Q2 2018

ANTARES INVESTMENT MANAGEMENT

QUARTERLY REPORT

*For investors who care as much about the return **of** their principal as the return **on** their principal*

In April and May we attended several conferences and company meetings with some of the world's smartest investors. As usual, the highlight was Omaha where Warren Buffett and Charlie Munger regaled listeners with timely nuggets of wisdom. As one CEO put it, "Omaha is the touchstone where we get re-energized to fight the battle." We offer our annual list of the highlights:

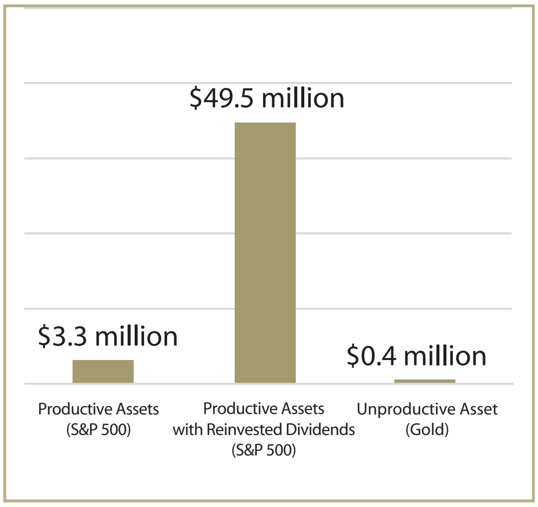
The United States is successful because its institutions outlive its Presidents: "this country works." – Warren Buffett

1) The United States remains an attractive country in which to invest: "this country works." Buffett, born in 1930, reminded attendees that during his lifetime the country has had 14 presidents of which one was assassinated and one resigned, seven were Republicans and seven Democrats. It matters little who is sitting in the Oval Office, because the country's institutions, while imperfect, support a system that has proven better than most at unleashing human potential to create wealth. Buffett is notably optimistic about the prospects for the United States, and not worried about the current Administration.

Productive assets, i.e. companies, generate substantial compound returns to the patient investor.

2) The best investments are productive assets owned for the long term. Buffett recounted the story of his first investment. In 1942 he bought some shares and sold them shortly thereafter, locking in a profit of 12%. He self-deprecatingly noted that if he had held them longer, the profit would have been 300%. The bigger story, in his mind, is that a $10,000 investment in 1942 in a broad cross-section of productive businesses as represented by the S&P 500 would have grown, by 2018, to approximately $50 million. [Figure 1] The same investment in gold, a non-productive asset, would have grown to approximately $400,000. The companies produced a return of approximately 100 times the shiny metal.

Figure 1 - Today's Value of $10,000 Invested in 1942



Source: Bloomberg and Antares calculations using quarterly data. Start date: June 30, 1942. End date: June 29, 2018.

Tesla's CEO Elon Musk made public comments that "moats are lame", arguing innovation is what matters today. We agree with Musk that innovation matters but so does cash flow, and Tesla doesn't have any. Moats matter too.

3) Gold is a non-productive asset. So is crypto-currency. Buffett: "it will come to a bad ending." Munger: "I like it less than you."

4) There was a lot of chatter on one of Buffett's cherished investment concepts, a company's sustainable economic advantage, or the "economic moat". Tesla's CEO Elon Musk said "moats are lame" during that company's quarterly conference call. Musk appears to be arguing that a company's competitive advantages are unsustainable and what matters is innovating, not defending. We agree with Musk, – and so would Buffett – that innovation is good; we would also point out that if you cannot develop barriers to thwart your competition your innovation will not retain its value.

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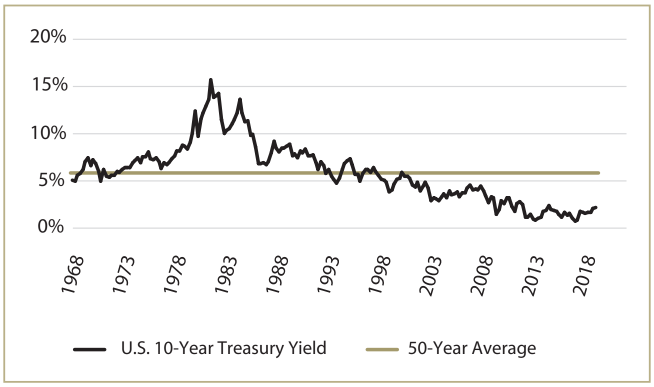
Buffett and Munger are sitting on $102 billion cash. Waiting for bargains has worked exceptionally well for them.

5) What about bonds – where are interest rates headed? This question gets asked every year and the answer is always the same: "I have no idea." Buffett added that "members of the Federal Reserve don't know." One thing we do know is that long-term bonds are a "terrible investment", which is why Berkshire Hathaway is holding $102 billion in cash and short-term investments for future deployment. Figure 2 illustrates 50 years of yield data for the U.S. benchmark 10-Year Treasury Bond: yields are near historic lows. It's worse after taxes. Buffett believes that they will revert to higher levels; if so, locking in for 10 years would indeed prove a "terrible investment." The reward is paltry; the risk is significant.

Figure 2 - Bond Yields Remain Well Below Historic Average



Source: Bloomberg.

Gentlemen prefer bonds. Buffett prefers cash.

6) On the same topic of reversion to historic averages, Buffett suggests that earnings have been growing at an unsustainably high rate of 8% since 2008. The normal historical range is 4-6%. Investors would do well avoid the temptation of thinking that what has happened over the past 10 years is likely to continue indefinitely.

7) Buffett and Munger are more patient than most. (And they are wealthier than most, too. Hmmm...) The cash they hold gives them options to buy companies when terms become more favourable. In the meantime, said Munger: "part of Berkshire's secret is when there is nothing to do, Warren is good at doing nothing."

On Amazon: what CEO Jeff Bezos has accomplished is "close to a miracle."

8) There were a significant number of attendees from China, many of whom asked variations of a question on U.S. – China relations. Buffett suggested the two countries can win together by trading, signaling disagreement with the idea of new tariffs. He noted that in 1970, exports and imports each accounted for 5% of U.S. GDP. Today, exports account for 11% and imports 14%. The overall economic pie is bigger and the country is better off in 2018 than in 1970, even if there is a trade imbalance.

9) Amazon was a topic of discussion at all of the investment forums we attended. Amazon is an innovator and a disruptor. They are transforming retail and moving into grocery, media, and pharmacy delivery. While Amazon's valuation is much too high for us – reflecting immense optimism about future growth – as investors we need to be aware of its influence on the companies we own or are researching. Of note, Buffett acknowledges that "Bezos has done something close to a miracle – the problem is if I think something is a miracle, I tend not to bet on it."

Thank you for your continued trust,

Your Portfolio Management Team

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