

BEST BETS

## Manage your expectations, analyst advises

### Investors should lower sights after rise in loonie, above-average stock recovery

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INVESTMENT REPORTER

Investors should be lowering their expectations of stock returns given the gains that Canadian stocks have had in the past three years and the rise in the Canadian dollar, equity analyst David Jiles suggests.

Mr. Jiles is part of a five-person investment team that runs the Leith Wheeler Canadian Equity Fund. The fund, which has assets of \$418-million, has risen 7.99 per cent so far this year, continuing a strong performance that has seen the fund return 27.29 per cent in the 12 months ended April 30, 25.49 per cent annualized over the past three years and 14.12 per cent over the past 10 years.

Since the bottom of the market in the fall of 2002, "we have had an above-average recovery compared to previous market cycles," Mr. Jiles said. The Canadian dollar has also advanced considerably. Hence, his recommendation that investors should probably reduce their expectations. He uses a baseball analogy to explain his point: "I would be happy if I am hitting a lot of singles at the moment; I think it is going to be harder to get these extra base hits over the next little bit."

In choosing stocks, the management team estimates the earning power of a company over a one- and three-year period and then applies a price/earnings multiple to that. With energy companies, Leith Wheeler Investment Counsel Ltd. uses cash flow, rather than profit. It then discounts the potential returns and compares that with the returns on stocks it already holds. "What we have found is that in . . . the third quarter of 2002, the average return we were looking at on our stocks was 16 per cent and now it has dropped to 10 per cent," he said, illustrating how things have changed in the past three years in the Canadian market.

Leith Wheeler specifically looks for quality stocks that are cheap and unloved.

**Transat A.T. Inc.** (TRZ.B-TSX) is one such stock. Montreal-based Transat is the leading provider of leisure travel in Canada. "This is one of the few companies in Canada that should benefit from a rising loonie," Mr. Jiles said. "I think one of the things that the market is overlooking here is that with the aging demographics and also with a rising currency, people are going to be looking at going outside of our borders because they can now afford it better

than they could be in previous years." Leith Wheeler thinks Transat can earn \$1.70 a share this year, up from last year's \$1.33, and \$2.50 a share in 2008. At yesterday's close of \$24.50 on the Toronto Stock Exchange, the B shares are trading at 9.8 times the 2008 estimate.

Shares of **Onex Corp.** (OCX-TSX), the Toronto-based holding company, have recovered significantly since setting a 52-week low of \$18.09 last December and now stand at \$22.27, but that is well below the high of \$29.73 established in 2000. "Since that time, I think that management has shown that they haven't lost their ability to make money for investors," Mr. Jiles said. Among the relatively recent investments was Spirit AeroSystems. "I think . . . we are in the early stages of a very strong aerospace cycle and investors are probably at this time underestimating the value of Spirit . . . within Onex's valuation." Also, he is hopeful that Onex's Celestica Inc. is "finally starting to show some signs of recovery." The discount to net asset value that Onex is trading at makes it a "very, very compelling purchase at the current time," he added.

Leith Wheeler has held shares of Vancouver-based **Finning International Inc.** (FTT-TSX), one of the world's largest distributors of Caterpillar products, since 1999. It has a "great geographical footprint" in Western Canada with the oil sands, in South America with mining and in Britain, which is a "vibrant market for smaller equipment," he said. "Our view is that in 2006, 2007, we are finally going to see the real earnings power of this company." Consensus has Finning making a \$2.30-a-share profit this year, but "if we get some tailwinds, [Finning] could actually earn \$2.50 a share this year," he said. The shares closed yesterday at \$40.01.

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## A value proposition

The five-person investment team that runs the Leith Wheeler Canadian Equity Fund specifically looks for stocks that are cheap and unloved.

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## Top 10 holdings\*

1. Nexen	9.35%
2. TD Bank	7.61
3. Manulife Financial	7.39
4. Royal Bank of Canada	7.17
5. Finning International	5.11
6. Bank of Nova Scotia	4.74
7. Canadian Pacific Railway	4.62
8. Shoppers Drug Mart	4.49

9. Toromont Industries	4.28
10. Saputo	4.24

\*As of March 31, 2006

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### **Leith Wheeler Canadian Equity**

Inception date: April, 1994

Total assets: \$418-million

Fund type: Open-ended

RRSP eligibility: Yes

5-star rating system: \*\*\*\*\*

Management expense ratio: 1.50%

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### **Returns** (as of April 30, 2006)

1-year 27.29%

3-year 25.49%

5-year 15.67%

10-year 14.12%

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**DAVID JILES**, OF THE LEITH WHEELER CANADIAN  
EQUITY FUND

*SOURCE: GLOBEFUND*

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