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CANADA TIP SHEET:

Graham Feels Safer In Equities

By **MONICA GUTSCHI**

TORONTO (Dow Jones)—David Graham says the jury's still out on whether Canada's main equity market is due for a major correction. On the one hand, there's the 25% gain logged since the beginning of the year. On the other, the price-to-earnings ratio of the overall market shows the market is fairly priced compared to historic trends.

As well, he believes the jury's also out on how much higher the market can go without some sort of impetus. While companies generally beat third-quarter earnings forecasts, much of the outperformance came from cost-cutting. He says investors will now be looking for revenue growth before pushing a stock higher. On the other hand, Graham says, investors believe interest rates are bound to go up eventually, and that means bonds are likely to underperform.

So the manager of the CIBC Monthly Income Fund is keeping his equity allocation at 65% of the C\$6 billion portfolio. Another 21% is in fixed income, 4% in preferred shares, and 10% in cash.

"I'd rather be in good equities that have a nice dividend yield and be safe, than take the risk that government bond yields go up and hurt the bond part of the portfolio," Graham says.

Graham had trimmed his equity exposure to 34% last year as the economic signals worsened, moving heavily into cash and

Government of Canada bonds. But he returned to stocks early this year and spent the spring looking for "safer" equities, those with high yields, good downside protection, and a healthy earnings outlook. Among his picks are telecommunications company BCE Inc. (BCE), cable-television provider Shaw Communications Inc. (SJR), pipeline companies TransCanada Corp. (TRP) and Enbridge Inc. (ENB).

He also purchased some energy companies such as Crescent Point Energy Corp. (CPG.T), which has a 7% yield, low costs, excellent management and exposure to the Bakken oil formation.

And he moved back into the Canadian banks, betting their fortunes will improve along with the economy. Any fear of dividend cuts has dissipated, with the debate now centered on when dividend hikes might resume. His favorite name is Toronto-Dominion Bank (TD), which he believes will wring a healthy ROE out of its new U.S. operations over time.

A value investor, Graham uses a model that calculates a two-year target price for each stock on the Toronto Stock Exchange by assuming each company's return on equity and price-to-earnings ratio will be in line with its 10-year historical average. If a stock is trading well below that target price, it goes on a "candidate list."

From there, Graham embarks on detailed analysis of the company, including meetings



with management to see if those potential future multiples are achievable.

For example, pharmaceutical retailer Shoppers Drug Mart Corp. (SC.T) has traded at an average multiple of 21 times earnings, but is now trading at 15-16 times because of concerns regulatory limits on generic drugs could hurt its earnings. But Graham believes it can increase its earnings through new product lines such as cosmetics and food. While its valuation multiples may not get back to the 20s, there is room for a move higher, he says.

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