Sionna Investment Managers®

SOUNDBITE

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The Headlines *(as usual)* Are Too Dramatic

Despite the weakest post war economic recovery, heavy global debt burdens (debt to GDP at 125%) and brewing geo political issues, equity markets have been rather buoyant, especially in North America. For the year ended September 30, 2014, the S&P/TSX Composite was up more than 20%, well ahead of average annual market returns of around 9.5%.

In that environment, we anticipated that a pullback was possible – so the 10% market correction we recently experienced was not particularly notable.

The hand wringing about Canada is particularly perplexing since the S&P/TSX Composite's year-to-date return (+5.3% as of the close of October 22, 2014) ranks among the top of all the 18 major markets. (Note: it had a sizeable rally and correction over the year.)

More heartening is that the market has now shifted from an expensive valuation of 19 times trailing earnings to a more reasonable 16 times – and a level much closer to long-term averages– and dividend yields have similarly moved to be more in line with their historical average of 3%.

In addition to fears about slowing global growth causing recent market volatility, we suspect the markets are also adjusting to the growing realization that inflation and bond yields might stay “lower for longer” after all, with fears of stagnation and an extended period of low returns for all securities setting in.

We believe that Canadian equities will return approximately 5% - 6% annually over the next 5-10 years (between the market peak on September 1, 2000 and June 30, 2014, Canada’s total equity return was 4.63% per annum). We think that this investment alternative looks much more attractive than the current 10-year government bond yield of 1.91% whose expected return is “what you see is what you get.”

Following a record result in fixed income returns over the last 30 plus years, we expect the asset class will be more challenged than equities and that best investment opportunity over the next 10-years will therefore come from the latter. With that in mind, we would encourage investors to use the opportunity to increase their equity weights closer to normal levels and “stay the course.”

Because we make it our business to understand companies, we know that emotions are currently driving the market– not fundamentals. For a value investor, it is precisely the kind of environment that we seek to capitalize upon. We are doing so by paring back some of our defensive names, picking away at names that have begun to re-enter buy zones and brushing up our research on some emerging opportunities.

Following an extended period of multiples lingering above their long-term averages, and the market yielding few contrarian investment ideas, we welcome this pull back. We are confident in the stability of our portfolios and are embracing the opportunity to identify further upgrades – both from the perspective of quality and valuations.

The Sionna Team

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