TRIUMPH ASSET MANAGEMENT

May Flowers

The origin of “April Showers Bring May Flowers” can be traced to a poem written in 1157 by Thomas Tusser. The poem goes as follows: “Sweet April showers Do spring May Flowers”. The saying is a reminder that even the most unpleasant of things, in this case the heavy rains of April, can bring about very enjoyable things indeed—even an abundance of flowers in May. It is also a lesson in patience, and one that remains valid to this day. ***After a tumultuous start to May, we are relieved that the final week brought about some “flowers”, as the Fund rallied to nearly flat for the month and down -16% YTD.*** Importantly, we note that our holdings have declined 20% YTD, meaning our trading profits for the year are +4%.

As we have stated in our past four monthly letters, dark clouds have filled the skies since the beginning of the year. Despite the inclement weather, ***I believe that the scale of the Market’s acclimatization has exceeded the magnitude of the storms.*** This belief is based on one simple premise, namely, the mathematics of present value. The value of a business or any financial asset (such as bonds or real estate) is the present value of its future free cash flows. Most money management firms (including us) discount the first 5,6 or 7 years (during which a model can be reasonably crafted) and then add this figure to the terminal value (the discounted value of a perpetuity) which assumes modest future growth rate tied to GDP growth. The numerator of this equation is the annual FCF figures, while the denominator includes the discount rate, among other figures. What this means is that both a rise in the denominator or a decline in the numerator have a negative effect on the present value. Given the environment we are in, where inflation is causing interest rates (the denominator) to rise and a potential recession is causing earnings (the numerator) to decline, the confluence of both fronts is causing the DCF of all businesses to fall.

Nevertheless, some further insight into the DCF calculation will explain why I remain bullish at these levels. As stated above, the DCF is calculated by adding the value from the front years with the terminal value. Value stocks have a higher proportion of the two components in the front end, while growth stocks have most of the value derived from the terminal value. In every case, the terminal value makes up no less than half of the total value, leaving the front-end portion representing less than half. ***Given most stocks in our portfolio have fallen more than 25%, this means that at least half of the front years has been wiped out.*** While it is possible that interest rates continue to rise and FCF numbers continue to fall, the magnitude necessary to wipe out half the value over the next seven years is virtually impossible to achieve. ***It is therefore our belief that our holdings are undervalued and should be bought, not sold.***

Of the three classifications of flowers (annuals, biennials, and perennials), our company ownership focuses on the perennials that flower year after year and need not be reseeded or replanted. ***Their enduring nature enables us to focus on their long-term value, rather than the short-lived beauty of an annual (like cyclicals or oils)***. While we remain steadfast in our bullishness, we continue to hold 15% of the portfolio in cash in the event another storm appears. We thank you for your continued support and are hopeful that the May flowers yield to both blue skies and an ever-greener landscape--preferentially, on my quote screen, in June.

Sincerely,

Steven Tuchner
Founder and CIO

130 Adelaide St W., Suite 1010
Toronto, ON, M5H 3P5