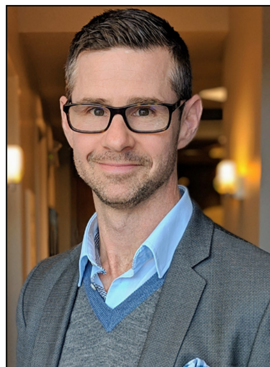
Portfolio Management Commentary

Quarter Ending June 30th, 2019



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The second quarter of 2019 can best be described as volatility bookended by positive return. We had a strong April, a very challenging May, and a strong finish in June. The fundamental backdrop was largely unchanged as the continuing story of moderating global growth, accommodative federal banking, and tariff rhetoric occupied the internet. For sake of consistency, we've been here before. I feel that this is a perfect time to dust off the time-honoured words of Ben Graham, the father of value investing:

"In the short run, the market is like a voting machine—tallying up which firms are popular and unpopular. But in the long run, the market is like a weighing machine—assessing the substance of a company."

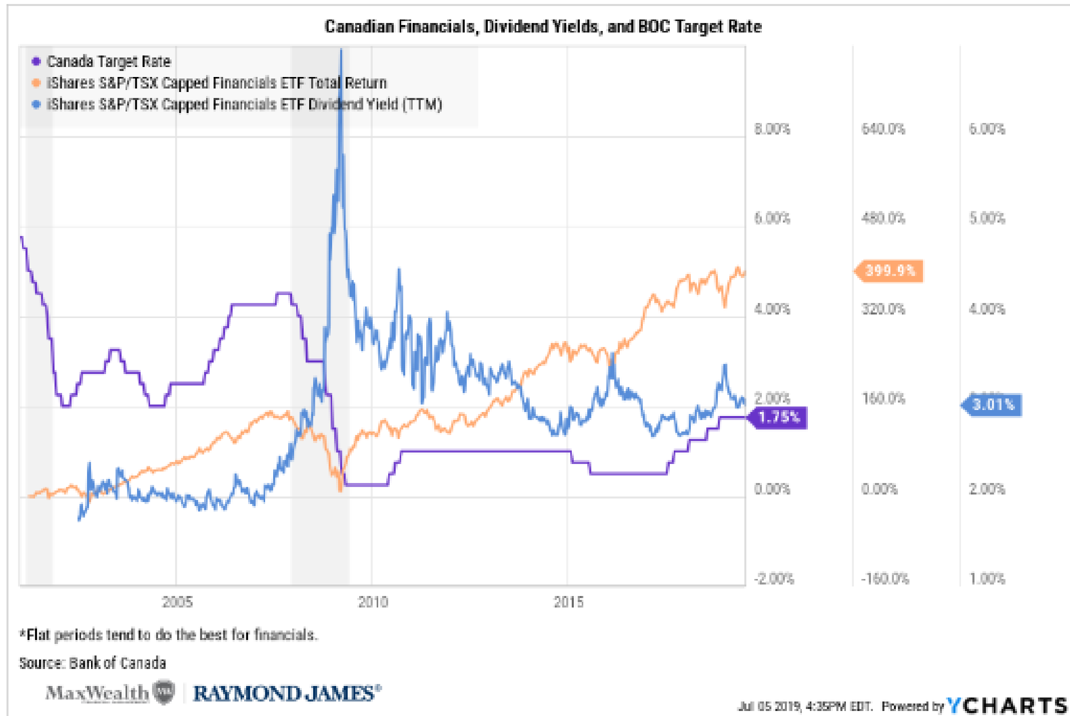
Clearly, these words still resonate with meaning more than 80 years after they were written. President Trump is overtly aware of the above distinction. This is, in part, why his incessant tweets have been moving the market in the short run. People are voting with their money and he wants to capitalize on that fact. In the end, if the US market stays strong up to his re-election, he will leverage his influence on American prosperity as a catalyst for a second term. It is the long run that serious and intelligent investors care about. This is why we focus our efforts on populating our accounts with great businesses at reasonable prices. While this process takes time and discipline, it does reward its practitioners for their patience.

I see no real changes in the larger world view as we enter the third quarter. I expect that volatility will continue as short run players react to Fed speak, Trump tweets, and the "R" word. Once again, I believe that all of these issues are just temporary conditions that momentarily interrupt the steady ascent of global capital markets. Sure, there will be corrections and bear markets from time-to-time, but they are statistically less-likely than recoveries and bull markets[1]. But these facts are lost on many who would like to swing your opinion by causing fear and spreading doubt. Remember that financial markets traders are happy to exploit your emotional nature to their and their firms gain. One way to combat this feeling of panic is to have an asset allocation that you can live with through any investing climate. This is precisely why we diversify portfolios by asset class (stocks, bonds, real estate, commodities, and cash), geography, and sector. If we know that real success happens in the long game, then we need to be in for the long run!

On a strategy note, I have been monitoring the relationship between Canadian financial stocks, their dividend yields, and the Bank of Canada target rate for clues to increase exposure. As illustrated below, these investments tend to rally after periods of interest rate stability and decline rapidly when rates are aggressively cut.

[1]*https://www.thebalance.com/u-s-stock-bear-markets-and-their-subsequent-recoveries-2388520*

Arguably, this makes intuitive sense because financial stocks are highly levered to the general well-being of the economy. There is a need for capital when economies are expanding, higher interest rates and net interest margins occur, and business activities are robust and fee revenue flows to financial institutions. Of course, the reverse happens when corporate and personal belts are tightened. The BoC lowers interest rates to stimulate the economy, but there is a lag. It takes time for sentiment to change and for businesses and consumers to adjust. Finally, the cycle starts over again. So, the question now is where are we in the interest rate cycle? I believe we may be in a period similar to 2015-2017 where the BoC actually lowered rates to stimulate the economy and counteract the shock to oil prices. Assuming that this is true, it would be prudent not to overweight financials at this time, but to wait until prices fall and yields rise before we add meaningfully to this sector.



Your Portfolio

The only model trades this quarter were repositioning trades in the growth model as we switched the CIE (iShares International Fundamental Index) to the XEF (iShares CR MSCS EAFE IMI). XEF is a lower cost and better representation of the investable EAFE (Europe Asia Far East) market. We also added a platform traded fund ITIC (Invesco International Companies) to increase our international exposure with a seasoned HK based investment manager. This gives us additional access to Asian technology names such as Tencent (the maker of the online game Fortnite). Finally, given the increased risk allocation in this model we added a 5% position in the Productivity Media Income Fund. This is a private debt fund which lends to the media and entertainment industry while protecting capital through government grants, distribution rights, and insurance bonds. It is an example of an alternative investment vehicle usually reserved for accredited investors only, but as your PM (portfolio manager) I am able to purchase small amounts and apportion it out to the various accounts. This is another reason why having me as a PM is a great advantage to you.

Final Thoughts

As I write this commentary, I am actively reviewing your model and preparing to implement some enhancements in the coming quarter. I believe that this current state of risk-on risk-off will provide great opportunities for additional shares in the great companies and investments that we own. I also contend that short run mispricing will provide some attractive entry points for companies whose prices got a little ahead of themselves. As always, I am looking for the best combination of reward vs risk over the long run. What happens in the short run is of little consequence. We are invested in the long run. We would like to thank you again for your business and the trust you place in our service. We would also encourage you to pass on your comments so that we can address any concerns and enhance your experience with our firm.

Many Happy Returns,

Patrick

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