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COMMODARI ANTINORI GROUP

SAFEGUARDING YOUR WEALTH

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"There's a new hit rock group or singer every five minutes, but with country music, you have one hit and those people love you forever."

– Kenny Rogers

At first glance, the above quote may appear a little out of place given the nature of our subject matter. Indeed, newly initiated readers, still unfamiliar with our sometimes deep-rooted sense of meaning, may argue that a more fitting place for Kenny's wisdom would be within the pages of *Country Weekly*, not a hard-hitting and revered investment commentary such as this – humor us, please! In any case, for those of you wanting to know how we will weave this country music legend into our latest commentary, you have no choice but to read on.

But first, let us take care of some formalities shall we. For the year-ended December 31, 2013, the total returns in Canadian dollars for the S&P 500 Index and the MSCI World Index were 41.53% and 36.16% respectively, while in Canada, the S&P/TSX Composite Index posted a more subdued advance of 12.99%, and the DEX Universe Bond Index dropped 1.19%.

Many of you will note that it is uncharacteristic for us to include the DEX Bond Index in the listing above. You are right, but since this is the first time since 1999 that bond returns in Canada (and the U.S.) posted a negative year-over-year return, we thought it noteworthy. And no, the fact that we have been harping about the poor prospects for the bond market in recent years had nothing to do with it. Ok, so maybe it did – please indulge us in a small victory lap.

When all was said and done, portfolios managed by the Commodari Antinori Group posted exceptional results in 2013 – in many cases surpassing the above indexes by a wide margin. This should come as no surprise to clients given our limited exposure to long-term bonds and the fact that we have always advocated the need to look outside of Canada when building high quality investment portfolios on your behalf. As always, to view your individual results, please refer to your personalized Portfolio Review enclosed with this commentary.

IF YOU'RE GONNA PLAY THE GAME, BOY, YA GOTTA LEARN TO PLAY IT RIGHT

Some may ask why we put so much time and effort in writing these commentaries. The answer is simple. We do so in the hope to explain our actions to you – both past and present – in a manner that sheds some light on our investment philosophy

and current thinking. More importantly, we do so because we know that you get a very different perspective when reading our thoughts as opposed to simply analyzing our historical performance. This perspective is what drives our actions today and what seeds the performance of tomorrow.

Results in 2013 were superb and, based on current valuations, unlikely to be repeated in 2014. So, going forward how should an investor play his hand if he wanted to play the game right? In other words, should he hold'em, fold'em or walk away? Unlike the gambler in Kenny Rogers' famed song of the same title, we, like you, don't have the luxury of knowing what the cards are by the way people hold their eyes. In fact, there is no one sitting at our table and the game is far more serious than a simple game of cards.

The good news is that in managing your portfolios we do have an ace up our sleeve. That ace is Benjamin Graham's timeless principle of intrinsic value.

KNOW WHEN TO HOLD'EM

It goes without saying that before being faced with knowing when to hold'em, you must first know when to buy'em – a subject we have covered at length in past issues. Needless to say, we heed our own advice and as a result, hold many positions in client portfolios that have since appreciated considerably in value.

The question before us now is whether or not we are holding securities *"on a train bound for nowhere"* as Kenny puts it in his song or, on a train bound for easy street where getting off early would be a mistake. Clearly, in the former case, it would be difficult to argue in favor of holding'em. But what about the latter? How do we know if our train is bound for easy street?

We cannot promise to know the answer nor can we always be right, but one thing is certain, we own superior businesses. Provided they continue to operate with above average economics and management allocates the earnings of those companies in a productive manner, inactivity strikes us as intelligent behavior.

Our approach may appear quirky to those accustomed to actively buying and selling stocks on a regular basis, but it has one important hidden benefit. In addition to growing capital at an above-average rate, it also increases your after-tax returns. When you sell a stock at a profit, you will be hit with a capital gain tax that inherently eats into that profit. Owning superior businesses, our solution is simply to accrue gains thereby allowing your capital to compound more forcefully.

KNOW WHEN TO FOLD'EM

Buying quality undervalued companies gets you only halfway to a successful investment experience. Sometimes, knowing when to sell a security is just as important. On the whole, selling is definitely harder than buying. We say this because when you follow an approach such as ours, where you invest countless hours in trying to understand and really know a business before buying it, you end up owning only those companies that you really like and would be happy to own for a lifetime.

So when do we sell? If we do our job right, the answer is very infrequently. When we do sell however, it is generally for one of the following three reasons.

- The stock price has reached our assessment of intrinsic value and the future prospects are unfavorable.
- We have more good ideas than money. In other words, we replace an existing position by one we like even better.
- We identify a mistake in our valuation analysis or receive new information that causes us to reassess our position.

Our sell discipline is a logical outcome of our investment process. Simply put, if an investment fails to satisfy one or more of the variables that led us to the investment in the first place, we will sell it. We did so with Walgreen's in 2012 after the company made, what we thought, was a foolish acquisition. In 2011 we sold Martin Marietta Materials because we felt the company's financial strength had deteriorated. And, in yet another example, we sold Whole Foods Market in 2010 because we felt the valuation placed upon it by the stock market was detached from reality.

Regardless of the name, in every case, selling is a company-by-company decision based on current market prices and what we think the underlying value is – not a broad based stock market decision. After all, we buy them one stock at a time and we sell them the same way – one at a time.

KNOW WHEN TO WALK AWAY AND KNOW WHEN TO RUN

As you all know by now, we never attempt to make stock market predictions and liken the activity as something designed to make fortune tellers look good. That said, in the spirit of Kenny Rogers, and the fact that not doing so would ignore one of the most famous verses of the song we are paraphrasing, we will begrudgingly chime in on the matter.

As we have already mentioned in our conversations with many of you, we do not believe the stock market is unusually cheap right now, nor do we believe that it is excessively overpriced. If anything, the 128% increase in the S&P 500 over the past five years has returned the market to fair value. Today, metrics such as price-to-earnings ratios are consistent with historical averages and, when that is the case, we can expect returns going forward to be near average as well. Clearly, there is no need to walk, or run, from the stock market at these levels however, to achieve above average returns, it does pay to be patient and selective.

PORTFOLIO DEVELOPMENTS

Finding businesses that sell at a 50% to 70% discount to their intrinsic value is more difficult in this fairly-priced market. We remain resolute, as experience tells us that opportunities will always present themselves for those who know where to look. Case in point, we are delighted to write about two of the most recent additions to client portfolios.

Sirona Dental Systems – We started adding this roughly $4 billion global provider of dental equipment to client portfolios early last summer. Our interest in Sirona is centered on the types of products they manufacture and sell to dental practices, clinics and laboratories worldwide. Despite not being a household name, Sirona has been around for over 130 years and is credited for having introduced the first electric drill to dentistry in 1887. Today, it remains the market leader in high-tech dental equipment – everything from digital imaging to computer-aided design.

Over time, we are convinced that the future for dentistry will be digital and that dentists will use more high-tech equipment. With penetration rates in the U.S. and abroad still relatively low, we believe that Sirona is better positioned than any other company in the world to benefit from the inevitable shift to digital. If your dentist has yet to make the move, feel free to introduce him to the virtues of Sirona.

Potash Corporation – Not too long ago, Potash was one of Canada's brightest and most sought after companies – by investors and suitors alike. Today, with global nutrient markets in turmoil, its popularity - having wilted faster than Kenny Roger's once mighty rock band, *The First Edition* - has dwindled, and its share price has fallen to levels not reached for several years. Naturally, never ones to rely on popular opinion, we initiated a position in the name in December.

Potash is collateral damage to the fracturing of the cartel between two of its overseas competitors,

Belaruskali and Uralkali, the world's largest producer of potash. We certainly do not want to downplay the importance of this event, but do wish to point out that Uralkali is a very minor player in Potash's largest market, North America, and that Belaruskali is unable to sell here because of political constraints. Although future reconciliation is only speculation, we think that ultimately, logic will prevail and that the cartel will be reformed.

Until then, Potash's balance sheet is very strong and with 90% of their capital expenditures already complete, we expect future earnings to make their way back into shareholders' hands via increased dividend payments and share repurchases. In the meantime, we believe that there is very little downside based on the price we paid and are happy to collect our 4.5% dividend yield as we wait for the Potash's fortunes to turn.

CONCLUDING THOUGHTS

Alas, the curtain has fallen on our tribute to Kenny Rogers. We chose the quotation that began this commentary not only because it resonated with us, but also because its underlying message lent itself well to our time-tested and proven approach. In the investment world, where fads and concepts come and go, value investing endures because, when applied with discipline, it will safely grow your capital forever.

As the market moves higher, you can count on us to remain vigilant and continue applying the principles of value investing on your behalf.

As always, thank you for investing with us and for your continued confidence.

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