Laurus
INVESTMENT COUNSEL

GLOBAL SMALL CAP SPECIALISTS

MONTHLY COMMENTARY | april 2022

"Logic is the subject that's helped me the most in picking stocks, if only because it taught me to identify the peculiar illogic of Wall Street. Wall Street thinks just as the Greeks did. The early Greeks used to sit around for days and debate how many teeth a horse has. They thought they could figure it out by just sitting there, instead of checking the horse. A lot of investors sit around and debate whether a stock is going up, as if the financial muse will give them the answer, instead of checking the company."

- Peter Lynch, One up on Wall Street

In his letter to Amazon shareholders for the year ending December 2000, Jeff Bezos began with the word "Ouch". Given market conditions since November 2021, it seems appropriate to reflect, not just upon the word itself, but the context in which it was written. Amazon had closed that year with a market cap of $5.6 billion having fallen from $26.3 billion the prior year end. And nine months later, by September 30th, 2001, the market cap had halved again.

Roughly twenty years later, Amazon finished 2021 with a market cap of $1.73 trillion – a sizeable, and commendable, record of shareholder return.

Of course, it would have taken a strong heart to stand by idly and watch your investment in Amazon fall 92 percent over roughly eighteen months. Imagine being a professional and trying to explain this investment to your client! Yet if one had to illustrate how a unique business with strong management can lead to incredible shareholder returns, Amazon would be a poster child.

The past ten years or so have been a wonderful environment for investors. Even with the very abrupt pullback at the pandemic beginning, the bounce-back was quick.

But, for the meantime at least, the party has finally concluded. The issues about which many been expressing concern are finally coming to pass. Inflation is proving to be a more difficult challenge to central banks, while interest rates and commodity prices have increased to multiyear highs, with all that juxtaposed on a war in Europe. At last, like a clock striking twelve, the perma-bears are finally right!

Long duration investing in quality companies is often challenged in these times. With valuations based on long term cash flow models, when the future is less certain Mr. Market tends to focus on current cash flow yield. Increasing nervousness ignores the compounding effect of businesses that are regularly investing to increase their heft through unique, innovative, and often disruptive ways.

These businesses become far more valuable the more they are ignored. Case in point, over the past few months we've had half a dozen companies in Canada, the US, and Europe either acquired or approached to be acquired. The long-term value of these businesses is far greater than what they trade for today and well-recognized by professionals in the know.

Quality businesses are defined by long, well-established track records of successful growth resulting from superior business models run by committed, visionary, and trustworthy management teams. These characteristics enable companies to achieve high levels of profitability over time and generate durable and growing streams of cash flow. Most are also asset-lite with strong balance sheets enabling them to readily fund their growth without needing to rely on external capital.

In short, we believe that the best way to create strong risk-adjusted returns for our clients over time is to own the best assets for the long term.

The current environment has value outperforming growth, positive momentum faltering, negative momentum accelerating, and cyclical asset–heavy companies gaining favor. While history has proven this change in investor attitude is transient, its length is unknowable.

The exuberance that drives the market upwards as well as the fear that drives it down is well beyond our scope. While beyond our control, we are mindful of the risks and challenges of the current environment along with the potential for permanent loss of capital. Fortunately, at this writing, our long-term invested capital remains intact; in fact, our role is to take advantage of the current uncertainty to explore new and innovative companies now trading at greater discounts to their intrinsic value.