FROM THE DESK OF

Ian Hardacre , MBA, CFA

SVP and Chief Investment Officer, Empire Life

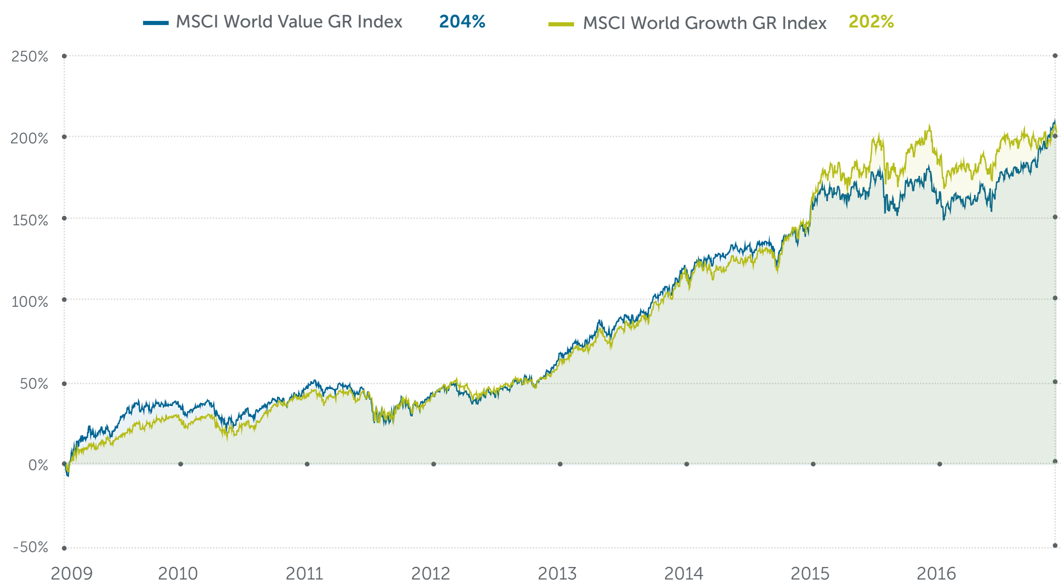
Chief Investment Officer, Empire Life Investments Inc.

STAYING DISCIPLINED

August 9, 2019

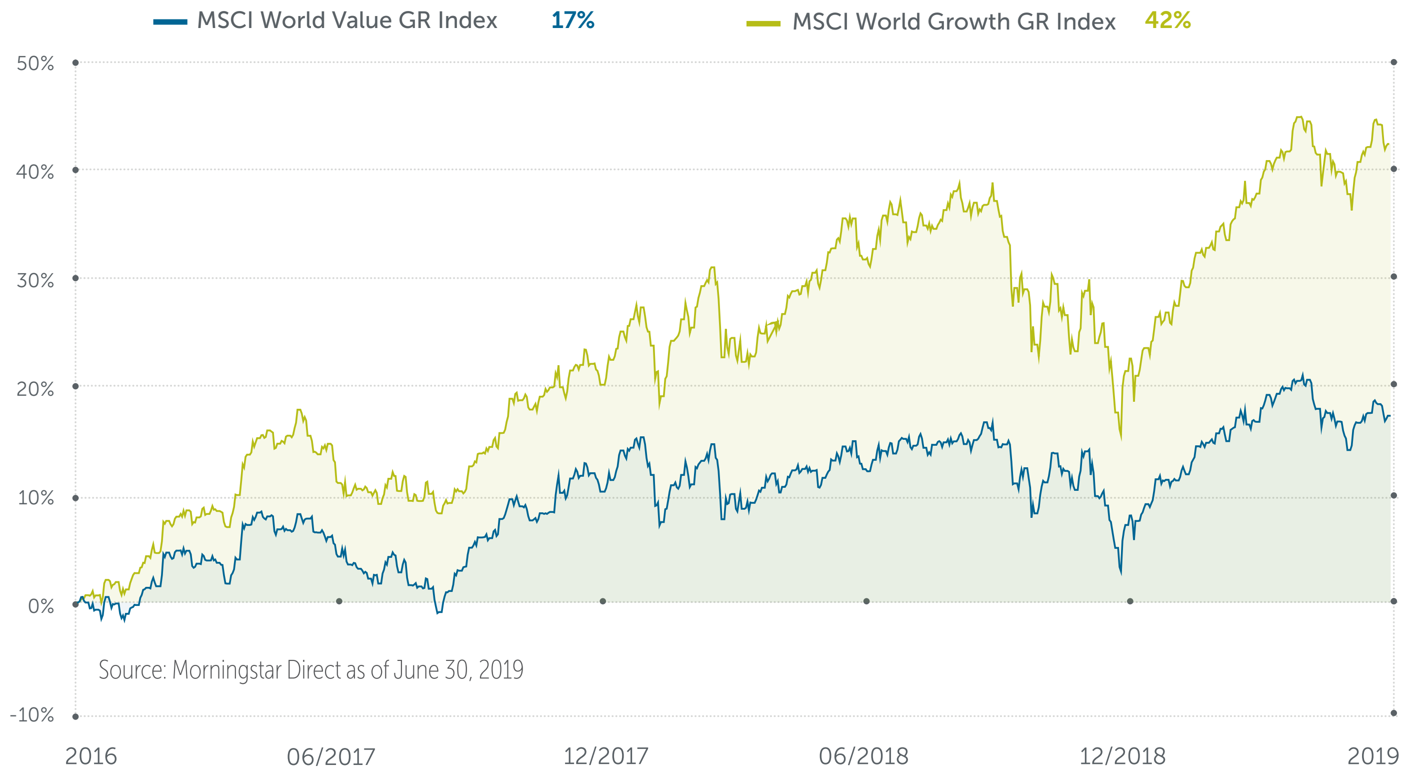
Often one of the hardest activities as an investor is to be patient and disciplined when one's investment style has temporarily gone out of favour. Remaining patient with a keen eye on long term objectives is essential through all market cycles. At the current time a value oriented investment style like we practice at Empire, is out of favour. However, as we explain below value has won the majority of the time.

In the seven years following the financial crisis (February 2009 to December 2016), both the MSCI World Value and Growth Gross Return Indices posted almost identical cumulative returns[1]:



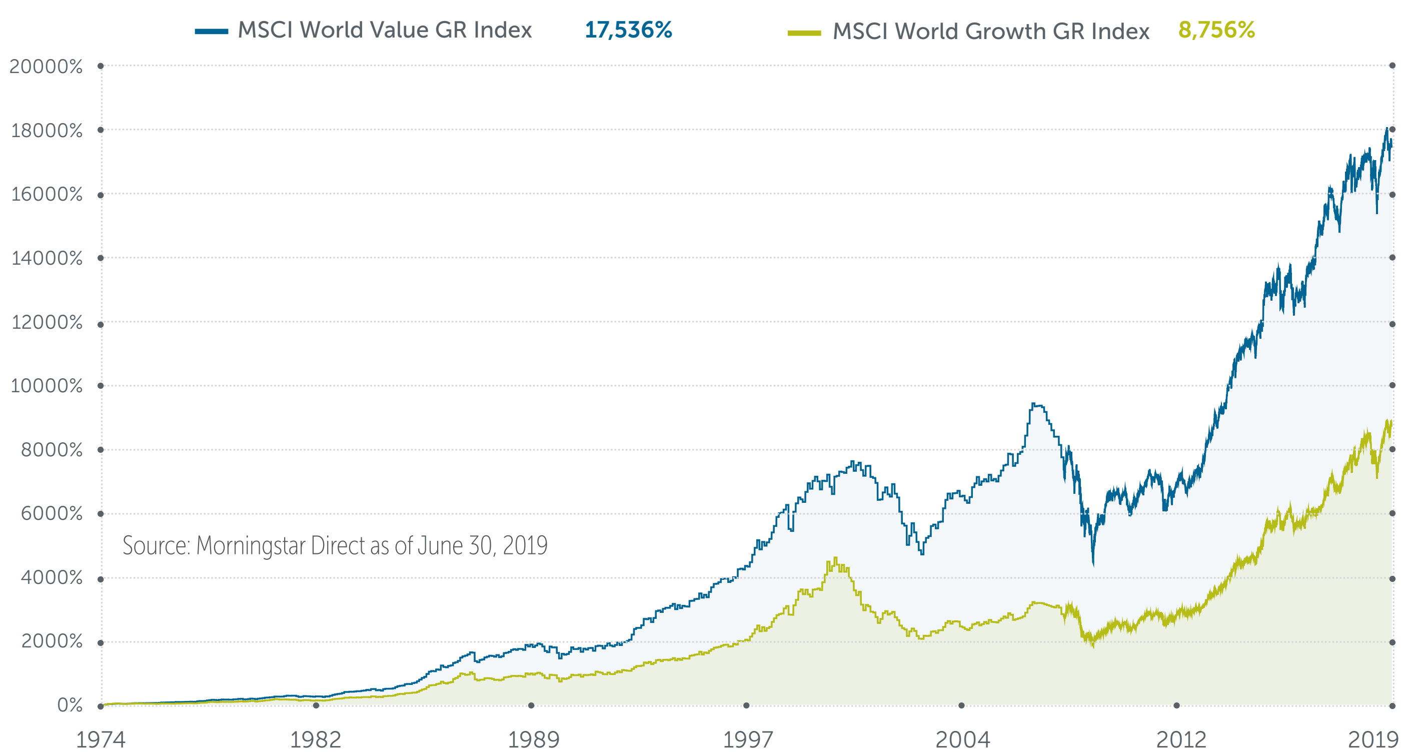
Source: Morningstar Direct as of Dec.31, 2016

Since then, (December 2016 – June 2019), the MSCI Growth Index generated a total return of 42%, more than doubling the return of 17% for the MSCI World Value Index. Value has taken a further leg down so far this year, underperforming growth by almost 8% in the first half of 2019.



Why has this happened? One reason has been interest rates. Low interest rates have been a global phenomenon and have persisted much longer than what would occur during a normal business cycle. This tends to benefit the stock prices of companies demonstrating strong earnings growth as future earnings are more valuable at a lower discount rate. A second reason is lacklustre economic growth, since investors tend to favour fast growing companies and are willing to pay a premium to own them.

Sector biases also play a role. The U.S. equity market has been among the best performing regional markets, driven largely by a boom in passive investing which funnelled a disproportionate amount of inflows into a narrow group of fast growing names like the FAANG[2] stocks, which are generally twice as expensive as that of the S&P 500 index.



Longer term however, the story is different. The recent outperformance of the growth is only a blip when you examine a longer history. Since the inception of the indices in December 1974, value has outperformed growth by an astonishing margin of 8,780% on a cumulative basis.

Value investing involves more than just investing in companies with low multiples. You can't invest based solely on price. That would be like buying a house based solely on price, without considering neighbourhood, schools, proximity to work, building quality, etc. A successful value investor seeks out attractively valued businesses that have strong balance sheets, sustainable competitive advantages, and are run by experienced management teams. We look for strong and resilient companies that have a track record of weathering changing economic conditions. Understanding business models is key to what we do, it allows us to avoid "value traps" – stocks that are cheap for a good reason. Most importantly, value investing requires patience.

So what's next for value investing? The macro environment is ever-changing. It is impossible to call the timing of the next value turnaround. But given that we are getting later in the business cycle, prudent investors need to seriously think about the longer term perspective and position their investments for a possible turn in the cycle when economic conditions stop supporting further expansion and growth.

What will be the catalyst for a shift? It could be a resolution to global trade talks, however from my experience it will likely be an event that is very hard to predict. If you believe in value investing then maintain your course and do not lose faith. Constantly, switching between investment styles is a recipe to lose money. Value investing has performed well in the past and we believe it will again in the future.

At Empire Life, we remain focused on our value-oriented investment philosophy and on high-quality, attractively valued companies, regardless of environment. Technology has disrupted industries in a way that may permanently destroy "moats" that used to exist around certain industries. That is why when we look for solid businesses trading at a discount to their fair value, we remain particularly focused on quality of balance sheet, and sustainability of free cash flow generation. We believe that owning businesses with these characteristics driven by durable competitive advantages, positions us well for success over the long term and makes us less concerned about short-term market gyrations. We remain very disciplined and selective in our stock picking.

We thank you for your support,

Ian Hardacre

[1] Returns are in Canadian dollar terms

[2] An acronym refers to the five technology companies: Facebook, Amazon, Apple, Netflix and Google

For more information on products visit empire.ca.

Empire Life Investments

INV-2297-EN-08/19