Lessons from the Surf

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> "There are no more committed people on the planet than surfers. We fall down a lot. We turn around, paddle back out, and do it all over and over again. Unlike anything else in life, the stoke of surfing is so high that the failures quickly fade from memory" – Gary Sirota

As investors, we often draw parallels between the way that we invest money and everyday life. One of our team members has developed a passion for surfing, a difficult task to master and that requires discipline, drive and quite a bit of patience, terms often used to describe portfolio management:

We woke at 6 am to the familiar tune of my iPhone alarm, «waves». How appropriate. I had a meeting at 10 am but really wanted to surf on our last day in Victoria where we planned to visit Sombrio Beach, along the west coast of Vancouver Island. After a quick breakfast, we loaded up the truck and set off in search of a good wave.

After winding our way up the coast for an hour and a half, we slowly skidded our truck down a dirt road, dodging potholes along the way, before reaching the trailhead where we could park. We soon found ourselves walking through the forest – toward the beach and the shining sun. A quick change into our wetsuits and we began paddling out into the chilly Pacific.

For the novice surfer, successfully catching a good wave is a lot of fun. Exhilarating really. It is like hitting a great golf shot after a dozen bad ones. It brings you back for more even when you've failed repeatedly. Not to say it is easy. Catching a good wave is hard, especially when you are learning. It is difficult to get the timing right, to be in the right spot and to balance yourself among a host of other variables.

Some days, for example, you have too many choices. Too many waves breaking. You chase this one and that one but never really catch a great one. It feels like you always must do something to catch the next wave, especially if more experienced surfers nearby appear to be doing so well. In the end, much time (and energy) is wasted chasing low quality waves.

Other days you could have too few choices. Waves are breaking infrequently and it seems like you are always in the wrong spot. If only I was out a few metres more. Why is it breaking over there now? This describes our day in Sombrio. The ocean was relatively calm and I only caught one good wave.

The lesson imparted upon us that day was simple: be patient. The patient surfer, who waits for the right wave as opposed to just any wave, has the most success (and most fun).

> “Just take your time – waves come. Let the other guys go, catch another one” – Duke Kahanamoku

Investing: Chaos or Predictability

On another trip I was surfing in Piha, New Zeland with a fantastic instructor named Brett. During one of our lessons, he told our group to stand on the beach and just watch the ocean.

“What do you see” – Brett asked

“It looks really rough today. Waves are breaking quickly, everywhere, it seems” – I replied

“Let’s walk up the hill and look again”

Once on higher ground, the ocean suddenly looked very different. What was once chaotic now looked more predictable. The waves were breaking in reliable patterns – or sets. Brett pointed out where the waves were breaking, the direction of the current and potential danger spots.

“Every day is a little different” Brett said, “but, if you watch the ocean, you will understand it better, you will catch more waves and you will have more fun.”

This was another important lesson.

These stories, written by one of our team members, highlight the similarities between two very different activities: surfing and investing.

At first glance, the stock market can seem chaotic and unpredictable. A crazy, volatile place that is difficult to understand. Everyday news outlets and brokerage houses bombard investors with all types of new information, analysis, and «great ideas». A particular sector might be in favour and every strategist has the best idea how to «play» it. You cannot afford to miss this great trade. Or, maybe a stock is «breaking out» and it looks tempting. Here's a chance to make quick, easy money. It can feel overwhelming and sometimes difficult to discern what is useful and what isn't for those with a long-term horizon.

Waves we try to Ignore

- **Citi: Here's the best way to play gold's rally –** ***CNBC, August 2016***
- **How to play the oil rally? Look to the drillers –** ***Globe and Mail, December 2016***
- **Play the 'Trump Bump' or stay the course –** ***BNN, February 2017***
- **Why chasing the TSX's strong year could spell trouble for Canadian investors –** ***Financial Post, February 2017***

However, when we step back, the market, like the ocean, looks different. It has predictable patterns. If a business does well and increases earnings, its value should eventually increase as well. Like surfing, investing is also an activity where patience pays off. Wait for the really obvious waves Brett would say. Equities have proven to be a predictable means of long-term wealth creation but, in exchange, the market demands patience and a good temperament.

Our Philosophy

Our investment philosophy is relatively simple: buy high quality businesses trading at good valuations, which can be described as a quality/value approach. We do not intend to spend time and energy chasing low quality stocks with outsized financial risks or susceptible business models. We will also do our best to avoid short-term trades, flavours of the day or «can't miss» ideas. We want to own good businesses that have the potential to build intrinsic value over time for our investors. Some of our criteria include:

- **The business is simple with competent and well-aligned management**
- **Identifiable competitive advantage and economic durability**
- **Proven history of earnings growth and free cash flow generation**
- **Above average return on equity and invested capital**
- **Minimal financial risks**
- **Discount to our estimate of intrinsic value**

Most importantly, perhaps, we are patient. We know they'll always be another wave and are happy to wait for the right one.

How ESG Helps

Increasingly, we're finding that many companies who «do well» for shareholders also have a good social conscience. A good quality, durable business that expects to be around for the long-term must think about opportunities to reduce their environmental footprint, treat employees well, strengthen customer loyalty and improve their role (and brand image) in the community.

In other words, it's impossible to assess the quality of a business without assessing environmental, social and governance considerations.

For example, Metro – Canada's third-largest grocer – has quietly taken steps to improve their environmental footprint. Since 2010, Metro reduced landfill waste and energy consumption by 25% and 10%, respectively. They are now targeting 100% waste diversion by 2020 and expanding a local purchasing policy in Quebec and Ontario. Local purchasing is not only good for communities but can also reduce transportation costs and minimize exposure to weather-related disruptions elsewhere. Good for shareholders, communities and the environment.

The ESG opportunity for grocers extends to the supply chain as well. Annual food waste in Canada is estimated to be worth $31 billion[1]. As a result, reducing food waste not only helps the environment but helps reduce costs and prices for consumers. Loblaw is one such example. Their No Name brand of «Naturally Imperfect» fruits and vegetables is one step toward reducing waste while also providing better prices for consumers.

Similarly, expanded prepared food departments provide an opportunity to use ripe fruits and vegetables while providing customers with a lower-priced alternative to restaurants. We like management teams who think about both reducing their environmental footprint and delivering value to consumers as it can increase efficiency, lower costs and, in turn, improve the value of the business for shareholders.

Delivering value can increase the importance of that product or service to the customer, strengthen its franchise and build loyalty – factors that can widen an economic moat. We want to align ourselves with managers who think about shareholders, look to reduce costs and their environmental footprint, and actively engage in building brand loyalty. These considerations are vital to assessing the culture of a business and one of many components needed to build and maintain a high quality franchise.

ESG can also help identify threats to the long-term sustainability and value of a business. The protection of client capital remains a cornerstone of our investment philosophy and ESG is a vital input into our capital preservation objective.

Sincerely,
Nessim, Tony and Nick

1 http://www.cbc.ca/news/business/canada-food-waste-1.3813965