Spring 2019

"Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply, and to sell wisely when they advance a great deal. At other times, he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies."

~ Benjamin Graham
The Intelligent Investor

Fundamentally based and more specifically, value investing, is being questioned again. Investments in low Price/Earnings, Price/Book Value and Dividend Yield have not been as successful as purchasing disruptive technology stocks and companies that show any signs of potential revenue growth. Consequently, the financial press, pundits and both institutional and retail investors doubt the merits of an investment strategy based on immutable economic and financial principles and that have produced acceptable returns over many centuries.

This is the third time since PCM's inception in 2000 that the value style of investing has been deemed irrelevant. We only have to look back to the tech bubble in 2000 and the debt and real estate boom in 2008. What followed these "new paradigms" was quite predictable; a substantial amount of capital was permanently lost as it became apparent that their business models and valuations were unsustainable. On the other hand, investments in businesses that generated cash, were profitable and purchased at reasonable prices continued to grow and prosper. But the fear of "missing out" is extremely powerful and memories can be selective, particularly when share prices of very risky enterprises continue to rise for extended periods of time.

These views are reinforced by today's trading environment. It is estimated that algorithmic, headline and passive investment strategies account for approximately seventy-five per cent of equity trading on major stock exchanges. These strategies pay no attention to the real economic drivers of value but instead focus on short term information that essentially boils down to share price momentum. These trading strategies are executed via high speed computer systems that all act virtually simultaneously. Consequently, the share price of any particular security can move quite dramatically in either direction on any piece of information, regardless of its importance.

This environment presents a real challenge for you. What you see is the quoted or market value of our portfolios. It can be unsettling to see wide price fluctuations on your monthly statements. As stewards of your capital we are not concerned by price volatility.

As you know, very much like a private business owner, we focus on what we estimate the true value of the business to be. Our assessment of value is independent of the quoted share price of a potential investment. PCM has considerable experience in assessing the value and quality of a business. As our long time clients have experienced, our average annualized return, of companies that we have bought and sold, is over twenty per cent.[1] More importantly, we have been able to avoid the permanent loss of capital. Over the past nineteen years we have only sold one investment at a loss. It is this conviction that anchors our confidence in the businesses that we own and their potential returns. We see intrinsic value while others see stock quotes.

This is why we are more excited about our portfolios than we have been in a long time. We have made five new investments over the past several months. In addition, we have increased our investments in Canadian bank shares that are yielding more than five per cent. These investments add to our portfolios in several ways.

Our cash balances have declined to their lowest level in several years. As we are all well aware, the yield on short term government securities has been quite low. The investments we have made, all have attractive dividend yields and provide income that is higher than short term fixed income instruments. As a result, the **total yield or income is approximately 3.5%.** We now

[1] **Past performance is not an indicator of future performance.**

have a portfolio that is earning substantially more income than safe alternative fixed income investments and broader equity North American equity indexes. Furthermore, this attractive income stream is sustainable and growing.

Shares that have a sustainably high yield have a significant advantage over other investments. We are getting “paid to wait” for the share price to increase to its intrinsic value. The dividend income is received irrespective of the share price movement. Furthermore, when the share price eventually reaches its fair market value, the total return is typically higher because of the dividends received over time.

Until recently, the few equity investments that we owned were in the energy sector. While we are very comfortable with the quality and underlying value of our energy holdings, the unprecedented share price volatility has made some of you understandably uncomfortable. Our portfolios are now more diversified across several industry sectors. We have added businesses in the industrial, consumer, health care, financial and utilities sectors. These businesses are leaders in their respective industries and offer us the opportunity to participate in the broader growth of the economy.

What excites us even more is that we have been able to purchase these new investments at a substantial discount to their intrinsic value. As a group, they have the potential to double in value. These new investments along with our existing investments give our current portfolios the potential for substantial future gains. At current prices, our equity holdings are trading at approximately 55% of our target prices. This suggests that our portfolios should increase in value by almost fifty per cent from today’s value. And we have approximately forty per cent in T-Bills waiting to be deployed!

Our estimated values can only be realized if the businesses perform as we expect. On this score we are equally excited. Virtually all of our investee companies are meeting or exceeding expectations. The results are evident in a very tangible way. Our businesses are increasing revenues and market share, reducing costs, strengthening their balance sheets and investing for future growth. Several of the management teams have acquired competitors and assets at prices that add significantly to shareholder value. The future prospects are indeed very bright.

We are also pleased to tell you that we have added a new member to our team. Joanna Tountas Wolff joined PCM in March. She will be helping us with research and client communications. Joanna has fit into our team quite seamlessly and it feels like she has been part of our family for a long time. We look forward to Joanna's contributions!

As always, thank you for continued confidence and support.

All of us at PCM very much appreciate it.

Vito Maida