Sionna Investment Managers®

INSIGHT

July 2020

# Navigating Through Disruption

Over the past several months, the COVID-19 pandemic has caused unprecedented disruption in financial markets and how businesses operate as most companies made the move over to a working from home structure. As we all continue to navigate through this uncertainty, we want to assure you Sionna remains fully committed to our clients, employees and partners, and we continue to take the necessary steps to ensure the highest level of business continuity during this time.

We transitioned to working from home in March, and thanks to our technology initiatives over the last several years, we were well equipped to work outside of the office environment for as long as necessary. Thus far, there has been limited impact on our operations thanks to the business continuity processes and procedures we put in place well before the crisis. On the investment team, we have maintained open communication by instituting a daily one-hour call, as well as deploying an online communication platform to share information within the group.

## Focused Research Process

At Sionna, we pride ourselves on our disciplined research process and our focus on analyzing securities from a bottom-up value perspective. Having a disciplined research process in place is critical in investing, but even more so during times of significant market volatility. The team's deep analysis into our holdings meant we had the confidence to act when dislocations between stock prices and intrinsic values arose. We were able to take advantage of the volatility to add to holdings that were particularly discounted as well as add new names to the portfolio, all because we had completed our research in advance and waited patiently for the names to reach attractive valuations.

COVID-19 and the resulting market volatility has certainly impacted businesses across all industries. We thought it was prudent to thoroughly revisit all the holdings in our portfolios and update our estimate of their intrinsic values to reflect this new environment. We have been holding calls with management teams to understand how they are managing their business, both now and in the "new normal" that is to come, and the team has been taking this opportunity to conduct portfolio reviews to discuss how to best position the portfolios for the future.

We have also been adjusting our coverage responsibilities over the last year – in some cases assigning analysts to different sectors. We believe occasionally rotating sector coverage and having fresh eyes on portfolio holdings can help minimize biases that may develop over time. This rotation allows us to maintain a balanced perspective on the portfolio and ensure we have invested in the most attractive value opportunities for our clients. We believe our dedication to our research process is of utmost importance, and what helped us find true value opportunities during this recent bout of market volatility.

## Selloffs Create Opportunity

Following sharp declines in March, the stock market staged an impressive recovery during the second quarter of 2020. While we were a bit surprised by the speed with which it happened, we also understood that, historically, the largest market gains can be found immediately following sharp declines. As we have discussed previously, throughout human history irrational investors have fluctuated between fear and greed. March was ugly, but the selloff created many value investment opportunities for us, as selloffs usually do.

The dip was relatively brief, but we were able to make incremental additions and subtractions to the portfolio that benefited in the subsequent recovery – thanks to our consistently contrarian mindset and our research process focused on uncovering value. Oftentimes, our best ideas come from names we already own, and we can act quicker when we have accumulated knowledge on the company. Although we already had a high-quality portfolio going into the downturn, additional opportunities to upgrade the portfolio presented themselves as valuations fell.

As value investors, we were very excited by the opportunities that arose in many areas of the market during this selloff. For example, in our Canadian large cap mandate, we added to positions in Methanex and Nutrien, which had fallen due to commodity price concerns. Despite the temporary setback, these companies still have strong franchises with ample prospects to grow the business. We were also able to add a large cap name, Allied Properties, an office real estate landlord and developer, and in the small cap space, we added Aritzia, a well-run fashion retailer. We had our sights on both names for quite some time, but they were previously out of reach due to valuations.

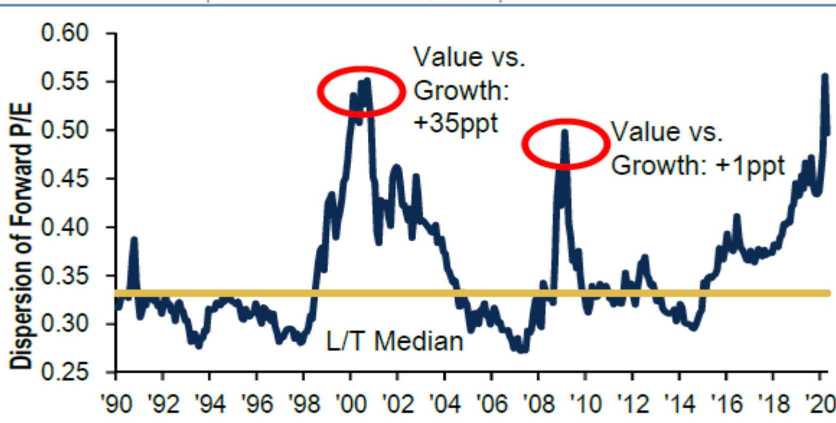
We especially like companies that can benefit from market dislocation. Brookfield Asset Management is one such company we increased our position in as we believe it can expand its acquisition pipeline because of the current tumult in the business world. CGI Group, an information technology consulting company, is another large cap name we increased our holdings in, which is seeing higher client demand for digitization due to the pandemic. All of these purchases were made at attractive valuations amidst the broader market selloff.

**Focusing on our Value Philosophy**

Regardless of the market environment, we remain steadfast in our value approach. Recently, the value investment style has been challenged, but we remain confident that value will come back into favour. As shown in the following chart, the valuation dispersion between value and growth has risen to its highest level since the Great Financial Crisis. Historically, when dispersion was this high or higher, value stocks have outperformed growth 95% of the time over the subsequent 12 months according to a recent BofA report. As value managers, it is reassuring to see that we have history on our side.

**Chart 91: Valuation dispersion suggests Value is more likely to outperform**

S&P 500 valuation dispersion on forward P/E, 1990-present




Note: dispersion is measured as the coefficient of variation of forward P/E

Source: BofA Global Research. US Equity Strategy in Pictures. June 2020.

In periods of volatility such as these, our long-term, research-intensive approach acts as a guiding light and allows us to proceed forward with conviction while others are paralyzed by uncertainty. This is the philosophy we apply regardless of the investment climate.

Overall, our investment philosophy remained constant through the downturn. Our answer to unforeseeable events, such as the COVID-19 pandemic, is to maintain a balanced portfolio of strong, resilient businesses acquired at a discount to our estimate of their intrinsic values. We cannot, and do not, predict the path of the broader market, but we constantly re-evaluate our ideas in the context of available opportunities and remain dedicated to our fundamental, value knitting.

We thank you for your continued support, and hope that you and your family are safe and well.

**Jackie Au, CFA**
**Associate Portfolio Manager**
**Sionna Investment Managers**

Sionna Investment Managers  8 King Street East, Suite 1600  Toronto, Ontario  M5C 1B5
For further information, please email clientrelations@sionna.ca.