Seymour Investment Management

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Following a year of unprecedented calm in 2017, investors were met with a return to volatility during 2018. Market weakness, particularly during the fourth quarter, dominated headlines and led to negative returns felt across markets and asset classes. The Canadian S&P/TSX Composite Total Return Index ('TSX') fell 8.9% for the year. The S&P 500 was down 4.4%, and the EAFE (Europe and the Far East) was down 16.2%.

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Although corporate earnings continued to show robust growth during the year, equities were faced with uncertainty and pessimism. Increasing interest rates, global trade tensions (notably between the US and their various trading partners) and political turbulence created a degree of unrest amongst investors.

We will go into further detail on how these market conditions, notably the inexpensive valuation that stocks are at today, have us excited. But first, we touch on the natural response that many investors feel during times of market volatility and the best way to mitigate the pitfalls of succumbing to these common emotions.

Staying the Course

History has long since shown that it is time in the market, not timing the market, which produces superior long-term results. Compounding effects and long term positive trends work in the investors' favour over time. However, harnessing these benefits requires a long-term perspective, something which many investors stumble on. The common pitfalls of short term thinking and attempting to time the market are key factors that contribute to the average investor underperforming the market.

Corrections are a normal part of market behaviour and occur more frequently than many realize. In fact, since 2000 the average of the largest annual peak-to-trough correction for the S&P/TSX Composite Index was over -16% while during that same period, the average return was 5.4%.

Riding the waves of volatility is key to achieve long-term positive returns. Not only does history show the waves of volatility settle as the time period elongates, but also it demonstrates that during periods of high volatility, the best and worst days are often clustered together.

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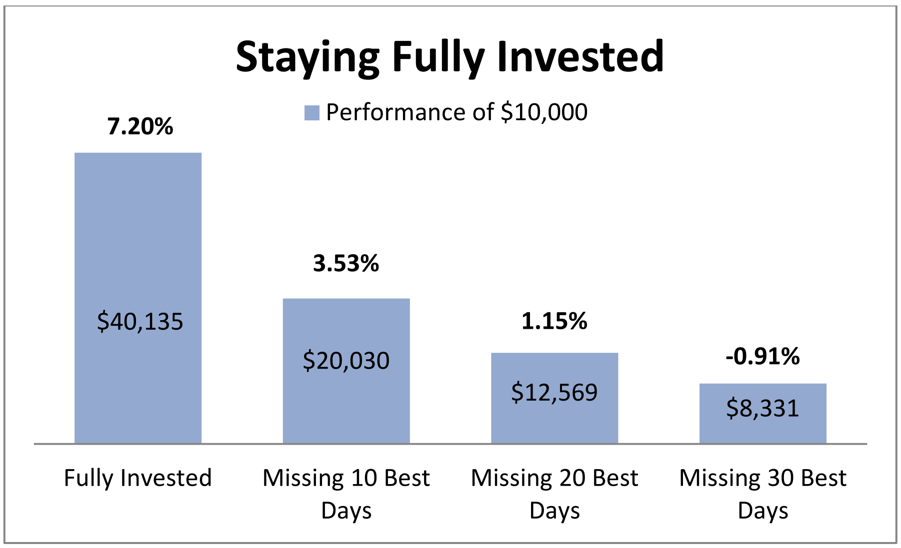
Although corrections can be unsettling, attempting to time the market or deviate from long term plans during these periods of volatility can lead to missing out on the positive days. The impact of this is significant. **As we can see, depicted in the graph below, missing just 10 of the best days over a 20 year time period halves the return from 7.20% to 3.53%.**

Exhibit 1: Performance of $10,000 in the S&P Total Return Index from 1998 - 2017



Source: J.P. Morgan Asset Management, Bloomberg, Seymour Investment Management

By maintaining a disciplined and patient approach, investors will be rewarded with greater success in achieving their long term goals

Market volatility is a normal part of investing. As we have said in previous letters, we cannot predict what is going to happen in the short term. However, over the long term, we see markets converge to more predictable, stable, and positive trends. Detailed in our 2018 Q1 letter, on a daily basis the market is up 55% of the time, however on an annual basis the market is up 75% of the time. By maintaining a disciplined and patient approach, investors will be rewarded with greater success in achieving their long term goals.

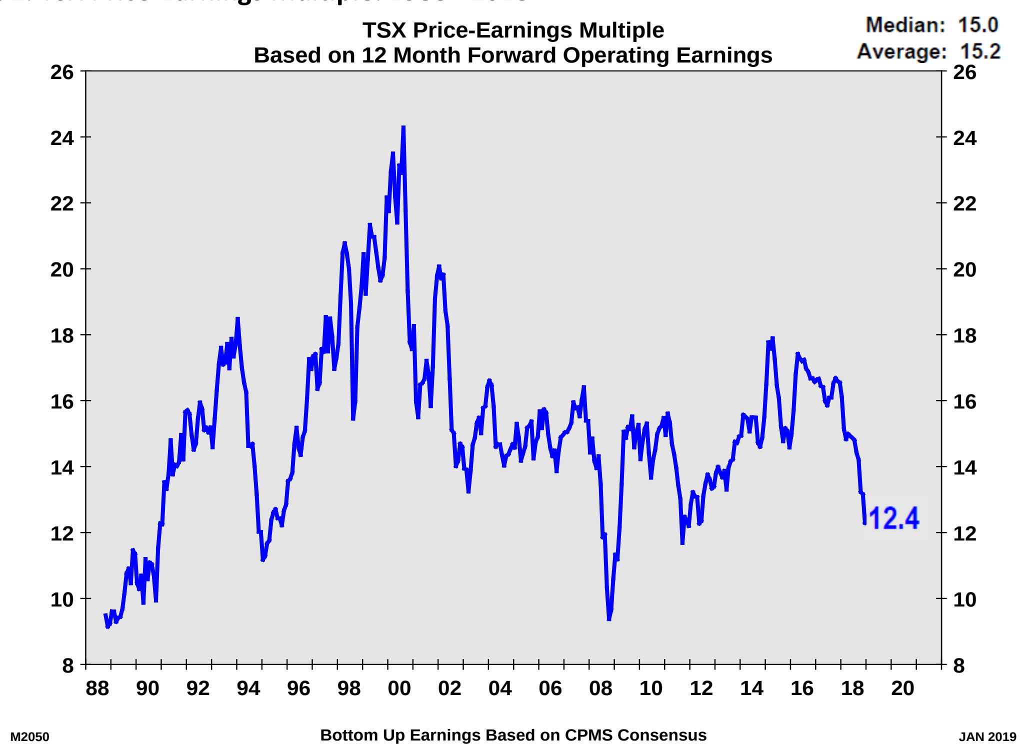
Earnings Growth

As mentioned above, over long term time horizons, market trends become more predictable. One such trend the market typically follows is that of corporate earnings growth. Historically, stock prices have tracked earnings growth fairly consistently. Although short term deviations occur, over the long term consistent trends emerge.

TSX Price to Earnings Multiple sits at 12.4 times, below the historical average of 15.2

Despite the negative headlines and the fluctuating stock prices, underlying corporate profits have been progressing in a fairly stable and positive manner. This has led to valuations moving into attractive territory. Valuations, which look at the price an investor is willing to pay for a piece of a company's earnings, are at historically low levels. The TSX Price to Earnings Multiple based on 12 month forward operating earnings sits at 12.4 times, below the historical average of 15.2. In previous cycles, investors who have bought at similar low valuation levels have been rewarded with above average returns. For example, following similar valuation low points in 1994 and 2008, the TSX saw elevated returns of approximately 9% over the subsequent ten year period.

Exhibit 2: TSX Price-Earnings Multiple: 1988 - 2018



Source: TD Securities

Investor Sentiment

"Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria"

Market sentiment acts as a contrarian signal to market movements. Typically, when markets are reaching a peak, sentiment is positive, euphoric even. Conversely, when markets are reaching the lows of a correction, pessimism is prevalent.

Sir John Templeton, who is widely viewed as one of the greatest global stock pickers of the 20th Century, asserted: **"Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria."** Presently, pessimistic sentiment indicators are higher than normal. CNN monitors a Fear and Greed Index suggesting investor emotions are at 'Extreme Fear' levels as at December 31st and have been for much of 2018.

While some weary investors are running for the hills, there are many informed investors who are getting excited about the opportunities available in the market today. Interestingly, a group of these optimistic investors includes corporate executives.

Looking at insider trading volume, the number of corporate directors and executives purchasing shares of their own companies has doubled in the past two months. Bloomberg notes that the ratio of insider buying relative to insider selling is at its highest point since August 2011. The support these executives show for their own companies demonstrates a vote of confidence in the businesses that they run.

Investors too often focus on share prices, and forget that they have an ownership position in a business. Stock prices will see volatility, but through this the business itself will continue to operate and hopefully grow. As always, we strive to own quality companies with strong management teams that can skillfully navigate the world we live in.

As we look towards the coming year, we are optimistic about the opportunities in front of us. We recognize that the market is inherently unpredictable, but we do know that valuations have proven to be a reliable predictor of future returns. At this juncture, valuation multiples are at multi-year lows presenting a more attractive opportunity than we have seen in quite some time.

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As always, we welcome any feedback. As a reminder, TFSA contributions have increased to $6,000 this year. If you would like to make TFSA or RRSP contributions please reach out to any member of our team.

We thank you for your continued support and wish you and your family all the best in the year ahead.

Warm regards,

The Seymour Team