DM Monthly Report

December 2015

PORTFOLIO ACTIVITY

Aside from portfolio rebalancing, no transactions were executed in either DM Canadian Equity or DM Foreign Equity in November.

FEATURE STOCK
Canadian Tire (CTC.A)

In difficult Canadian equity market conditions, CTC shares gained 9% in November, driven by a quarterly earnings report that highlighted solid same store sales growth across its main retail brands and a continuation of management's commitment to returning capital to shareholders through both share buybacks and dividend increases. In 2014 CTC spent $200 million retiring shares and in October, the company completed the $400 million buyback it had scheduled for 2015; on November 12th, a new $550 million stock repurchase program was announced, which is expected to be completed by the end of 2016. In the same report, CTC also raised its dividend by 9.5%, marking the company's sixth consecutive annual increase. Despite expected weakness in Alberta and challenges stemming from the slumping Canadian dollar, we continue to believe that CTC remains well positioned. In the quarters ahead, management expects to devote capital expenditure to additional expansion, as well as digital and technology initiatives.

WHAT IS RISK?

Despite its central importance to portfolio management, there isn't really a universal definition of investment risk. When we launched Dixon Mitchell, we decided that our best chance of getting the risk question right was to put ourselves in the shoes of our clients and make sure that our decision making process was mindful of the following two common concerns:

1. *I might lose money and not get it back* (permanent capital impairment); &
2. *I might outlive my financial wealth* (asset/liability mismatching)

Traditional investment risk measures are more quantitative in nature and are generally linked to either interim portfolio volatility or relative performance vs. a given benchmark. Though intellectually appealing and easily calculated, such barometers may not carry a strong correlation with the actual goals of a real client and the management behaviour they incentivize can result in unexpected and undesired outcomes. For example, a manager too focused on avoiding near term volatility may construct a portfolio which does little to satisfy an individual's long term objectives, while one overly concerned with what a benchmark is doing might feel pressure to own market moving stocks which don't necessarily meet his or her investment philosophy.

Much as with Nortel, RIM, and Potash Corp. in the past, the recent meteoric rise and subsequent retreat of Valeant Pharmaceuticals provides a glimpse into how the lure of index chasing can impact managed portfolios. At Valeant's peak valuation this summer, when it was briefly worth more than the Royal Bank of Canada, 73 Canadian mutual funds held a position of 4% or greater in the company (it's probably reasonable to assume that not all of these managers bought the stock on its investment merits alone). Likewise, the main Cdn equity fund of one of Canada's major banks opened a significant position in Valeant in March of this year, just before it peaked; in reference to the decision, the fund's June-2015 interim report stated:

> *"The portfolio manager was skeptical about the company's growth by acquisition strategy, but being absent of the third biggest stock in the benchmark was too high of a risk."*

This comment is a fairly explicit admission that the manager was willing to expose his clients to capital risk (i.e. he had misgivings about Valeant's business model) to reduce the fund's benchmark risk. A cynic might even say that the transaction was really about managing career risk.

Perhaps the most vivid example of philosophy abandonment in favour of index chasing occurred when the Canadian dividend mandate of one of the country's most recognized independent mutual fund companies made Valeant its 3rd largest holding. The problem? Valeant doesn't pay a dividend.