Mackenzie Portfolios Re-Constructed PM Event Summary

Value Investing

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Value investing can outperform for long periods of time. After years of growth outperforming, we believe we are starting to go back to what is normal for the investment environment when there is a cost to capital to take into consideration, which means that valuation does matter. That's why a value strategy will do well.

The macro backdrop is changing as we see higher rates due to structurally high inflation. Higher rates and higher inflation historically are tailwinds for the value strategy and headwinds for growth. Structural inflation is due to years of underinvestment in some very important inputs in industrial processes. Raw materials and energy resources are structurally short in incremental supply, so for the long run in the next cycle, we think that they will form the basis of structural inflation as demand continues to be there as we transition into the new energy environment. The labor force really changed during the pandemic, and we have a structural deficit in the supply of labour for years to come. Therefore, tight labour markets are also part of structural inflation, which we believe will last for several years.

Value stocks are currently delivering much higher growth than-growth stocks. The main reason is that many growth stocks, in various segments such as media and hyper-growth internet, were front-loaded –that is, a lot of earnings were pulled forward from future years during the pandemic when people were locked down and forced to consume digitally. Meanwhile, value stocks are now benefiting from re-opening and inflation, and you will see an acceleration in their earnings growth. The Mackenzie Cundill Value Fund is currently positioned for higher growth rates in earnings than the benchmark over the next three to five years. That is a very great time to buy value because you are paying lower valuations for higher earnings.

Investment philosophy and strategy

We define value stocks as those that are out of favour and that have suffered significant price declines. We look for stocks trading at low multiples that can rerate to much higher multiples. We look for stocks that are laggards in their sector to become leaders again.

We are looking for bargains, stocks that trade at lower valuations than the market. However, being cheap is not enough. We identify drivers and catalysts that will rerate and improve the valuation of stocks that we own. That is how we define value, and we want to capture the upside alpha of buying bargains that will rerate upwards.

Margin of safety

We put value in three different buckets: deep value, cyclical value and quality value. Depending on the type of value, we look for different margins of safety – this is a core tenant of value investing. The way we approach margin of safety is incorporating the risk in the business. The riskier the business is, the bigger the margin of safety we need. We look at the business' overall quality, financial factors and ESG factors which all get reflected into the margin of safety.

For deep value stocks, we require them to trade at a significant discount to fair value because they tend to be in restructuring, they are in transition, or they have to reinvest in the business to cut costs. Cyclical value stocks tend to be leaders in the industry, and they get very cheap during downturns in their sectors or the economy, so we also demand a fairly healthy margin of safety to own them. Quality value stocks are businesses that tend to be more resilient. They produce steady cash flows and have good balance sheets. We will buy them when they follow out of favour, and when their valuation is low. Because of the high quality of these businesses, we demand less margin of safety.

Investing over the market cycle
The economic cycle is a key determinant to positioning across the value spectrum. We find that different types of value perform differently in the economic cycle. When the economy is emerging from recession, cyclical value, with its economic sensitivity, tends to do very well. During the middle of the economic cycle, risk appetite is healthy and market sentiment is positive, and that's a great time to buy deep value stocks which are very cheap with a lot of upsides. Then as we approach the end of the cycle, as the market becomes worried about recession, a slowdown, or maybe an inventory correction, quality value stocks provide downside support. They provide the non-cyclical growth and resilience that we want. As we roll into the new cycle, you will see the fund shifting back into the cyclical stocks. We believe that by managing the portions of the portfolio in these different buckets of value, we smooth out our clients' experience in value.

Here are some examples:

1. **Deep value: SNC Lavalin**
   They exited their loss-making construction business and are now focused on engineering services. The engineering business is growing and trades cheaply.

2. **Cyclical value: Daimler Trucks**
   This company is the global leader in truck manufacturing, in electric and autonomous trucks development. Daimler Trucks has a strong balance sheet, pays a good dividend and it trades at a very cheap multiple.

3. **Quality value: Dollar Tree**
   The company is resilient against e-commerce due to the low price point for their products. It did very well during the last recession. It's a laggard relative to Dollar General and Dollarama.

Investment themes
Themes we like are **reopening trades**, with consumers returning to normal life and old habits and b**usiness transformation**, like Dollar Tree and SNC Lavalin. Anyone that has filled up their cars lately can understand our interest in the **energy majors**. They have strong cash flow, have very good balance sheets and pay out dividends. **Inflation and interest rates** is another theme that we are focusing on, and we believe that banks and credit companies could do well as consumers remain strong and willing to spend. The final theme is **electric vehicles.** The traditional automakers we own are already producing EVs and are planning to phase out internal combustion engine vehicles at some point in the future.

Closing
At Mackenzie, we've always understood the value of diversification by geography, asset class and investment style. The economy has recalibrated and with that change comes opportunity to take advantage of greater style diversification. After years of growth outperforming, many investors have little exposure to value. The opportunity is for us to adapt, and we think this is the right time for value investing.