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Profiting From Volatility

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Presented by



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MANAGER'S VIEW

While the optimist in him knows things are going to recover sooner or later, good news remains in short supply, so David MacNicol insists a buy and hold mentality won't work in this type of environment.

"The smarter investors have to be more adept to change into sector rotation," says the president and portfolio manager at MacNicol & Associates Asset Management Inc.

Since he views the recent strength in equities as a bear market rally, that is the exactly the strategy being adopted -- going into names with an expected return, then moving out and into others when that objective is achieved.

MacNicol manages assets approaching \$100-million, mostly for private clients. While this primarily involves stocks, bonds and t-bills, the firm also offers alternative strategies such as investing in hard assets like real estate and gold bullion, as well as private companies.

In the Global Balanced Portfolio, MacNicol has started to take some profits off the table after rallies like the one we've experienced recently, while shifting into more defensive names after reaching these peaks. He sold both Uranium One Inc. (UUU/TSX) and Labrador Iron Ore Royalty Income Fund (LIFun/TSX) for a profit, and bought technology firm CGI Group Inc. (GIBa/TSX), for example.

"I think we're into more of a sideways deflationary market in the short run," he says, noting that a shift to inflation is already starting to emerge in places like the U. K. "The U. S. government has only one thing that they can do at this point because interest rates are so low, and that's to inflate."

MacNicol looks back to Japan's Nikkei index, which peaked at around 40,000 in 1989, but has hit lower lows ever since.

The main thing they've had to battle is deflation. While he thinks North America is more willing to take the hard medicine to make things change, the first drop for Japanese stocks was a familiar 48%, which was followed by a rally of about 25%.

In Canada, investing in the TSX alone between 1965 and 1976 basically made you no return on your money. But there were plenty of ups and downs to capitalize on. And that is the type of scenario MacNicol sees playing out.

As a big believer in hard assets, he owns physical gold bullion as opposed to exchange-traded funds. It is bought through the BMG BullionFund and the holdings are stored with the Bank of Nova Scotia. He also feels there is huge amount of money to be made in gold miners.

MacNicol's approach for trading into this market includes moving into more defensive names from three sources: cash, some cyclicals that have rallied and by occasionally trimming his gold position.

This "recycling" of the portfolio will continue until the true economic indicators come through and show a recovery. Then it will be time to move back to a properly diversified portfolio.

For now, MacNicol says we're just starting to see signs of improvement. For example, he keeps a close eye on the Baltic Dry Index, which measures the price of moving raw materials by sea.

The banking sector is also just starting to build a base after plummeting to new lows at the beginning of March, he notes. "It got us into this trouble and I think it's going to lead us out of this trouble."

Energy is another sector that saw dramatic extremes. So while it all happened very quickly on the downside, MacNicol thinks the recovery might be more rapid, as commodity prices have already started to suggest. Regardless, he wouldn't be surprised to see some more false starts before we're through this completely, so he is positioning the portfolio accordingly.

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BUYS

ALIMENTATION COUCHE-TARD INC. (ATD. b/TSX)

MacNicol bought this name recently and says while it is a bit of a bet on an economic recovery, the stock is also a defensive play.

"The stock has come under pressure but I think this is a great entry point."

With roughly 130,000 convenience stores in North America (second to only 7-Eleven), Couche-Tard has 5,444 locations, including Mac's stores in Canada and Circle K outlets in the United States. As this is a highly fragmented market, MacNicol says there is plenty of opportunity for consolidation.

He noted that Couche-Tard also pays a small dividend. The manager would continue to buy the stock above \$11.50, but would exit the position if it fell below \$11 as this would signal that the economy is in worse shape than anticipated.

FORTIS INC. (FTS/TSX)

The St. John's, Newfoundland-based utility has 36 years of dividend increases and offers a dividend yield of around 4.5%. With analyst targets for the stock in the high \$20s, MacNicol is trying to take advantage of the recent sharp sell-off.

Using point and figure charts, he saw that it bottomed around \$21. The manager points out that Fortis is a good example of how he is trying to marry technicals with fundamentals going forward.

If it broke below that low, he would exit the position. Again, this is because the economy probably deteriorated more than previously thought and people are using utilities less.

Fortis is the largest investor-owned gas and electric distribution utility in Canada. It has two million-plus customers.

GOLD FIELDS LTD. ADR (GFI/NYSE)

MacNicol has owned this stock for some time. No longer a victim of the South African discount now that it is truly a global player, the miner has operations in Australia, Ghana and now Peru. The manager likes the fact that it is of the world's largest unhedged producers -- an important trait when gold prices are rising.

While Gold Fields had problems with electricity in the past for their main mines in South Africa, the platinum business has turned down, making access to electricity easier.

MacNicol also notes that the appreciation of the South African Rand is also working for the company, while its drilling results are another positive factor at a time where growth is difficult for the sector.

SELL

FRANCO-NEVADA CORP. (FNV/TSX)

The manager has been selling down his position at a nice profit recently as his gold position has become fairly large. He says Franco-Nevada is a perfect example of the sector rotation strategy, as the stock has done really well in the past six months.

MacNicol is calling on the experience of veteran managers who were still able to make money for their clients in the 1960s and 70s. As a result, he plans to add to his oil and gas holdings, but is not completely comfortable with the financials just yet.

MacNicol also owns some smaller Canadian gold miners and sees plenty of opportunities in the space.

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