

Investment Update for Q2 of 2019


It was an eventful 2nd quarter to the year coming off one of the best first quarters in recent memory. We went from trade optimism to trade pessimism and then back again a few times. In addition there was potential geopolitical flare ups in Hong Kong and Iran which riled markets. There was also near constant speculation as to whether the Federal Reserve was going to cut interest rates amidst harassment from Donald Trump. As we head into summer a lot of uncertainties remain with respect to all of these issues, but that hasn't stopped the S&P500 from reaching new all time highs.

On top of this our bonds have done really well this year as interest rates have fallen across the developed world. This is a bit of a conflicting message as falling bond rates seems to indicate the bond market expects there to be a recession, whereas all time highs in the stock market would indicate the opposite is happening. I think that in the short term these two markets can become dislocated but it won't last forever.

It's also possible that the reason the two markets are in disagreement is that the economy finds itself in some kind of safe middle ground where it's not overheating but it's also not falling into a deep recession. Unemployment remains near all time lows in both Canada and the US, so there just isn't that much room for the economy to expand in the short term. It's important to remember that the economy is made up of real people doing real work. When employers start to have trouble filling jobs, it slows the growth of the economy and eventually forces wages and prices up. So far we haven't really seen that but the slowing economy could be a sign of the initial stages of it.

As far as our own portfolios, we had a very up and down quarter pricewise, though I have never been more optimistic about the companies we own.

Fears over a slowing global economy hurt the oil and gas industry which has led to significant opportunities in that space. Normally we try and avoid the oil and gas industry because it is highly competitive with lower margins and no significant moats to protect your business. In the absence of a moat we have to rely on the management team to be exceptional and that's normally not a risk we choose to take on. However some of the companies are now trading at less than half of the value of their assets. Combine that with a very good dividend which is fairly stable and we decided it was a good idea to invest in two energy companies (Whitecap Resources and Surge Energy). Given the margin of safety provided by the cushion of assets they own, and given their managements' strong track records, we think this is an investment with far more upside than downside. The Oil market is going to always be very volatile and



unpredictable in the short term, but the long term trends still indicate higher prices than what Oil currently trades at, and that would obviously be very positive for our positions. In the meantime we will collect our dividends which amount to over 8 % annually for both Surge and Whitecap.

We can't get through this report without talking about the trade war. As the US blacklisted Huawei in May, there seemed to be a real threat that the US was going to attack all Chinese technology companies as part of the broader trade war. That risk seems to have subsided somewhat as cooler heads have prevailed, and as business leaders have rightly pointed out that such a move would hurt the US as much as China. Nevertheless we took advantage to add to our Alibaba and Tencent positions. These companies are not directly affected by tariffs though their shares did drop along with the other Chinese technology firms. We don't believe that the trade war presents a significant long term threat to either Alibaba and Tencent and given the tremendous strength of their two businesses and the huge and still largely untapped potential of the Chinese consumer, we are very excited about these two companies over the next 5-10 years.

Lastly but not leastly, we've been adding to our positions in Fossil Group as the price has come down. Fossil is a small company with a market cap of just over half a billion dollars. Because it's so small, the price of its shares can be more volatile than some of the larger companies we invest in. Fossil's share price struggled in the second quarter as the market concerns over trade wars and a slowing economy in the US weighed more heavily on Fossil as a small cap company. They also had a logistics issue which hurt their sales in the first half of 2019. That issue has now been rectified and Fossil is set to rebound strongly in the second half of the year. They released a new line of athletic smartwatches which takes them into even more direct competition with Apple and other smartwatch makers. The advantage that Fossil has is they have a lot of experience in watch design and their watches tend to look better. In addition they've partnered with Google to make sure that their technology can compete with and beat Apple's technology. More to the point Fossil, generates about \$3-4 of cash per share every year, and despite the fact that their sales are in decline, the amount of the cash generated has increased over the past two years as they have generated more profitable sales.

The market has gotten more volatile in the past year as the economic expansion has gotten longer in the tooth and market valuations in certain sectors have gotten more stretched. The political environment is also very unstable, to put it mildly. Nevertheless, these are not unusual situations for markets and it doesn't change the fundamentals of what we're trying to do, which is buy good businesses at a price which builds in a large margin of safety. All of the purchases we made in the last three months have fit this criteria, and because of that, I am very confident that we will do well with those purchases, though the results may not

show up immediately. Eventually you can rest assured, we will be rewarded for our patience and our discipline.

Should you have any questions or concerns about your portfolio or about the topics discussed in this letter, please feel free to reach out to me.

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Craig White is an Investment Advisor at the award winning firm Endeavour Wealth Management with Industrial Alliance Securities Inc. Together with his partners he provides comprehensive wealth management planning for business owners, professionals and individual families.

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