Vanessa Rohl-McNabb, BComm I Wendy Booker-Urban, BA

Playing the Trap

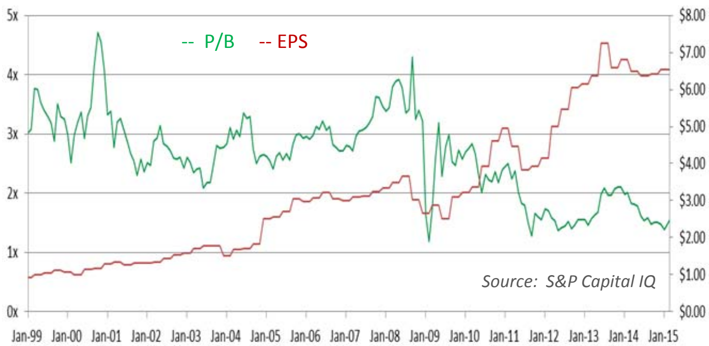
"The Trap" is a defensive strategy used in hockey and made famous by the New Jersey Devils of yesteryear. It is a strategy employed to protect a lead early on in a game. A result of this type of play can be a lackluster, low scoring game for spectators, but it has been known to win Stanley Cups. One might argue that QV is "playing the trap" as we continue to focus on protecting capital. Although the ultimate goal of the strategy is indeed the same, to protect what we have earned in our clients' portfolios, our process of doing so is engrained in our investment discipline.

Clients often ask us how we define defensive positioning. To answer this question, we must first define risk. QV defines risk as the potential for permanent capital loss. Our approach to defending against capital loss is through owning companies that provide a margin of safety. Margin of safety is the difference between a stock's current price and its true worth, otherwise known as intrinsic value. A stock will have better downside protection the farther below it trades to its intrinsic value. We believe attractive valuation, above average compounding characteristics, and prudent balance sheet management build that margin of safety. We do not simply flock towards traditional defensive sectors such as utilities, telecoms, health care and consumer staples. That being said, we have had success protecting capital in these types of businesses in the past. The most recent being the 2008 financial crisis when QV was able to find value in these defensive areas due to the margin of safety they provided. This is not the case today, as these areas have become more expensive and potential downside has increased as a result. Our investment process has driven us elsewhere to defend against capital losses.

We have been diligent in reducing highly valued stocks and have been focusing on healthy balance sheets. As an example, in our global equity strategy we have significantly reduced our health care exposure by nearly 50% over the past year and a half on the back of record valuations. These are great businesses and we look forward to having the opportunity to hold them again or increase their weight at better valuations. One of the drawbacks of focusing on valuation is that these companies may continue their ascent upwards after we have reduced or sold our positions. We understand that we may be leaving return on the table, but we are doing so to lock-in gains and protect that margin of safety in our clients' portfolios. However, we would be lying if we said it is not painful to watch; similar to a low scoring, uneventful hockey game.

A company that exemplifies our defensive positioning is our global equity holding Aflac Inc., the US based supplemental insurance provider that generates 75% of its earnings in Japan. Aflac is currently trading near the valuation lows it experienced during the financial crisis, as illustrated by the chart below. Reported earnings have been supressed by the low interest rate environment and by the depreciation in the Japanese Yen. Despite these headwinds, it has achieved an industry leading return on equity resulting in continued growth in shareholder equity over time, and has raised its dividend for 32 consecutive years. The company has an attractive path to growth through expansion of its product offering throughout Japan, increasing its presence in the US and continued plans to buy back shares. The company will also benefit in an increasing interest rate environment. It is currently held as a top weight in the global equity strategy at 4.9%.

Aflac Inc. – Earnings per Share vs. Price to Book Value



Hockey season is officially over. It did end in the Stanley Cup being awarded to a "C of Red". Unfortunately for Flames fans, the "C" stood for Chicago, who also happens to don red jerseys. My prediction from the QV Update on November 7, 2014, only came half true. The lesson here is that it is very difficult to make accurate predictions and being only partially right is not enough, especially as it relates to making investment decisions. This is why we will stick to our proven practice of managing risk even if it means "playing the trap."