"Buy when there's blood in the streets!'
Baron Rothschild

Equity markets have been extremely volatile lately and we love it!

The source of this volatility has been the fear regarding the European sovereign debt crisis. As has widely been discussed Greece will likely default on its debt while Spain, Italy and Portugal are teetering. Many European banks hold these countries' bonds and are facing massive write-offs. The fear has been that the European Union will not be able to arrive at a solution to their problems or solve the continent's banking crisis. As a result, a global financial crisis may ensue. Based on this fear, markets incurred substantial losses in August and September. Just recently, European leaders have come to an agreement that they believe will deal with Greece's debt and protect European banks. As a result, markets soared in October and erased much of the previous months' losses.

We expect more volatility in the months ahead as the details of this plan are negotiated and worked out. In our view, the solution while not perfect protects against catastrophic bank failures which would freeze up the global financial system and could lead to a worldwide depression. We believe that politicians in Europe, pressured by other global powers, will find a way to implement the required changes and financial lifelines. They understand that the political, economic and particularly social costs of economic failure would be far too great to bear. Similar to other crisis, we are confident that common sense will prevail and that we will "muddle through".

However, there is no free lunch. The cost of this massive bailout will be much slower economic growth for several years as governments implement austerity measures and raise taxes to deal with these large deficits and financial bailouts. Slow economic growth, burgeoning social unrest, and political gridlock in the developing countries will undoubtedly lead to more volatility.

Most associate high levels of volatility with increased risk and fear these fluctuations. We on the other hand view volatility as an opportunity to purchase high quality businesses on sale. In The Intelligent Investor, Benjamin Graham describes the market's (Mr. Market) behaviour to that of a manic depressive. This comparison is very appropriate in today's environment. Graham compared Mr. Market to a business partner who was euphoric one day and depressed the next. When he was excited he would ask to buy your shares at a very attractive price. When he was depressed he would offer to sell the shares back to you at an extremely low price. A rational buyer would sell to him while he was in an excitable mood and buy from him when he was unhappy. Fortunately, we have been able to take advantage of Mr. Market during the past few months and purchase very attractive businesses at prices that have the potential to offer an exceptional long term rate of return.

The confidence to buy from a despondent Mr. Market during these periods of extreme volatility is rooted in our process and philosophy. There are three critical elements to our strategy; the purchase of high quality businesses, buying these businesses at a substantial discount to their intrinsic value and time. These three factors allow us to take advantage of volatility and transform it from perceived risk into a source of long term returns.

The purchase of high quality businesses is important for several reasons. Because the companies that we purchase have successful long term records, several competitive advantages and strong balance sheets, business risk is reduced. Well managed and well financed businesses survive all sorts of macro threats. The probability that these companies suffer serious financial or competitive threats is quite low even under the most severe economic conditions. The strength of these businesses gives us comfort in the knowledge that irrespective of the economic environment or share price fluctuations the underlying fundamentals are sound. We invest during periods of uncertainty and as a result, our investments provide us with the time to allow our investment thesis to materialize.

Several years ago I invested in Hudson's Bay Co. The company's valuation was extremely attractive; the shares were trading at a substantial discount to its book value and were not reflecting the underlying value of its substantial real estate holdings. The reason for this depressed valuation was the imminent arrival of Wal-Mart into the Canadian retail market. The decision was a mistake. We focused only on value and overlooked several issues that pointed to the company's fundamental weakness. Ultimately, Hudson's Bay was not able to compete effectively against one of the best retailers in the world. Despite the very attractive valuation we lost money on the investment because the underlying quality of the business was weak.

As we often discuss, we purchase high quality businesses at a forty to fifty per cent discount to their intrinsic value. Irrespective of macro conditions, it is highly unlikely that a high quality business will experience a significant reduction in its long term intrinsic value. While share prices often experience a high degree of fluctuation, intrinsic value, is very stable and grows over time. The extreme movement of the share price is what allows us to purchase our investments at very attractive prices. This very large discount to intrinsic value once again gives us the confidence and comfort to purchase during times of uncertainty and volatility.

In 2002 we started purchasing shares of Cogeco Cable; a cable company serving smaller communities in Ontario and Quebec. We believed that it was very good company with an intrinsic value close to thirty dollars per share. Our initial purchase was in the $16.00 range. Within a very short time of this initial purchase a U.S. based cable company was found to be using fraudulent accounting and went bankrupt. Investors sold off all cable companies and the share price of Cogeco Cable was driven below $8.00 per share. Comfortable in our analysis and our calculated intrinsic value we continued to purchase shares in the company despite the extreme volatility in the share price. Our last purchase was slightly under $8.00. Approximately three years later we sold the shares at about $28.00 per share. More recently, we purchased shares in CBS Corp. During the financial

crisis in 2008 the shares fell from our purchase price of $8.00 per share to $2.00 per share. Once again, confident in our research indicating the underlying value and quality of the business we continued to purchase the shares and sold them two years later at $16.00.

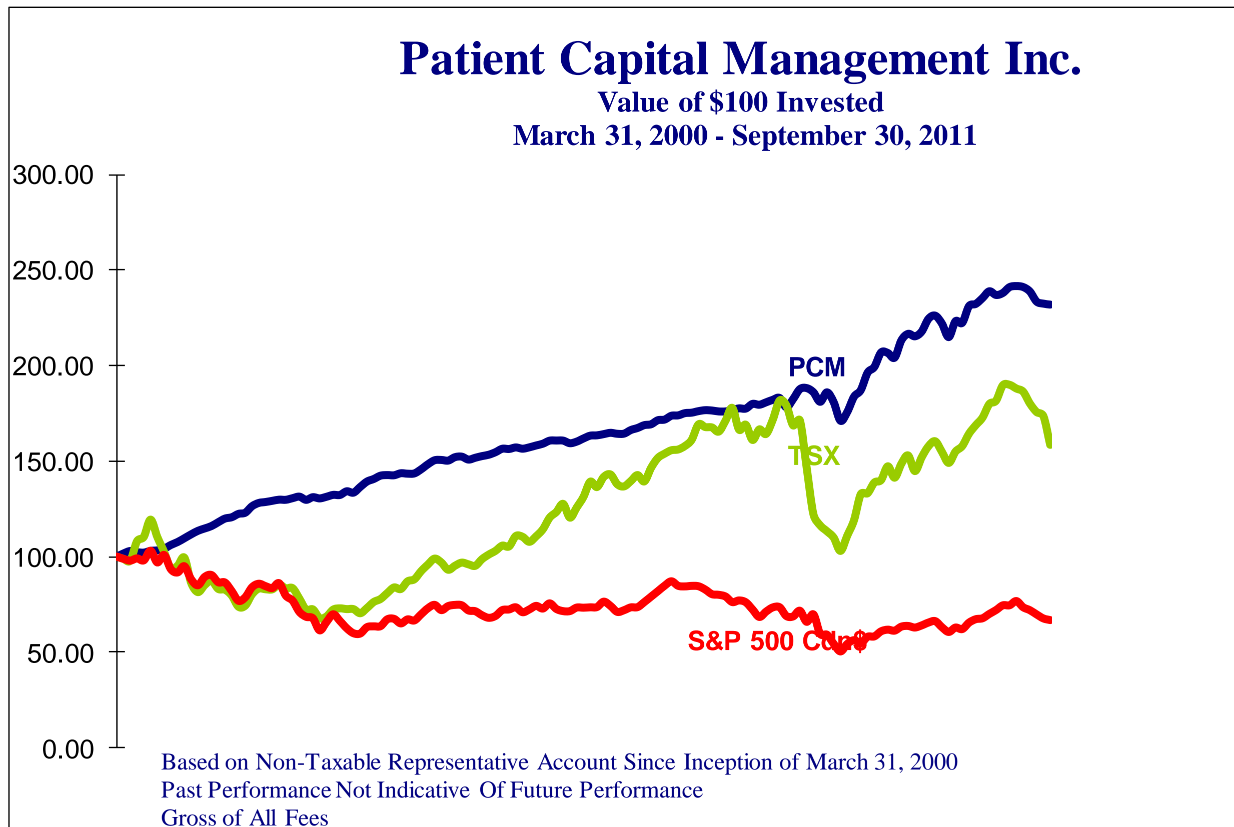
The third element in our process that gives us the comfort to purchase in periods of high volatility is our time frame and patience. Time and patience are the most important elements of our strategy; particularly during uncertain and volatile times. It allows us to "keep our heads about us while others are losing theirs".

A long term approach gives our business and valuation thesis the necessary time to materialize. In addition, a long term time frame allows compounding to work in our favour and the income from dividends to accumulate. For example, we have owned one investment for the past ten years and the total dividends that we have received, are now greater than our original purchase price for the shares! We typically purchase investments when they are depressed due to a short term company specific issue, concerns about an industry problem or when markets are generally in a tailspin. It has been our experience that over a three to five year period company specific or industry issues are resolved and that the market eventually increases the share price of our investments to their intrinsic value.

The advantages of a long term approach are well known and espoused by most investment professionals but patience is rarely practiced. A long term time frame is an incredible competitive advantage in an industry where the vast majority is focused on the short term and reacts emotionally to volatile stock price movements. Indeed it is this advantage that allows us to successfully execute our strategy. We are able to purchase high quality businesses at prices that generate substantial returns over three to five years because others overreact to negative short term developments.

The benefits of a long term approach are illustrated in the chart below. We have been able to compound and grow your assets at a better rate than the North American indices over

the past eleven years. We have achieved these results by focusing on the long term and not concerning ourselves with performance in any one particular calendar year.



We welcome volatility! Our approach has worked quite effectively for many years and through all sorts of tumultuous periods. Quality, value and most importantly time and patience are the key ingredients to successful and low risk long term returns. These pillars are the foundation of our philosophy and process and give us the confidence to buy when others are fearful and sell when others are greedy. We could not implement our strategy without your confidence and support. Thank you!

Vito Maida

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