

Why We Worry Top-Down, Invest Bottom-Up

FRANK K. MARTIN

IVEY BUSINESS SCHOOL'S BEN GRAHAM CENTRE FOR VALUE INVESTING 2015
CONFERENCE

APRIL 15, 2015



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INVESTORS IN THE POTENTIAL FUND WILL BEAR ASSET-BASED FEES, EXPENSES AND A PERFORMANCE-BASED ALLOCATION AT THE INVESTMENT LEVEL AND MAY BEAR, INDIRECTLY, FEES, EXPENSES AND IN CERTAIN CASES, PERFORMANCE-BASED COMPENSATION OF THE UNDERLYING INVESTMENTS; PERFORMANCE-BASED FEES MAY CREATE AN INCENTIVE FOR SPECULATIVE INVESTMENT BY AN INVESTMENT ADVISOR. IF INCLUDED, INDEX INFORMATION IS INTENDED MERELY TO SHOW THE GENERAL TREND IN THE MARKETS FOR THE PERIODS INDICATED AND IS NOT INTENDED TO IMPLY THAT THE INVESTMENTS ARE SIMILAR TO THE INDICES EITHER IN COMPOSITION OR RISK.

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CERTAIN STATEMENTS MADE DURING THIS PRESENTATION ARE FORWARD-LOOKING AND ARE SUBJECT TO RISKS AND UNCERTAINTIES. THE FORWARD-LOOKING STATEMENTS MADE ARE BASED ON OUR BELIEFS, ASSUMPTIONS AND EXPECTATIONS OF FUTURE PERFORMANCE, TAKING INTO ACCOUNT INFORMATION CURRENTLY AVAILABLE TO US. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THE FORWARD-LOOKING STATEMENTS MADE IN THIS PRESENTATION. WHEN WE USE THE WORDS “BELIEVE,” “EXPECT,” “ANTICIPATE,” “PLAN,” “WILL,” “INTEND” OR OTHER SIMILAR EXPRESSIONS, WE ARE IDENTIFYING FORWARD-LOOKING STATEMENTS.

THE FORWARD-LOOKING STATEMENTS MADE IN THIS PRESENTATION ARE SUBJECT TO THE SAFE HARBOR OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.



“We are reminded again of the warning from the distant past from our mentor, Ben Graham, which I have quoted before: ‘Only 1 in 100 survived the 1929-1932 debacle if one was not bearish in 1925.’ We continue to be early – and bearish!”

- Prem Watsa, Fairfax 2013 Letter to Shareholders



Introduction: MCM GIPS Performance

Information Redacted
Please contact chris@mcmadvisors.com

What We Don't Include in Our Definition of “Worry Top-Down”



Federal Reserve opens door to first rate rise for a decade

'Patience' pledge dropped June increase now possible Growth forecasts cut back

Fed member warns against raising rates too early

Fed to Market: No More Promises

Fed policy makers face challenge in moving long-term yields up; 'conundrum' for new era

Pushing and Pulling on Rates Riddle

Fed's mixed signals expose gulf with markets over rate cut expectations

'Moonwalk' messages said to be conflicting Investors bet levels will stay at historic lows

Slowing Job Growth Tests Economy

US inflation bounce unlikely to move the Fed needle

Fed Tiptoes Into Rate-Hike Debate

Timing of Fed rate increases called into question as weak hiring punctuates recent hiccups



“Anyone who attempts to direct the employment of capital will not only bring much unwanted attention upon himself but also will unwittingly or otherwise assume authority that should be trusted to no political entity, however mighty, and which would nowhere be so dangerous as in the hands of a man who had the folly and presumption enough to fancy himself fit to exercise it.”

- Adam Smith

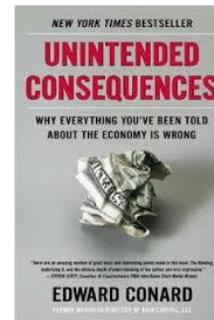
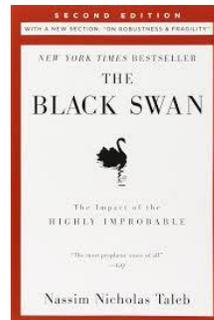
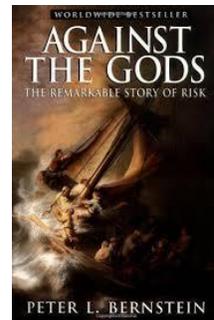
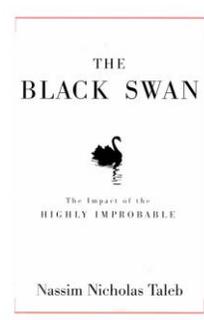
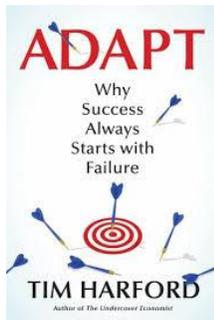
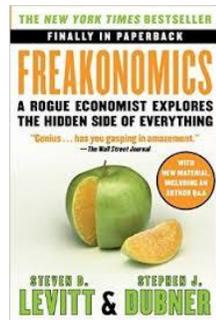
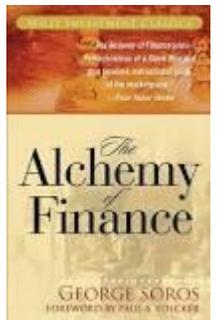
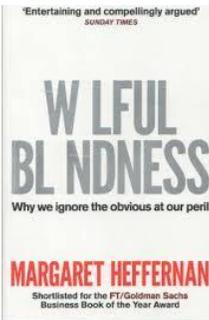
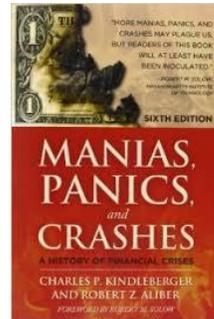
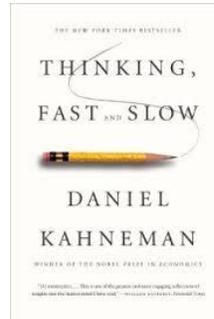
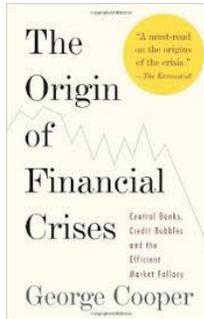
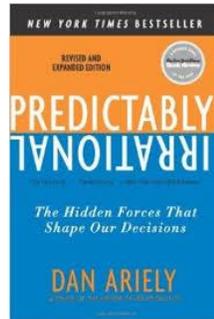
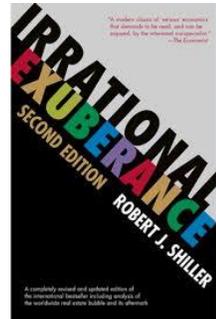
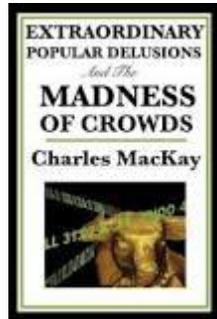
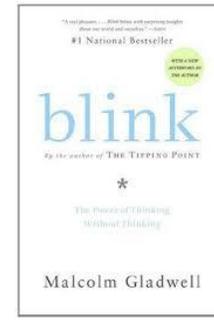
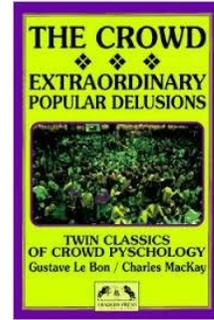
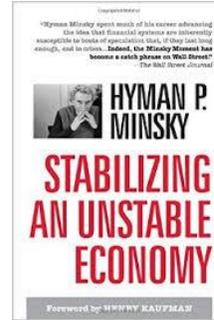
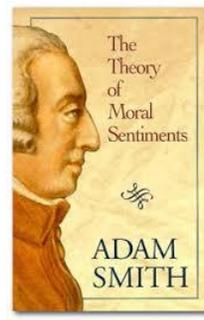
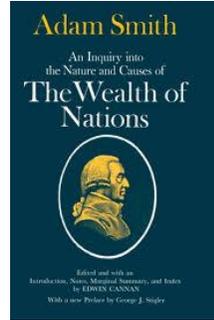
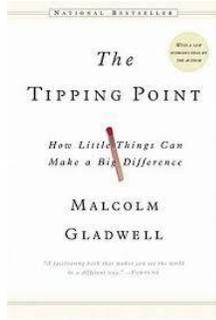
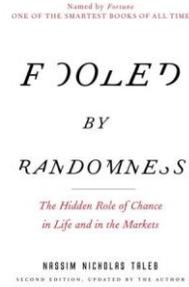
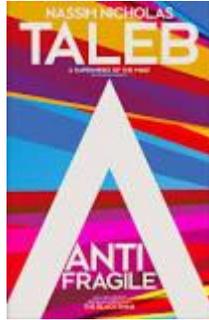
What We Do Worry About



Behavioral Economics and Market Valuation



Behavioral Economics





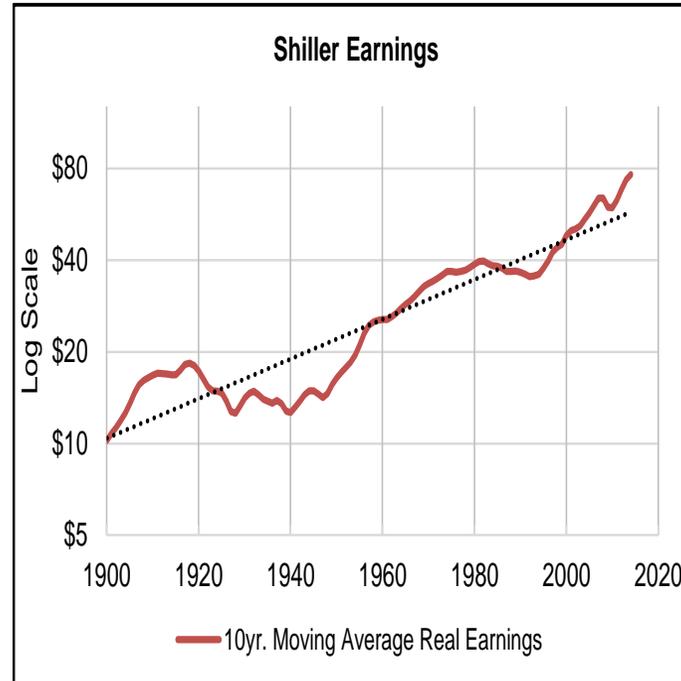
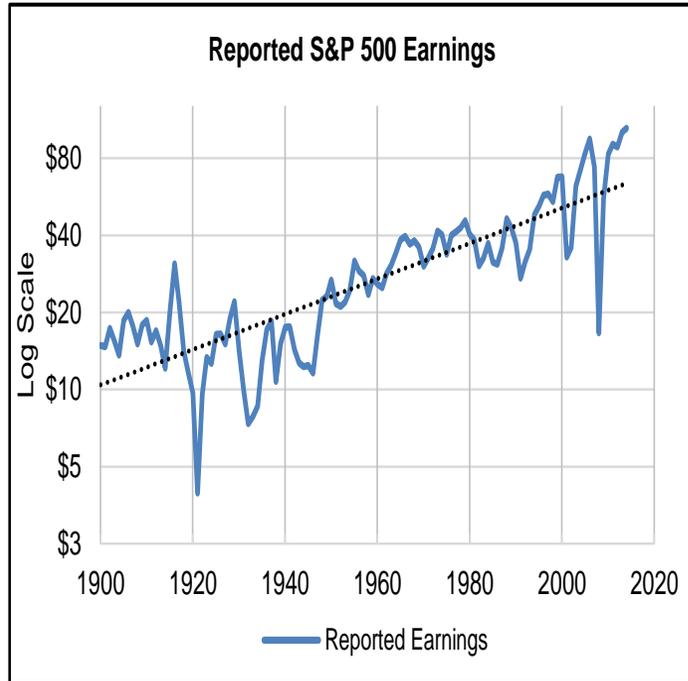
“[An investor] should have an adequate idea of stock market history, in terms, particularly, of the major fluctuations. With this background he may be in a position to form some worthwhile judgment of the attractiveness or dangers ... of the market.”

- Benjamin Graham

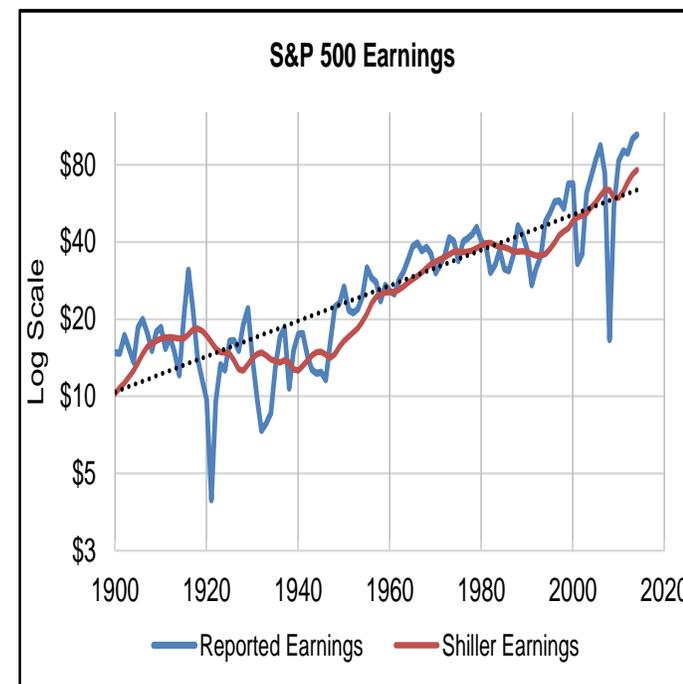
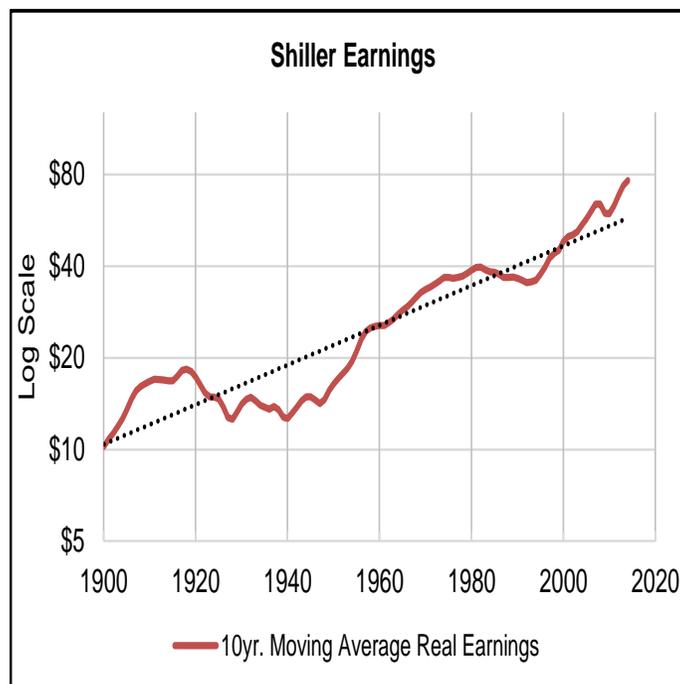
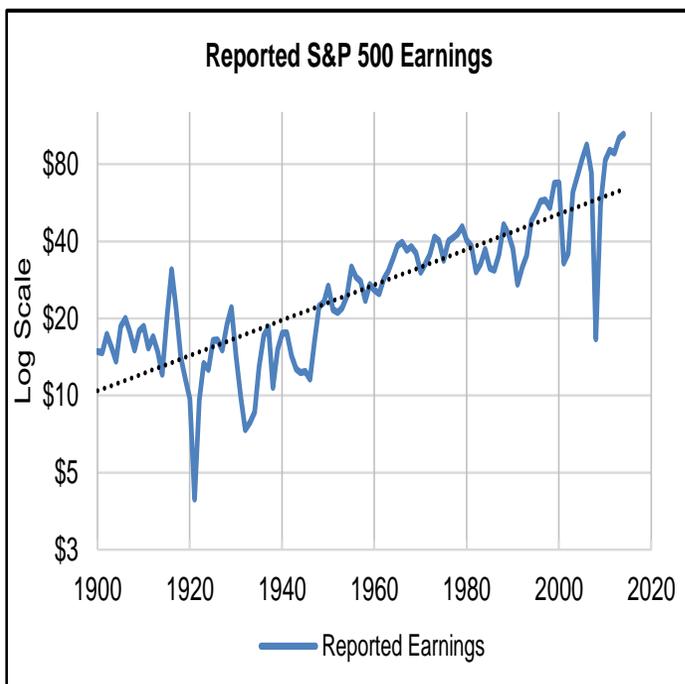
S&P 500 Real Annualized Total Returns

S&P 500 Real Annualized Total Return w/ Dividends Reinvested		
<u>Time Span</u>	<u>Ebb</u>	<u>Flood</u>
1900-1921	2.6%	
1922-1929		26.9%
1930-1949	2.7%	
1950-1965		13.9%
1966-1981	(1.0%)	
1982-1999		14.4%
2000-2014*	2.0%	

Reported vs 10-year Moving Average S&P Earnings



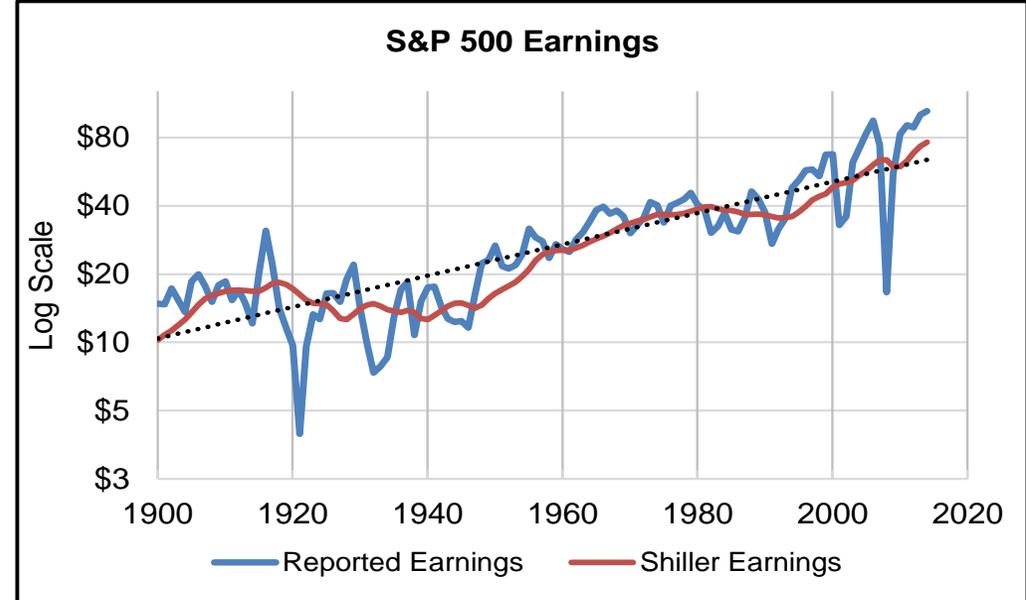
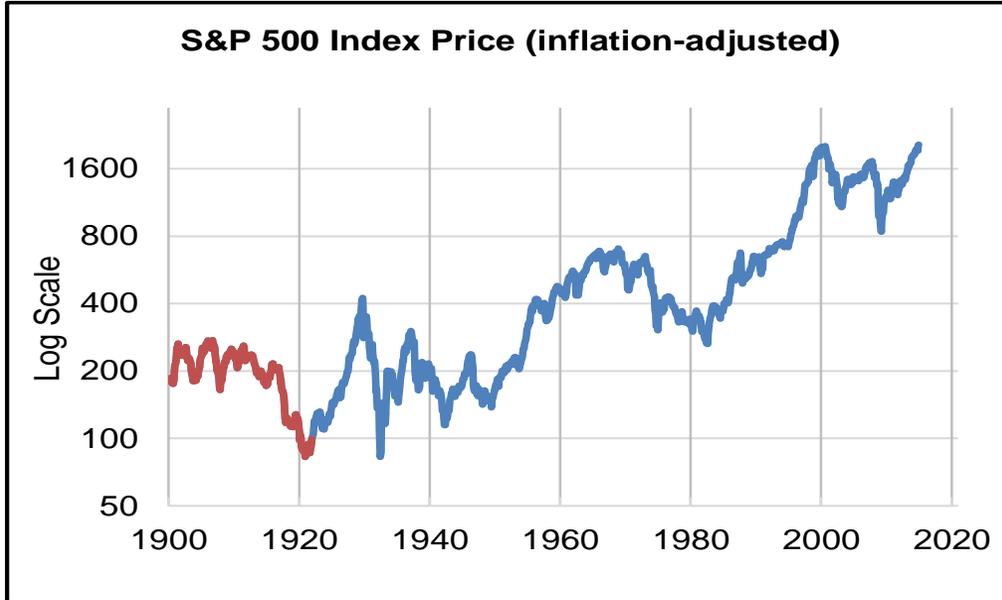
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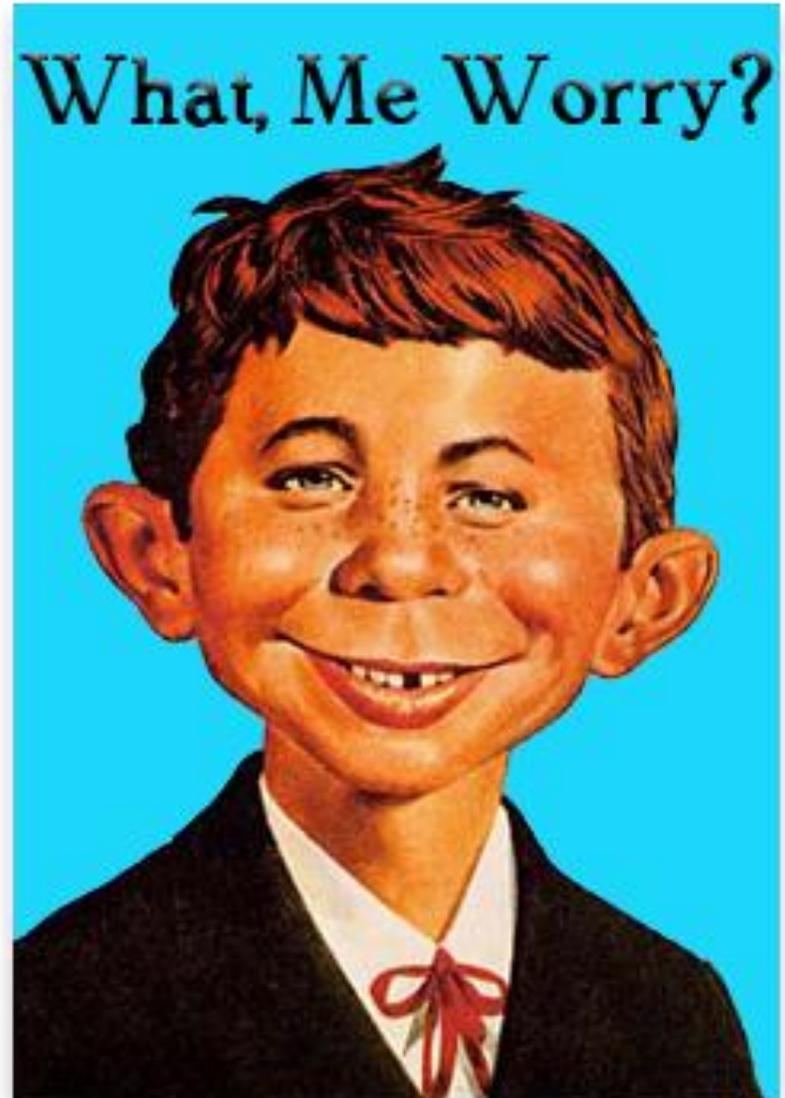
From 1900 to 2014 in 19.5 Minutes



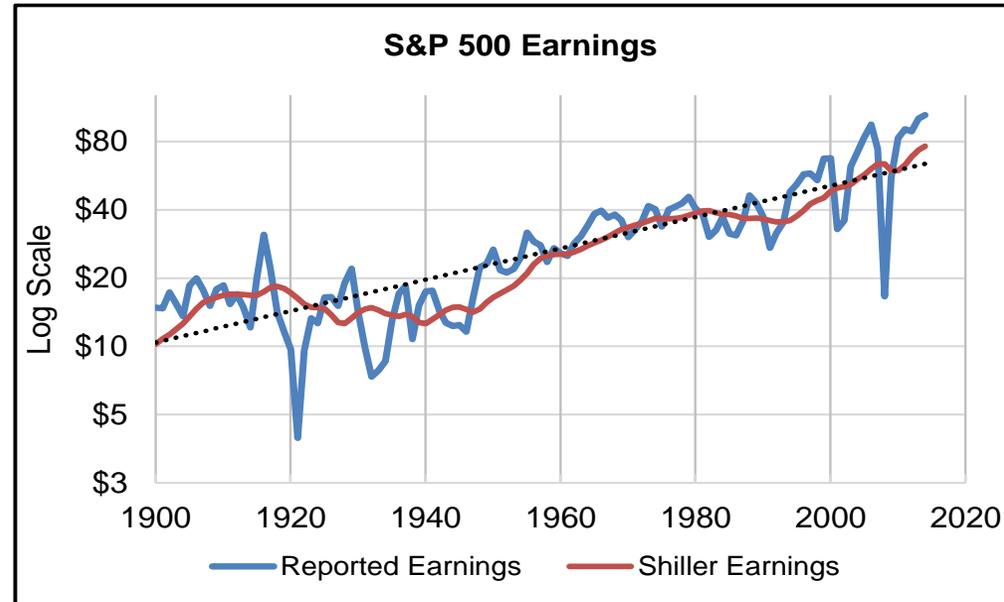
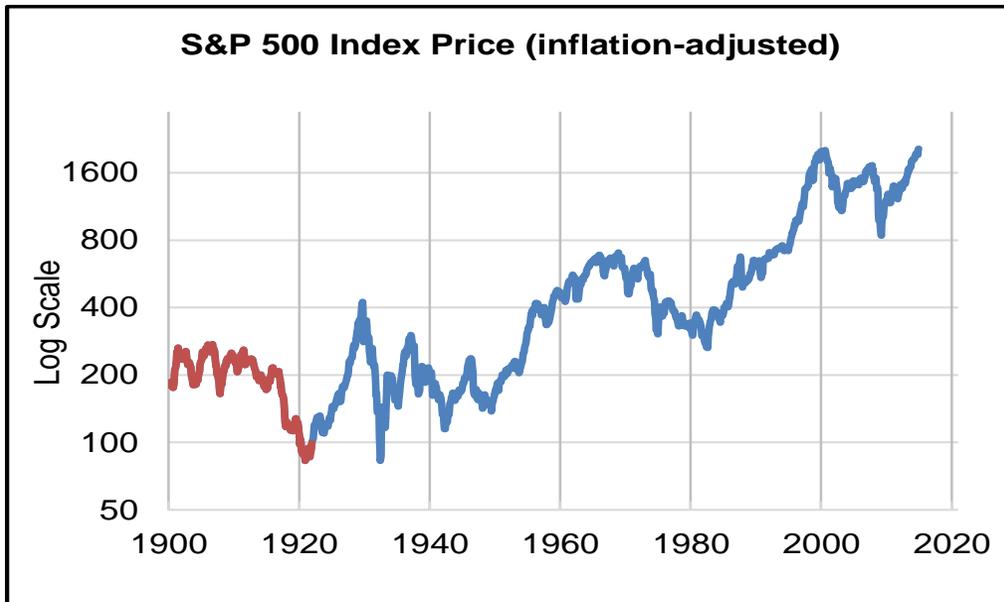
1900-1921



<u>Time Span</u>	<u>Shiller P/E</u>			<u>Shiller EPS</u>			<u>S&P 500 Real Annualized Return</u>		
	<u>Beginning</u>	<u>End</u>	<u>Ann. Change</u>	<u>Beginning</u>	<u>End</u>	<u>Ann. Change</u>	<u>Capital Appreciation</u>	<u>Dividend Return</u>	<u>Total Return</u>
1900 - 1921	18.5	6.1	(-4.9%)	\$9.68	\$16.25	2.4%	(-2.6%)	5.3%	2.6%



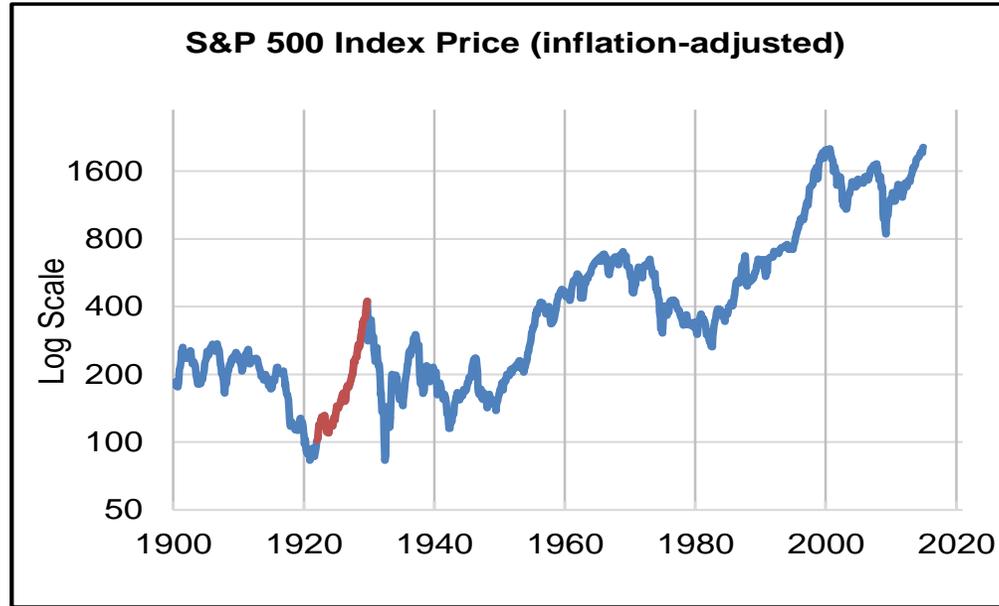
1900-1921



<u>Time Span</u>	<u>Shiller P/E</u>			<u>Shiller EPS</u>			<u>S&P 500 Real Annualized Return</u>		
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1922-1929



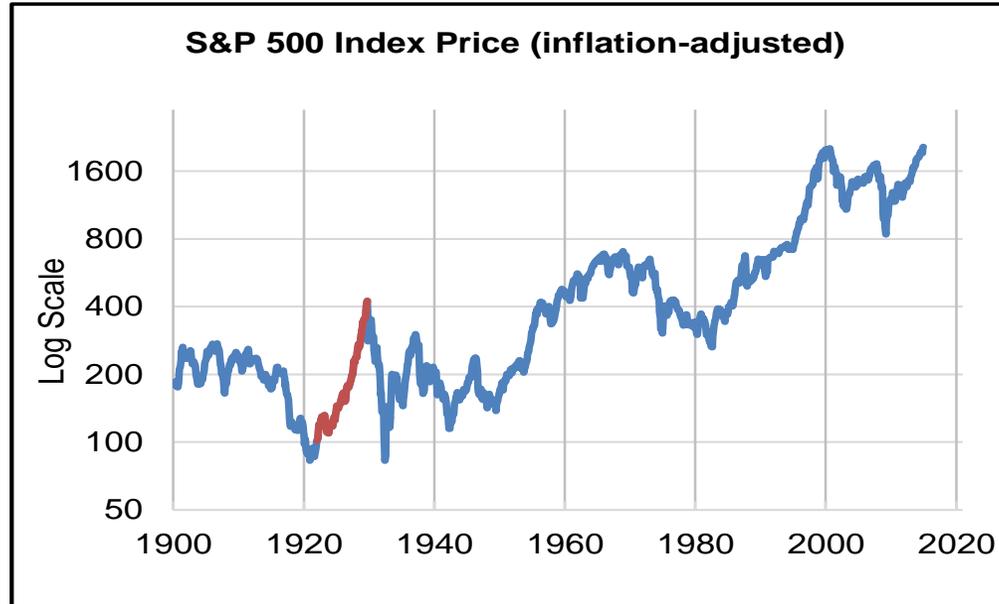
<u>Time Span</u>	<u>Shiller P/E</u>		<u>Annualized Rate of Change in</u>		<u>S&P 500 Real Annualized Return</u>		
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1922-1929	6.1	32.6	24.1%	(2.8%)	20.6%	6.2%	26.9%



“In their calmer moments, investors recognize their inability to know what the future holds. In moments of extreme panic or enthusiasm, however, they become remarkably bold in their predictions: they act as though uncertainty has vanished and the outcome is beyond doubt. Reality is abruptly transformed into that hypothetical future where the outcome is known. These are rare occasions, but they are unforgettable: major tops and bottoms in markets are defined by this switch from doubt to certainty [emphasis added].”

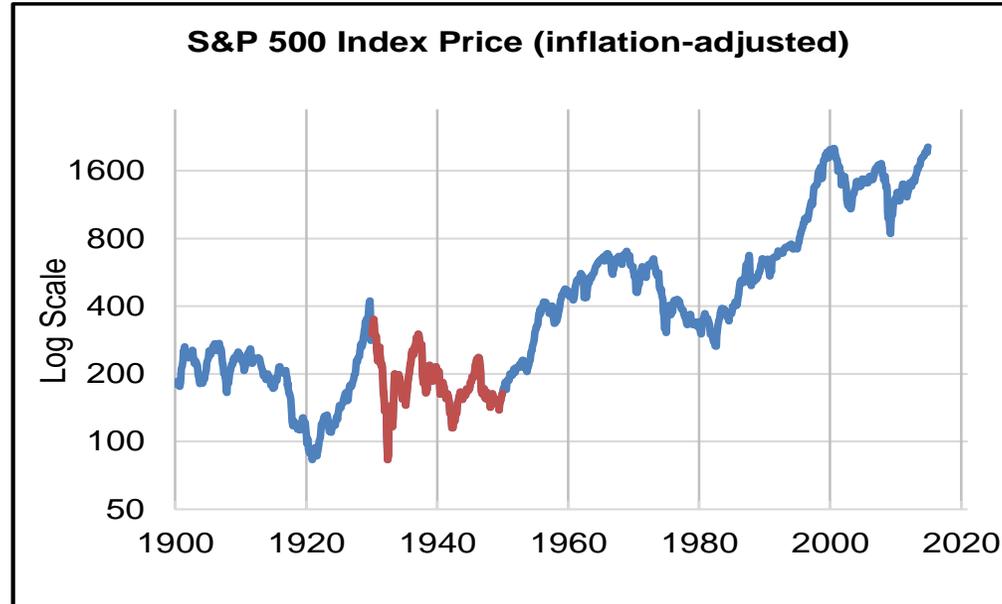
- Peter Bernstein

1922-1929



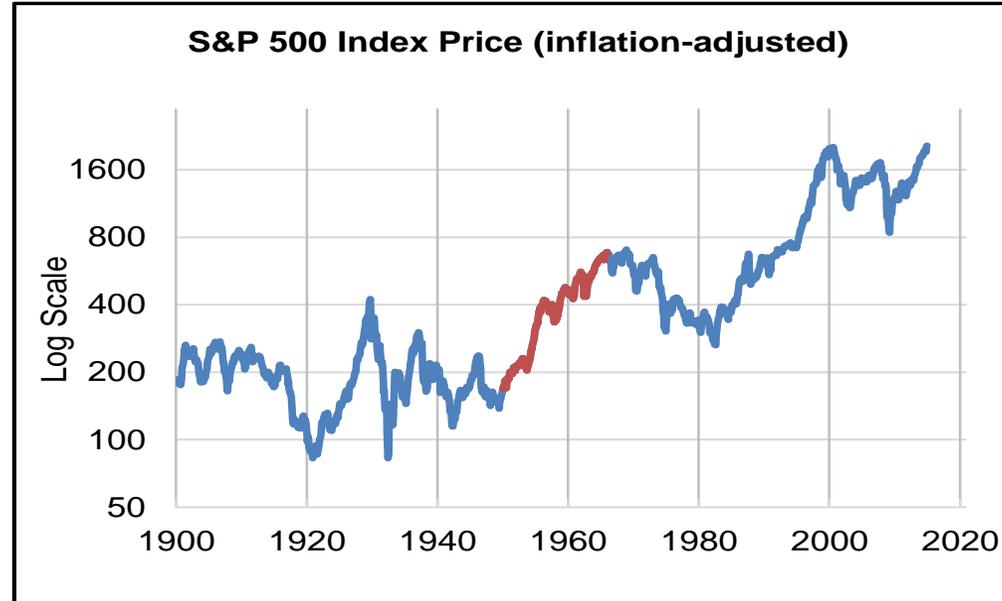
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1930-1949



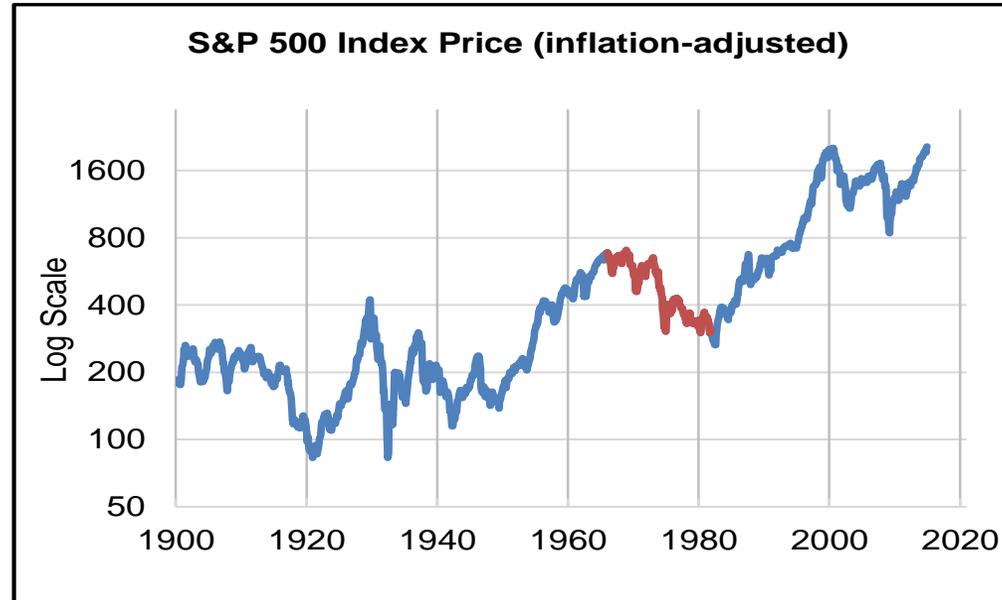
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1930-1949	22.0	10.5	(3.6%)	0.8%	(2.8%)	5.6%	2.7%

1950-1965



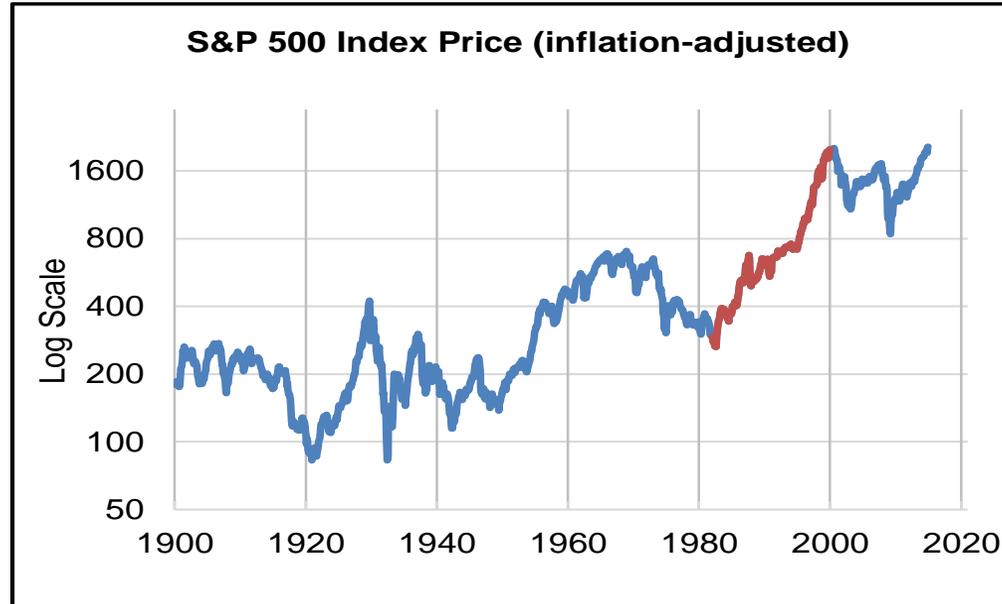
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1930-1949	22.0	10.5	(3.6%)	0.8%	(2.8%)	5.6%	2.7%
1950-1965	10.5	23.7	5.2%	3.8%	9.2%	4.7%	13.9%

1966-1981

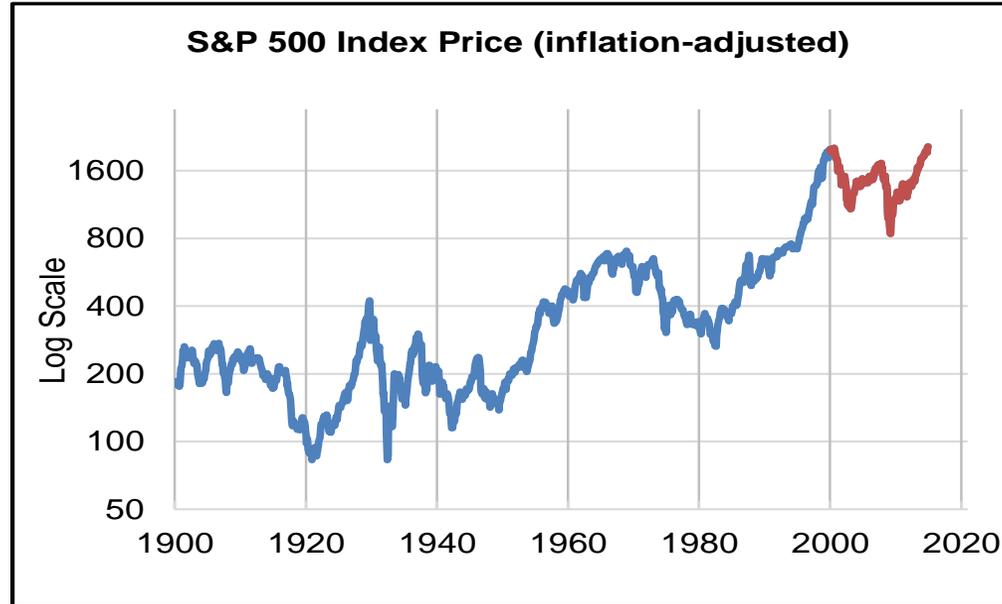


<u>Time Span</u>	<u>Shiller P/E</u>		<u>Annualized Rate of Change in</u>		<u>S&P 500 Real Annualized Return</u>		
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1950-1965	10.5	23.7	5.2%	3.8%	9.2%	4.7%	13.9%
1966-1981	23.7	7.8	(6.7%)	2.0%	(4.8%)	3.8%	(1.0%)

1982-1999

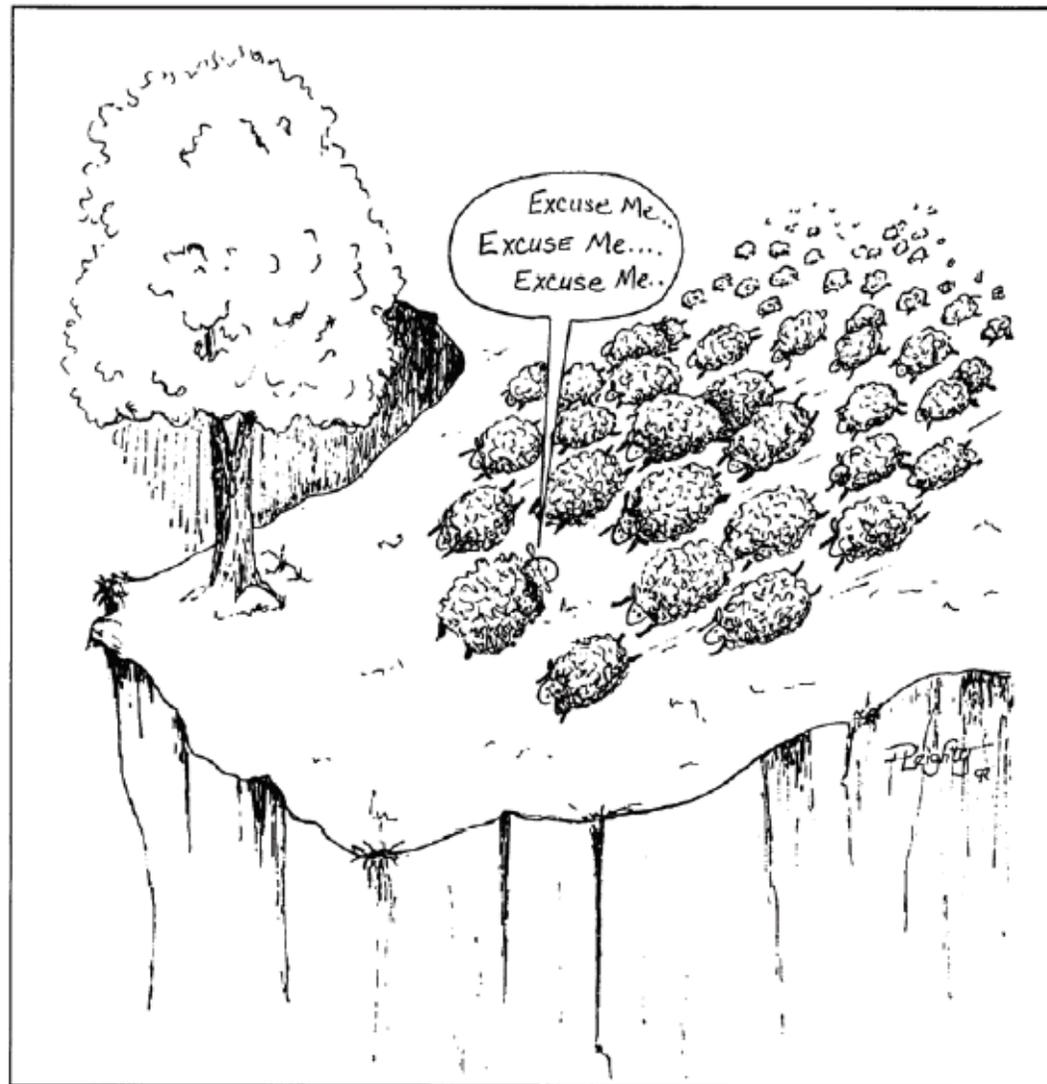


<u>Time Span</u>	<u>Shiller P/E</u>		<u>Annualized Rate of Change in</u>		<u>S&P 500 Real Annualized Return</u>		
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1950-1965	10.5	23.7	5.2%	3.8%	9.2%	4.7%	13.9%
1966-1981	23.7	7.8	(6.7%)	2.0%	(4.8%)	3.8%	(1.0%)
1982-1999	7.8	44.2	10.1%	0.7%	10.9%	3.5%	14.4%



Time Span	Shiller P/E		Annualized Rate of Change in		S&P 500 Real Annualized Return		
	Beginning	End	Shiller P/E	Shiller EPS	Capital Appreciation	Dividend Return	Total Return
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1950-1965	10.5	23.7	5.2%	3.8%	9.2%	4.7%	13.9%
1966-1981	23.7	7.8	(6.7%)	2.0%	(4.8%)	3.8%	(1.0%)
1982-1999	7.8	44.2	10.1%	0.7%	10.9%	3.5%	14.4%
2000-2014*	44.2	26.8	(3.3%)	3.6%	0.2%	1.9%	2.0%

Going Against the Herd



Q&A

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