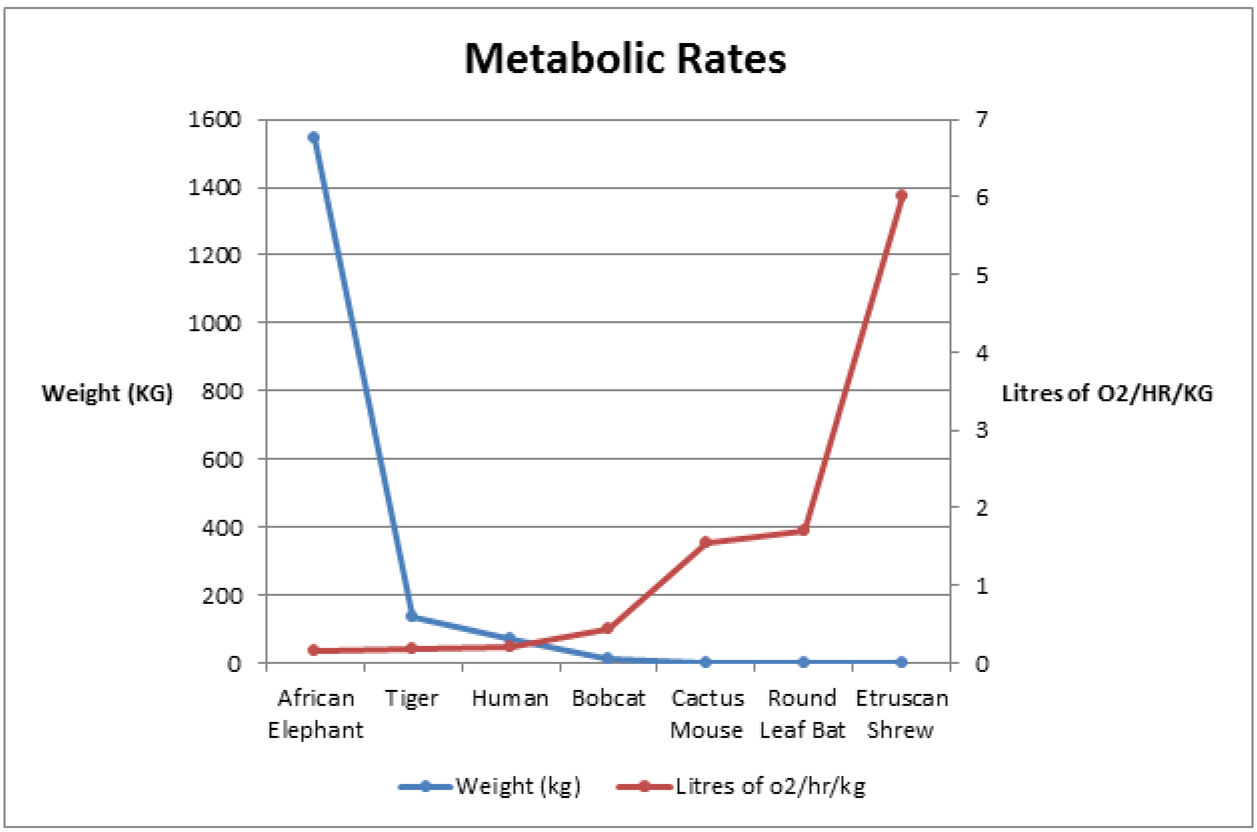
The Elephant and the Shrew

Often times fables are told to children to teach social values. One of the most famous is that of the Grasshopper and the Ant. The Grasshopper plays all summer while the Ant toils in the hot sun. Winter arrives, the Ant has provisions and shelter prepared, while the Grasshopper suffers for his summer of folly. This fable rings true today, those who save and invest in their futures are far more likely to reach their goals than those who spend today and hope tomorrow. This fable is ascribed to Aesop, perhaps correctly, his children would have grown to be quite wise, as he is credited with nearly eight-hundred of these little lessons. Twenty-six centuries later, one of Aesop's most famous tales still rings true.

In fact, a great deal of wisdom can be found in these fables. The boy who cried wolf, the donkey who wished for a greener pasture, all of these make a great deal of sense even in these modern times. It seems a shame then that he wrote nothing about the Shrew and the Elephant, because there is indeed a lesson for today's investor in the very different approaches of these two very interesting animals.



Few could claim to be unfamiliar with an elephant; majestic, intelligent, massive, and slow moving. An elephant needs about five percent of its body weight in food each day to survive. Most of us are unfamiliar with shrews. Small, quick moving, always eating, and metabolic rates through the roof; some species of shrew need eighty percent of their body weight each day simply to survive. With a heart that beats up to twenty-five times each second, a shrew will spend its entire life looking for its next meal – it has to, or it will perish. Perhaps this is not the stuff of fables, but the plight of these creatures both great and small do provide an interesting lesson for investors today. The lesson? Activity, like that of the elephant, is good. Hyper-activity, like that of the shrew, begets more hyper-activity. Put simply, there is a real difference between trading like an investor, and trading like a trader.

Investing by definition requires some trading, prudently chosen stocks and bonds need to be bought at the outset, small costs are inescapable. The goal, naturally, is to select the best securities, those that represent the best businesses in their sector and geography. Paying up-front a few dollars to own stocks with quality earnings, growing dividends, barriers to competition, and distinct operating advantages more than pays for itself – and quickly. Investing in great companies means buying and holding, although some turnover is simply inescapable; as long as trading is done for investing purposes, turnover need not be a bad thing necessarily.

Situations change, once-darling stocks can encounter competition, bad management, bad choices, bad luck, or simply be unable to escape their circumstance; the best run oil and gas companies are still stuck selling oil at the current prices or storing it away and waiting for the environment to improve. Even the Canadian banks, a government protected oligopoly with history on their side, saw their stock prices suffer greatly in the market meltdowns in 2008 and 2009. Sometimes good stocks go bad. And that is when trading like an investor comes into play, when the reasons for buying a stock no longer apply to that particular company, it may be time to sell.

Remarkably - at the precise moment an investor has decided a stock has to be sold, that there is a greater use for their capital – there will always be a buyer out there. Of course opinions can vary on what makes a great stock, a beaten-down oil stock represents a tax-asset to the seller, the new buyer picks up those shares at the new lower price. At that moment, two completely differing views on a security can both be correct. Of course of all the parties involved in any transaction, there is one party guaranteed to make money no matter which way the stock moves post-trade, and that is the broker who charged the commission. This is of course an overly cynical view, but brokerage is profitable enough that each employ armies of analysts to produce reams of research and make garish predictions on how a stock might perform in the future. Brokers employ analysts in the hopes that investors can be convinced to put aside their long-term views and trade like a trader. Brokerage commentary can be sold by the tonne.

The search rarely ends for the next high-flying stock; mutual funds are sold based on their past-performance – and strictly with the caveat that the performance in the future will not be the same as in the past. Investors are bombarded with low-cost trading platforms, fund ideas, newsletter pitches, and hype-men screaming 'buy buy buy' at all hours on television. The allure of a fast trade and easy money captures many, but few will actually capture the fast trade and money is rarely ever easy. Activity, in the form of constantly paying commissions, taxes, and fees, is precisely the problem the shrew faces. When faced with the inherent deficit associated with activity, more activity is required to overcome the deficit. Trading for the sake of trading is the lifeblood of the brokerage business. Activity can be useful, but in small and well-directed amounts.

How much then is the correct amount of turnover in a portfolio? Clearly the answer is strictly situational. Share ownership represents owning a fraction of a company, and if that company is has real earnings then selling those shares represents selling all future claims to profits and dividends. If each stock in your portfolio is behaving properly – using capital well, growing earnings, growing dividends, and taking market share – there is no need to look for a trade for the sake of trading. And of course, the opposite is true. If the company underlying the stock is languishing, then the stock price is probably off as well. Bad management – sell. Does the dividend appear under pressure? Sell. Are good companies in a bad market being punished unfairly? Sell. Can you take a tax loss and buy something very highly correlated? Sell. The right amount of turnover is optimized by external forces, sometimes the right number of trades in a portfolio is zero, and sometimes the right number is just a few. Trading is necessary, but not necessarily trading.

Trading for the sake of trading consumes two very valuable commodities – time and money. Just as the shrew is in a hyper-active and constant cycle of looking for food, turning over a portfolio constantly looking for minute upticks in performance can be exhausting. Owning best of breed companies whose underlying businesses are predictable leads to portfolio performance that is predictable – and restful too. Aesop might not have written about the modern stock markets, but he knew a great deal about human behaviour; if Aesop was to write a fable for the investor today, the Elephant and the Shrew would be one that everyone would do well to read and remember.

accurate. Investing involves risk. Equity markets are volatile and will increase and decrease in response to economic, political, regulatory and other developments. The risks and potential rewards are usually greater for small companies and companies located in emerging markets. Bond markets and fixed-income securities are sensitive to interest rate movements. Inflation, credit and default risks are also associated with fixed income securities. Diversification may not protect against market risk and loss of principal may result. This commentary is provided for educational purposes only. It is not offered as investment advice and does not account for individual investment objectives, risk tolerance, financial situation or the timing of any transaction in any specific security or asset class. Certain information contained in this document has been obtained from external parties which we believe to be reliable, however we cannot guarantee its accuracy. Guardian Capital Advisors LP provides private client investment services and is an indirect, wholly-owned subsidiary of Guardian Capital Group Limited, a publicly traded firm listed on the Toronto Stock Exchange.