency frenzy seems to hit all of the buttons of speculative behaviour. The motivators of Greed and Fear (i.e., the fear of missing out) are definitely in play here. The Recency Bias, whereby people have a tendency to take short-term trends and extrapolate them forward, also factors in here. The power of Social Proof plays in, because everyone seems to know someone who is apparently jumping onto the Bitcoin bandwagon.

This Bitcoin saga is an extreme and obvious example of the type of risks we strive to steer you away from. There are many other risks in the market that are not as sensational or obvious, and not as dangerous, but could still have a very detrimental effect on your wealth. Many of these risks are contained in a lot of the conventional instruments and strategies being marketed by the investment industry as solutions for meeting your wealth building and income generating needs.

We continue to maintain a high level of cash in the Total Equity Portfolio. Markets in general appear to be very expensive, and have still not provided the type of new opportunities that we are looking for to deploy this cash. We remain patient, and stick to our discipline to achieve our objective of protecting your capital so we can do a better job of growing your capital. ■

At Your Service,

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