

FINANCIAL POST

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The October Caution

Jonathan Ratner, Financial Post

Presented by



Peter J. Thompson, National Post

China this week celebrates 60 years since Mao Zedong declared the founding of a new communist nation. It is an extremely proud country, so we can be sure everything will go smoothly. But after that, the gloves could come off to a certain extent, which could contribute to a very challenging fall season for the markets, says David MacNicol, president of MacNicol & Associates Asset Management Inc.

He points to questions that remain in terms of how the United States will deal with its largest financial partner. China holds the largest amount of U.S. debt as it watches the greenback move down against other global currencies.

"That's really one of the only ways the American system is going to correct itself," MacNicol says. "A lower currency is definitely what they're betting on, whereas the Chinese are not going to be at all pleased."

While he doesn't know what will cause the correction, the portfolio manager is preparing for a market pullback

"We are very cautious going into October, it is historically the worst month to be in the markets," MacNicol says, noting that we could see some profit taking from those investors who were more fully invested.

However, he does note what is working for the market this time around is the fact that we're not coming off of considerable highs, as we were last fall.

"Although the market has rallied back, the multiples aren't quite as high as they were then. There is more awareness in the market now, so people are more cautious in how they are placing their market bets."

MacNicol believes many institutional money managers are still underweight equities. As a result, he warns that there could be a lot of window-dressing in the end of the quarter, with these institutions going to have to show investors that they do have some market positions.

"But all bets are off come October and into the new quarter," the manager adds. " We've seen a great recovery, but we're seeing that there could be something really challenging on the horizon."

MacNicol's mostly private clients are offered a portfolio mix of equities, bonds and alternative asset strategies such as real estate, private equity, and hedge funds through the firm's partnership with Montreal-based BT Global. The firm recently expanded with the addition of five new team members, including Paul Mascard and portfolio managers David Cockfield, Arthur Salzer and Ian Kerr.

MacNicol is currently raising cash in anticipation that some more buying opportunities will emerge. This position is typically around 10%, but MacNicol wouldn't be surprised if it doubled rather soon.

The manager is optimistic on Canadian stocks, which constitute the majority of the equity portion in the global portfolio. The rest lie outside North America, in such places as India, to a lesser extent Japan, and in some of China's closest trading partners. He has essentially avoided the U.S. market since 2002 due to concerns about its debt levels and weakening grip on the global system.

In equities, gold continues to represent the largest sector holding. Clients typically have anywhere from 10% to 20% in gold and precious metal-related stocks.

MacNicol also notes that except for commodity-related names, essentially all the stocks he owns these days pay a dividend.

"We're in an environment right now where if we just own growth stocks, that is based on the hope of a global economic recovery. That is a bull market strategy. I'd rather have most of my stocks in a portfolio that are high yielding."

Manager David MacNicol, MacNicol & Associates Asset Management

Portfolio Global balanced

Description Combination of equity, fixed income and alternative asset strategies

Assets under management Approaching \$300-million (roughly 250 families)

Style & Process Opportunistic blend of value and growth

jrater@nationalpost.com-----

BUYS

Bombardier Inc. (BBD. b/TSX)

MacNicol owns Bombardier and expects to continue to add to this position. He notes it is no longer just a Canadian company that gets support from the government, but rather a major player in global aerospace.

The manager also likes the fact that the company has an order backlog of nearly \$50-billion.

"I don't even think we have to see more good news on the production side coming out of Bombardier," says MacNicol. "There is just considerable upside for the stock."

While EBITDA was down a bit year-over-year due to the decline in the global economy, the manager thinks that trend is going to start to reverse itself.

The stock hit a low of \$2.34 on March 9, but has continued to climb since. It now trades at about \$5 per share.

Silver Wheaton Corp. (SLW/TSX)

The manager has owned this name for some time and continues to add to the position.

Silver Wheaton's recent US\$625-million deal with Barrick Gold Corp. makes it the largest and fastest-growing royalty company in the world. The company will get 25% of the silver production from Barrick's Pascua-Lama mining project straddling Chile and Argentina for the life of the mine, as well as all of the silver production from three currently producing mines.

"I think it is a very sweet deal for both parties," MacNicol says. "I think silver is actually a better way to play precious metals and this concern about inflation." He notes silver tends to outperform gold at about 2x in precious metals upmarkets and also benefits from being an industrial metal.

North West Company Fund (NWF. un/TSX)

MacNicol has owned this name for a while and continues to like it at these levels.

"I think if we're going into more of a volatile fall, we want to own investments that people have to have -- like food," he says, noting food makes up 73% of North West's Canadian business and 87% in the United States.

"Even though sales have been off a bit, their earnings continue to go up," he says.

He also likes George Weston Ltd. (WN/TSX) at these levels. "I think Weston really hasn't shown the growth that Loblaw has in this recovery," the manager says.

Since it is sitting on more than \$3-billion, or about \$25 per share, MacNicol thinks Weston could do something as smart as pay a special dividend.

SELL

Shoppers Drug Mart Corp. (SC/TSX)

The manager has been trimming his position in this retailer for several reasons.

In Canada, generic drugs cost 25% more than they do in the United States, says MacNicol, pointing to a renewed drug pricing reform effort by the Ontario government. Shoppers shares have suffered as a result. They have fallen substantially from about \$50 at the end of June.

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