The Miatello Quarterly

Let's connect

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The Dominant Factor

The single most important factor that affected Canadian investors in recent months has been the ascent of the Canadian dollar against the US currency. From a low of 72.7 cents on May 4th, the dollar closed September 30th at 80.4 cents. If you held a US asset, your loss from the currency move was over 9 per cent. The Canadian dollar was not alone. Measured against a basket of world currencies, the US dollar dropped 5.8 per cent over the same time.

Rapid foreign exchange adjustments are somewhat jarring to investors. However, in the longer term, for holders of equities, they are meaningless. What is the proof? The asset manager, Tweedy Browne, has run international funds for decades. In one case they have two versions of the same fund. For one fund there is complete hedging of the currency. In the other fund there is no hedging.

There is virtually no difference in performance.

If you own equities you should have a longer term time horizon. This horizon applies to the currency exposure as well as to the underlying equity risk.

An Idiosyncratic Market

For years stock pickers, a.k.a. active fund managers, have had difficulty exceeding their benchmarks. It has been widely thought by leading lights that this was because there was just no way to prevail given fees and transaction costs. Well yes, that was true in the market conditions that have prevailed. In particular, the underlying condition was that stocks were highly correlated. They all went up together or they all went down together.

The condition was described in the media as "risk-on, risk-off." As a side note, the rush to soporific exchange traded funds can be largely attributed to this condition.

Things have changed. Correlations have crashed to their lowest level since 2007. Recently the correlation of the US equity benchmark's constituents is about 18 per cent which is down from 60 per cent a year ago. The result is utopia for active managers.

In The Spotlight

Affiliated Managers Group (AMG)

AMG is an aggregator of money managers. It holds stakes in 39 managers worldwide with total assets of US$772 billion. AMG is the buyer of choice for many independent investment management firms, providing liquidity for retiring partners yet still providing incentive for the remaining managers to grow the business. AMG's strategy is to acquire firms that provide investment possibilities in areas attractive to sophisticated clients for the alpha portions of their investment portfolios. By this strategy AMG sidesteps the trend toward beta market exposure through exchange traded funds. The investee managers are a diverse group with styles including deep value, quant, GARP, emerging market, credit-oriented, activist, and private equity. Alternative managers comprise 38% of total assets under management. AMG's investee firms are mainly institutional money managers. In Canada, AMG owns stakes in Beutel Goodman, Foyston Gordon Payne, and Montrusco Bolton.

With a history of over 20 years, the firm has developed a smooth organic growth methodology. As well, it has a target investment universe of 1,500 investment management firms globally including a select subset of 150 core prospects. AMG buys a majority interest in boutique asset managers, receiving a fixed percentage of revenue from these firms in return. The affiliates operate independently, with AMG providing strategic, operational, and technology support, as well as access to its global distribution platform.

We have recently initiated and hold a position in AMG.

What Would Brian Do?

Dear Brian:

Some years ago I informed my advisor that I wanted a certain amount of income from my investment portfolio. He constructed a portfolio with high yielding common and preferred stocks. The preferred shares have not done well and are in substantial negative territory. The common stocks were mainly financials, telecoms, and initially high yielding energy plays. The energy stocks have been very volatile and are now quite a bit below cost. Needless to say this is not exactly what I had in mind when I started. What should I do now?

Best regards,

Dave

Dear Dave:

Your situation is not unique. However, the fault is not yours. A strategy that focuses entirely on dividends contains risks that are not initially apparent. Preferred shares occupy a very complicated space that requires keen attention. Every issue has its own unique features. High yielding common stocks tend to be in certain sectors that have their specific risk factors.

For the common stocks, you have to realize that you are not buying an inert dividend stream, but you are buying the company. The fact that the firm pays a dividend is interesting, but should not be a determining factor when an investment decision is made. The question should be - is the firm a good business managed by superior managers? One of the most important questions is whether they are wise allocators of capital. There is obviously a lot more behind this advice, but it is beyond the scope for this letter.

My advice to you would be to find someone who understands this concept and let him or her reorient your portfolio.

Sources: Financial Times, Morningstar, Affiliated Managers Group

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