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Kim Shannon is the Founder and Co-Chief Investment Officer of Sionna Investment Managers in Toronto, Ontario, Canada. Kim spoke with the editors of the Ben Graham Centre's Newsletter about her experience being a value investor.

To start, we would love to hear about your background and what led you to being a value investor today.

I didn't start off in business. I think that's common in the generation I came up from, going into business or investing was not in the cards particularly. I started off in science, but I was an avid volunteer and got involved in student politics and initiated a number of organizations on campus and I loved that. It was saying, *"Gee, I'd like to do more (of what I called) 'organizing'",* and I had an epiphany moment when a friend of mine said, *"You know, that's business"*. I had never thought about business being that. To me, when I realized that business was about making things happen with other people, that's eternally fascinating. You can keep that going a whole career. People get stalled out in their career. They get it, they master it, and it gets dull. Unless you can take a kaleidoscope out and try and see the world through fresh eyes, how do you keep your enthusiasm and passion in the field? The market is tough to master, so it created that for me. But I still have to take out a kaleidoscope once in a while, to just keep various practices that you do as a value manager fresh and alive.

On that journey, I looked around for a job and started working for a small trucking fleet insurance company. I was rolling T-bills back in '83 when they were 13% overnight. You can imagine in that kind of era nobody is moving into equities, nor is it of interest to anyone, because if you can get 13% overnight, why play? Because equities in the long run will get you 9.5 - 10.5% total return. So, guaranteed 13, but risking 9.5? Probably not.

But I did start moving in the equity circle, but what was interesting, was the dearth of people that had joined it. And there was a lot of aging people in it. So, sometimes by accident, by falling into a stale field, a dull field, not the hip field… because a lot of people chase the hip field and get there too late when the ride's over. That might be happening for tech people today. It certainly happens to anybody interested in crypto right now. But to go into like an emerging field or a field that's curved down. And I think that right now from a student perspective, that entering value could be that same thing.

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We've just gone through the deepest, longest period of underperformance for value in financial market history of a century of data, and we're just coming out of that. And assets in value have shrunk dramatically. So, there's a lot of room for them to grow. It could be like a starter position in a field where no one really wanted to go for a while. It was opportunistic for me from that perspective and I moved from job to job, just enhancing my skills and taking more courses, such as the CFA and an MBA part-time at Rotman, and I found out I had a talent for stock picking. I was fortunate, I worked under a value manager, John de Tomaso, who was the founder of Burgundy Asset Management, and I learned so much from him.

Then I became Chief Investment Officer at Merrill Lynch. I ran a mutual fund, growing it from nothing to 40 million to the largest Canadian equity mutual fund in Canada at about 9 billion in total. CI mutual funds was my client at the time when I started my firm, and we built the assets a lot but they got a little bit greedy on the fees. Hence, I parted ways with them and started over, and my assets went from 9 billion down to 900 million, then we built it up to 5 billion and now we're at 2 billion. So we had the shrinkage recently that is fairly similar to our peers all around North America in value; hoping, especially with good numbers recently, to improve it. In the last year, having stayed with value, we were in the top percentile. All our funds outperform the benchmark by 9% to 19%. So it was a really good year and year to date, we've been outperforming a couple percent already and it's been more growthy too. Value is in our opinion back and we think it's going to be here for a good decade.

So that's the background of my career. Sionna is now 20 years old. And lots of volunteerism all through that, which I think has been very helpful to my career. It's also been helpful to sit on both sides of the table. I present to pension committees, and I sit on pension committees. It's very insightful to be on the other side of the table hiring managers, it gives you incredible insight to how to do your job. If you get that chance, go do it. It's easier to do it with smaller investment funds or small charities with investment funds since they take who they can get. Almost any investment committee needs one investment professional on that committee, otherwise they sometimes will go off kilter in terms of decision making.

It's also about networking, because especially as an entrepreneur you've got to be a rainmaker. I didn't learn that terminology until much later in my career, but I was doing it. I didn't know I was doing it, nor didn't know how to name it, but networking is doing volunteerism and knowing the street, befriending the street, knowing the players on the street, who they are, how they're functioning, being a known commodity. One thing in life is to be a "yes person". Say yes, find the time, and go out there and network.

Digging deeper into networking, throughout your career you met a lot of professionals and individuals in this space, did any individuals serve to you as a mentor?

I do believe you do have to learn from a professional. My first job at a trucking fleet specialist I started by rolling T-bills, then they started saying, why don't you play with some equities? I didn't know what I was doing. I took a course and I was very cautious, and I didn't lose money because I was very scared, but I quickly realized I needed to work in a real investment department. I applied around and I was fortunate enough to get a job at Royal and Sun Alliance, staying there for a decade. That's when I started working under John Di Tomnaso and Allen Westbrook. John was a philosophy major who absolutely believed in deep cigarbutt value and liked to buy a lot of small cap beaten up ugly companies, but he avoided financial risk. I learned a lot working beside John in investing for over five years. Then when he left, I was able to win the role. It was a big struggle because you've previously had a 45-year-old talented pro leaving and then a 33-year-old young woman, and in that era, a woman? Wow! They looked high and low and interviewed elsewhere before they gave me the job. But I learned value from John, and I remember him saying that stocks revert to their mean. Given I was a science major, I asked him how he knew, because they did! Later on, I was really excited when I read Andrew Smither's book and he had the data that said so. Smither did this long term longitudinal study and found that 90% of stocks reverted over five years. I was like, okay, I've got my data point. But sitting beside John, I remember that I thought I was so unlucky - I've got the worst boss to learn value investing from. You think these things because you don't really know. You sit beside this guy and he's buying all these weirdball stocks and he's so confident about what he's doing. And over two years, I watched these cigarbutt, broken, ugly little stocks flip and shoot up. After two or three years of watching this happen, you can't help but be a believer. It was inoculated in my system, the method. The core of my method is John. I talk about John a lot and I still keep in touch with him. He is semi-retired, of course you never retire as you always manage your own investment portfolio, so we're always talking stocks.

John had so many valuable insights to teach me on investing that have stood the test of time. But eventually I found that I changed. I learned some different things and I'm modified around the edges to minimize risk. Playing a super deep value game means you can be really far offside the market from time to time and a lot of clients don't like it at all and can't stomach it. So I'm modified from deep value to relative value, which I felt that clients could live with a lot easier as the amplitude of over and underperformance isn't quite as great so clients aren't as stressed and you don't go down as low in a cyclical market where they feel like you've lost your mojo. And that's where you have to be a bit of a storyteller, and a bit of a rainmaker - how to hold clients when the numbers are weak. A lot of people will come into investment management and think that they're really excited about being here and they want to pick stocks because buying is so fun. But holding clients' hands, presenting bad numbers - which inevitably you will be doing - they say that they don't want to do it, they want to avoid it like the plague. You can't avoid it. You go in and you feel terrible, but sometimes the committee has to just take a hunk out of your flesh as they're feeling angry too. They're going to ask you some tough questions and they're going to ride you. You must learn that it's a game and play the game and make it a game. But not everybody can deal with that, especially recently, I think that's why you saw several people leave the industry. It was tough to defend bad numbers for a long period of time. Then you kept saying, it's so long, we're going to be out of it soon, but then we weren't out of it. Then clients were finding it harder and harder to believe unless they absolutely believed in value themselves already.

“ The investment approach: businesspeople buying businesses. What we are trying to do is to go out and find a business that will look materially different in the future than it does today, where we are not being asked to pay for that growth today ”

Being in business school, a lot of us are interested in entrepreneurship, so we would like to know what prompted you to start Sionna? And what was the motivation to start your own business vis-a-vis working for another firm?

I'd moved around a little bit in my industry. I'd had to move rapidly, but I had moved around and after leaving Royal where I was head of equities, I went to AMI Partners. I took a low-level job, I campaigned for a mutual fund and got it, then they made me head of equities within nine months and helped turn that ship around. I've got a lot of job offers to clean up broken asset management firms. I thought I did that once and found it hard, not trying to do it again. Then had a chance to go and build an asset management firm at Merrill with Victor Dodic. I jumped for that and I thought that would be fun with a big global firm Merrill Lynch backing me to start and launch an asset management firm, which we did.

In three years, we'd raised $3 billion. With AMI partners, we also did turn around. You can't always in the short term find success, but in the longer term you've got to show success to get opportunities. Then Merrill left Canada and I didn't want to work for a big bank in their investment department because they don't really want enormously talented people. They want clients coming in the door because it says the bank's name, not because people think that you're really good at doing something. Then my biggest client got sold at the same time, Spectrum United, which had followed me to Merrill I had taken over their fund. I said I'd campaigned for a mutual fund, and I knew that was just up my alley. I had done a good job and helped to grow that asset. When I went to Merrill, it followed me. I wasn't allowed to haul it out my former employer. Then Spectrum United were sold to CI mutual funds and then CI phoned me up and said that they've liked to have a deal with me and not with CIBC. We negotiated for about five months, and I waited for the fat pitch because I had other opportunities. I had firms come up to me and then me to start my own firm. I felt that I wasn't going to do it unless I'm inspired myself. I first started negotiating with CIBC to split out and then start a firm.

I had a contract with them and it fell apart. At that point I had the taste for it. When the contract fell, I was disappointed but still staying. Then when my client got sold, I had the opportunity to start Sionna and jumped at it. But I also said to CI that I didn't have quite enough assets to manage, given the low fee I gave them, to run the business properly. I told them that they had to help me find out other assets. They fired another manager and gave me more assets, so I had enough to build the business and provide the service they wanted. Then we grew it dramatically. That's how it started but I did write an article once for the CFA Institute called Waiting for the Fat Pitch.

Where you've had a major client, making it a lot easier. I've witnessed a lot of people try and start asset management firms and it doesn't always work because they sit there hungry. You've got to build a four year, maybe you'll get some people to give you institutional money after three years. You must build a franchise first. For example, I've built a franchise first and was well-known commodity in the mutual fund world and won mutual fund manager of the year and had top numbers. It's a franchise when people are willing to give you money, so that's a fat pitch. Then when somebody comes along and says, I'm going to help you get up and running, having a key client that covers your basic upfront costs so you're not overly focused on that.

The other thing I'm going to tell you which I always suggest to anybody who wants to go into the investment management world is to manage their whole career. Part of that whole career management is to save and invest. Your clients are investors and you've got to be an investor. You must know that in order to give the best level of client service you must understand what it's like to be a client. What it's like to have your own investment portfolio and how to manage it and look after it. The only ways are to get really good at saving and really good at managing it, so that you understand that client and it also buys you freedom.

One of my favorite books where I hate the investment advice is Rich Dad Poor Dad. The authour talks about how to squeeze your life down, not living in a big house and driving in a fancy car unless the income coming off your investment portfolio can finance your lease. In fact, I'd say don't do that and buy the car. But even in investment management it's a risky job. When you're underperforming for a little while it's not uncommon for a lot of PMs to think they're about to get fired. Certainly you might have the odd client leaving and your bosses might not be happy with you. You need to have financial freedom because there's so much pressure mentally looking after your clients. You need to not have personal financial pressure. You should not have loans.

As soon as I got mortgage free, I never had another mortgage. Just keep yourself away from financial conflict. And that's the only way you can be an entrepreneur as you can't ask other people to put money in solely for just putting yourself in. You got to have skin in the game and convince the client that you're also risking something. I had golden handcuffs at Merrill and then at CIBC that I've walked away from to start my business.

It's about not only understanding your customer, but being that investor as you mentioned. Having the flavor for what gives you that ick of when to invest and when to not invest, that makes you great entrepreneur too.

When you were waiting for the big pitch, did you feel like there was any time before where you felt confident that you could be starting your own fund when you were already leading groups? Or was it just about the moment where you got that good opportunity where you took the plunge?

After the opportunity with CIBC fell through, I was still working at the job but looking for an exit strategy. I was looking, planning, strategizing, chatting carefully with other people until the big opportunity came in the door.

You've had such a long career in the investment industry, so has your investment process changed over time in terms of your approach to investing. Are there any key moments in your career that served as a major learning experience?

There was many of them and the investment process had always evolved. You're always testing and that's part of the kaleidoscope, keeping it fresh, alive, and knowledgeable. In order to scale up you must work with a team, and they come with a different knowledge base or interest level. They're reading lots of academic stuff and want apply some new techniques but it's important to say what's the central golden rule or thought process through it all and what's the core of the product. Although you excite yourself by looking elsewhere, you only bring in that which fits in with what you're already doing and enhances it. But if says that they've got this new shiny way to pick stocks, you must remind yourself that you've got a method here that stood the test of time and be willing to enhance it.

However, there's a lot of things about the process that have changed just because of technological enhancement. I started investing in 1983 before there were computers on desks. I remember part of my job was phoning publicly listed firms to ask them to mail annual reports so I could analyze them. If I wanted to do research, I went through the financial postcard deck. So now when there's so much information you have access to, it's incredible.

But there's positives and negatives to technology. There was something really exciting about pulling open a simpler financial statement and looking for the discrepancies. Because the dislocations, the weird stuff that didn't make sense, taught you so much. You can still do that today, but people tend not to because they got FactSet. They can have the software to do all the math. If I wanted to get analytical into the company, I would just sit there and go through the manual calculations. When you don't get out your calculator and calculate it yourself, it's not as real somehow.

Nevertheless, there's a lot of change because of the access to data. But from the beginning, John was technologically minded. We start with a quantitative model with all the stocks listed on it and ranks them according to cheapness. We'll test columns regularly to see if they're useful tools in terms of that quick, fast look at a company. Testing if it's truly cheap or is there a lot of financial risk? You're skimming through the cheap with low expected returns. So the process does evolve. The questionnaire template evolves.

We try and add disciplines to the process. Starting off quantitatively as one of the major tools, but 70% of our stocks are priced directly off the model. Not all stocks work or can be truly valued well off of it, but most will filter through fairly well. Other companies are identified through NAV or priced to cash flows more heavily. I also find that sometimes you go out to lots of management meetings and you fall in love with a company. You sometimes witness it's an expensive stock today but love that management team and business model, wondering if it'll ever get cheap. It's amazing how often in two years it gets down to your price and then you are jumping to get at it.

In terms of my key moments, it was discovering relative value from a client. I've learned so much from clients as they'll ask me tough questions. I love when I get stumped because when it happens it's an area that I don't know the answer to but I want to know the answer. I used to say I was a value manager and a sailor who read the sea. For example, if forest products were super cheap, I'd paw around the forest products by the cheap names and overweight the sector. However, I did notice this trend in our performance where we got strong scores for stock selection but gave up some of the performance to sector weights.

Using pure value isn't good for sector timing is they stay cheap for a long time. I had a client who was fighting with me. The client asks me why I bother even choosing a sector weight given that this is happening? They suggested that if I neutralized my sector weight and performance purely from stock selection, we'd have a better result with less risk.

The discussion with that American investor, who were one of the biggest pension funds in the world, made me realize that they've just gave me a gift. They told me how to get better returns with less risk. I went back and said the style box matrix was developed in the US, which is the deepest and broadest market in the world. You can have lots of growth stocks, values, momentum, and GARP. GARP is now just quality growth.

Quality didn't exist early on in my career, and now everybody buys quality as this new category. But most other markets are idiosyncratic and don't have as much in each sector. In Canada, because we're so cyclical, value is a bit tougher, and you would get more offside. For example, gold, for three or four times now in my 40-year career, has been over 10% of the benchmark. On the other hand, in the US, gold has never been more than 1%. Hence value managers in the US don't have to worry about gold. For a Canadian value manager, you can get your head handed to you for not owning gold, such as in 1993 or two years ago in Canada. So I said, why don't we industry group neutralize and we'll do plus or minus 5%, which is not very constraining for small sectors and enormously constraining for big sectors.

This ultimately gave us better returns and less risk. We've stuck with that and think it's uniquely well placed for constrained markets like Canada, especially as cyclical markets. It probably would also apply very well in Australia. But I also think relative value could work in all markets and you could play it a little bit differently, but that was a big innovation. However, that's not all our strategies, as we have some very concentrated strategies now that don't do relative value. They just do big bets and don't care about sector weights. But for clients who want stability, we think relative value in Canada is very good.

> “If we were to stop a hundred people to ask them, “What is risk in the stock market?”, a hundred out of a hundred would say risk is volatility. But we think that definition is just plain wrong. We think the real risk is the opportunity for permanent loss of capital”

We'd love to hear about your process towards coming up with investment theses. Do you often consider macroeconomic themes?

I don't think that anybody can consistently make money having a top-down perspective. Looking back in history, if you were able to predict the economic growth perfectly, it was something like 17 different major economies over 112 years and the correlation is 17%. So that's not a lot to make money on. How many firms have been able to do that and become ginormous and successful doing asset mix? I would say the biggest would be GMO. But they go up to $120 billion and fall back.

So that's as good as you can get doing macro. I think they do it quite well and they do it from a value perspective. I do use a little of top down just because you got to engage clients and communicate with them. I also think it's good to have a sense of where the market is going. Hence, I do look at the long-term sweeps of history and how emotional human beings have interacted with financial market data.

I look at things like long-term interest rate trends and the impact on equities. For example, I believe that right now we've entered an inflationary period that will last 20 years. Oh.

Because of that I can weave a very good story on why, if you couldn't use proof, all you could say is value had a great year last year, I don't know what's happening next. However, it's a lot nicer to be able to say to clients, “value had a great year last year, and I think I can point to why. Here's my reasoning and this is why I think this is going to last for 10 years.”

So there isn't a room for some of it, but I don't think it drives our performance very much. It'll help us push the portfolios a little bit in certain directions. For example, if you're in an inflationary environment, debts going to start to get very painful; so let's start paying a lot more attention to that than you would've in a disinflationary environment. But the real numbers come out of bottom-up stock selection. And for me it's the price you pay and it's how cheap was the stock when you entered it and is it likely to go back to normal? What are the risk factors preventing it from getting back to normal? That's the game we play and you have to add a big dose of patience.

When we were leaning about Sionna we found that your team incorporates an unique intrinsic value model to find pricing disparities. A couple of measures that it relies on is book value and historical ROE. What made you choose these metrics over others?

We wanted to make it rational, so we're always looking at two years. Why two years? Because it's easy to get two years consensus earnings estimates. You can't go easily out there and get five years and the further out you go the less accurate is anyways. Then you're always hoping that the stock will do better than you think anyhow because you're being conservative. We have an average hold period of five years but some stocks we would own a lot longer than others. We're looking for normalized values going forward in the future. What's a rational way of doing that? Well, disaggregating price, as we have a stock price and we have financials. So how can we break a price out? Well you just do some interesting ratios such as earnings times a PE multiple to get back to price. I'm looking for normalized earnings per share going forward to the future, a normalized ROE, and you're trying to combine it out to get the future price but not doing a DCF model because then you have to forecast interest rates and are you getting that accurate? So I prefer to be focusing more on normalized earnings, normalized ROEs, normalized relative PE multiples, normalized market multiple levels and calculating the future earnings based on that. Then adding in a couple of dividend yields to get to total return. Then you rank the entire universe according to cheapness and you take a look at it. We've incorporated in the model a number of different columns where it shows the long-term numbers across the page from classic value ratios to financial risk. You watch how things are moving around on the chart where suddenly you're starting to see at the bottom end into an acceptable buy zone names you haven't seen in a long time that you know you like. Then it's time to pick up the research and get familiar with it for when it gets cheap enough to go into the portfolio.

> “ A lot of portfolio managers like to talk about how they bought a business for a dollar and sold it for two, but equally important in running the portfolio, you would want to diversify it by business ideas. You would want to diversify it away from obvious correlations and non-obvious correlations. ”

So I guess it's more so about keeping it simple.

People get so caught up in mathematical complex models here. By keeping it simple, you’ll understand how every number moves, everything.

But then you must do your deep fundamentals, which is the risk research questionnaire template. It makes you look at the company thoroughly. There are enormous incentives for corporations to tell a good story, they're not all doing it, but they're all kind of motivated to push it a little. There's lots of little tells of how there's such a happy accident which so often that the share option day that got chosen happens to be the lowest price day. There's lots of little tells that there's motivation to win the game and to take advantage of the game. Humans are natural gamblers. So looking at the financial statements from multiple levels to make sure that the quant model is fairly realistic about the results and then you fine tune and come up with your buy or sell recommendations.

I know you mentioned a bit about financial risk and segmenting that out, but how do you evaluate risk both quantitatively and qualitatively?

Much more so qualitatively. I used to say that I used to say there's only three major risks in companies and now I say there's five. It was cyclical, operational and financial. Now there's also ESG and disruption. So those are the big risks that you face when you enter a stock. The issue of entering a stock is on the one hand you can see that opportunity where the model is indicating its cheap. On the other hand, you also have to consider all the risks. You can scare yourself quite a lot about how this stock never going to recover based on the risks, so you have to consider how do you get off that wall between the two of them.

To me the first two risks (cyclical and operation) are beautiful risks as a decent management team can deal with both; especially if the company didn't take on too much financial risk. For cyclical risk, the cycle might also last longer and you won't know. That's why in my view as a value manager, you say, at this price, I'm willing to enter and I also believe that it can go this high and I also think it can go this low, and I'm not going to have a full position till it's down here.

Then operational risk is that you're trying something new, something different. A brand new technology that may or may not work. That can create problems for the firms or lead to write offs, creating an opportunity to buy the firm if you think the culture in the management team is good enough and they don't have financial risk. It always comes down to if the company doesn't have financial risk because financial risk is a choice that management gets to make. You can decide not to take on any financial risk, but once you do, you better make sure it's not too big for what you are. If you're cyclical, you can't have a lot of financial risk. Financial risk is what puts companies in a bankruptcy; disruption risk takes a lot longer, but it'll get you there too.

ESG can also lead to bankruptcy if it's a big claim and the company's done something dirty. But if you did enough diligence, you wouldn't have owned a company like that. I think that ESG risks are a lot about what are the potential problems that can hit you; and making assessments about them is a very important part of the risk analysis. We also do quarterly risk analysis top down on every strategy and we look at what's the overall debt burden, what are the overall characteristics of the fund and the strategy and are they living within the term sheet or the policy statements that the funds were set up in.

> "There's very little as uncomfortable in life as watching the price of something you own go down if you don't know the value of that something."

We'd love to hear about your attitude towards selling a business as well. Sionna's strategy involves gradually reducing exposure as a stock approaches intrinsic value, but how do you know when to start and finish selling, is there a timing element to that?

There's an art and a science to it as well. When we enter a stock, we have a proposed ideal exit point, where hopefully over time, the stock gets to your expected sell point. But if you redo the calculation, hopefully the sell point is now higher, that's the ideal situation; and then you don't sell because there's a bigger future. The other one is that the stock gets there, and you start trimming at intrinsic value and higher because you have to make that judgment call on whether you think if the risks are very high, then you take it out at its intrinsic value. If the risks are moderate and its cyclical and the markets kind of going, you can kind of play it out.

The best is when the universe unfolded the way you wanted it to, and you get a great return off of the stock. The worst is when you miss something, and you start to realize you've made a mistake. The company might suddenly take on too much debt or risk burden of the firm goes a lot higher. Part of the question ask yourself is if you started with a fresh new portfolio today, would you own that stock? If the answer is no, the answer is sell. But there's a lot of switching that goes on where a name still has more upside, but another name in the same sector looks even more attractive. So you switch to the bigger future. With some stocks you might wonder why you didn't wait for more upside; but it's because this other opportunity had more: it had less risk, better characteristics, and helped the portfolio overall look like a cheap stock. Keep in mind that your portfolio will never have the characteristics of the cheapest stocks you buy because it's like running a wine cellar: you buy some wines that are better to be drank 30 years from now. So you put them in the cellar and you don't touch them for a long time. And then there's others that have been in the cellar for 30 years and it's time for them to come out and you're constantly rotating. So that's why the average characteristic in your fund is never as good as the characteristics at which you buy or as horrible as the characteristics of when you're selling.

You mentioned in your career there were some leadership opportunities where during your time it was hard for you to get those opportunities as a woman; but since then you've made lot of progress in the industry. Do you have any suggestions to furthering the significant progress in both attracting and retaining women in the industry and specifically in value investing?

I think one of the most important criteria that I find most managers really respond well to is if you get two identical candidates, and they've gotten everything so far and they all have the same education level. The managers will want to make a new criteria to differentiate between the two to be fair. But the managers themselves don't realize that they're men, so they're going to put up a criteria that may be sexist but aren't intentionally doing. So they're going sit there and want to come up with another test. However, I ask them how hard it was for the male candidate to be sitting in front of them vs. the female candidate. Whether they can imagine for her to be sitting there in this industry at that moment in time, she's tougher, she works harder, and she's better.