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INVESTMENT OUTLOOK

Leith Wheeler's Value Investment Philosophy

After 30 Years, Not Much Has Changed

No investment philosophy exists that can always beat the market while being unique. If there was such a holy grail, our work would be easy. The combined elements of fundamental analysis, good judgement, thorough research, expertise and a healthy amount of skepticism is a good start to market beating performance but it is difficult to argue that these elements are unique and proprietary to Leith Wheeler. Furthermore, the stock market does a pretty good job of aggregating massive amounts of information in an attempt to calculate the value of a business. However, because the task is so difficult, and because the human emotions of fear and greed are thrown into the equation, the market is sometimes wrong. Here lies the opportunity for an investment philosophy that focuses on active stock selection vs. a passive investment in the market. But how is Leith Wheeler different?

We understand that to beat the market, we need to be different than the market

Albert Einstein said, "The definition of insanity is doing the same thing over and over again and expecting different results". We feel the investment managers' version of this is to own a portfolio that looks very similar to the market yet expecting very different performance. Too many people worry about the risk of an investment in comparison to the market when the real risk is that of losing money. Our portfolios tend to be distinctly different than the markets as we are attracted to ideas we hope will perform well in the future rather than those that did well in the past. Focusing on our best ideas means we avoid many other investment ideas along the way and even entire sectors of the market. At times in the recent past, it has been uncomfortable to not own a relatively large component of the Canadian market like gold but we simply are finding better ideas elsewhere. Having a contrarian view does have its benefits.

We pick stocks as though we were buying the whole company

Like all sensible investors, we prefer to buy businesses that have some competitive advantage or franchise that will preserve the company's ability to deliver attractive returns on capital. However, we realize that the market usually recognizes and fully values companies that have clear and understood businesses. Therefore, our efforts are focused on finding solid businesses that may not be fully appreciated by the market. Often these businesses may be under some temporary cloud or competitive pressure

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such that the franchise value is not clear to the market or perhaps the business lacks the speculative appeal or flavour of the day that many investors find so alluring. A good question then becomes, do we like the stock enough to own the whole company?

Patience required

Our firm's private ownership and independence allows us to take meaningful investment positions and to maintain them for periods long enough to allow events to unfold. We are not driven by quarterly performance measurement or by a need to build market-like portfolios. Leith Wheeler sees businesses as potential long term investments and not merely an idea to 'rent' for a short period of time. Since most research available to investment managers is focused on the short term, we must do our own homework and think independently. We feel this is best done when our investment teams focus on what they know best and stay within their 'circle of competence'.

Price, Price, Price

Businesses are worth the present value of their future cash flows. We calculate business value and try to buy stocks below this level. Who doesn't like getting a deal when something of value to them is on sale? We like businesses with strong balance sheets; conservatively financed companies give us a margin of error if events do not go according to plan. We like to own such businesses that have real earnings, not the promise of earnings. The price of promised growth tends to be too costly. And like the three rules of real estate are 'location, location, location' the same is true of 'price' in the world of value investing.

Focus on People

The strength, integrity and experience of a company's management and its Board of Directors are important considerations in our evaluation, just as it would be if we were entering a business partnership. We expect management's interests to be aligned with those of its shareholders. This means that a substantial amount of a firm's senior management's own personal wealth should be exposed to the risks as well as the rewards of their business. Simply granting stock options to management does not appeal to us, as options allow management to benefit in the good times but do not have the opposite effect when shareholders get hurt. Not only do we meet with management but we also speak to their customers, competitors and suppliers. We do this because we believe owning shares in a company is a fiduciary responsibility and we take it seriously. Our objective when voting proxies or taking other actions on corporate governance issues is to ensure, on behalf of our clients, that the long term value of our investment is maximized and all shareholders are treated equally. Ultimately, we ask ourselves if we are comfortable with how management is running the business?

"We don't have to be smarter than the rest. We have to be more disciplined than the rest." -Warren Buffett

At Leith Wheeler we believe this to be true. A patented investment philosophy for investment management that always beats the market simply does not exist. However, we feel our disciplined approach to value investing and the five simple rules above have served our clients well. We are driven to protect clients' capital, earn market beating results as well as continue to earn our clients' trust well into the future.

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