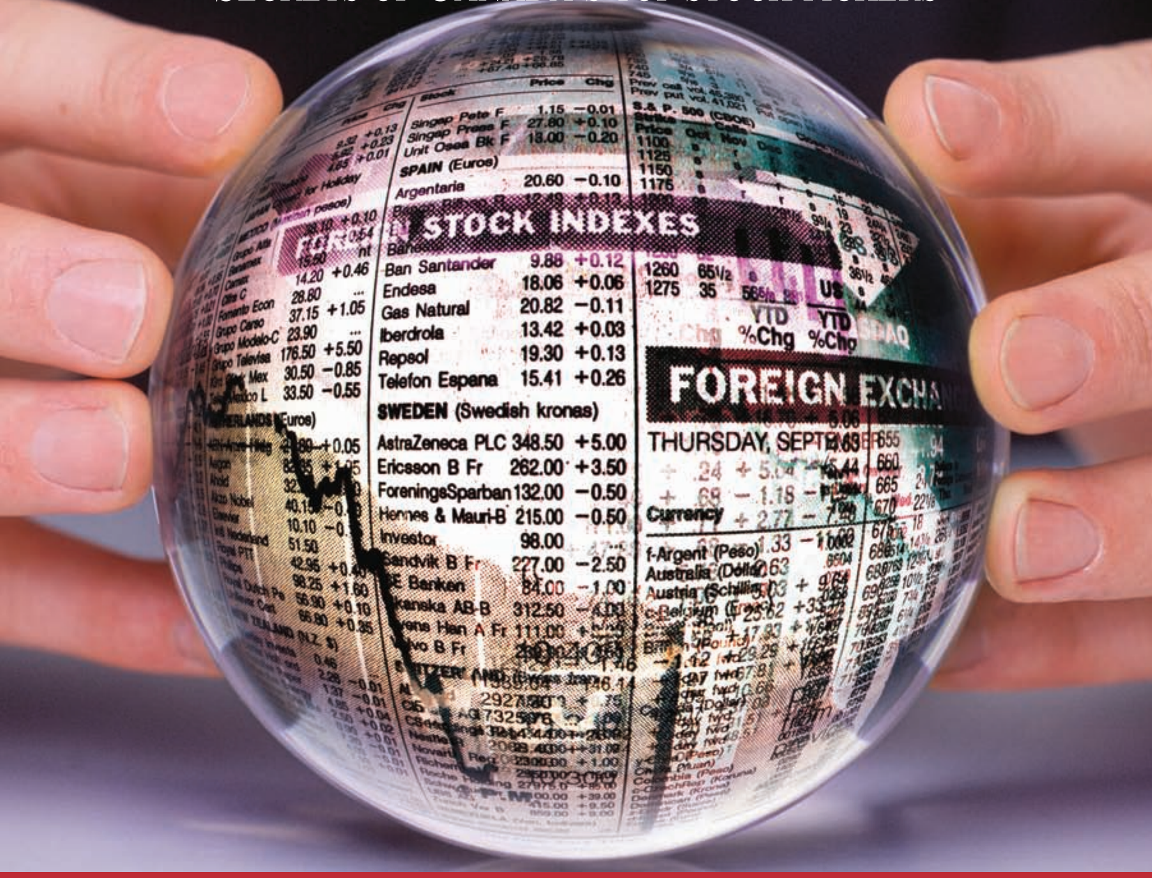
Stock Market Superstars

Secrets of Canada's top stock pickers



Tim McElvaine

Dealing in Nightmares, Not Dreams

Tim McElvaine

Dealing in Nightmares, Not Dreams

"I make Homer Simpson look active because there's not that much excitement happening in my office."

As the ex-chief investment officer for Peter Cundill's company, Tim McElvaine is all about deep value investing. If you wondered what the definition of deep value investing is, it is buying the equity of companies that are beaten up, unwanted, and unloved. Even hearing their name will sometimes make you cringe. As Tim says, "We deal in nightmares, not dreams." So why would you buy nightmares, you say? Well, because if you pick the right ones, you get a great bargain on the purchase price, and this is how Tim says he makes his money. With a 20 percent annualized return (16 percent net to investors) for the last ten years until December 31, 2007, "nightmares" have turned into dreamy performance for Tim's investors.

As a value investor who is strict in his style, he will build up the cash when he can't find bargains. Surprisingly, he has been able to achieve these returns while holding a lot of cash over the years. In 1997, the average cash position in the fund was 59 percent, and at various times over the last decade, the fund has averaged 20 percent-plus in cash. What even makes the performance more remarkable is that there are hardly any resource stocks that have accounted for the performance. Chances are, you won't have heard of many of the companies that Tim has owned over the years.

Buying stocks with a margin of safety can also help to reduce your downside and can result in amazing consistency. Tim is one of only a couple of managers I can think of who have not had a down year in the last ten years. Other than a drop during 2002, and the recent drop at the beginning of 2008, the chart for the McElvaine Investment Trust has generally been a nice upward sloping line over the last ten years with very few bumps along the way. Even in 2007, in which many "value managers" were beaten up, he squeezed in a positive return by the tightest of margins. The style has been pretty easy on the nerves over the years, and it proves repeatedly that to make a lot of money over time, you just need to avoid the big drops during the bad times.

Known for his witty and self-deprecating humour, it is always fun to chat with Tim. Putting yourself down in a fun way I think actually helps people to stay humble, which is one of the traits of the most successful investors. I actually had to convince him that he should be included in this book. When I asked him why he developed a value philosophy, he said, "I am not as bright as growth managers, so it was logical for me to do this." When asked why he tends to hold stocks for so long, he says, "Because it takes so long for them to go up," referring to the fact that many value managers get into stocks a bit early.

I first met Tim in 2006 after doing some research on value managers. The McElvaine Investment Trust had one of the best and most consistent return profiles going, and upon further examination, I found the results and process to be very repeatable. I called his office in Vancouver and arranged a meeting to sit down and talk about his philosophy. We had to book a meeting a couple of weeks out because Tim is only in Vancouver every so often, living full time in the beautiful city of Victoria, B.C.

What I love about many of the Stock Market Superstars profiled in this book is that most have small unassuming offices. Tim is no exception. With only a few people working at the firm, including Kim and Di, who Tim constantly praises in his updates, the office in downtown Vancouver is very small. We chatted the first time in Tim's office, which was about as plain as could be, with simply a laptop on his desk. I interviewed him a second time in his room at the Four Seasons Vancouver in May 2008 just after one of the more brutal drubbings for value stocks in years.

Bob:

You were the CIO at Cundill. How did that come about?

Tim:

At the time, I was working in Bermuda for the Bank of Butterfield taking my CFA. I wanted to get more involved in the investment business, and I went through a list of people who I view as mentors. John Templeton was on the list, Peter Cundill was on the list, and someone from Trimark, what was his name?

Robert Krembil?

Krembil was on the list. This was in 1989, 1990, which was not a great time for stocks and not a great time for hiring. Out of them, Peter showed the most interest, so I hounded him. He had to either change his fax number or hire me. Thankfully, he hired me, so I moved to Vancouver and started working with him, and that would have been in March of '91.

Nothing like persistence, then?

Nothing. Yeah, persistence. Companies get lots of resumes, but people who send resumes who obviously know a little bit about what you do I think is so important. So when people say they're looking for a job these days, if they can tailor the package they're sending to the person they're sending it to, it goes a long way.

Mark Holowesko used to run the Templeton Growth Fund. He called Templeton at 27 years old, or 25, and said, "I want to work for you," and Templeton said, "Go get your CFA and then talk to me."

He went back a few years later with his CFA—three years later or whenever he finished it—Templeton said, "Sure." I think he gave Mark the Templeton Growth Fund at 27 years old, right? The people at Cundill today are fairly young when you look at them. Is that something that Peter did, is he'll bring somebody young in with not a lot of experience and say, "I'll teach you the value way"? Or did you have a lot of experience before you went and saw Peter?

No, but Pete's a value investor. They're cheap that way.

Right, right. So they run their businesses that way too.

No, I didn't. What I did do is send Peter a lot of very specific ideas, so I think he had an idea of how I thought. Then when I went to start to work with him, it was kind of just working, how I always approached stuff and how he approached stuff.

How long did you work for him before you were a CIO? It was pretty quick, wasn't it?

The advantage was there were only two of us, so [laughs] I didn't have to climb to the top of a ladder. We had fifteen people in the firm, but there were only two on the investment side.

How much money did the firm manage?

Probably about $300 million, give or take a little bit, and going down because it was 1991, so things weren't going too well.

You have an accounting degree and a CFA. A lot of people have CFAs and a lot of people don't have either one and do fine. So which one do you think was better, as far as helping you with what you do?

I didn't have the personality to do your job, so that meant I became a CA. It's a language thing. A CA is like learning French—there's nothing magical there, but it makes you quite comfortable with the lingo and mostly with the BS that people toss out. Then it also makes you understand how divorced accounting sometimes is from the reality of the situation. So you're not in awe of it; you say, "Well, that's crap." What they're doing for accounting is whatever the CAs or CPAs want, but that's not what's happening in the economics of the business. The CFA—and God bless the CFA because as long as they keep that program, there won't be very many people doing my thing in the business. So the CFA was interesting to me because it's where I wanted to go, but there's an awful lot of stuff in it that doesn't apply to what you or I would do on a day-to-day basis.

My accountant who's a CA told me this. He said, "What do accountants use for birth control?" I said, "What?" He said, "Their personalities." [Laughs] That came from my accountant. That wasn't me. Obviously, you said you sent Peter some ideas. You were a value guy before you met Peter Cundill. How did you evolve into that, rather than a growth investor?

Well, partially given that I was a CA, I obviously had low self-esteem, and when you have low self-esteem, you work towards value stocks. If I really thought I was that smart, maybe I would have been a growth guy. That's kind of what got me towards it. In the '80s, I had read a lot of stuff about Buffett and Ben Graham and John Templeton. I had been to a number of John Templeton AGMs in Toronto in the early '80s, so it felt like a better fit to how I thought about the world.

Do you remember the first stock business experience or when you became interested in the stock market, or when you started buying stocks?

My first experience—other than the lemonade-stand-on-the-side-of-the-road-type stuff? My first experience in business was probably when I was about 12. We lived on a farm. I decided, with certainly my parents' "encouragement" so to speak, to produce eggs and sell them to the neighbours. I ended up getting twenty chickens or something like that. We built a coop. My dad put up the capital cost and lent me the money to build a chicken coop and the wiring to buy the chickens. Then my theory was the chickens would lay the eggs, and I'd sell the eggs to the neighbours, and we'd pay my dad and then make some money for myself, and this would be my enterprise. So I had visions of being the chicken king of Kingston, Ontario.

Well, you know, agriculture is a tough business. First of all, the chickens' eggs kept breaking, so I had to change their feed. Then the foxes came by and ate the odd chicken, which doesn't do very good for production. Then winter came and the eggs would freeze before I came home. Finally, for the poor egg that made it from the chicken into my fridge, sometimes my mom took them without telling me. I quickly moved into bankruptcy in my chicken business. We ended up selling them to the farmer across the road, and he slaughtered them. After that, I decided I didn't want to do anything in agriculture, and picking stocks seemed a heck of a lot easier than taking care of chickens, so I kind of worked towards that.

You had seen a business go through a rough time, so you're familiar with that.

As well as the liquidation value; I was quite familiar with it.

You were a value trap, weren't you?

Yeah. Yeah.

You wouldn't buy your business even at a cheap price?

No, it was not a good business, but I think like my early stocks, like everyone else, I was kind of lurching around trying to figure out how to do this. I looked at technical analysis. I tried to think about growth stuff. I think I had some Wardair and some Pop Shoppes International at one stage, and I think Wardair made some money and Pop Shoppes went to zero. Sometime around that area I kind of bumped into Buffett and then Ben Graham and I thought, "Okay, well, that makes sense. Here's more of a framework that makes sense to me."

Your personality has a lot to do with how you invest money a lot of times. Some of these growth guys that are out there, they're cocky. You could look at somebody and say, "That's going to be a growth investor." Somebody else can say, "That's going to be a value investor," because value investors seem to be more conservative in their personal lives. They're softer spoken.

Yeah. Yeah, I guess so, meaning if you want to party, find a growth guy. I think that's what you're saying.

Yeah, maybe. But none of the growth guys are as funny as you are, and you don't even know it. Now, were there some lessons that you learned from Peter?

Yeah. The two biggest things are, when you have the courage of your convictions—if you're right—then don't worry about what other people think. The second thing is it always takes longer than you think for stuff to work out. That would be the two I recall at this moment.

Your average holding period is a long time with stocks, right?

Yeah. We own stocks for a long time quite simply because it takes a long time for them to go up. If they went up quickly, I'd love to have high turnover and sell them quickly, but it'd take a long time to go up.

There was a poster that you saw a long time ago that you read …

Oh, yeah. Yeah.

How did that affect you?

A lot of people who come into the business want to do something. They like the activity, I think it comes a little bit from—our business today is like Xbox on steroids, right? You can get the game in front of you, you see the lights flashing, you can hit a button and buy and hit another button and sell. There's lots of adrenalin; it's exciting. So for me, I kind of operate at a completely different spectrum. I make Homer Simpson look active because there's not that much excitement happening in my office. I can go to the bathroom and not worry that I missed making a million dollars because of a portfolio decision. So my sister had this poster up that said, "Sometimes I sit and think, and sometimes I just sit." That kind of summarizes a day at the office for me.

In other words, if there's nothing to do, nothing to buy, then don't spend the money.

Then don't do it. Yeah.

One of the best hedge fund managers of all time, George Soros, the big macro guy, said exactly the same thing. He said, "I sit there…I do nothing…until if I see a big pile of money in the corner, then I'll go pick it up, and I'll bring it over." And then he said, "I'll sit and do nothing for a long time until I find another big pile of money." It's interesting because he has a totally different philosophy from what you do, but he was really saying the same thing.

Yeah, it's kind of like.…

You don't feel the need to always be busy.

Yeah, Buffett talks about how you don't have to swing at every pitch. It's kind of like value investing. Certainly, maybe investing in general is really boredom with moments of pure panic in between. A lot of time there's nothing to do, and then all of a sudden there'll be those moments where there's something to do. You need to make sure that in the boredom times, you are getting yourself ready to act when you need to. But you don't need to do everything every minute. I think that's the most important thing I learned.

Do you think most people have the ability to be as patient as you need to be? It certainly doesn't seem like it because you have to be extremely patient. You've owned stocks for years before they go up, and then they'll go up 50 percent in three months.

It's helpful to be somewhat challenged, so time passes and I'm still thinking well of stuff. I think if you're confident with what you're doing and you see the value building over time, then you don't mind waiting at all. It's a lot easier to do than you think. The important thing is not to get distracted by greener fields, because every day you come in there'll be something over there that looks like it might be more interesting. It's kind of like with a girlfriend or a boyfriend, and for sure if you're on a diet you can look at the menu, but you'd better not go and start sampling unless you've decided you're no longer on the diet. Same thing with investing, for me at least. It's fine to go and look at all these other stocks to see because they look interesting. To actually make the purchase and sale decision, you have to be really careful because the only thing we control in this business is when you buy and when you sell. That's the only one thing I can do. I can't make the stock go up or down.

Frank Mersch said the one thing he could do better is to be more patient. He said that he owned 30 percent of Canadian Natural Resources, of the entire company, at $0.10 a share. He said that he got bored with it and sold it. He said, "Can you imagine?"

I had over 10 percent of Denison Mines at one stage. It went up a little bit, and I thought, "Wow! Ooh, ain't I bright?" So I think I sold it for $0.15 or whatever. The interesting thing too is quite often the ideas you're most focused on will languish and the one that you've kept in the portfolio because you think it's cheap but you're not expecting anything out of it this year…suddenly something happens. So, yeah, it's kind of funny that way. You start a year and you never know exactly where your gains are going to come from, at least in my case.

What are the three things that you look for when you assess a stock?

There are actually like three and a half, and the half thing I'm a little bit reluctant to talk about because most people think I'm dumb when I mention it, but, regardless, I will. First thing is, "Does it trade for less than it's worth?" which you know every person will say that. So you figure out what you think the company is worth, and we go through a four-step process to do that. We look at liquidation value. We look at kind of a break up value. What would a private market buyer pay for it? We also look at what happens if things go the way we think. I try and model out three years. I don't try and go out a long period, but try and go out a couple of years and say, "This is where I think they're going, and if they're going in that direction, what does it mean the company will look like in three years?" What will happen to cash primarily? Not so much worried about earnings, but what will happen to cash over that period? A fourth one is a kind of discounted cash flow, but there are so many things you can play around with when you go out longer term. I'm really careful not to let the Excel spreadsheet rule me. In fact, I much prefer analysis that you can do with a pencil and a piece of paper to one that's very elaborate with multiple spreadsheets. That's the first thing. Does it trade for less than you think it's worth?

The second thing is, "How volatile is that estimate of what it's worth?" Think of the story of "The Three Little Pigs." If you take an example of a straw hut, at the first sign of difficulty, the first time a wolf comes around, it'll get blown down. Then, perhaps a comparison to that is Nortel. When Nortel was a hundred bucks, the winds came up and the company blew up essentially, and the valuation was way too high. So that's a straw hut. I kind of look for brick houses in the three little pigs lingo, and what I mean there is you feel like you have a strong foundation in what you're buying. Because I'm a value investor, your brick house won't look like a beautiful waterfront property on Lake Muskoka or West Vancouver. The roof might be damaged, the window might be missing, it might need a paint job, but "the bones" in real estate lingo are good, and then that gives you your foundation.

We owned shares of a company called Sun-Rype many years ago, and even if Sun-Rype may be no money for a number of years, I felt comfortable that its presence, its position in the marketplace, had an intrinsic value, that no matter what I could get our money back. So that's what I mean in having a firm foundation. Going back a step, the first thing was, "Does it trade for less than it's worth?" How volatile is that estimate? The volatility you want is on the upside and not on the downside.

The third thing is to determine whether management is for or against you. Basically, are they in the same boat as you, the management and the board? Many times, a good board has saved us from a difficult situation.

The half, as I call it, the three and a half thing, is I try and look for situations where the sellers don't care about price. What I mean there is when you're buying a stock, if the seller is thinking carefully about whether or not they ought to sell, then it's a tougher decision to buy because you're basically betting the buyer is wrong. I prefer situations where people just want out, and that can happen. There are a couple of reasons. One is it's an area people don't want to be involved in, meaning there's really bad news. It can be specific to a stock or it could be an industry. An example might be newspapers these days. People just don't want to be involved in newspaper stock, so they sell them. That'll lead to depressed valuations. A second reason is if there's some type of constraint that prevents them from buying the stock. For example, with a bond, because I do distressed too, I would ask if there was a bankruptcy filing, then you might have someone sell the bonds because they can't own those shares in their portfolio, or those bonds in their portfolio. The third reason, and the one I tend to use the most, is a corporate event. For example, a spinout, a rights issue, something happens like that. An example there is we own some shares in a company called Citadel Broadcasting, the third largest radio broadcaster in the U.S. It suffers from two things: one, people don't like radio, so they're not particularly interested. Secondly, it existed before, but primarily a large portion of it's float, or a large portion of the shares that are currently outstanding came in June of last year when they acquired ABC Radio from Disney. They gave Disney shares in Citadel, and Disney then spun those shares out to Disney shareholders. So very roughly speaking, if you had $5,000 in Disney, today you'd have about $40 in Citadel stock. The inclination then is I don't even want to look at the Citadel. I'll just sell it because Disney is the company I bought. That's what I mean as a spinout, someone just wants to get rid of the security without thinking about price, and that's when we like to get involved.

That was the situation with TELUS bonds a few years ago.

TELUS was the same thing. I actually didn't end up buying them, so I missed that one, but I looked at them, that's for sure.

They went down to $0.50 on the dollar.

Yeah, yeah.

When did you take over the Cundill LP? Is that what it was called at the time?

At that time, I was living in Ontario. I came back to Vancouver to work with Peter on Value Fund. I acquired Cundill Capital Limited Partnership at that time and changed the name.

Peter, he had a lot of his own money in it at that time. Does he still?

No, Peter has been very generous with me, not only allowing me to set up my own business many years ago, but also being a large investor of mine over the last eight years in the case of the LP or twelve years in the case of the trust. He owned part of my management company for a number of years, but when he sold his business to Mackenzie, they had a non-compete, so I bought him out of that. In typical Peter fashion, he did it on a generous basis to me.

I find it incredible that Peter Cundill, one of the gods of value investing, entrusts his net worth to you. He obviously must have a tremendous amount of confidence in what you're doing for him.

Maybe he has a tremendous amount of money too. [Laughs] He says, "Aw, I can afford to give him a little bit."

What is the difference between the trust and the other fund?

Yeah, it's now a corp.

Right. It's the same now?

Yeah. On investments, I always believe strongly in simplicity. For example, if you hire an MBA or a CA or even just someone off the street and say, "Can you tell me ten reasons to buy a stock?" It's easy to come up with ten reasons. It's hard to say instead, "Can you tell me the three key drivers that we should be thinking about, but only the top three?" That's a lot tougher, so it is the same thing with valuations. It's actually very easy and comforting to do a big Excel model because you feel like you're active, you have all of these numbers, and it feels good that you're putting something together. It's very hard to sit there with a pencil and say, "What do I really think? Define how this company should be valued." The same thing with my business—I try and keep everything simple. We outsource as much as we can to RBC Dexia, as far as doing valuations, record keeping, and trade settlement. We try and do all of that outside so that the people inside are focused on client relations and investment. We had two funds. To the extent that I can get them together and make it one fund, I'd be happy with that and keep everything very basic, very simple. I don't want a family of sixteen different funds.

I think one of them was more foreign?

Yeah, originally it was set up to be foreign. I ended up getting a lot of calls from people. Someone would come to me as an investor, and they don't come because they think I have a brand or they want my Far East Asian Fund or my mining fund or something like that. They come because they like the fact that I have all my money in our funds, and they want to be a partner. So having two funds actually complicated that process because instead of saying, "We're interested in the foreign fund or Canadian fund," just said, "Well, I don't care. Where does Tim have his money?"

Right, right.

That was part of the impetus behind combining everything, keeping our business very simple, and keeping my focus very simple.

What funds at Cundill did you run?

I ran Cundill Security Fund from June '92 until June '99. Then I was involved in Cundill Value Fund from 1999 to 2004. I co-managed Value Fund with Pete, and I managed Security Fund by myself, primarily out of Ontario where I was living at that time. I came back to Vancouver to work with Peter on Value Fund in '99 or 2000.

Cundill has been kind of famous in the last few years for having a massive amount of the fund in Japan. A lot of people just didn't see what you saw in Japan. I think the Japanese market was going down and down and down, but you were doing great. I think the stocks, generally speaking, were doing fine.

We had a good group of research guys at Cundill on Japan, but I think it suffered. Even if you look at the period from 2000 onward, it was a pretty good period for value investors in North America. You had a lot of stuff in Japan that had bad balance sheets but high valuations, so that stuff just kept going down. You had stuff with good balance sheets and low valuations, and that kind of percolated up a little bit, so it was a little bit of a two-tiered market.

Have you ever shorted stocks? Peter did, I think.

Yeah, we used to short indexes for a little while. I bought puts on stocks in 2000, and in typical fashion, the puts expired. I had puts on GE, CIBC, and some others as well, but they expired in January of 2000. Then I didn't renew them because I was so tired of losing money, and then all hell broke loose in March of 2000. So other than a good tale, I can't say I profited from it, but that's about the closest I ever got to shorting.

Last year in Omaha, Nebraska, somebody asked Buffett about silver. He said, "Oh, yeah, we owned a lot of silver, and we bought it way too early, and we sold it way too early, and we never made any money. But that's what we always do, so that's okay." So he said to Charlie Munger, "Well, what do you have to say about silver, Charlie?" Charlie said, "That'll just about cover our expertise in commodities." How is running what you run now different from the funds that you ran at Cundill? I think one of the things I'm thinking about here is size. I think it helps to be smaller generally.

When I got involved with Peter in '91, the Value Fund had 400 stocks. I think it shrunk down to about 150, 100, 125 when I got involved in Value Fund again in 1999 or 2000, and then we worked it down to about 30 stocks after that. I think my predisposition has always been to have a more concentrated portfolio than maybe the average traditional value guy. I think Ben Graham certainly espoused having a large number of securities, and that's been Tweedy's approach as well.

Templeton's got a ton of stocks too.

I'd say that's a difference. The second thing is I do sometimes get involved in the securities, for example, go on the Board. That would be different from Cundill. Finally, I don't mind looking at small stocks or big stocks, and when you're running a large mutual fund, as much as you'd like to, you can't spend your time working on small companies.

Do you look for stocks a lot of times that are undercovered by analysts, or analysts don't even cover them at all?

There are two ways that they get undercovered. One, of course, is if they've collapsed. There's a certain…I don't want to be cynical about it, but you see it happen with some regularity where a stock may be $20, and a broker will have a buy on it with a target of $30. The stock falls to $10, and a broker will go to a hold, and then the stock falls to $5, the broker will go to a sell. The stock falls to $4, and the research analyst will suddenly no longer be working there. That is, I'd say, not an unusual pattern of some of the stocks we get involved with. Then over time, the analysts will come back in and they'll get covered again, or sometimes the stocks just weren't really covered from the beginning. That is the case with even something like Citadel Broadcasting, which used to be a billion dollar type company, but now is maybe $300 or $400 million in market cap. Because of all of the changes over the last year, there's a very limited amount of analyst coverage, and that works to our advantage, of course.

Right. It creates the inefficiencies.

Yeah, it creates inefficiencies, so I agree. An undercovered stock $15-something that we're quite happy to get involved with.

I think a value investor believes that the market is very inefficient in the short run, but you're banking on the fact that it's efficient in the long run or else you're never going to realize the value that you think you should have. Is that true?

Yeah, for sure. I joke that there are two types of investors out there. There are the people who approach life saying, "I'm smarter than everyone else because I think I can figure out," and this is my comment about that. I think that's great. They think I can figure out why the stock is cheaper and therefore will go up more than people realize. That would typically be a type of growth manager because he's saying, "My cousin's best friend's housekeeper works also for the CEO of Research in Motion. They tell me the number of units shipped is going up; therefore, I think I have an inside edge, and I want to buy that stock." Once again, their analysis is all based on the fact that they think they know something the market doesn't, or they think the market is wrongly valuing it.

On a value basis, I suggest that value managers are much dumber than growth managers, but at least they know they're dumb. When I'm buying a stock, I don't think about all the wonderful things that could go wrong. I just try and think about all the things that are going wrong and whether or not they're really serious, so that means a couple of things. First, it means if the market thinks things are worse than they are, then you'll get appreciation—the relief, so to speak—because things weren't as bad as they thought. The second thing is it usually takes some time for the stock to turn around, so that's why your holding period is a little bit longer.

A lot of stocks that you own are very illiquid, but you own big chunks of the company. How do you get the liquidity you need to either buy or sell when they trade 500 shares a day?

What always happens is you see a stock and you say, "I like that idea," and I try and have my positions between 5 and 10 percent. Let's assume I buy a 5 percent position in a stock, and the broker says, "Tim, this is part of a cleanup. This is a guy who had a million shares, and he can't get a bid on this somewhat illiquid stock, and there's bad news on it. Are you interested?" So I'll end up buying some, and I'll think, "All right, we got a somewhat illiquid position but it has a good story." The stock will promptly fall by a third and then, lo and behold, if the broker doesn't phone back and say, "Actually, it wasn't a cleanup. There's another block of a million shares available. Are you interested?" I end up saying, "Yes." Then, over time, I end up with these relatively large positions in stocks that don't trade all the time. The situation usually changes a little bit, and either there's a takeover or pick up of research coverage, and we're able to sell into that.

So you got liquidity?

So we get liquidated that way. You have to be a little bit careful, and I'm guilty of this a couple of times. When the liquidity comes in on some of these stocks, it's usually because there's good things happening. It would be easy, then, to say, "Oh, maybe I should hang onto this for a lot longer because maybe I was too pessimistic." When you see liquidity start to come in, one of the things I'm very conscious of is, I make the easy decisions when there's no hope, and then it gets some hope. The person who's coming in and trying to value how much that hope is worth has a much tougher job, and I'm better off to sell to them and take my money and go and find another hopeless situation.

I don't know if you ever read this, but I found it very interesting. Benjamin Graham set up his office down the hall from Tweedy Browne, and they were the broker, and they'd accumulate the stock that nobody wanted and then he'd buy it. Tweedy Browne looked and said, "Well, he's actually doing pretty well on these crappy stocks, the ones that we're dumping off to him." So they became a value money management firm themselves. Many great stock pickers have a team of analysts working for them. I've been to your office in Vancouver here, and it was an empty office with a laptop. How do you find ideas when you don't have a bunch of people looking around for you?

The first thing is, I worked with a good group at Cundill, and without a doubt, a lot of them were brighter than I. The important thing in the investment business is that you have someone who the buck stops with—so someone who feels responsible for the fund or for the portfolio. When you have a lot of people working with you, you can spend a lot of time getting into elaborate discussions over what you should and shouldn't be doing. That can be quite helpful, but it can also be quite distracting. I get involved in messy situations, so I feel quite comfortable with how I'm approaching it. It can be good to have a sounding board.

It's kind of like the song by Sony and Cher.

Oh, "You've got me, babe." Yeah. With my funds, my name is on the door—You got me, babe, so to speak—and unfortunately, I'm the only one. I'm working now with another guy who's helping me with some structural stuff as well as the investment portfolio, and it's a bit of an experience for both of us. I do think that having people working with you that help generate ideas lets you cover more ground. The only question is, how distracting is that to the decision making process?

Peter Puccetti told me he has a good friend who just watches what Peter buys. He says, "I'll just watch what you buy and then two years later, I'll buy it." When you get into something, does the news usually get a bit worse? Is it catching a falling knife?

Well, I think for sure every time I buy a stock, it tends to go down by a third after we buy it. Every time I buy it, I'm pretty sure this one won't go down by a third. So the answer to your question is yes. The neat thing about value investing is if you think a company is worth five and you're paying three, you have a margin of safety. If the stock falls to two, and you still think the company is worth five, it's actually a better deal. You have a larger margin of safety. Unlike a growth guy, the second the stock may start to go down, they worry that it's an indication that they've missed something in the valuation and the smartest thing to do is sell. Quite often with a value stock, if you're confident that your analysis is correct, a stock going down is really the opportunity to keep adding money to it. So averaging down is a fact of life, and I think probably the thing that tests your judgment the most is if the stock falls by half, would you still be interested in buying more? If you say yes from the beginning, and you're able to do that, then I think that says a lot about your discipline as an investor, certainly a value investor.

You said once that you tend to own cheap stocks—stocks that everybody agrees are cheap. I think your idea is to take out the *but*.

Yeah, it's the same thing, I would be a great golfer but for the fact that I can't hit the ball properly. So that *but* is a pretty big thing in life. I'd look like Fabio but for the fact that I'm thirty pounds overweight and bald, so *but* is a pretty big word in stuff, and it's certainly a big word in investing. So people will say, "You own some shares in…." Let's take Citadel again because I talked about it, "…but it'll be a couple of years before they execute on their plan, but it's in the radio segment, but there are a lot of sellers." You just look at what's behind the *but* and say, "Does that really matter to me? Does it matter that it might take a couple of years?" No. One of the things I think we do as investors is trade time for price. Does it matter that it's in the radio business? No, because I think the price I'm buying at is attractive enough. So, yeah, we try and take the *but* out of investing. It sounds like a bad joke, but that's the way we do it.

Right.

The other thing that is related is quite often I think people mix up uncertainty and risk. I can say without a doubt all of the stocks I get involved in are uncertain, and by uncertain I mean you don't know what's going to happen over the next quarter, over the next six months, maybe even in the next year. But I measure risk as: What's the chance that we'll actually lose money on the position? Whether or not it goes up and down in the stock market, whether or not I know what's going to happen next quarter, isn't a risk to me. As I said, risk is: What's the chance in permanent loss of capital? So when someone looks at a stock and says, "I'm uncertain about where it's going," I think that's fine.

If you're wrong on a growth stock, and you hold it, you can have a permanent loss of capital. If you're wrong on a value stock, other than being a value trap, you don't normally get a permanent loss of capital?

Yeah, let's face it, value portfolios look ugly. I think the best example is I remember I used to take my kids to Stanley Park when it had a penguin exhibit. When you were just entering the area, you were maybe a hundred yards away, you'd see the penguin exhibit and all these penguins are splashing and dancing, and you go, "Oh, ain't that cute?" When you walk up within five feet of a penguin exhibit, it stinks like heck, and you say, "This thing is awful, like let's get away from here." So it didn't matter how picturesque it looked from the distance. My portfolio is like that. From a distance it's a beautiful work of art. Up close, someone would say, "You own twelve duds." I guess that's what I do for a living.

Own duds?

Own duds.

How important is the qualitative side of it? Do you get to know the management? Are these guys honest? Are they going to execute properly? Is that why you get on the board of companies?

Well, let's try and pull that apart. The first thing I think is running the numbers on the stock doesn't give a reason to buy it. The things I'm looking at are the qualitative stuff. What can go wrong? What can go right? Where are the incentives for the group? What's in it for the managers? I think that's a very important part. Of course, it's always nice to see insider buying. That's a well-known thing. Sometimes at moments of crisis, though, insiders may be restricted from buying, or they're unable to for a number of reasons. So you have to be a little bit careful with insider buying.

What I look for is, as I said in the beginning, is management in the same boat as you or not, or is their compensation, or preferably, their ownership such that in a moment of crisis when they're dealing with shareholders' money, will they make a decision in the best interest of the owners, or will they make it in the best interests of the managers? That's the main thing I try and think about. What are those crises occurring? How damaging are they to the company? How will management make a decision when they reach that position? Now, in a couple of cases, three in particular, I've gone on boards, but I don't go looking for a fight. I'm a lover, not a fighter, so I don't like doing activism. I don't say, "I'm going to buy that stock," and agitate. That's not our way. It's more like I've got backed into a corner, and I'll get involved because I have to be. Once again, in all of those cases, I can say without a doubt I've never met a board member who wasn't honest and had the best intentions, but as a shareowner of a company, you have to try and evaluate whether or not their intentions are really in your interest. An example of that might be where someone is making an acquisition that they believe will make the company stronger in aggregate, but on a per-share basis, it is not. The best example of that would be oil and gas stocks. They may feel that they want to buy more reserves when the price is high because it'll make the company stronger. If you measured reserves per share, you might figure that it's a dilutive deal for each of the individual investors. So that's what I'm talking about when I say I am trying to figure out where the incentives are.

One of the biggest shareholders of Sun-Rype was the Jim Pattison Group. I think they still are one of the biggest?

Well, yeah, I think if you have a choice of investing with a billionaire or investing with a pauper, you're probably better off investing with the billionaire.

The billionaire. There you go.

Certainly, we've sold a large portion of our Sun-Rype position to the Pattison Group. I was on the board with Mike Korenberg and Don Selman from the Pattison Group. I was always very impressed with their honesty and their integrity but also how they looked at stuff. They were focused on return on capital. They were focused on cash flow; everything that you and I would think about as a value investor, they were doing from a business perspective. I think that's a tribute to Jimmy and the culture he's put in place there.

Everybody kind of says the same thing about how they look at a stock, but why have you generated 20 percent a year for the past ten years before performance fee and hardly anybody else has? What makes you different? Is it the smaller base of money? Is it the different ways you look at it?

The bizarre thing in this business is when you meet someone and they say, "The stock's going to $30." You can't control that part of the business. Where I sit, you really can't. Sometimes if you get involved in the board, you can do stuff that will further it, but, nevertheless, you can't control what the market is going to do with the price each day. The only thing you can control is when you can buy and when you can sell. I've been fortunate in that I've been really involved in a number of hopeless things that became not as hopeless as people thought, and that's been a large part of the performance. Unlike some of the other investors that you talk about in your book, some people make overall projections and then find stocks that'll fit in. I have enormous respect for people who do that, but that's not where I am. I'm really looking for complete despair and protecting the downside and knowing that when the turn comes, it usually comes back, and it's a lot better than you expect.

I think Benjamin Graham said that he would definitely buy a crummy business as long as it was at the best price, whereas other people have said,

"I'm going to buy a great business at a good price but I'll never get a great business at a fantastic price."

What I've tried to do is stay away from the really bad stuff and realize that whenever I think a really wonderful business is at a good price, it's usually me who's confused about the quality of the business, not the person selling. So what I've tried to do is say price is important and cash is important, meaning cash flow. I'll try and stay away from the stuff that consumes cash. What I ideally like is a mediocre business, so to speak, that each year will be worth a little bit more primarily because of cash flow. If the stock prices stayed the same, your margin of safety over time inches up. That's where I've had the best luck. If we take Sun-Rype, for example, I think we bought our first stock at \$2.10 or \$2.20 or something like that. We got \$1.50 in dividends, and we sold our stock to Jimmy for \$11.50. When we bought it, we definitely did not think it was worth \$11.50, but over the years, the value kept compounding. The return on invested capital within Sun-Rype was very, very high, and it doesn't take very many Sun-Rypes in a lifetime to have a good outcome.

How do you avoid a value trap? A company is really, really undervalued because it's going to zero! Have you ever had a situation like that?

Well, yeah, sure, you get them all the time. I don't mind buying situations that are challenging at the moment, but I'm not a dumb contrarian in that I'll buy situations that there's no hope of winning. For example, if I go and box against Mike Tyson, I'm not going to win. So if I'm going to get into a fight, which I don't want to, I want to make sure it's a fight I can win. Same thing with a business. If it's losing money, losing cash, and the value is staying constant or declining, you have to be really, really careful what price you pay. The value traps I've been stuck in tend to be where the net asset value has stayed about the same over the period and the stock price hasn't gone anywhere. The best situations for me have been where the value of the company has grown. It can be quite slowly over time so that my margin of safety is getting bigger, and that gives you the large return. I try and avoid stuff where I think it's going to be stagnant. I'm talking about the underlying value, not the stock price, so I'm really careful about what you pay in those circumstances.

You said you're the only guy in Canada who missed the entire oil and gas run in gas and minerals.

Yeah.

Have you ever had resource stocks in a portfolio? Cundill had Canadian Natural Resources for a long time.

You know, I never had that.

Have you had resource stocks? How do you analyze a resource stock versus a retailing company because it's a totally different business?

I've been in all of the hottest sectors. I was just, like, five years too early and sold three years too early. We owned real estate, closed-end funds, and sold them before they became very popular. I think we owned some oil and gas trusts, and I owned some gold mining stocks and Teck, which then became Teck Cominco. I owned Denison Mines, I owned oil drillers, and I bought them when there was despair, meaning people felt they didn't have any hope. Then the stocks go up somewhat and you sell them. I could definitely be faulted on selling early, but that's okay. What I said before was I try and make the easy decision that things aren't as bad as people think. I have protection in the price, and when it gets up into the area where you're debating what type of multiple should be put on it, then I'll let someone else make that decision. Paraphrasing a little bit the Rothschild quote, "I buy on assets or I buy on intrinsic value; I sell on earnings." That's kind of what I do. I don't try and figure out what the multiple ought to be—that's someone else's job—or where the growth rate is going to be. They're difficult decisions, and I'm happy to leave them to someone else.

To give you an example of that, we had a large position about five years ago in a company called Sask Wheat Pool. It actually first was a distressed debt position in that there were some concerns that Sask Wheat Pool was going into bankruptcy, so we bought some debt, and that got resolved. We made some money on the debt and sold it. Then Sask Wheat Pool did a rights issue at about $5, and we stepped in and bought a lot of the rights, which then led to stock. That's how we got a large part of our Sask Wheat Pool position, or really nearly all of it, is around the rights issue. At the time, people said Sask Wheat Pool had been through a couple of years where there had been not very much production on the prairies, so it was a business that was going to be impacted by global warming. They had too many fixed costs in that business. It was controlled by the railways because they did all of the shipping, and there was generally despair. Now, today, with the stock almost three times higher and with many, many more shares outstanding, people are setting up agricultural funds to invest in stuff like Sask Wheat Pool, which is now called Viterra, because they feel that the outlook looks bright.

Without a doubt, I did not make any prediction when we were buying the stock that agriculture was an important place to invest. I'm not that smart at all. It was just that Sask Wheat Pool was cheap, they were doing some smart stuff, and they had a very important presence in the industry. That's why we bought it, and, of course, we sold it too early. I think I sold at $10 or $11 or something like that. It worked out very well. We got very high rates of compounding because it came off such a low base, and that's kind of what's helped the numbers.

A stock like Potash used to be a value stock that nobody in their right mind would ever own.

Exactly. I didn't buy it, but I was aware of it, yeah.

Now it's only growth momentum managers who own Potash. How does the baton get passed when a value manager sells their stock to a growth manager?

We buy stocks when they're burned out, and then they start to go up a little bit, and we sell it to maybe a GARP (growth at a reasonable price) manager who then might sell it to a momentum guy. I don't know who he sells it to, but he sells it to some poor person, and the stock collapses and comes back.

It's like passing the hot potatoes.

[Laughs] Yes. It's a good thing about getting older in this business. Some of the stocks I used to own come back. It also shows you have to be a little bit careful that you don't believe that all trees grow to heaven.

I've heard some value managers say the biggest mistake you can make is extrapolation. They say, "Well, this has happened for the last five years, so if this continues to happen into the next ten years, it's going to be massive." It never seems to work that way.

I'm also a little bit careful on reversion to the mean. People who say, "Well, they had 30 percent margins two years ago, and they only have 5 percent margins now. If they go back to 30 percent margins, I'll make this much money." That's always a big leap of faith that I think you have to be careful about making.

My dad moved to California in the early 1960s; I always remember this story. There was a weatherman speaking on TV, and the way he said it everybody knew it was a joke. There was a huge influx of people into California at the time, and he said, "Now, I've calculated that if this number of people continue to move to California, then twenty years from now everybody in the United States will live in California." Everybody laughed because everybody is not going to live in California. However, if you extrapolated that, that's exactly what it would show, right?

Yeah. If you're playing poker and you don't know who the patsy at the table is, then you're the patsy. It's the same thing a little bit in the investment business. If you're looking around and you don't know who the sucker is, then it's probably you.

In poker, I think a good poker player will make most of their money on a relatively small number of hands. Is it the same in the stocks? Do you make most of your money on three stocks out of ten that you'll own?

Well, I run a pretty concentrated portfolio, so I agree that I'm always surprised with which of those stocks go up in any year. I think what I also try to do is not make too many bets but just wait until the odds look definitely in your favour, and then bet significantly. As we talked about before, I think it's human nature to say, "Well, that looks kind of interesting, so I'll buy some of that. And that one looks kind of interesting, so I'll buy some of that." Then you soon end up with a hundred things that look kind of interesting. I much prefer to sit and wait for something that looks really interesting, and then go into it very significantly.

Go big or go home.

Yeah. So in your poker analogy, you wait until you've got a really good hand, and then bet strongly. Now, of course, in poker, when you do that, if you've been quiet all of the previous five hands, the second you do that everyone else is going to fold. In the investment business, that doesn't happen, so that's a huge advantage you have in our business versus playing with a group of poker players.

To get more understanding of your philosophy, let's go through some individual examples, like Humpty Dumpty Foods.

Yeah, we.…

What attracted you to that stock? How about Indigo?

Yeah, the good, the bad, the ugly. We talked about Sun-Rype, and that was clearly a good. A bad one, to some extent, would be Humpty Dumpty. I got involved in it—I don't remember exactly when—but it was an IPO. They acquired a private brand business, I think, from Cott for chips, so there was a growth idea. They thought it was going to do really well, and I don't know if it got as high as $10 or $8. Then the stock collapsed to $2 or $3, and that's when I started to buy it on the basis that they were the second largest potato chip manufacturer east of Winnipeg and their competition was Frito Lay. They had got into a price war with Frito Lay, and management owned a significant amount of stock. I learned a lot from the Humpty Dumpty experience. I eventually ended up going on the board as part of a proxy fight and we replaced management, and then closed the facility and ended up selling the company to Old Dutch, so it came out as a save at best.

But I learned a lot about business being on the board, as I did at Sun-Rype, and as I do on Rainmaker. I think that's made me a better investor. The type of things you think about are a competitive situation and cash flow and business model. In the case of Sun-Rype and Humpty Dumpty, in a different fashion, in the case of Rainmaker, there was a focus on doing volume perhaps at the expense of margins and cash flow. This gets back to my earlier discussion. Even in my own business, I'm just trying to keep things simple. Activity doesn't equal success or profitability. I think that's what was a bit of the issue with Sun-Rype and Humpty Dumpty. But Sun-Rype resolved it quite successfully, and Humpty Dumpty, as I said, was at best a save.

That was a criticism people had about Japanese companies. They weren't shareholder friendly and they didn't really make a lot of money.

Oh, for sure. When I look at a company, there are lots of wonderful companies run by great people. It doesn't mean that you have to buy them. That's the great thing about being a value investor. I can benefit from the RIMs of the world who are doing things like the BlackBerry, although I actually don't have one. That's too much connection for me. I don't have to put my money into that type of situation. I wait. When I really think I have an advantage on the investment, on the price, then I act.

I've always found when stocks go into the index, they've already gone up a tremendous amount, so the index is momentum based. Microsoft and Intel were put into the index in 2000, right at the top.

Yeah, I think it would be fair to say, because as a value guy, I do look at when the index changes come out. It's not because I'm thinking about the weighting of my portfolio, but it's quite simply to see what's being deleted because, once again, I like ideas where the seller is not caring about price. You get a certain amount of selling after an index deletion that might be interesting, but it hasn't really been a source of great ideas. But who knows? Maybe tomorrow.

If you look at the past ten years—and it's been a rough year for value in the past year—you've still generated before the performance fee 20 percent a year, 16 percent net to investors, which is right at the top. You've had great returns while maintaining pretty high cash positions along the way. I think at the end of '97 you had 59 percent cash. You've had less cash recently, but I think 25, 27 percent cash has been common. How did you generate those returns with that much cash?

This gets back to a comment I made before: I try and only act when I think there's something to do, and I don't care what the portfolio looks like relative to the index. If there isn't anything to do, I'm quite happy to sit on my hands. That's what cash ends up being. It's not an asset class in my mind, it's the residual. If there's nothing to do, we'll just sit in cash. If there's something to do and it's really good, then let's spend the money. As I said to you before, when the year ends and you look back and say, wow, I was up whatever this year, sometimes I'm as surprised as the next person. I can't say how it happened that way. All I know is I try to be disciplined on when to buy, and that's worked to our advantage.

Back to distressed securities. The Loewen Group bond—did that work or not?

Yeah, it did. Yeah, I like doing distressed debt.

It's the same thing as buying distressed stocks, really.

It's just a different part of the capital structure. There hasn't been as much stuff to do recently, although I have to say in the last six months, we've started looking at the distressed again, and we're quite close on at least one idea to buying some of the debt. The advantages to distressed debt are twofold. Sometimes you get a coupon, sometimes not. Secondly, there's usually an event that comes along—a restructuring, an emergence from bankruptcy, or something like that—that allows the position to turn over naturally. You're not dependent on waiting for the business to improve or analysts to get coverage or liquidating to come in. There's usually an event with distress that gives you liquidity. It's an interesting place to invest. We do not buy bonds unless they're significantly discounted from face, and that's the only time we would do it.

Can you pinpoint one thing that has helped you to do well?

As I said this to you before, it would be trying to emulate Homer Simpson in my daily investment activity. I'm always amazed with the people who get on television and people ask them stock ideas, and they know something about every stock. My brain can only hold so much information. If it's not something that I want to focus on, then I'm not going to spend a whole bunch of time thinking about it. If it is something I'm interested in, then I'll focus on it, and if it's attractive, I'll actually do it. So not feeling like I come in every day having to make a decision but being focused on waiting for what I think are the right decisions and being confident when you make them. I think that there's some advantage to dropping your children on their head at an early age because I think that's what happened to me. Send them into the investment business if that happens.

There was a study done where they gave investment problems to sociopaths in prison, and they did much better than the average population. They had no conscience. They didn't care. They just made logical decisions without any emotion.

At times, my performance has been compared to everything from sociopaths to primates, so if there's any day you're feeling like you're a bright person, don't worry. You can find someone to tell you you're not. So it keeps you humble.

Why did you make the insignia for your firm a toad with a prince's crown?

Well, I guess all of our stocks have warts on them. We have to kiss a lot of frogs to look for the prince, so quite often I think that if I needed one investment tool in this business, it might be LypSyl and not a calculator. That's how the frog came into being.

Does one stock kind of stand out in your mind as being your biggest win and your biggest multi-bagger?

Your mind is always drawn to most recent stuff, so Sun-Rype was a great win for us. I probably overstayed by a couple of years. I could have sold it earlier. Glacier Ventures is one of the largest publishers of community newspapers. I think we bought our first stock at $0.70 or so. That management group, Sam Grippo and Jon Kennedy, have been wonderful at creating value over the last five years, and the stock's roughly $4 give or take a little bit. What I found, is when we look at a stock, I'm not looking for a 20 percent discount to what I think it's worth. I'm kind of thinking if things go right and we wait three or four years or five years can the stock be a double or triple, or quadruple? Thankfully, we've had a number of those and that's helped the performance a lot.

You seem to find a lot of stocks that are under $5.

It's quite often not before I buy them.

Indigo Books, what drew you to that? At the time Indigo was a dog with fleas.

I go back to my joke earlier about penguins. It's certainly like that when you go up and you look close at each individual idea. There's usually some significant part that stinks. What happened in Indigo was that they bought Chapters, and the stock essentially had collapsed.

Heather Reisman was involved.

Yeah. Heather Reisman had formed Indigo, but she was the person behind the merger with Chapters, because Chapters had gotten into some difficulty. They were doing a rights issue. I just was scrolling through the paper, and I saw, "Oh, Indigo is doing a rights issue." As I said before, I try and look for situations where there's an event going on. Following that up, I noticed that the rights issue was backed by Gerry Schwartz. Now he is Heather's husband, but he's also one of the most successful businessmen we have in Canada. I have a partner as well, but I know she's not going to put money into something that I'm doing, into my fund if she thought it was a losing proposition. I think Gerry approached life the same way.

What you had there was essentially insider buying, so that got my interest. I got the documents and said, "Well, what's interesting about Indigo?"

First, they have an important presence in Canada. It would be very hard to come in and compete against them. Chapters and Indigo are a large, large network of stores, both in the malls and the superstores, so they have a competitive position. Whether it's worth a lot of money or a little bit of money, it's there. The second thing is the book business is extremely cash generative compared to a lot of retail. The furniture and fixtures are not as significant as you'd expect, so there's actually a fairly high return on invested capital. The business is seasonal. Thirdly, their margins were significantly below similar companies elsewhere in the world. That was basically the four key things. Gerry was putting in money to backstop it, they had an important presence in the industry, they could produce free cash flow, and there was the opportunity for margin expansion. Then from there, I talked to the company—I tried to figure out what might happen over time, and they worked out okay.

You bought it at $4.50?

Yeah, something like that. It got as high as $18 and it is now about $12. Having a stock go from $4 to—let's average those two and say $15 or $16—that's quite helpful to performance.

When you take a stock on, is it always less than 10 percent of the portfolio at cost?

Yeah, it's like say 5 to 10 percent. In the case of Indigo Books, I think it was like a 7 or 8 percent position, or something like that. If it doubles, it's extremely accretive to performance; if it doesn't, that's where it's painful. That's why I try and only invest in stuff I feel confident in, because when you have a 5 percent position in the portfolio or a 7 percent position in the portfolio, you hate to make a mistake on the easy stuff. There's always going to be stuff out of the blue that hits you, but you hate to make a basic unforced error, as Warren Buffett would call it, on the analysis.

There's a difference between patience and delusion. The important thing for me in Indigo was hearing that management thought margins could expand and seeing some progress towards expanding margins. If that didn't happen, then you have to get out of the position because it's not becoming what you thought it would. I think that's important to understand. You have to be patient for stuff to happen, but you also have to be realistic where you think they're going and test the company against that.

How much money do you manage now?

About $160 million give or take a little bit. I enjoy my goal in this business: to make my partners a respectable return and enjoy the relationships with them and have fun. Although I'm an accountant, so it's not the same as a growth guy, as I said before. My objective isn't to have a $10 billion fund. My objective is not to have a family of funds. My objective is over time to compound at a respectable amount of money. I have all my money in the funds, so I can look people in the eye and say, "I'm in the same boat as you."

How many investors do you have approximately?

Probably about 500, give or take a little bit.

I think you try to treat them, like you said, as partners. You did something a few years ago where you got their pictures?

Yeah, what I said to people was, "Why don't you send us your picture—you doing something fun, not your passport photo. With 500 people, it's unrealistic to know all of them. The people broke into three categories: those who just didn't respond, those who sent pictures of themselves doing fun things, and those who just thought I was some psychopath wacko who wanted a picture of them to post on my bathroom wall.

Didn't they get bonus points if they were holding products?

Yeah, if they sent a picture holding a product of a company we owned in the portfolio. Now at the time, we had Loewen bonds, which was a funeral home, so I wasn't really looking for someone sending that along. We had Molson too, so if they sent a picture, drinking Molson or eating Humpty Dumpty chips or Sun-Rype, that was fine. As I said, not an insignificant number of people thought I was some type of warped psycho. We haven't done that recently.

What's your biggest mistake? Is there something that stands out that you just wish you hadn't have done?

I make a fair number of them. The one that I make consistently is buying too big a position too quickly. Every time I do that, I vow next time I won't, and then I do it again. That's always one of those kind of "I should have known better" things. It doesn't mean that I think I was wrong with the initial position. It was just I went in too early, thinking this time it won't go down by a third or half or more, and then they always do. So one of these days I'll figure that out, but I haven't yet.

What did you learn from your biggest mistake?

Well, I was hoping to learn.

You haven't learned it yet, but you're still working on it? [Laughs]

I think that's getting into my brain. The other thing is, if I kind of look back over the ten years, it always takes a little bit longer than you think in a value stock. You get in there and you think that it's a two-year turnaround, and it ends up being a three- or four-year turnaround. Sometimes it can take more money that you think, but sometimes it goes up more than you think. I never once thought that Indigo would ever see $18 when we bought it. The second thing is being invested with good people has always made a difference to me. I've been fortunate enough to understand the incentives or where people are coming from. I'm talking about primarily the board here. That's bailed me out of many a difficult situation. I think more about that now than I perhaps did when I first started in the business in '91.

Management is the key?

Not so much management; it's having directors. I've seen companies with the largest compliance manuals on earth, but I'd rather take a director with common sense and $200,000 worth of stock over the best compliance follower in the world. I think having some skin in the game makes a real difference at the board level because the board then sets the goalposts for management.

I think sometimes you have warning labels on your reports. What are those all about?

You always say, "What I did yesterday doesn't mean that I can do it again tomorrow," so that's a big thing in the investment business. Conversely, I would say that if you invest with someone, whether it's Eric Sprott or Warren Buffett or George Soros or whomever, the first thing you want to do is understand how they invest and whether or not you're comfortable with it. Then, from time to time, check and make sure they're still investing the same way they said they would invest. People are going to have good times and they're going to have bad times, but I think the best investors have been ones who are disciplined and consistent in their approach.

I think that's why a lot of these guys that I've interviewed for the book work for themselves, because they can be free thinkers. You can afford to think outside the box when you work for yourself.

What you do is you get people who come in and say, "You shouldn't own this, you shouldn't own that, you shouldn't own this," so you end up succumbing to the pressure from others. With your own business, you answer to your investors, of course, but also to yourself at the end of the day. A lot of my investors are friends or family or people I can put a face to, which means I do feel quite a responsibility to them with every decision I make. My reputation is really all I have, so without a doubt I can make mistakes, but I'm not going to do anything that disadvantages my investors.

The McElvaine Investment Trust ("The Trust")

1. Highly satisfactory longer-term performance can be achieved by focusing on companies selling below net asset value.
2. Given the size of the Canadian market, a small investment fund has a significant competitive advantage.
3. The purpose of an investment vehicle is to make money, not to own stocks. This is an important distinction because it means the Trust will only invest when presented with an attractive situation.
4. As there are few good ideas, there are times when concentration may be helpful.
5. An incentive fee structure rewards performance, not asset growth.

Stock Market Superstars
by Bob Thompson

TOM STANLEY

IRWIN MICHAEL

ALLAN JACOBS

ROHIT SEHGAL

ERIC SPROTT

TIM MCELVAINE

WAYNE DEANS

FRANK MERSCH

PETER PUCCETTI

NORMAND LAMARCHE

RANDALL ABRAMSON

JOHN THIESSEN

In these absorbing interviews with twelve of the greatest money managers in Canada, Bob Thompson explores the mechanics and psychology behind the key characteristics that make these managers great. How do the country's top stock pickers make millions of dollars in the markets? That's the question Thompson answers in interviews with these money-making superstars. This book highlights the common traits of some of the best money managers in the country. It will help average investors increase their skills by having the money managers, in their own words, explain how their strategies, styles, and success have developed over the years. In this entertaining book, investors will see the insights, personalities, foibles, outlooks, and misgivings of some of the brightest minds in the investment world here in Canada. It will help make investors aware of their own strengths and weaknesses. Learn what it takes to be a great investor!

At Canaccord Capital, Bob Thompson holds the title of Associate Portfolio Manager and Alternative Investment Strategist, and manages discretionary portfolios on behalf of clients of Canaccord Capital. Thompson is a regularly featured financial columnist in the *National Post*, writing specifically on alternative investments. He is a recognized authority on alternative investing in Canada, and maintains a select clientele of high-net-worth investors and institutions.

Thompson is a frequent guest on the Business News Network and has written and advised on articles for the *Globe and Mail*, *Canadian Business*, *Investor's Digest*, *Canadian Hedgewatch*, *Benefits Canada*, and others. He is a popular guest speaker at international investment conferences on portfolio strategy, and in particular, alternative investments.

For additional information about the managers in this book and a unique portfolio managed by Bob Thompson comprising the strategies of many of Canada's top stock pickers, please visit:

www.stockmarketsuperstars.com

INSOMNIAC PRESS