QV UPDATE

Weekly Commentary | March 23, 2018

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QV Investors Inc.

Investing is a marathon, not a sprint

We find it helpful to share the client feedback we receive from time to time. We know that if at least one client has asked a question, it has likely crossed the minds of several others. Not surprisingly, the topic that has come up most frequently as of late is QV's softer relative returns. It's a fair question. With the exception of QV's Canadian Small Cap Fund, most of our strategies have marginally underperformed their respective market benchmarks over the 12 month and year-to-date periods ending Feb 28, 2018. In absolute terms, all of our strategies have generated positive returns over 12 months and our long-term relative returns remain attractive as displayed in the chart below.

In our communications and client meetings, we have been very open about some of the company specific challenges we have experienced over the past 12 months. Most notably, the issues surrounding Home Capital Group are responsible for approximately half of the 12-month underperformance in our Canadian equity strategy, which is up 1.1% before fees compared to the S&P/TSX return of 3.2%. A few other company specific challenges over the past year have also weighed on our relative performance. In these cases, we believe the headwinds are short-term in nature and we continue to hold these positions.

Our defensive asset mix of 50% fixed income and 50% equity, at a time when equities have outperformed bonds, has further dampened our balanced strategy returns. The QV Canadian Balanced Fund is up 1.0% before fees over the past 12 months versus its benchmark index return of 2.3%. However, at this stage in the cycle, now is not the time to concern ourselves with potentially missing out on further upside in equities.

One of the primary reasons clients come to QV is for our track record of generating above average returns over the long-term, while protecting capital during severe market downturns. For newer clients in particular, these valuable qualities can be harder to recognize today given the issues highlighted above and the general strength of equity markets over the last nine years. Assessing our ability to add value must be done through a complete market cycle, not just in the positive years. Although our returns are not fully reflecting the underlying quality of our strategies, aspects of our process come through in our portfolio characteristics, which we believe the market will eventually recognize.

Take our Canadian equity strategy for example, which trades at an earnings multiple of 14.6x, nearly a 10% discount to the 18-year average of the S&P/TSX. The margin of safety this discount provides should help to protect capital during significant market downturns. We have remained focused on driving this valuation even lower with recent purchases of businesses that are trading near decade low multiples. As a result, our portfolio looks very different from the index, with less than half of its exposure directly invested in the energy, materials and financials sectors. Strong diversification helps to limit the impact of company and sector specific risks that we highlighted earlier. With only 30 businesses, the portfolio is concentrated in our best opportunities. Out of these 30 businesses, all but one pays a dividend, 23 grew their dividend in the past year, and 17 of them have consistently grown their dividend over the past five years or more. The performance of Canadian dividend growers has been almost twice that of the broader S&P/TSX since 1986.

One might ask, if the above is true, why did QV not hold in better during the recent market volatility? Portfolio performance is not immune to the volatility of any one day, month or year. If you look at our monthly returns over our 21-year history, you would see several instances where QV underperformed a negative market in the short-term, but you will also see as volatility turned into a significant sell-off, our portfolios protected capital better. The process of selecting good businesses at reasonable prices is proven to add value over longer periods of time, spanning multiple cycles. This is why one's time horizon is an important factor in assessing performance. We encourage clients to maintain a longer-term view when assessing the achievement of investment objectives. Although we may underperform in the current market environment, markets tend to reward quality and value in the long-run. We understand this requires patience and faith in our process - possibly two of the hardest, but most important virtues of investing.

	Annualized Gross Returns (%) to Feb 28, 2018				
QV Pooled Fund	**1 yr**	**3 yr**	**5 yr**	**10 yr**	**20 yr**
Canadian Balanced	**1.0**	**2.3**	**6.0**	**6.9**	**7.8**
*Cdn Bal. Comp. Index**	*2.3*	*2.4*	*5.0*	*4.4*	*6.1*
Canadian Equity	**1.1**	**3.5**	**8.2**	**7.5**	**12.2^**
S&P/TSX Comp. TR Index	*3.2*	*3.5*	*6.9*	*4.3*	*6.5*
Canadian Small Cap	**3.8**	**7.8**	**11.8**	**10.1**	**13.0**
BMO Small Cap (unwtd) TR Inx.	*-3.1*	*3.8*	*2.9*	*2.7*	*4.4*
Global Equity	**13.0**	**9.9**	**15.1**	**11.6**	**n/a**
MSCI World TR Index ($C)	*14.1*	*9.7*	*16.3*	*9.5*	*n/a*

^ Represents return of Canadian equity carve-out of QV Canadian Balanced Fund;
** 5% FTSE TMX Cda 91 Day T-Bill Index; 40% FTSE TMX Cda Univ. Bond Index; 55% S&P/TSX Comp. TR Index*