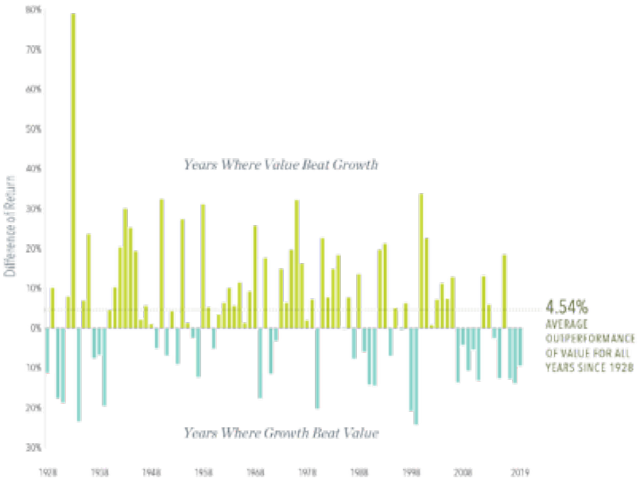
FIRST CAPITAL FINANCIAL

WORLDSOURCE FINANCIAL MANAGEMENT INC.
Sponsoring Mutual Fund Dealer

Stock prices are set by the trading between buyers and sellers. Fierce competition ensures that new information is reflected the instant buyers and sellers begin trading on it. This process makes stock prices our best prediction of the future. More, Markets price securities to provide investors adequate compensation for bearing uncertainty. Differences in uncertainty across companies result in differences over how forecast cash flows are valued today, and are reflected in the discount rate applied to them by investors. When the discount rate is high, prices are low relative to expected cash flows and expected returns are high.

"It's not the company you keep, son, it's the companies you own."

Our portfolios are predicated on the position that investors will continue to apply different discount rates to stocks with different exposure to uncertainty. This is the intuition behind the value premium. Value stocks are those with low prices relative to some fundamental measure of firm value or forecast net cash flows. Empirical research using almost 100 years show that the average annual return of value stocks is 3-4 per cent higher than that of growth stocks, and yet the value premium has struggled over the past decade. Much of this is the result of the past three years, where surging technology stocks left value investors far behind. The degree of underperformance of value stocks is literally *unprecedented*, as illustrated by the rolling three year value premiums Of the 1,093 rolling observations in US history, the three years ending June 2020 ranked dead last. Click <here> and look at **Exhibit 2**. This is the very definition of an outlier (a statistical anomaly).



Despite this, the premise behind value investing -paying a lower price for expected future cash flows- is just a valid today as it was ten years ago. A reversion to the norm should mean that value stocks can reasonably be predicted to outperform going forward, to bring their numbers back to their long term averages. Holding value stocks then is important to capturing this source of higher expected returns. This is why we partner with wealth management firms including **Dimensional**, whose funds have a distinct value-bias to them and where the data strongly supports the position that the longer the investment time horizon, the higher the probability that value stocks will outperform growth stocks.

So no Tesla, no Facebook, no Netflix nor any other (for now) high flying growth stocks driven by unrealistic expectations of new technologies. No, our investment allocations are based on what is measurable and what has held up over the long term. Simply put, value has outperformed growth and it is our conviction that this will hold true going forward as well. We believe that a globally diversified portfolio comprised of value stocks positions your capital for solid, risk-adjusted returns over time. This is an investment philosophy that will weather all Market conditions and Market cycles and one that will reward patient investors by capturing the value premium in their portfolios' bottom line. For more on Value and investing click <here>

Be safe, be well!

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