Wolverton Securities

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PORTFOLIO MANAGEMENT
Make every year count.

Have Your Cake and Eat It Too Investing

Make Your Own Luck

By Jeff Woods

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Sometimes we get asked how much of our investing success is due to just being lucky. It reminds me of a quote I once read:

"Luck is where opportunity meets preparedness."
Seneca (Roman Philosopher)

The best answer we could give is that there is a component of randomness to investing that you just can't control – we just have to accept that and roll with it. But there is also a component that is driven by the portfolio manager's investment savvy, or skill. This can be in the form of his or her analytical acumen, the reliability of their research team, their knack for timing the big moves within the market, and so on. In other words, every professional money manager is going to have a blend of unique strengths and weaknesses that over time will produce results that are measureable and quantifiable. This result can be compared to both their peer group and their 'benchmark' – usually a stock market index that the manager is trying to beat. One of the elements of being a portfolio manager I enjoy is the fact that, at the end of the day, the sum total of all the decisions you've made is reflected in one elegant number. Whether it's a good, average, or poor result, it is what it is and no amount of excuses, rationalizations, or blame is going to change that number. So we would say that luck can drive some portion of short term returns, but over time, the good luck is balanced with the bad and the longer term merit shows through.

Beating the Market

It is a commonly accepted premise that most investors 'can't beat the market'. The corollary to that statement is that a few people do indeed do better than market on a consistent and long-term basis. Like Edison and his repeated failures with the light bulb, it took me awhile (about 10 years) to establish which investment approach I could apply to achieve consistent results for clients. I've tried and tested the fundamental approach (earnings-based and decisions driven by analyst opinion), trading/timing approach (driven by charts, technical, and third-party research opinions), and macro/predictive investing (collect all the information you can about the 'hidden facts' in the economy and base decisions on that). They all have their pros and cons, but none of them were able to consistently deliver the results I thought clients deserved. That all changed in 2011, when I started to study an investment philosophy based on a mix of trend following (buy rising, sell falling) and relative strength (hold your winners, sell your losers). It was confusing at first because before I could learn why this strategy worked so well I had to unlearn most of the investment myths I'd assimilated over the last decade. But, what I learned in those first few years of testing, re-testing and researching was that this approach of identifying trends combined with relative strength, above all others I had tried, had tremendous potential to refute all those many myths I'd adopted as truth.

Since then, we have developed three stock and five ETF model portfolios which covers the range of nearly all client risk tolerances and investment objectives. Our investment philosophy is supported by Wolverton management, as our models are now available to all Wolverton clients through our Separately Managed Account (SMA) platform. We can't comment on the performance of the newer models yet (as we are restricted on reporting performance results less than a year), but we can say that the results are consistent with our longest standing model - the Canadian Growth Portfolio.

The Canadian Growth Portfolio is a pure domestic stock model of twenty positions. We keep it simple by diversifying by sector and individual position size and a one billion dollar minimum market cap. Year to date, the portfolio is up +6.9%(1), versus a market return (S&P/TSX Composite) of –4.8%. Since inception (Dec 17, 2013), cumulative returns are +21.9%(1) versus market returns of +8.0%, generating a respectable market outperformance of +13.9% over the last 21 months. So, is it luck, or by design?

Markets are not as inefficient as we think

I spent countless hours in the early years of my career reading research reports, parsing economic data, and generally looking for the 'hidden opportunities' that I was convinced would be the key to 'outperformance'. I never did find my silver bullet.

It was many years later, after suffering through two bear markets and countless analyst-driven disaster stocks that I found myself pondering Einstein's old quote: "The more I learn, the more I realize how much I don't know." Stocks that are trending down in price are very likely are falling because something is "wrong" with the company (remember Bombardier, Blackberry and Enron?) or with the sector (energy, gold, emerging markets…). These names should be sold or avoided when the down trend becomes established. Stocks that are trending up in price are very likely moving up because something is "right" with the company. These stocks should be bought and held (for as long as the uptrend holds). It can really be that simple.

When I stopped being concerned about making money on every single investment within the portfolio (which just leads to analysis paralysis because it can't be done), and instead became obsessed with just making money on the overall portfolio, that's when the results really started to improve. In essence, our process helped us to become 'lucky', both in what stocks we bought and when they were sold.

How lucky can you get?

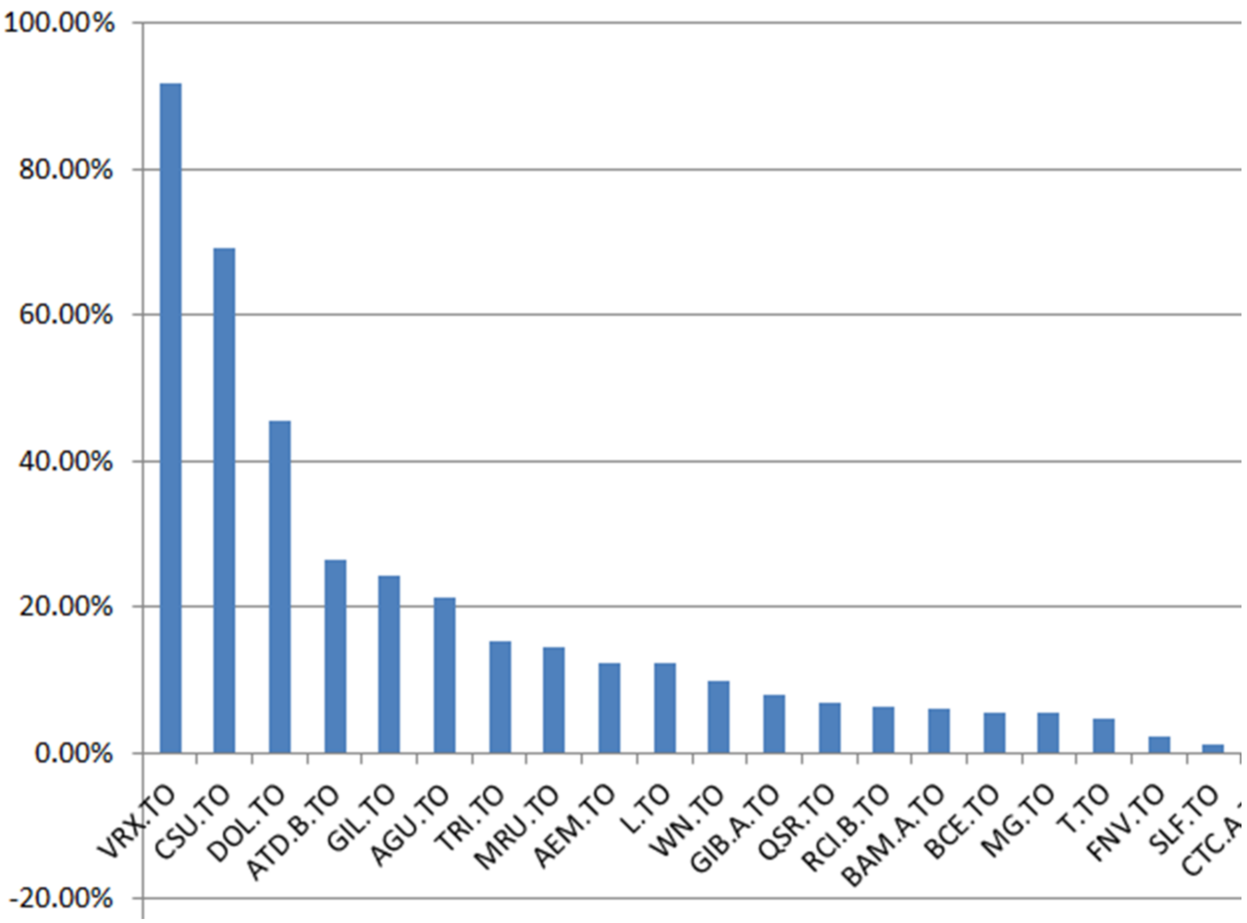
The theme of this article is about making your own luck in investing. I came across a great example of this on the weekend as I was reviewing our holdings in the Canadian Growth Portfolio (CGP).

The CGP can invest in any Canadian stock larger than $1B on the TSX Composite Index, subject to sector allocation limits. That gives us about 200 names to choose from. The 60 largest companies in the Composite Index are also listed on the TSX 60 Index.

It hasn't been a kind year to most investors thus far, with the TSX 60 index losing about –4.1% year-to-date.

So let me ask you this. How do you think the best 3 stocks and the worst 3 stocks (see page 4) have performed this year? Make your guess and then take a look below.

I think most investors would be completely shocked to see that the top 3 stocks in the TSX 60 this year have really ripped! The chart below shows all the stocks that are up year to date in this index.

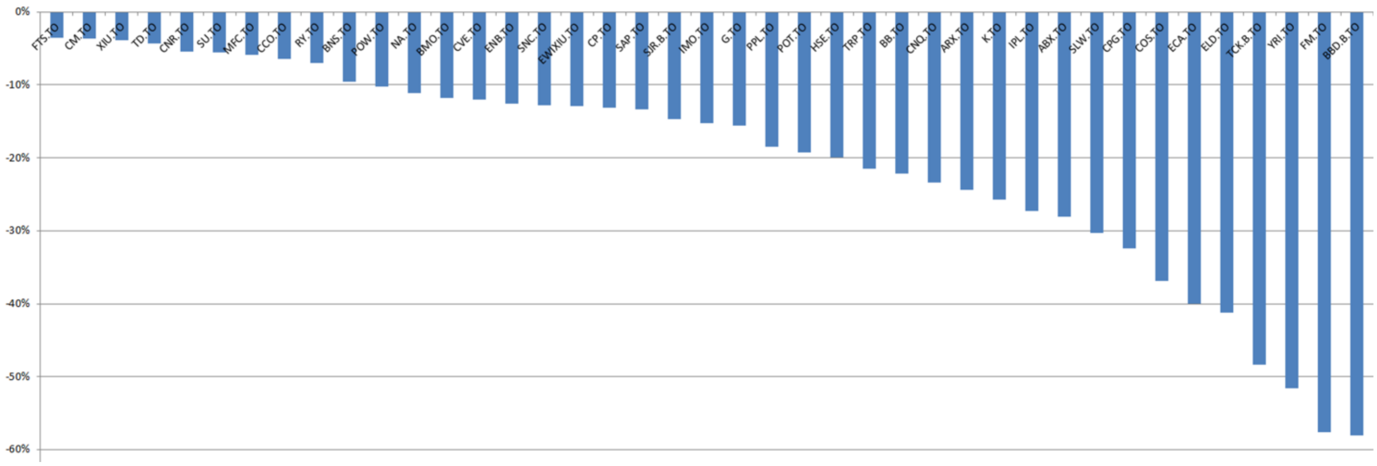


As you can see by far the biggest 3 gainers (from the TSX 60) year-to-date are Valeant Pharmaceuticals (VRX +92%), Constellation Software (CSU +69%), and Dollarama (DOL +45%).

Is it luck that our process would direct us into buying one of these winners? What about all three?

We purchased Constellation Software in January 2014, Valeant in October 2014, and Dollarama on January 2nd this year. We also own the #4 and #5 best-performing stocks as well (Alimentation Couche-Tard and Gildan Activewear), although they were purchased in March this year so their performance year-to-date is different than the values shown above (+30% and +8%, respectively).

For comparison, the chart below shows all the stocks that have lost money year-to-date in the TSX 60 index:



The only two names in the above chart that we have owned this year are Kinross Gold (we took a -18% loss in March) and Canadian National Railway (sold for a 10% gain in January).

We are not so smart

I want to stress the effectiveness of our investment process, not the brilliance of our individual stock picking skills. I have eaten my fair share of humble pie in my career, and do not want you to confuse the respectable results of the Cameron Woods investment process with any individual market-timing/research-orientated skills on my part. In fact, I whole-heartedly believe that one of the key ingredients to our success is the fact that we completely put aside our own emotions – our fears, our hopes, our foibles – and simply follow the process we developed. We are passionate about the process and agnostic about the investments.

Would you like to "get lucky" too?

1. Call us for a review of your current investment positions and how they stack up – are the odds of success in your favor, or not?
2. Follow along and familiarize yourself with our process and when you're ready we can talk. Sign up to receive our newsletter (contact information is listed at the bottom of this page).
3. Call us to book a meeting and we can discuss whether our unique investment approach would be a fit for you.

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Cautionary Note

This report does not constitute a recommendation or solicitation to buy or sell any investments mentioned in the article. At the time of writing we own shares of some of the stocks mentioned in this report within our Canadian Growth Portfolio, North American Growth Portfolio, and/or Dividend Growers' Portfolio. We may sell these positions at any given time that our indicators dictate.

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