

*Macro Value Investing*  
*What to Expect in Sideways Markets*  
April 13, 2016

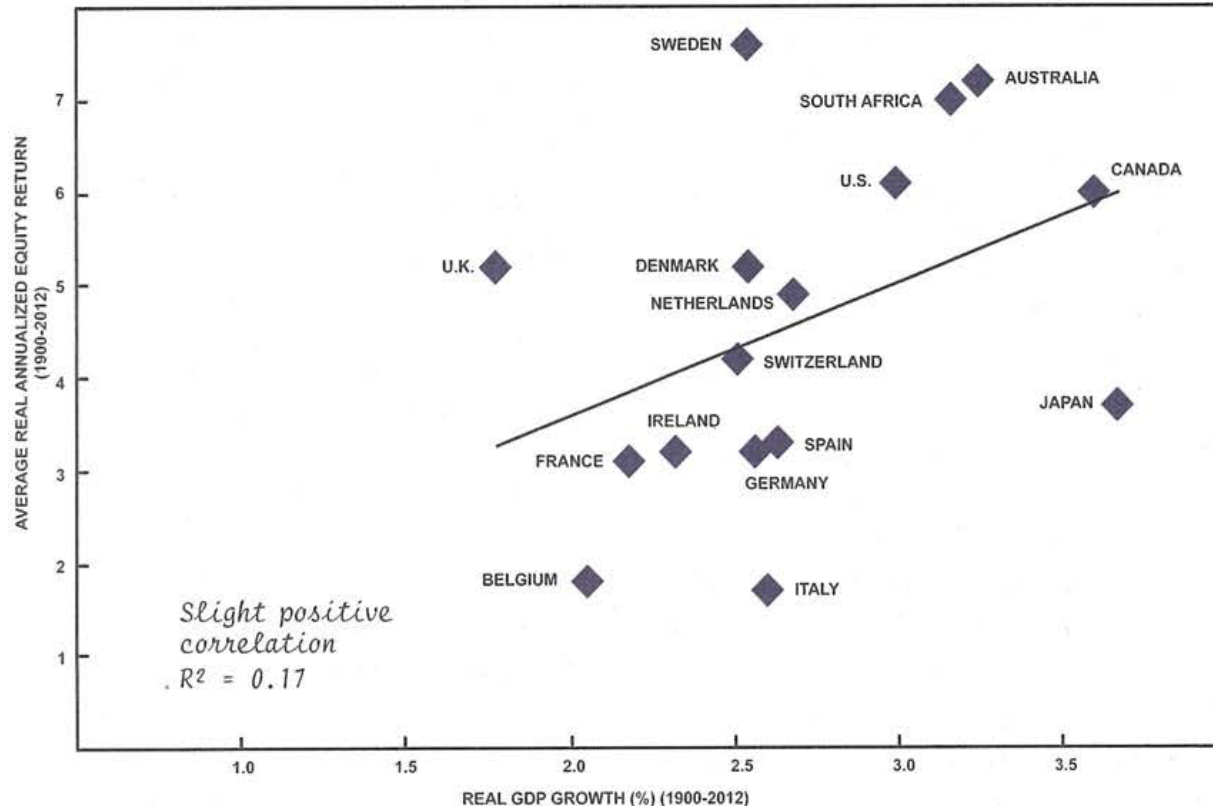
BEN GRAHAM CENTER 2016 VALUE INVESTING CONFERENCE

Presented by:

Kim Shannon, CFA, MBA

# Economic Growth Only Explains 17% of Stock Market Returns

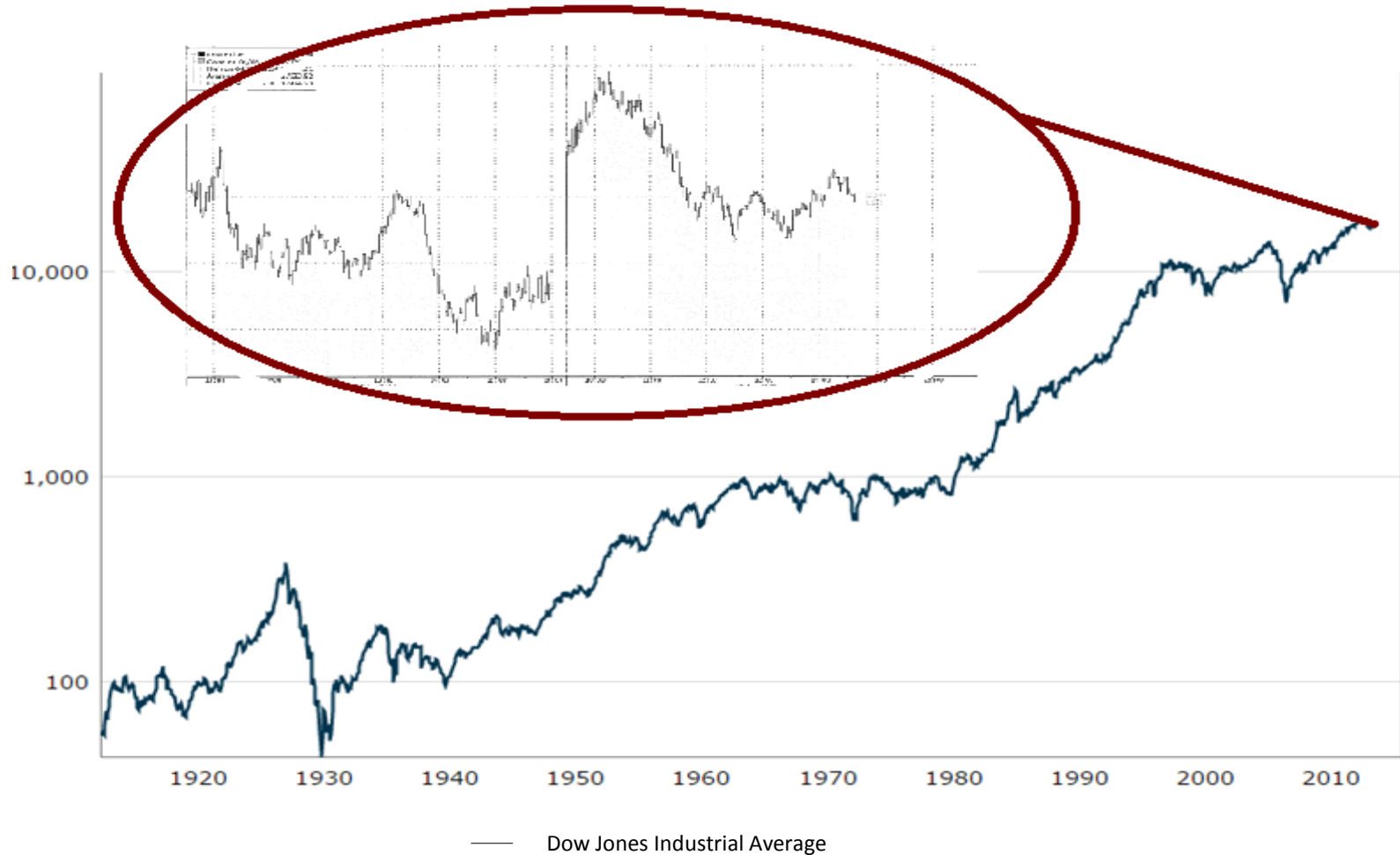
No Clear Correlation Between Long-Term GDP Growth and Equity Returns (1900-2012)



"We continue to ignore political and economic forecasts which are an expensive distraction" – Warren Buffett

Source: The Bank Credit Analyst as at November 2012. Provided for illustrative purposes only. Past performance is not indicative of future results

# Short-Term vs. Long-Term Historical Perspective



Source: <http://www.macrotrends.net/1319/dow-jones-100-year-historical-chart>. Provided for illustrative purposes only. Past performance is not indicative of future results

# Invisible Hand-Benefits of Trade

“By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it”

**Adam Smith, Wealth of Nations  
1776**



# Range-Bound Markets are Frequent

## U.S. Stock Market

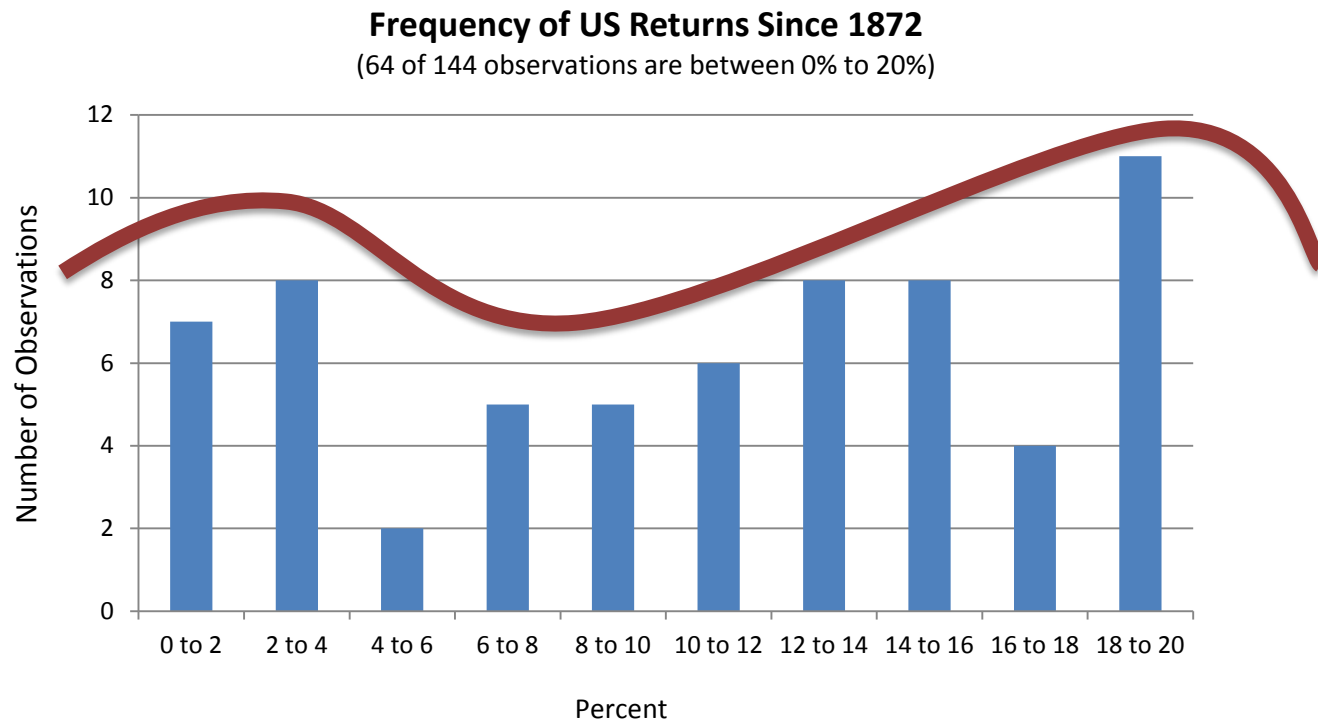


As of 2015:

- Markets have been range-bound 106 of the last 142 years
- Secular bull runs are a rarity; not the norm
- After major bull markets, markets have historically trended sideways for a minimum of 15 years

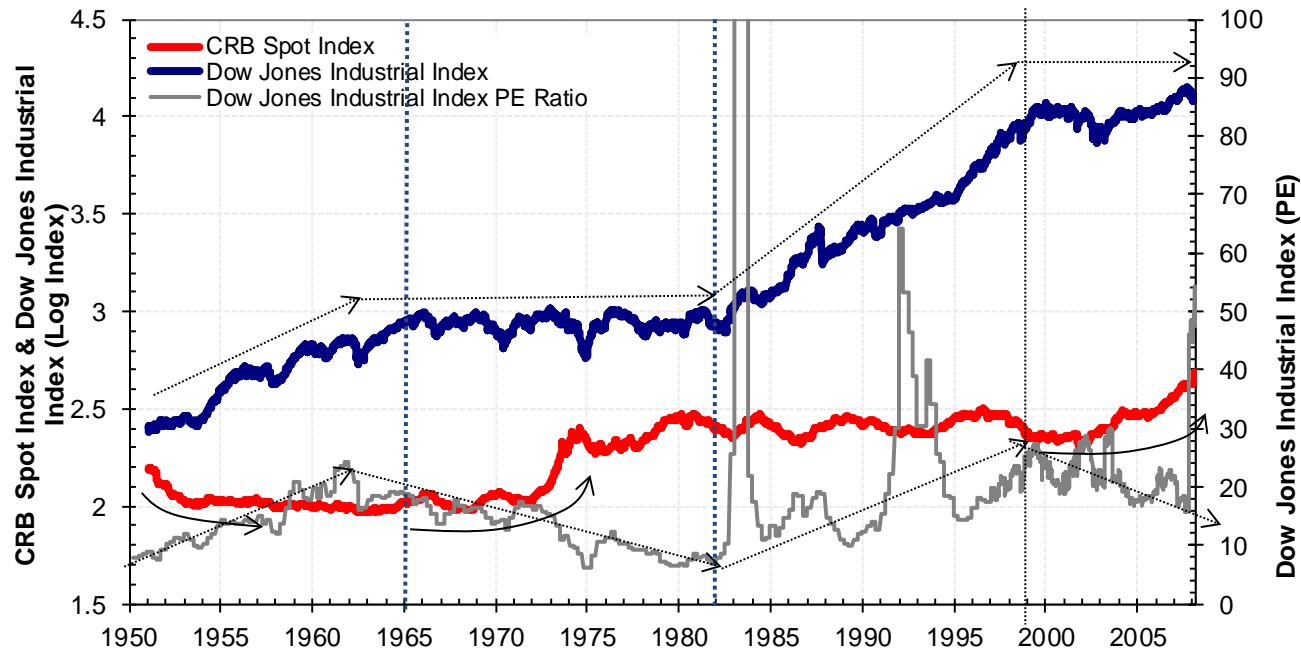
Source: Wells Capital Management. For illustrative purposes only. The above returns do not represent the performance of any product or security managed by Sionna or Bridgehouse and are provided for illustrative purposes only. The performance presented represents historical performance of an unmanaged index. Returns would have been lower if they were subject to management fees and trading expenses. Past performance is not an indicator of future results. The indices are unmanaged and have no fees. One cannot invest directly in an Index.

# Market Returns Tend To Be Bi-Modal



Source: Robert J. Shiller, S&P 500 Price Returns, average annual returns since 1872 is 5.9%.

# Last Full Sideways Market (1965-1982)



- Sideways Markets typically end with single digit P/Es
- S&P/TSX at 19.8 P/E\*
- S&P 500 at 17.3 P/E\*

Source: Rathbones' Investment Strategy, February 2008. CRB: Commodity Research Bureau. P/E: Price/Earnings ratio

\*As at January 31, 2016. The above returns do not represent the performance of any product or security managed by Sionna and are provided for illustrative purposes only. The performance presented represents historical performance of an unmanaged index. Returns would have been lower if they were subject to management fees and trading expenses. Past performance is not an indicator of future results. The indices are unmanaged and have no fees. One cannot invest directly in an Index.

# Learn to Love 6%

## Expected Return of Sideways Market

	Earnings Growth + Change in P/E Multiple + Dividend Yield		
	Bear Market 1929–1932	Range-Bound Markets* Average	Bull Markets† Average
Earnings Growth	-28.1	5.6	5.6
+/- P/E Growth	-12.5	-4.6	7.0
= Stock Return	-37.1	0.7	13.0
+ Dividend	7.1	5.3	3.7
Total Return	-32.6	5.9	17.1
Inflation/Deflation	-8.4	4.9	2.5
Total Real Return	-26.4	1.0	14.2

January 2000 – March 2016	Annualized Return
S&P/TSX Composite	5.5%
S&P 500 (CAD)	3.4%
S&P 500 (US)	4.1%

\*Range-Bound Markets: 1906–1924, 1937–1950, 1966–1982

†Bull Markets: 1950–1966, 1982–2000

Dividends are 90% of total returns in range-bound markets

Values in chart shown in percent

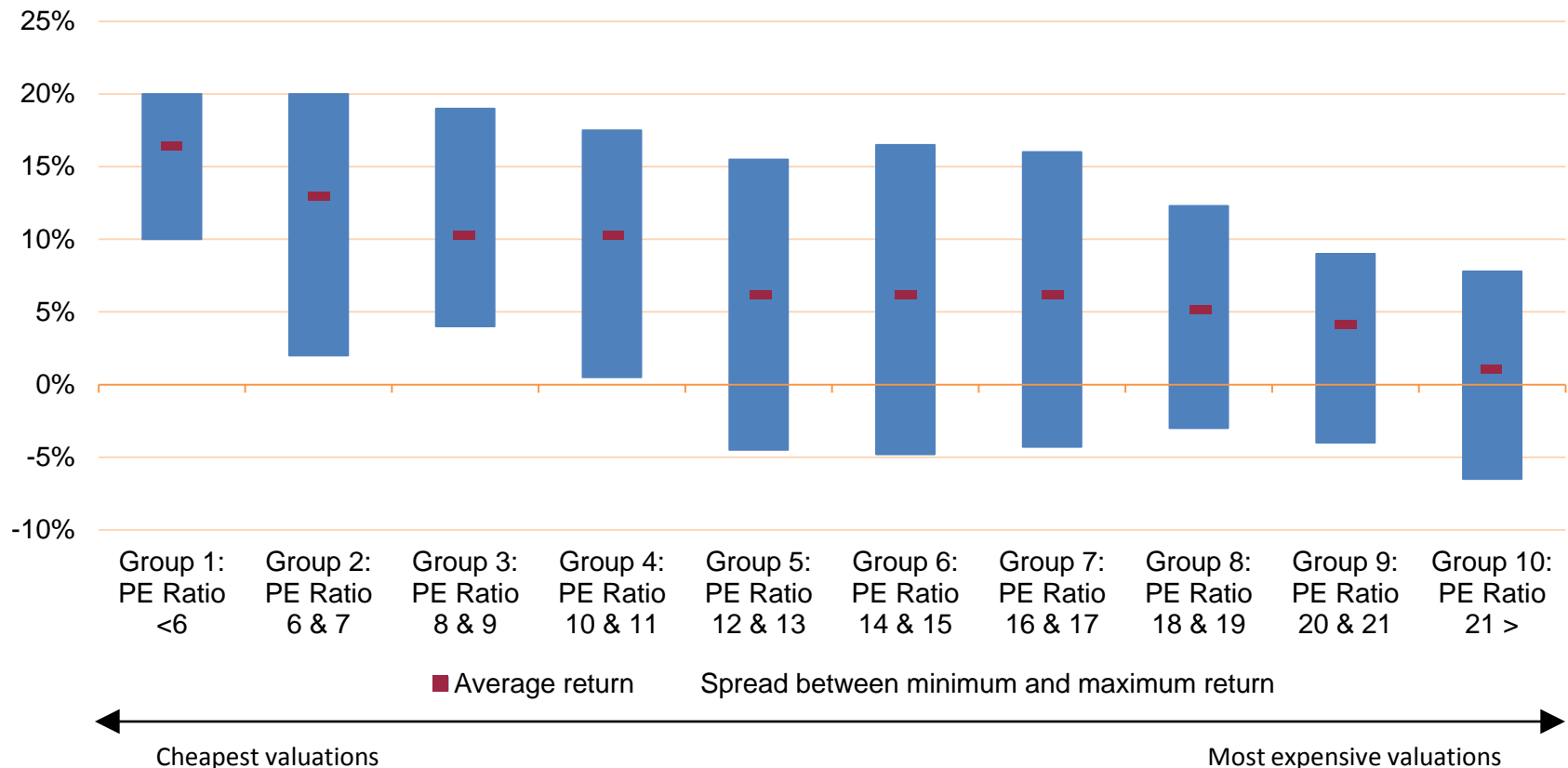
Source: Vitaliy N. Katsenelson "Active Value Investing – Making Money in Range Bound Markets", 2007.

For illustrative purposes only. Indices are unmanaged and cannot be directly invested into. Index returns from eVestment



# The Price of Entry Contributes to Returns

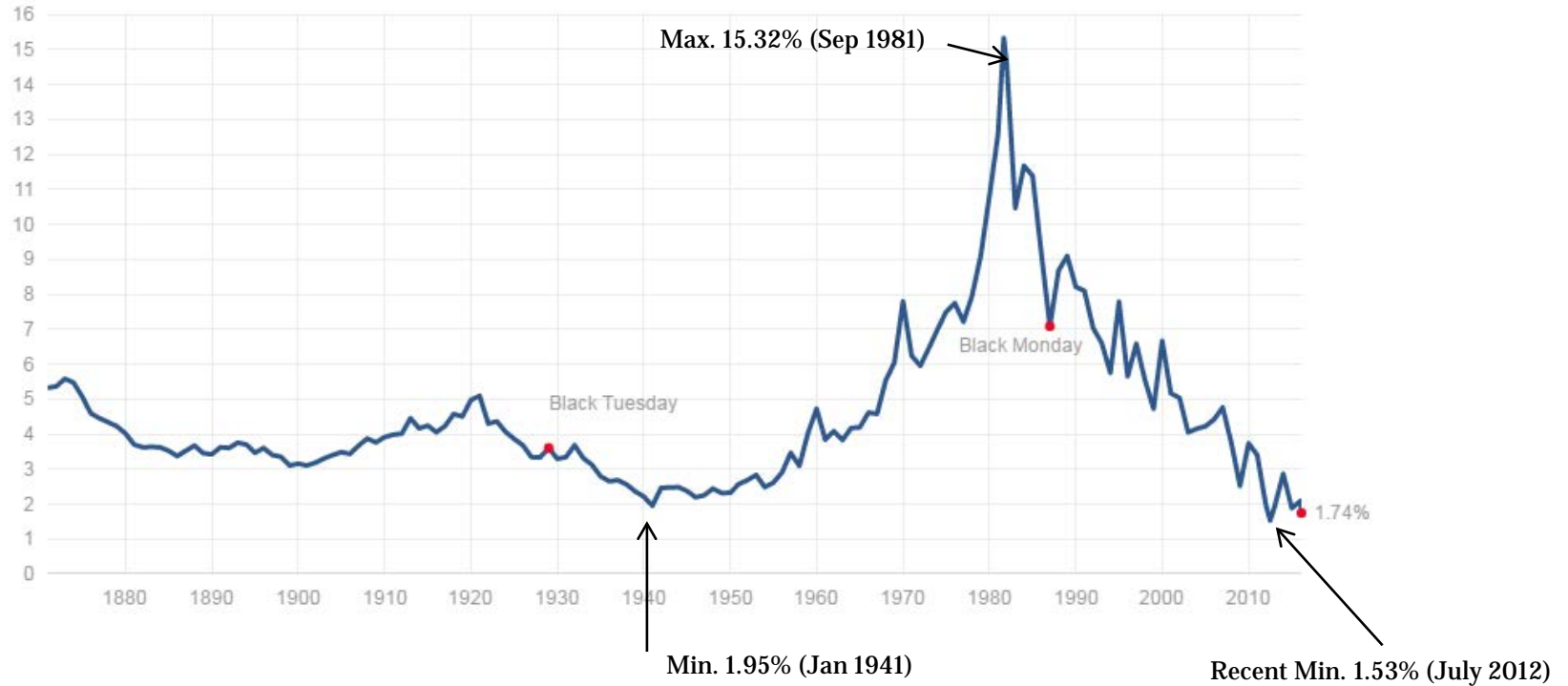
Subsequent 10-Yr Real Returns Based on S&P 500  
P/E Ratios from 1871 - 2012



Source: Plexus Asset Management (based on data from Prof Robert Shiller and I-Net Bridge). As at September 30, 2012. The above returns do not represent the performance of any product or security managed by Sionna or Bridgehouse and are provided for illustrative purposes only. The performance presented represents historical performance of an unmanaged index. Returns would have been lower if they were subject to management fees and trading expenses. Past performance is not an indicator of future results. The indices are unmanaged and have no fees. One cannot invest directly in an Index.

# Bond Yield Trends Tend to Last 20 Years and Symmetrical

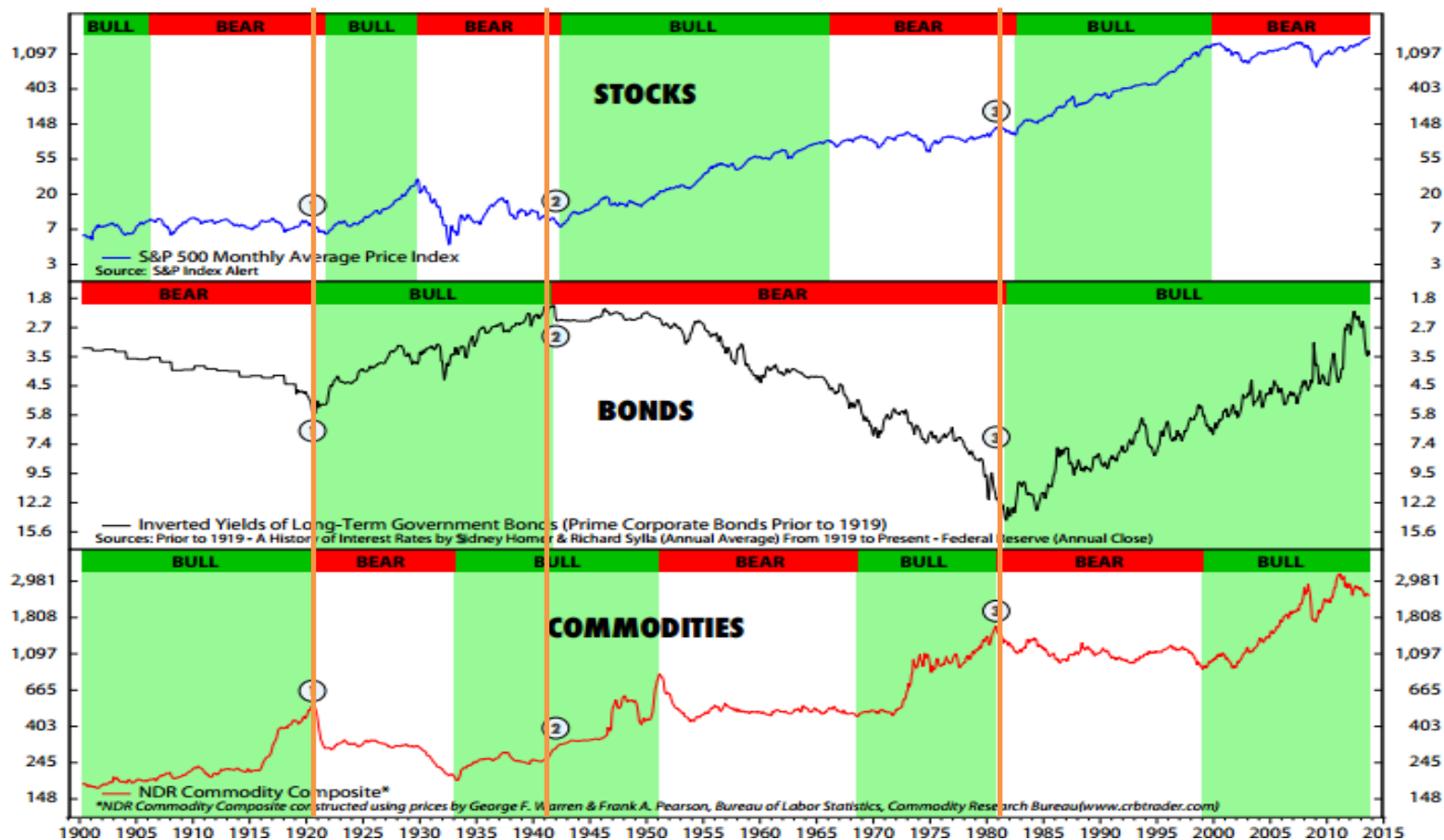
10-Year Treasury Rate  
(percent)



- Suggests rates may bottom 2021

# Interest Rate Change Will Signal Equity Bull Market

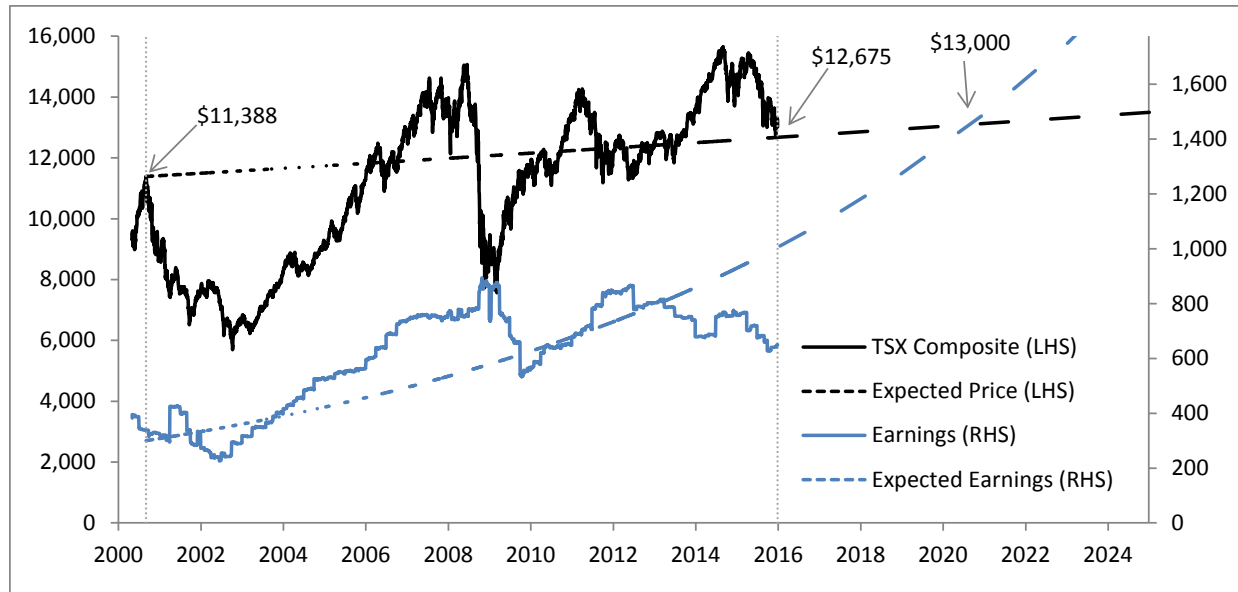
## Asset Classes & Secular Trends



Monthly Data 1900-01-31 to 2013-11-30 (Log Scale); Source: Ned Davis Research Group, December 2013. Indices are unmanaged and cannot be directly invested into.

# Are We There Yet?

If earnings growth continues at same pace since 2000,  
P/E will fall to 9x in 2021

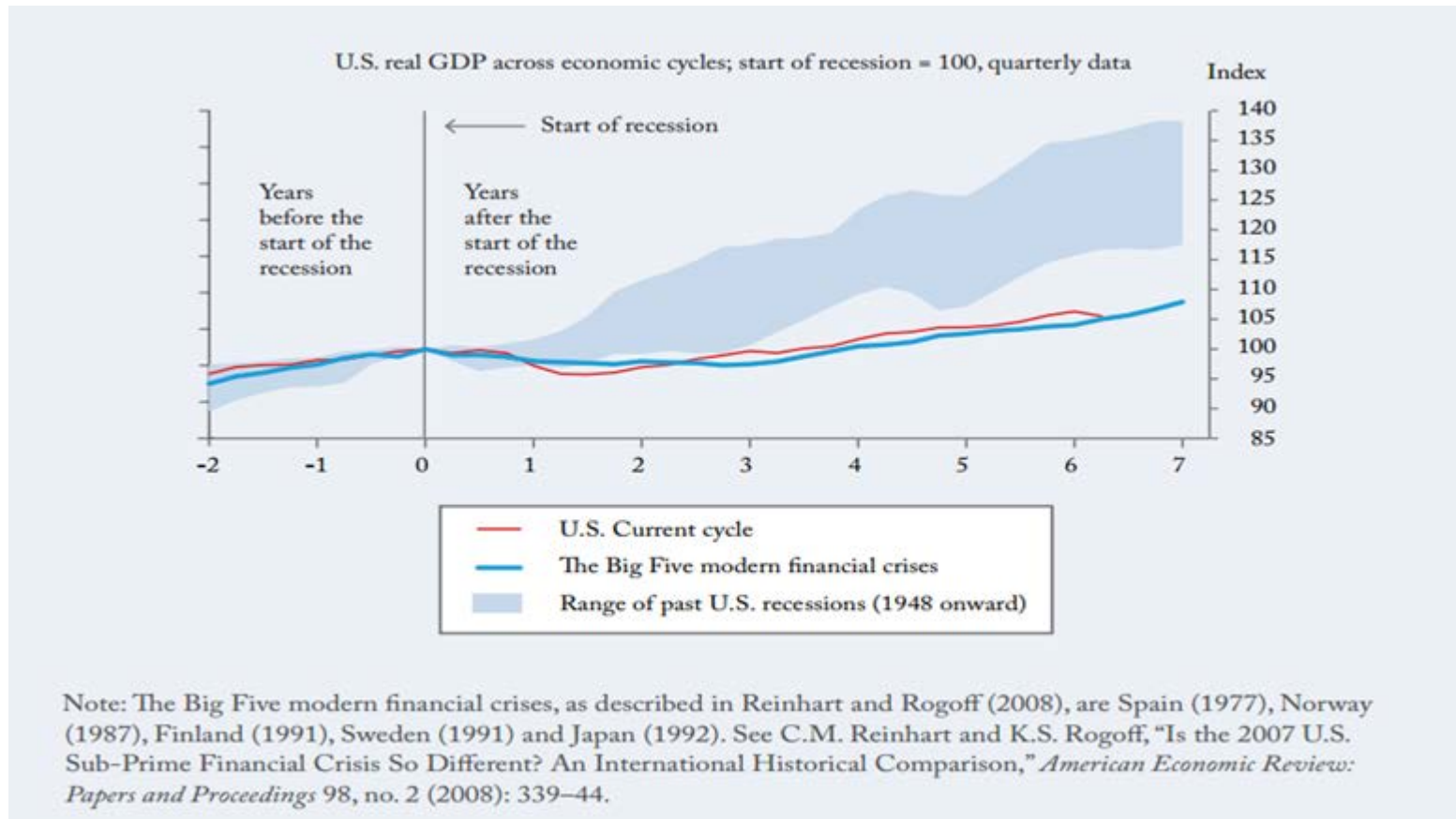


Price and Earnings levels of the S&P TSX Composite Index

Source: Bloomberg

# U.S. Weak Recovery Follows Path of “Big 5 Modern Financial Crises”

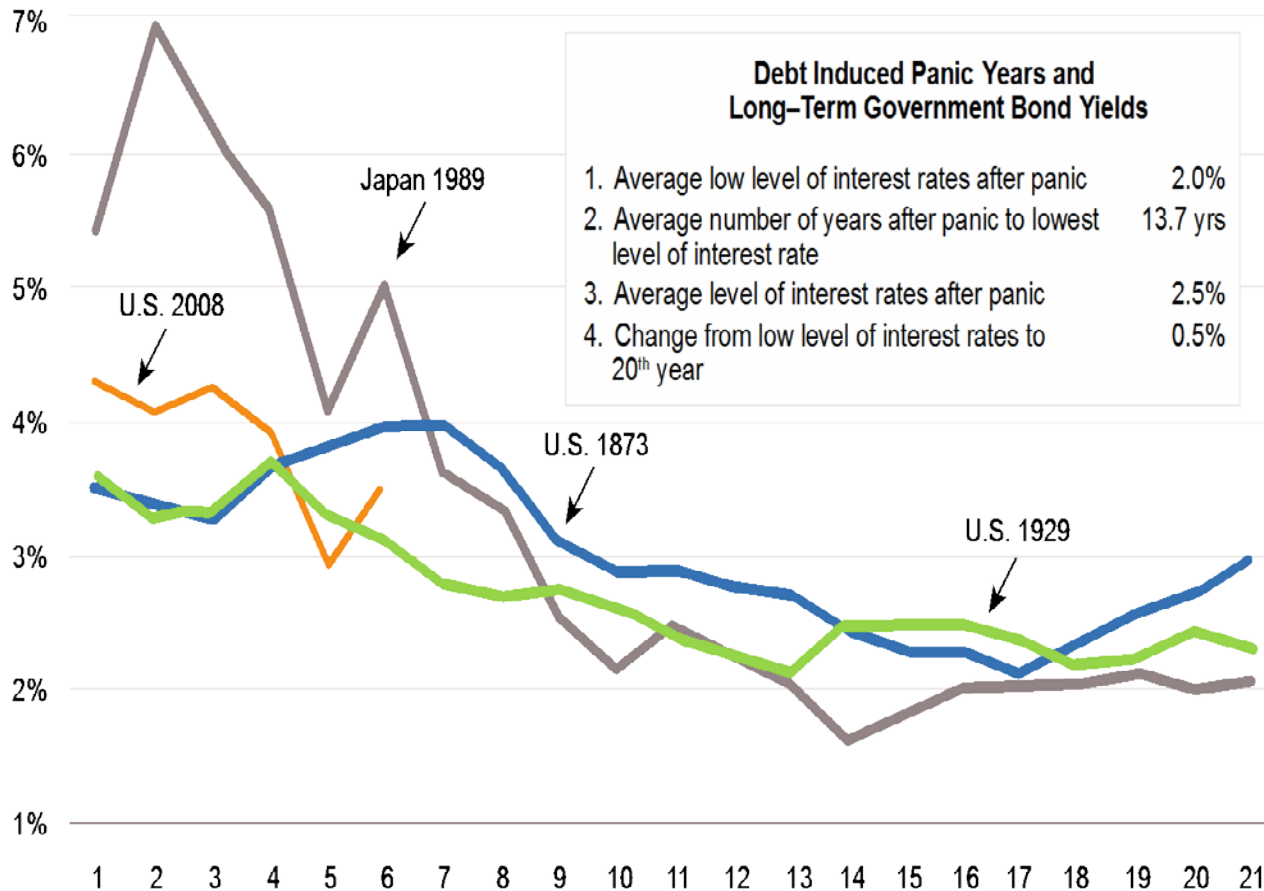
## The Slow Pace of the U.S. Recovery



- Suggests That Economy and Bond Yields Will Rise After 2018

Source: C.D. Howe Institute, Commentary No. 413, July 2014; U.S. Bureau of Economic Analysis, Organisation for Economic Co-operation and Development, and Bank of Canada. This chart updates one which originally appeared as Chart 7 in Bank of Canada, *Money Policy Report*, July 2012.

# Excessive Debt Leads to Extended Periods of Low Interest Rates



## After excessive debt panic years:

- Reduces GDP Growth, slows inflation and lowers long term interest rates
- Suggests low in bond yield could be 2021

Source: Federal Reserve Board, Homer & Sylla. Bank of Japan. U.S. line through 2012

# Best Guess Based on History is Yields Bottom and Equities Enter Bull Around 2018-2021

- Current earnings growth trend suggests single digit P/E of 9 by 2021
- 2 standard deviation event symmetry suggests after an 18 year bull market, will get an 18 year sideways market... thus sideways will end 2018
- Bond market symmetry suggests 40 years.  $1981 + 40 = 2021$
- Reinhart and Rogoff – after major financial crises it takes 10 + years for economy to recover and return to normal.  $2008 + 10 = 2018$
- Rates bottom on average 13.7 years after major financial crisis  
 $2008 + 13 = 2021$

# Lessons From Sideways Markets

- Equity returns modest, expect 4 – 6% average return.
- Ends when equity P/E multiples fall to single digits a second time (fell below P/E of 10 in March 2009).
- Ends after long bond yields change direction (in this case, begin to rise), likely 2018-2021.
- History suggests rates will bottom next 2-5 years, followed by equities entering a bull phase
- Current dividend yield of 3.5% a critical part of return (typically 90% of total return).
- Diversify broadly, avoid excessive risk, avoid capital loss.
- 3.5 dividend yields and almost 6% annualized returns are solid especially today with low bond yields. Better returns are ahead for equity investors.
- Time to bring equity allocations back to normal levels.

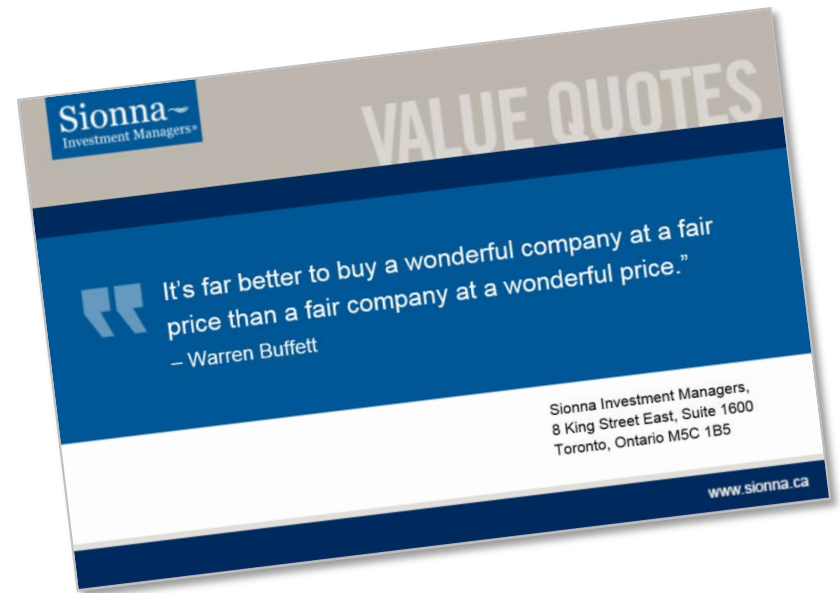


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