

A Post-Truth World?

With all of the recent media coverage regarding the current President of the United States, one wouldn't be surprised by the following excerpt from a recent article in the New York Times:

President's Misstatements Getting Less Attention

"The President's aides used to become visibly alarmed at suggestions that he had given mangled or perhaps misleading accounts of his policies or of current events in general. That doesn't seem to happen much anymore. Indeed, the President continues to make debateable assertions of fact but news accounts do not deal with them as extensively as they once did."

Although his aides may be less concerned, President Trump's questionable assertions have contributed to the increasing confusion about the veracity of statements by political leaders. Indeed, in 2016, the Oxford English Dictionary selected "post-truth" as its word of the year and defined the adjective as, "Relating to or denoting circumstances in which objective facts are less influential in shaping public opinion than appeals to emotion and personal belief." While this post-truth world may seem new, Sionna believes that it's something that has existed for quite some time – discerning the truth, whether in politics, in the media or in business, has always been a challenge.

In fact, the New York Times excerpt quoted above is not recent at all. I came across it while reading Neil Postman's novel, *Amusing Ourselves to Death*. The excerpt was originally published in 1983, but we changed the reference of President Reagan, to President Trump. The actual piece from the New York Times was titled:

Reagan Misstatements Getting Less Attention

Evidently, the notion that American Presidents may not speak the truth, and that the media may not challenge them, is by no means new. We have always lived in a post-truth world.

So what do Presidential misstatements have to do with investing? Much like political leaders, business leaders can also entangle themselves in misstatements and post-truths.

In the investing world, the truth matters – it always has. A successful investment decision is difficult without an accurate and objective picture of the financial strength, competitive advantages and challenges facing a company. Yet many of the documents that are often used to better understand a company, such as corporate communications, the financial media and sell-side research, are often full of the same kind of misstatements that come from Presidents.

One of the ways Sionna approaches investing in a post-truth world is to regard corporate press releases and annual reports with a healthy dose of scepticism. These documents serve more as marketing tools written to persuade by appealing to emotions, rather than to convey facts about the company. Instead, our research process relies heavily on financial statements and the notes to financial statements, which act as the foundation of our investment analysis. We believe that these documents are the closest we will get to the truth about a business since they are governed by national or international accounting rules and are externally audited.

However, we recognize that even financial statements are not foolproof, as the auditing scandals and financial misstatements of the past have taught us. This is one reason why an analysis of earnings quality is a fundamental part of our research process and why we focus on cash flows, which are typically harder for a company to manipulate than earnings. A recent article from the Financial Analysts Journal¹ stated that, “The further down the income statement one goes, the more ‘polluted’ profitability measures become and the less related to ‘true’ or economic profitability.” Studying the cash flow statement can help to avoid the truly disastrous investments; when you consider, “Notorious Bankruptcies, including Enron and WorldCom, graphically illustrate that profitable GAAP income statements can coexist with negative operating or free cash flows for the same company for long periods.” The article concludes that a company’s cash flows can be a better predictor of its stock returns than its profits are.

As corporate citizens, we are active in promoting truth and transparency in financial reporting and corporate communication. Sionna is a member of the Canadian Coalition for Good Governance, an organization committed to promoting good governance and transparency at Canadian public companies and aligning the interests of management and shareholders. Sionna is also active in the CPA Canada User Advisory Council where we provide guidance on what we believe is most useful for investors when analyzing corporate financial statements.

When searching for the truth about a potential investment, another challenge is the impact that financial media can have on investment decisions. Over the last number of years, we have watched the media sing the praises of companies like BlackBerry and Valeant while their stock prices performed well, and then disparage the same organizations when they stumble. We have seen articles recommending the shorting of a stock when it is inexpensive and buying it when it reaches record highs. And who can forget BusinessWeek’s cover, *The Death of Equities* in 1979, right at the start of the biggest bull market in history. (At least sometimes the media is a good contrarian indicator.) Even the Financial Times tried to scare us with the same headline (albeit with a question mark appended) in May 2012, and generally speaking, that wasn’t a bad time to invest either.



Media can often entertain and distract us rather than educate and inform us. The ability of media to mislead has been exacerbated by the rise of social media and algorithms that filter information so we only see news, opinion pieces and user-generated content that we are interested in, and often agree with, all of which can feed confirmation bias. In investing, confirmation bias can be disastrous, which is why seeking out the opposing view is an integral part of Sionna's investment analysis.

Despite these challenges, political and financial, investment opportunities will continue to present themselves. The ability to seek out and identify the truth in confusing situations has always been an important differentiator between investors. Sionna's structured research questionnaire and uninterrupted deep work time are tools that we use to discern fact from fiction. Studying the past helps us understand the present and guide us to better decisions for the future. At any decision point, we can choose to respond with thoughtful analysis or react with fear, anxiety or enthusiasm to the latest headline or corporate press release. At Sionna, we choose the former in our effort to build resilient portfolios that can outperform despite the vagaries of markets, the media and politicians. We do this by seeking out the objective truth as best we can, in order to avoid being fooled by misstatements – financial, presidential or otherwise.

ⁱ CFA Institute. Financial Analysts Journal. *Are Cash Flows Better Stock Return Predictors Than Profits?* First Quarter 2017.



Sionna Investment Managers 8 King Street East, Suite 1600 Toronto, Ontario M5C 1B5
For further information, please call (416) 203-8803

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