

Case Study: Safety (Owning Good Assets In Good Places)

We would like to share a couple of recent developments which confirm our belief that investing Safely in today's world is best served by owning a hard asset or business in a sound legal jurisdiction.

This month's economic event of interest is the unwinding of the tax haven of Cypress. The two-state island exists inside the umbrella of the European Union but there are many complicating issues. The overleveraged banking crisis has now hit the island in such a way that a traditional bailout is not possible. At this time it looks like basic bank deposits will take a hit.

When you put money in a bank and the bank lends the money and loses it, in this case by lending it to Greece, the bank shareholders lose first, then the bank bond holders and finally the bank depositors. Usually the government comes in to save deposits because a run on a bank is bad for everyone. However, in the case of Cypress where the majority of depositors are wealthy Russians, it seems to only be bad for tax evaders. The bank is going to fail and foreigners are going to have to find another place to put the remainder of their money.

What is important about the events in Greece and Cypress is that the traditional view that cash and government bonds are the safest assets no longer holds true. We believe that owning a good business is the safest way to maintain and compound your wealth. We also believe a few more Cypress savers and investors now share our view.

The second argument is that you have to own the business in a solid legal jurisdiction. China now has many inter-listed public companies in Canada and the US. However, we would not recommend owning them given the lack of accountability.

Recently uncovered fraud in inter-listed Chinese public companies has prompted the US Securities Exchange Commission (SEC) to demand domestic audit documents for these companies. The Chinese auditors have refused to cooperate because they fear that releasing Chinese audit documents might accidentally pass on "state secrets", which of course is illegal. Amusingly, the answer to the SEC's request for records is that they will not be getting any and nor will shareholders.

Our conclusion here is that in this age of global investing, the importance of where your business is located and if it is supported by a high quality legal structure is under appreciated. We certainly prefer to invest in Canada first and we have observed that more and more individual Chinese citizens share our conviction as their personal money is landing on our shores every day.