VOLUME X, ISSUE 1

CAG
COMMODARI ANTINORI GROUP
SAFEGUARDING YOUR WEALTH

INVESTMENT COMMENTARY: JANUARY 2016

"The mistakes we make as investors is when the market's going up, we think it's going to go up forever. When the market goes down, we think it's going to go down forever. Neither of those things actually happen."
– John C. Bogle

He put on a good façade for a long while and even had us consider that he had turned over a new leaf. Calm, reasoned, dispassionate – dare we say rational? Could this really be our foil, Mr. Market? As summer transitioned into fall, we got our answer.

Concerns about slowing growth in China, the devaluation of the yuan, slumping oil prices and the prospect for rising interest rates in the U.S. finally proved too much for Mr. Market. As the year came to a close, major equity markets were characterized by a dramatic increase in volatility.

When all was said and done, the S&P/TSX Composite Index posted a total return of -8.32% for the twelve month period ending December 31, 2015. Elsewhere, total returns in Canadian dollars for the Standard & Poor's 500 and MSCI World Index were 20.95% and 18.83% respectively. Stripping away currency gains however, these results look much less impressive as they clocked in at +1.38% and -0.32% respectively.

Relatively speaking, portfolios managed by the Commodari Antinori Group posted strong results for the period. That said, as always, we remind you that short-term results should be taken with a grain of salt. After all, in the end, only performance measured over a multi-year time horizon really counts. On that metric, portfolios continue to excel.

BE CAREFUL WHAT YOU WISH FOR

Given the lack of attractive buying opportunities in the last year or so, readers of our most recent commentaries know that in addition to asking for your patience in deploying cash, we have also been asking Mr. Market to serve up some long forgotten downside volatility. He finally delivered on the latter. Good news, right?

We certainly view it as such, as it gives us the opportunity to buy undervalued companies, but do acknowledge that this wish is a double-edged sword in that volatility also brings with it the repricing of some of the businesses we currently own. Although unpleasant, these fluctuations are very much part of the fabric of being a long-term investor and should not bother us provided we keep in mind that value is not always accurately reflected in Mr. Market's eyes.

To sidestep this market ebb and flow, some may be wondering why we simply don't liquidate all our holdings at the first sign of trouble and buy them back at a later date. The simple truth is that markets, in the short-run, move with such randomness that it is impossible to repeatedly predict their movements with success. Who is to say that today's price is the wrong price and that tomorrow's price is the right price. It's enough to drive a sane person crazy!

Luckily for us, a natural by-product of our value-driven investment approach is that we end up *timing our purchases* as opposed to the market. Thus, cash reserves tend to increase during periods of buoyant valuations, and decrease during periods of undervaluation. This generally makes the ride somewhat more tolerable for clients and more often than not, leads to outperformance over longer periods of time.

WE'RE NOT AS DUMB AS WE LOOK. BUT DON'T EXPECT TOO MUCH

Today, staring fixedly back at the road just traveled, most investors have rosy expectations. That said, we continue to caution against expecting compound returns going forward to keep pace with those experienced over the last six years.

Don't get us wrong, over time we will do just fine but, mathematically speaking, you need to remember that future returns are always affected by current valuations. That said, a repeat of recent past performance is highly unlikely unless of course you believe that the bull market that started in earnest in March 2009 cannot possibly end until we reach the same valuation levels attained during the dot.com craze. We for one would not take that bet.

Indeed, for investors to continue to experience outsized profits in the market over the next six or ten-year period several things must happen. Most notably, interest rates must remain artificially low and two, corporate profitability in relation to Gross Domestic Product must rise further still from their already historically high levels. Experience tells us that these two scenarios are unlikely.

The good news is, with the return of volatility and a healthy dose of skepticism in recent months, we have begun to see valuations come back to what we believe is a more reasonable relationship with our assessment of underlying business value relative to future prospects. That said, despite small pockets of value here and there, with price-to-earnings ratios still 18 to 19 times trailing earnings, we believe the stock market's current risk/reward profile – although improving – remains fair.

CURB YOUR EMOTIONS

It would wise to always remember that price is set by people, who are both fallible and emotional, and thus subject to all sorts of influences beyond the pure economic characteristics of the underlying asset. In some cases, the influence of emotions like euphoria and panic can become so dominant that prices become irrational. This is dangerous because most people tend to chase what has already gone up and get out of what has already gone down.

Another danger, particularly in times of adversity, is that people become consumed with looking for the investment equivalent of the needle in the haystack and thus fail to act when it is timely to do so. Precious opportunity – not to mention time and effort - is lost trying to assign *meaning* to random events or in attempting to divine what the stock market is signaling.

Never forget that the stock market is here only to serve us and not instruct us. Outsized returns are experienced only by those who are able to remain detached in times of euphoria and calm in times of despair. This detachment is what allows us to part with businesses that we deem to be fully priced even though they may have caught Mr. Market's fancy. Conversely, in times of despair, it is this same detachment that will allow us to buy - at deeply discounted prices - businesses once coveted by Mr. Market.

WHAT YA TALKING ABOUT WILLIS!

We have never professed to be fans of energy and material related businesses. In fact, on more than one occasion we have written about how their high capital expenditure requirements make them less than ideal long-term investment choices and, be it for our lone holding of Suncor, up until recently have shunned the space altogether.

We do recognize however that it *takes different strokes to rule the world* and, given the fear that currently seems to reside in global equity markets vis-à-vis anything commodity related, we deem the potential reward relative to risk in this sector too compelling to be ignored and have thus been accumulating meaningful positions in many businesses not only in this space, but servicing it as well.

> *"I've been in the oil business all my life. I saw six cycles – I saw very high price, I saw low price, and this is one of them. This will not continue. In a few months or a year or so this will change."*
>
> *– Abdullah al-Badri, OPEC Secretary-General December 15, 2015*

We will stop short of venturing a guess as to the low for copper, fertilizer, soybeans, gas or oil. That is not our domain. What we can say, is with the price of underlying commodities now at speculatively low levels, our view is that the price of commodity stocks are so battered that they offer us a substantial margin of safety. Given industry demand and cost considerations, we believe that oil prices are likely to move higher over time and, when that happens, the divide between price and value will eventually close, favoring the additions we recently made in this area.

PORTFOLIO DEVELOPMENTS

Until the day that fear and greed no longer exist, short-term emotions can impact stock prices at any given point causing them to diverge from the real value of a business. Our job then is two-fold: one, determine the value of a business and two, use that knowledge to act with conviction in either the purchase or sale of that said business on the open market when we believe a compelling mispricing exists.

In the past few months, we have been presented with several such mispricing's and have been quite busy acting on our convictions. Holdings that were near our estimates of intrinsic value were trimmed back, some were sold and, recently, a handful of new businesses were added to client portfolios. Here are some of the most noteworthy:

Precision Castparts – We wrote about this first-class business just six short months ago when we reported to you that we added it to client portfolios at under U$200. Alas, it is with mixed emotion that we write that our partnership with this wonderful company will be short-lived as it was announced only a few days after our purchase that it would be acquired by Warren Buffett's Berkshire Hathaway for U$235.00. With the transaction slated to close early this year, we view this holding as a source of cash and have been selling it where needed.

Of course, never ones to be upset to reap a quick profit, we do feel that the business was sold at a less than favorable price. At the risk of ex-communication, we may take up our beef with Mr. Buffett when make our annual trip to Omaha later this year.

Valeant Pharmaceuticals – Intense public and regulatory scrutiny related to drug price increases, the ended relationship with mail-order pharmacy Philidor and a scathing report issued by short-seller Citron Research all combined in November to create the perfect storm for Valeant's stock price. At the storm's apex, Valeant's share price traded as low as $92.65, and was off some 75% from the $347.84 high reached just a short three months earlier.

With much of the downside already priced into the stock, we set public opinion aside and took a position in this multi-national pharmaceutical and medical device company at $99.99 a share. While scrutiny related to price hikes are likely to remain an overhang in the near term, we believe the sum of Valeant's assets – Bausch & Lomb, Pharma Swiss, Dermik, Salix Pharmaceuticals to name but a few – hold incredible value and were well worth the price of admission.

Whole Foods Market – Disappointing same-store sales figures rattled the market late in the year and gave us an opportunity to once again partner with this leading international organic and natural foods grocer. Having originally sold the name many years ago for double our initial investment, we were happy to see its valuation return to normal, thus giving us the opportunity to own it again. Unlike Wall Street, we do not feel that the produce has gone bad and believe that rising demand for natural foods coupled with the potential for further expansion via new initiatives will rekindle growth - albeit at a less torrent pace.

Computer Modelling Group – This company develops and licenses reservoir simulation software to oil and gas companies, consulting firms, and research institutions worldwide. The market's distaste for all that is oil related has given us a wonderful opportunity to buy into a first-class specialty software business with no debt, fat margins and a recurring revenue stream at a second-class price. We accepted the offer!

Microsoft, Corning, Becton Dickinson, Walt Disney – Not ones to look a gift horse in the mouth, these businesses were trimmed back due in part to their fair value from a Canadian residents perspective. In many cases, the funds were repatriated back into Canadian dollars.

CONCLUDING THOUGHTS

We wish to remind readers that volatile markets which respond to the emotions of fear and greed do not change the value of the businesses we own. In the long term, it is always underlying business fundamentals that inevitably drive share prices – real dominance of industries, real innovation and real earnings – not mob psychology.

At Commodari Antinori Group, it remains business as usual through this turbulence. Our task as stewards of your capital remains first and foremost to conserve what you have worked hard to accumulate over the years and to grow it at a reasonable rate over time.

We do this by identifying and investing in quality businesses whose value we deem will grow at satisfactory rates over time. Then we simply stick with them. It never has, nor will it ever be, wise to throw one's lot in with the masses and allow investor sentiment to dictate our actions or change our course – especially when the approach being used is sound.

On that note, we never read anything into Mr. Market's behavior and are confident that our conservative approach will continue to yield satisfactory results in the years to come.

We extend to each of you good cheer and our wishes for a very healthy and happy new year! Once again, thank you for the confidence you have placed in us.

M. Antinori

Mario Antinori
Associate Portfolio Manager
Tel.: 514.286.7311
mario.antinori@nbpcd.com

A. Commodari

Alessandro Commodari
Associate Portfolio Manager
Tel.: 514.286.7254
alessandro.commodari@nbpcd.com

January 18, 2016

BMO Wealth Management
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 wealth management 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."