VALUE PARTNERS INVESTMENTS

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MARKET COMMENTARY

VPI DIVIDEND GROWTH POOL

A NOTE FROM IZET ELMAZI

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RECENT MARKET VOLATILITY...OPPORTUNITY TO BUY

The continued spread of the coronavirus beyond China is causing chaos in the markets. Last night S&P futures were limit down, dropping approximately 5%. The selloff has been highly correlated, indiscriminate and violent, bringing the S&P 500 approximately 19% lower from its highs in just a matter of weeks.

The VIX Index, the market's gauge of fear, has spiked to levels not seen since the Global Financial Crisis. Bond yields have collapsed with the 10 year dropping below 0.5% and the 30 year below 1% and now the oil price has followed suit, dropping approximately 30% overnight as Saudi Arabia effectively declared an all out price war with its OPEC+ partners.

This is what panic looks like. Fear and uncertainty are high. Like a soccer goalie facing a penalty shot, many investors are feeling the need to react so they can say they did something. Sometimes though, just staying the course is the best option.

Our research has demonstrated, and our results have proven that over time, higher total returns can be achieved by owning stocks with higher dividend growth. The top dividend growers have consistently outperformed the broad US market. We do not believe this has changed because of the coronavirus.

Our process is focused on identifying high dividend growth supported by sound fundamentals, not financial engineering. This leads us to companies with strong business models with enough financial flexibility to finance ample, attractive reinvestment opportunities. We believe acquiring high returning businesses that can compound capital over longer periods of time at reasonable prices is the best way to protect and grow capital.

There is no doubt that the near term earnings of many of our portfolio companies will be affected by the coronavirus – supply chains have been disrupted, travel has been cancelled, and overall demand has been reduced. But we believe this is only a temporary affect.

Unlike many of our competitors who are focused on next quarter's earnings to value stocks, we take a longer term view of a company's true earnings power to determine intrinsic value. As such, one time, near term events have little impact on our determination of value. Said another way, Visa recently lowered their FYQ2 revenue guidance by 2.5-3.5% mostly because of a reduction in cross border travel. Does that change the longer term opportunity represented by the fact that 80% of global payments are still not performed on card networks? We think not.

All the companies in our portfolio have secular trends such as this that will continue to drive long term opportunity despite near term challenges. Although we are never happy when our portfolio is down, we take comfort in how it has performed on a relative basis in an environment where yields have been driven to historical lows. We believe that speaks to the general fundamental strength of our investments.

In addition to the above, there are a several other points that are worth mentioning with respect to the VPI Dividend Growth Pool that we think are relevant during times like this:

- Our systematic, quarterly rebalancing effectively acts as a contrarian mechanism, trimming stocks that have done relatively well and reallocating that capital to stocks that are lagging.

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- We own no energy stocks and are effectively net short via our positions linked to consumer spending. The fall in energy prices will act as a bonus to consumer discretionary spending and we expect many of our holdings to benefit from this.
- We do not hedge our US dollar exposure. During turbulent times, that currency exposure usually acts as a hedge as the US dollar typically benefits from a flight to safety. While the market has fallen 19% from its highs, the USD is up approximately 4% over the same period.
- Money has been coming into the pool almost daily and we have been dollar cost averaging as the market has declined. While this is sometimes painful in the short term, being fully invested ensures we catch the rebound when it happens – and it may be just as violent (but in a good way) as this decline.

If you are like that soccer goalie and feel the need to act, perhaps buying a little on days like today makes more sense than selling. Although we don't know when the bottom will occur, or how bad this will get, we have seen panic before and know one thing for certain. It always subsides.

Izet Elmazi
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