

GoodQuarter

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“In the short run, the market is a voting machine, but in the long run, it is a weighing machine.”

— Benjamin Graham

IN THIS ISSUE

- > Thinking About Valuation
- > The Buy: Amazon

Dear Valued Client,

Long-term investing inevitably comes with bumps along the road to prosperity. In the moment, those bumps can feel relentless, but they pass. They always do. At the same time, technology evolves, and we must adapt thoughtfully, adjusting the portfolio where necessary without overreacting to short-term noise. Proverbially, we cannot throw out the baby with the bathwater. It is vital to distinguish between a declining stock price and a deteriorating business. During the first quarter, many of our holdings saw their stock prices fall even as their earnings, revenue, and market share increased. This "divergence" is often where the greatest long-term investment opportunities are created for business owners.

Over the past year, we recognized that the consulting businesses we owned could face structural pressure from Artificial Intelligence. As a result, we exited our positions in Booz Allen Hamilton Holding Corporation, CGI Inc., and Genpact Limited. While each company has its own characteristics, in all cases a combination of technological change and political risk led us to conclude that, as owners of liquid securities, we could redeploy capital into businesses with brighter long-term prospects. We therefore acted.

We will continue to adjust the portfolio where we see risk. As noted in our previous newsletter, given evolving market dynamics, we believe it is prudent to diversify beyond the 18 businesses we held for many years. We now own 20 companies and expect to continue broadening the portfolio with select new investments over the course of the year.

Our investment approach remains consistent: to invest in high quality companies operating in growing industries that generate attractive returns on capital. More recently, this has led us to investments such as Brookfield Asset Management Ltd., Amazon.com, Inc., TMX Group Limited, and Canadian Utilities Limited.

We are optimistic about the future of the portfolio, while recognizing that periods of volatility are inevitable.

As always, we are available should you have any questions.

The GFI Team

Thinking About Valuation

Investment risk is often framed in terms of volatility, economic cycles, or unforeseen events. Yet one of the most persistent and underappreciated risks is far more mundane: overpaying. The price you pay for a business ultimately determines your return, and even the highest-quality company can become a poor investment if purchased at an excessive valuation. This is the quiet danger that confronts investors who chase perceived safety without regard for price.

Consider Walmart, a company we do not own, and one of the most admired and durable businesses in the world. It has scale, strong cash generation, and a dominant position in essential retail. Today, an investor buying Walmart pays 44 times last year's earnings and 55 times cash flow, a 50% premium to the historical Walmart valuation (ongoing capital expenditures exceed depreciation). At such a valuation, even superb execution may not be enough to justify the purchase price. If growth slows, margins compress, or capital allocation falters, the multiple can contract, leading to disappointing returns despite the company remaining fundamentally sound. In this way, valuation risk can overwhelm business quality.

High multiples embed optimism. They assume favorable conditions will persist and that management will execute flawlessly. The real world is rarely so accommodating. Competition evolves, consumer behavior shifts, and technological change introduces new threats. When expectations are elevated, the downside from even modest disappointment can be severe.

In contrast, companies trading at low valuations, when that discount is unwarranted, can offer a different kind of opportunity. These situations arise when the market extrapolates short-term challenges too far into the future, or when a business is simply overlooked. If the underlying economics remain intact, buying such companies at depressed prices can lead to strong returns as sentiment normalizes. The multiple expands, cash flows continue, and the investor benefits from both.

The key distinction is between justified and unjustified cheapness. Some businesses are inexpensive because they are structurally impaired, overleveraged, or in decline. These are value traps, and they deserve their low multiples. Other companies are temporarily out of favor, perhaps due to cyclical pressures, misunderstood strategy, or transient issues. In these cases, the gap between price and intrinsic value creates opportunity. The margin of safety works in the investor's favor, providing protection against downside while allowing for upside as conditions improve.

Ultimately, investment risk is not just about what you own, but what you pay. A great business at the wrong price can be a poor investment, while a good business at the right price can be exceptional. The discipline lies in resisting the allure of quality at any price and instead focusing on the relationship between price and value. Different business models justify a different price. We are willing to pay higher valuations for capital-light growth while eschewing high multiples for perceived safety in capital intensive industries. Over time, it is this discipline that drives superior returns.

The Buy: Amazon

Contrary to intuition, purchasing Amazon in January of this year required a willingness to look past a mediocre 5-years of stock performance and focus instead on the underlying evolution of the business. For much of the prior five years, Amazon shares have delivered mediocre returns compared to earlier periods. That stretch of underperformance, driven in part by pandemic pull-forward effects, cost inflation, and heavy reinvestment, had an important consequence: it compressed the company's valuation multiple. What was once an expensive, high-growth business began to look far more reasonable on a price-to-earnings basis, particularly as earnings power started to recover post-COVID. To be specific, Amazon now trades at 30 times earnings with renewed Amazon Web Services ("AWS") growth and retail margins that should grow from 6% to double digits.

This reset in expectations created an opportunity. Beneath the surface Amazon's retail business is quietly becoming more efficient. After years of building out its logistics network, the company has begun to reap the benefits of its scale. Delivery speeds have improved, regionalization of its warehouses reduced shipping costs, and automation drove productivity gains. These changes translated into expanding margins in the North American retail segment, a notable shift for a business known historically for thin profitability.

At the same time, AWS has remained a pillar of the overall business. Although growth has moderated from its earlier hyper-growth phase, demand for cloud infrastructure and associated tools remains strong. Enterprises continue to migrate workloads to the cloud, and AWS's broad suite of services, ranging from compute and storage to advanced analytics and machine learning, position it as a dominant platform. AWS also owns a material equity stake in Anthropic PBC, creator of Claude.

Within AWS, newer initiatives add another layer of potential. Amazon's Trainium chips, designed to lower the cost of training machine learning models, represent a strategic move into custom silicon. As artificial intelligence workloads expand, controlling the cost structure of compute becomes increasingly important. Trainium offers customers an alternative to more expensive third-party chips, potentially improving both performance economics for users and margins for Amazon. While still early, this initiative underscores Amazon's willingness to invest in long-term advantages even during periods of market skepticism.

Another structural shift strengthening the business is the continued move toward third-party services within the retail marketplace. Third-party sellers now account for a majority of units sold, and this shift is inherently more profitable. Instead of taking inventory risk, Amazon earns fees for fulfillment, logistics, and marketplace access. This model enhances returns on capital and contributes to margin expansion, reinforcing that the retail segment is not just growing, but improving in quality.

Finally, Amazon's advertising business has emerged as an underappreciated profit driver. Leveraging its vast first-party data and high-intent shopping traffic, the company has built a rapidly growing ad platform. Advertising carries significantly higher margins than traditional retail, and its growth has meaningfully boosted overall profitability. As brands increasingly allocate budgets toward digital channels, Amazon's position at the point of purchase gives it a unique advantage.

Taken together, the case for purchasing Amazon became clear. Retail margins are improving, AWS remains an industry leader, Trainium is gaining traction, third-party services are enhancing profitability, and advertising continues to grow very profitably. We are excited to be shareholders of Amazon for years to come.

Our Client Commitments

Here are the promises we make to you (formed over decades of industry experience):

- 1. We will always** manage your money as if it was our own – and we don't take unnecessary risks with our own money.
- 2. We will never** claim to be able to time markets.
- 3. We will always** ensure you understand what we are saying.
- 4. We will** return your phone calls and emails promptly.
- 5. We will always** report your performance net of all fees.
- 6. We will always** disclose how and what we charge you.
- 7. We will always** use the appropriate benchmark and include dividends when comparing our performance to benchmarks
- 8. We will** manage your capital rationally.
- 9. We will never** discuss or use terms like "macro," "tactical," "sector rotation" or "absolute return."
- 10. We will never** chase the most recent investment trend.
- 11. We will** charge fair fees; not the fees we think we can get away with.
- 12. We will never** use the term "risk-adjusted" to justify poor results.
- 13. We will never** use Greek letters to explain our approach or rationalize our returns.
- 14. We will never** tout illiquid investments as if they are "less risky" just because they are private.
- 15. We will never** launch new products simply because a sector is "hot."

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**.



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family capital™*