

A Whole Lot of Noise

The week started with the Spaniards defeating the Dutch in a 1- 0 extra time victory to conclude South Africa's World Cup. The vuvuzela horns which hummed throughout the tournament causing viewers from around the world to ask; *what is that noise?* have been, at least temporarily, silenced. Despite this, Calgarians have yet to receive any peace and quiet. The steady buzz from vuvuzelas has been replaced by the rodeo horn at the Calgary Stampede. For the brave cowboy that can last a full eight seconds on the back of a forbidding bull, the prize can be sweet. For the first time ever, prize money will top the \$2 million mark.

With all of this noise, you might be wondering how we can stay focused on generating an attractive return on your investment. Although distracting, the noise distractions caused by cow bells and vuvuzelas should be the least of your noise related concerns. In this business, the more serious decibel induced risks are spawned from day to day gyrations in the market. These gyrations cause a never ending slew of news items, upgrade and downgrade recommendations from analysts, strategists and other experts. These updates tend to come more frequently than mealtime. This noise whether it comes in the form of an overcrowded email inbox or ticker symbols racing across a television screen can create overstimulation. Overstimulation can cause a manager to feel like they need to do something, even when patience is best.

Currently there is some noise in the market related to what the Bank of Canada will do next week. Will they raise 25 basis points and then take a pause? Will they stand pat despite the strong recent Canadian job creation numbers? Will they increase 50 basis points, moving interest rates back towards a more "normal" level? This is a lively discussion, but it is immaterial to long term investment decision making.

A long term investor is best served investing in strong business franchises, priced reasonably. Investment Industry legend John Bogle sums up this rationale very well:

"Over the long run it is the enterprise that has determined total return. The evanescent *emotions* that surround investing - speculation - so important over the short run, have ultimately proven to be virtually meaningless. For example, the 9.6% annual return on US stocks over the past century was composed of 9.5% points of investment return (an average dividend yield of 4.5% plus an average annual earnings growth of 5%) and only 0.1% of speculative return, arising from an inevitably period dependent increase in P/E."

Source: John Bogle, Financial Analyst Journal, March/April 2008

Despite so much evidence pointing towards dividend and earnings growth dominating investment return over long time horizons, short term speculative actions dominate our industry today. In the 1950's and 1960's, average stock market turnover was approximately 30% per annum. In 2008 annual turnover was over 300%.

Smart Technologies

Yesterday, Smart Technologies (SMT) went public on the Toronto and Nasdaq stock exchanges. It was one of the largest IPO's in North America this year and the largest Canadian technology IPO in over a decade. We did our due diligence. We met with management, toured their site, tested their products and modeled their prospects. We commend the founders in creating an exceptional business but we couldn't stomach the price tag of over 25.0x trailing twelve month earnings, 15.5x trailing EV/EBITDA and 3.2x revenue, according to our calculations. It appears as though many new SMT "investors" have bought stock to help alleviate anxiety caused by Attention Deficit Disorder rather than as a result of any assessment of Smart's underlying business. Over half of the 38.8 million shares offered in the IPO turned over in the first day of trading despite hovering around issue price. With the price of the business nearly unchanged, we ask *what has changed so drastically over the past 24 hours to justify this colossal ownership shift?* We shake our heads over our industry's excessive addiction to short term noise. It is no wonder why some view stock market money shufflers and riverboat gamblers the exact same way.

Inside the Funds

Astral Media reported quarterly results this week. This billboard, television and radio company continues to perform, generating profit margins in excess of 19.1%. The Return on equity for the business remains attractive at approximately 14.3%. The balance sheet is strengthening as cash flow has been used to pay down debt. Their net debt to equity ratio has improved from 0.58x at the start of the year to 0.44x. The price of this above average business appears attractive, trading at a 12.5x P/E compared to approximately 15.0x for the S&P/TSX Composite Index. I don't know what music Astral is playing on their radio stations, but with a strong business franchise, an improving balance sheet and a reasonable valuation, it is noise QV can enjoy.