

*Buy-and-hold investing is a lot like the bumblebee. Scientists have studied the bee's wingspan, bodyweight and shape and proved it could not fly. Investors, likewise, cannot imagine how buying and holding... can yield superior results...*

*John Bogle,  
Founder, The Vanguard Group*

*We at PCM have made a commitment to you, our clients, that we would manage our business in such a way that our “corporate activities” did not distract us from managing your portfolios. In addition, we also promised you that we would not incur high overheads that may one day tempt us to compromise our intellectual integrity in order to increase assets under management so that we could cover our costs. In this spirit we want to report to you two recent developments that we believe show our commitment to these principals.*

*We recently considered acquiring an investment management firm. Our analysis indicated that there would be many benefits to our clients and PCM arising from a larger asset base. Most importantly, we concluded that the selling shareholders were people that we would be proud to be associated with. However, once we entered into detailed due diligence we quickly realized that integrating the two firms would take a tremendous amount of time and effort. Recognizing that this task would distract us from managing your portfolios we decided not*

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*to pursue the acquisition. We learned first hand why more than eighty percent of all mergers fail!*

*We recently rented office space. If you are ever in downtown Toronto please drop in! Our new address is:*

*121 Richmond Street West  
Suite 203  
Toronto, Ontario M5H 2K1*

*You can rest assured that the cost is not onerous. We were fortunate to be in the market at a time when rental space is becoming available due to the high tech slowdown. In addition, Gary and Domenic painted and set up the offices over the course of a week under the direction of Brenda Sharpe (Gary's wife), a professional interior designer. Needless to say PCM has acquired professional quality premises at a very reasonable cost!*

*We now want to turn away from PCM business to what is most important to you; the business of managing your money. In the following paragraphs we discuss why most active equity managers fail to outperform an index over a long period of time and how our*

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*investment philosophy greatly increases our long-term chances of outperforming the major indices.*

*It is a well-known fact that approximately ninety percent of all investment managers do not equal the performance of major indices such as the TSE 300 and the S & P 500 over an extended period of time. An examination of the various costs associated with active management illustrates why the task is so difficult.*

*There are three distinct costs associated with active investment management; administration charges (management and custodial fees), transaction costs and taxes. Indices do not incur any of these costs and as a result are well ahead of the active manager before the race has even begun. As we shall see below, the most onerous charges are transaction costs and taxes. The higher the portfolio turnover, the higher these two costs.*

*Many researchers have found that today's typical investment manager turns over their portfolio once a year<sup>1</sup>. Accordingly, we have based the calculations presented below on a portfolio that holds each security for*

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*an average of one year. We have made the following assumptions that we believe to be somewhat representative of actual costs:<sup>2</sup>*

<i>After-Tax Management Fee:</i>	<i>0.60%</i> <sup>3</sup>
<i>Transaction Cost:</i>	<i>3.00%</i> <sup>4</sup>
<i>Tax Rate</i>	<i>25.00%</i>

*As the calculations below illustrate the typical investment manager is more than six percentage points behind the index before he or she even starts. That's equivalent to allowing an Olympic gold medallist to start sixty yards ahead of the field in a one hundred yard sprint! No wonder it is virtually impossible for most managers to consistently beat the index.*

*The problem is further compounded by the fact that most portfolios hold fifty to one hundred securities and are in effect over diversified. Many academic studies show quite convincingly that approximately twelve to fifteen securities are needed for proper diversification.*

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<sup>1</sup> Estimates vary anywhere from twelve months to sixteen months. We have used twelve months for ease of illustration. As discussed in the footnotes below, using a turnover rate of sixteen months would not materially alter our argument.

<sup>2</sup> Please Note: We do not contend that these costs are exact but representative enough to illustrate our argument

<sup>3</sup> Based on management fee of one percent, custodial fee of twenty basis points and fifty percent tax rate

<sup>4</sup> Forbes Magazine July 23, 2001 Stand Fast page 150 – 151

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*Anything more than this number of investments brings a portfolio closer and closer to the characteristics of its relevant benchmark. Over a long period of time the gross returns of the portfolio are not likely to be greater than the gross returns of the index.*

*Using actual dollars to illustrate our argument provides dramatic evidence of the impact that the aforementioned costs have on long-term returns. Over a ten year period a \$100,000 portfolio invested in an index earning a gross return of ten percent would be worth \$259,374.25 while an actively managed portfolio with the same ten percent gross return and a net return of approximately four percent would be valued at \$146,607.26.<sup>5</sup>*

*The above discussion is summarized below:*

	<i>Index</i>	<i>Active Manager</i>
<i>Gross Return</i>	<i>10.00%</i>	<i>10.00%</i>
<i>Less: Admin. Costs</i>	<i>0.00%</i>	<i>0.60%</i>
<i>Transaction Costs</i>	<i>0.00%</i>	<i>3.00%</i>
<i>Taxes</i>	<i>0.00%</i>	<i>2.50%</i>
<i>Net Return</i>	<i>10.00%</i>	<i>3.90%</i>
<i>Value of \$100,000 in Ten Years</i>	<i>\$259,374.25</i>	<i>\$146,607.26</i>

<sup>5</sup> Using a turnover rate of sixteen months would value this initial \$100,00 at \$165,231.47 as annualized transaction costs, taxes and total costs decline to 2.25%, 2.00% and 4.85% respectively.

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*PCM's long term buy and hold strategy minimizes the costs mentioned above and thus increases the probability that we will outperform the major indices. In effect our long-term strategy helps us to amortize the costs over a ten-year period (hopefully longer!). At the risk of confusing you, we present the above calculations as applied to PCM's investment philosophy.*

	<i>Index</i>	<i>PCM</i>
<i>Gross Return</i>	<i>10.00%</i>	<i>10.00%</i>
<i>Less: Admin. Costs</i>	<i>0.00%</i>	<i>0.60%</i>
<i>Transaction Costs</i>	<i>0.00%</i>	<i>0.30%</i>
<i>Taxes</i>	<i>0.00%</i>	<i>0.25%</i>
<i>Net Return</i>	<i>10.00%</i>	<i>8.85%</i>
<i>Value of \$100,000 in Ten Years</i>	<i>\$259,374.25</i>	<i>\$233,498.63</i>

*PCM's investment philosophy puts us far ahead of our competitors and only slightly behind the index. We believe that we can make up the index differential and earn excess returns through our stock selection, which focuses on absolute value and detailed independent financial*

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*analysis. Our portfolio concentration (we will hold a maximum of twenty companies) also ensures that we will not mimic the index.*

*From the seventeenth century Rothchilds to John Templeton to Warren Buffet virtually all successful investors have followed this long-term buy and hold strategy. We at PCM follow this philosophy without compromise. Our discipline combined with the careful monitoring of our costs and yours, will help PCM to “patiently create wealth.”*

*Vito Maida*

*June 30, 2001*

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