ANTARES INVESTMENT MANAGEMENT

QUARTERLY REPORT

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

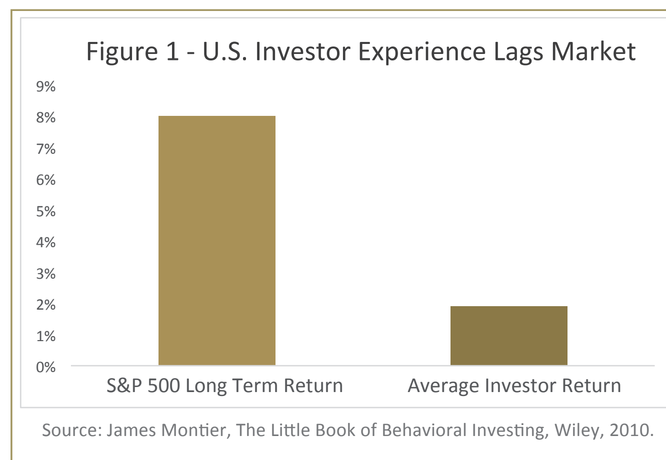
Thinking Straight, Avoiding Alligators

Investor behaviour has a significant impact on returns.

We believe that you, our clients, have a sustainable long-term advantage over the average North American investor. We recently re-read James Montier's intelligent and highly readable book, *The Little Book of Behavioral Investing*, subtitled *How Not to Be Your Own Worst Enemy* (Wiley & Sons, 2010). Montier begins with the sobering reminder that the average U.S. investor has experienced returns that are substantially lower than the stock market as a whole. We have seen studies showing the same is true for Canada. In 2010, when the book was published, the 20-year annualized return of the S&P 500 was approximately 8%, but the average investor's return was a paltry 1.9%, i.e. 6.1% per year less than the index (Figure 1). How can this be? Investment fees account for a small part of the discrepancy, but the much bigger issue, Montier concludes, is investor behaviour.

Evidence suggests humans are neurologically pre-disposed to making investment mistakes. This is true for amateurs as well as professionals.

Studies show the average investor buys a stock after it has moved up, and thus misses a big part of the advance; this is compounded by bailing out at the wrong time after losing patience. One interpretation for this "buy high, sell low" behaviour relates to the structure of the human brain and nervous system, which are wired for survival in a hostile world in which we are more often prey than predator. As we gain experience in the world, we avoid pain and seek confirming evidence before taking risks: I won't swim in that river until I am confident there are no alligators in it; I won't buy into the market in 2009 when it is cheap but rather will wait until it has climbed 100% or more off the bottom. In short, not stepping into a river that may have alligators makes perfect sense; not "stepping into the water" when equities are cheap, by contrast, will invariably produce an investment result that lags the market average. When it comes to investing, our brains can be our worst enemy.



Source: James Montier, The Little Book of Behavioral Investing, Wiley, 2010.

The investment industry's focus on short-term results gives rise to index-like portfolios.

Professional investors, being wired the same way, are prone to the same mistakes as the so-called "average investor." To illustrate, consider that the institutional investors who manage pension funds, mutual funds, etc. need to report quarterly on how their portfolios fared against a benchmark. When they beat the benchmark, it's a good meeting with lots of laughter and high fives. When they lag the market—and, in particular, for several quarters in a row *as will happen*—institutional investors quickly learn that being "too different" from the index often results in getting fired. In consequence, many institutional portfolios end up looking eerily similar to the benchmark index, the unspoken reasoning being "I won't get fired if I lose 20% and the index is down 20%." Thus, the temptation is to take a position in a high number of stocks, even ones that don't pass analytical muster, so as to resemble the index sufficiently. The very structure of the industry encourages short-term conformity while discouraging independent long-term thinking.

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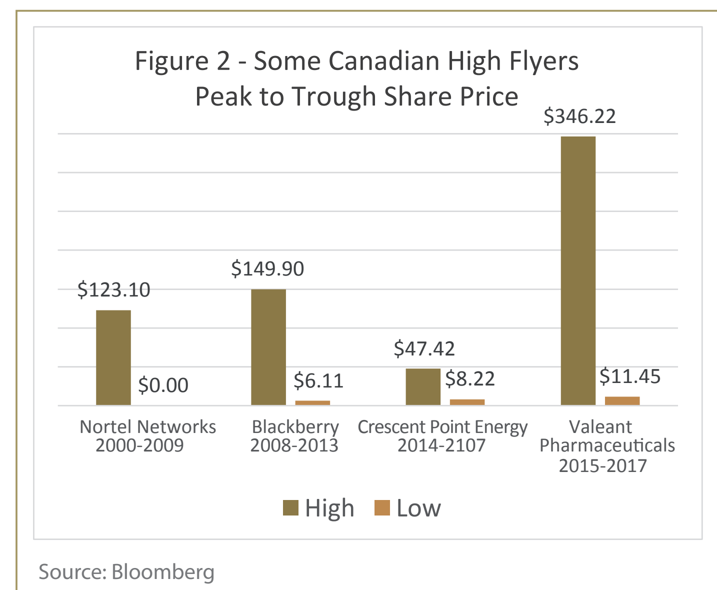
Investors of a certain age will recall the bull market of the late 1990s, led in Canada by Nortel Networks whose shares at one point represented over one third of the value of the TSX. Unlike 2017, in those days dividends were unfashionable because paying them was seen to suggest that a company was lacking in growth prospects. Nortel, whose shares traded for $102 at June 30, 2000, offered a paltry dividend yield of 0.1% - a good thing according to the Kool-Aid drinking stock jockeys of the day. The pressure on institutional investors to own Nortel was immense. For example, despite the 0.1% dividend yield, at least one bank-owned Canadian dividend fund had placed a whopping 19% of the portfolio in Nortel at June 30, 2000. We surmise that human behaviour (fear of being different) trumped sound analysis. Nortel shares subsequently reached a peak of $123 in July, 2000, then started a painful journey to zero, via a dividend cut only one year later, hurting shareholders, employees and retirees in the process.

There are multiple examples in Canada of the terrible impact of buying late in the game – a common error.

At Antares, we believe our portfolio structure and investment processes have built-in advantages that can help avoid such behavioural pitfalls.
We design our equity portfolios to have no more than 20 companies, which implies that each holding will amount to 5% of the total portfolio. This obliges us to be highly selective about what we put into your portfolio. We aim to own high quality companies purchased at sensible prices, and as a result the portfolios look nothing like market indices which hold a wide swath of companies ranging from ugly to great, with most falling somewhere in between.



At Antares we intentionally structure our process to avoid behavioural mistakes.

In our framework, we view the act of investing as taking a partial ownership stake in a company for the long term. That is very different from the institutional manager's "taking a position" in a stock with the upcoming quarterly meeting in mind. We try to avoid talking about "what the market did" over the quarter: you do not own the market and we do not feel pressure to own shares of the high flyer *du jour* (Figure 2). Our process keeps us intentionally focused on what works in the long run: quality, dividends, value, and avoiding the temptation of being greedy at the wrong time. We think our approach gives you a competitive advantage over other investors. Neither you nor we need to be swayed by short-term winds or market fads. We will leave it to the institutions and the talking heads on CNN to duke it out over "the markets"; we are ignoring the noise and attempting to create portfolios of businesses that stand apart from the average.

When investment actions are made with the long term in mind, the probability of success increases.

Thank you for your continued trust,
Your Portfolio Management Team

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