

FINANCIAL POST

Look for catalysts among small caps

Wed Apr 14 2010

Byline: Jonathan Ratner

Column: Buy & Sell: Big Picture Views, Current Issues, Outlook And Picks

ABOUT THE MANAGER

Jennifer Law, CIBC Global Asset Management

Fund: Renaissance Canadian Small-Cap Fund

Description: Well-diversified portfolio,
focus on stock picking

Style & Process: GARP (growth at a reasonable price)

Assets under management: ~\$200-million

	1 Year	3 Year	5 Year	10 Year
Performance	69%	1.03%	8.42%	10.81%

THE RECOMMENDATIONS

Buys

COPPER MOUNTAIN MINING CORP. (CUM/ TSX)

NEW FLYER INDUSTRIES INC. (NFI.UN/ TSX)

GENIVAR INCOME FUND (GNV. UN/TSX)

Sell

GAMMON GOLD INC. (GAM/TSX)

COMMENTARY

It is fairly typical for small caps to outperform their larger counterparts coming out of a recession, but the margin has been much greater than usual in the past five quarters. After a rough six months at the end of 2008 as investors fled risk, small caps have since outperformed the broader S&P/TSX composite index by 33.4%, according to Jennifer Law, portfolio manager at CIBC Global Asset Management. She looked at the past five recessions and found that small caps usually outperform by 15% to 20%.

While Law expects this recent outperformance to moderate in 2010, the manager does see some bright spots that should continue to support small caps.

“Typically, when the Fed tightens or when there is less money supply, small caps tend to underperform,” she says. “While that is true, there are a few drivers I see going forward that will propel small caps to perform at least in line with the market.”

The portfolio currently holds 68 names and is typically in at least nine of the 10 GICS, or Global Industry Classification Standard, sectors. Individual stocks have an average weight of 1.5% to 1.6% and the fund is benchmarked to the BMO Small Cap Index.

The manager highlights the energy and materials sectors, which outperformed the benchmark index by 8.5% and 8%, respectively, in the first quarter of 2010. In 2009, small-cap energy outperformed by 39.2% and materials outperformed by 92%.

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"As long as you're comfortable being in energy and materials, small caps are not a bad place to be," says Law.

She focuses on finding stocks that have a near-term catalyst or re-rating event. In the energy space this includes companies that are drilling wells in places like the Cardium or Montney, and will hopefully prove up a lot of resources and increase their net asset value (NAV).

In the mining sector, the manager looks for names that are currently in mine construction or are near commissioning of new mines. "As soon as they become a producer of gold or silver, a re-rating will take place," says Law, adding that these stocks should trade towards their NAV or above it, depending on the company's growth prospects.

She feels these are the types of events investors should be focused on this year. "The tide may be up and down, but because you have these positive catalysts and positive re-rating events, that in turn will drive price performance," the manager says. "It is not a year where high tides lift all boats. It is a year that you want to make sure you're in a speed boat, fully gassed up. You really want to be a strong stock picker this year."

It may come as a surprise but Law also focuses on yield. In fact, the fund offers a yield of 2.2%. While there have been a number of corporate conversions in the portfolio, it still has about 18% exposure to income trusts and Law is confident the fund will always carry a yield.

"Finding growth and finding yield can be easy but sometimes not at a reasonable price, especially over the last little while," says Law. "Everybody wants yield, even small-cap investors."

BUYS

COPPER MOUNTAIN MINING CORP. (CUM/ TSX).

Law added this name to the portfolio at \$1.15 per share through an offering that closed in September 2009.

The emerging copper producer is restarting a British Columbia mine that had been shut down. The existing infrastructure makes the project a little bit more attractive, the manager notes.

"You're not starting from scratch," she says, adding that Copper Mountain has re-hired some of the management that used to run the mine and its CEO has experience operating in British Columbia.

"This is going to be a pretty decent mine for a small cap company," says Law, noting its 15-year expected mine life, production of 100 million pounds of copper in the first few years and cash costs below US\$1.25.

She expects the company will receive the remainder of its debt funding from 25%-project owner Mitsubishi Materials Corp. and its syndication in the next month.

NEW FLYER INDUSTRIES INC. (NFI.UN/ TSX).

The fund has held this Winnipeg-based heavy duty transit bus manufacturer for about four years. As one of the top two market players in North America, New Flyer offers visibility, a reasonable yield and an attractive valuation.

"When you have a backlog of two years or more, that gives us a lot of confidence in the business plan," says Law, noting that Ottawa subsidizes 80% of the cost of buses.

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Under the guidance of a new CEO, the company is reorganizing its production line. Law expects this will serve as a catalyst for the share price.

"I think it will help them in terms of realizing some cost synergies and to optimize efficiencies in the plant," she says.

So while Law is not expecting huge growth from New Flyer, she feels its current 10.7% yield is sustainable given the stability of the business and its low payout. As an Income Deposit Security, the income trust rule changes do not apply to the company.

GENIVAR INCOME FUND (GNV. UN/TSX).

Another longer-term holding, this engineering firm offers a yield of roughly 5.2%. However, its 45¢ special distribution last year pushed that closer to 6.8%.

"This company has solid organic growth rates and we like the fact that its partners own 30% of the company, so we know that our interests are aligned with theirs. With all the stimulus money and infrastructure spending, it really feeds into their sweet spot."

The manager notes that Genivar has a variety of businesses that provide exposure to municipal, infrastructure, transportation, environmental and building projects.

She also highlights the fact that it has been able to make attractive acquisitions.

Law sees this as a high dividend paying company going forward, particularly because its post-conversion guidance suggests the payout will remain \$1.50.

"We're not worried about what happens in 2011 with this company," she says.

SELL

GAMMON GOLD INC. (GAM/TSX).

Law exited this position very recently after the company provide disappointing guidance for the next three years. Gammon guided down in terms of production and up in terms of costs, the manager explains. Both its reserves and grades also declined.

As a result, she prefers to sit on the sidelines and wait for things to turn around. However, Law notes that many of the weak numbers are backward looking and 2010 could see some improvement as Gammon is doing a lot of exploration. She hopes the company replaces some of its reserves and finds higher grades.

"When this kind of negative event happens, investors tend to put companies in the penalty box. They tend not to participate, even when gold goes up," the manager says. "You want to see two or three quarters of good, stable production and some success in terms of exploration."

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