ALL GOOD THINGS

Building Wealth For My Clients

ADAM HENNICK

HENNICK
WEALTH MANAGEMENT
YOUR FUTURE IS WORTH MORE

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ACKNOWLEDGEMENTS AND DEDICATION

This book is a culmination of the epiphanies that usually struck me around four in the morning over a number of years. While I often spoke about my desire to write a book about financial advisory, I was never sure how it would take form. I began reading back on my previous monthly newsletters to clients called *A View From Here* that are archived on my website and realized that these notes documented the life of an investment account as seen through the advisor's eyes. Many thoughts and expectations spoke of in one month revealed its conclusion a year or so later, even though none of us knew what the future held. As a result this project took a different form than intended, but I am so thankful about the result.

I'd like to thank my editor and publisher, Bruce Batchelor, who straightened out awkward phrasing and helped clarify my thoughts. I knew early that he was the right person to work on the project when he suggested that I entitle it *All Good Things* as that is a sincere wish I use to sign off most memos and emails.

Unfortunately my parents are no longer around to receive the following mention: they provided loving support in bringing up four

strong-minded individuals who have been successful in their own lives, not just in business but more specifically, bringing up families of their own. My siblings and I have never lost sight of our past and often comment to each other how loving our home was.

There have been a number of mentors and co-workers, band buddies and teammates who have provided an objective view of our triumphs and tribulations that I have used to draw on in my professional life. I'd like to acknowledge close friends who have been part of my life for so many years. It is so nice when someone from my past reaches out like it's 1990 (or 1980, for that matter) and we can pick up where we left off despite the years that separate contact.

Then there are the masters – Howard Marks, Joel Greenblatt, Michael Steinhardt and Bernie Brillstein – who have spoken or written the holiest of treatises on investing and business. I cannot understate the importance of finding unique individuals who have a track record of success and are willing to provide their thoughts, anecdotes and methodology. I could not think anyone seeking a career or having an interest in investing that would not benefit from digesting these inspired offerings.

I would be remiss without mentioning the importance of music in my life and by extension how much I still love the Grateful Dead. But mostly, I think of every investment as another great song and/or a great album. I remember after a short time working in the financial services industry realizing that there was a unique parallel between creating art and a successful practice that has never ceased.

There have been a number of associates and assistants that I have worked with over the past 27 years, some of which I am still in contact with. I have been lucky that during my tenure they have all treated our clients with the respect they deserved. However, I do not believe that our success could be accomplished without the help of my longest standing assistant who entered into my practice after years of friendship, Afsaneh Shaygan. I don't think I could keep the careful

conviction in my approach without her worldly and even-handed view. She is one of the most beautiful and generous people I have ever met.

It has been a special treat to watch my children develop into their own unique personalities and strength of character. I don't remember having the same resolve when I was a teenager, but then again, we go through these roles but once in our life and now we are seeing it from another side. Thanks for making the phrase – 'the more things change, the more they stay the same' – so true both in life and investing. While none of us truly know what we are doing bringing up children, there is a similarity to investing as it requires faith and an objective perspective especially during the drama. I think I'll miss these busy days of their individual programs despite the pure insanity of logistics.

Lastly, I would like to acknowledge my wife Alison who has put up with trials and tribulations of my business, my desire to achieve great things for our clients, and my many activities such as playing music and sports. As low key from most of my investing thoughts as she is, she provides the base to let me explore these things confidently and unencumbered. Our relationship remains a love-based partnership that affords us the freedom to achieve our own personal goals. I will love you forever.

This book is dedicated to my family, and in particular – my wife Alison, and our three amazing kids: Rachel, Jeremy and Sarah. May you pursue a life filled with *'All Good Things.'*

Thanks for taking the time to read some or all of this publication. And, as always…

All Good Things,

— *Adam*

All Good Things

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All Good Things

For over 20 years, I have been writing a monthly newsletter called *A View from Here* with a goal of keeping clients abreast of the stock markets, our investments and thoughts that pertained to the economy and our finances. The newsletter has evolved over my career and I've been told that many enjoy reading it. Examined over a span of years, *A View from Here* clearly reveals and proves the otherwise difficult to believe success my clients' portfolios have achieved.

About 7 years ago, I went through a transition period in my professional life and began to document in a journal that evolution of my thinking on financial advisory. This book, *All Good Things*, combines my philosophy and methodology of investing (from the journal) with the success we have achieved for clients as told through those monthly letters. I have organized the newsletter reprints around annual summaries.

Before starting the methodology section and the monthly/annual notes, it is appropriate that I reveal my background – how I got into financial advisory as a career, and what I learned through various positions before setting up my own Hennick Wealth Management. So expect three sections: my background; our investment philosophy and methodology; and the proof in monthly and annual notes.

One of the driving factors to writing this book has been how difficult it has been to explain to individuals the success of Hennick Wealth Management and the impact it has had on our clients. Extended family members, parents from my children's sports teams and acquaintances have told me about their skeptical view of their advisors. More often than not, most point to a lack of understanding of why they are not achieving satisfactory performance, while commenting on the lack of transparency. Moreover, most are confused as to exactly how they are doing, as performance numbers are rarely offered or are presented in a confusing manner.

I am happy to talk about what and how well Hennick Wealth Management does… not from the perspective of gaining clients, but rather to sincerely help them understand what is actually going on and what to look for. It pains me that their investments are doing so poorly – needlessly. Actually, very few of these random conversations ever turn into clients. My 'book' (within the financial business, one's clientele is called a 'book') has grown exclusively from referrals so I'm well aware that when I give my view in a brief conversation in the stands of an ice skating arena or in a grocery store aisle, it is unlikely that there will be a follow-up email or a phone call. I believe this occurs because I tell them a very real truth that is hard to believe. When people ask me about our performance and I give them a double-digit answer, there was a certain uneasiness that suddenly ensues. It is almost as if I've suddenly 'gone to the dark side' and they don't want to have any further discussion. They look the other way, as if to say, 'Oh, so you're full of it as well.' I wonder if it is a blow to their belief system that long ago gave up on the notion of even a reasonable return.

Because of this reaction of disbelief, I usually avoid talking about our performance. Frankly, a great motivation to write this publication was borne out my frustration with those dreaded conversations. Maybe, just maybe, I am now thinking, if people can read what is possible in a book, digesting at their own pace the true potential, and weighing our years of monthly evidence, they will be able to change their approach to investing and see their investments grow toward a significantly better future.

And, for my existing clients, this book is a gift from me – a souvenir celebrating the decision about where to entrust your investments, and a further demonstration of Hennick Wealth Management's commitment to transparency.

I wish every person reading this will share in experiencing *'All Good Things'* in their life.

— Adam Hennick

My Journey
Into the Investment Industry

My entry into the securities industry began with a newspaper clipping taped onto our refrigerator showing a group of men associated with the Initial Public Offering of MDC Corporation. My older brother Jay was among that group along with an individual named Frank Holmes who looked so familiar. I asked my brother if he had grown up in our neighborhood but was told that he was from a different part of Toronto and was a very successful stockbroker. Impressed, I dismissed it as a coincidence. But every time I looked at that picture I felt a connection to him.

This was December 1987 and our university class had begun to split into those who would earn a BA, and those who would go on to graduate school. The line between the potential have's and have-not's was starting to form. I was at the end of my BA with few prospects, thinking that it was probably best to extend my education for another three years by earning a Bachelor of Commerce or an MBA. After that I had no idea where this would lead me as I had just turned 22.

What I did believe at the time is that I would eventually work 'downtown' and that I had a knack for making a premium amount of money from my experiences in part-time and summer jobs. This premium wasn't from all of those jobs mind you; working for Daiters Cheese & Creamery store and Sam the Record Man was not producing a stellar wage, but a lot was learned from those experiences. Sam's in particular had forward-thinking management who had given incentives to perform and paid us bonuses when the store achieved its goals. This incentive was extended to part-timers such as myself and was very impactful to me. It made perfect sense that a person should earn his or her share of profits.

I had an on and off flea market business with a friend at the Stouffville Flea Market (about 30 miles north of Toronto) where we would make good money as fledgling entrepreneurs. It was all cash and some days we could earn between $200 and $500 each after expenses. It was during a visit to our booth by my parents and grandmother that my father first suggested I should be a stockbroker.

I had absolutely no interest in the stock market and knew only three things about it. One, it seemed people in the business had a mystique about them, as if they were 'in the know' about pending business deals; two, a modest investment could turn into a castle in the Spain; and three, when everybody thought alike, they were likely to be wrong. It also seemed incredibly dull: buying and selling and then coming home at the end of the day with the difference in your pocket.

Yet destiny continued its calling when a girlfriend told me that she went to see a psychic and was told I would become a stockbroker. So here were two people (her and my dad; actually three if you include the psychic) who declared my future profession yet I hadn't the slightest interest in it. I was all about music and its artistic pursuit although

I could hardly play an instrument. Your money for nothing and your chicks for free – who didn't want to be a rock star?

With school just about wound down and the next chapter around the corner, I needed to earn enough so that by June I could take off for a planned backpacking trip to Europe. I had an opportunity to work as a representative for MCA records that attracted me because of my love of music. I would be promoting their artists to record stores. I actually loved that idea. However, that was not to be, as the picture of Frank Holmes on my fridge was calling me and my brother and father advised that a job at a brokerage house would be more practical. I remember my father reasoning that music was a hobby and to enjoy it as such. My brother told me he would reach out to his contacts to determine any interest. He came back with instructions to call Frank Holmes.

The call went exactly like this: "Hello Frank; my name is Adam Hennick. My brother Jay asked me to call in regard to a potential job at your company."

His response, still etched into my brain: "Great, are you going to be another one of those guys we hire who puts his feet on the desk and waits for the phone to ring?"

Even though I had no idea what he was saying, I knew he was being facetious, so I laughed and said, "Yes, I am!"

He said, "Great. Come into our offices and meet with me tomorrow morning at 9 am."

I didn't really have much in the way of suitable clothing so I pulled some socks and a tie from my father's collection and hopped into my 1984 Mazda GLC, put on a cassette tape of World Party's *Private Revolutions* and drove down University Avenue to the skyscraper at number 55 housing Merit Investment Corporation. When I approached the security desk to inquire which floor the company was on, the guard impressively stated, "The tenth floor!" – giving me the immediate impression that I was going into a place of great privilege.

Exiting the elevator, I was greeted by a friendly receptionist who alerted Frank's office. I waited, noticing people busily making their way through the reception area. Everyone looked so full of purpose.

Finally, Carolyn Archer who was Frank's assistant, a tall, beautiful, red-headed career girl dressed impeccably, came out to greet me. As she escorted me through the bullpen full of people on telephones, I saw that some were huddled in conversation and everyone seemed to look busy. We passed a large glass-enclosed trading room to the very impressive offices of Frank and his partner Barry Kasman. Together, they were the key executives who ran the firm and had their offices opposite to each other between workstations that contained six people dedicated specifically to their practice.

I was ushered into Frank's office – he greeted me enthusiastically while talking on the phone. Frank was always on the phone. Between calls, he asked me a series of obvious questions like about school, and what I had studied but hardly seemed interested in any of my answers. During that brief encounter, he would pick up the phone either on an incoming or outgoing call or was just a million miles away in thought.

By all appearances Frank was the poster child of the 1980s yuppie. He was maybe 30 years old, big glasses, successful, confident and the antithesis of his partner, the 60-something-year-old Barry Kasman who was the heart and soul of the firm. After a short time in his office, Frank asked me to walk around the firm by myself for a while to see if I liked it. I did that for what seemed like an hour, every once in a while peaking through the doorway to see if he was still on the phone.

Finally, on what seemed like my 50th lap around the office, I looked into the crack of Frank's door, saw that he was off the phone and quickly told him that I liked what I saw.

He said, "Great. Put your coat in the closet down the hall and get me a coffee. I like it black with one sugar."

And that is how I was hired.

After locating the coffee area, and bringing Frank his request (which I would spend the better part of a year doing), he suggested that it was time to meet his partner Barry Kasman. I had no idea what I was in for.

Barry Kasman is impossible to adequately describe in a short paragraph. He was a sort of cartoon character in a real world of people. Standing at least six-foot-four, he wore made-to-measure blue suits with big collared white shirts, a vest with cigarette ashes on it, cufflinks the size of Gibraltar, his BHK initials on the sleeves, a goatee and perhaps the worst toupee this side of the Atlantic. He sat at his large desk in a massive oak-walled office with expensive and oversized artifacts he bought on some whim, from the ornate letter opener to the $1,000 pen. By all accounts, he looked rich. I mean RICH and he always had an entourage of people who sat with him during the day looking for money to drop out of his pockets.

Barry was a larger-than-life personality. Meeting him one would be able to determine in less than thirty seconds that he was prone to powerful emotive outbursts. He was one of the last of a dying breed of Bay Street's finest questionable characters, running a quasi-legitimate national investment firm. I wouldn't have known the degree of legitimacy at the time, but I was convinced I'd just come in contact with one of the wealthiest people in the country.

While under most circumstances I would have feared the man, fate had interrupted our meeting through a glance over to a mantle containing a picture of him with his only daughter. It turns out I had dated her. I had never met her father when we dated and had little knowledge other than the fact that he had a chauffeur. In fact we really didn't hook up for very long, and it didn't end well. But wouldn't it be my luck that I would get a job has her father's personal gopher? Some people view the world as a tragedy while others see it as a comedy. After that moment, I could never take Barry Kasman seriously, and my life at Merit

Investment would take on a series of events that would ultimately take me to better horizons. However I would learn so much, laugh so hard and make some lifelong friends there.

Barry immediately told me that I looked like someone who would take over the firm when he retires. He apparently said that to a lot of people, but it did have the desired effect on me, giving me a lot of confidence that day as I went downstairs to meet with Jack Douglas (who also had a bad toupee with nicotine stains on the fake part in the rug) and his assistant Joan Brighten. Both were wonderful people. Joan immediately enrolled me in the Canadian Securities Course and Jack treated me like somebody he cared for. After getting signed up as an employee earning $12,500 a year, with no job description, I called my parents and my brother to thank him for the referral and tell them about the boss's daughter. My luck … we all laughed. The problem was I didn't know what I was supposed to do there!

The balance of my first day was spent with two other gophers and Frank's assistant Carolyn introducing me to people in the firm. That was, of course, when I wasn't getting lunch, coffee or moving chairs from one place to another. I also ran into a friend from university who had recently become a stockbroker there. A year later, he left the industry, teaching me my first lesson in sticking things out. I believe that to have some success in this business, it takes at least three years before you get some real traction.

Meeting people that day was a surreal adventure in itself and after several coffee runs, cigarette requests and generally sitting and waiting to do something, I was sent home for the day. Yet I remember thinking that I had been given a license not to fail and have never disbelieved that thought.

That night, I went to our local movie theatre with my parents and saw the film *Wall Street*, which had just been released a month back. I walked out inspired and ready to take on the world of high finance. It was January 1988, and I had just turned 22 the previous November.

Gaining Inspiration and Positive Energy from Important Mentors

I believe that in order to be successful, you must draw energy from a successful person whose positive energy will inspire you. When I started as an advisor I went from investment idea to investment idea based on bad information. Although it took the better part of a decade before I started to really make money for clients, my practice grew because of the influence from successful mentors. My first mentor was Frank Holmes, and despite how successful he was and how he cared for me, he didn't really work in the world that I understood. Also, he left to take over a mutual fund in Arizona shortly into my career.

My second mentor was George Hagopian for whom I acted as his personal assistant for six months in late 1988 until May 1989. This was the wrong mix for me as I was basically a runner between his office and the trading desk, putting in orders for futures and commodities contracts for his clients. These people were basically gamblers and seemed to have nothing else to do but waste their own and George's time losing money trading on instincts in the futures and option commodity markets. No work went into this form of 'investing'. I remember one of them leaning over my screen and mumbling as he convinced himself that "the banks are gong to support the Canadian dollar" and instructed George to buy him some contracts. It usually went poorly, and while George was a good man, he was under a lot of pressure from those who hung out in his office. What I took from this time was: if this was what is going to be like to be a stockbroker, I won't be able to do it. George and I would not see eye-to-eye and a few battles ensued between us.

I got lucky when an opening appeared in the office next door. In there I found partners Bill Wong and Leon Kieselstein. This became my third mentoring, and one of the more profound. Bill and Leon took me under their wing and showed me a different world of investment ideas – from a potential takeover of Hershey to trading ideas built mostly on information from 'sources'. Needless to say, many of them didn't work out, but some of them did. As the years went on, Bill and Leon eventually broke up their partnership. I am truly thankful for the attention they gave me and still feel a deep connection to them. The allegiance with Bill runs deep enough that if he called me today and asked me to help him do something, I couldn't move fast enough. That team and their assistant Gwen were just that good to me.

In late 1989, the firm put me into the bullpen to sink or swim on my own. In terms of learning, this was a fruitful period as I spent time with one group near the commodities section, and then moved across the room to another, only to find myself in a pod of four in 1991. In late 1990, I met an interesting broker named Allen Eisen who came to Merit Investment after a dispute with his old firm. I just happened to be very interested in a concept called *convertible hedging* and low and behold Al showed up and he specialized in this type of alternative investing.

Al told me that if I wanted to learn how to make these investments I would have to pay him half of what I earned from any ideas he presented to me. I took a few days to think about it and in one foul swoop I got rid of my previous partner and took Al up on his offer. My business doubled as I started to put on hedges. But there was a problem. While they were great at generating fees, hedges were not so good at making money for clients. Yet I believed in the concept, and after a year or so began to look for another firm who specialized in that type of investment.

In September of 1991, I transferred my small practice to MMI Group that focused both on wealth management and alternative investments. I stayed there for the better part of 7 years and that time shaped a lot of what I do now. Finding alternative investment strategies required a new skill set that meant doing more of your own research and having conviction in your own ideas. I became a more successful advisor and my clients benefited from the returns.

The firm operated as an open-concept office and I sat beside the firm's largest producer, Scott Leckie. This had a profound affect on my practice and my business again doubled as I drew energy from a mentor whom I could emulate. I have never forgot this experience and Scott remains a partner in many investment ideas today.

Working with Scott early on, I recall him telling me about a particular investment idea he was working on. I expressed the usual concerns loudly, all the bad ones. Market might go down, economy is weak and the company might do badly, blah… blah… blah.

The next day, he said, "You're crazy, Adam. Those concerns are always there and you'll never have perfect information. I'm going to start buying it because it's cheap."

He also once said something important to me: "You don't want to be the broker, you want to be the client." At first I thought this was absurd, but the gravity of that comment has grown over the years to be one of the most important principles of my role as an investment advisor. Act like it is my own money. Better still, actually invest my own money right beside my clients.

However, I became increasingly dissatisfied at MMI and, following an offer to purchase a small stake in the business that didn't meet my expectations, began to look for a new home in late 1996. In fact, there was so much to learn and try out there, that it was probably time to move on.

Through discussion and a lucrative offer, I decided to move my practice to Research Capital in March of 1997. A strange choice to some, Research proved to be a springboard to First Marathon Securities in 1999 (to fulfill a dream that taught me to be careful for what we wish for), only to go back again in 2001 as the dream turned to nightmare. Leaving again in 2007 for an ill-fated journey to Nesbitt Burns, brought me back to Research in September 2009. I have to say, that Research (now called Mackie Research Capital) has been the most client-centric firm that I have worked with. Few have ever heard of it – it isn't well-known to the investing public. Yet Mackie Research has its own back office and adds tremendous value to any independent thinker in Canada. However, in this world of large bank-owned brokerages, Mackie Research falls between the cracks of recognition despite being one of the largest independent firms and on strong footing.

I was always fortunate to have the full support of my family. My brother Jay in particular has been a huge influence plus he's given me access to one of the country's, if not the world's, leading entrepreneurs. Jay's counsel is just a phone call, email or glass of scotch away. Many choose to envy or even oppose other people's achievements perhaps because of their own inner issues, but I was lucky because I reasoned at a young age that Jay would go on to great prosperity. It is my firm belief that by embracing his success I've kept our relationship genuine even in times when relationships can get strained. I really like the places that we have in each other's lives and how his success extends into my world.

Even more fortunate was the steady guidance from my father who absolutely loved the stock market. He sat in his office, almost retired, and took calls from his family and friends, generously dispensing his steady-handed wisdom on any matter. Until he passed away suddenly in 2010, I spent many hours every week discussing all aspects of my personal and professional life with him.

One of the most profound things he ever told me was when envy would appear, usually about another financial advisor whom I had heard was making great strides: "Go up and down your wing, cover your man in the defensive zone, and don't worry about what anyone else is doing because you don't know the whole story."

My father and I had different views of success in the markets, however, as he was part of generation that believed that through different strategies, they could trade their way to continued profits, though most didn't. They just ground their money away. The biggest success he had was in my brother's company, called FirstService, in which he had been an early investor and only reluctantly sold shares over the years. This taught me a great deal about finding excellent investments, knowing a lot about them and holding onto them as they reached further heights. I believe his influence is so deeply rooted into me, that at times I find myself channeling him in one way or another.

Becoming a True Bay Street Warrior

Most people who enter the world of finance don't start out to be financial advisors. They either enter because they have dreams of great wealth in the industry that went awry or had careers in another business entirely. Fate stepped in at some point and they found themselves building a book of assets and advising people on their finances. Similar to insurance, the barriers of entry are quite low. There is no prerequisite degree or schooling, only the completion of a series of licenses to begin a career. However, there are two things that are essential to longevity: client assets and investment acumen. Although they are not necessarily dependent on each other, the best (not necessarily the most successful) advisors are good at both.

While the industry has evolved so much during my tenure, the most impactful development has been the entrance of large Canadian financial institutions. In the 1980s banking deregulation allowed Canadian banks to begin offering investment services to their customers. As that decade came to a close, banks were well on their way to purchasing up all the well-established brokerage houses. Wealth management was complementary to their existing business of lending and banking services so they invested huge sums into discount and full service platforms to meet the needs their customers. This change had two effects: firstly, it mowed the lawn of the less-than-scrupulous characters who offered questionable business practices; and secondly, it decreased the potential returns their customers could ever earn.

It was told to me early in my career that less than 30% of Canadians were invested in the stock market. When the banks and insurance companies entered the game that percentage changed through marketing efforts and the creation of a more streamlined approach to investment. Wealth management 'solutions' (also known as 'products') were created to give peace of mind and the impression of a low fee structure, coupled with the financial stability of the bank offering these products. It had been determined that Canadians have two fears: losing money and paying fees. Therefore products were concocted where the fee is embedded and, except for periods of extreme volatility, the value of the investment goes nowhere. In other words, the institution has created a product where they could extract a larger fee from these 'solutions' but which does little to enhance client returns beyond what would be available from Guaranteed Investment Certificates.

For an independent investment advisor like myself, this situation could be viewed as an opportunity, but clearly an uphill one. This is because most professionals are trained to procure assets and place them into products that are managed by a third party. It has been my experience that this process yields little, if any return to the client. Think of it this way. If you were put in charge of Royal Bank of Canada's wealth division, and had control of over 10% of the wealth of the country, what would you do? It's not that these are bad things, it's just that it is important to understand that financial advisory is a business. The business is to make a profit *from* clients in the most compliant way and because banks do so on such a large scale, this orientation makes it difficult to produce returns. This methodology runs in direct opposition to what the best investors do to create wealth. We all know someone who has built a successful business, and I assure you that they did not do so through an investment product created by a large corporation. They did the exact opposite. I wanted to do what the wealthiest individual investors do, with my clients' investments and my own money.

My journey through this industry began in 1988 and went through a lot of trial and error before finding proper footing in 1998. Since that time, the returns we have generated for our clients have been stellar. I believe this has occurred because I let go of the notion that I was in business to create as many fees as possible, focusing instead on adding real value to the lives of my clients. Once the need to drive fee revenue was released, my practice began to grow to much higher levels. At the big bank-owned firms, advisors are trained to bring in assets, place them into products and collect an annuity that is split with their firm. There is no better proof of this than what information is available in month-end statements or through on-line access. As an advisor I can always access client returns, but for some reason, clients cannot. This is because apathy is a key profitability factor to the financial advisor. I often tell people who are not clients but show interest in what I do that when looking for a financial advisor, there are two very important questions that they must ask:

i. Can you show me proof of an established track record of returns? and
ii. Can I speak with some of your clients who had that experience?

It is with these two questions that you can separate the wheat from the chaff. I cannot overstate the importance of finding an excellent financial advisor (even if it is yourself) as it will have a significant impact on your future financial security.

My clients are the beneficiaries of my 27 years of experience. The next section of this book will take you through the process that has taken our client's investments to levels of success that I believe few in the industry have been able to achieve.

Our Investment Philosophy & Methodology

Achieving a successful investment portfolio requires an acknowledgment that there is no perfect information, so there can be no 'perfect' investment. In fact, each consideration is the weighing of potential risks to potential reward – carried out through a good deal of research.

Prime opportunities exist in the back alleys of the stock market and are not limited to what is currently popular. For example, we all walk past the Apple Store and conclude that their business is flourishing. This is not to say that Apple has not been an excellent investment, it's just that it is so popular that one has to ask if there is something that I can ascertain that millions of others don't already know. This questioning extends to all of the largest capitalized corporations who have scores of analysts and mega-investors valuing them daily if not hourly. If it is true that 'markets are efficient' – which is to say, valued appropriately based on all the information that we collectively currently know – then by extension, it is likely that well-known companies are also *already* valued appropriately – and therefore significant gains are not likely. That's why I do not believe large-cap companies are where the best returns can be achieved.

The North and South Pole

A few years back, a lot of advisors I know were eagerly purchasing shares of Blackberry (then called Research in Motion or RIM), which had fallen from its all-time high above $140/share and was currently residing at the $90 level. To many investors, this appeared to be an ideal time to enter for its resurgence. We all knew people who had a Blackberry and despite many consumers purchasing Apple and Android phones with superior technology, the opportunity to purchase the former darling of the smart phone market was tantalizing.

RIM shares continued to trend lower and many pointed to a potential buyout, large cash position and the value of its patents as catalysts for a grand rebound. But none of this manifested into much of anything and the shares continued lower down to the $4 level and who knows what investors did with all those shares they'd purchased as prices continued to slide. It is likely that at some point they capitulated and sold to crystallize a tax loss or out of fear of something even worse, or both.

During that period, I made a point of staying away from RIM mostly due to its popularity. I also took notice of the apparent disinterest of the management whose focus seemed more on bringing in another NHL franchise to Ontario than on what was happening in the underlying business. Being distracted is always a bad sign. I cannot believe how many investors got caught and stared like deer in the headlights as the shares continued lower. This was because, on a very real fundamental level, they had no idea what they were doing. They read opinions, and the fear of selling at the low kept them engaged. The lesson is that in order to own something you really should have a handle on its value proposition. Most investors do not – because as humans, we are inherently lazy, and most do not have access to a robust research department.

If Blackberry was the South Pole, Apple was certainly the North Pole. Apple shares continue to trend higher and some analysts say it is a foregone conclusion that the company will continue to prosper well into the future. They may be right, but as a potential investor in both cases – what edge do you have?

An Epiphany

During my first 10 years in practice as a financial advisor, the largest component of my time was spent servicing clients who wanted to purchase and sell shares and options on a short-term basis. My phone would ring daily to have me research a potential 'trade'. So I would go on the news service and read off some opinion or another, hoping to get some sort of edge. Often, my client's information came from a guest on CNBC or an article they had read in a publication. The market – being efficient – instantly valued this 'news' and the clients usually paid a premium, however temporary, for the shares. If the shares managed to move higher, most would sell for a small profit and remember only what went right so that they could repeat the process. If share price went higher afterwards, they would either get annoyed for their lack of fortitude, or reason that 'you can't go broke taking a profit.'

More often the share price would 'consolidate' (drop) from its recent surge and as the hope of profit began to evaporate, the client would hold on and hope for something to bring it back to at least the price he or she paid for it. It all seemed such a great idea 5 days ago, but now they had lost more than they anticipated making in the first place. If the share price continued to decline, they usually capitulated at some point and sold the shares at a loss.

Typically this happened over and over until the client departed, looking for another advisor – or should I say, craps dealer – who had keys to the golden kingdom. Frankly, I found it difficult to deal with the emotion of an investor who in moments of frustration would point to the casino-like nature of the markets, and remark that the only winner was me – the financial advisor earning a small commission on trades. Of course nobody realized how much time they were taking out of my day… not even myself at the time. One thing was clear: they lost money because they had no real fundamental reason for acquiring the shares in the first place. Although I was making a good living servicing these clients, this impulse-based trading was absorbing a lot of my time and emotion, and most of these clients didn't have the patience for what I really thought could make us a handsome profit.

I say 'us' because I wanted to invest alongside of my clients and have us all making a handsome profit.

Well, the clients who *did* have patience consistently built wealth, albeit with less excitement than the quick flip traders. It became clear that successful investing is comparatively uneventful from point A up to point B. Steadily I began to move in the direction of what I had always believed deep in my investment soul: *Have a reason to own something and know it well so that you can make a proper reaction to changes in its valuation.*

In 1998, my wife and I bought a home, had our first of three children and my mother underwent a significant surgery. One Friday evening, we were having my parents for dinner to our new home with our first child but I couldn't get out of the office because a client who had traded a lot of his money away felt the need to tear me apart for over an hour after the market closed. In that conversation, he had explained that he had lost hundreds of thousands of dollars and that I was the only benefactor of his misfortune. That conversation was a call for change as I realized this client had not followed *any* of my passionate investment ideas because they did not satisfy his craving for an 'emotional high' of short-term profit potential. I also knew, coming home late for dinner, that these individuals were actually taking up almost all of my day and it was likely that, as they ran out of money, they would go elsewhere. Further the advancements in discount brokerage were starting to make many trade execution advisors redundant.

I made a commitment: I just would not play their game anymore. That night I laid the foundation for the transition of my practice to focus only on serving clients who valued my advice and wanted to invest in a more enlightened manner.

My mother passed away in early 2000 and the impact on me was to become even more committed to my approach. By 2001, I had let all the quick-trading clients know that my commission rates have gone much higher (effectively chasing them away) and so began the long process of gathering a large asset pool from like-minded, patient people. This realignment provided me the time to do what I loved and thought I was good at: *Finding unique opportunities and focusing on the specific investment needs of each client.* Those believers have been well rewarded for their faith.

What Few Have Been Able to Achieve

Early in my career, when I first licensed as a stockbroker (as we were called in the 1980s), it was difficult to see how I was adding any real value. In early 1990 (when I still couldn't afford to move out of my parents' house) I questioned my future. Sitting on the front porch with my father, I asked him if it would be a better idea to give it up and try to come into his jewellery manufacturing business. It seemed that everything I was buying for my clients was continuing to deteriorate. He reasoned that mid-term outlook for his business was on the decline but that the economy was just in a recession and that the markets would recover. By early 1991, he would prove to be right and the investments began to rise. But, what I had really been confronting was a common misconception that in order to be a stockbroker, I have to be comfortable knowing that most people will not achieve real success.

As such I began to look for more profitable ventures than simply reading research reports and working off of daily instinct and desire to drive quarterly revenue. It took a decade to achieve success from my methodology and it came at the cost of a lot of trial and error. As I began to establish a solid track record of success by the mid-2000s, I had a most memorable conversation one evening with an advisor who, despite a successful career, had decided to pack it in and do something else. We talked about our career paths and observations of the industry over the years. In that conversation, he said something so impactful that I will never forget, which unfortunately sums up most people's experience: "Just think about it this way, Adam. This is the only business where participants can earn enough to live in a nice house, drive great cars, send our kids to schools and camps – all the while not making clients any money." This is a very dark view – with some truth to it – about financial advisory. However I knew that it wouldn't be my path and even as he and I agreed on that common description, I was aware that Hennick Wealth Management had indeed begun to establish a track record of solid success for our clients. We are somewhat of an anomaly. This is why when I send out my monthly note (called *A View From Here*) outlining our performance, I often finish with – "that few have been able to achieve."

Winning the Loser's Game

In a conversation with an acquaintance, I mentioned that our clients have a long-term track record of success. He rolled his eyes like I was trying to sell him a rusted 1977 Ford Pinto dressed as a Rolls Royce. I've seen that look before. The one that says, "You must be full of it." And I understand why he feels that way. Most investors do not do very well in the stock market and perhaps his belief system was not ready for an epiphany that positive returns actually exist.

I have long wondered what it is going to take for the return-challenged investing masses to wake up and realize that better alternatives are out there. In Canada we are driven to the *perceived safety* of large investment dealers or local wealth managers who offer financial products based on security and an *apparent low-fee* structure. Studies have shown that these two factors (safety and low fees) are foremost on the public's mindset, so products are offered which hide or mask the fees, and create an illusion of safety through diversification. As a result, most investment accounts go nowhere, but in a subtle enough way as to not raise too much concern. Attention to actual results is avoided because the statements clients receive are onerous and people who use investment advisers tend to be busy and do not follow their portfolios that closely. The industry thrives on that apathy.

Concerns raised in email, phone conversations and meetings are deflected with comments like "the markets fluctuate", "it's for the long-term", and "would you like to meet our in-house insurance specialist?" Often, a chart depicting the upward slope of a stock index such as the TSX or the Dow Jones Industrial Average over decades is presented as proof of performance. Moreover, there is a misguided belief that stocks have outperformed every other asset class (such as bonds, real estate, artwork, etc.). Sadly, actual growth is usually absent from most portfolios – most investors *lose*. It is for this reason that Charles Ellis titled his investment classic – *Winning the Loser's Game*.

It is important to realize that financial advisory is a business of scale. A firm's goal is to have agents procure as many new clients as possible and spend their time servicing and obtaining more. Most investment professionals farm out the actual investing to a third-party. That is okay as long as the returns are acceptable. But sadly, returns are hard to find and noticeably absent on month-end statements. I often wonder if this is by design because, if people had ready access to their performance then they might think twice about their advisers.

New clients who have reached out to us are fatigued with their low return and typically come as a referral from one of our existing relationships. In almost every case, I can ascertain that they would have been better off simply purchasing GIC's or government bonds instead of the recommended equity portfolio. Some might reason that it is because the markets have been weak for years. Think again – the third party route (i.e., farming the actual investing off to another firm in exchange for fees) has always been a key element in the loser's game and if you haven't noticed, most North American stock markets are not far from their all-time highs.

So what's an individual to do? If you are adept at making good investment decisions and have access to robust research sources, you could do it yourself. If that is something that you are not prepared to tackle, find a great adviser – they are out there, and you only have to pose those two questions I provided earlier (page 13).

Pessimism is a Luxury that Few Can Afford

"The US economy remains almost comatose. The slump already ranks as the longest period of sustained weakness since the Depression. The economy is staggering under many 'structural' burdens as opposed to familiar 'cyclical' problems. The structural faults represent once-in-a-lifetime dislocations that will take years to work out. Among them: the job drought; the debt hangover; the banking collapse; the real estate depression; the health care cost explosion; and the runaway federal deficit."

Sound familiar? This quote is from *TIME* magazine, September 1992!

We have to accept that fear is a constant that exists in the world of investing. Perhaps we should get to know it and maybe even become friends with it. On the other hand, the need for goods and services is also a constant and that is what makes the economies tick. The world is a comedy or a tragedy. You choose.

Ever since I entered the securities industry in 1988, we have seemingly been on the cusp of collapse. At that time, investors were still reeling from the crash of 1987 because it was a harbinger of terrible things that ultimately didn't occur. In the subsequent years, other fears revealed themselves that had the power to knock out the worldwide economy as we know it. In 1991, it was the Gulf War – which sent oil prices rising, only to have them collapse below $20. In 1998, there was the Russian collapse, Y2K and loads of generators that hardware stores didn't take back, the technology bubble bust, 9-11, the recession which followed, and of course the 2008 collapse of Wall Street and the international credit crisis. Get used to it. Fear has been around for longer than you've been alive and will continue to be around forever, except for *brief* periods when all seems well… almost too well. The only tip-off of pending change might be the bestselling publications pontificating extreme optimism and, conversely, dire pessimism. Both selling strongly at the same time.

Not long ago I had a conversation with an old friend who was adamant in his view that there are very real, long-term problems plaguing the financial markets today. Let's now consider the quote from *TIME* magazine, which could be plugged right into today's headlines. The more things change, the more they stay the same. I pointed out that when he was born in 1965, the world was at its wits' end, reeling form very real concerns such as the Cuban missile crisis which threatened nuclear annihilation, the assassination of JFK, Vietnam and the Cold War. It all brought genuine fear to people around the world then, yet all that seems somewhat forgotten now, save for in history books.

As investors, we must understand that fear is a part of the equation and assess it properly as to how it should pertain to our wealth planning strategy. Looking back to the last major crisis – 2008, which remains fresh in the collective mind – the world didn't end as expected, and possibly ushered in a period of exceptional investment growth. Ultimately, I believe that we must be optimistic and if the glass is always half empty, investing might not be for you. In the end, I believe that pessimism is a luxury that few can afford.

The Real Secret of True Investment Returns

The real secret to true investment returns is that *growth is not as hard as you would think to achieve, but requires thorough on-going research, disciplined actions, and a great deal of common sense.* Basically you must first ascertain an excellent investment and be prepared to have the fortitude to stay with it and be willing to take action if and when necessary. There is a significant amount of reading comprehension involved before you can take action, and when you do it should be done in stages because it usually takes a reasonable amount of time for an investment to make good returns. If you are prepared to do this work and have the tenacity and patience to see it through, you can do this for yourself because it is not brain surgery.

A great place to start is one of my favourite books by Joel Greenblatt called *The Little Book that Beats the Market*. The book is tiny and was written for the author's children so that they could understand how to value investments. Mr. Greenblatt's stellar investment returns add phenomenal credibility to this publication, because many authors are better at writing books than they are at investing money. My two cents on this matter is that, the most successful outcomes from my experience started off with a great idea that came from a smart person. Smart people who have a track record of success are worth listening to in the first place, but the rest was up to us to do the work and put in the time required to make it happen. If you don't have the mindset to do the work, find a great financial advisor. Although there are thousands of advisors out there, the *really* good ones are who should be sought out.

Diversification and the Road to Nowhere

There is a great business book that was published almost 30 years ago called *The Zurich Axioms* by Max Gunther.

Gunther's book drives home some of my very deep beliefs on the subject which include:

- investing is just another word for speculating;

- diversification is like shopping for investments in a supermarket where you end up with a basket of overpriced stuff you don't need; and
- in order to be successful you must concentrate your investments to as few positions as possible.

Do you know anyone wealthy who ever said that the secret to their investment success was that they built a widely diversified grouping of stock holdings? I do not.

Another interesting axiom from this publication is that very few people ever attained real wealth just by earning a big salary. Sure, if they have been prudent, there will have been some important lifestyle investment decisions such as buying a home, making ongoing retirement savings contributions, and obtaining some real assets – all the while maintaining a premium lifestyle. But the real question is: are they going to end up with the kind of wealth that allows them to retire or look back on a successful investing history? My own experience advising clients investing for the future is that *growth from their investments* is the key to success and it is achieved over time. The good news is that time moves quickly. That is why I believe that registered investment accounts, such as Tax Free Savings (TFSA) and RRSPs, give you the proper long-term time horizon to realize this fortunate fate.

A great question to ask oneself is, what will my financial well-being look like when I'm 70 years old? A few years ago, I met with one of my elderly clients and he presented the proceeds from the sale of his home and taxi licenses. During that meeting he said, "Throughout my life, I often had opportunities to invest but chose not too. I regret those decisions now as I have very limited wealth to pass on to my two children."

It has been my experience that most investors fare badly until they take control of their investments and get out of diversified funds. I can't stress this enough. The difference between growth and going nowhere is significant, especially compounded annually over a few decades.

Guidelines to Success

Success through investment is so important to building wealth. What follows are some guidelines we have learned from our 27 years of investing.

Trading = Loser's Game: Let me get this out of the way, because in my time I have seen clients lose millions of dollars trading stocks. So much so, that a decade ago we "fired" all our clients who wanted to trade as we saw it as a liability to our own reputation. Making quick trades is why people see the stock market as a casino, with "losers" betting against the house.

Seek the Deeper Understanding: An investment is *possibility measured carefully by risk*. This requires a lot of reading comprehension. What are their closest peers valued at? What is management's motivation? Is there a catalyst for a potential re-valuation? An important by-product of deeper understanding is the ability to react properly to adverse conditions, which almost always occur. Over the years, most losses were based on not having a true grasp on the investment thesis. Knowing more gives you a real edge.

There is no perfect information: There is an information gap in every investment; otherwise it would be perfectly valued. You have to accept this in the context of its valuation because there are always potential issues that might hinder a company's performance. The larger the information gap is, the greater the difference might be between the 'true value' and the current market value.

Epiphany: The holy cow moment must not be ignored. One such moment occurred when our investment in InterTAN (Canadian RadioShack) got a shot in the arm from a catalyst investor who announced a 5% stake and demanded monetization of value. It was an important moment for the investment and due to what I perceived as its low valuation, I knew immediately that it was about to get hot.

Variant Perception: If you believe something is undervalued, then in order to invest there should be a 'variant perception' to what the consensus perception is for that investment. The key aspect to this is to have a real understanding of consensus so that when your variant perception becomes consensus, you can realize a meaningful profit.

Buying Into Apathy: Waiting out emotion is important to buying a position well. Investors take notice of a company (or industry for that matter) when it becomes newsworthy whether it is going up or down. I see this as a risky endeavour as they are competing with a lot of emotion. The best time to build an investment position is in apathy… the point where no one seems to really notice the company exists.

Build Slowly: Your first purchase should be modest… something along the lines of 10%–30% of what could be the final position. This is because you rarely have as much information as you will gather over the ensuing period. Further, the valuation will likely fluctuate, offering opportunity to purchase more. Also because your understanding may be flawed, selling the smaller position at a loss will be more tolerable.

Meaningful Stake: I believe that if you have an excellent investment, you should be prepared to play for meaningful stakes. That is at least 10% of the value of your financial account. In some cases we let it get a lot higher. At the point in which an investment gets to a meaningful stake, we have built enough confidence over the preceding period because we always start small and let the corporate signposts lead us to where we are.

Signposts: Corporate and industry announcements must be scrutinized and given some degree of thought because they are important indicators of whether your perception of an investment being undervalued is correct.

Smart People: Who better to represent a potential investment than someone with a good track record of success? You still need to do the 'work' as a lot of money has been lost following what is deemed as 'the smart money'.

Patience: Things rarely go exactly as expected so patience is required for a thesis to play out. An investment may be valued at $10 for what seems like an eternity and then, based on some catalyst, find its way to $15 in a very short period. Don't be deterred by price action as long as your thesis is intact. Jittery investors fare badly. Many investments take years to be overnight successes and remember that time moves quickly.

Agility: Investors must remain open-minded and non-emotional about decisions that must be made. If it is no longer attractive for whatever reason, you must act. While it is always harder to sell a position than buy, it will be easier if you know your investment well.

It's All about Valuation: A great business does not necessarily make a great investment. We avoid what is popular for this reason. While you might like a company's products, you have to ask yourself what edge you have over the millions of potentially smarter investors? However, when a business with a low valuation finds its way to where you have modeled it, then the most crucial part of the investment – recognition of its low value – has been achieved. Don't be fooled by a 'new paradigm', and remember that 'the more things change, the more they stay the same.' If it is no longer cheap, act.

Market Noise: Many people focus on economic or market outlook to determine what to do with a particular investment. That is just noise. Except for a few extremes such as 2007–2009, market turbulence should never be a factor in making an investment if it's attractively priced. And if you have such a market, take solace in the fact that value always bounces back and offers further opportunity. We couldn't believe how cheap things got during that period, but some found it hard to act… because of the noise.

Keep Concentrated: Any really smart investors I have ever read about tend to stay concentrated on the few positions that they really understand. Real wealth is not created through a diversified portfolio. The best investment managers know their investments well and keep them concentrated. Warren Buffett, Seth Klarman, Michael Steinhardt, Joel Greenblatt and Howard Marks are some of the greatest I've ever followed and all of them stayed concentrated.

The Hardest Decision is to Sell: Buying is easy but selling is another story. There is always a fear that if you sell, you'll be missing out on some future development that will make the investment go way higher. It is for this reason so many people can't sell at a loss. I believe that it is the most flawed investment stance. Constant revaluation of your thesis will help make the best decision. If a position has achieved what you were looking for, start selling and because one doesn't know how far it may go, we often sell in pieces. The best advice I ever heard is that you "should sell when you think you should have already sold at higher prices."

Taking Losses: For many, taking losses is a blow to the ego and it can be seen as proof of having made a mistake. We know that it is reasonable that everything is not going to work out all of the time, so take the exceptions cheerfully and as part the battle on our way to winning the war. If there is a fundamental change that requires action whether it is good or bad, it is imperative to act. Sometimes this means selling at a loss. There really doesn't need to be any emotion.

If I can recap my philosophy in one paragraph, I believe it is imperative that one finds an excellent advisor with a proven track record of success (it could be yourself if you are able to do the in-depth research); diversification adds little or no value to investors; and that great investments occur in the back alleys of the stock market and need time for the thesis to play out.

The Things We Look For in an Investment

As I stated earlier, I spend a great deal of time scouring through potential investment opportunities and try to be as open-minded as possible.

I generally screen through names using Joel Greenblatt's 'Magic Formula' that locates companies that have a large return on equity. From there, I omit the names that are in the popular investment themes, resulting in a myriad of unique companies that are usually off the grid. In Canada we are fortunate that many of these enterprises have large management ownership, and because of that there is a limited amount of free trading shares that can be owned. This results in less coverage by the financial press and/or analysts because even if it is a great investment opportunity, how is a large money manager going to be able to build a position? I see this as a real edge for us as investors.

The following are things that we look for and it is rare, but not impossible, to find all these things existing in one investment.

1. **Large Management Ownership:** Except if they have something unique going on, nothing speaks to investment purity than having your fortune aligned with the management team. If the management and/or board of directors own a large share of the business, it is less likely that stupid things occur. Our investment in Glentel is a case in point. We purchased the shares in part because the family held almost 46% of the company. That meant that all avenues of the business were viewed through the lens of their personal ownership. When they were presented with an offer to purchase the company, they negotiated to maximization value – mostly because they owned a lot of shares. This can backfire, because sometimes management might be a kleptocracy and just keeping the business where it is provides them with annual income and lifestyle expenses. These are things that have to be looked for when taking a position in a situation such as this.
2. **Large Cash and Asset Position:** I have a particular desire to find companies with large cash and/or asset positions (such as real estate) as they provide a margin of safety often overlooked by investors. For example, we have held a long-standing

investment in Leon's Furniture. Not only do the insiders own almost 70% of the company but the business has always owned the real estate on which their stores sat and often the real estate around it as well. While it's difficult to value all those buildings and property, we have come across potential values between \$5 to \$12/share, meaning that I can price-in the value of the real estate, even though it may never get realized. Leon's also had a significant cash position that allowed them the rare opportunity to purchase their much larger rival The Brick based on their financial strength.

3. **Comparison to Their Peers:** Looking at any investment requires a view of their peer group. While each company is not exactly the same, you can get a sense what a high-median and low valuation can bring to the share price if you believe that the shares are mispriced. The Softchoice example is a perfect way to look at this. I always knew that the 'blue sky' valuation of the company was 11.3x pre-tax cash flow metric and the median valuation was 6x, when Softchoice was trading at 3x and achieving success beyond the scope of its closest peer. Using this metric helped me derive potential valuations if their success was to continue. When I got numbers such as \$20, some clients would laugh… but that's the price it ended up being taken over for. Glentel was similar; when we started buying shares in the \$13.50 range and all the way down below \$11, the conversation would often revolve around the ultimate value it could fetch. It received a takeover offer based on \$26.50.
4. **The Time It Takes:** One of the real secrets to successful investing is that it requires time and patience – which is something most investors lack. The truth is that time moves quickly and it usually takes us 12 to 24 months to build our investment position to where it is meaningful. Knowing this allows us to begin taking a position as we gain more knowledge about the

investment. We have held an investment for over two years in Domtar. I watched it closely for over a year before reasoning that it was time to take a position and that, by the time we are fully committed, the valuation will be well reflected.

5. **The More Things Change…** Often opportunities can be found among what is perceived to be on the decline. We hold an investment in Domtar which is an office copy paper company that it has universally been declared in 'secular decline' which means 'never going to be the same again and will fall to a level of much lower output.' While the world (and management of the company) accepts this, what happens when the economy expands and things go to scale? Is it possible that more copy paper will be required just to sustain the increased number of people working in offices? To support that theory, we are in a fragile economy that could possibly get a whole lot better at some point. I know – it could get worse. The market has priced a great deal of that risk in – in my opinion. We have also owned regional newspapers for this reason and Canadian retailers. On the surface, that looks like three dying businesses, but our track record of success suggests that the more things change…
6. **Acting on Corporate Developments – the Signposts of an Investment:** Building positions based on corporate developments is really important; sometimes we do not make additional purchases because the signposts don't give us a clearer picture. We made a small commitment to Brick Brewing years back, and have since experienced that the company, while doing an admirable job managing their business, is growth challenged. As a result, we haven't taken an additional stake but continue to monitor the investment and are prepared to act if things change. We also bought a small initial position in Danier Leather for the same reason, but corporate developments consistently pointed to ongoing challenges that cannot seem to be

resolved, so we sold at a loss and took cold comfort knowing that we did not add to the position throughout the tenure of the investment because we didn't see a reason to do so.

What is Behind the Right Choice – The Softchoice Story

Great investments are like a blank canvas. You must envision the possibilities and challenges that can occur as you paint your journey. Each week I go through at least 5 new ideas to determine whether any one of them is worth following. Most great ideas come from pitches by smart people who can explain the opportunity in three sentences or less. It is then up to me to determine how realistic those possibilities are. When something looks to have merit, the financial data only tells one part of the story – usually its history. As important as these metrics are, there is much more that needs to be understood. Among those is the motivation of its management team, the valuation of its closest peers and a very real understanding of why the market has currently overlooked or valued the company at what appears to be a discount. This is not only quantitative research, but rather the pursuit of a deeper and broader understanding of how and why something is cheap relative to the data. I have found that having a full understanding why the market has valued a company a certain way is a very important component of why we should own it. This is because if our view is realistic, then the market will at some point revalue the investment, which should lead to a meaningful profit. This deep knowledge process is ongoing for the life of an investment and I have found that is one of the key reasons for our success.

Investment Themes and Back Alleys

In each investment case we are looking for a 'variant perception' (love that term – thanks to Michael Steinhardt) to what is currently viewed in the market for a company. This is most likely to occur in companies that operate in industries that are not part of a currently popular investment theme. For example, in recent years, we refrained from commitments that were tied to metals, resources, oil & gas or growth from China. It is not that I dislike those industries or that country, but rather felt that a popular investment theme might have baked in valuations linked to very high expectations. This made all companies in that field susceptible to sudden change if the market's perspective on that theme took a different view. This happened in spades in 2011 for those previously-mentioned investments and many have not fully recovered since.

Another great example of this popular theme bandwagon occurred with technology companies from 2000 to 2013 when their valuations dropped 10-fold. You have to envision that possibility into an investment painting you make, by asking yourself – how hot is the investment theme and how will a company fare if things were to suddenly cool down?

If we look on the periphery or in the back alleys of the stock market, you will find companies operating in an industry that is not directly tied to a popular theme and it is more likely that you can save yourself the shock of re-valuation. Our most successful investments were not popular when we initiated our positions and as such required some coaxing of clients to make an introductory commitment. For example, over the past number of years it seemed reasonable that Canadian retailers were extremely cheap – and for good reason. The economy had been weak, personal debt levels are high, online sales and foreign competitors entering the Canadian landscape presented very real challenges. However in each case, the companies were trading at historically low valuations, had large management ownership, a long history of success and strong balance sheets with significant cash and/or real estate holdings. It seemed reasonable that a higher re-valuation of these companies was possible unless they are going the way of the Dodo bird. While that is always a possibility, we at least know that management's personal wealth is on the line and that they have the cash and hard assets to come through a period of difficulty, should my underlying belief that 'the more things change, the more they stay the same' bear truth. While we have to accept that there are seismic changes in the world, such as replacing camera film with digital that can make an industry essentially redundant, big changes are likely to occur in a reasonable enough period of time to take action. And while we've had a clunker or two pursuing these investments, our success in this Canadian retailer area to date has been stellar. Hopefully there is more to come.

Investment Weighting

I believe that there are only 5 to 10 equity investments that any one manager can know well at any time. Having 30 or 40 names [investments are often called "names"] is too difficult to manage. Having a modest number of names assures that we are playing for meaningful stakes, and we have to be prepared to let one investment grow to as much as 10 to 20% of an equity portfolio. In all cases we purchase a quarter of that size of position at the onset and let the ensuing months or years dictate further action based on continued evidence that our investment is moving in the direction of our thesis.

Softchoice

A prime example of our investment philosophy and methodology was a company we began to purchase in late 2005 called Softchoice, at about $9 per share. We were introduced to the company (by a smart person) as an opportunity in the technology services area that, despite excellent growth, was very cheap. As such the board of directors (led by its largest shareholder) pursued the possibility of changing the corporate structure to what was popular in Canada at the time – an income trust. But they concluded that by taking that step, they would not create as much long-term value as expected, so they abandoned the idea and decided on what was less popular for companies of that size: paying dividends. I saw that as a major catalyst for further pursuit of this idea as it showed an even hand and a long-term vision for the company.

Softchoice had only a few publicly traded peers and in 2007 their largest one went private for a valuation that was a least double theirs and the company shares increased 80%. For the two years that we held the shares, they stayed within a 10% range of our original purchase price as earnings releases and subsequent corporate and peer information pointed us to increase our investment size. By early 2008, the company had completed three acquisitions and its share price topped $20 as its valuation approached the buyout price of its largest peer. We used this as a reason to close out half of the position and the shares continued to move at least 20% higher. When the financial crisis began to work its way into valuations, the share price fell in half, and I began to repurchase shares in the $12 range, reasoning that the company was now twice the size it had been when we first purchased the shares and now it was more reasonably priced.

I met with the CFO and a few other investment managers in September 2008 and had a sinking feeling that there might be a problem refinancing maturing debt that was coming due by year-end. You have to remember that from the fall of 2008 until mid-2009, it was difficult to refinance. But they were successful in doing so – as they should, given the amount of cash flow they created. This didn't help the share price, which had fallen to almost $1 by that time. With the refinancing now looked after, it seemed likely that the company had the ability to earn its share price over the next 12 or 24 months – an anomaly that has never occurred in my investment experience. As such I made an appointment to see the CEO in May 2009 and came away with the belief that I might have the greatest investment opportunity that I'd ever seen.

We made a significant investment in their shares and by year's end its price moved to the $8 range. It stayed within 10% of that range for the next two years, while I scratched my head following successful earnings quarter after quarter and even the re-initiation of a dividend. Throughout that period, I continued to hold on to the fact that its largest peer had fetched a takeover value of almost 4x what Softhoice was currently valued while their closest peer traded at least 2 times that number and was not performing as well on a corporate level. If the company was successful at continuing its growth, then something had to give.

By mid-2012, the share price broke through the 10% variance in its trading range and began a surge to $12. Knowing the investment so well, I reasoned that it still represented excellent value based on any metric I could find. By early 2013, the share price had moved up to the $16 range and we began to close out a third of our position on the belief that it had approached its maximum value based on its closest and only publicly traded peer. By April 2013 – the company received and accepted a takeover offer of $20/share.

The reason for this success was that we understood the investment and had the fortitude to stay with it during the process. There was a lot of doubt that crept in during this tenure, which provided a sort of check and balance to our thesis and thankfully we came out undeterred. A further note on this matter is the importance of the alliance I formed with the top analyst covering the company, and we remain good friends to this day. He provided invaluable insights during the process. It is for this reason that we need a quasi board of directors in each investment… that is to say, like-minded individual(s) to bounce things around. Softchoice had grown to a significant holding in each client account and its ultimate success changed the course of our investment and retirement accounts. It was nice to see some clients take some of their returns out and do something nice for themselves. In other words – it changed people’s lives for the better.