January 2018

> ***"Success is a lousy teacher. It seduces smart people into thinking they can't lose."*** -Bill Gates

Let the Good Times Roll

Dear Investor,

Last year at this time, it looked like investors were facing a potentially difficult 2017. An unpredictable president was elected in the U.S., the UK was in the early stages of dealing with Brexit, Germany and France were going to the polls with unpopular leaders, the Middle East remained in perpetual turmoil and the era of cheap money was coming to an end.

As we celebrate the 2018 New Year, despite widespread global political uncertainty, rising interest rates, and stock markets which are certainly "not cheap," equity markets have hit new highs and investors have enjoyed another good year.

U.S. tax cuts and a buoyant economy are driving the market indices ever higher, and most Wall Street forecasts are bullish for 2018. "Let the good times roll" could be the title of most of the market forecasts that we see. In rising markets, Wall Street analysts continually raise their price targets, which creates the illusion that stocks are cheap. Investors forget that in declining markets, these same analysts usually lower their price targets, making everything look expensive. Do not waste any time looking at Wall Street price targets – these are purely momentum-based and of little value to long-term investors.

Be early

I started in the investment business 28 years ago as an equity analyst. One of our clients was a well-known mutual fund manager at a large U.S. firm. He was a very smart investor, with a tough demeanour, who did not mince words. His office was sparse – containing only an old desk with annual reports scattered all over it, his chair and a large ashtray (people could smoke in their offices back then!). The walls were bare except for a poster that read: "Be Early."

In an effort to make conversation, I asked him what the poster meant. He looked me in the eye and said "...young man, in the investment business, one is either early or late, and if you want to succeed, you had better be early, otherwise you will lose money for your clients."

I never forgot those words, and the wisdom behind that statement remains true to this day. When markets are going up, everyone wants to go "all in," never wondering if they are early or late. Investors who are late rarely succeed in the long-term. Our philosophy has never changed. We need to be early, seeking compelling value, or we need to wait until opportunities arise.

Japan

Our investments in Japan are an example of "being early." Japan has been one of the least followed markets over the past many years, despite the fact that it offered the most compelling value in the developed world. We started buying Japanese shares in 2010. With Japan so out of favor with investors, there were few analysts providing any coverage. But with value so often hidden in places where most are not looking (or willing to venture due to the increased effort), we thankfully conduct our own independent research and do not rely on third-party reports and forecasts (mostly aimed at short-term investors).

Since we started investing in Japan a couple of years ago, earnings have been rising, the yen has become more stable and the economy is finally showing signs of growth. The stock market has also showed signs of strength. For some or all of these reasons, a number of large global investment firms (JP Morgan and Blackrock among others) are now advising clients to increase exposure to Japanese shares. From a valuation perspective, we also note that while equity valuations rose in almost every market in 2017, the P/E (price-to-earnings ratio) in Japan actually declined, leaving Japanese shares trading at a 30% discount to the U.S. stock market. If investors start to move funds into Japan, valuations will eventually move closer to fair value, suggesting that significant opportunity remains.

Our team

As I reflect on the year that has passed, I would like to say a few words about the bright and wonderful team with whom I work every day. This truly is the best group of colleagues that I have ever been surrounded by. Diverse personalities to be sure (!), but everyone is passionate about doing a great job for our clients, both in terms of investment research and client service. It helps that everyone here is pulling in the same direction and fully invested alongside our clients. We all own the same investments and share the same performance as you. I am grateful to everyone here for their dedication, hard work and wise counsel.

High Yield Bonds

A review of the high yield bond market and our high yield fund is available here: **High Yield Quarterly**.

Final Thoughts

When markets are rising, investors look "smart" because almost everything is going up. Making money appears easy. I remember the many people who became day traders in the late 1990s during the dot-com boom. Every technology stock that someone bought on Monday was up 10% (at least) by Friday, and a lot of people thought they were smart. It was only when the bubble burst that hard lessons were learned. As of late, I am starting to hear people talking in much the same manner as they did twenty years ago. Too many are making investments without any understanding of what they are buying. Bitcoin is a great example. If you were smart enough to invest in Bitcoin last year, you have undoubtedly enjoyed a huge return, but I have yet to meet anyone who can explain the rationale behind such an investment.

Speculators are always rewarded in frothy markets – if they get out in time. The quote from Bill Gates at the beginning of this letter crystallizes this thought. Being lucky does not make us smart.

Wise people know that failure is a much better teacher than success. We remain conservatively positioned and, if the markets ever stop going up, we will be able to take advantage of the opportunity.

We wish you all peace and good health for 2018.

Sincerely,

Lorne Steinberg
President
