Small cap funds review: 2017

By Greg Dean | January 29, 2018

Dear fellow Fundholders,

Fund Code	1 YR	3 YR	5YR	Since Inception	Inception Date
4594	14.72%	14.41%	-	15.25%	July 2014
11108	5.84%	8.07%	15.81%	17.96%	February 2011
11109	0.71%	5.75%	15.33%	16.28	February 2011

As of December 31, 2017, taken from www.ci.com

2017 was a very transformative year for investor psychology, in my opinion. The lingering fears of the Great Recession finally began to fade, and for the first time I would characterize the behaviour of market participants and the average investor as "risk-seeking" and no longer "risk-avoiding." In hindsight the last 10 or so years have reminded me of the adage of the frog in the pot: The premise is that if a frog is put suddenly into boiling water, it will jump out, but if the frog is put in tepid water, which is then brought to a boil slowly, it will not perceive the danger.

I don't think the decisions made by the average investor in 2017 would have been conceivable in 2008 as the lingering scars of the Financial Crisis had yet to fully heal. There likely would have been no appetite for Bitcoin, initial coin offerings (cryptocurrency) or other means of speculation because the average investor would have likely been too worried about their RRSP, paying their mortgage or remaining gainfully employed. But here we are several years later and the narrative has evolved from "Just don't lose the money" to something closer to "Why haven't I been able to earn more?" I empathize in many ways with the average saver/investor as there doesn't appear to be a lot of great alternatives to the expensive stock market today. Many investors have decided to dial up their risk appetite and turn the stove to "high" from "low" or "medium" in the quest to meet their long-term financial goals.

It's much easier to commit to the long-term goal when you have a plan that you trust and can stick to, adjusting when major shifts occur in your life. But most investors fiddle with their objectives far too often and feel a sense of angst when they aren't keeping up with the market or their neighbours. Investing according to your emotions is a terrible idea, one that is typically very costly in the long term. As professionals our job is to not allow our emotions to dictate our investment decisions and remain disciplined and consistent in the pursuit of your long-term goals. In my July letter last year, I wrote: "***Our goal is to deliver long-term superior risk-adjusted returns*** and we feel very comfortable taking on less risk than the market when we believe the markets' risk appetite is high (as we do today)."

It seems even more appropriate today given the amount of speculating we are witnessing. The challenge comes from the question of timing: "When will it end?" We at Cambridge have never been very good with timing markets, so we focus on the boring stuff like finding companies that are creating value and trying to buy them for less than what we believe their intrinsic value to be. We will surely not win every year, but we believe no other method exists over the long term to compound wealth at an above-average rate.

One last comment about some observations over the last year or two: Our decision to re-open the Cambridge Canadian Growth Companies Fund was well-timed, with the fund up just over 20% in the last 18 months vs. the TSX up about 8%. This has pleased us and hopefully also the clients who followed us by adding to the fund when we re-opened it. We wish to continue to earn your trust by putting your needs ahead of any competing interests.

Ok, now over to the funds….

Somewhat tongue in cheek, I set out in 2017 to establish an appropriate base rate for newer clients to accept before giving us their hard-earned savings—and that was the hopes of earning “above zero” in 2017. This was to ensure we didn’t accept money from clients who were solely chasing short-term performance (2016 was an above-average year for the small cap funds). I am happy to say we’ve met or exceeded our objective across all three strategies. If I am being honest, I think the market gave us more chances than what I had expected in 2017 and I as a significant owner am disappointed with both Pure and Canadian Growths returns. Many the larger holdings in those funds de-rated more than expected, which cost clients. However, I am happy to report there were no major permanent losses of capital (i.e. large holdings that were sold from the fund at meaningful losses).

Within the Cambridge Growth Companies Fund, returns were driven by consumer and financials, while energy and cash allocation drove much of the underperformance. Over the last several years, I’ve spoken at length about the opportunities we felt BREXIT had created in the UK for our clients in the UK; interestingly, after looking through the attribution of the top 10 contributors to returns, 5 of them have been UK, so clearly our team is uncovering uncorrelated ideas there and we’ve made good on our promise to find good businesses at depressed valuations that we believe to be unfounded or short-term in nature.

Below you will find a list of the top 10 contributors and top 5 detractors (in alphabetical order) in CIG 4594 **Cambridge Growth Companies Corporate Class.**

Contributors	Detractors
ASCENTIAL PLC	AUTO TRADER GROUP PLC
BURFORD CAPITAL LTD	DOMINO'S PIZZA ENTERPRISES L
B&M EUROPEAN VALUE RETAIL SA	PPLA PARTICIPATIONS LTD
ENVIROSTAR INC	SIGNATURE BANK
HASTINGS GROUP HOLDINGS PLC	TOURMALINE OIL CORP
ISRA VISION AG	
MCCOLL'S RETAIL GROUP PLC	
NUMIS CORPORATION PLC	
SAO CARLOS EMPREENDIMENTOS	
SERIA CO LTD	

Obviously with Canada lagging behind most other developed markets’ returns globally, the Cambridge Canadian Growth Companies Fund couldn’t deliver as strong of an absolute return. As you can see from the list

CAMBRIDGE®
GLOBAL ASSET MANAGEMENT

below, many of the companies we are finding and benefitting from today are not common or well-known, and even at this later stage of the economic cycle, our willingness to do our own work is handsomely rewarding clients. 2017 reminded me of why I must be VERY careful investing in base or precious metal companies, as it is far less about the cash flow they generate and far more about how they are perceived by the stock market and what the commodity price is. While I am happy their weight was very small, the impact on returns was noticeable.

Below you will find a list of the top 5 contributors and top 5 detractors (in alphabetical order) in CIG 11108 **Cambridge Canadian Growth Companies**.

Contributors	Detractors
BURFORD CAPITAL LTD	AUTO TRADER GROUP PLC
B&M EUROPEAN VALUE RETAIL SA	BYGGMAX GROUP AB
KELT EXPLORATION LTD	MANDALAY RESOURCES CORP
PRAIRIESKY ROYALTY LTD	TFI INTERNATIONAL INC
SERIA CO LTD	TOURMALINE OIL CORP

The Cambridge Pure Canadian Equity Fund struggled to keep pace with the benchmark in Canada, which I caution newer clients is never the goal, but we do believe we must exceed this benchmark over 3-, 5- and 10-year periods to earn our keep. Starting with the mistakes, as described in the paragraph above, I was reminded to tread very carefully when investing in base/precious metal companies, even when there is a sound fundamental thesis as I believed there to be for both Mandalay and Klondex. Combined, these positions were about 2% of the fund but suffered very significant declines for reasons that were self-inflicted. The positives were delivered by the smallest company and the largest company in the fund: Brick Brewing and Brookfield Infrastructure Partners, respectively. Brookfield was a holding we had had since our inception of the fund. It delivered much greater returns than we could have expected, but it was no longer a small- or medium-sized company, and so our decision this year was to sell it entirely from the fund for very substantial gains. Brick, on the other hand, remains in the portfolio, and we have allocated up to 10% for companies that are below $1B in market cap as these are positions that we typically cannot exit easily or trade around in the short term given the size of the fund.

Below you will find a list of the top 5 contributors and top 5 detractors (in alphabetical order) in CIG 11109 **Cambridge Pure Canadian Equity**.

Contributors	Detractors
B&M EUROPEAN VALUE RETAIL SA	KLONDEX MINES LTD
BRICK BREWING CO LTD	MANDALAY RESOURCES CORP
BROOKFIELD INFRASTRUCTURE PA	STORM RESOURCES LTD
KELT EXPLORATION LTD	SYLOGIST LTD
PRAIRIESKY ROYALTY LTD	TFI INTERNATIONAL INC

CAMBRIDGE GLOBAL ASSET MANAGEMENT

Last word from me is on turnover: It has been declining substantially over the last few years as we haven't found the opportunities to trade around core holdings (broad volatility measures are at all-time lows). Having stock markets at/near all-time highs and volatility at all-time lows is not an environment where trading will lead to excess returns so the best thing we can do is to be patient for prices we like. We acknowledge that trading is a direct expense borne by our clients, so lowering overall portfolio turnover ***without sacrificing returns*** is another tool we have as portfolio managers to help lower costs for our clients.

Fund Code	Fund Name	2015	2016	2017
4594	Cambridge Growth Companies Corporate Class	188%	110%	76%
11108	Cambridge Canadian Growth Companies Fund	160%	106%	60%
11109	Cambridge Pure Canadian Equity Fund	88%	54%	46%

Source: CI Investments, December 31, 2017

As we enter 2018, we remain focused on growing our global universe of stocks under coverage and continuing to hold ourselves to the highest of investment standards in the pursuit of above-average long-term wealth creation for our clients. Our best years remain ahead of us. Please drop in to see our team when you are in Toronto. There is a lot going on behind the scenes every day to deliver our clients' investment outcomes, so we urge you to come see the Cambridge team at work. It is by far the strongest team we've ever had at any point in our career, and we are getting a little better every day.

Kind regards,

Greg