

# QV UPDATE

Weekly Commentary | December 19, 2014  
Ian Cooke, CFA



## Season's Greetings

"I will honour Christmas in my heart, and try to keep it all the year. I will live in the Past, the Present, and the Future. The Spirits of all Three shall strive within me. I will not shut out the lessons that they teach!"

— *Charles Dickens, A Christmas Carol*

Perhaps Ebenezer Scrooge could have taught a course in security analysis and investing. Not due to his ability to pinch pennies, but because of his desire to be mindful of the past, present and future. Spending too much or not enough mental capacity in one of these periods can be particularly detrimental for an investor.

### The Past

Ignoring the past provides little guidance or respect for possibilities in the future. Can oil prices collapse by nearly 50% in six months? That magnitude of a decline has occurred several times before over the past thirty years. In 1986, Saudi Arabia stepped away from supporting the oil market. Oil prices buckled more than 65% and remained below prior highs for 15 years, with the exception of a short-term spike during the Gulf crisis. We cannot ignore that possibility going forward. However, spending too much time in the past can also be detrimental from an investing perspective. Studying history can provide clues but it may not provide answers. Anchoring one to the past can also lead to investment paralysis; the inability to make any decisions when needed.

### The Present

An investor needs to tackle the present head on. One of the biggest mistakes we can make as investors is ignoring present day discomforts. A weak investment thesis today tends to get even weaker during challenging times. One test we ask ourselves to try to uncover weaker investments is whether our appetite towards owning a business would grow substantially if its share price declined in value by 20%. If not, we have to revisit the merits for investing today. The longer we put off tough decision-making, the more costly it can become when trying to correct our mistakes.

### The Future

"There are two kinds of forecasters: those who don't know, and those who don't know they don't know."

—*John Kenneth Galbraith*

The present day market backdrop is much different than it was just six months ago. In addition to oil's precipitous drop, German long-term bonds are now at new record lows, Venezuelan long-term bonds now trade at less than \$0.40 on the dollar, suggesting a high likelihood of default, the Russian rouble has collapsed, and the US economy, if ever in question, looks to have reclaimed its position as the world's economic engine. These changes demonstrate that what we know today may not be tomorrow's reality.

When investing, we need to be comfortable with the business, the management and the balance sheet. Not just from a past or present context, but stress tested for a less than certain future. We also need to be comfortable with the price we are paying for our ownership. Ultimately, the value of any business is the sum of its future cash flows. Clarity comes at a cost. The more clear those future cash flows, the more likely they are fairly, or more than fairly reflected in the current share price. Some of our best investments over the past decade have occurred when the future appeared most uncertain.

The Canadian small cap market recently entered a bear market, declining 20% since its summer highs. At present, a number of businesses we own have had their share prices negatively affected. Our cash levels have been elevated for a while. We believe select opportunities are emerging. Using market weakness to improve upon growth, balance sheet and valuation characteristics for our portfolio combines lessons from the past while positioning for the future.

All the best in 2015 and have a happy holiday season. The QV Update will resume after the holiday season on January 9th.