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

Covid-19 makes today's investing environment even more uncertain than other historic market bubbles.

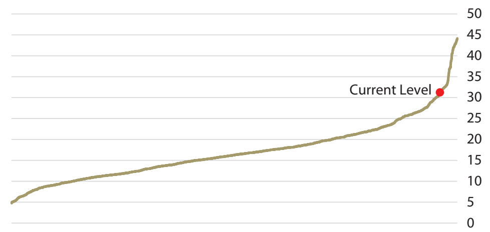
In reading and researching investing history, it is hard to find a time period that is similar to the one we are currently experiencing. Parallels have been drawn to several different eras, including the tulip bulb mania of the 1600s, the South Sea Company bubble of the 1700s, the 1929 stock market bubble, the "nifty fifty" era of the late 1960s, the Japanese stock market bubble of the late 1980s, the Asian Financial Crisis of 1997, the technology bubble of 1999/2000, and the housing bubble of 2006/2007. While many of those events were marked by extremely high prices and subsequent collapses, they had a commonality that is not shared with the current period; they were all characterized by events that were limited to a certain company, industry, geography, or country. Today, Covid-19 is a global event. That in itself makes this time period especially uncertain. There are simply more moving pieces and those pieces are spread out across the world.

Given the extreme uncertainty, it does not make sense to us that market values are near historic highs.

It is a bit perplexing, then, that in an era marked by, perhaps, the greatest number of unknowns in investing history, we are also faced with one of the highest priced markets of all time. Usually, when there is economic uncertainty and the prospect of future growth and profits is unclear, prices for businesses come down. In the U.S., in particular, prices for businesses in general are at levels only exceeded in the runup of the technology bubble in 1999, and the month in 1929 that preceded the stock market crash of that year. This is illustrated in Figure 1, which shows that the cyclically adjusted P/E ratio has rarely been higher than it is today, going back to 1881. As respected strategist James Montier put it recently, "never has a market been priced so highly when faced with so much uncertainty" (*GMO Capital White Paper, August 2020*).

There are many proposed explanations to "justify" high prices. We are skeptical.

Figure 1 - Monthly Cyclically Adjusted Price to Earnings ratios in order of lowest to highest since 1881



Source: Robert Shiller

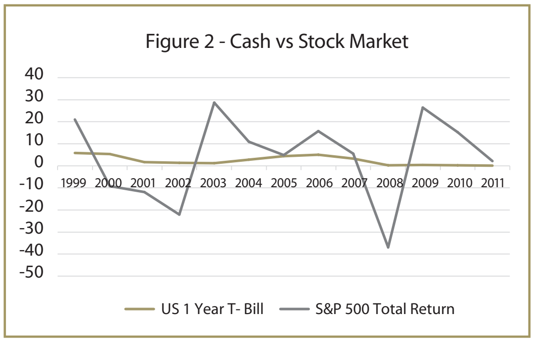
Things were already at elevated levels BEFORE the pandemic set in. Prices are even more at odds with the additional uncertainty Covid-19 presents. Estimates of the time to full recovery range from two to five years. Remember that entire industries are running at much lower capacity than before the crisis, and some businesses will not survive.

Many explanations for this seemingly implausible situation have been put forward. One is that with government intervention of forcing interest rates lower and continuing to pump money into a moribund economy, buying businesses at any price still somehow makes sense. Another is that as long as interest rates are so close to zero nothing can go wrong. When you can get money for free, almost anything you do with it will generate a return higher than the cost. In essence, you can't go wrong with leverage. We have certainly seen that in action; corporate, government, and household debt are all at historically high levels. A third is that with interest rates so low, the alternatives are not worthwhile. This thinking implies that no matter how poor the choices, you HAVE TO pick something and sitting on the sidelines is NOT an option.

We are wary of government and central bank actions – liquidity is pushing up stock prices for now, but this could end badly.

The argument against each of these is that interest rates will not stay at zero forever, and government intervention has seldom yielded economic benefits. Government decisions, by default, tend to be made for political reasons, not financial reasons. Financial decisions can be quantified and qualified, but I am not sure how you assess businesses through a political lens. And paying outrageous prices just because the alternatives are even less attractive does not always work out well. It is worth remembering that good ol' cash outperformed the stock market from 1999 through 2011 (Figure 2), despite the fact that this period featured two market bubbles and recoveries, and short term bond rates went from the 5% range to less than 0.5%. High prices have a way of self correcting… sometimes this happens slowly over time, but mostly it happens suddenly and dramatically.

Borrowing costs are very cheap. It does not follow that it makes sense to rack up debt.



1 Year U.S. Government Bond returns vs 1 Year U.S. stock market returns, January 1, 1999 to December 31, 2011. Figures in USD.
Source: FactSet and Bloomberg

Company fundamentals drive value in the long run.

High prices for businesses and low interest rates have created one of the most challenging times for investors. The fact that the government has had a hand in both sides of that equation makes me extra nervous. When have you ever seen a government make good long-term decisions that are founded on solid financial principles? (Call me if you can think of any.) "In Government We Trust" may not be a worthwhile endeavour for investing success.

That leaves us in a quandary. Either we go along with the crowd in saying, "All is okay. Interest rates are low and money is flowing. What could go wrong?" Or we continue to invest based on solid financial assessments and economic sensibilities of the businesses we want to own; being careful not to overpay for something that cannot provide certainty of future profits. We call that investing with a margin of safety.

If we believe that company fundamentals (sales, profits, cash flows) still matter, and that at some price the price is too high, then we are forced to resign ourselves to the sidelines until prices for solid businesses make sense again. On the other hand, if we believe that governments will continuously bail everyone out, then any price is an ok price and buying anything at any price makes sense.

I believe history is on the side of the former. Bubbles and subsequent crashes are nothing new. A time of speculation and easy access to borrowed money has always been followed by a time of austerity and restraint. To go against the odds can work for some time, but eventually the odds catch up. Everyone in Las Vegas knows that…but somehow the lure that "this time is different" continues to entice with money lost by yet another sucker, er gambler, er investor.

Thank you for your continued trust,

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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