April 2013

"Trees that are slow to grow bear the best fruit."
- Molière

Planting Trees

Dear Client,

Global stock markets continue to benefit from low interest rates.

Japan has been one of the best performing stock markets over the past quarter, as investors have been focused on the new leadership at the Bank of Japan. The U.S. market has also done well, supported by improved economic data and a continuation of accommodative central bank policies.

The exception has been Canada, which is only up 3% over the past twelve months. The commodities-led boom that lifted the Canadian market over the past decade has stalled. This is due, in part, to global economic conditions, as well as specific supply/demand imbalances (such as natural gas.) One commodity whose price has remained strong is gold.

A "golden" opportunity?

Despite gold trading near its all-time high, shares in gold companies have performed poorly. In fact, the long-term share price performance of most major gold producers has been abysmal. Nonetheless, with the growing divergence between the price of gold and the price of gold company shares, we decided to take a closer look at the sector to see if there might be any interesting investment opportunities.

Our conclusion is that there has been a steep increase in both production and environmental compliance costs, neither of which is temporary. Added to this is the fact that most recent gold discoveries require much larger upfront expenditures than in the past, as the ore is harder to extract. Therefore, despite the fact that the price of gold has remained high, we do not see attractive value in the sector.

Cyprus and the EU

How many people knew that Cyprus was a member of the EU until a few weeks ago? Accounting for only 0.2% of EU GDP, the EU could have easily stepped in and solved the Cyprus crisis on its own with a further cash injection of 5-7 billion euro. Instead, the EU decided that this was the moment to take a stand and force both depositors and senior bond holders to take losses when banks become insolvent. Up until now, depositors have been fully protected in similar circumstances. Not this time. Depositors at two of Cyprus' largest banks may lose a large portion of their deposits over €100,000.

If Cyprus is the new precedent, we anticipate significant changes in depositor behavior going forward, which may have a significant impact on the European banking sector. Depositors can be expected to move funds out of the weaker banks and into the stronger ones. It is too soon to assess the impact of the Cyprus solution, but one would imagine that many individuals and companies with large euro deposits will be taking a much closer look at where their money is held.

The Steinberg High Yield Fund

There have not been any major changes in our High Yield Fund over the past quarter. The focus continues to be on quality, rather than yield. The fund continued to perform well, despite an emphasis on maintaining a portfolio with a short duration. While we expect the Federal Reserve Board and its Canadian counterpart to maintain rates at current levels for the balance of this year, we are well positioned for an eventual rise in rates.

A more in-depth review of our high yield fund is available here: High Yield Quarterly Commentary

Ben Bernanke has moved to Japan

The rally in the Japanese market has continued into 2013. Investors have been encouraged by the rhetoric of the new governor of the Bank of Japan (BOJ), Haruhiko Kuroda, who is sounding very much like Ben Bernanke. Expectations are that there will be aggressive quantitative easing and perhaps other measures to deliver on Kuroda's promise that the BOJ will do "whatever it can" to end deflation. In addition to central bank actions, Prime Minister Abe plans increased fiscal stimulus to get the economy moving. His recent decision to enter the Trans-Pacific Partnership free trade talks is another sign of the policy changes under way.

We bought shares in our first Japanese company, Aida Engineering, in 2010. At that time, foreign investors had absolutely no interest in Japan. Our list of Japanese investments now numbers 23 and for the first time since we started down this path, institutional investors are getting excited about Japan. As noted recently in the Wall Street Journal, *"Global investors are piling into Japan at the fastest rate in several years…"* (WSJ March 8, 2013 – Investors Grab Japanese Shares).

Final thoughts

Patience is as important an attribute for value investors as it is for tree farmers, but it has almost disappeared from the world of so-called "professional investors." We have spoken of our Japanese investments countless times over the past few years with other investment managers. The common refrain has been that, despite the obvious value, there is too much risk that the payoff will be several years out. The typical investment manager today is under pressure to perform on a quarterly basis, with no focus on the concept of capital preservation. Wall Street understands this and that is why broker research is aimed at momentum strategies designed to encourage excessive trading.

This creates opportunities for investors, such as us, who have the patience to seek opportunity in that which is out of favour. The risks are usually lower and the opportunities for reward more attractive.

As always, we welcome the opportunity to discuss our outlook and investments with you.

Sincerely yours,

Lorne Steinberg
President