July 2022

KEEP IT SIMPLE

Amanda Baxter

IN THIS ISSUE

Our theme for this month is: **Keep it Simple**. Current market conditions feel anything BUT simple. Nothing about this feels effortless, painless, or manageable – all synonyms for simple. I can understand wholeheartedly how being down double digits in your (our) investments feels arduous, frustrating and sometimes maddening.

As a new mom (my son is ten weeks old as I write this), who is saving to buy a home, and the breadwinner of my family, this market downturn is painful. The investor in me is wishing it was November again and we were at all-time highs and life seemed simpler. It was so much easier when the markets were up, inflation was “normal”, interest rates were low, and we all got to brag to our friends about how great our investments were doing. Then the investment advisor in me wakes up realizes the fantastic position we are in right now. Everything is on sale. The price has changed but the value hasn’t.

Imagine if an Arc'teryx jacket is on sale – 50% off, and you buy it at the reduced price, the value of the jacket is still intact - the Gore-Tex is still the same material, the same high quality. You are still protected from the rain. The value of the jacket is still there, it’s being offered at a lower price point. What is potentially happening here is a retailer has overbought of the specific item (they have overleveraged their position in the jacket), or the color is less desirable than originally anticipated, or a myriad of other market conditions beyond the retailer or your control have created a situation where a high value jacket is being sold at a lower-than-normal price!

This situation is what portfolio managers & advisors dream about, the chance to gobble up these companies we love at low prices. **This is when suddenly it seems simple;** it’s incredibly straightforward, easy and uncomplicated (also synonyms of simple) to buy high quality assets at low prices. Once the advisor setting in my brain takes over, the theme of ‘keep it simple’ makes sense again. The companies we buy in our model portfolios have retained their value during this downturn (in fact most have increased their intrinsic value), only the pricing has changed.

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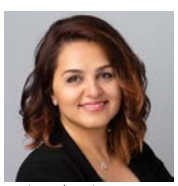
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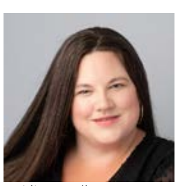
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Now, I say this knowing full well that pricing is relative to performance and when you get your statements each month, it's the pricing you see on there – not the value. Seeing double digit price drops of your portfolio does not feel good and I'm not going to try and convince you otherwise. I do, however, hope you begin to see the value because when you see the value, you will see the opportunity. We are in a spot of massive opportunity to buy at depressed prices. I have been topping up to take advantage. To my advisor brain (where I want to act like a business owner), it's that simple. So I ask you to use your 'business owner' brain, not your investor brain, to try and understand the current position and see the value. Remember what Buffett said: "**price is what you pay, value is what you get**".

I do want to touch on our retirement planning with the theme of Keep it Simple and on the trend of painful (but opportunistic) market conditions. When Mike and I put together retirement plans, we use a 4% rate of return, with a 2% inflation rate. What this means is, we plan to get you to your target retirement lifestyle with a 2% real rate of return. We do this to be conservative and to account for times of volatility like we are currently experiencing. This way, we know even when the market decides to take a little dive into the deep end, you can keep your head above water. You will still be able to retire and live the lifestyle you want. If you need to update your projections or haven't had a chance to go through projections with us yet, take this as your call to action!

I'm going to leave you with our three (simple) rules for investing:

1. No long-term money in cash (it is eroding in there)
2. No short-term money in stocks (look at market change from November 2021 to July 2022 if this doesn't make sense to you)
3. Do not look at your portfolio every day (I can tell you with some certainty that in the next 24-48 hours it is not magically going to return to November 2021 levels so you can give it some time and let it be to do it's thing)

> Another Buffett quote: *"To refer to a personal taste of mine, I'm going to buy hamburgers the rest of my life. When hamburgers go down in price, we sing the 'Hallelujah Chorus' in the Buffett household. When hamburgers go up in price, we weep. For most people, it's the same with everything in life they will be buying — except stocks. When stocks go down and you can get more for your money, people don't like them anymore."*

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HILLSIDE FAMILY SUMMER

Amanda and her family recently enjoyed a summer evening in Vancouver and shared some of their favorite local spots (small business shoutout!) - the IPAs at Superflux brewery in east van are always thirst quenching, and the hot dogs from Two River Meats (a north van staple) are so delicious even Kit was trying to figure out how to get his hands on one (as per photo below!)

PORTFOLIO UPDATE: SHORT, SWEET AND SIMPLE

Jason Del Vicario, CFA

We are focusing on our commitment to 'keep it simple' this month at Hillside. As Warren Buffet once said: "**Investing is simple, but not easy**".

Here's a reminder of Hillside's simple approach to Portfolio Management:

1. Find a business that has high returns on invested capital and has done this for a number of years.
2. Determine if the founder is still involved with the business either operationally and/or via ownership.
3. Make sure the business doesn't rely on debt or continuous large injections of capital in order to maintain and grow the business.
4. Make sure the margins are high.
5. Contact and speak with management to confirm findings and uncover facts not readily obvious by reading filings.
6. Figure out why the company generates these elevated returns/margins and determine whether the competitive advantage(s) is sustainable and/or can strengthen over time.
7. Study how the company allocates excess capital.
8. Determine fair value of the business.
9. If the business passes the above steps AND is at, or below, fair value estimate: invest.
10. Wash, rinse & repeat.
11. Have a great summer!

This Twitter string has some great illustrations of more simple investing principles and thought it worthwhile to share: https://twitter.com/BrianFeroldi/status/1548637128518770690

THE HILLSIDE FACTOR(Y) FOCUS - BOUVET: A SIMPLE BUSINESS BUILT UPON A COMPLEX TECHNOLOGICAL WORLD

Much as people applaud the benefits of technology to our society and daily lives, we tend to be cautious on the sector from an investment perspective. The space is often complicated with hard-to-understand, emerging concepts, and hence, lack sufficient understandability or predictability in our opinion.

That being said, there is this small group of technology-driven businesses that we think are relatively immune to complexity and obsolescence risks but can enjoy industry tailwinds. Bouvet is one of them. Although engaged in the IT field, the Norway-based company is essentially a people business that is not built upon any technology product. It provides consulting services for public- and private-sector entities to build digital solutions using different technologies, ranging from web/cloud, cyber-security, IoT, to VR/AR, big data, automation, and so forth.

As you may have imagined, customer satisfaction largely relies on the team's capability to understand clients' needs and solve their problems instead of the (future) success of one particular technology. Consequently, our investment theme would become much simpler, as it should be reasonable to expect "needs" and "problems" in the digital space to keep emerging for a long, long time.

To succeed in any business model built on people, the corporate culture is a primary factor. This is exactly where Bouvet has a laser focus, as reflected by the company's disclosed ambition of being "the most credible consultancy with the most satisfied employees and clients." How does it fare on that front so far? We found three reference points: 1) a substantially lower percentage of sick leave compared to the nationwide average (please note that Norwegian employers tend to suffer from a high sickness absence rate due to the favorable legislation compared to the other countries); 2) an extraordinarily high and still increasing participation rate of the employee share scheme; 3) a lower employee turnover rate compared to the industry average.

Bouvet earns the majority of its sales in its domestic market, where the company is the no. 1 local player for years (if not decades). Prominent competitors are mostly global and more international consulting firms like Accenture, Capgemini, and Sopra Steria. In our opinion, the combination of the aforementioned strong culture, the reputation earned through the track record of serving Norwegian customers, and the emphasis on being local/close to clients points to the sign of moat around Bouvet's lucrative economic castle, which has been consistently delivering industry-beating profitability and gaining market share at the same time. In that regard, it is also worth noting that the company rarely lost a client and the existing client base represented the dominant source of revenue in a typical year.

We had a one-hour chat with Bouvet's new CEO and CFO late last year and was impressed by the team's conservative thinking, which is understandably in part due to the corporate history – i.e., the company was formed via a merger where one party was almost broke. The management aims to concentrate on organic growth, the core value (which is, again, the culture), and their target markets (i.e., Norway and Sweden) while attempting to avoid aggressive acquisitions, which tend to dilute the culture, competing on pricing (another sign of moat here), or expansions into areas outside of its core competency. Additionally, it is encouraging for us to learn that the management still sees growth potential across the current markets where white space exists in terms of both the company's geographic coverage and service portfolio. With the digital economy growth continuing to outpace the overall GDP growth, we cannot help but expect Bouvet to generate superior returns for shareholders like us in the long term.

JUNE 2022 PERFORMANCE RESULTS

An overview of our three portfolios to date.

Performance to June 30, 2022	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	5 Yr**	Inception **
Hillside Conservative Growth*	**-14.77%**	**-3.50%**	**-14.77%**	**-7.96%**	**2.40%**	**5.03%**	**5.98%**
HCG Benchmark[1]	*-14.14%*	*-4.70%*	*-14.14%*	*-12.06%*	*1.08%*	*2.68%*	*3.26%*
Hillside Balanced Growth*	**-16.46%**	**-4.92%**	**-16.46%**	**-8.72%**	**3.63%**	**6.22%**	**8.09%**
HBG Benchmark[2]	*-14.73%*	*-5.27%*	*-14.73%*	*-12.16%*	*2.08%*	*3.55%*	*3.90%*
Hillside Focused Growth*	**-22.22%**	**-7.22%**	**-22.22%**	**-14.00%**	**4.20%**	**5.97%**	**7.48%**
HFG Benchmark[3]	*-16.87%*	*-7.80%*	*-16.87%*	*-12.21%*	*5.88%*	*6.39%*	*6.21%*

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] Hillside Conservative Growth Benchmark: 100% Vanguard Conservative ETF
[2] Hillside Balanced Growth Benchmark: 100% Vanguard Balanced ETF
[3] Hillside Focused Growth Benchmark: 100% Vanguard All-Equity ETF

Source: SIACharts.com

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.