

Inside the Fund

That's right, the title says it all, this week we're talking about the portfolio. No economics, no monetary reports, and no commodity reflections - just the portfolio. For those of you who read this Update you know our outlook on the economy and for those of you newcomers ... let's just say it's not that rosy.

We have recently been asked to look at the composition of our portfolio today versus the beginning of the decade. Have we always been negative on commodity stocks? Have we ever invested in technology? How about cash? That's a drag on performance and QV seems to generally carry high levels of it. Why?

We thought we'd start with the cash question. For much of 2006 and 2007, we complained about the lack of good opportunities and the relatively high valuations built on optimistic expectations in the marketplace. We went back and observed our cash weighting in the period was generally in the low double digits with spikes to above 15%. Let's remember that global economic growth and investor confidence was very strong in 2006 and for the first half of 2007.

Today in the midst of a plethora of negative economic news and a falling stock market gripped by fear, the cash balance has shrunk. In fact, our cash reserve is less than 5%, a level not seen in our portfolio since 2000. So the answer is no, we do not always carry high levels of cash. Our cash reserve is a result of our ability to opportunistically put money to work. In 2000, small cap stocks were at historically low valuation levels. Today they are not as low as they were back then, but are much closer than they have been for years. We don't know where the bottom will be nor do we really spend much effort in trying to pinpoint it. We have been waiting for years now for a number of excellent companies to offer us a reasonable valuation. That's what this plethora of bad economic news has provided. For that we are grateful.

Another lingering question seems to be our rather cautious stance on the commodity sector. Today our energy exposure is about 15% and materials about 12% for a combined exposure of just over 25%. This compares to both the small cap and the TSX Composite Index of over 50%. This has not always been the case though. We went back and looked at the portfolio back in the 2000 period and found that our weighting back then was 45% in energy and

materials. The simple reason was the valuations were exceptionally attractive so we invested heavily. Back then, technology stocks did not offer us an attractive valuation. Today many of them do and we have 10% of the portfolio in this sector.

The world changes as do the opportunities which we as investors are presented. Our philosophy of value investing leads us to areas of the market which are often under pressure. The sectors which look the best are often the least attractive to us from an investment perspective. We know this can be frustrating and challenging to clients because they feel they are "out of the game". Our goal is to be in "the future game". In 2000, commodities were a ridiculously bad idea; we couldn't even make much of a macroeconomic case for when things would get better ourselves. We just knew with patience the next cycle would reward us well.

Today with stock markets globally under pressure and the small cap bear market even more amplified, we are finding opportunity. In fact, we feel more confident in the outlook for the next 3-5 year cycle than we did back in 2006 when everything looked rosy. Are we early in spending some of this cash? Probably, we know that the same way market psychology overshoots on the upside it works the same way on the downside. We have been building positions and adding to holdings in many areas of the market including financials, industrials, and consumer discretionary. One of the challenges we have with smaller companies is liquidity. We know we have to build positions while they fall and that's often in the "eye of the storm".

One of the businesses which we very much like but have had to be patient waiting for a sell-off is Astral Media. After the most recent quarterly earnings report the stock plunged and we now have Astral Media as a top 10 weight in the portfolio. Astral is one of Canada's leading media companies, active in specialty and pay TV, radio, and outdoor advertising. The market is fearful of a slew of issues with media stocks including regulatory changes and an economic slowdown which would impact advertising activity. The share price has fallen over 40% from its peak, where it was probably overvalued. Today the shares trade at a small premium to book value. The recent acquisition of Standard Radio will provide some future opportunity, and we are paid a dividend of 1.7% while we wait.