



## Overview

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January 24, 2022

## Dear Fellow Investor:

For the calendar year ended December 31, 2021, fully invested accounts in the Flagship Strategy increased 48.4% to 49.3%, while fully invested accounts in the Mid-Large Cap Strategy increased 43.7% to 45.5%. During the period, the S&P TSX Total Return Index increased 25.1% and the S&P 500 Total Return Index increased 27.6% in Canadian dollars (28.8% in USD)<sup>1</sup>.

Annualized to December 31, 2021.	<u>Flagship</u>	<u>Mid-Large Cap</u>
<i>Inception date</i>	<i>Feb. 10, 2015</i>	<i>Mar. 16, 2017</i>
Trailing:		
One year	49.0%	45.3%
Two Years	25.2%	24.2%
Three Years	23.4%	23.3%
Four Years	15.0%	15.0%
Five Years	14.9%	<i>n/a</i>
Since Inception	9.9%	13.5%

Calendar year results:	<u>Flagship</u>	<u>Mid-Large Cap</u>
<i>Inception date</i>	<i>Feb. 10, 2015</i>	<i>Mar. 16, 2017</i>
2021	49.0%	45.3%
2020	5.1%	6.2%
2019	19.9%	21.4%
2018	-6.7%	-6.6%
2017	14.5%	3.9%
2016	4.2%	<i>n/a</i>
2015	-8.4%	<i>n/a</i>

<sup>1</sup> The benchmarks cited by Starvine are standards against which the performance of the strategies can be measured. However, the Starvine strategies approach portfolio construction with a bottom-up approach and thus do not refer to the composition of any index as a reference from which to select securities. Performance of the strategies may differ significantly relative to benchmarks in any time period.

The composite figures above are unaudited and include discretionary fee-paying accounts within each respective mandate. Composite results are presented as time weighted rates of return, net of management fees and other expenses. Results will vary with subscription date, most notably for recently formed accounts whose position weightings and cash levels tend to differ initially from the investment strategies. Clients will therefore each have their own net-of-all fees performance results from investing in Starvine. References made to indices may provide clients with a benchmark to compare results. However, the Starvine strategies are operated with a bottom-up selection framework and thus no effort is committed to tracking any index. Lastly, the composite results displayed above should not be interpreted as a reference for future returns.

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## Outlook

The year of 2021 proved to be one of good fortune for the Flagship and Mid-Large Cap strategies. I would assign the year's returns to the following factors: (1) strong equity markets providing an accommodating backdrop, (2) the rebounding in early Q1 of key holdings that were laggards in 2020, (3) the reporting of better-than-expected earnings growth in certain holdings, and (4) near-term timing/luck on decisions meant for the long term. All in all, I'm grateful that most stars aligned within the 12-month period, and with that it must be added that Mr. Market is not typically so cooperative.

Since the beginning of 2022 (less than one month), much has happened in the markets. There has been a distinct sell-off in growth/tech stocks, especially those that trade at high multiples of sales and generate insignificant earnings relative to market capitalization. With the NASDAQ in correction territory and the S&P 500 also down significantly within a few weeks, the most speculative companies have received the harshest treatment, and in turn most sectors have been dragged down. We've had it so good for too long with declining interest rates - so long in fact that the reverse is foreign to most market participants.

With the potential of inflation to remain higher than expected for the foreseeable future, there is much uncertainty about how one should allocate wealth. Gold would be viewed as the most traditional inflation hedge, and more recently, crypto currencies have gained widespread popularity as a store of value. Despite the various risks, I view equities as the best place to be. Why is that? Neither gold nor cryptos have the prospect of compounding intrinsic value or paying a dividend. They are just that - stores of value.

The common stock of a company has the potential for long term appreciation of an exponential nature. All else being equal, inflation is a headwind for equity returns because it eats away at the purchasing power of an investment portfolio. If inflation turns out to be seven percent this year, an investment strategy must produce at least that much to keep a client in the same spot in terms of what the liquidation value of the portfolio can buy after the 12 months are over. Still, there is the possibility of selecting companies with pricing power, and thus able to protect their profits by raising prices enough to offset costs increased by inflation. Furthermore, the investor can exercise discipline in purchasing those companies only when the price is low enough relative to estimated value. Yes, things can go wrong with any stock: competition can erode profitability, management can make dumb

acquisitions and operate the company poorly, and the investor can make mistakes in valuing a company. To get around the risk of selection error, one can invest in a low-cost ETF that mimics indexes and just tune out. Regardless of whether an active or passive approach to equity participation is chosen, one thing remains true: stocks can be thought of as machines whose mission it is to compound per-share value. There may be all sorts of risks, but thoughtful diversification is a mitigant. On the other hand, gold can only sit still.

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## Idea Generation and The Beatles

Two recent releases on the Disney+ streaming service, both relating to The Beatles, have prompted a few thoughts about idea generation in investing.

***Rushing investment ideas does not tend to end well.*** In other words, hitting the buy button before you believe enough boxes on the checklist have been checked off is not ideal. That is not to say the due diligence process should require a defined amount of time. The reality is that some ideas will ‘click’ easier than others based on one’s circle of competence.

In music, the contrary is possible. In the docuseries *The Beatles: Get Back*, there is [footage that captures the moment](#) that Paul McCartney ‘doodles around’ and created the beginnings of a classic song under the pressure of a tight deadline. That song was *Get Back*. What is so striking about that scene is witnessing McCartney strumming on his guitar and *searching* for the riff, while creating the main melody of the verse. He would struggle over the next few weeks to backfill the tune with lyrics and arrive at an incredible final product. The main takeaway here for a long-term value investor is that cramming the due diligence within a confined, quick timeline should be avoided. This approach may work in music but rushing investment decisions tends to mean missing critical risk factors. The problem is particularly acute in a situation where a windfall of cash is received and the investor has an inadequate watchlist of ‘ready’ candidates - pressure is felt to make decisions within a reasonable time, especially in a rising market with inflation humming in the background.

The second point is related to the first, and that is the understanding that an investor in stocks does not create anything. The Beatles created amazing content; investors on the other hand are relegated to identifying things already in existence and moving capital between them. There is perhaps labor involved in searching for investment candidates and the due diligence process for each selection, but ultimately investors react. Is there a discrepancy that can be capitalized on by buying and then waiting for the gap between price and value to close? If there isn’t a price-value disconnect, or if it has closed, is the investment still compelling from the standpoint of intrinsic value being likely to compound at a rapid clip going forward? Investors should try to stay humble by realizing their limitations and giving due credit to blind luck.

***Simplicity can be powerful in forming cogent decisions.*** In the docuseries *McCartney 3 2 1*, Paul McCartney stated that a key reason many of their songs were memorable was the need to remember them due to the lack of portable recording devices in the 1960s. That got me thinking about technology and how its use can help or hinder the investment decision making process. Could it be that The Beatles’ tunes would have turned out to be less catchy had smartphones been around? Warren Buffett did not grow up with Microsoft Excel to build valuation models for his stock picks. Perhaps that made him a better thinker and investor than if he could rely on technology since childhood. I use financial models to value companies and it’s possible they weakened my capabilities in some ways. Being able to save a spreadsheet substitutes the need for memory and the need for making mental calculations. Mental math is like a muscle that needs to be trained. For most, it will be slower and

less precise than being able to perform sensitivities on an intricate model. And yet it can be argued that having to think through a valuation in your head or on the back of an envelope leads to a firmer grasp of the numbers.

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As we look forward to the remainder of 2022, I don't know when the current rout will end but see the recent sell-off as a natural opportunity for the market to wring out its excesses. The word gravity has been used recently by market commentators to describe the pull-back of high multiple growth stocks. In a write-up I named [Grade Four Math Applied](#), published about five years ago, I provided a reductive yet useful way to isolate the returns of most investments: (1) multiple expansion, or (2) earnings growth. In the absence of dividends, there's a strong chance that investment returns can be attributed to one of the two buckets. It doesn't take too much insight, for example, to reason that a company trading at 30x to 40x revenue will require a high sustained growth rate to justify its current price. What will gravity do if the company's growth does not meet the expectations embedded in that multiple? I'll take a lower potential return to feel the ground close beneath me any day. I'm afraid of heights and shall always remain so.

Sincerely,

Steven Ko  
Portfolio Manager

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