

THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

MARKET WISDOM

When markets are unpredictable, stick with well managed companies that have stood...

THE TEST OF TIME

David Graham, CFA

WHEN YOU CAN'T SEE WHICH WAY the wind is blowing, go with the guys that have been through many storms.

The only consistency in the Canadian equity market has been its inconsistency.

After a whopping return of 17.6 per cent in 2010, and a robust start in 2011, the S&P/TSX Composite Index is now up less than one per cent year-to-date.

Since peaking in early March this year, the Index has retreated by about 4.0 per cent, and when you look at the equity market chart so far this year, you see



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steep peaks and deep valleys, not a steady move up or down.

The goal of the **CIBC Monthly Income Fund** is to always deliver consistent returns no matter what the shape of the market.

We try to do that by balancing the proportion of stocks and bonds in the portfolio depending on how we view economic factors influencing the investment environment.

We also gravitate towards those stocks that we believe will react most positively to specific situations.

Finally, we choose stocks we are familiar with and trust – companies in which we feel management has the good judgement to weather any storm.

We don't operate in a vacuum. We have an internal team of analysts to advise us on the specific

companies they favour, and we put those companies on our list of candidates for the portfolio.

We also work closely with our asset allocation team to monitor the macro-economic factors that could influence our portfolio.

The main CIBC Global Asset Management scenario calls for a continuation of the economic recovery. Many economists remind us that this recovery is sub-par by historical standards due to headwinds arising from Greece's debt and the combination of America's deficit and the end of its quantitative easing (QE2), not to mention concerns over China's inflation. Nevertheless, it is still a recovery.

We do not believe those headwinds will be enough to put us back into recession. In our view, central banks around the world will keep interest rates low enough to help us muddle through.

For Canada, we expect better economic growth prospects and higher energy prices to support earnings growth.

The Canadian market has already corrected somewhat, and may be vulnerable to further correction if investors become nervous. Still, we believe this will only be a mild correction, followed by a resumption of the uptrend.

SOLID YIELDS

Uncertainty about the strength of the recovery does

pose a challenge in managing the CIBC Monthly Income Fund for consistent results.

We are meeting this challenge by consolidating the number of holdings in the portfolio, and by focusing on stocks with solid dividend yields.

We eliminated a few smaller, less liquid companies, while adding to our existing core holdings in energy, materials and financial companies.

Our main strategy is a shift towards the companies in which we have the strongest conviction. Here are some examples:

☛ **BCE Inc.** (TSX-BCE, \$38.75). In 2007 BCE announced that one of its major shareholders, the Ontario Teachers' Pension Plan, wanted to take it private. The proposed privatization didn't go through, but we think BCE benefited from the process.

BCE was going to increase its debt load in order to go private and the company had to cut costs dramatically to pay the higher interest expenses.

The cost cutting was already well underway when the deal was scuttled in December, 2008. But BCE has maintained that "lean and mean" philosophy ever since.

Other factors have helped BCE as well. It has staunchly resisted the decline in local and long distance revenue.

Also, BCE can now offer all the same smartphones – the Apple iPhone and Blackberry devices – as its competitors do. As data use increases on these phones so does revenue. At the same time, it is offering 'Bell Fibre TV,' an advanced Internet Protocol Television (IPTV) service, another steady revenue stream.

The federal government wants

to encourage foreign ownership of smaller Canadian telcos. This could hurt BCE to some extent if the smaller companies can gain traction, but we don't expect the impact to be material.

Finally, BCE has a healthy dividend yield of 5.5 per cent and says it plans to keep boosting the dividend as earnings go up. We view BCE as a good solid holding.

☛ **Telus Corp.** (TSX-T, \$53.12). Telus is a similar story to BCE and may actually have better dividend growth over the next five years. Telus also benefits from solid wireless growth and lower declines in local and long distance revenues.

The company is paying off its debt (which reduces interest expense) and reducing its capital spending, so cash flow is growing more quickly than earnings. Telus offers a 4.2 per cent dividend yield with the intent to raise the dividend by 10 per cent a year until 2013.

☛ **Manulife Financial** (TSX-MFC, \$16.26). Manulife suffered badly during the 2008 recession. It had offered certain investment products with guaranteed returns. These returns were based on assumptions about the stock and bond markets.

When both the stock market and interest rates fell, Manulife suddenly had huge potential liabilities. Fluctuations in the markets also caused earnings sensitivity because of the potential repercussions on future liabilities.

Since 2008, Manulife has stopped selling the products that were causing the problems. It has also taken action to dramatically reduce sensitivity to future fluctuations.

We view its balance sheet as

very safe today (although the company is still waiting for the regulator to clarify the rules going forward).

Manulife has a 3.0 per cent dividend yield, and is waiting for the regulator's clarification before considering any increases.

☛ **Toronto-Dominion Bank** (TD-TSX, \$80.21). TD Bank continues to be a core holding in our portfolio. TD is now one of the top ten banks in North America. Its retail franchise in Canada contributes about 55 per cent of earnings.

With the purchase of Banknorth and Commerce Bank in 2007 and 2008, U.S. retail banking now contributes about 20 per cent of earnings.

TD's U.S. operations made it through the credit crisis with few problems, and we expect them to do even better as the economy improves.

At the end of 2010, TD purchased Chrysler Financial, making it one of the top five auto lenders in North America. Similar to all Canadian banks, TD has a strong balance sheet, and we expect to see dividend increases. The stock currently has a 3.0 per cent yield.

☛ **ARC Resources** (TSX-ARX, \$25.91) ARC was created in 1996 as an oil and gas income trust, and converted to a corporation in January 2011.

Its production is about 60 per cent gas and 40 per cent oil, with oil contributing about 70 per cent of the revenue.

ARC Energy's wells cost relatively little to develop. Because they produce both oil and gas, ARC is able to profit even when the price of natural gas is low.

The strategy is to provide a

return to shareholders through a combination of a steady dividend and production growth, and it has done this even when commodity prices were much lower than they are today.

The stock currently has a 4.7 per cent dividend yield, and we see steady, consistent dividend growth over the next few years.

These are just a few examples of our “strongest conviction” holdings.

Given our view that the economic recovery will continue, however sluggishly, our portfolio

continues to lean towards equities, which take up about 65 per cent of the total, 28 per cent is in bonds.

We certainly feel comfortable with well-managed companies that have ridden out previous storms and thrived. We have a lot of time for those stocks that have proven they can stand the test of time. ▼

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