

# Sionna Monthly Income Fund

## Fund Commentary

The S&P/TSX Composite Index was up 4.5% this quarter on a total return basis.

While all sectors positively contributed to the Composite's performance this quarter, the financials sector, specifically the banks, had the most notable impact. Earnings continue to surpass expectations and concerns regarding real estate remain unrealized thus far.

During the quarter, the Sionna Monthly Income Fund underperformed its blended benchmark (60% S&P/TSX Composite Index and 40% FTSE TMX Canada Universe Bond Index).

## Positive Contributors

The Fund's position in Methanex Corp. contributed positively to performance. The increase in global methanol prices over the quarter caused Methanex Corp.'s stock price to rise and positively contribute to performance. Sionna likes the fundamentals of the business and believes that there is an upside to the company's free cash flow generation with higher long-term methanol prices and the relocation of some of the company's facilities to North America.

Sionna's lack of exposure to Enbridge positively contributed to performance. Enbridge is one of the largest energy infrastructure companies in North America with a prominent footprint in the pipeline business. The company experienced a challenging quarter as investors questioned if Enbridge could fund its large capital expenditure plans and maintain its dividend growth in the near term, causing weakness in the company's share price. Recently, Enbridge issued equity and announced a dividend increase, which helped the stock recover some of the losses that occurred earlier in the quarter. Enbridge has strong assets that have allowed it to generate solid operating cash flow and strong dividend growth over the long term; however, Sionna believes that there are more attractive opportunities in the energy sector.

Boardwalk REIT also contributed positively to performance this quarter. Boardwalk REIT owns apartment buildings across Canada, with most of its portfolio in the western region. The energy downturn negatively impacted these assets, leading to lower rents and reduced occupancy levels. Boardwalk's cash flows have been weak, putting pressure on distribution payout ratios. The company recently made the difficult but necessary decision to cut its dividend. The management team is focused on investing internally to

improve the quality of its rental properties and to better position the business for when the operating environment improves. Boardwalk continues to have quality assets and a strong management team that is well aligned with shareholders.

## Performance Detractors

The Fund's position in Imperial Oil Inc. detracted from performance. Oil prices were volatile this quarter, resulting in stock price movements that were not reflective of the underlying value of Imperial Oil's business. Sionna continues to be impressed with the company's financial strength and ability to generate cash flow, especially considering the low oil prices we have experienced over the last two years.

Sionna's lack of exposure to Canadian Imperial Bank of Commerce (CIBC) was a negative contributor to performance. CIBC has a large domestic banking franchise, and has recently expanded materially into the United States. Sionna prefers to obtain exposure to the Canadian banks through our holdings in Bank of Nova Scotia and Toronto-Dominion Bank, which have more established non-domestic

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operations and more conservative risk management practices.

Sionna's lack of exposure to Royal Bank of Canada (RBC) was a negative contributor to performance. RBC is the largest bank in Canada and has a strong banking franchise that benefits from its domestic scale advantage. The bank continues to produce solid results, with low loan losses and reasonable capital levels; however, Sionna has chosen to maintain exposure to the Canadian banks primarily through our holdings in Bank of Nova Scotia and Toronto-Dominion Bank.

## Select Buy & Sell Activity

During the quarter, Sionna added Industrial Alliance Group (IAG) to the portfolio. IAG is the fourth-largest life insurance company in Canada. Based in Quebec, IAG is a conservatively run business that also owns one of Canada's largest networks of non-bank-affiliated financial advisors. The tenured management team has demonstrated a track record of being strong operators and good capital allocators. The market appears to be skeptical about its growth prospects; however, Sionna believes IAG can meaningfully expand into new niches. In addition, it has been increasing its share of mutual fund assets despite the industry headwinds. The stock is also trading at a very attractive

valuation of 11 times price-to-earnings, which is below its peers and well below the market.

The Fund sold its position in Jean Coutu Group Inc. during the quarter. Jean Coutu, the largest drugstore chain in Quebec, is a family-controlled business led by good operators and capital allocators. The company has competitive advantages that enable it to earn high margins and returns. It was recently announced that Metro agreed to purchase Jean Coutu at a premium to market value. The stock reacted positively to the news and Sionna took the opportunity to exit the name.

## Current Positioning

In Canada, 2017 was another eventful year. The housing market finally took a breather after the Ontario government introduced measures to cool the imbalances. Mortgage lender Home Capital Group experienced missteps and a fall in value that kept real estate concerns at the forefront. The price of oil erased some of the previous year's gains to dip to the low \$40s before closing the year stronger than where it started.

In the U.S., the Federal Reserve raised the benchmark interest rate three times this year – notable, considering

rates were increased only five times in the past decade. Consumer confidence continued to trend upwards, while unemployment continued to trend downwards. The Republicans passed the first major tax bill in 30 years that will lower the corporate tax rate from 35% to 21%. This change was what the market hoped for, but seemed to be reflected in equity prices already and unlikely to create further gains.

In more niche corners of the market, the combined market value for crypto-currencies skyrocketed from just under US\$18 billion in January to almost half a trillion dollars by mid-December. If you haven't heard, cannabis stocks are getting a lot of attention, although it's unclear which ones will be winners and which ones will eventually go up in smoke.

The only "sure thing" is that 2018 and beyond will also be eventful. While the market focuses on the "sure things," Sionna will instead focus on applying their proven investment process: bottom-up analysis, buying stocks below their estimate of intrinsic value and properly diversifying the portfolio. This should protect and grow capital over the long term even as macroeconomic events unfold in the backdrop.

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Going with the consensus “sure thing” may appear easier. Sionna prefers to think deeply about where the crowd may be wrong. Thinking like a contrarian is a hallmark of their investment approach and has yielded many investment opportunities over the years. It may be true that great minds think alike. We just resonate more with a saying from *The Economist*, “Great minds like a think.”

## About Sionna

Founded in 2002, Sionna is an independent, value investment firm with over 80 years of experience shared among its portfolio managers. Sionna believes that value investing is a craft. It takes discipline and patience and it is the foundation on which Sionna has grown. As an independent firm, Sionna runs its business with clients' best interests in mind and takes a long-term view with focus only on companies that it believes will help compound its clients' capital.

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## Contribution Analysis (relative to benchmark)

### LAST QUARTER

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Oil, Gas & Consumable Fuels	0.48	Banks	-0.36
Chemicals	0.38	Pharmaceuticals	-0.27
Capital Markets	0.36	Insurance	-0.27
Equity Real Estate Investment Trust	0.25	Aerospace & Defense	-0.09
Trading Companies & Distributors	0.23	Multi-Utilities	-0.09

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Methanex Corporation	0.37	Imperial Oil Limited	-0.23
Enbridge Inc.	0.35	Canadian Imperial Bank of Commerce	-0.20
Boardwalk REIT	0.34	Royal Bank of Canada	-0.19
Empire Co Ltd. Class A	0.32	Metro Inc.	-0.18
CI Financial Corp	0.22	PrairieSky Royalty Ltd	-0.17

### LAST 12 MONTHS

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Food & Staples Retailing	2.29	Media	-1.51
Oil Gas & Consumable Fuels	1.73	Energy Equipment & Services	-1.10
Commercial Banks	0.89	Equity Real Estate Investment Trusts (REITs)	-0.59
Chemicals	0.66	Banks	-0.59
Trading Companies & Distributors	0.47	Multiline Retail	-0.28

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Empire Co Ltd. Class A	2.17	Aimia Inc.	-1.55
Methanex Corporation	0.64	ShawCor Ltd.	-1.11
Finning International Inc.	0.51	Imperial Oil Limited	-0.92
Brookfield Infrastructure Partners L.P.	0.44	Boardwalk REIT	-0.68
Brookfield Asset Management Inc. Class A	0.35	PrairieSky Royalty Ltd	-0.33



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