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AN INVESTOR'S ODYSSEY: WHERE WILL YOU CAMP ALONG YOUR JOURNEY?

Mike Preto, CFP®

Imagine you're on a journey: a long one that will last a lifetime. Many other people you know are on the same odyssey and choosing their own path. Everyone is moving forward into the unknown simultaneously and each moment comes one after another. There are experts who have studied the landscape, environment, and weather; passionately learning as much as possible. These experts are available for hire to lead whoever wishes into the future. You are free to make the choices you wish at every turn, but no one has been ahead of you. This is how we look at the financial world.

There have been extended periods of time when the travelling conditions have been ideal: the wind at your back, pleasant temperatures and good solid footing. There have been times when the conditions have been brutal; treacherous terrain, persistent and strong headwinds and extreme temperatures ranging from frigid to scorching. The conditions can be static, both favourable or treacherous, for extended periods of time, 30 years or more. There are two types of camps to choose from, the active camp, the one that comes with a guide, and the passive camp, the one that doesn't. As you might imagine, it costs less to live in the passive camp.

As time goes on, society is motivated to succeed and innovation spawns new solutions, some of which are useful and others which only appear to be. A recent innovation has made the passive camp a viable option for some travellers. The passive camp is where you own assets in your portfolio which represent an index. The index can be very broad, narrow or anything in between. By broad- we're talking 1 security that you can invest in which mirrors the majority of the world's markets. You might be thinking, well hang on, we need some cash, bonds or other fixed income to balance the stocks. Your thinking is solid, and the industry has already created the solution. By buying one security, you can invest in a broadly diversified portfolio that has all of it- stocks, bonds, in a variety of proportions- even the flagship 60% stocks/40% fixed income. 1 ticker- VBAL- The Vanguard Balanced ETF Portfolio, look it up, it's our benchmark.

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VBAL was created in February 2018 by Vanguard, the world's second largest asset manager at over $6 Trillion USD. This is a game changer for the investment landscape and we're not sure everyone realizes it just yet. There are all kinds of people on this journey - investors paying their hard earned money to live in a camp where their portfolios are broadly diversified, rebalanced and looked at on a regular basis to ensure it's ready for whatever is coming up ahead. This is exactly what VBAL does, at roughly 1/10th the price most are paying to live in the passive camp.

When conditions are favourable the passive camp, the new viable option, is a great deal. Costs are low, and all you have to do is sit back, relax and leave more money in your portfolio to compound and grow. The bigger question needing to be answered is what happens when the conditions change for the worse and do so for an extended period of time, which they tend to do after long periods of being favourable. The passive camp says, don't worry about it, eventually things will change for the better. Ride it out and wait for the conditions to improve, it's all about time in the market. Try telling that to Japanese investors who in 1990 put $1m into the Japanese stock market which is now worth ~$700,000, 30 years on.

So, what's the solution? How do you avoid these extended periods of time where the markets don't provide you with the tailwinds you need to enjoy your hard-earned retirement? The answer is simple, we must understand what's in your portfolio and decide whether it can handle a challenging future.

Stocks are a security representing the ownership of a fraction of a corporation which is run by a management team put in place by an elected board of directors. The ultimate question we need to answer regarding the stocks in your portfolio is *would we want to own this business*. If the answer is yes, it's because we understand the business, it's ultra-high quality, we trust the management's ability to keep managing it well and believe the business has an ability to protect against competition from driving down profits.

When there's a meaningful downturn in the market, the price of these businesses will drop, potentially a lot. Does this mean that the business is now worth 20,30,40 or even more than 50% less? Absolutely not; it means people are panicking and want to "get out" before this gets any worse. In other words, more people want to sell the stock than buy it, this does not seem like a good reason to sell a great business we've said we want to own. In fact, it sounds like a great opportunity to buy more of a share in the business- see last month's newsletter for more on this topic.

In theory this seems great; pay someone who is passionately devoted to their trade to help protect your future, so you can follow their lead and safely navigate the road ahead, sleep well at night and live happily ever after. So why doesn't everyone do this? There's one simple reason- the comfort in numbers is incredibly enticing. In other words, people are more comfortable suffering if they know others are suffering alongside them.

Hillside is an active camp. Our purpose is to make sure you enjoy life today without compromising life tomorrow. By choosing to live in the active camp, you are accepting there will be times you are doing well when the market isn't and there are times when the market is doing well, and you are not. Many portfolio managers and investors are scared off by this so they have created a third camp, the closet indexing camp. This is the camp that looks active but is actually passive and charging active prices- you don't want to find yourself in this camp.

By accepting you are willing to be different than others, which takes courage, you have created independence- courage builds independence. By being independent, you gain the strength needed to overcome challenges others can't. By preparing yourself for the challenges ahead, you put yourself in a better position to overcome them. By overcoming challenges, you will get to where everyone else wants to go, but maybe not everyone will arrive with you- just those that chose the right camp.

PORTFOLIO UPDATE: LESSONS ON CAPITAL ALLOCATION FROM THE BEST

Jason Del Vicario, CFA

This past month we were able to listen in on the 5-hour(!) AGM of Berkshire Hathaway and the 3+ hour (also!) AGM of Constellation Software. The formal business of each meeting lasts but ~10 minutes with the rest of time taken up with management patiently and diligently answering question after question after question…

Both companies are run by founders/owners obsessively focused on returns on invested capital and shareholder friendliness. While Berkshire is a conglomerate of public (Apple, Coca Cola, American Express) and private (GEICO, Dairy Queen) companies, Constellation has successfully acquired and integrated 200+ VMS (vertical market software) companies into its fold. We own both.

Two different business models in two different countries that have lasted decades. While different, the managers of these companies share a passion for efficient capital allocation and deployment. While there wasn't much new revealed in either meeting, the commonalities are what strike us. All three, Warren Buffett, Charlie Munger and Mark Leonard are self made billionaires but don't behave like free spending

JOIN US: A DISCUSSION ABOUT ACTIVE VS. PASSIVE INVESTING

Have you ever wondered if YOU are you an Active or Passive Investor?

With names like "couch potato" investing, passive investing sounds kind of bad, doesn't it?

Not always, but find out why by joining us for a conversation on June 3rd.

CLICK HERE for more information and to register!

JASON IN THE NEWS!

One of our favourite shows is BNN's Market Call and we are always especially excited when Jason is invited as a guest!

Don't miss Jason's next appearance on June 1st. Listen live at 9 am PDT/12 EDT or stream the full episode online!

billionaires. Warren lives in the same house he bought in 1958. Charlie once quipped 'frugality is basically how Berkshire happened. I look out over this audience and I see a lot of understated, frugal people. We collect you people.' Mark Leonard perhaps sums up this way of living best in his 2007 shareholder letter: 'I recently flew to the UK for business using an economy ticket. For those of you who have seen me (I'm 6'5", and tip the non-metric scale at 280 lbs) you know that this is a bit of a hardship. I can personally afford to fly business class, and I could probably justify having Constellation buy me a business class ticket, but I nearly always fly economy. I do this because there are several hundred Constellation employees flying every week, and we expect them to fly economy when they are spending Constellation's money. The implication that I hope you are drawing, is that the standard we use when we spend our shareholders' money is even more stringent than that which we use when we are spending our own.'

It occurs to us all three are playing the game of capital allocation and seeking to be the very best. The by-product of playing this game well just so happens to be money. In a day and age where we are encouraged to spend beyond our means by politicians, banks and relentless 'keeping up with the Joneses' advertising it's worth emphasizing that we at Hillside think differently. First, one should spend less than what they make and develop and strong savings ethic. Second, one should have a plan in place to enjoy today as we never know what tomorrow will bring. Third, at Hillside we are laser focused on helping our clients realize their big meaningful dreams by constantly putting them in a position to outperform. Our objective isn't to be the biggest or flashiest, rather we strive to be the best stewards and allocators of your hard-earned (and saved!) capital. Period.

THE HILLSIDE FACTOR$^{(Y)}$ FOCUS: NIHON M&A CENTER

In this month's episode, let's switch gears and talk a look over the Far East. Based in Japan (as the name implied), Nihon M&A Center (TSE:2127) is one of the many high-quality businesses we have not got a chance to own but are following closely. It is a decent example to demonstrate how a secular social problem can be turned into a decades-long investment opportunity for businesses and their shareholders.

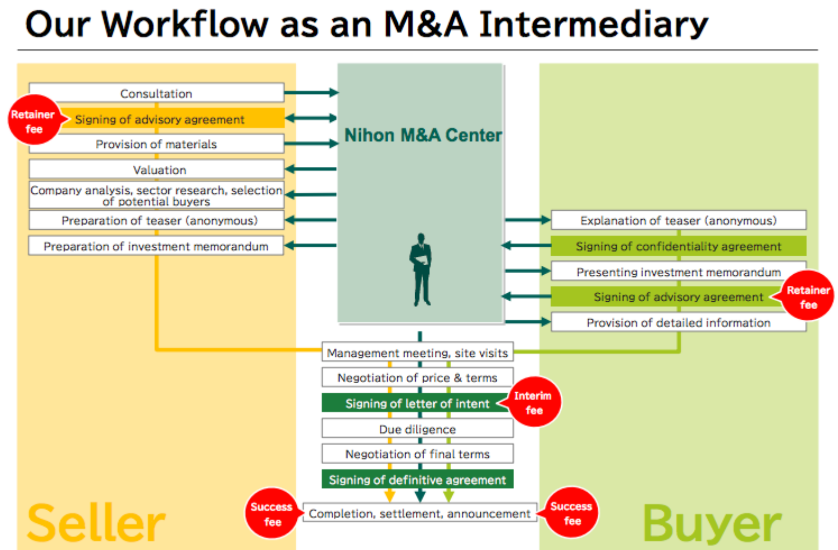
Many economists see the ageing population as the top chronic issue facing Japan (alongside many Japanese companies) over the foreseeable future. We have no doubt in this regard, but what does that matter for equity investors? In our opinion, a macro perspective would not always be meaningful. As a matter of fact, a headwind for most businesses may be a tailwind for others. This is partly why we, at Hillside, prefer to employ a bottom-up approach when it comes to stock picking.

Nihon M&A Center positions itself in a sweet spot to benefit from the nationwide ageing population and its significant impact on small and medium-sized enterprises (SMEs). To put this into context, SMEs play their critical role as the backbone of Japan's economy by representing, in aggregate, roughly 99% of all businesses in number, 70% of total workforce, and over 50% of economic value added. Meanwhile, they are facing unprecedented challenges, including hiring younger leaders, an ageing workforce, and low desire/qualification among family members to take over the business. This is where Nihon M&A comes to help. The company is the largest M&A services provider for SMEs in Japan to solve their business succession needs.

Nihon M&A Center adopts an easy-to-understand consulting sales model towards business buyers and sellers, and charges retainer, interim, and success fees across multiple stages throughout a deal cycle (see below).

REFERRALS: THE HIGHEST COMPLIMENT

We are currently welcoming new clients to the Hillside family and almost all are coming via way of referral from existing clients. We are happy to sit down with friends, family or co-workers to show them how Hillside Wealth can help them articulate and reach their big and meaningful dreams. We thank you for your continued trust and support.



Source: Source: IR Presentation, May 2021.

What differentiates the company from a pure consulting business is, as implied above, it also acts as the intermediary between two parties (i.e., the buyer and the seller), meaning the two-sided network is a crucial factor to the quality of services provided. In our view, Nihon M&A Center offers the best matchmaking capability to potential SME buyers and sellers, partnering with nearly 1,000 accounting firms, more than 200 Shinkin banks (an 83% share), almost 100 regional banks (an 95% share), and large institutions (e.g., Nomura, MUFG) and supported by the largest in-house M&A database in the country. Furthermore, the size leadership (i.e., more than tripling the runner-up in yearly revenue) and long-history track record (i.e., 6,500 transactions over the previous 29 years) help Nihon M&A Center gain trust in front of new clients. These hard-to-replicate intangible assets provide a multi-layered economic moat that protects the superior returns on capital of the business, which averaged over 30% (including cash on the balance sheet) for the last three years (per our calculation).

According to the company's management, the SME business succession is a JPY 23 trillion market, compared to approximately JPY 36 billion sales achieved by Nihon M&A Center in FY3/2021 as well as JPY 12 billion and JPY 7 billion by close competitors M&A Capital Partners and Strike in the latest FYs, respectively. In addition to the white-space opportunity, Nihon M&A Center also takes initiatives to expand overseas (i.e., in ASEAN) and into adjacencies (e.g., online matching services, IPO advisory). The company is still owned and led by the co-founders, Yasuhiro Wakebayashi and Suguru Miyake, the two computer salesmen who leveraged their network to found the company back in 1991. The balance sheet is sound with plenty of liquidity and no debt.

So what is not to like? Well, while it is very likely the best days are still ahead of Nihon M&A Center as a business, we think the share of the business has been priced too highly to meet our valuation criteria. Warren Buffet once penned: "*Price is what you pay. Value is what you get*". The Oracle of Omaha often compared stock investing to the no-called strike in the baseball game. Similarly, as Hillside, we enjoy being pitched by dozens of high-quality businesses (including Nihon M&A Center) that "compete" for a position in our highly-selective portfolio. When the price is right and the value is still there, we will make sure to swing hard enough!

APRIL 2021 PERFORMANCE RESULTS

An overview of our three portfolios to date.

Performance to April 30, 2021	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	5 Yr**	Inception **	**Added Value** vs. Benchmark**
Hillside Conservative Growth*	**1.36%**	**2.44%**	**7.59%**	**10.6%**	**8.04%**	**8.46%**	**8.03%**	**2.69%**
HCG Benchmark[1]	*0.98%*	*1.18%*	*7.46%*	*12.97%*	*6.78%*	*6.27%*	*5.34%*	
Hillside Balanced Growth*	**4.09%**	**3.55%**	**13.1%**	**17.27%**	**9.22%**	**10.35%**	**10.48%**	**4.4%**
HBG Benchmark[2]	*2.59%*	*1.57%*	*10.37%*	*17.39%*	*7.85%*	*7.41%*	*6.08%*	
Hillside Focused Growth*	**7.82%**	**6.51%**	**23.02%**	**37.09%**	**8.88%**	**11.74%**	**10.6%**	**1.85%**
HFG Benchmark[3]	*8.87%*	*2.73%*	*24.68%*	*37.84%*	*11.09%*	*11.8%*	*8.75%*	

Past performance is not an indication of future returns.
** Performance is presented gross of fees.*
*** Inception: Sept 2, 2014. Results beyond 1 year are annualized.*
[1] HCG Benchmark: 100% Vanguard Conservative ETF
[2] HBG Benchmark: 100% Vanguard Balanced ETF
[3] HFG Benchmark: 100% Vanguard All-Equity ETF
Source: SIACharts.com

The performance presented in this portfolio report is hypothetical and does not represent a specific client account. Details regarding actual returns of an investment account are available from the client's advisor.