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FUND MANAGER'S CORNER

How Renaissance Small Cap got the 'A' grade

By Jennifer Law, CFA, Vice President, CIBC Global Asset Management



CIBC Global Asset Management is proud that the [Renaissance Canadian Small Cap Fund](#) has been honoured with a [FundGrade "A" rating by Fundata Canada](#). It is gratifying to be included in the elite group that represents the top 10% in the category, and to be recognized for the risk-return characteristics which are so important for investors and their advisors in their endeavors to build stable, growing portfolios.

How did we do it? It hasn't been easy over the past year. Sovereign debt issues in Europe, especially in Greece, political unrest in the Middle East and Africa, and the U.S. negotiations to raise its debt ceiling weighed on the sentiments of the small cap market.

Generally, investors look to small caps to add a little oomph to their portfolios, and looking at the last 40 years, Canadian small caps outperformed large caps by 55% on an absolute basis. At a time when you are not getting a lot of inflation-adjusted returns by investing in bonds, you are probably looking for some growth to boost your overall long-term returns. We recommend, depending on your risk tolerance, that you consider a proportion of the equity component of your portfolio to be in small cap stocks.

The way we manage the Renaissance Canadian Small Cap Fund is to structure the portfolio to participate when the small-cap equity market is strong, but still offer some downside protection if the market declines. We always have exposure to well-managed companies with strong balance sheets, predictable cash flow, and attractive dividend yields. We focus on companies that have the ability to develop their businesses and net asset values. The stability provided by these investments provides the portfolio with the fundamental ballast to take advantage of Canadian resource opportunities.

A glance at the largest holdings in the Fund should give you an idea of how we accomplish that. [Canadian Western Bank \(TSX: CWB\)](#) is the largest western-based bank in Canada. It is focused on commercial lending and is increasing its leasing, trust, and direct insurance operations. It concentrates its business in western Canada, where it has a long history of above-average loan growth and earnings.

[Glentel Inc. \(TSX: GLN\)](#) is a telecommunications retailer operating under the Wireless Wave, T-Booth/La Cabine T, and Wireless Etc. brands, selling both Rogers and Bell wireless products. In an industry growing rapidly through the increased use of smart phones, Glentel is in an envious position. Its customers can comparison shop and theoretically get advice without bias. Glentel's

valuable coast-to-coast distribution network is becoming more strategic as more competitors enter the Canadian wireless telecommunication market. In August 2010, Glentel agreed to purchase Diamond Wireless, a 128 store Verizon Wireless retailer operating in the U.S. west and south-western states, giving it a valuable U. S. presence.

[Canadian Energy Services & Technology Corp. \(TSX: CEU\)](#) is one of the best-positioned drilling fluids companies to benefit from the increasing use of horizontal drilling in unconventional resource plays throughout North America. Its market share rose by more than 300%, to over 25% in Canada since 2006. And, through an acquisition, has captured 6% of the U.S. market share in less than 18 months. In addition, the company has recently moved into the production of drilling chemicals, which will provide another avenue for growth.

[Cineplex Inc. \(TSX: CGX\)](#) is the largest player in the Canadian cinema market, with a market share of 66%. The movie industry is economically resilient because it is an inexpensive form of entertainment with its success more dependent on the quality of movie releases than the economy. In recent years Cineplex has benefited from the trend to 3D movies, which command higher ticket prices. The successful SCENE loyalty program gives it a large membership base to build and maintain market share.

How does the future look for small caps and for the Renaissance Canadian Small Cap Fund?

CIBC Global Asset Management expects the economic recovery in the developed world to be sluggish and to lag developing countries. We think every investor should have some exposure to emerging markets. Canadian small caps are a good way to get that exposure within a regulatory and legal framework that Canadians are familiar and comfortable with.

The Canadian small cap market has over 50% of its holdings in energy and materials stocks. The Fund's exposure to resources is focused on commodities essential to the industrialization of developing economies driven by the rise in urbanization and increasing wealth in China, India, and Brazil. This will continue to stimulate the demand for oil, copper, fertilizers, and iron ore.

We believe that current conditions also support the price of gold. The evolving European sovereign debt crisis, high U.S. government debt levels, growing Chinese demand and inflation in the developing world, all support the price of gold and its place as a store of value is increasing. The price of gold is ultimately a measure of investor sentiment. Although we expect to see a good measure of volatility, the current environment remains positive for gold.

Even when the economy looks shaky, over a longer period of time, investors would benefit from small cap exposure in their equity holdings. When the general economy does emerge out of a recession, small caps tend to outperform the overall market in a dramatic fashion.

At CIBC Global Asset Management, we have examined five recessions in Canada that took place between March 1970 and April 1992. The average outperformance for small caps over large caps for the 12-month period after a recession is 13.1%. Coming out of this latest recession, from 2008 to 2009, small caps outperformed by an astonishing 48%, a record performance.

On a portfolio basis, small cap exposure offers sector diversification to an equity portfolio. The small cap materials sector favours gold and copper. A 39% overweight of the materials sector in small caps counterbalances a 30% concentration of banks and financials among large caps. Even within the energy sector, there is a complementary relationship. The small cap energy sector has a higher concentration of service companies and firms focused on natural gas, as opposed to the large cap energy sector, which has a greater concentration of oil companies. Better diversification contributes to better equity returns.

While we are not expecting the small cap outperformance to continue in such dramatic fashion, history has shown that small caps positively contribute to long-term returns. We believe that consistent exposure to the Renaissance Canadian Small Cap Fund would benefit any long-term portfolio.

Jennifer Law, CFA, is vice president of Canadian equities at [CIBC Global Asset Management](#) and is the manager of the Fundata A-Grade award-winning [Renaissance Canadian Small Cap Fund](#) and [the CIBC Canadian Small-Cap Fund](#).

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