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

Canadian Household debt has continued to rise since the financial crisis of 2008/09.

U.S. corporate debt: short-term benefit at what long-term cost?

Negative interest rates in Europe are concerning.

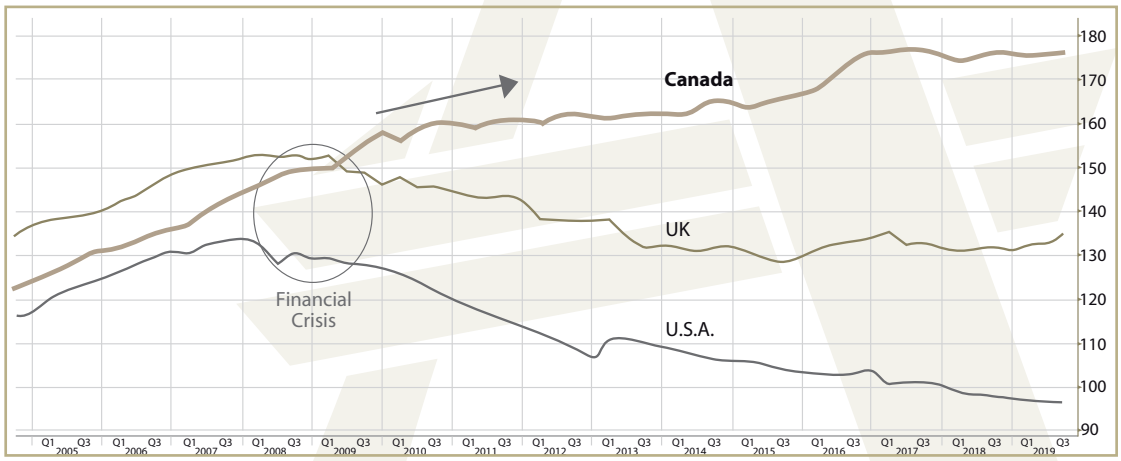
As we start a new decade, we remember the Twenty-Tens as a decade of rising debt. After the financial crisis of 2008/09, central banks pushed down interest rates through several means, making interest payments less painful for businesses and consumers. The response was not surprising; businesses and consumers loaded up on debt.

The Canadian debt situation, in particular, is considered precarious by many global economists. Household debt compared to income is significantly higher than it was in the U.S. and Britain just before the financial crisis ripped through both countries. This is illustrated in Figure 1, which shows a continued rising trend in Canada compared to a declining trend in the other two countries. The Canadian imbalance may get resolved soon. Banks in Canada have increased their loan loss provisions and insolvencies are up across the country. Could it be that the "reset" for Canadians follows the same path as citizens of other countries with large-scale consumer defaults and write-downs of debt by banks?

U.S. corporations have also taken on record amounts of debt.[1] Low interest rates make it attractive to pile on the debt because payments are cheap. Lower interest rates are supposed to be an incentive to spur companies on to finance plant and equipment purchases that will help them become more productive. The concern is that companies are not spending the money they borrow on becoming more productive, but on buying back shares. Spending money on share buybacks rather than capital investment may temporarily boost share prices, but the cost to a company may be a gradual degradation of overall business efficiency. With substantially higher debt levels and less productive capacity, many companies may find themselves in a difficult position in the future.

Low interest rates have taken an interesting form in much of Europe. A decade ago, no one would have thought that *a bank would pay you* for your mortgage with them and *you would have to pay the bank* for keeping money in your bank account. These are the real-life impacts of negative interest rates in some parts of Europe.

Figure 1 – Household Debt to Disposable Income for Canada, United Kingdom, United States



Source: Bloomberg

1. See for example "Corporate debt nears a record $10 trillion, and borrowing binge poses new risks", *Washington Post*, November 29, 2019

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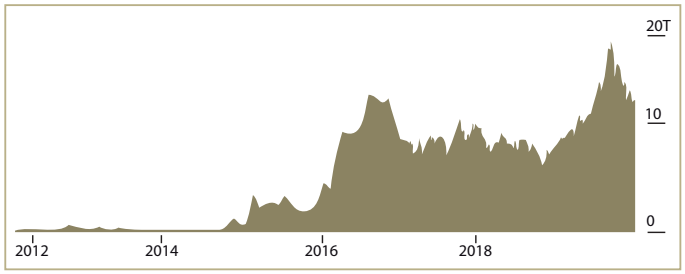
There is U.S. $11 trillion of global debt with negative interest rates.

"Predicting rain doesn't count, only building an ark does."

Client portfolios are structured conservatively.

Figure 2 – Value of Global Debt at Negative Interest Rates (U.S. Dollars)



Data: Compiled by Bloomberg

As shown in Figure 2, currently more than U.S. $11 trillion of bonds outstanding have negative rates. That is down from a record $17 trillion mid-way through 2019, but is still very high and historically unusual. The existence of negative interest rates highlights an interesting twist on lending and borrowing. Lenders need to be compensated for the risk of lending money. Normally that is in the form of interest payments. But when the lender is the one paying for the privilege of being able to lend money, it is far from normal. Negative rates indicate to us that something is wrong with the current state of affairs in the financial system.

Our approach is to take a cautionary stance that may seem at odds with a world awash in debt. Rather than getting caught up in the debt mania, we have focused on companies with clean balance sheets; those with little debt. There are companies in your portfolio that have no debt and several more that hold high levels of cash and/or short-term bonds. Managing debt prudently provides them with plenty of flexibility. Companies can use funds to reinvest in additional productive capital and pay dividends without having to worry about additional demands on their cash flow. We believe this provides them, and you, with protection from global events while still providing ample firepower to invest that money when business opportunities arise. There is an interesting phrase in investing that "no one wants cash...until one day, cash is all anyone wants". We believe that being prepared with added flexibility both in your portfolio and within the companies in your portfolio will serve you well in the coming years. Companies that have access to cash when others are choked for capital are beneficiaries when extreme financial dislocations occur.

In the 2001 annual letter to investors of Berkshire Hathaway, Warren Buffett introduced the Noah Rule of investing. Buffett explained the Noah Rule simply: "predicting rain doesn't count, only building an ark does." What Noah understood, and others missed, was that bad times were coming and only the prepared would survive. In 2020, it should strike a cautionary note for all investors that Warren Buffett – arguably the most successful investor ever – has not made a complete company purchase since 2015, despite having over $128 billion of cash at his disposal that he would very much like to deploy (at the right price). That cash horde has been growing recently at roughly $6 billion per quarter.

We believe the current holdings in your portfolio, which include conservatively financed companies such as Berkshire Hathaway and short-term bonds, will protect it from adverse global events. That is our implementation of the Noah Rule. As we know, all debt is eventually settled in one of two ways: repayment or default. We want to ensure your portfolio is not impacted if there are significant defaults around the globe by governments, businesses, or individuals.

Thank you for your trust,

Your Portfolio Management Team

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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