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CAG

COMMODARI ANTINORI GROUP

SAFEGUARDING YOUR WEALTH

INVESTMENT COMMENTARY: JANUARY 2013

"Most investors cannot control their emotions and as a result, alternate between moods of excessive greed and fear. They fail to exercise discipline, patience, and common sense. They fail to employ sound and proven strategies, even though there are countless books that have repeatedly stated and proven that these are essential qualities for success."

– Anthony Boeckh, The Great Reflation

Major market indexes performed well in the year ended December 31, 2012, as the Standard & Poor's 500 Index and the MSCI World Index posted total returns in Canadian dollars of 13.48% and 14% respectively while in Canada, gains were more modest as the S&P/TSX Composite advanced 7.19%.

Unfortunately, despite favorable valuations, unrelenting predictions of financial doom over the last several years by noisemakers in the media diverted people's attention and investment dollars elsewhere. Their latest refrain points to continued problems in Europe and the now since averted American "fiscal cliff."

Understandably, most investors – retail and institutional alike – not knowing which headlines are worth being concerned about, long since threw in the towel. They chose to stay on the sidelines and thus failed to participate in recent gains. Indeed, since March 2009, $138 billion have been yanked from U.S. equity mutual funds while a staggering $1 trillion was placed into bonds over the same period.[†]

Marching to the beat of our own drum, we did not follow suit by liquidating our positions and are happy to report that portfolios managed by the Commodari Antinori Group posted stellar results in 2012. These results, rooted in actions - and sometimes inactions – taken in years past, outline the importance of having a sound framework for investing and the benefit of being farsighted when constructing client portfolios.

For newer clients, who have recently entrusted us with the management of their portfolios, we ask for your patience. Although equities still remain relatively inexpensive, the list of those that present us with a large enough margin of safety to take a position is slowly shrinking. In time, that will change, but until then we continue to hold larger than normal cash balances.

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THE OTHER INCONVENIENT TRUTH

When it comes to investing, there are generally two prerequisites that will allow you to make money. You either possess (1) an informational advantage or (2) an emotional advantage. Although both are important, the first without the latter is useless. Let us explain.

An informational advantage is just a fancy way of saying that you know something that other people do not. No, we're not talking about illicitly obtained private information à la Gordon Gekko, the Hollywood character and antagonist in the 1987 film *Wall Street*. The type of advantage we are referring to is obtained by using a rational methodology for valuing a business and draws on publicly available information and experience.

Because we live in a world where some people may know more than others (or think they do anyway), investment opportunities will arise when lesser informed sellers cause under-pricing in a given security creating investment opportunities for more knowledgeable buyers.

In the same way that Noah predicting the rain would have been useless had he not built an arc, all the knowledge in the world would bear no fruit if one fails to act on what they know - hence the importance of the emotional edge.

STACKING THE DECK - AN EMOTIONAL EDGE

Fear and greed do not discriminate. Both are powerful emotions and have the ability to paralyze and blind even the most rational and intelligent of people - eliminating any informational advantage.

Based on centuries of historical evidence regarding booms and busts, we know that under certain conditions, large groups of people often act irrationally as a 'herd-like' behavior takes root. This type of behavior can occur on a macro-level as it did in 2008/09 affecting the market as a whole, or a micro-level, affecting only a select few businesses as it did with Visa temporarily in 2010.

In both cases, very predictably, as prices go lower bearishness grows higher. This is counter-intuitive because the lower stock prices go, the higher the future rate of return and, vice versa, the higher the stock prices are, the lower the future rate of return.

Logically speaking - as we are sure Mr. Spock, noted Vulcan of *Star Trek* fame would agree - people ought to get more bullish as prices decline – but they don't. They allow emotion to cloud their judgment and fail to act. To gain an emotional edge, they should look to *Starfleet Regulation 619*. It states that the commanding officer must relieve themselves of command if their current mission leaves them emotionally compromised and unable to make rational decisions. We like this notion and have hence adopted CAG Regulation 3.0 which reads: *"Do not allow emotion to corrode your rational decision making process."* By now, you should all be familiar with CAG Regulations 1.0 and 2.0 (call us if you have forgotten).

On a more serious note, we use historical context, market sentiment, and the margin of safety principle to tell us how aggressive we should be. Needless to say, over the last several years, we have been quite aggressive.

WIRING YOURSELF FOR SUCCESS

At the Commodari Antinori Group, we have an emotional advantage simply because our wiring for greed and fear are backwards from that of general society. This means that when people become greedy and eager to buy, we become fearful and look to sell. Conversely, when people become fearful and eager to sell, we become greedy and look to buy. This emotional advantage, coupled with our methodology for selecting stocks, is at the cornerstone of our success.

COMPANY DEVELOPMENTS

While the economic recovery from the 2008 financial crisis has been less than robust, our portfolio companies continue to make excellent progress and for the most part, in our estimation, have grown their underlying intrinsic values. Some, simply by conducting business as usual, others by spinning-off business units and still others, by making strategic acquisitions. Here are just some of the most noteworthy highlights.

Kraft – On October 1, Kraft Foods Inc. completed the long awaited spin-off of its North American grocery business and re-christened itself *Mondelez International*. As shareholders, you received one share of the new company, Kraft Foods Group Inc., for every share of Mondelez held.

For the record, Mondelez retained the high growth global snacks business including brands such as Trident, Nabisco, Cadbury, and Oreo while the newly spun-off Kraft Foods Group held on to labels such as Oscar Mayer, Kraft and Maxwell House. As you know, we have since made the choice to allocate the proceeds of the spin-off back into our original holding – Mondelez. So don't stop dunking those Oreo's!

This transaction unlocked value in the stock price and with it, involuntarily triggered gains in accounts. Although the split-up of the company is a tax-free event in the U.S., as Canadian's, we are not automatically granted a tax deferral unless an election is filed with CRA. That said, we urge you or your accountant to file the necessary documents with them sooner rather than later.

Walt Disney – In addition to making great strides across its business lines over the past few years, management continues to put its cash to good use. Its latest announcement, the acquisition of Lucasfilm Ltd. for $4.05 billion worth of cash and stock, will surely cause a disturbance in the force for its competitors if completed. The deal makes great strategic sense allowing Disney to leverage the Star Wars brand in its theme parks and to utilize Lucas' technology in its films.

Loblaw's – Following years of lackluster stock performance, Loblaw's announced on December 6 its plan to spin-off its real estate assets into a real estate investment trust (REIT) and to sell units of the REIT by way of an Initial Public Offering. The news was well-received triggering an immediate upward reappraisal of the stock price in excess of 20%. We will be assessing the deal closely, and will report back to you as soon as more information is forthcoming.

Wells Fargo – Investor concerns about the financial services sector aside, Wells Fargo remains the jewel in the banking industry as it continues to outperform most of its rivals with loans, assets, and net profits among the highest in the industry. More importantly, its credit quality continues to improve and will gain additional traction once a steady housing recovery in the U.S. is well underway.

CONCLUDING THOUGHTS

While recent market advances make new entry points into stocks somewhat more difficult, we believe that the businesses we already own remain reasonably valued and are cautiously optimistic as we head into the New Year.

It goes without saying that prices will always fluctuate and that we will have periods of disappointment along the way. One thing is certain however, our appraisals will continue to anchor us in choppy seas as we embrace volatility and buy at points of pessimism.

As always, we remain mindful that our primary objective is to protect your hard-earned capital. Towards this end, our emotional advantage will continue to serve us well.

Thank you for investing with us, and for your continued confidence.

Mario Antinori
Investment Advisor
Tel.: 514.286.7311
mario.antinori@nbpcd.com

Alessandro Commodari
Investment Advisor
Tel.: 514.286.7254
alessandro.commodari@nbpcd.com

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BMO Nesbitt Burns®
COMMODARI ANTINORI GROUP
1501 McGill College Avenue, Suite 3200
Montreal, Quebec H3A 3M8
www.commodariantinorigroup.com

"Commodari Antinori Group is a boutique private client investment advisory group within BMO Nesbitt Burns. We work exclusively with high-net-worth individuals and their families and build for them unique portfolios — no pooled funds or other proprietary products."

Member-Canadian Investor Protection Fund

Source: † The Wall Street Journal, Despite Gains, many Flee Stock Market, October 23, 2012.