

*"A turkey is fed for a thousand days by a butcher; every day confirms to its staff of analysts that butchers love turkeys "with increased statistical confidence." The butcher will keep feeding the turkey until a few days before Thanksgiving. Then comes that day when it is really not a very good idea to be a turkey. So with the butcher surprising it, the turkey will have a revision of belief—right when its confidence in the statement that the butcher loves turkeys is maximal and "it is very quiet" and soothingly predictable in the life of the turkey....The key here is that such a surprise will be a Black Swan event; but just for the turkey, not for the butcher...."*

from "Antifragile" by Nassim Taleb

This is a favourite quote, not because of the obvious message but its inference to the distinction between true and manufactured price stability. It's always a conundrum as a portfolio manager.

Let's start with oil. Over the past number of years, supply has continually increased due to growth in shale oil production in the U.S. and that increase, along with a stronger US dollar, drove oil prices lower (since oil is priced in USD). At the same time, demand for oil has weakened in the developed markets as economies slowed and vehicles have become more fuel-efficient. However, none of these things are new. The fall in oil prices on OPEC and its unwillingness to lower production, but what is now an obvious decline was not obvious six months ago. Oil prices have sunk more than 60% percent since the beginning of 2015, and this happened not during a financial crisis but in a reasonably stable, slow-growth global economy.

Now let's place these events in the context of the current environment. Ultralow global interest rates have pushed all market participants into riskier assets. In addition, low interest rates are also pushing investors into using more leverage. But volatility and leverage are not friends and, unfortunately, we never know where all the leverage is buried and will only find out after the fact.

"As crude has soared more than 50 percent since Feb. 11, the number of bets on increased prices has barely budged," Bloomberg reported in late March. "Instead,

the upward pressure on prices appears to have come from traders cashing out of bearish wagers at an unprecedented pace. The liquidation of short positions during the last seven weeks covered by data from the U.S. Commodity Futures Trading Commission was the largest on record."

The bearish short trade became too crowded—and the shorts pushed their luck. In the past couple of months the market has been punishing them. Is the world drowning in oil? Maybe, but the market doesn't care - when one group leans too far over the edge, a powerful snapback usually isn't too far behind.

Which brings us to the current state of our portfolio strategy. While oil dropped precipitously to sub-\$30 levels, our under-weighted portfolio surpassed the commodity-biased index as well as our peers. But, since the end of the third quarter of 2015, the price snap-back has left us in the lurch relative to, not only the TSX Index, but our heavier-weighted peers as well.

The same is true of metal and mining shares which have rallied strongly after years of decline. Mostly the same reasons – a 20% gold price increase (copper is still more than 50% off its 2010 peak) from December lows have "gold bugs" once again whistling a happy tune.

But are they the butcher...or the turkey?

We've learned over many, many years that investing in companies without a definable intrinsic value leaves our clients susceptible to the vagaries of commodity price increases and decreases on which these businesses trade. Accordingly, our 10% energy weight is balanced between two financially-strong, well-managed exploration companies and three service companies that are leaders in their respective markets. While this may change over time, for now it's sufficient.

Our long term investment strategy continues to focus on true price stability over manufactured. Performance has begun to recover in recent weeks as the speculative commodity prices, once again, wane. We continue to consider new opportunities that look promising.