IRA'S MUSINGS

January 15, 2010

Many years of observations have confirmed to me that good golfers pay very little attention to their occasional bad shots. I've watched television interviews where the famous pro first denies that he hit a single bad shot all day, and then, after some pushing by the interviewer, observes that the wind took his shot off course, or that a rude spectator had interfered with his backswing. Investors, on the other hand, are all over the lot in terms of admitting to errors. Some are like the pro golfers described above; I, on the other hand, tend to privately obsess about bad stocks and bad performance, while maintaining my public, polite demeanor.

For the record, calendar 2009 was a good year for the funds that Christine and I are responsible for. The percentage gains were quite strong by normal standards. Unfortunately, the results are not good enough to offset the poor numbers of calendar 2008. I am not surprised by these calculations. At the beginning of 2009 I thought it could take a number of years to get even, but today I can actually see some daylight ahead.

I am not about to disintegrate into tears on this topic. I just don't want anyone to think that my memory is so selective that I would forget about 2008. What I would have done differently is a whole other topic. The answer, however, is less than you might think. We had a thesis for a number of years that China and India and the inevitably impacted Canadian commodity stocks, were the places to be. This remains our thesis today. For six months during the last half of 2008, this thesis was discredited, which lead to rapid and dramatic price declines in virtually all equities, but the commodity stocks were the hardest hit. Decades of history, however, have reminded me that one should stick to one's thesis if you have one, and not get caught up in the latest wave of popular thinking. On the same topic, you shouldn't sell, if your thesis also happens to become popular for the moment. Certain themes can continue for very long periods of time.

My original intention for this edition was to inform you that my so-called retirement was highly overrated. I spent the Christmas holidays in South Florida, exactly as I have done in the past. I played with family and friends, watched CNBC periodically during the day and read the exact same material that I read in Toronto. Business life for me is not exactly the same. My involvement within the firm and within the investment department has been shrinking for years. I meet with few clients. I have more free time on paper, but this is all hypothetical. Trust me, you can obsess about bad performance 25 hours a day and dream about new ones for almost as long. Normally this particular edition might contain some kind of forecast, but as you know we were fortuitous enough to hire David Rosenberg eight months ago. David's economic arguments are compelling, especially the enthusiasm he has for the China/India commodity story. I have devoted much space in these *Musings* to the importance of asset mix and I am not recanting, but I also believe that there is a role for old-fashioned stock picking. For the record, the majority of the

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time of most of our investment professionals is spent analyzing companies. The complication is that almost by definition most of the attractive stocks in Canada are in the resource area.

It is possible to find resource stocks without huge volatility, but the majority of good ones (almost by definition to repeat the phrase) have high volatility. The perfect resource stock has resources in the ground and in monetary terms is priced somewhat near the net asset value, so you can capture the upside potential from exploration, or development, or some sort of new initiative, at little cost. This is an admirable thesis, which we strive for all of the time. Unfortunately, the stock market interferes on a daily basis. Sometimes investors can become very excited about the exploration potential and the stock is unable to match the hype. The analogy is a great growth company that has spectacular quarterly earnings, but comes up a few pennies short of analyst's estimates and the share price proceeds to tank for awhile.

I can live with all of this, but I am just pointing out the pitfalls. For obvious reasons, a lot of investor attention is focused on junior resource companies. They have the most leverage. These are not the centre of our attention, nor are the very large companies (with the odd exception at either end of the spectrum). Our focus historically, and again at this moment, is on mid-sized resource stocks. There is a big range of potential under this definition. It is not just a matter of identifying companies with good potential. Some companies in the resource space (just like in the non-resource space) do not get the praise that they deserve. The largest stock in the Value Model for most of the last five years has been Petrobank. Today the combination of Petrobank and two of its affiliates - PetroBakken and Petrominerales - remains by far our largest grouping. In simple English, Petrobank is a massive success story, and yet there are abundant critics who nitpick all day about all sorts of aspects of the story. Why Petrobank does not get the respect that it deserves from the investment community has been a topic which has bedeviled me for most of the last five years. Nevertheless, our investment has been a home run and all indications are that it will be a home run in the future.

I often read the first draft of *Ira's Musings* to my wife Maxine, who typically offers some constructive commentary. This time she wanted me to delve into greater details about Petrobank, but I disagreed this time around. These essays are intended for the general reader. If you want more details on Petrobank, Jeff Hales, Matt Ritzel, Christine Tan or I can supply these in abundance, or, as Casey Stengel used to say, *"you can look it up"*.

I realize that the paragraph about finding low risk resource equities sounds totally bland. Old-timers will remember many resource stocks that had their whole future depending on one exploration bet. The *Wall Street Journal* of January 5th had a front page story entitled *"Big Oil Bets at Sea"*. The story is about the billions of dollars of high risk capital that the majors must spend to maintain their reserves. Our preferred companies are at the opposite end of the spectrum. They have myriads of opportunities and in the majority the resources itself are at the opposite end of the single monstrous bet. It is about lowering risk, while maintaining the opportunity for significant reward.

At one time in this publication I used to recommend various books. I did the same in my *Globe* column and I apparently convinced dozens of readers to buy a book by hedge fund manager Barton Biggs, who proceeded to ignore my e-mails to him suggesting that he and I discuss the world. I will give you only one book recommendation today and fortunately for you it is not one of the genre explaining what went wrong in the U.S. financial world in 2008. Trust me, I have read my share of these, but I am still awaiting the first one that discusses what happened in Canada in 2008. In the U.S. nothing is a secret. All the major and minor participants will tell their stories to the press. In Canada it is the exact opposite. My friends the cynics would argue it is because nobody cares. I disagree. My book recommendation is *The Last Empress: Madame Chiang Kai-shek And The Birth Of Modern China*, by Hannah Pakula. This is not the forum for a discussion of whether China is the future and the U.S. is the past, but it is a worthwhile debate. At the very least we should know more facts about China's history and the book is a painless way of learning them. Season's Greetings to all.