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COMMODARI ANTINORI GROUP
SAFEGUARDING YOUR WEALTH

INVESTMENT COMMENTARY: JANUARY 2015

"Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."

– Winston Churchill

Major equity markets began the second half of 2014 continuing the relentless march upward that characterized the first half of the year. The rise, insistent with an air of inevitability and invincibility, shrugged all worries aside as markets moved ever so higher and volatility had seemingly been vanquished. Indeed, our ever lively protagonist, Mr. Market, handled geo-political tensions with uncharacteristic composure and, dare we say, indifference. *Will the real Mr. Market please come forward!*

As summer transitioned into fall however, Mr. Market's blissful state reverted back to a more manic one and global equity markets were knocked off their August highs. Volatility returned in force, and in its wake, energy heavy indices like Canada's S&P/TSX saw 6.31% of its accumulated return disappear in just four months.

Still, when all was said and done, equity markets posted healthy gains in 2014. For the year-ended December 31, the total returns in Canadian dollars for the Standard & Poor's 500 and the MSCI World Index were 24% and 15.08% respectively while in Canada, the S&P/TSX Composite Index finished the year with a gain of 10.55%.

In writing to you last year, we noted that the stellar results we achieved in 2013 would likely moderate going forward. Alas, helped along by growing cash reserves, our cautionary warning to you then came to pass this year. That said, on an absolute basis, portfolios managed by Commodari Antinori Group still posted strong gains in 2014. As always, for your individual results, we encourage you to consult your personalized report enclosed with this commentary.

THE GROUND RULES - REVISITED

Periodically, we feel it is important to remind existing clients and new ones alike what they should expect from working with us. Having delivered exceptionally strong results since we last outlined our ground rules to you over four years ago, we felt now was a good time to remind you of those rules. Our goal here remains the same - paint a clear and realistic picture of what you can expect as opposed to the typically lofty promises made by the investment industry that often fall short. With this in mind, we remind you of the following.

We are not adventurers aiming to turn pocket money into a jackpot. Our primary goal is preventing your already **large** nest egg from

becoming a **small** one. In so doing, much of the value we add is by protecting capital during down markets not outperforming in bubbling ones.

Over a period of time, we expect to have good and bad years; there is nothing that can be gained by getting enthused or depressed about the sequence in which they occur. The important thing for us is beating par for the course. After all, when all eighteen holes are tallied, that is all that really matters.

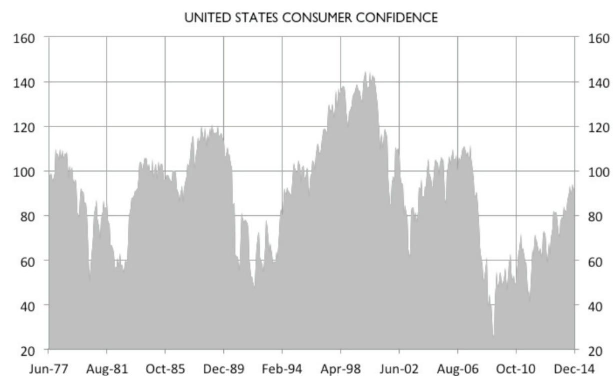
TIME TO BE FEARFUL?

As long-standing readers of our commentaries will remember, we began chronicling the exceptional investment opportunity that stocks presented investors back in 2009. A heading from our January commentary of that year read "Time to be Greedy" and concluded by us writing that "regardless of what happen[ed] over the next several months, it [was] likely that over the next decade, we [would] be well rewarded for putting our capital to work and favoring equities over bonds at [that] point." Needless to say, despite being two months early, readers that took our advice then have been well rewarded.

Today, after but a brief pause in 2011 following S&P's downgrade of U.S. sovereign debt, the *"great equity bull market"* that began in earnest in March 2009 will soon turns six years old. With this in mind, you may ask yourself if it is still wise to be greedy or has the time come to start being fearful? Not ones to try and reinvent the wheel, we have decided to stick to our original thoughts on the matter. That being that profitable investing is mainly common sense and can be summed up in four words – buy low, sell high.

Unlike 2009, when pessimism kept people from acting rationally and buying low, today record corporate earnings and historically low interest rates have combined to fuel an ever increasing sense of optimism. This optimism has moved what were once grossly undervalued equities to what we now believe – for the most part - are fair reflections of their value.

A quick look at the historical measure of consumer confidence illustrates just how far confidence has risen since hitting a low of 25.3 in February 2009. Remember in each case going back to 1977, when consumer confidence reached their lowest levels, investors shunned equities and subsequent returns as measured by the S&P500 were above average. Inversely, in each case where confidence was at its highest, investors piled into equities and subsequent returns were quite modest.



Source: The Conference Board

As consumer confidence returns toward a normalized confidence level of 100, it is fair to deduce that returns going forward will moderate and the above average returns experienced in recent years will also return to average. As you all know, we are in the business of chasing value, not performance. That said, current sentiment has resulted in us having to pay, on average, a whole lot more for a dollar of value today than we did just a few of years ago.

Fear not! This is clearly not the end, nor is it the beginning of the end. For the disciplined equity investor, results over time will always trump a multitude of other investment options. What it does mean however is that we have reached the end of a phase where stocks presented investors with the greatest potential for gain.

Finding companies that now meet our deep discount criteria is becoming increasingly difficult. As confidence continues to rise there is a danger that stock prices will be propelled more rapidly than their growth of intrinsic worth. Should this come to pass, our cash position will likely grow as we continue to exit and trim existing positions in the anticipation of better value opportunities that are sure to present themselves down the road.

FORGET THE SMOKING GUN – CAPITALIZE ON VOLATILITY

Characteristically so, after an abrupt shift like the one that appears to have recently soured the markets' mood, hapless squads of talking heads take to the airwaves trying to name potential culprits. In their quest to pinpoint the proverbial "smoking gun," some point to the malaise in Japan, others the slowing growth in China, and others still European deflation. Wait, by some accounts, Greece has now made it back onto the most wanted list!

As always, our view at Commodari Antinori Group is that trying to pinpoint a catalyst for stock market movements is an irrelevant and unprofitable exercise. Despite occasionally causing us indigestion, we have long ago accepted volatility as the handmaiden to opportunity and welcome its presence knowing it causes the mispricing that eventually leads to profit.

Consider Potash Corporation which we wrote about last year after industry-specific events gave us the opportunity to add it to client portfolios in December 2013 at an average cost well under $33 per share. As 2014 progressed, Potash's stock price swiftly recovered and traded as high as $41.55 – great news for existing clients; less so for newer ones. Having missed the initial opportunity, newer clients would have to be patient. That patience was eventually rewarded in October as temporary weakness once again depressed the stock price below our desired purchase price and finally triggered a slew of outstanding limit orders to buy the name for newer clients.

PORTFOLIO DEVELOPMENTS

We continue to invest in businesses that distinguish themselves through the quality of their management, durability of their franchise, and strength of their balance sheets. When all three of the above elements are infused into one business and combined with a favorable purchase price, great things happen. On that front, here are some notable developments.

Tim Horton's – In late August, Tim Horton's announced that they would be sold to Burger King for a combination of stock and cash valued at roughly $11.4 billion. No surprise, on the news, Tim Horton's share price surged upward by over 30% - well above what we estimated to be the $88 USD takeover price. With little interest in owning the combined venture and given that the share price traded slightly above the proposed deal price, we decided to sell our stake in Tim Horton's ahead of the special stockholders vote on December 9th. Sadly, this ended what was a very profitable five year relationship owning the name.

World Fuel Services – We first added this Miami-based business to client portfolio's back in 2013 – just months before being named in a civil suit for their involvement in the Lac Megantic derailment. As many of you have come to know, the company's name is really a misnomer. While it is in the a energy business, World Fuel is really a global logistics company engaged in the worldwide marketing and sale of marine, aviation, and land fuel products and services.

Over the last twenty years, companies like Exxon, Shell and BP have lost interest in staying in the downstream distribution business, so companies like World Fuel have stepped in to become the intermediary between the refineries and the end user. Essentially, they are buying the fuel and reselling it.

Our investment thesis when we first bought World Fuel was that the business would grow because

they could take market share by consolidating the industry. Aided by their recent Watson Petroleum and Colt International acquisitions, they are doing just that as sales have now reached $11.7 billion. Despite this progress, shares of World Fuel Services were on a wild ride over the past year, reaching a high of near $50 before falling to a low of $35. Needless to say, we seized the opportunity and added to our position at under $40.00.

CONCLUDING THOUGHTS

Despite having a long list of outstanding businesses that we would love to add to client portfolios, today's less than outstanding valuations for those said companies has kept our "buy list" quite bare. Indeed, in the absence of purchases, recent trims - and sales – have caused us to carry larger cash positions than clients have come to expect.

While a higher cash balance may be a drag on our returns in the short term, over the long term the benefits of avoiding lower quality investments and having the flexibility to take advantage of buying opportunities during market dislocations are, we believe, key drivers of outperformance.

Though new ideas and bull markets are exciting, the valuation discipline inherent to our process ensures that time, rather than excitement, is always on our side. We welcome any meaningful correction in the stock market to temper outsized enthusiasm and to serve up investment opportunities to us and our growing cash reserve.

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

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