August 27, 2018

Dear clients and friends,

Ten years!

A decade has passed since LCM opened its first account in June 2008. It was not an auspicious time to start an investment company as the global financial crisis hit nine months later. Despite that initial headwind, LCM has earned 13.75%[i] per year compounded and has achieved its primary objective to earn an attractive level of absolute return. Our first clients have seen a notional investment of $100 grow to over $300.

How do these results stack up relative to the market? I believe absolute performance is the most important metric because a relative performance goal requires an assumption that the level of market returns will be decent and the risk inherent in the market will be sensible. That said, over long periods of time, competent investment managers should beat the averages. A secondary benchmark we have used from day one is a fully invested North American index portfolio, and LCM has beaten that by 5.1% per year over the past ten years. Canadian stocks have earned a meagre return of 4.2% over this period, and the US stock market has earned 10.2% in USD, plus the USD strength has added another 2.8% for Canadian-based investors. Relative to surveys of Canadian institutional managers, LCM has beaten at least 95% of Canadian Equity Funds and at least 75% of US Equity Funds over the 10 year period ended June 30, 2018.[ii]

Most discussions of investment performance begin and end with the total return number. However, I think it is a mistake to judge a process only by its outcome. Before starting my own company, I worked for large institutional investment firms for 15 years, and although we did a good job for our clients, I always believed we could do better if we went narrower and deeper, focusing only on our best ideas, thinking longer term and ignoring both the marginal ideas and short-term fluctuations of the index. I founded LCM with this objective in mind. LCM's patient and disciplined process is based on Philip Fisher's approach, which combines rigorous due diligence, a conservative definition of risk, and a long-term mindset. As an illustration of our focus and selectivity, LCM has invested in only 16 businesses in the first 10 years. LCM does not lower its standards in order to get capital invested; instead, we prefer to hold cash while patiently waiting for the next opportunity. As we conservatively define risk as capital loss, it is important to consider that LCM's returns were earned without leverage; additionally, for a new idea to qualify as a potential investment it should have limited downside at the time of purchase.[iii] On average we've held over a third of the portfolio in cash over the last ten years, meaning the *invested* portion earned over 20% for the total portfolio to earn 13.75% per year. As for the long-term mindset, I am fortunate that all our clients have a minimum five-year horizon for their capital and although we all receive monthly statements, we formally report performance on an annual basis.

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I believe LCM's process has a structural advantage over many large managers. Warren Buffett once cleverly described the stock market as a "no called strikes" baseball game with unlimited pitches.[iv] LCM is deliberately designed to play this type of game, while most of the investment industry with fully invested mandates, short term comparisons to benchmarks, and limited flexibility on how to structure a portfolio is not able to capture this natural advantage of investing. The structure of the industry forces large teams of talented institutional investors to swing continually at difficult pitches every day with understandably mixed results. I believe our structure and process are the key reasons for our success over the first ten years. I am grateful to have been given the opportunity to do a job I enjoy and will work hard to continue to deserve your trust over the next decade.

Sincerely,

Dan

[i] All stated returns are gross of fees. We take pride in ensuring that our fees are fair and reasonable for the service LCM provides. If you would like a copy of LCM's Investment Management Agreement that outlines our fees and services in more detail please contact us. Returns for LCM are from a representative account as all client assets are held on a segregated basis. Small differences will occur between accounts due to rounding and the timing of cash flows.

[ii] Data on institutional manager returns and percentile breaks for the 10 year period ended June 30, 2018 are provided by RBC Investor and Treasury Services and Mercer. RBC ITS results are from the RBC All Style Canadian Equity Funds Equal Weighted Universe, and the RBC US Equity Funds Equal Weighted (C$) Universe. Mercer results are from their Investment Performance Survey of Canadian Institutional Pooled Funds, specifically the Canadian Equity and US Equity categories. Both RBC and Mercer surveys yielded similar results.

[iii] Most of the investment industry talks about protecting their portfolios against loss, but instead measures risk as price volatility and tracking error relative to a benchmark. LCM's constraint for a new idea to have limited downside at the time of purchase has been a difficult hurdle in the current market, resulting in a higher than normal cash position.

[iv] Warren Buffett has been credited with the analogy of the stock market as a "no called strikes" baseball game. The basic idea is that there is no penalty in the stock market for an investor to wait for his best pitch. His exact quote from an interview on Adam Smith's Money World in 1984 follows:

> "There are no called strikes in this business. The pitcher just stands there and throws balls at you....You sit there and they throw U.S. Steel at 25 and they throw General Motors at 68, and you don't have to swing at any of them. They may be wonderful pitches to swing at, but if you don't know enough, you don't have to swing. And you can sit there and watch thousands of pitches, and finally you get one right there where you want it, something that you understand—and then you swing. I might not swing for two years."