2013 Q4

Case Study on Equity Portfolio Volatility:

We have written about Avenue's theory regarding equity portfolio volatility, or risk, over the last 10 years in several case studies. Now that we have completed our first decade, we are happy to share with you that the results were much better than what we had hoped for.

Our stated goal was to capture the long term stock market compounding of 8% but do it with as little risk as possible. We had hoped that we could reduce volatility by as much as 25 to 30% and still meet our return targets. We are off slightly on our return target of 8% as the average Avenue portfolio has compounded at 7.2% over the last 10 years. Nevertheless, we managed this in a decade where we experienced the worst stock market crash since the 1930s.

Our constant focus on risk reduction resulted in the volatility of Avenue's equity portfolio coming in roughly 44% lower than the TSX Canadian stock market index. Volatility is calculated by comparing the amounts that Avenue's portfolio and the TSX index swing up or down monthly to their long term average returns. This is the standard way that the investment industry measures risk.

We accomplished this low volatility by a commitment to invest in high quality businesses and other consistent income streams. If our companies are established and profitable, with reasonable levels of debt, they usually have a more predictable stock price.

The Avenue Equity Portfolio is also slightly more diversified across uncorrelated asset classes than the major Canadian and US indexes. The TSX index has a high concentration of resource stocks and the US S&P500 index is predominantly a mix of financial and consumer/industrial businesses. Avenue's portfolio has a much more balanced exposure to the securities in both those indexes and also includes meaningful positions in utility and telecom businesses, real estate and high yielding bonds.

Our investment process continues to be driven by searching for securities where we can lock in an 8% return with limited downside. If we find one, we grab it. This sounds simple enough but it is not that easy in practice. Today's very low interest rate environment makes it much more difficult to find quality securities and means we must consistently maintain our disciplined approach.