ANTARES
INVESTMENT MANAGEMENT

VALUE PORTFOLIO

The Antares Value Portfolio focuses on companies that, in our analysis, are underpriced in the stock market relative to their underlying worth as businesses. Our strategy aims first to protect investors' capital by not overpaying for a given company - holding fixed income or cash when bargains cannot be found - and second, to grow that capital through share price appreciation as the company's value gets properly recognized within the equity market.

LEARNING FROM THE MASTERS

Many of you are already aware that the second quarter of the calendar is the time of year that many companies in your portfolio have their annual general meetings (AGMs). This might just be my favourite time of the year! AGMs attended were Fairfax Financial (Prem Watsa), Fairfax India, Markel Corporation (Tom Gaynor), and Berkshire Hathaway (Warren Buffett and Charlie Munger). Additionally, conferences were attended: Value Investing Conference in Toronto, Creighton University Value Investing Panel discussion in Omaha, and a local CFA Society luncheon. Those AGMs and conferences are the inspiration for this newsletter that shares the combined wisdom of the people I view as some of the smartest investors and those whose long-term track records I greatly respect.

Focus on a company's business operations and the share price will take care of itself.

Here then, are the top things discussed and learned at the various AGM's and investing conferences I attended recently.

Companies with strong brands tend to have leading profit margins.

1. Berkshire thinks of private companies and public companies (stocks) as the same thing; ownership of a fully functioning and operating business. (This is the way we approach things as well; the stock market only provides an easy and effective way to purchase your ownership stake.)
2. Companies with better margins typically have these things in common:
   a. People recognize the brand or brands.
   b. The company controls its own distribution.
   c. People ask for their products by name.

   Those attributes showcased in companies that provide products or services that people will continue to buy irrespective of the economy, interest rates, or energy prices are our favourites.
3. Buffett thinks of what he does as allocating capital; allocating to the place that provides the most upside combined with the least amount of risk. The concept is simply to buy at the right price when an opportunity presents itself. In his estimation business schools make it out to be more difficult.
4. Business operations are what counts, not stock price movements. Businesses have done worse the last 6 months as the business environment is different than it was just a few months ago. It is expected that there will be a marked slowing in business through 2023. –Buffett
5. In insurance there is a trade-off between growth and profitability. Many new companies have entered the insurance market in the past few years and their prioritizing of growth has led to a dearth of profits. That is not sustainable and it is likely that many of these new entrants will not succeed. This could be good news for the future profitability of Berkshire, Fairfax and Markel in your portfolio.
6. The history of banking is boom and bust and what we are seeing now, with several banks failing in the US, is nothing new. It is interesting that there is very little appetite for owning a bank, at the moment, amongst that group of seasoned investors. Your portfolio is in good company on that front.
7. On the issue of the U.S. dollar being the reserve currency of the world, Buffett and Munger see no other logical choice at this moment. However, both cautioned that the action of continuously printing money, to garner votes, will not work well in the long run, and they strongly suggest not testing the limits of that money printing.
8. The world response to climate change is a big mis-allocation of capital. There will be financial ramifications of misspent money in the future and moving away from oil and gas will make the world a more volatile and dangerous place.

   In thinking about the whole ESG (environmental, social, governance) movement, Buffett added that it is not in the interest of investors that politics dictate investing principles.

Insurance companies that focus on profits before growth may be poised to take market share from competitors that overextended themselves by focusing on growth before profits.

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High interest rates will reveal who borrowed too much.

High interest rates will reveal which banks lent too much.

Canadian grocers avoided censure from the federal government, as expected.

9. Almost everyone touched on the issue of higher interest rates and the impact that might have. I have lumped all their thoughts into one section here.

   The rise in interest rates will reveal a plethora of financial issues in the coming years.

   Inflation, interest rates, and recessions are discussed more than anything else, but you cannot do anything about them.

   Buffett has no idea what interest yields will be in the future. At Berkshire, they always invest for safety rather than stretching for yield.

   Most of the money made since 1980 has been made because of declining interest rates as a growing economy and declining rates combined to push stock prices to uncharacteristically high levels.

   One major risk in the future is what will happen as we get off ultra-low interest rates. With capital no longer being "free", that will change the profitability of many projects. Highly indebted companies will face a further risk when debt financing needs to be renewed.

   We are starting to see the consequences of the high leverage that had been used to fund commercial real estate purchases. The risk is that the people will go away, but the buildings won't. That means that the lender will end up with the property; and they really don't want it. They will sell the property to try to recoup as much of their loan as possible.

   Adjustable rate mortgages make up 1/3 of outstanding mortgage debt in Canada and about 3/4 of these have fixed payments. This means that payments will not go up but the dollar amount of each payment going to interest does.

   That, combined with the willingness of banks to extend amortizations to 30 years has allowed borrowers to stay afloat...for now. (30 year mortgages went from 0% in 2020 to over 25% of all mortgages by end of April 2023.) The real pain will come in the future as mortgage terms are renewed. Amortizations will be reset to 25 years which will increase mortgage payments by themselves. When combined with higher interest rates, mortgage payments will increase substantially.

10. Buffett also offered some common-sense strategies that everyone can use for their own betterment.
    a. Don't spend more than you make.
    b. Stay out of debt.
    c. Delay gratification.
    d. Praise others by name, vilify others by category only.

And finally, a quick update on our last newsletter, the one about investigations of price gouging and excess profits for Canadian food retailers. A House of Commons Agricultural Committee report, Canada's leading food research institute, and the Competition Bureau have all chimed in on the rising food costs and determined that there are no excessive profits in the Canadian grocery industry. The Competition Bureau's report even suggested that various international grocery chains are avoiding Canada for now, at least in part, due to the fierce price competition here in Canada. There was never any doubt of this outcome.

Enjoy your summer knowing that we will continue to be vigilant for opportunities to invest profitably while also being mindful of the extensive risks higher interest rates may entail.

Thank you for your continued trust,

Gerry Bettig, CFA

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The Antares Value Portfolio is available to investors within a Separately Managed Account ("SMA") that holds securities directly, and through the Antares Value Pool ("Pool") which is held in the accounts of multiple investors. Data presented refer to the Pool. SMAs are customized and therefore their holdings and weights may diverge from those within the Pool. Sources for the data include: Bloomberg, NDEX, and Antares calculations. Unless otherwise stated, all data are as at quarter end.

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