RBC Wealth Management

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"*The best way to ride a horse is to go the same way the horse is going.*"

— Unknown

Makes perfect sense. In almost everything. Most certainly when it comes to horseback riding. But maybe less so when it comes to investing. Often times the best work we do entails zigging when the crowd is zagging. In our line of work the terms used to describe this predilection are contrarian or contrary opinion. A classic example of this kind of behavior in recent years was the collapse of the stock market in 2008-2009 in which, late in the cycle, Warren Buffet became a serial investor in banks. The very tip of the spear of the crisis. When asked about his purchases, he was famously quoted as saying, "There will be an end of the world, but this isn't it." Without exception the investments he made turned out well.

How is this possible? Isn't the same information available to the seller and the buyer? Of course. There is even a concept referred to as the Efficient Market Hypothesis that addresses this issue. The hypothesis states that the price of a stock already reflects all of the publicly available information about that company. Therefore, no investor has an advantage over any other (of course assuming they have done their homework). We have never been a proponent of this point of view for a variety of reasons, some of which follow.

- All of the publicly known information is, by its nature, historic. The success of a company lies in future decisions and events, not those of the past. You can have an opinion about that future but it cannot be known with certainty.
- Companies constantly have to react to outside influences. What are competitors doing? Raw material costs? Offshoring? How about this one… a pandemic?
- Innovation. Cornering the market on buggy whips did not make a significant difference when another kind of horse power came along.
- Finally, the human element. Two well-informed and experienced investors can look at the same data set and arrive at polar opposite conclusions about that business. Quite legitimately. Buffet reported that his decision to invest in Bank of America was made on a Saturday night while reading the Bank of America annual report…in his bathtub.

Your writer is more of a shower kind of guy and reading an annual report in a shower is not the same experience...the laminating gets expensive. Our process tends to begin with companies that have done poorly of late whether as a result of a Bear Market, a COVID-19 like event, a recession, pricing problems, technology, competition or whatever. We spend a great deal of our time reading from a variety of sources and tend to get a lot more excited when prices for stocks have gone down than when they go up. You witnessed that with the series of stock purchases made in March and April as the market swooned. Who doesn't like a sale?

But rather than exploring the concept of contrarian investing generically, let's use a real time example. One of the purchases we made in late March in the high 50's was Albemarle (ALB), the world's largest producer of lithium. The company has been around for some time and floated quietly in the backwaters of the stock market until Tesla began to be taken seriously in 2014 as sales of the Model S began to ramp up quickly. Where was all of the lithium to power these cars going to come from? Rather quickly ALB

began to draw interest and the stock ran from $42 a share in September of 2015 to $146 over the course of about two years. (So much for the theory of efficient markets.) Earnings improved but not nearly enough to support a 240% rise in the price of the stock. The term often used to describe this kind of company is a *concept stock*, a form of recognition that the company is overvalued based on current earnings but just wait for next year and the year after that! In the case of Albemarle the number of competitors/capacity increased in short order. It was not long before the price of the commodity collapsed under the weight of new supply. Albemarle fell from $146 to the low 50's by late March of this Pandemic Year. The company had become what is referred to as a value stock (a moniker managements dread) at 9 times earnings for 2019. Along the way one Albemarle competitor filed bankruptcy at the same time the market share for electric cars was continuing to grow. The first long haul electric trucks are rolling out; the science around the miles that can be driven from a single charge is growing. Other devices such as forklift trucks, riding lawnmowers, motorcycles, vacuum cleaners, cell phones…virtually most things electric are candidates for lithium batteries. The company's finances are strong; the dividend has been raised each of the last 27 years including the bear market of '08/'09. The company prudently slowed its addition of new capacity, a sign of good discipline. These are the types of characteristics that are prerequisites for us before investing.

Last point: time. Patience is not a characteristic for which Wall Street is known. Among the things I've learned over nearly a half century in this industry is how much inspiration, hard work and *time* is required to improve and grow a business. Competitors do not sit on their hands waiting for you to take their business away. Time also matters for taxable investors as there is a lower tax imposed on shares held for more than a year than for lesser periods. We are off to a good start with Albemarle, up about twenty points since purchase in March.

While mostly background information, we hope this is helpful for you to see how we approach the process of investing your savings from a philosophical point of view. If we can get the horse to go along with the concept we may be onto something.

Stay safe. Be well. Wear those masks.

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