Sionna Investment Managers®

SOUNDBITE

Thursday April 4th, 2013

Stretch when exercising, not when investing

One theme that we continue to see in the Canadian equity market today is a willingness to “stretch for yield.” Investors are so desperate to find income-producing investments that they are prepared to pay an elevated price for that yield. We think this “stretching” behaviour is partly a result of the low interest rates in the fixed income universe – investors are unable to find attractive yields in the bond world and are flooding the equity markets in search of income.

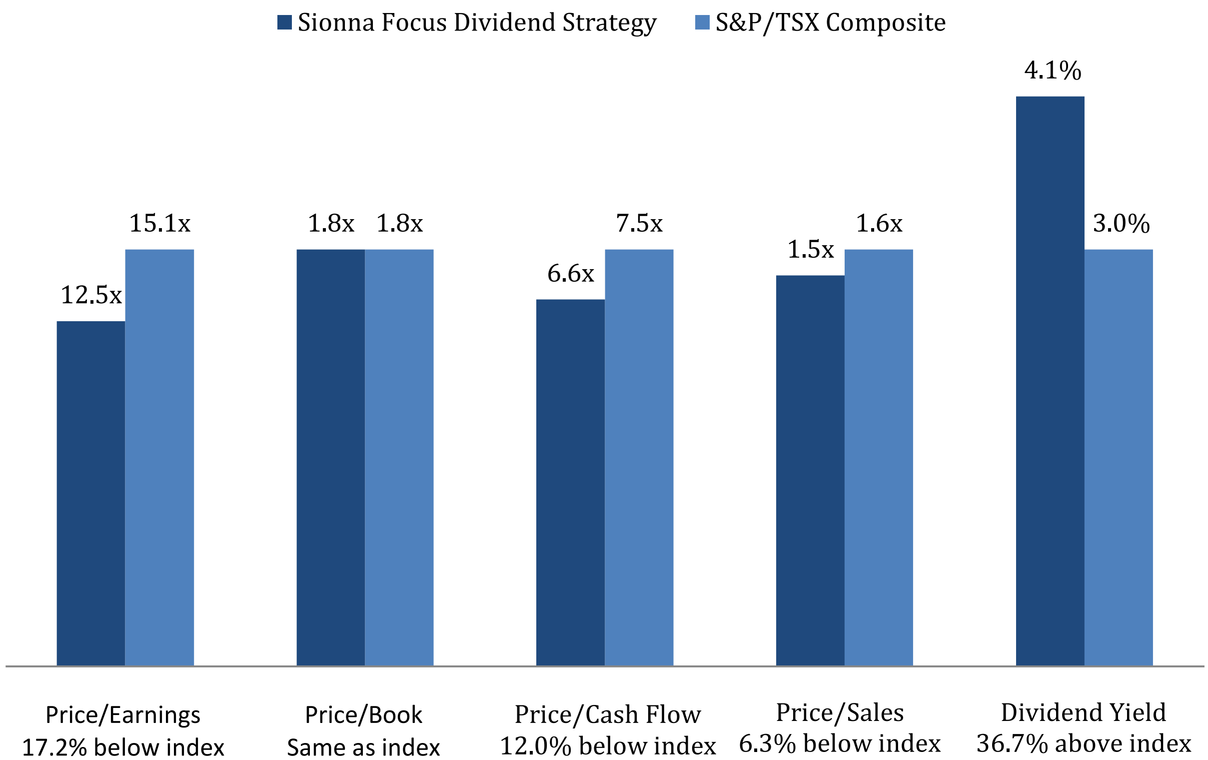
High yielding stocks have also benefited from the increasing appetite for safety and conservatism that has followed the 2008/2009 financial crisis. Investors tend to view dividends as a sign of stability, and as being less risky than lower-yielding equities. In general, Sionna would agree and we have long been proponents of dividend-paying stocks because of their history of outperformance and downside protection over the long term. However, the current valuation of many dividend-paying equities makes us cautious.

Evidence of this stretching behaviour is apparent in the premium valuation levels reflected in sectors generally known for their yield. Sectors such as utilities, pipelines, and REITs are all trading near the upper end of their historical valuation ranges.

At Sionna, we spend time looking for equities with strong and sustainable yields, but we don’t evaluate our investment opportunities solely on the basis of their dividend streams. Sionna believes in the value approach and will not ignore other traditional valuation metrics or pay any price for yield. This approach is not only true across our traditional equity mandates, but is a discipline we maintain even in Sionna’s Focus Dividend Strategy – a specialty mandate that targets quality equities with above-average yields.

We think that a key differentiator of our Focus Dividend Strategy is that we refuse to stretch for yield. The table below shows that the portfolio has a dividend yield of 4.1%, which is more than 35% above the market’s yield. However, our portfolio has achieved this yield without compromising on other characteristics: price to earnings, price to book, and price to cash flow multiples are all significantly below the market. We have been able to strike a balance between yield and valuation – and are keeping our stretching confined to our exercise routines.

Balancing Yield and Valuation



As at March 31, 2013
Source: FactSet
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The Sionna Team

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