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> ***"Most of us spend too much time on the last twenty-four hours and too little on the last six thousand years."*** –Will Durant

The Lessons of History

2015 was not kind to most investors.

The commodity boom ended with a thud. The Fed finally raised rates in December and cracks appeared in China and other emerging markets. All major stock markets declined and 2016 has started on the same note.

China's stock market is down some 15% this year alone, and other markets have followed to varying degrees. The price of a barrel of oil has fallen below $30. The U.S. dollar has soared, which has negative implications for emerging markets, as well as U.S. corporate earnings. The corporate bond market has not been immune to the selling pressure, with prices falling for even the healthiest issuers.

Canada was one of the worst performing markets in 2015, due in large part to the commodity sector. We have had little exposure to the Canadian market over the past number of years, but the drop in currency and recent market weakness is causing us to take another look.

Our equities actually performed reasonably well in 2015, due to minimal commodity exposure, performance of our Japanese investments and the weak Canadian dollar. We have maintained a conservative stance and remain well positioned to take advantage of the recent market turmoil.

Commodity investing

Commodity companies are difficult to evaluate. By nature they are cyclical, with cycles of profit and loss that can last for many years. Unlike most other industries, where market leaders command some pricing power, commodity prices are set by the market, and there is no differentiation between suppliers. A barrel of oil is a barrel of oil. Regardless of the oil producer, the product is the same. When commodity prices are high, these companies make huge profits, but when prices fall, losses can be substantial. That is the history of commodity businesses.

Given the risk that commodity companies can suffer significant losses, they need to be especially well capitalized in order to mitigate an extended down cycle. The reality is, however, that during the recent commodity boom (2002-2012), most of these companies (including the majors like Rio Tinto, BHP, Barrick Gold, Glencore and Freeport-McMoRan), used their profits to make acquisitions and buy back shares at the top of the market, destroying shareholder value in the process. Prudence and history should have compelled them to build up some cash reserves (for a rainy day) and pay down debt; however, almost every commodity company, large and small, believed that the China-driven commodity boom would continue forever, and that this cycle would be different from those of the past.

Many companies and investors appear to suffer from "short-termism" – they have short memories and place too much focus on short-term analyst predictions. While much of what we read from market forecasters may seem incredibly intelligent and reasoned, there are many uncertainties around us and things that cannot be accurately predicted. Analysts are notorious for only having one item in their tool bag: a straight ruler. When commodity prices are rising, they extend the straight line and their forecasts, predictably, remain bullish. When prices start falling, their predictions suddenly turn bearish.

> **"We've long felt that the only value of stock forecasters is to make fortune tellers look good... short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children."** –Warren Buffett

Remember when the price of oil peaked in 2007 and Wall Street analysts raised their long-term forecast for oil prices well above $100 per barrel? Research reports were chock-full of terms like "peak oil," a concept suggesting that with all the cheap oil having already been found, oil supply would inevitably decline. At the same time, they were forecasting a continued rise in Chinese demand at the same rate as years past. Now that the price of oil is below $30, these same analysts are forecasting a continued oversupply of cheap oil and a slowing in demand growth.

History teaches us that commodities will always be cyclical industries. When prices are high, companies use their cash flow to increase supply, and this increased supply eventually leads to a supply-demand imbalance that causes prices to fall. Unfortunately, the management of most of these companies seem to pay little attention to history.

The massive decline in the share prices of commodity producers may present some opportunities, but it is impossible to know when commodity prices will start to recover. We have looked at a number of companies in these industries, and if we decide to invest, our focus will be on companies that are lower cost producers, which are financially sound enough to withstand a prolonged downturn, such as Royal Dutch Shell, Total and Alcoa.

High Yield Bonds

An extended commentary and outlook of the high yield bond market and our high yield fund is available here: High Yield Quarterly.

The year ahead

The price of oil; rising interest rates in the U.S.; growth in China; the global economy; the geopolitical landscape; corporate profits -- these are but a few of the variables that may impact global markets in 2016.

The market downturn at the start of this year has caused many investors to panic. One European bank recently issued a warning to its clients to "sell everything."

We own a portfolio of excellent companies whose share prices are trading at very attractive valuations. We also hold cash. As many clients have heard us say, "the only investor who is happy when the market falls, is the person who has cash to spend."

We will never be able to perfectly pick a market bottom, but with the recent decline in share prices, we have added to several positions. The question we always ask ourselves, before we make any investment, is when we look back five years from now, will we be happy with the money we spent? If we are convinced the answer is yes, then we proceed. We do not spend all of our cash in one day. With the various risks that exist, we keep some cash on the sidelines, so that if markets continue to decline, we will be able to take advantage of the opportunities that present themselves.

The great historians, Will and Ariel Durant, were the authors of many brilliant historical essays and books, including the massive 11 volume “The Story of Civilization” series. In their volume titled “**The Lessons of History**,” they provide a beautiful compendium of just that. Through their journey of history, what becomes most clear is that so much of what we are experiencing today has played out, in one form or another, many times over the past 2,000 years; from the commodity price collapse, to investor reaction to market volatility, to the global events that we read about every day.

The world has survived countless calamities and the lesson from history is clear: invest when pessimism reigns supreme.

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

Sincerely,

Lorne Steinberg
President