

BARGAINS IN MARKET 'A VERY HEALTHY SIGN'

Jonathan Ratner, Financial Post, Friday, June 10, 2011

With the maintenance of accommodative fiscal and monetary policy, Gaelen Morphet expects economic activity will continue to improve. However, the veteran value manager and chief investment officer at Empire Life points out that the bond market appears less convinced as yields have trended lower.



Gaelen Morphet, CFA
Senior Vice-President &
Chief Investment Officer

"The bulls seem to be determined to drive the market back to its old highs. Revenues and corporate profits have supported this trend," Morphet says. "Valuations are still reasonable -with some exceptions -and balance sheets are solid, so the market has fundamental support."

The Empire Elite Equity fund, co-managed with Lieh Wang, falls into the focused equity category and therefore has non-Canadian exposure. Its benchmark equity weighting is 75% Canadian, 15% U.S. and 10% international, however the portfolio currently has more exposure to U.S. stocks relative to Europe, Australasia, and the Far East (EAFE).

Morphet, who took over at Empire Life in February 2010, targets a well-diversified portfolio with a higher-than-average dividend yield.

"That's part of the foundation of our approach -diversification and high dividend yield," she says, noting that the fund is close to fully invested. "I don't think the market is expensive, so that's the prudent approach."

Morphet's bottom-up work demonstrates that the market remains less expensive than it's been during most of her more than 20-year career.

"A new range may have come out of what we've gone through, but that remains to be seen. For now, it's still quite reasonable," the manager says. "We can find value right across the spectrum of the market. To me, that's actually a very healthy sign."

Morphet notes that while both earnings and revenues remain strong, balance sheets are in the best shape ever. And while this is reflected in stock prices, the manager doesn't consider equities over-valued on that basis, "so there is room for them to go higher."

In the materials sector, most of the fund's exposure comes from gold stocks as the only other holding is Labrador Iron Ore Royalty Corp.

The portfolio maintains broad exposure to the energy sector, with higher-than-normal positions in Enbridge Inc. and TransCanada Corp. Morphet explains that this is a result of the stable nature of their earnings stream and higher dividend yields.

"That offsets the volatility in the energy producers, which is coming from oil and gas prices," she says.

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BUYS

ATCO LTD. TICKER ACO.X/TSX CLOSE \$62.60 P/E 11.7

The position: Owned for years and represents core position in funds.

Why do you like it? The company, with operations in utilities, energy and structures has a history of building value for its shareholders, Morphet says. In fact, 2010 marked the seventeenth consecutive year ATCO paid a dividend. ATCO reported strong first-quarter results in May, supported by increased earnings from its structures business, higher power prices in Alberta and strong results from its Canadian Utilities Ltd. subsidiary.

Biggest risk: Higher interest rates, but Morphet notes that ATCO's structures business provides some cushion to higher long bond yields and regulatory surprises.

METRO INC. TICKER MRU. A/TSX CLOSE \$48.00 P/E 13.1

The position: Adding to this long-term holding.

Why do you like it? Morphet considers Canada's third-largest food retailer a well-run company. Management has delivered on earnings profile for decades, with Metro's 10-year return on equity averaging 17.3%. "This is no small feat given the low margin, competitive nature of the grocery business in Canada," she says. Despite strong competition, Metro delivered 8% EPS growth in the second quarter. Morphet expects Metro to stay on trend for the rest of the year and anticipates further share buybacks and debt reduction.

Biggest risk: Inflation looked like a bigger risk earlier in the year, however Morphet notes that the company is not seeing any real inflation pressures yet.

CANADIAN NATURAL RESOURCES INC.

Ticker CNQ /TSX Close \$40.45 P/E 44.9

The position: Fund's top energy holding.

Why do you like it? "The share price has lagged other energy companies due to problems at its Horizon project

earlier this year, but we believe it offers excellent value and it's a good buying opportunity," Morphet says. She highlighted CNQ's average return on equity of 17% over the past 22 years. CNQ is also one of the manager's top value stocks as it is trading at a discount to its intrinsic or long-term value.

Biggest risk: The price of oil due to geopolitical factors, however CNQ has an offset in its natural gas exposure. es that the company is not seeing any real inflation pressures yet.

SELL

SILVER WHEATON CORP. TICKER SLW/TSX CLOSE \$32.33 P/E 51.5

The position: Exited entire position recently after more than 100% gain.

Why don't you like it? Morphet purchased Silver Wheaton because much like an old favourite, Labrador Iron Ore, its business model creates significant shareholder value by providing considerable leverage to a commodity, while reducing the downside risks faced by traditional mining companies. However, the manager sold the stock when she felt the risk-return profile favoured the risk side of the equation. "It was getting a little too volatile for us," she says. "We made very good money off the investment and we left very happy shareholders."

A potential positive? Less volatility around the silver price.

MANAGER PROFILE

Manager: Gaelen Morphet, Empire Life

Fund: Empire Elite Equity

Description: Large cap fund designed to protect wealth

Assets under management: \$750-million

Total equity mandates: \$4-billion

Performance: 1-year +8.87% (as of April 30, 2011)

Management fee: 2.54%

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