LIONRIDGE
QUARTERLY REPORT
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How Far Can The Rubber Band Be Stretched?

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Dear Clients,

As we're sweltering in this heatwave, I've been sheltering indoors and pondering thoughts only as big as those that I'm capable of. I spend a great deal of time following the companies we own and looking at new ideas (which continue to be scarce). I also continue to be fascinated by the dynamics of market behaviour (which over short time periods of time have been unpredictable, but over long term cycles have been pretty consistent).

The bull market charges on. I never went beyond high school physics, but I believe that in a hot room you can stretch a rubber band farther than usual. If that room cools off, however, that over-stretched band will snap. That's how the markets seem right now - highly stretched in a heated atmosphere of optimism and speculation.

Managing your money requires an ongoing balance of my dual objectives of protecting your capital and growing your capital. Although the market value of all of our holdings have risen over the last year, I'm unable to identify additional investments that comfortably meet my criteria for valuation. As a result, the cash allocation remains high. In the twelve months to the end of the second quarter the Total Equity Portfolio has seen a 26.9%* return, and that's with a lot of downside protection built in. (I feel compelled here to provide the caveat that this number is well above any reasonable expectation of long term average annual returns.)

I'm often questioned as to why I'm one of the few managers holding a significant amount of cash in an equity portfolio (in the Total Equity Portfolio cash is close to 30%). In the short term, it's easier for managers to stay fully invested, going with the crowd under the mantra that they are "paid to manage equities". But if they are fully invested at this time, in my view they're not doing a good job of protecting capital. They might look great while the party continues, but their true effectiveness becomes evident when the exuberance subsides and the rubber band snaps.

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A combination of low interest rates and the extrapolation of recent years' returns continues to propel the bull market. We see a lot of headlines about certain stocks and crypto-currencies that have had a particularly steep and illogical rise, but a very significant factor in the rise of markets has been the flood of money into index ETFs. They are easy to buy and the costs are low, and with the returns attributable to the ongoing bull market, people have come to believe that they are far more effective than actively managed portfolios. And to be sure, many if not most actively managed portfolio options aren't any better.

However, when people own index funds, they, by definition, own pieces of companies that are expensive, or unprofitable, or over-levered, or just badly run. Owning those stocks exposes one to risks that can be avoided with a rational and disciplined selection process. And that's what I endeavour to do for you.

In my opinion the market cycle will turn towards rationality at some point, and a reversal of the flood of money into index funds could cause a significant downturn in the markets. If we still have a significant amount of cash at that time, it could provide some very attractive buying opportunities. The rubber band is stretched very taut. Rather than getting sucked into the whirlwind of exuberance, I remain patient and vigilant.

At Your Service,
Hardev Bains, LLB, MBA, CFA
President and Portfolio Manager

*The Composite consists of all fully discretionary accounts managed by Lionridge Capital Management Inc., according to the investment objective of the Lionridge Total Equity Portfolio. The objective of the Lionridge Total Equity Portfolio is to maximize long-term returns while minimizing long-term risk by investing in a concentrated portfolio of undervalued securities. The manager seeks to invest in securities only at prices offering a margin of safety, with a view to achieving the dual objectives of outstanding returns along with protection of capital. The strategy has a global focus and the manager has discretion over the geographic allocation of assets. Return figures are presented in Canadian dollars, are gross of management and custody fees but are net of all trading expenses, and include cash holdings. There is no minimum portfolio value required for inclusion.

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