# INFORMED INVESTOR NEWSLETTER

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## WHY DO I NAME MY BIKES?

*Amanda Baxter, B.A*

It helps me visualize, it helps me dream up adventures, it helps me see how to get "it" done, it's how I dreamscape my cycling life.

Let me start at the beginning though. In 2013 I bought my first road bike, I wanted to compete in an Olympic distance triathlon. I had clip in pedals but couldn't clip in or out. I had a water bottle in a cage on my bike I was petrified to reach for, and aero bars basically there for decoration. When it came to race day, I actually biked fairly well – mind you it was pure fear driving me. I had no relationship or attachment to the piece of equipment called a bike. I didn't know how to use it properly and there was no synchronicity between myself and this instrument.

I loved that race; I love to race. The disconnect between being able to race the way I wanted to (and am now able to) and my lack of implementation was bothersome. So I did the only thing I could think of – and no, it was not train more or hire a coach, that seemed way too rational to me 😉 – I named my bike. My first bike was named Ratchet, after the Transformer (Ratchet was the weapons specialist for any of you non-Transformer fans). Naming my bike gave it power, a purpose, a raison d'être otherwise lacking. I now had a teammate in my bike. We were one. That internal voice egging me on in training and races wasn't just talking to me, it was talking to Ratchet as well.

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This very small and seemingly inconsequential thing changed the way I approach cycling. It attached value and meaning to it that was always there but only on the backburner. Ratchet has since passed on to a new owner and Harley Quinn (in the photo on the previous page) is my new companion. I love her. Our adventures are endless. She is only one of my bikes but most used.

When I think of what I want to accomplish cycling wise, it's me and Harley Quinn against the world (luckily the world also has some great friends of mine and their bicycles who also love to adventure). I have attached meaning and substance to my goals. I've dreamscaped my way to some massive achievements, and have some grandiose ones in the works.

Many of you have gone through, or are going through, our Dreamscape process. We've been asking you about your goals and dreams. What are those things that make you tick in the best way possible, what are the things you didn't think you would get to do, or be able to do? Walt Disney had a point when he said "if you can dream it, you can do it". Let us marry the concepts of save for the future and you only live once. At Hillside, we are firm believers in working together to help you achieve your big, meaningful dreams.

## PORTFOLIO UPDATE: LESSONS ON CAPITAL ALLOCATION FROM THE BEST

*Jason Del Vicario, CFA*

> *"I have a simple rule for success in fishing. Fish where the fish are. You want to fish where the bargains are. That simple. If the fishing is really lousy where you are, you should probably look for another place to fish."*
>
> - Charlie Munger @ the Daily Journal Annual Meeting 2020.

At Hillside we have a commitment to recognize and honour our responsibilities. As we move forward, this will require us to behave differently than the masses. There are two very important factors when we analyze a security: quality and value. Quality speaks to the predictability and sustainability of a given business model. The quantitative factors we favour as an indication of high quality:

- High/stable/growing margins.
- High/stable/growing returns on invested capital.
- Asset light; low CAPEX/sales.
- Little to no leverage (debt).

The qualitative factors we favour are:

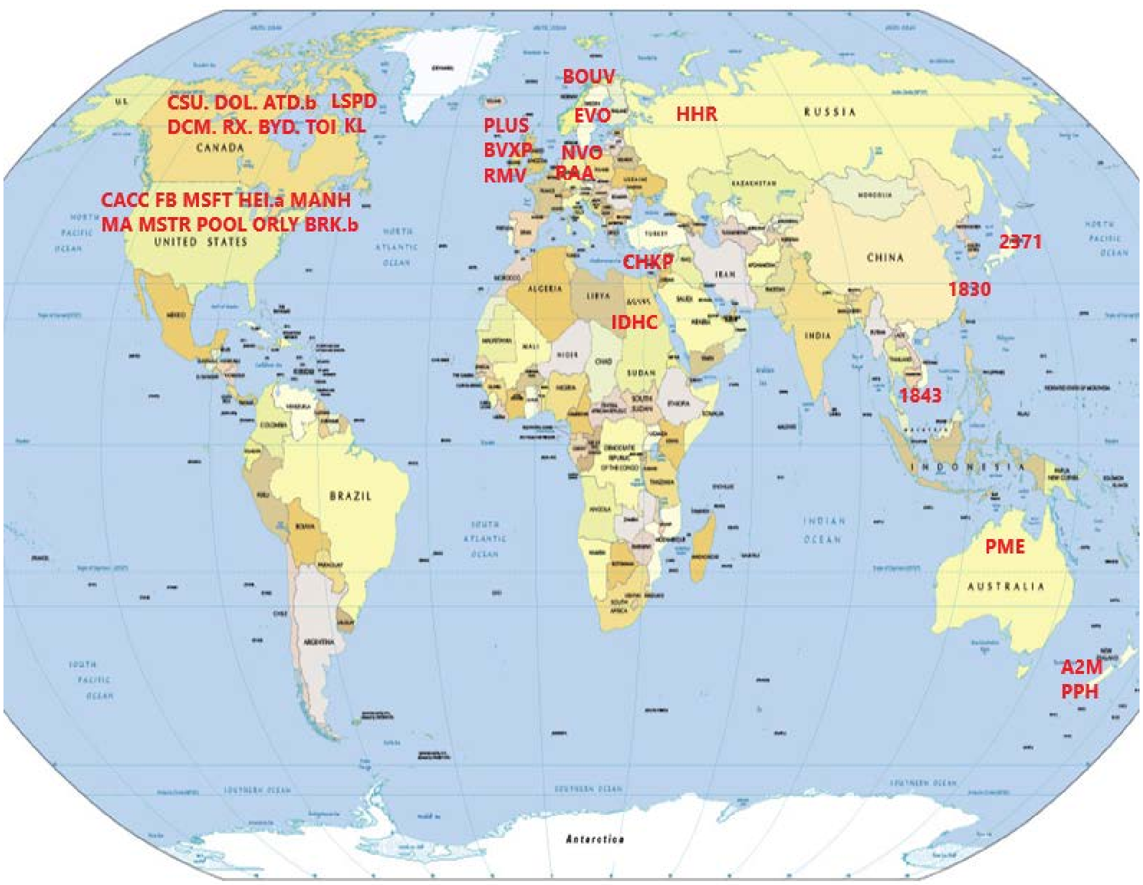
- Founder run/owned.
- Management has demonstrated efficient capital allocation decisions (re-invest in business, pay dividend, share buybacks).
- Business is easy to understand and possesses enduring competitive advantage(s).

At present we have 232 high quality companies in our investable universe. This may sound like a lot but we have filtered these stocks from a database of over 130,000 global publicly traded companies. We are therefore attracted to fewer than 0.2% of available options!

*"Price is what you pay, value is what you get"*

- Warren Buffett

If you think we end the pain/difficulty there, you're wrong… we make our lives even more difficult by requiring high quality companies we purchase to be put through a rigorous valuation screen. Of the 232 stocks we follow, fewer than a dozen meet our valuation hurdle which brings us to Munger's quote re: fish where the fish are. It became increasingly obvious to us that the Canada-US pond, while containing a good portion of high-quality companies, simply wasn't offering any at bargain prices and hasn't for some time. We recognize our responsibility and have thus picked up our rods and tackle boxes and moved to fishier ponds. In time you'll learn about the global companies which now comprise ~35% of the equity portion of our portfolios. In the meantime, we thought it might be fun to show our reach on a global map.




Source: HillsideWealth | NB: Asian securities have numerical stock symbols.

## THE HILLSIDE FACTOR(Y) FOCUS: MANAGEMENT MATTERS

### YOUR REFERRALS MAKE US FEEL LIKE WINNERS!

Our Hillside Family keeps on growing - mainly through referrals from existing clients.

***We are honoured to and consider your referrals the highest compliment.***

Thank you for making Hillside Wealth feel like Sally Field on Oscar® night!

Stock investing involves agency risk, as (outside) investors essentially delegate their capital to corporate executives to generate business returns without active participation in the management. At Hillside, we like to regard managers of our (partially) owned companies as trusted partners. We look for owner-oriented stewards who treat shareholders fairly (instead of benefiting themselves at others' cost). There are some easy-to-grasp gimmicks we can leverage to gauge this factor.

An intuitive approach is to find a decent alignment of interests between management and shareholders. This can be easily achieved when management has their skin in the game. Currently it is not uncommon for executives to own some equity stakes (many through the so-called Long-term Incentive Plan), the question has become how much insider ownership is enough. In this regard, we can compare the executive's personal shareholding wealth to his/her annual package. The end goal for us is to gauge the financial incentive of the management.

Let's take Credit Acceptance, one of our portfolio companies, as an example. According to the filing, the company's long-time CEO Brett Roberts (who retired just recently) received a total package of just over USD 1 million as of FY2019 compared to more than 300,000 shares under his name. Assuming a share price USD of 350, we would come up with a shareholding wealth of nearly USD 100 million – that is, 100x the annual pay. In history, the long-term average total return of the total equity market is around 6%-7%. Therefore, it can be rationally indicated Brett's primary monetary motivation for the job is to grow the equity value of the business (for owners, including himself) rather than the salary, which we would applaud. It should not be surprising that Brett and his management team frequently displayed their shareholder-oriented mindset: e.g., a great emphasis on return on capital and repurchase share only below fair value, both of which have become ultra-rare among today's public companies.

So insider ownership is crucial. But even with that checked, how do we evaluate the fairness of executive compensation? One quick method we often employ is to look at the ratio of the management pay to the corporate profit. For example, Credit Acceptance earned a profit of USD 656 million in FY2019, and hence, the ratio for the CEO for that year would be less than 0.2%, which is a fairly low number for a company of around USD 8 billion in market cap. By contrast, the CEO of Chemed (another US-based mid-cap business) was paid over USD 10 million (including bonus and share-based reward) in the same year – approximately 4.6% of the company's earnings. That ratio reads consistently high: e.g., 4.3% and 8.1% in FY2018 and FY2017, respectively. What's the implication for Chemed's shareholders here?

The return on equity at the company averaged nearly 30% for the last five years. During the period, the company was able to reinvestment opportunities (including acquisitions) to deploy roughly 50% of its operating cash-flow. So basically, without the CEO, not only could the shareholders have earned 4% more every year, but also would they probably have compounded more capital at an even more attractive rate of return over the long run. Of course, every company needs a CEO. The question is whether he/she is worth the price.

## MAY 2021 PERFORMANCE RESULTS

An overview of our three portfolios to date.

| Performance to May 31, 2021 | YTD | 1 Mo | 6 Mo | 1 Yr | 3 Yr** | 5 Yr** | Inception ** | Added Value vs. Benchmark** |
|---|---|---|---|---|---|---|---|---|
| Hillside Conservative Growth* | **-0.16%** | **-1.47%** | **1.76%** | **7.78%** | **6.63%** | **7.65%** | **7.68%** | **2.27%** |
| HCG Benchmark[1] | *1.85%* | *0.87%* | *3.39%* | *11.84%* | *6.71%* | *6.2%* | *5.41%* | |
| Hillside Balanced Growth* | **2.1%** | **-1.91%** | **4.96%** | **13.23%** | **7.49%** | **9.41%** | **10.03%** | **3.89%** |
| HBG Benchmark[2] | *3.47%* | *0.87%* | *5.35%* | *15.8%* | *7.72%* | *7.33%* | *6.14%* | |
| Hillside Focused Growth* | **4.62%** | **-2.97%** | **8.9%** | **26.93%** | **6.49%** | **10.2%** | **9.97%** | **1.08%** |
| HFG Benchmark[3] | *0.59%* | *1.58%* | *14.15%* | *34.4%* | *11.03%* | *11.71%* | *8.89%* | |

*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.



Performance is calculated using month-end market values of the model portfolio. Since we use a model portfolio to calculate performance there are no client-initiated cash flows (deposits/withdrawals) to account for. Performance is calculated by dividing the change in the model portfolio's market value by the model portfolio's market value at the beginning of the performance period. Also, all income generated by the portfolio's holdings are held within the model portfolio in cash and is accounted for in the portfolio's month-end market value - this results in a total return measure of the model's performance.

Returns for periods less than 1 year are shown as periodic returns while returns for periods greater than 1 year are annualized. Returns do not include fees and actual returns experienced by an investor may differ from those shown. Past performance is not a guarantee of future results.