

The Pendulum's Swing Back to Value is Only a Matter of Time

By: Dominique Beauchamp

— Stephen Jenkins, Co-Chief Investment Officer, Sienna Investment Managers

LES AFFAIRES — Is it when the value style you practise seems to be over, that the tide turns in its favour?

Stephen Jenkins — The lower performance of undervalued stocks compared with high-growth companies over the last ten years is an anomaly. Over the very long term, cheap stocks perform better 80% of the time. This time around, COVID-19 is extending the cycle in favour of growth because technology companies offer solutions to the pandemic whilst serving as a safe haven given their more visible profitability and strong balance sheets. Examples of pure speculation are beginning to emerge. The global recovery may trigger a return to undervalued securities.

L.A. — Are you confident about this approach despite the fact that top technology titans have become the new blue chips?

S.J. — Certainly, these crowd movements can last a long time. Sluggish rates may also justify placing more value on the future profit streams of iconic tech companies. I'm not saying that champions can't continue to perform well, but inevitably their valuation will backfire. You have to distinguish between the company and its share price on the stock market. Whether it's Disney after the *Nifty Fifty* wave in the 1960s or Microsoft after the dot-com bubble, these high-quality companies yielded little performance for years because their valuation had become unsustainable. Other stars of the moment will experience the same fate. In the meantime, all we can do is maintain our discipline.

L.A. — Precisely, the March fall in stock markets has enabled you to make a few purchases for your Opportunities Fund, which comprises 30 of your best ideas. Can you share some examples?

S.J. — Charlie Munger, Warren Buffett's partner, once said success is the result of extreme patience combined with extreme decisiveness when needed. We were ready and we have been able to add to our quality holdings at attractive valuations and buy new companies that were previously out of our reach. In particular, we added Ulta Beauty (ULTA, US\$199.54) whose share price plunged by half in March. Its earnings multiple had fallen from 18 times to less than 14 times, an attractive valuation relative to long-term growth prospects. This cosmetics retailer understands the needs of its clients, as the 23 million members of its loyalty program account for 95% of its total sales. We also purchased additional shares of PerkinElmer (PKI, US\$198.82), an equipment and services provider for disease screening analysis, when its multiple reached 16 times

forecasted earnings. Based on a return to normal earnings growth within two to three years, this valuation is reasonable.

L.A. — The banking sector is often well represented in the portfolios of value approach followers. Which securities do you hold in this industry?

S.J. — One of Sionna's funds holds RBC, TD and Scotiabank stocks. We find these three institutions to be the best capitalized and most resilient ones. Low interest rates and the recession present significant challenges, but we believe banks are in a much better position than before to overcome them. It's easier to invest against the tide when you look three to five years ahead. In March, bank valuations dropped to below 10 times earnings and their dividend yield rose to 7%. Our Opportunities Fund doesn't hold shares of these banks but holds shares of Berkshire Hathaway (BRK.B, US\$194.14) and Wells Fargo & Co. (WFC, US\$24.55). Warren Buffet's company is the value stock *par excellence* because it is inexpensive, as are its underlying investments. Its US\$147 billion in liquidity is both a kind of insurance policy in troubled times and an option on future opportunities. As for Wells Fargo, the bank will eventually emerge from the regulatory restrictions imposed on it to sanction its aggressive practices. In the meantime, the new CEO is cutting costs, which further enhances the potential for earnings recovery in the medium term.

L.A. — Your fund has the flexibility to invest outside North America. What type of investment do you currently have abroad?

S.J. — We hold shares of the spirits group Diageo PLC (DEO, US\$149.87), which has a well-established portfolio of well-known brands. This ever-expensive stock is a long-standing investment, but we added to our holdings in recent months when its valuation declined relative to its earning power. The stock fell to US\$102.59 at its lowest on March 23, but has rebounded strongly by 46% since then. This British company, best known for its Johnnie Walker, Smirnoff and Guinness brands, is also a good capital allocator, offering a successful mix of innovation, smart acquisitions, dividends and share buybacks.

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