

Finding Value in an Expensive Market



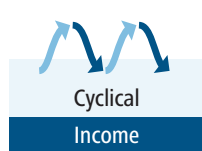
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Key Takeaways: Three great reasons to own a Mackenzie Cundill fund

1. The dispersion between the performance of growth and value is at its highest level in years while value is at its lowest. Trends do not continue forever but the key is to know the catalyst that could alter that trend.
2. Historically, value has had a high correlation to rising interest rates. We think inflation numbers will surprise to the upside, pushing long bond yields up. Higher rates could snap the growth outperformance over value.
3. The Mackenzie Cundill Value Fund is trading at a 40% discount on price-to-book value to the MSCI World index.

Stock markets are expensive, so goes the common refrain from the media and market pundits. If you also fear that markets are expensive and want to know where to find undervalued stocks, this paper identifies three key approaches used by the Mackenzie Cundill Team. The team is unearthing plenty of unloved, unrecognized value stocks with investment catalysts that are expected to drive share prices toward their intrinsic value (what we think they are truly worth) over three to five years. Sometimes, the time horizon is even shorter.

We are finding opportunities in what we call the “3Cs of Value”: Cyclical, Compounders and Cigar butts.

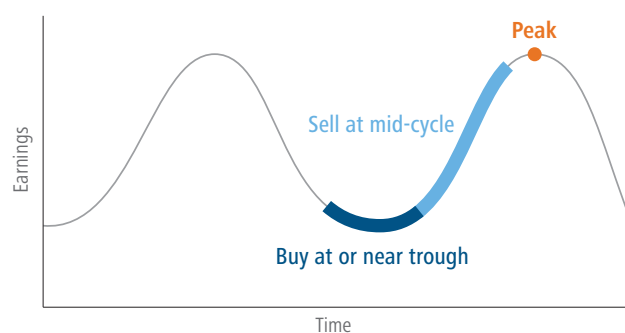


Cyclical

The first ‘C’ of value is in cyclical stocks such as energy, industrials, materials and financial services companies. We aim to buy cyclical companies at trough valuations and sell them at mid-cycle earnings. Often, we sell them to growth managers, who will try to hold these stocks before they surpass their peak and head back to another trough.

Barclays, a UK-domiciled bank, is an example of a cyclical that the Mackenzie Cundill Team owns. Barclays has a quality franchise in UK retail banking, credit cards and payment processing which earns exceptionally high returns, but currently that franchise is masked by a cyclically-challenged investment banking operation. The lower British Pound and uncertainty over Brexit gave us an opportunity to acquire Barclays shares with significant upside. The Bank’s capital position and balance sheet are strong and new management is focused on improving returns on the investment banking business. We are also optimistic about improvements in their dividend policy going forward.

Earnings cycle for cyclical stocks





Compounders

Compounders are the second “C” of value and these are stocks where we focus on cash flow. These companies could be in business transformation and are able to grow their intrinsic value while undergoing this transformation. A great example is Novartis, a Swiss-based company that is a leading branded and generic pharmaceutical company with an eye care business (Alcon) that the company is enhancing. We believe that the market is paying nothing for Novartis’ pipeline of drugs which, in our opinion, provides us a huge margin of safety given that Novartis is one of the most productive pharmaceutical companies at converting Research and Development dollars into commercial products.



Cigar butts

The third “C” of value is what we refer to as cigar butts, a phrase coined by the great father of value investing, Benjamin Graham. “Cigar butts” are discards but often have a “free” puff left in them. These are companies which, for example, could realize substantially higher value than the public market ascribes them, if they were “hypothetically” liquidated. We think a classic example of this is the Hudson’s Bay Company, which has strong real estate asset values that we believe are worth significantly more than the market value of the whole company.

Conclusion

Amid the noise about current market valuations, the “3Cs of Value” can reveal unrecognized value stocks with investment catalysts, providing opportunities for the Mackenzie Cundill Team to capture the upside as share prices move toward their intrinsic values, what we think they are truly worth.

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