THIRD QUARTER 2019

Index	Q3 2019	YTD
S&P/TSX Composite (C$)	2.5%	19.1%
S&P 500 (US$)	1.7%	20.6%
S&P 500 (C$)	2.9%	17.0%
MSCI EAFE (US$)	-1.1%	12.8%
MSCI EAFE (C$)	0.1%	9.5%
FTSE TMX Universe Bond Index (C$)	1.2%	7.8%
C$ / US$	1.3087 to 1.3243 (-1.2%)	1.3642 to 1.3243 (+3.0%)

**** Index returns are total returns, including dividends.***

MARKET RECAP

After a strong rise in stock prices globally this year, the S&P 500 Index and the S&P/TSX Composite Index both reached all-time highs while the MSCI EAFE reached its highest level since the onset of the Global Financial Crisis of 2008.

Although stock indices have risen across the board, the price appreciation of the individual stocks that make up these indices has varied greatly. In fact, prices for the average stock have notably trailed that of the broader index: the performance of the Russell 1000 equal-weighted index has trailed that of its cap-weighted counterpart by over four percentage points. This discrepancy can be largely attributed to the lagging performance of companies with smaller capitalizations. The Russell 2000 index of small capitalization stocks has lagged the S&P 500 by nearly 6% year to date and by over 16% year-over-year. Similarly, the S&P 400 Midcap index for somewhat larger capitalization stocks has lagged the S&P 500 by almost 3% year to date and by more than 6% year-over-year.

Growth stock indices continue to extend their decade-long performance lead over their value counterparts. Year to date, the Russell 3000 Growth index has outperformed the Russell 3000 Value index by over 5%. As the rise in prices for the Growth companies continues to outpace that of its Value counterparts, the price to trailing earnings multiple for the Growth index is now 10 times higher than that of the Value index, the widest margin we have seen since the tech bubble in the early 2000s.

During strong market run-ups such as we have seen so far this year, broad market behaviour invariably builds momentum, and stocks whose prices have recently risen are then pushed up still higher. Meanwhile, the prices of more overlooked stocks either remain the same or gain relatively little. Such a dichotomy of the “haves” and “have nots” reminds us to be cognizant of the age-old

adage from Ben Graham: “In the short run, the market is a voting machine but in the long run, it is a weighing machine.”

VALUE OR GROWTH?

The investment industry has traditionally categorized investing styles as falling into one of two camps, with value on one side and growth the other. We are at times perhaps guilty of this as well, but at the same time we would like to argue that value and growth are very much two sides of the same coin.

At its core, value investing is simply getting more then what you paid for. As an investor, what you get is, simply put, the future cash flows that the investment will deliver to its owner. For bonds, the future cash flows are obvious: they are the coupons (interest payments) that the bond’s issuer is obligated to pay until the bond’s maturity. For stocks, however, the future “coupons” need to be estimated. How much higher or lower these “coupons” will be in the future is central to ascertaining a stock’s value.

While value stocks have traditionally been qualified by quantitative measures such as low price-to-earnings and low price-to-book ratios, growth is also a crucial part of the value equation. For example, a company selling at a multiple of 20 times earnings (a multiple typically used for companies falling in the “growth” bucket) but growing at 20% a year may well be a far better value investment than a company selling at a multiple of 10 times earnings whose business is stagnant or in decline.

When phrased in these terms, the conventional line delineating growth and value investing styles makes little sense. Investing is simply the process of paying less for what you will receive in the future. While we have always characterized ourselves as what are traditionally called "value investors", we prefer to think of ourselves as investors, plain and simple.

Our ideal investment candidate is a company with strong and enduring competitive advantages, with able management and plenty of room for growth. Of course, the virtues of such companies have often already been well recognized by other investors, and as a result their prices are often bid up to the point that they are overvalued. Nonetheless, we seek to purchase them at reasonable valuations when possible—even if they may be somewhat beyond the threshold that conventional value investors would deem appropriate.

INVESTING VERSUS SPECULATING

In our view, the term “value investing” is redundant; **all** investing is value investing. Rather, the key distinction that needs to be made is the one between investing and speculating, which are often conflated. To us, the key difference between the two originates from the intent of the buyer.

An investor looks at the company itself, estimates the future cash flows that the company can reasonably produce, and looks to purchase its stock at a price that presents an attractive discount to the present value of those cash flows. A speculator, on the other hand, is more focused on

what they think the stock can sell for in the future and has little regard for what the company can produce in future earnings.

Periods of strong market run-ups induce the positive momentum forces that attract speculators who buy stocks for no other reason than that they have recently risen, as evident so far this year. However, the effect can also work in the opposite way when speculators rush to sell stocks that are falling, which can lead to ever-lower prices and the negative feedback loop that we saw late last year.

The market often resembles a game of dice; the price movements day-to-day are random, but the rational investor can use this to his advantage. When speculators push prices to irrational extremes, we sell the companies that have risen to their fair values and buy more of the companies that we like whose prices have fallen well below what they are actually worth. We believe that the speculative behaviour of others, while leading to results that reflect less favourably on us in the short term, will continue to be an advantage for us in the long run.

Thank you for investing with us and for your continued confidence,

The Evans Team