QV UPDATE

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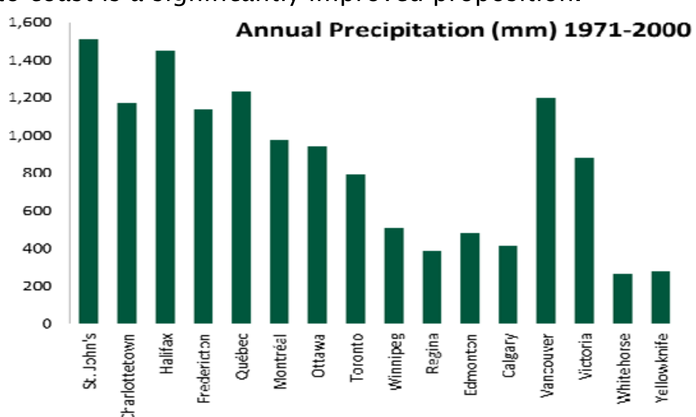
Reducing Our Error Rate

Predicting events in 2016 across the global landscape has been a challenge. After a choppy start to the year, few at QV would have predicted an all-time high for the S&P 500 by late 2016. Fewer would have correctly predicted the results of the Brexit vote and U.S. election. Errant prediction for weather this season in Calgary has been no different, with the Farmer's Almanac calling for a chilly winter. Thankfully, milder trends have persisted. 2016's events are an acute reminder that anyone's ability to consistently predict future events is limited.

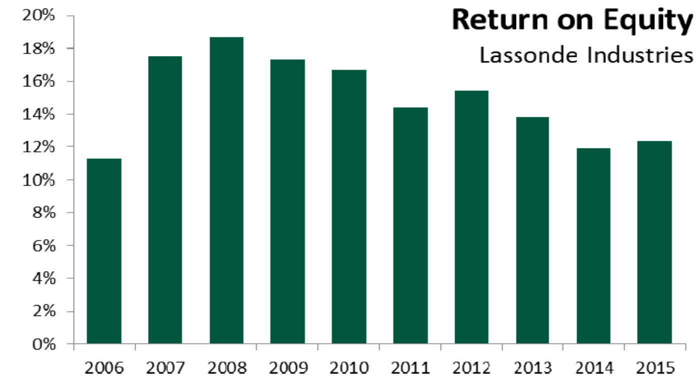
While predicting the weather on any given day, in any given city, could be a fool's errand, supplementing predictions by triangulating facts can improve predictive performance. The chances of correctly predicting an event can be substantially improved by collecting, analyzing and interpreting information. For example, information such as the time of year, location of city, and historic experience would likely improve the accuracy of a weather forecast. Armed with three decades of StatsCan data, predicting wet weather coast to coast is a significantly improved proposition.



Source: Statistics Canada

As financial analysts, the odds of 'not being wrong' and the probability of capital appreciation can be enhanced by looking at the facts, such as the financial records of companies through business cycles.

An indicator of prospective business viability is return on equity (ROE) over time. QV holding and juice producer, Lassonde Industries, is among a limited number of Canadian firms that have generated 10%+ ROEs through the past decade. Although no company may be impervious to difficulties in the economy, these records can help identify enduring firms.



Source: Capital IQ

Scrutinizing results through challenging environments such as '08-'09 can support confidence in an investment's ability to grow during tough times. Historic data helps to ascertain whether strong performance is repeatable. During '08-'10, Lassonde maintained margins and generated revenue growth of 3%/year, reflecting stable demand for their products. While Lassonde has used debt to support growth in the recent past, it has consistently repaid debt and reduced the potential for financial distress each year.

Simply buying businesses that can stay afloat or even grow is no guarantee of success. Price and value must be considered in conjunction. On price, QV attempts to ground on reality, in terms of both entry prices that provide reasonable absolute returns and rational exit prices. Dependence on a frothy exit valuation or on the ability to time exits perfectly is not sound business practice. Leaving potential returns for the next investor, to mitigate downside risk, can at times be a prudent strategy. In terms of value going forward, a firm's ability to provide essential products to customers can be a driver of equity growth. For Lassonde, with growing reach of its products amongst U.S. customers, the path to continued value creation is evident.

Since past performance is not necessarily a predictor of future results, we strive to balance historic analysis with consideration of prospective trends. As with the weather, we will not always be able to predict market outcomes, but we can seek to ensure the portfolios are prepared for stormy conditions.