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COMMODARI ANTINORI GROUP / BMO NESBITT BURNS

INVESTMENT COMMENTARY: WINTER 2020

"Time discovers truth."

– Seneca

Investors will remember 2019 with fondness. Notwithstanding escalating trade tiffs, slowing global economic growth, stagnating corporate profits and riling political cleavages such as Brexit, global equity markets surged ahead last year. Remarkably, ***every*** G-20 nation's equity benchmark index finished the year higher.[1] Many notched record highs.

For the year-ended December 31, 2019, the total return for the S&P/TSX Composite Index was 22.88% while abroad, the S&P 500 and MSCI World Index gained 25.18% and 22.25% respectively in Canadian dollars.

Bonds too registered above-average returns. Indeed, asset classes across the investment spectrum enjoyed robust gains in 2019. We shall pass on that Austin Healy roadster as well as that Paul Gauguin watercolor, thank you!

These asset class returns were primarily the outcome of global central banks' accommodative monetary policy – little else mattered to investors except central bankers keeping their foot on the monetary policy accelerator. Stock markets around the world responded with significant expansions in price-earnings (P/E) multiples. For example, in the United States, the P/E multiple on the S&P 500 Index on a prospective, or forward, basis went from 14x to 18x [2].

Time will pronounce its verdict on whether P/E multiples can continue to inflate. We suspect that many investors joining the easy money festivities will discover an expensive, hard ***truth***: valuation matters. At Commodari Antinori Group, we subscribe to the time-tested truth that the price paid determines the success or failure of an investment operation.

BEWARE THE PURPLE DYE PACKS

Portfolios managed by Commodari Antinori Group performed well in 2019, with equity mandates delivering double-digit returns. That said, we recognize that we did not take all the loot that was available for the taking this year and so, even though we surpassed our respective performance hurdles on an absolute basis, we nonetheless felt frustrated knowing that markets did better on a relative one.

Investment management is a tough arena. Everyone wants to maximize gains (pleasure) while minimizing losses (pain). That said, the Holy Grail of investing lies in figuring out how to best achieve this blissful state without having to sacrifice one element at the expense of the other.

For us, the first step to investment Nirvana lies in clearly articulating one's investment objectives and selecting an approach to safely get you where you want to go. The other step is accepting that if results do not vary from the index – sometimes remarkably so – you cannot possibly beat it over time. Assuming, of course, that is your objective.

When it seems that everyone around you, regardless of aptitude, is minting money on the stock market, one must remember that *any* market will gain respectability if it goes up high enough – and any market will lose respectability if it goes down enough. To achieve outsized returns over time, the hardest part is psychological strength - sticking with a solid, proven approach through thick and thin, euphoria and dysphoria.

Herein lays the challenge. After all, human nature is such that we are drawn to crowd consensuses because, instinctively, it offers comfort and safety in numbers. Sadly, we suspect that this late in the business cycle, safety is but a mirage and the remaining loot to be had is probably not worth the risk. Indeed, history has demonstrated time and time again that crowds do sometimes get it wrong.

Our focus remains squarely focused on avoiding huge declines. This objective is elusive for many investors because, in a "beat the clock" effort driven by crowd psychology, they cannot help reaching for as many loot bags as they can. Unlike a game show where the clock is front and center and clearly visible, there is no clock on the investment wall. When everyone realizes - *after the fact* - that the clock ran out, it is too late. We believe that avoiding the temptation today to reach for those seemingly overstuffed loot bags will provide portfolios with welcomed protection tomorrow!

THE GOOD, THE BAD & THE UGLY

Without a doubt, the question on everyone's mind is how long can the market continue to march forward unabated? Can the good times persist? Let us get one thing clear from the onset; although the probabilities are against it, anything is possible. We discovered long ago that trying to forecast future returns is near to impossible, but at best it's hard to imagine another year as good as this past one.

In a rising market where everyone wins, there has been a continued trend toward passive investment vehicles. And rightfully so, as indexing is, fundamentally, a good idea … right? We plead the Fifth on this one and remind readers that Ben Graham, Warren Buffett's mentor, once famously said, "*it's not the bad ideas that do you in, it's the good ideas.*"

Think about it, if something is a bad idea, it is hard to overdo because you recognize it as a bad idea and so it is unlikely to cause much investment trouble. But when there is a good idea with a core of essential and important truth, you cannot ignore it. After all, it is a good idea with important truth causing big effects. Graham argued that in such an instance it is easy to overdo and so, good ideas are a wonderful way to suffer terribly if overdone.

With less than one percent of the S&P 500's constituents now accounting for a whopping 18% of its market value, we suggest that this idea may have run its course and point to the fact that never before have just five companies (Apple, Microsoft, Alphabet, Amazon, and Facebook) held such a powerful sway over the index.

As money continues to flow to U.S. stocks primarily through index funds, the problem is likely to get exacerbated as 18 cents of every dollar invested will go to buy additional shares in the *Fab 5*. This means that investors will be increasingly beholden to the fortunes of five companies who, keep in mind, would carry just as much weight on the way down as they did on the way up.

While our client portfolios would not be immune to the negative effect of a recession, the relative quality and value of our holdings should make the ride much more bearable.

BUILT TO LAST

The stock market is a complex system where, in the short term, there are few if any interdependencies between decisions and outcomes. In other words, in the short-run, stock prices are driven by thousands

of random variables as market participants with different risk tolerances, emotional aptitudes, and time horizons - ranging from milliseconds to years – make their way in and out of stocks.

Today, it seems like the market is overly focused on external factors that are very difficult to predict. What is President Trump or the Federal Reserve going to do next? What will happen in Europe now that Brexit is done? Rather than focusing on these external factors, experience has taught us that sticking to our knitting will pay off handsomely in the end

As always, predicting where a stock price will be in a day, a month or even a year from now is not much different from prognosticating whether the ball on a roulette wheel will land on red or black. Given enough time however the soundness - or folly - of an investment approach become apparent, as the fundamentals of an investment always converge with its true value over time On that note, client portfolios are built to last and, like soccer great Ronaldo, positioned where the ball will eventually be.

PORTFOLIO DEVELOPMENTS

We have always built client portfolios on the simple idea that if you want a different result from the average investor, you should focus on your best ideas and create a portfolio that looks very different from the market averages. On that note, we own a collection of 25 outstanding businesses whose aggregate quality, growth prospects and valuation make them a much more appealing investment than say a diluted portfolio of 200. More importantly, we believe the earnings of our companies are more resilient to the vagaries of the economic cycle than most major indices.

Our job as portfolio managers is to combine painstaking research and thoughtful, disciplined judgment in order to steadily improve our holdings over time. On that note, we made a number of purchases during the year that should enhance the underlying earnings stream, quality, and growth rate of client portfolios without increasing the aggregate valuation relative to earnings. Of course, time will tell if we are right as the business results of our companies will eventually shine through in their stock prices and any divergence will accrue to performance.

The table below shows the stock price performance of our fifteen largest holdings at the end of 2019:

Source: BMO Retail Information Systems **Holdings**	**% of Equity 31-Dec-18**	**Price Change [3]**	**% of Equity 31-Dec-19**
Carmax	4.0%	33.1%	5.3%
Facebook	-	49.1%	4.6%
Alphabet Cl. C	-	22.9%	4.6%
Berkshire Hathaway	4.3%	5.6%	4.5%
Rolls Royce Holdings Plc	5.4%	-18.5%	4.5%
Mohawk Inc.	-	11.0%	4.4%
Great-West Lifeco	4.8%	18.0%	4.3%
Wells Fargo	3.8%	11.1%	4.3%
Toronto-Dominion Bank	4.0%	7.3%	4.2%
Jacobs Engineering Group	3.6%	46.3%	4.2%
Booking Holdings	3.7%	13.5%	4.1%
Saputo	4.8%	2.6%	3.9%
Ritchie Bros Auctioneers	3.8%	24.8%	3.7%
Nutrien	4.2%	-3.0%	3.4%
Diageo Plc	3.6%	13.1%	3.3%
	49.71%		63.09%

Many of the positions that we sold or reduced last year trade for more than twenty times their expected earnings but are not capable of growing much faster than the economy in the absence of acquisitions. By contrast, recent purchases like Alphabet, Facebook and Booking Holdings trade for similar multiples but grow organically at much faster rates than the average business. Others, like Mohawk or Rolls Royce, grow more modestly but trade for roughly half the valuation.

While Alphabet, Booking Holdings, Facebook, Mohawk and Rolls Royce are very different businesses, rest assured they have a crucial attribute in common: each have a vast and sustainable competitive advantage. Also, each were purchased at what we believe to be a discount to their intrinsic value.

CONCLUDING THOUGHTS

It rarely gets easier; we are tasked with investing in an ever-present environment of uncertainty. As we look forward, we remain convinced that a portfolio of genuinely wealth-creating businesses remains a prudent approach for investors looking to protect and compound capital over long periods of time.

Regardless of what may happen in 2020 or 2021, our belief is that the collection of businesses we currently own will have the strength to deal with any uncertain economic climate as they generate impressive free cash flows and this will be the catalyst that drives value creation going forward.

As always, we thank you for your patience and continued support. You make possible our success.

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"The Commodari Antinori Group of BMO Nesbitt Burns offers a boutique private client wealth management experience. We work exclusively with high-net-worth individuals and their families and build for them unique portfolios — no pooled funds or other proprietary products."

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[1] *Business Insider, 2019.12.10*
[2] *Bloomberg Markets*
[3] *Based on the closing market price the last business day of 2018 & 2019 and reported in Canadian dollars*