



Autumn 2014

After a prolonged period of calm, equity markets ended their lull during the past few weeks. Volatility and the appreciation for risk have returned. Equity investors have started to worry about the potential spread of Ebola outside of Western Africa and a slowdown in global growth. Problems in Europe have once again become apparent as some financial institutions are facing financial distress and the European Union's largest economies are either in recession or slowing down dramatically. Expectations for China's growth prospects have also been reduced.

To read the headlines and listen to the pundits one would think that the market had fallen dramatically. The TSX has fallen approximately thirteen per cent while the S&P 500 has dropped about seven per cent from their respective peaks. A large part of the drop in both indices has been due to the steep declines in the energy sector as the price of oil has fallen to eighty dollars per barrel. In fact, the recent declines have been relatively minor and when viewed in the long term historical context a "non-event".

As you would expect we at PCM go on alert when we see markets start to fall in the hopes that buying opportunities present themselves. Unfortunately central bankers also go on alert when markets decline and they decide to step in. True to form as the markets were falling, a member of the U.S. Federal

Reserve suggested that quantitative easing should be prolonged past its October end date. European central bankers also called for increased monetary stimulus across the Eurozone. And true to form investors jumped right back into equities with the expectation that central banks can and will bail out equity markets every time. Historically those who believed in the infallibility of central bankers have ultimately suffered large losses. We are quite confident that this time will be no different.

While the recent declines have been a step in the right direction markets have a long way to go before they reach fair value. It is important that you put the recent declines in perspective. While the absolute numbers may seem large, the percentage declines are modest; particularly in light of the very strong rise in prices over the past three years and the substantial overvaluation of equity markets.

As we stated in our last newsletter (www.patientcapital.com/news), by virtually any historical measure, most global equity and bond markets are either fully priced or overpriced. Current valuations and projected economic growth rates all combine to make acceptable future long term returns challenging. It is highly likely that over the next five to ten years returns from virtually every asset class are going to be well below average and unlikely to beat inflation.

As a result, the current investment climate is highly problematic. The most fundamental of all investment objectives is to preserve and enhance the long term purchasing power of capital; in essence, investment returns should outpace the rate of inflation. Investors have been conditioned to believe that being fully invested all of the time is the only true method of staying ahead of inflation; irrespective of valuations. This principal has been followed blindly by most in the investment industry; often with serious consequences. For the vast majority this view has become conventional wisdom. Furthermore, those who propose “all equities all of the time” insist that holding cash is always wrong.

As you have come to expect, we rarely agree with conventional wisdom and this case is no exception. We believe that there are times when investing in equities is very likely to result in a loss of purchasing power over an extended period of time. At times, holding cash is the best course of action in order to achieve long term investment objectives. As we have often stated the “tortoise always beats the hare”.

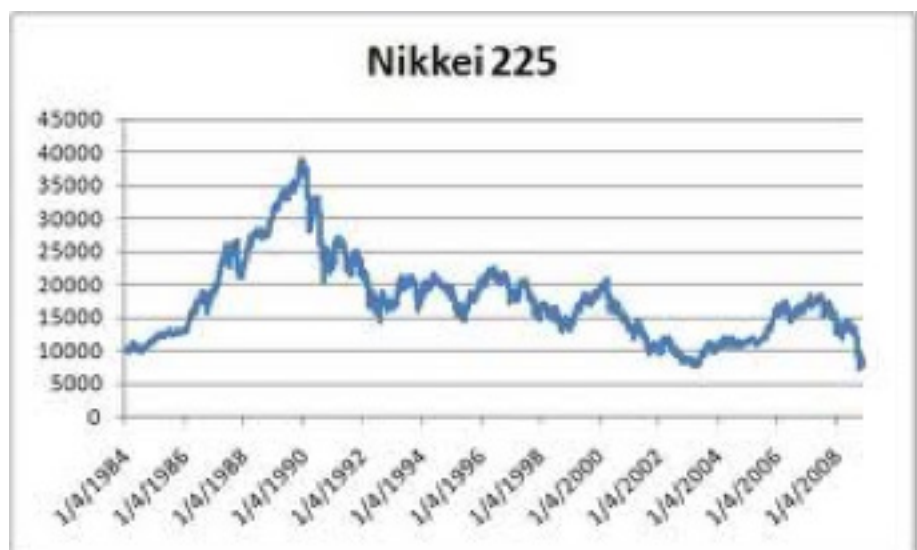
In fact, there are some relatively recent examples that clearly illustrate this point. The most dramatic example is the Japanese equity bubble that peaked in 1989 as the graph below illustrates. Twenty five years later the Japanese equity market is more than sixty per cent below their

peak! A forty year old in Japan who had followed the advice to be fully invested in equities in 1989 would be facing a dismal retirement outlook today.

Closer to home the NASDAQ is still below the peak reached in early 2000 and the S&P 500 just recently surpassed its peaks in 2000 and 2007. In all of these cases simply holding cash would have been a far better alternative.

At Patient Capital we **STRONGLY BELIEVE** that it is appropriate to forgo speculative short term returns in order to preserve capital and grow long term purchasing power. We are willing to hold cash for a period of time rather than risk the loss of your capital when we can't find investments that meet our criteria for quality and value. Since our inception this approach has stood our clients well.

Japanese Equity Market 1984 to Present



The table below provides PCM's Calendar year returns since our inception in 2000. From 2003 to 2007 our returns were relatively modest and in some years far

below the index. This was because at the time we could not find opportunities that met our criteria and consequently we held very high cash balances.

PCM Performance Calendar Year Returns

	PCM	TSX	S & P 500 C\$
Mar. 31, 2000 to Dec. 31, 2000	7.64%	- 4.77%	- 8.29%
Dec. 31, 2000 to Dec. 31, 2001	19.01	-12.57	- 6.46
Dec. 31, 2001 to Dec. 31, 2002	3.28	-12.44	-22.74
Dec. 31, 2002 to Dec. 31, 2003	10.15	26.72	5.29
Dec. 31, 2003 to Dec. 31, 2004	7.37	14.44	3.12
Dec. 31, 2004 to Dec. 31, 2005	3.44	24.13	1.76
Dec. 31, 2005 to Dec. 31, 2006	6.11	17.26	15.74
Dec. 31, 2006 to Dec. 31, 2007	3.61	9.83	-10.27
Dec. 31, 2007 to Dec. 31, 2008	4.53	-32.93	-22.95
Dec. 31, 2008 to Dec. 31, 2009	16.47	35.05	8.72
Dec. 31, 2009 to Dec. 31, 2010	8.24	17.61	8.94
Dec. 31, 2010 to Dec. 31, 2011	2.68	- 8.71	4.41
Dec. 31, 2011 to Dec. 31, 2012	9.85	7.19	13.49
Dec. 31, 2012 to Dec. 31, 2013	12.96	12.99	41.53

Inception Date March 31, 2000
Before Fees and Expenses

Based on PCM Total Composite Returns
Past Returns not Indicative of Future Returns

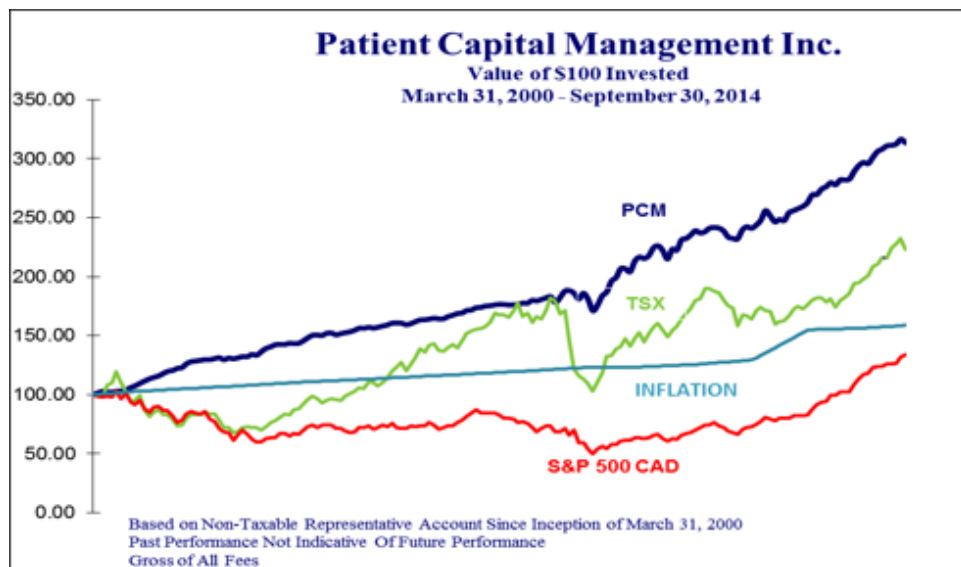
However, because we were willing to forgo short term returns and just as importantly, you believed in our philosophy, we were able to preserve your capital throughout the entire past fourteen years. As a result our long term returns have outpaced inflation and our benchmarks as the graph below indicates.

Today we find ourselves in a similar situation to our portfolio position of ten years ago. We have very high cash balances

to note that our approach cannot work without your confidence and trust in us. We are grateful that you have the patience to allow our investment philosophy to be fully implemented over an entire investment cycle.

Thank you.
Vito Maida

PCM Performance Compound Annual Rate of Return



and our expectations going forward are for modest returns. We are willing to suffer the opportunity cost of today's modest returns in order to protect and grow your capital over the long term. It is important



Patient Capital Management Inc.