ANTARES INVESTMENT MANAGEMENT

VALUE PORTFOLIO

The Antares Value Portfolio focuses on companies that, in our analysis, are underpriced in the stock market relative to their underlying worth as businesses. Our strategy aims first to protect investors' capital by not overpaying for a given company - holding fixed income or cash when bargains cannot be found - and second, to grow that capital through share price appreciation as the company's value gets properly recognized within the equity market.

MANAGER COMMENTARY

The financial impact from Covid-19 may endure due to high levels of debt that have been building up over many years.

There is little doubt that the world is different now than it was a few short months ago. Covid-19 will have a lasting effect on health and safety protocols, and I believe it will have a lasting financial impact. Unfortunately, much of the financial impact is the result of years of unaddressed issues piling up. Covid-19 has simply exposed the many lurking problems beneath the surface, mostly caused by excessive debt.

The U.S. stock market is more expensive today than was the case at the high point before the 2008 financial crisis.

Economic activity has dropped dramatically. Businesses where people congregate have experienced significant declines in revenues: this applies to stores and factories, restaurants and theatres, and travel and hospitality industries that may not recover for years. The unemployment rate is at the highest level we have seen since the 1930s' depression and 743,000 households in Canada, representing 15% of all mortgages, have already asked for relief from mortgage payments. That is double the U.S. rate of deferrals. These deferred payments are scheduled to start up again in the fall. With households already straining under high debt levels and now a precarious environment for employment, banks may yet face a rising tide of defaults on loans and mortgages.

Downside risk is elevated due to high stock prices. We are being highly selective and cautious with your capital.

With all the economic uncertainty and risk to businesses worldwide, it is surprising to see stock markets at historically high levels, as illustrated in the accompanying table. In the U.S., the recent low point for stock prices was still higher than the high point just before the 2008 financial crisis. In that downturn, the ultimate low occurred in March, 2009, when the S&P 500 was down 57% from its previous high point in late 2007. Arguably, things are much worse now and there is much more uncertainty. The disconnect between business operations and stock prices has only been greater on two other occasions: in 1929 before the great crash, and in 1999 before the technology bubble burst.

S&P 500	Sept 2007	Mar 2009	Mar 2020	June 2020
Price/Earnings	16.6	13.1	17.1	21.2
Price/Sales	1.6	0.8	1.8	2.2
Price/Book Value	3.1	1.7	2.8	3.5
Price/Cash Flow	11.5	6.9	10.1	11.4

Data Source: FactSet

Today's prevailing mindset in the markets reminds us of that infamous quote from economist Irving Fisher. Only a few weeks before the October 1929 stock market crash, he wrote "*stock prices have reached what looks like a permanently high plateau.*" He never lived that one down.

I believe that, at these elevated levels within equity markets, there is little upside opportunity, but plenty of downside risk. At a time like this, it may be instructive to look at what some of the best all time investors are doing. Berkshire Hathaway (run by Warren Buffett) and Fairfax Financial (run by Canadian Prem Watsa) have similar 30-year track records. Both Buffett and Watsa have achieved outstanding results because they are willing to go against the grain by buying ownership stakes in businesses others do not want to buy.

It was interesting to note that through the recent downturn in prices, Warren Buffett was not an aggressive buyer, and in fact sold his entire stake in airlines in April. If the recent downturn didn't entice him to buy much, it is unfathomable to think he is enticed to buy at

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It is telling that Warren Buffett did not invest in the recent downturn: prices are too high.

Prem Watsa of Fairfax Financial has been buying the shares of his undervalued company using his own cash. This is a good sign for your ownership stake.

Like Buffett and Watsa, we hold cash and bonds on the sidelines to deploy when prices become more attractive. Patience is required.

even higher prices now. His company Berkshire Hathaway now has an estimated $150 billion of cash to deploy. That is the largest cash horde he has ever had, but there are plenty of other times in his career when he sat on the sidelines while others were giddily buying. He has indicated that at current prices he will buy back shares of Berkshire, as that represents the best value for money.

While Fairfax is also buying back shares, Watsa has gone one step further by purchasing over $200 million worth of Fairfax shares with his own money, citing the absurdly cheap price of the company. One additional difference is that both Berkshire and Fairfax are buying shares with existing cash, rather than by borrowing, as most other companies have done in recent years. Excessive debt is a big risk factor for many companies, but Fairfax and Berkshire are not among them. These two companies have plenty of cash they can invest with. As a result, we have added to your ownership of both; in our analysis, we have been buying a dollar of value for less than a dollar.

We have also made an initial purchase of Brookfield Asset Management. Though this is a small holding, it shares many of the attributes we value at this time: a long-term focus on cash-generating assets around the world, and conservative business practices. Like Berkshire and Fairfax, Brookfield has an abundance of cash it can put to use.

Governments around the world have indicated that they are committed to keeping interest rates low for as long as it takes to see economic growth again. We may even see negative interest rates in North America, as we have seen them in Europe and Japan. That is likely to lead to harder times for financial companies. For life insurance companies that rely heavily on the interest from their bond portfolios, the last decades of ever declining interest rates have left them in a quandary as to how to increase profits. Raising premiums on life insurance contracts can only be done so much before people forgo insurance altogether. Lower future rates will depress interest income even further, causing an even bigger profit squeeze. Because of this risk, we have sold all ownership positions in life insurance companies. As well, some longer-term government-backed bonds were purchased for your portfolio as a hedge against these risks.

It appears that stock markets have been propped up by interventions from governments and central banks. This may prove to be a temporary reprieve. Inevitably stocks must reflect the underlying economics of the business they represent. Overpaying for those businesses is not likely to lead to the best long-term outcome; both Buffett and Watsa have proven that over their decades of investing.

Patience will be needed as the coming months are likely to bring additional volatility in prices and portfolio fluctuations. We are committed to investing by adhering to the same principles as Buffett and Watsa – taking advantage of low prices to buy when the price makes sense and sitting out when prices are too high. The cushion you have in your portfolio (short-term bonds) will protect on the downside and provide the ammunition to go hunting for bargains when prices become more attractive.

Enjoy your summer and stay safe.

Gerry Bettig, CFA

VALUE PORTFOLIO

The Antares Value Portfolio is available to investors within a Separately Managed Account ("SMA") that holds securities directly, and through the Antares Value Pool ("Pool") which is held in the accounts of multiple investors. Data presented refer to the Pool. SMAs are customized and therefore their holdings and weights may diverge from those within the Pool. Sources for the data include: Bloomberg, NDEX, and Antares calculations. Unless otherwise stated, all data are as at quarter end.

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