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Sionna Canadian Equity Class A

Slow and steady wins the race.

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The approach used by Sionna Investment Managers shows that funds don't need bells and whistles to outperform. The investment process is transparent and rooted in the idea that stock prices should revert back to their intrinsic values over time. Using a combination of quantitative screening and fundamental research, manager Kim Shannon and her team look for names trading at least 30% below their values and favour companies with defensive traits.

The team uses a standard set of questions to gauge a firm's ability to generate steady earnings and free cash flows; this helps ensure consistency in the research and makes it repeatable. When building the portfolio, the team may trim or add to positions to maintain the fund's value characteristics. This has resulted in the portfolio looking remarkably consistent over time, with the fund's aggregate price-multiples consistently being below the benchmark and peers.

The fund can lag its more aggressive peers in speculative markets but it earns its keep by playing good defense. Its 24.1% loss in 2008 was less severe than what the vast majority of its peers suffered, and it stacks up well against the benchmark's 32.2% decline. Shannon also achieved a similar feat during her roughly 10-year term (through November 2006) leading CI Canadian Investment. By sidestepping the overheated technology sector of the late 1990s, Shannon posted stellar results, outpacing the benchmark by an annualized 2.6% while keeping volatility subdued.

While the fund's recent returns continue to impress, over the last six years they have been dragged down by the fund's foreign equity sleeve which is managed by Brandes Investment Partners' global equity team. While their investment process is well thought out, the team's deep-value strategy can go through prolonged periods of underperformance. The foreign sleeve's weight has been as high as 14% but will now max out at 10%, which will limit its impact on the fund. The change also moves the fund into the Canadian Equity category from the Canadian Focused Equity category.

People Sept. 3, 2013

The Canadian equity sleeve is led by Kim Shannon, who is also president and CIO of Sionna Investment Managers. Shannon founded the firm in September 2002 and launched the Sionna Canadian Equity pooled fund in July 2003. Over its 10 year history, this pure Canadian equity fund's Sharpe ratio ranks 13th out of 105 Canadian equity pooled funds.

With the exception of Shannon, all members of the investment team also have research responsibilities. Analysts start off as generalists before focusing on sectors. The team now boasts a stronger bench with Teresa Lee, Marian Hoffmann, Mel Mariampillai and Dave Britton taking some portfolio management responsibilities in addition to their sector coverage. They are examples of the way Shannon prefers to groom individuals. All were hired very early in their investment careers so they can be steeped in the Sionna discipline.

Until recently, the firm's dependence on Shannon for investment decisions represented significant key-person risk. Her departure would still have a negative impact, but the growth of her supporting cast and the repeatability of the process ease the risk associated with her potential departure.

The foreign equity sleeve is managed by the global large cap investment committee at Brandes. The committee has no shortage of experience in applying the Brandes philosophy. Team members have an average of more than 13 years' experience at the firm.

Parent Sept. 3, 2013

Brandes Investment Partners serves as the sponsor and distributor of this fund. San Diego-based Brandes is a fully independent advisory firm founded by Charles Brandes in 1974 and has been selling mutual funds in Canada since 2003. In May 2013, the firm separated its marketing activities in Canada under the trade name Bridgehouse Asset Managers.

The firm has avoided launching flavour-of-the-month funds and instead has stuck with funds managed by the Brandes investment team in San Diego and Toronto-based Sionna Investment Managers. Recently the fund struck a deal with Lazard Asset Management, who will manage a multi-strategy and global dividend fund to be distributed by Bridgehouse.

Overall the firm's fees rank in-line with those of its peers, but manager incentive programs rank well. All portfolio managers at both Brandes and Sionna have more than one year's base salary invested in the firm's funds.

Process: Investment Approach Sept. 3, 2013
While there isn't one part of the process that sticks out as having a competitive advantage, Sionna gets its edge from the consistency with which it applies its approach. The team uses an internally generated intrinsic value model to narrow the stocks on which it needs to do further analysis. While the model's use of book value, historical return on equity and relative price-to-earnings ratios isn't earth shattering, it narrows the investment universe to stocks that appear at least 30% below their intrinsic values.

The analysts then do a qualitative review of the firms. They answer a set of questions which focus on the firm's ability to generate consistent earnings and free cash flows. The team also uses consensus earnings estimates or a more conservative earnings estimate to model a stock's intrinsic value two years out. This doesn't mean the team will hold the stocks for just two years though; in fact the portfolio turnover reveals a holding period of between three and five years.

Bridgehouse Asset Managers incorporates Brandes's global equity picks into the Sionna portfolio to build the foreign equity exposure. The Brandes team also follows a value approach but can invest in depressed securities. Investors need to be patient with the global portfolio, as it can experience periods of underperformance, but it has done well over the long-term.

Process: Portfolio Positioning Sept. 3, 2013
Sionna builds its concentrated portfolio of 35 to 50 stocks with remarkable consistency in terms of the characteristics it exposes investors to. The fund's price-to-earnings, price-to-book, price-to-sales and price-to-cash flow ratios have consistently been below those of the benchmark and peers. These are characteristics consistent of a value-oriented manager. Sionna reviews the portfolio and may trim or add to positions to ensure it displays these value characteristics.

Its benchmark-relative approach to portfolio construction results in Sionna keeping sector weights on the Canadian equity portion within 5% of the S&P/TSX Composite Index weights. Though its financial sector weight is in line with the benchmark, Sionna has an underweight position in commercial banks in favour of asset managers like Onex, Brookfield Asset Management and IGM. While Sionna avoids big sector bets, the portfolio remains concentrated with the top 10 holdings accounting for about 40% of the total fund.

Brandes's global equity sleeve can range between 65 and 80 holdings, resulting in a long tail of tiny positions. However, the foreign component can complement the Canadian equity portion. For example, investors have some exposure to healthcare and technology stocks which are otherwise a small part Sionna's portfolio.

Performance Sept. 3, 2013
The strength in the performance comes from the low volatility, which ranks in the lowest quartile of the category. The fund's 1.3% annualized return since inception beats the 0.7% average return for the Canadian Focused Equity category and ranks in the second quartile (the fund moved to the Canadian Equity category in July 2013). These returns didn't rank as well against a custom benchmark of 90% S&P/TSX Capped Composite and 10% MSCI World, which returned 2.3%. However, the benchmark's 14.8% standard deviation comes in higher than the fund's 11.3%.

The fund's performance is impressive considering the struggles of the Brandes global equity strategy. On its own, Brandes Global Equity has lost 5.3% while the MSCI World Index has gained 1.1%.

The Sionna Canadian Equity pooled fund, a pure Canadian equity fund launched in July 2003 by Kim Shannon, has returned an annualized 10.6% gross of fees since inception. This easily outperforms the S&P/TSX Composite's 8.7% return. The strategy outperforms the benchmark 76% of the time over rolling three-year periods, and its volatility ranks in the lowest quartile among Canadian equity pooled funds. Consistent with management's defensive approach, the fund has earned its keep by protecting investors on the downside, with downside capture ratio of 80%.

Price Sept. 3, 2013

The A share class falls in the second most expensive quintile of the Canadian Equity category. Its 2.65% management-expense-ratio is 40 basis points more expensive than the category median. Investors residing in provinces without a harmonized sales tax can purchase the AN series.

The team's three- to five-year holding period results in portfolio turnover between 20% and 40%. This results in a low trading-expense ratio of five to 10 basis points.