QV UPDATE
Weekly Commentary | September 8, 2017
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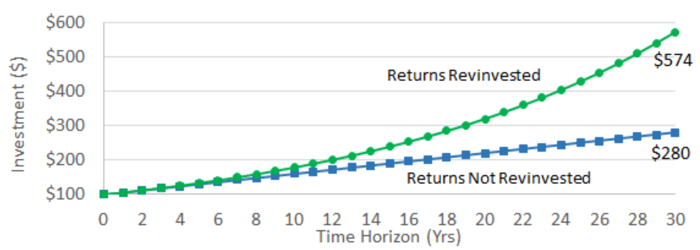
QV Investors Inc.

Take Some Time

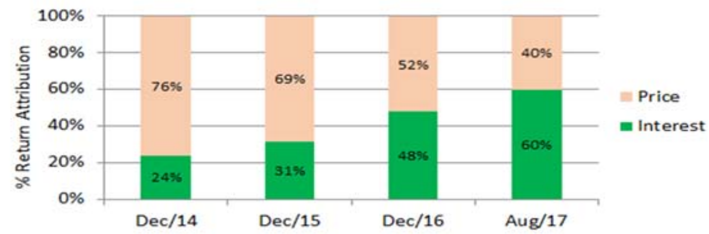
For many, the Labour Day long weekend marks the final days of summer before kids head back to school. For some parents, it is a sentimental time to watch children grow and enter their next level of study. While time can sometimes seem to pass at a snail's pace, it sure seems to fly in hindsight. As long-term investors, time is a tremendous asset that allows for a number of benefits.

Compounding – The power of compounding is arguably the most powerful concept in investing. Investment returns that are repeatedly reinvested will ultimately take on an exponential rate of growth. For example, a $100 investment that earns a 6.0% return for thirty years can compound into $574 if the returns are reinvested. This is more than twice what a similar investment would earn if returns were not reinvested. Similarly, a management team that can consistently reinvest surplus cash flow into profitable projects can also compound shareholder wealth. It works, but it requires patience.



Source: QV Investors

Smoothing – Market volatility can be frustrating to follow on a daily basis. Headlines are meant to elicit emotion and at times compel us to act when we shouldn't. Don't get us wrong, we are not downplaying the important ramifications of certain events. However, more often than not, swings in short-term sentiment turn into market noise over the long run. In effect, volatility is smoothed over time. For example, take a hypothetical 10-year Government of Canada bond issued on December 31st, 2013 at a 2.8% yield. We estimate that 60% of the total return achieved in the 3.7 years to August 2017 would be attributable to interest income alone. That's more than double the contribution of interest in the first year. The chart illustrates how the interest contribution grows and the price contribution declines as the bond approaches maturity. For bonds held to maturity, any price changes over its term are simply noise.



Source: Bloomberg, QV Investors

Similarly, price volatility in equity investing can seem daunting over short periods, but is dampened over a longer time horizon. According to JP Morgan Asset Management, the average 1-year return dispersion of the S&P 500 was 86% (-39% to 47%) from 1950 to June 2017. Using a 20-year rolling average over the same time period, the annual total return range smooths out to a much more tolerable 10% (7% to 17%).

Revelation – We have discussed how time can grow an investment and smooth volatility. As long-term investors, we also have to pay close attention to valuations as markets move in cycles rather than in a straight line. In our previous bond example, the starting yield (annual rate of interest earned) was an important source of return over the bond's life. With valuations in both the stock and bond markets at above-average levels, we are reluctant to deploy our clients' capital into investments that may pose more downside risk than upside opportunity. Higher valuations are typically associated with a lower return profile going forward. We must be aware of the environment we are investing in to avoid the pitfalls that could jeopardize capital. This has ultimately led to a defensive asset mix across our balanced strategies. With a higher cash weight and defensive bond portfolio, our balanced strategies are prepared to deploy capital during more opportune times. If we can maintain enough patience and discipline, we will be able to take advantage of opportunities as they develop. We recognize that we have been early in holding this defensive posture. In investing, we have found it is better to be cautious early rather than late. We use time as an ally, knowing the many benefits it provides.