PRIVATE INVESTMENT MANAGEMENT GROUP QUARTERLY REPORT

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THE "SMART" MONEY...

I often hear talk of the "smart" money. "*What is the smart money doing?*" "H*ow is the smart money reacting?*" and "*Where is the smart money investing now?*"

The smart money presumably is some elite class of investor that consistently achieves better results than the majority. By definition they are obviously 'smarter' than the (... shall we say), "less-informed" - and as a result of their uncanny investing acumen, they are obviously far wealthier than the rest of us.

But if it's so easy to identify who the smart money is by simply observing what they're doing today, or what they have done in the past - why wouldn't we all just simply follow along? By doing so, surely we can at least share in some of their excessive winnings in the future... can't we?

Given the potential for such outsized investment success, let's try to clarify exactly who we should be following. Just who is the smart money anyway? First off, is it some clandestine group that meets secretly and makes its moves in the market unbeknownst to the rest of us – shortly thereafter raking in the inevitable and unheard of profits? I don't think so - the investment world is hardly ever that intriguing and mysterious!

Much to the contrary, I had always been led to believe that the smart money was represented by the "institutional investor". These are the 'big guys' – too big, in fact, to do anything without the whole world knowing! The institutional investor is made up of huge pension funds and endowments - and the large scale mutual fund companies; some of which now manage over a trillion dollars and single-handedly represent a significant share of the daily trading volume on the world's largest stock exchanges. As someone who has immersed himself in the world of investing for well over two decades now – surely I know who the real smart money is. Or do I?

Or should I say, did I? Please allow me to briefly explain. It's a little more than two years ago on a cool Tuesday night in Calgary, Alberta (October 23rd, 2012 to be exact). Despite the all-too familiar feeling of winter's bite in the air at this time of year, I have a little extra spring in my step. I'm feeling grateful to have been invited - along with a small group of other Financial Advisors and Portfolio Managers - to an intimate dinner with none other than Mr. Charles Brandes (pronounced 'bran-dis'). While he may not be a household name along the likes of Warren Buffett or George Soros – Brandes has been described as a 'legend' and a 'guru' among investors, and (…like Buffett and Soros) Charles Brandes has been listed by Forbes magazine among "The World's Billionaires". He and his firm have been managing billions of dollars for both retail and institutional investors since the 1970s. While I've had the opportunity to meet Mr. Brandes on a couple of previous occasions, needless to say I'm eager to glean more wisdom from this true legend in the investment industry.

So imagine my surprise when Mr. Brandes informs us that many of the institutional investors he has worked with over the decades, have the same wealth destroying tendencies to buy high and sell low as do the novice investor (i.e. the aforementioned 'less informed'…)!? But wait a minute – I thought the smart money was the institutional investor? How could this be?

Yes indeed – Brandes went on to describe how his firm (with its stellar long-term investment track record firmly in place; hence the 'guru' and 'legendary' status) is often fired by their institutional clients after a brief period of poor past performance – and is inevitably hired back again by institutional investors after periods of relative outperformance. If memory serves me correctly, he even recounted one particular instance where the same institutional investor/client, who had previously fired them due to a brief period of poor results, had wanted to hire them back again after they'd put up some recent, presumably more satisfactory results – to which Brandes wisely said 'no thanks'.

This behavior among the institutional investors - the so-called 'smart money' - makes no sense at all to me (or to Charles Brandes for that matter!). Like the herd, the institutional investor appears just as likely as the neophyte to succumb to their short-term emotions when investing. This is the classic case of buy high/sell low when we all know that doing the opposite is obviously more conducive to any investment success whatsoever. Warren Buffett (and a rare few others) have amassed great fortunes by doing the opposite; by buying when others are fearful and selling when others are greedy. So if the institutional investor is not the smart money, then who is?

Is it the economists who represent the smart money…?

A large and very important function of the job of an economist is to predict the direction of interest rates, given that such interest rate moves can have a huge impact on almost all aspects of investing and the economy. And yet just this past week, when the Bank of Canada announced a cut in the all-important overnight lending rate, zero out of 22 economists who provided their forecasts had predicted the BOC's rate cut (you don't have to be good at math to know that that is obviously a horrible batting average!).

Legendary investor Peter Lynch once said "*If you spend more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes.*" And as for Charles Brandes, he has made it clear that his firm (remember, they've been managing billions of dollars for decades...) has never, and will never, hire an economist! Surely then, economists do not represent the smart money. The search continues...

Maybe the academics are 'the smart money'...?

After all, these are the really 'smart' people – right? Surely they can translate their genius over to the world of investing. Mystery solved - this group must be the elusive 'smart money'! Well, not so fast there either. Some of you may recall the book, "When Genius Failed" (by Roger Lowenstein) which tells the story of "Long-Term Capital Management" (LTCM). Founded in 1994, LTCM encompassed a virtual dream team of some of the smartest minds in the investment world. Among them, the firm's founder was one of the most well respected bond traders on Wall Street. Rounding out the team were two academics who shared the 1997 Noble Prize in Economic Sciences (...perhaps that should have been a warning right there?).

Surely with their all-star brain power, LTCM was destined for nothing but long-term success. However that's not quite the way the story went. It's very name -- Long-Term Capital Management --turned out to be more of an oxymoron than a representation of the smart money. The firm was anything but 'long term', having closed its doors in early 2000 (somewhat ironically, during a raging bull market). As for the 'capital management' part, in 1998 these academics managed to lose ~$4.6 billion of capital in less than four months (before getting financial intervention by the Federal Reserve!). So much for 'Long-Term'; so much for 'Capital Management', and so much for finding the elusive smart money among this crowd!

Alas, I have concluded after more than two decades of observation that the real smart money has been right under my nose all along. Please allow me to briefly elaborate. From its peak this past August to the lows reached just four months later in December, the Canadian stock market (as per the S&P/TSX Index) dropped close to 13%. Suffering a much greater downturn, the S&P/TSX Energy Index dropped by almost 45% in just six months (from its peak in June of 2014 to the lows also seen in December). As you may well imagine, my phone began to ring – and my email 'In Box' breached capacity. However, what was the reaction among my clients? It may not have been what some would think. I have to say that I have lost track of the number of my clients (you know who you are) who contacted me to inquire about the novel concept of investing more money in their accounts while stocks are temporarily 'on sale' – and AFTER having witnessed the recent significant drop in equities (can you say "buy low"...?).

This is a real life example of doing the opposite of the wealth destroying 'less informed' investor, who continually insists on selling after temporary market lows, AND enthusiastically buying more after the highs have received widespread media attention. This is akin to the same wealth destroying behavior of the institutional investor who fires the manager after a brief downturn (regardless of a stellar long-term track record), only to hire them back again after their performance has improved?

To the contrary, it turns out the real smart money (MY very own clients, among them) has indeed followed along – actually living by the motto of the world's greatest investor Warren Buffett. Buffett has repeatedly preached: *"Be fearful when others are greedy, and be greedy when others are fearful."* The simple translation (and perhaps the motto of the smart money) is to actually buy low and sell high, not just to say it or to think it! This is to go against the herd, to refuse to succumb to your emotions, and to remain firmly focused on the finish line - not the first 60 meters.

Benjamin Graham (author of "The Intelligent Investor" and mentor to Warren Buffett) has said that *"The investor's chief problem – and even his worst enemy – is likely to be himself."* The smart money differentiates itself by not being an enemy to its own success.

To wrap up this lengthy tale of discovery, it turns out the smart money is not the academics or the economists – nor is it restricted to the ultra-wealthy. Rather, the smart money is you - and the smart money is me. The smart money is any investor who does it the right way. The path to investment success has been clearly paved by the real smart money -- the likes of Buffett, Graham, Brandes and others. It's up to the rest to simply follow along....