AGAINST THE FLOW

The Vestcap Point Of View

July 2015

Since its inception over three decades ago, Vestcap has relied on an investment style best described as "contrarian." One of the simplest ways to understand a contrarian investment approach is a quote from Warren Buffet "Be fearful when others are greedy, and greedy when others are fearful." Contrarians think differently - when all looks good, we ask what may go wrong; when all is doom, we ask what might go right. A contrarian investment, when made right, tends to look foolish at the time. Think of Noah; he was a fool while building the ark!

Throughout history, the stock market has been a wonderful place for savers to earn returns on their invested capital. Over longer periods of time, the compounding of dividends and the benefits of growing earnings have made equities a premier asset class, especially where liquidity may be required.   Over shorter periods of time, however, the stock market is influenced by factors which cause it to go up and down. For many investors, this volatility is considered a risk to be avoided. For contrarians like us, this volatility creates potential opportunities.   For investors with longer-term investment horizons, the near term volatility tends to be rewarded through capturing the higher returns that equities over time generate.

The stock market is a funny place. It is, as has been said, "the only place that when things go on sale, nobody buys!" As contrarians, we know how foolish it looks to be buying on the way down, and selling on the way up. But that is how real wealth is generated in the investment arena.

With a view to the longer-term, and a disciplined investment approach honed by almost two centuries of market experience, the contrarian Vestcap approach has served its clients well. We know that over short term periods we will experience periods of underperformance. However, like Noah, we believe in our contrarian ark.

With markets today at near-all time highs (Canada being an exception), the perception of risk by the investing public at large has been minimized. The expectation is that the good times will continue to roll and the consensus is "I don't want to miss out on the only game in town." Gone are the dog days of 2008, when "get me out" dominated the market psychology. some."

The chart to the right show US interest rates since 1960. Of interest to us is how much interest rates have fallen for the past 30+ years. Equity markets have been a major beneficiary of that move. Our question, as contrarians, is what will happen when rates reverse? In particular, we ask when markets will awaken to the fact that 2% bond yields are not normal, but a historical anomaly.

The chart to the right shows US T-bill yields since 1954. Two points are worth noting. First, the decline in interest rates since the early '80s have provided a strong tailwind to market performance. Second, since 2009, US yields have effectively been nil, and suggestive of a patient who is critical. Our view is that the patient is not so bad, and that the period of zero interest rates will prove to be an historical anomaly.

Market perception is that with interest rates so low, cash is trash. In our contrarian view, when everyone has that opinion, it is probably time to have a bit more cash than less.

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