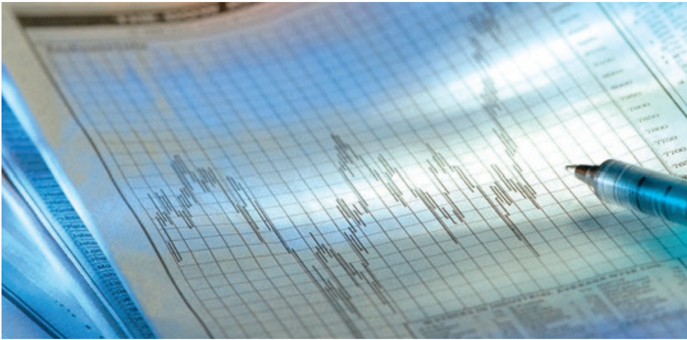
GFI Investment Counsel Ltd.

Preserving and growing family capital™

GoodQuarter Q3'19



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"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

— Peter Lynch

Dear Valued Client,

The third quarter of 2019 was positive for the operations of our businesses and, in aggregate, their stock prices as well. Near quarter end, we decided to exit one of our holdings and purchase a business with what we believe to be more attractive attributes. Given we only make changes to our portfolio three or four times per year, we are always excited when we find a new entrant.

We thought the quote (above) by Peter Lynch was very appropriate in light of the ongoing media attention being given to a potential recession. A recession will occur at some point, but that does not detract from the logic of owning profitable, efficient and growing businesses. Our article on page 3 discusses the pitfalls of market timing.

We have also included a recent article from the Globe and Mail that featured our firm. In it, Dan discusses the GFI approach to investing and goes into a little more detail about a few of our portfolio holdings.

As part of our commitment to improving security, please note that going forward, all e-mail attachments will require a password to open. This step is being taken to provide additional protection to your data. Your password will be familiar to you personally, or it will be provided in a separate e-mail. We apologize in advance for the inconvenience this change might cause.

Thank you for continuing to trust us with your assets. We ask, as always, that you please give us a call if you have any questions or concerns that you would like to discuss.

Daniel Goodman, CFA
President and
Chief Executive Officer

Effie Wolle, CFA, MBA
Chief Investment Officer

THE GLOBE AND MAIL

CANADA'S NATIONAL NEWSPAPER • WEDNESDAY, OCTOBER 2, 2019

How this $925-million fund manager has been beating the market and what he's buying and selling right now

BRENDA BOUW
Special to The Globe and Mail

Some portfolio managers talk about getting more defensive when markets are volatile and threats of recession loom, as is the case today. In that context, Daniel Goodman, chief executive at GFI Investment Counsel Ltd., believes he's already in a good place.

"We like to think of ourselves as defensive through the ownership of high-quality businesses and the avoidance of low-quality businesses," says Mr. Goodman, whose Toronto-based firm oversees about $925-million in assets under management.

GFI invests in about 15 to 20 stocks at one time, exclusively in North America, with a 50-50 split between the United States and Canada. He describes high-quality businesses as the type that "allocate their shareholder capital well and will take advantage of some sort of blip in the marketplace to either buy back stock, or possibly acquire a competitor." Some of GFI's key holdings today include Brookfield Asset Management Inc., Visa Inc., Apple Inc. and Restaurants Brands International Inc., the parent of Tim Hortons.

GFI's all-equity portfolio returned 29.2 per cent year-to-date, as of Aug. 31. That compares with a return of 15.1 per cent for the S&P 500 and a 17.1-per-cent return for the S&P/TSX Composite Index over the same period, the company says. All returns include reinvested dividends. The same portfolio has seen a compound annual growth rate of 18.1 per cent over the past five years, as of Aug. 31. The firm's returns are after fees that range between 0.6 per cent for portfolios over $20-million and 1.35 per cent for those under $2-million.

The Globe and Mail recently spoke to Mr. Goodman about his investing style and stocks he's been buying and selling.

Describe your investing style.

The best term would be value investors, but it doesn't mean we don't look for growth businesses or growing companies. Price is what you pay and value is what you get. We focus more on the quality of a business. We have a qualitative checklist we put all of our business investments through. We ask ourselves, do customers benefit? There is no sector domination in terms of how we think. Generally, our checklist leads us to businesses that have some pricing power.

Why are you focused on North American investments?

We really only want to invest where the rule of law is strong and where we know our rights as shareholders are protected. There are other places in the world where we can achieve that, but we also like to stay in our circle of competence. The reason why we have a fairly high degree of U.S.-based businesses is because the Canadian marketplace is pretty narrow.

What concerns are you hearing from investors today?

Some of our clients are concerned the markets have run too far, too fast. They're also concerned with the impeachment talk in the U.S., political instability and the inverted yield curve – topics they hear about in the media day in and day out. A lot of clients are concerned about generating yield, especially retired investors living off of their portfolio. We caution them not to chase yields. There are instruments out there that show a very high yield, but the quality of that investment usually is suspect.

What have you been buying lately?

We are in the process of buying Microsoft Corp. We've owned it before in the past, but it's a new position for client portfolios. It's a wonderful business. It has a long runway for growth, very high margins and it's an incredibly sticky business. I don't see a lot of businesses migrating away from [Microsoft's] cloud web-based services or their software. They have a pretty high cash position and no net debt.

What have you been selling?

Our turnover is quite low. Earlier this year, in the first quarter, we sold BlackRock Inc., one of the world's largest ETF providers. We weren't seeing the operating leverage that we would expect from an asset management firm. It's really predicated on the fact that ETF fees are going down significantly and the large [assets under management] they have is in the extra low-cost ETFs. They haven't really been able to grow the other aspects of the business. We found greener pastures elsewhere.

Name a stock you wish you bought (or wish you didn't sell so soon)?

Ferrari NV is a stock we wish we bought. It's a high-end brand that has built a following. It only produces a limited supply of new release automobiles. In many cases, [the cars] trade after-market at a higher price. It's a wonderful business, I think it will remain a great investment for many years to come. We've never owned it.

A stock we wish we didn't sell was McDonald's Corp., which we sold in the third quarter of 2014. They had shown weaker same-store sales growth and we weren't sure the fast-food industry would continue to dominate. There were newer upstarts that seemed to be grabbing share of wallet, but it has proven to be a wonderful business longer term. We underestimated the resilience of that business.

This interview has been edited and condensed. Special to The Globe and Mail.

Why market timing rarely works

With recent news headlines overwhelmingly insinuating that a recession is imminent, and a Presidential Twitter account driving steep market swings, it's only normal to question the current investment climate.

We always stress that we do not time markets and we don't let short-term opinions drive our investment process. We have no idea what the markets will do in the short term and, in our opinion, nobody else does either. We take a client-focused and holistic approach to building your wealth and ensuring your portfolio and risk are properly aligned with the timing of your various goals and objectives.

To illustrate how difficult it is to time the market, DALBAR, a leading research firm, wrote a report analyzing U.S. equity mutual funds' investor returns compared to the returns of the S&P 500 Index. The S&P 500 had an annualized return of 10.0% over a 30-year period, while equity mutual fund investors realized a relatively low 4.1% return. We can attribute some of the investor underperformance to mutual fund fees, but the larger difference is attributed to individual investors attempting to time markets or switching between different funds at inopportune times. Basically, too many investors lack the patience required to remain invested over the long term.

With this in mind, here are some other common mistakes that can lead to subpar returns:

Acting on information that is irrelevant to your particular investment goals and time horizon

Investors are often tempted to make investment decisions based on information that is irrelevant to their particular goals. For example, an investor may sell their equities because they feel that markets are inflated and may experience steep declines "soon." However, this investor might be 45-years old and he or she doesn't have a need to access these funds for at least 15 years. Even if this investor did happen to get lucky and sell before a downturn materialized, they have to time the other side of the trade properly and buy back their equities at a favourable moment. This has historically proven to be extremely difficult.

Having the incorrect asset allocation for your goals

Research has shown that asset allocation has a much greater impact on investor performance than selecting the optimal stocks or funds to invest in. Many investors think their risk tolerance is higher than it actually is and, of course, it's much easier to be aggressive in a bull market. Investors with an equity allocation that is higher than they're comfortable with tend to adjust their portfolios into less-volatile asset classes (like fixed income) when equity markets are trending lower, which is never the optimal time to adjust allocations.

Excessive trading

Not only does excessive trading result in higher transaction costs, you lose the benefit of tax-deferred growth on your investments (in non-registered accounts). Deferring taxes until a later date is most people's preferred option. That is one of the reasons why we own a diverse and concentrated portfolio of wonderful businesses that we understand well and can continue to own for a long time.

The mistakes we've outlined are all driven by emotional investing, and we all know the market doesn't care about our emotions. That's why GFI adheres to a disciplined investment approach that allows us to tune out noise that is irrelevant to our clients, and focus on the quality businesses we will continue to hold.

While we don't know where markets are going in the short term, we know with a very high level of conviction that sticking to your investment plan and ignoring the noise will lead to investment success.

GFI Investment Counsel

GFI Investment Counsel ("GFI") provides tailored investment portfolios to families, foundations, trusts and corporations. We work closely with our clients to customize investment accounts that coincide with our clients' unique requirements. GFI focuses on preserving and growing client capital through intense due diligence, focus, and discipline.

In January 2008, GFI launched Good Opportunities Fund ("the Fund"), an alternative investment fund available to accredited investors. The Fund focuses on a select group of investment opportunities that provide an attractive risk/reward dynamic regardless of asset class or market capitalization. The Fund is managed with a focus on understanding the businesses, their capital structure, and risks and opportunities.

For more information about GFI Investment Counsel or the Good Opportunities Fund,
please call **416.488.8825** or **email info@gfiic.com**.