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What Keeps us Asleep at Night

Nearly all employees at QV Investors are shareholders in the company. Additionally, all of our personal investments are held in QV pooled funds, so not only are we employees; we are also clients! Our financial futures are tied quite directly to the performance of QV's strategies and therefore we are highly aligned with our clients' interests. We are currently experiencing the second longest bull market in history, trailing the leader by less than a year. James Stack of Investech Research has concluded that five (possibly six) of his eight conditions that generally precede bull market tops are currently in place. Equity markets are often a leading indicator of recessions and with the North American economy humming along nicely, one can speculate that at some point things will turn. Although nothing is certain in this industry, there never seems to be a shortage of things to worry about, so it is a wonder we don't lie awake all night fretting about potential doomsday scenarios.

A long time horizon, to us, is like warm milk to a drowsy baby. Our portfolios are constructed with multi-cycle holding periods in mind. Alternately phrased, we invest in businesses that are built to withstand near-term challenges. One of the best defenses against potential corporate disaster is a well-capitalized balance sheet. It can buy critical time when whole sectors are under duress, as underlying commodity prices plummet, for example, and weaker companies cease to exist. In extreme circumstances, a healthy balance sheet can allow a company to purchase assets for dimes on the dollar from bankrupt cohorts. Companies with low debt typically hold up better than highly levered companies during bear markets. As has been shown in recent history, the opposite is true during periods of market expansion. More risky, levered companies have prospered to a greater degree of late. Despite this, we will happily continue to invest in the higher quality companies expecting that tougher times may lie ahead. Some economic cycles can persist for many years so patience is truly a virtue.

Diversification is our melatonin. We have an internal restriction that specifies a maximum weight of 25% in any given sector and we generally hold between 30 and 40 companies in a portfolio. Studies show that holding a minimum of 30 stocks in a portfolio is sufficient to diversify away company specific risk. The diversification ratio places portfolios on a scale of zero to 100 based on sector diversification. When compared to our benchmarks, our primary strategies are, on average, more diversified according to the diversification ratio. Of note, our Canadian large cap strategy's diversification ratio is 20% greater than that of the TSX Composite. This does not mean the dismal results from a single stock or a single sector will not adversely impact portfolio performance, but it should help lessen the blow in such unpleasant circumstances.

Another gauge of diversification is active share, which measures the percent of a portfolio that differs from its benchmark index. Our Canadian large cap strategy scores a relatively high 68.5%, indicating that there is potential for stark contrast in performance against the TSX Composite. Historically, this has manifested itself the most in troubled times. For example, during the throes of the financial crisis, the TSX Composite fell over 50% more than our Canadian large cap strategy from April 1st to December 31, 2008.

Valuation is like a hot shower before bed. We strive to maintain a relatively low valuation across all of our strategies. There is comfort in low valuations because when markets plummet, there is not as far to fall before finding support. Maintaining a respectably low valuation across our strategies ensures that the potential downside versus upside is tilted in our favour.

We take comfort in the fact that our bottom up, value-based approach to investing has yielded portfolios that are able to withstand whatever macro environment is thrown their way. The defensive mechanisms built into our strategies allow us to wake well rested every morning prepared to manage our clients' investments.