Chapter 2 Part 3 – 4 Pillars

At this point, it makes sense to discuss our guiding principles, which form the backbone of our company and how we operate. The investment business is a challenging one, as the sands are always shifting and there are many, many participants all over the planet working on the same questions we are. If you take some time to read books and essays about investing from successful practitioners, one of the universal beliefs repeatedly espoused is that each investor must decide for themselves how to maintain their "discipline" throughout all the vagaries of the markets. The future is murky and opaque, and we know human emotions can spoil the best laid plans, so it is important to codify how you respond to the "unknown unknowns" that are coming eventually. As every legal disclaimer in financial offerings so clearly states, "Past returns are not necessarily indicative of future performance." Therefore, it is up to us to spell out our parameters for how we handle this constant flux to eliminate human error and remain objective and consistent throughout all we do.

There are four overarching pillars that we embrace and clearly define for all to see on our website. They concern the concepts of independence, concentration, transparency, and performance, and are further elaborated herein below:

Independence: Relying on our own fundamental research

We explained previously how a large part of this industry is centred upon research and information bought from third-parties, which is often of dubious quality. The first question we must ask about such work is, "What is their motivation in publishing this report?", which is the same as questioning how unbiased and impartial is the information? Sadly, it is next-to-impossible to ascertain why analysts are recommending, or warning against, the stocks they are. Do they have opaque incentives to recommend buying it or selling it? We don't take their recommendations simply on face value without applying our own understanding to the situation.

The smartest and most effective way around this conundrum is to do your own research directly and to form your own opinions that you can trust with utmost confidence. This does require a lot of work, actually, and is how we distinguish ourselves from so many other shops that are reliant on other people's data and opinions. It is also why we charge the fees we do because we work persistently on these opportunities and there is a lot of value in this work. It would be something else entirely if we were just coasting along off the backs of others and merely paying to utilise other people's ideas. Sadly, in this new era of "passive investing", i.e. simply buying basic funds that own everything, the herd mentality is to go with what everyone else is doing. This is great when markets rise – as they have now been doing (at the time of writing) longer than ever– but when the market does turn down in a significant fashion, i.e. when it drops -20%+, we will see how prepared are the masses for the losses. Or rather, how much pain can they tolerate when there is no one telling them how to deal with the selling end of their investments? This happens because financial analysts tend to only tell you what and when to buy, but rarely are they around to tell you when to sell and close out your position.

Ergo, we are proud to call ourselves an independent investment management firm because we build our own financial models and conduct our own analysis of the intrinsic value of the securities we are evaluating. We work as a team to discuss the data and our projections, and come to mutually-agreed upon courses of action. Nor do we rely solely upon our own ideas, but rather, we are communicating frequently with the management teams of the stocks under scrutiny to identify the opportunities and risks attendant with each one. It is this interaction with the management teams of the firms we study that yields much more insight than a quarterly report on the numbers alone. Moreover, we also work with other industry stakeholders to unearth and analyse the different dynamics that drive the business, because sometimes management are biased positively, hence needing alternative opinions and perspectives on the company and its industry. Human behaviour is a great prognosticator of success, and when we get a funny feeling or cannot get comfortable with the people running the show, we will pass and wait for another, safer opportunity to come along. Like missing the city bus, there will be another one passing by any minute now…

We believe we are following in the footsteps of Mr. Warren Buffett, who allocates his money to opportunities as if he was buying the entire company. By limiting ourselves to only buying bargains at an attractive price that has potential to double in three-to-five years, we find this gives us a different point of view from the rest of the mainstream market and allows us to achieve superior results.

Concentration: Concentrating on a small number of holdings

Another topic wide open for discussion is the notion of "diversification" or spreading your money across many pots rather than putting all your eggs in one basket. No one is really going to dispute the validity of this idea, but there can be some issues with putting this into practice. Basically, you should not invest everything you own in just McDonald's shares because if they go bankrupt and out of business - and you hold all your shares to the bottom - then you will lose all your money. This is obvious. If you are not supposed to put all your money into just one stock, then how many pots do you need to be adequately diversified? This is where the sharpies in finance come out to prey upon the layperson.

In November 2016 Philippe took his class of equity investing students from Concordia University down to Nebraska to meet with Mr. Warren Buffett, where they enjoyed a brilliant lunch with the Oracle of Omaha and were able to ask him lots of probing questions about what he does. Perhaps the best questions of all was put to him like this, "Mr. Buffett, if you had to start all over today from scratch with only $1million, what would you do?"

His immediate reply was that he would buy four-to-five stocks only and get back to rebuilding his empire forthwith. With a mere four or five companies' shares!!! Someone asked if that was enough diversification, which he confirmed it is if you know what you are doing. Which then begs the question, why do so many managers and funds hold dozens, if not hundreds, of stocks in their portfolio? Is that in the client's best interest? Well, no, as you just learned, it is not necessary according the greatest living investor today. Then why would this happen?

There are a few reasons. When there are lots of stocks in a portfolio, then there are more names to buy and sell all the time, and there are always fees with every transaction, i.e. fees which are paid to the traders, obviously. This is not good for clients, but it is great for the industry. As the number of shares in a portfolio grows to equal that of an entire stock index, i.e. once a portfolio holds every stock listed on the Toronto Stock Exchange, the manager is no longer as accountable for performance because the portfolio will simply achieve the same results as the entire market. (This is actually passive investing, which is almost entirely the opposite of our "active investing" philosophy.)

To us, our recipe for success means we concentrate our portfolio in twenty or so holdings based in North America instead. And because we focus on a smaller number of securities, we gain a solid understanding of the companies and more accurately identify the risks to each one, which reduce the chance of errors or much worse, a permanent capital loss. If a portfolio of four-to-five stocks is sufficient for Mr. Buffett, then we are very satisfied with our slightly expanded universe of around twenty names.

As we go about deciding which stocks to own, we must be vigilant about maintaining our discipline in how we conduct our business. We like to consider ourselves extremely disciplined investors. This means that we only invest in securities that are trading at a great discount to the estimated intrinsic value we derive. Most importantly, we are very patient and will gladly maintain surplus liquidity, i.e. cash, when there are no clear opportunities in the market. We have had some challenges recently because we were unable to get comfortable with the popular tech stocks that have driven almost 100% of the stock markets' returns the past several years. But we remember the dotcom crash and the Great Financial Crisis all too well, and we refuse to get sucked in to the faddish ideas trending with housewives and cab drivers investing on the street!

Another clever – and essential - practice is that we retain a margin of safety in our portfolio, which we define as the difference between the trading value accorded by the market and the intrinsic value based on our analysis. The lower the trading price compared to our valuation, the greater the margin of safety, which affords added protection in the event that our initial hypothesis proves overly optimistic.

In sum, our active management approach and concentrated portfolio comprised of substantial weightings offer an alternative to traditional products that simply follow the benchmark indices. This level

of concentration provides us with a solid understanding of our holdings and can create different returns than do the public indices.