September 2011/Second Report

Volume 35, Issue No. 18

THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

VALUE INVESTOR

Invest in quality stocks now at attractive prices and create...

VALUE OVER TIME

Colum McKinley, CFA

What a year it's been! The European sovereign debt issues, the Japanese earthquake and tsunami, the debt crisis in the U.S., strife in the Middle East, the fears of a double dip recession and sluggish economic growth have all increased uncertainty and put a strain on the equity markets.

For many investors, the "what, me worry?" motto of previous years has become an attitude of "yes, I'm worried."

But over the years, the markets have survived countless recessions, wars, unfortunate natural catastrophes, the 9/11 attacks on the World Trade Centre and most recently, the financial crisis of 2008.

In fact, investors have done best when they have invested in markets where fear is at its highest level.

As Warren Buffett, arguably the most successful investor of all time, says "… be greedy when others are fearful and fearful when others are greedy."

Investors achieve the greatest results when they adopt a long-term approach to capital allocation and look beyond short-term market volatility.

For the **Renaissance Canadian Core Value Fund** and the **CIBC Canadian Equity Value Fund** we use the market's overreaction to short-term problems to build or add to positions that we believe will generate long-term returns for our unitholders.

No investment is without risk, but risk can be a value investor's best friend. It is an inherent part of investing; it is generally believed that investors must take greater risks to achieve greater returns.

We take action when we see an appropriate risk-and-reward balance. Our focus as value investors is on capital appreciation over time, and protecting and preserving that capital in times of volatility.

Warren Buffett also said "risk comes from not knowing what you're doing." At CIBC Global Asset Management, our dedicated research team focuses on understanding the long-term corporate fundamentals and earnings power of the businesses we invest in.

We then construct portfolios that represent the best combination of risk/reward opportunities and take advantage of mispricing that overstates near-term risks that ignore the positive long-term fundamentals of the business. That way we can invest at the best prices.

In our analysis and investment decisions three types of risk are considered – operational, cyclical, and financial. Here's how we examine each type and use the market's overreaction to invest at attractive prices.

OPERATIONAL RISK

"Operational risk" refers to a company's ability to carry out business on a day-to-day basis through its processes, people or systems.

This includes longer term strategic issues such as shifts in technology or broader competitive positioning.

The ability for a company to remain competitive and relevant in an ever changing marketplace is very important.

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Even great companies temporarily face short-term operating challenges. But good management teams, with the fullness of time and capital, are able to control and overcome these issues.

For example, when **Canadian Natural Resources'** (TSX-CNQ, $33.48) Horizon project had a fire at its Alberta oil sands facility in January 2011, operations quickly ground to a halt.

Horizon represents approximately 15 per cent of the company's production and is therefore an important contributor to CNQ's financial results. The Canadian Natural Resources stock price dropped by nine per cent in just two weeks.

Management quickly put plans in place to replace damaged equipment and, in fact, combined the reconstruction with much needed maintenance on the overall facility.

For the long-term investor, like us, this created the opportunity to add to a position in a well-managed business at more attractive prices.

Production resumed at Horizon this August and this high-quality project will reward patient investors with cash flow for many years to come.

CYCLICAL RISK

"Cyclical risk" refers to business cycles, or other economic cycles, that affect returns. The broad economy tends to move in cycles – periods of peak performance followed by a period of low activity.

It reflects the reality that businesses compete in a dynamic world and that corporate profits are influenced by these broader economic cycles.

The current CIBC Global Asset Management view is that we are in a period of sluggish economic growth, but with the risk of a deeper slowdown.

In the short-term, our holdings in **Canadian National Railway** (TSX-CNR, $68.78) and **Canadian Pacific Railway** (TSX-CP, $51.35) will be affected by changes in economic growth. A broader, deeper slowdown in the North American economy will surely result in lower freight volumes for the railroads.

But in the long-term, freight will still be shipped by rails and earning power will be determined by future cash flows.

Over the last number of years, highly efficient and cost effective railways have been more competitive than trucks.

Railways (like CP and CNR) will play an integral and growing role in shipping goods around North America, especially in the good times that will at some point follow today's uncertainty.

FINANCIAL RISK

"Financial risk" is the inability of a company to access capital needed in the business on a timely basis or at an appropriate price.

This is one risk we choose to avoid. We stay away from companies that have a habitual need to raise capital.

Companies go bankrupt when they are too leveraged and their business faces a shock from either cyclical or operational risks.

An economic slowdown or a problem at a facility can be the tipping point at a firm with a precarious balance sheet. Despite the current leverage concerns because of the uncertain economic climate, most corporate balance sheets in Canada remain quite healthy.

For example, following its acquisition of Petro-Canada, **Suncor Inc.'s** (TSX-SU, $29.40) debt levels peaked at $13.8 billion, or a net debt-to-capital ratio of 27.8 per cent. Suncor has a legacy of prudent financial management which focuses its strong cash generation to reduce debt.

Its recent second quarter results show that Suncor's debt now stands at $9.6 billion, or a net debt-to-capital ratio of 21 per cent. Debt levels at Suncor have continued to decline as cash flow from consistent operating results and strong energy prices increased.

Suncor is now in a position where continued cash flow could lead to dividend increases or share buybacks.

Risk and volatility will always be a reality for equity investors. But despite the chilling events and the resulting volatility upsetting the markets, Canadian stock prices are higher today than they were ten years ago.

By consistently focusing on the long-term fundamentals of businesses we hope to avoid the mistake of trading emotionally on the fear of risks.

To be clear, many of today's challenges are tangible threats – but we always consider if they might actually create a buying opportunity. ▼
