

# BUSINESS

SECTION C | THE GAZETTE | MONTREAL | FRIDAY, DECEMBER 24, 2010

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C8 Weather  
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TSX ▼  
13,371.2 9.5

DOW ▲  
11,573.49 14

NASDAQ ▼  
2,665.6 5.88

DOLLAR ▲  
99.12¢ 0.52¢

OIL ▲  
\$91.51 \$1.03

GOLD ▼  
\$1,380.50 \$6.90

PRIME  
3% DEC. 7



MARIE-FRANCE COALLIER THE GAZETTE

(From left) Marc Dalpé, portfolio manager at DalpéMilette, Dan Dupont, portfolio manager at Fidelity Monthly Income Fund, and Christian Godin, portfolio manager at Montrusco Bolton Investments, participate in the Gazette's annual investment roundtable.

**AFTER A TRANSITION YEAR THAT SAW MARKETS SOLIDLY AHEAD, THE AMOUNT OF DEBT CANADIANS ARE CARRYING AND A DEPENDENCE ON CHINA TO DRIVE COMMODITIES PRICES HAVE MONEY MANAGERS ON ALERT FOR 2011**

## Proceed with caution

Equity markets in North America defied the skeptics again in 2010, following up a banner year in 2009 with another double-digit rise. While Canada seems to be emerging from recession with vigour, there are still plenty of clouds hovering over the markets as we enter 2011. To discuss where we've been and where we're headed, Gazette reporter Paul Delean sat down with three local money managers: Dan Dupont, equity manager of the Fidelity Monthly Income Fund, Christian Godin, portfolio manager for Montrusco Bolton Investments, and Marc Dalpé, portfolio manager at the DalpéMilette division of Desjardins Securities. Here's an edited transcript of that discussion.

**GAZETTE:** A year ago, the outlook for equity markets appeared highly unsettled. Eur-

ope was headed for trouble and the U.S. economy couldn't seem to shake the recession. The Canadian market started the year well but had given up its gains by summer. Yet markets in Canada and the U.S. are going to end 2010 solidly ahead. How do you explain what unfolded this year, and in particular this abrupt turnaround?

**DALPÉ:** 2010 was always going to be a transition year between what we lived through in 2008 and early 2009, which gave rise to a couple of quarters of lower-than-normal rebound, but still a rebound from recession levels. Markets were trying to figure out in 2010 what type of environment would prevail for a year or two after the rebound and at what level the economy would stabilize. I think that has been done. But that

could change. The opinion of the market has many extremes, probably more so now than it's had in the last 20 years. Volatility swings from extreme sides. You saw it this year when the market was down almost 15 per cent from the start of the year to the end of June. It rebounded nicely because the economy is holding up a little better than people had anticipated.

**DUPONT:** Long-term bond rates bottomed out (in August with the announcement of another round of quantitative easing by U.S. Federal Reserve chairman Ben Bernanke). Generally, it helped liquidity in the markets. It helped people increase their risk tolerance and their willingness to purchase assets that are riskier. It's still unclear to what level we'll have that stimulus be with us and how long the willingness to take risks stays with us.

**GODIN:** We already knew earlier this year the Chinese economy was doing pretty well. There'd been worries their policies could potentially curb the economy in China, but despite the fact the government and the central bank of China have been imposing constraints to the system, the economy has done pretty well, and to that extent has somehow surprised the market. Its ability to pull the rest of the global economies also has positively surprised investors. Therefore, you had in North America, and several South American countries, quite positive returns this year in the equity markets.

**GAZETTE:** Is the advance sustainable in 2011 or is a correction, or stall, to be expected?

**GODIN:** We'll start positive for the first half of next year, but for

the entire year, I think it will be muted if not slightly negative. It can be put down to a very simple statistical idea. In 2009, the Canadian market was up 35 per cent. This year, it probably will be up about 15 per cent. So you have a deceleration. A third consecutive year of very strong performance would be a very positive surprise.

**DUPONT:** I have no idea what the next 12 months will be like. But there are certainly a few interesting risks out there if you think about the Canadian market. Profit margins are close to all-time highs, helped by the strength of commodities. Financial profits also are very strong. But even with the high margins, multiples are not at low levels; in fact, they're above average.

Please see ROUND TABLE, Page C2



ANDREW HARRER BLOOMBERG NEWS

The Marriner S. Eccles Federal Reserve Board Building in Washington, D.C.: One of our experts says the market will have to intervene and force politicians there to deal with the deficit.

## ROUND TABLE U.S. debt, Chinese growth shape outlook for 2011

CONTINUED FROM C1

That would be a risk. Another risk to the overall Canadian economy, in my view, is the level of real-estate prices, mostly residential, and the general amount of debt in Canada. I think Canadians are going to slow down the amount of debt they pile on and real estate is going to slow down as well. That should slow down financial profits. As for commodities, who knows what happens with China? It's a significant influence on profits in Canada. I don't know for the next 12 months what China is going to do.

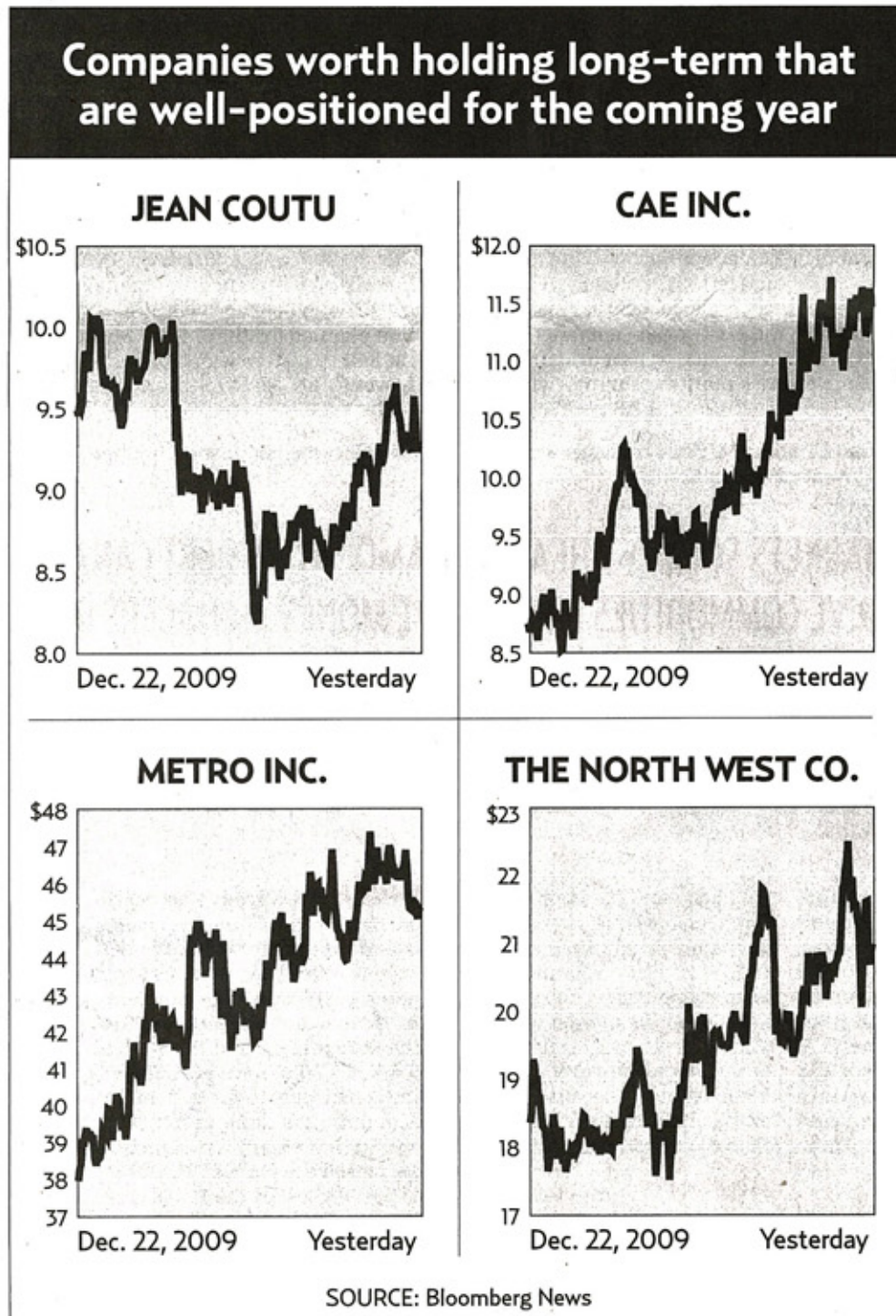
**DALPÉ:** A lot will depend what happens with bonds. Since 2009 in the U.S., there's 22 times more money in bonds funds than stock funds. Obviously, stocks did a lot better than bonds over the last year and a half, but you didn't do too bad with bonds, either. But as bond rates start to go up, and people not only don't make money with bonds but could lose a bit, you could see this flow of funds reverse somewhat. My feeling is long rates won't be going up significantly in the next year, but up enough to encourage the purchase of stocks. So I share the opinion stocks could do reasonably well for the next quarter or two or three.

**GAZETTE:** How much of a concern is the U.S., the massive debt it's carrying and the apparent lack of political resolve to deal with it?

**DUPONT:** I am somewhat concerned, but maybe less than the average investor seems to be. Based on the current policies and legislation and entitlements, they are driving toward a place where they cannot come back to a balanced budget. The situation has been dire in a lot of countries in the past. Canada was very dire in the '80s, and we fixed that. Eventually, politicians get some resolve. We're not there yet, but we're getting there quickly. I don't think the U.S. will default, but they'll get to a point where politicians will have to react dramatically and make dramatic changes to a lot of the entitlements.

**GODIN:** The trend is negative but the current level is not a concern.

**DALPÉ:** The U.S. situation is not, today, dire straits. Relative to many countries, they look good. But I suspect, at one point they'll have to address



their structural deficit. My feeling is that it won't be done at a political level. I don't think they'll have the political courage to do it themselves, especially now that it's very polarized in the U.S. The market will have to intervene and force the hands (of politicians). We're getting there, faster than slower, to where it'll be politically correct to take measures to bring the ship in line with prosperity because doing nothing will be politically incorrect. But I don't think the Republicans want to help the Democratic party to do this now. They'll stall because they want to run in the next election (in two years) as the ones ready to do the clean-up effort. But I don't know if the market can wait that long. The economy's not going to grow fast enough to solve those problems (on its own).

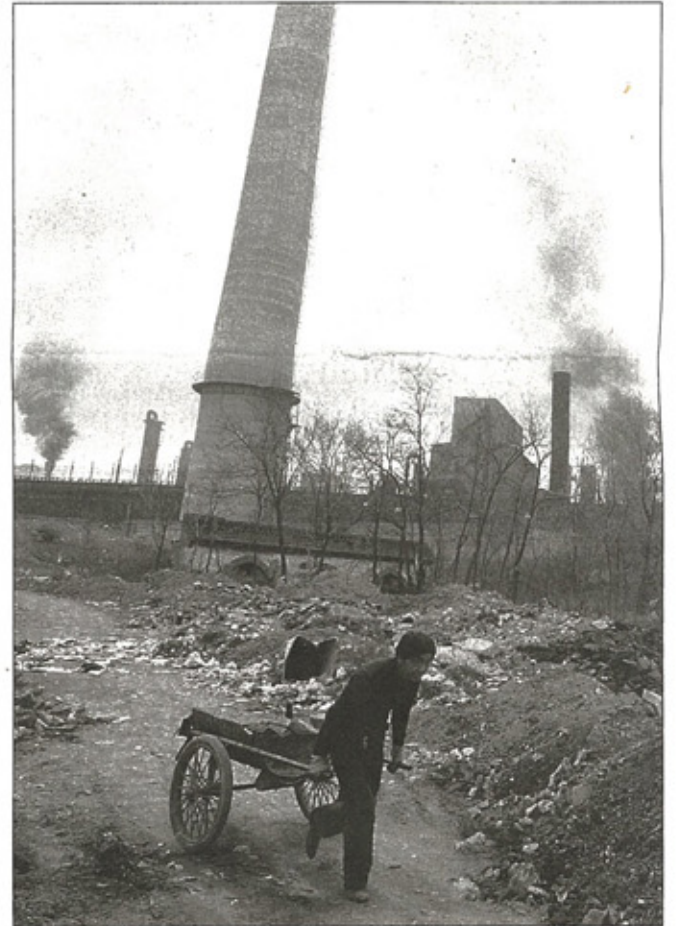
**DUPONT:** Even though all this means slower growth for the U.S., historically, there's no correlation between GDP growth and stock-market returns in any given year. I think it's quite likely you could still do very well buying good companies in the U.S. whose returns on capital are high and valuations are low at this point and thrive even though this period could be a little tougher.

**DALPÉ:** The combination of pricing, growth, demographics, currency, everything, still seems to me much more favourable in emerging countries than the U.S.

**GAZETTE:** Commodity, mining and energy stocks were exceptionally strong in Canada this year. Which sectors of the Canadian market do you expect to

perform best in 2011 and which would you play down or avoid completely?

**DUPONT:** The way I look at the market and invest for our fundholders is to protect capital, first and foremost. So I'm looking where the risks are. China is effectively driving commodities now, and there's a significant amount of downside risk from a slowdown in Chinese demand when it comes to building commercial residential real-estate and infrastructure. In a lot of places, it's overbuilt. There's going to be ups and downs in the development of that country and they will have a dramatic impact on the price of commodities, which drive a significant amount of profits in the Canadian stock market. That's the risk I see for the Canadian market.



REUTERS

A labourer transports bricks in front of a coking factory in Changzhi, in China's Shanxi province.

With commodities, be ready for a lot of volatility.

**GODIN:** In this environment, I would favour discretionary stocks, the so-called late cyclical. On the industrial sector, maybe something like CAE, which is driven by airline traffic. All airlines are experiencing big pickups. It's a good idea to consider stocks being driven by the airline industry and CAE, with its simulators, will do relatively well. I would also consider stocks like North West Co., the former Hudson's Bay. They have stores across the northern hemisphere and also the Caribbean islands. It's going back to a corporation from a trust status. The profit margins for consumer discretionary and industrial stocks will be improving this year, on top of earnings growth you'll have margin expansion, and that's usually a good recipe for stock-price appreciation. With financial services, we're still on a path of fundamental improvement. Laurentian Bank is an idea there. Other than energy, the resource sector could have muted returns (next) year. I don't see a tremendous downside risk as long as emerging economies are there to consume and build their infrastructure; we should still have a couple of years of that. But stock prices likely won't be the leaders if it's a positive market.

**DALPÉ:** We're quite positive on Canadian financials. The combination of probable increases in dividend rates and long-term interest rates not going up significantly from current levels could generate interesting returns, maybe six to nine per cent over the year. And we're bullish on oil. A lot of income trusts invested in oil will be converted this year to regular companies, and this has acted as a headwind to valuations, depreciating them a bit. Next year, you'll see those valuations coming back. I think the price of oil will remain robust, not only because of demand. More and more, it's being viewed as an alternative to gold. You can have the same kind of currency protection having an asset people use that becomes rarefied over the years. I'm optimistic also on materials. You could have some volatility, but the long-term story remains intact. You won't see the prices go down significantly for significant periods of time, I'm less keen on consumer and consumer-discretionary (stocks); Canadian consumers have been spared most of the U.S. drama so far, but there'll be pressure on discretionary spending, though it won't be as bad as it was two or three years ago in the U.S.

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THE GAZETTE



TYLER BROWNBRIDGE POSTMEDIA NEWS

Panelist Christian Godin says 2010 was "a rather quiet year from a Canadian perspective vs. other currencies. Not so long ago, we were experiencing annual swings of 20 or 30 per cent."

## ROUND TABLE Metro, Jean Coutu, Alamos Gold among the picks

CONTINUED FROM C2

**GAZETTE:** What are some of the individual names you see as well-positioned for the current economic context?

**DUPONT:** I'll mention a couple of companies that I think are extremely well run and that I'll probably be holding a long time in the portfolio. An easy example is **Metro**. It's had very high returns on capital since (former CEO and current chairman) Pierre Lessard came in in 1990. The philosophy at the management level hasn't changed and the returns are still as robust. I'm very happy owning a company like that, willing to buy back stock, increase dividends, and not do stupid capital expenditures just because they want the company to be bigger. **Jean Coutu** has the potential to become a company like Metro. I think it's in the process of becoming a strong long-term holding. The philosophy is slowly changing from one of acquiring, building, growing, to one of buying back stock and improving the return to shareholders. It has a great business model, decent dividend, and management that understands better how to create value long-term. I'm a lot more positive about Jean Coutu than I was a few years ago.

**GODIN:** Another one I'd mention is **Alamos Gold**. It's a low-cost producer with most of its assets and operations in Mexico. It has very savvy management and a pristine balance sheet. I expect a couple of new projects from them in 2011. It's one of the very few gold stocks in Canada with free cash flow. On the energy side, **Angle Energy** is a mid-size producer that is increasing its oil production. It used to be more of a gas play, but has shifted more to oil and the returns on oil if you have the right assets are higher than for gas.

**GAZETTE:** Dividend stocks appear to be back in favour in a big way, especially with interest rates so low. Is that just a phase?

**DALPÉ:** If people start selling bonds to go back into stocks, maybe dividend



DAVE SIDAWAY GAZETTE FILE PHOTO

In terms of real estate, Canada in 2010 feels a lot like the U.S. in 2006, says Dan Dupont.

stocks will be one of the beneficiaries of those moneys. If that happens in the same environment when dividends are increasing, they'll get some of that money.

**DUPONT:** People are getting older and they want more income, so for sure there'll be more demand for income products and that includes dividend-paying stocks.

**GODIN:** We're due for the turnaround where people will come back into equities rather than bonds. Stocks are providing you with some

growth over the long term, and if you add the growth and dividend yield, it's a quasi-certainty you'll do better with stocks than bonds on a five or 10-year time horizon.

**DALPÉ:** It's not just financials and utilities. There's been a lot of cash-hoarding, particularly in the U.S., at non-financial companies. They've made tons of profit and haven't been hiring or making capital expenditures. At one point, they'll have to invest, buy back stock or increase dividends. You could see a trend developing where

other types of companies start giving interesting dividends.

**GAZETTE:** A strong Canadian dollar remains a challenge for investors holding U.S. and international equities. What do you anticipate for the dollar?

**DALPÉ:** I think it will be one of the stronger currencies over the next five, 10 or 15 years. The risk you're taking internationally is moving from the Canadian dollar to currencies more challenged

than the Canadian dollar. You have to take a look at what currency you're buying. The best-performing ones are likely to be emerging-market countries over the next 10 or 15 years.

**DUPONT:** I try not to predict currencies too much. The first time I bought a European stock for the Fidelity fund was the second quarter of this year when the euro was about \$1.20. I always try to protect capital first, which means considering the possible downside for both the stock and currency.

**GODIN:** It's actually been a rather quiet year from a Canadian perspective vs. other currencies. Not so long ago, we were experiencing annual swings of 20 or 30 per cent. It's much better for businesses when currency fluctuations are limited. I hope it stays like this.

**GAZETTE:** All things considered, are you approaching 2011 warily or optimistically?

**DALPÉ:** Both. You always have to mix short-term views, which give me a sense of optimism, and midterm to long-term, which is not good, because of the way governments are managing balance sheets and debts levels. I still fear a tough environment will happen. Confidence is a very fickle thing. At one point, we'll be reducing our weighting in stocks and maybe sitting idle for a while. But that's not in the next three to six months.

**DUPONT:** It's exciting no matter what happens. New things come up every day. There are definitely downside risks out there, and not just commodity corrections, short-term or longer. Canadians' level of indebtedness is something to think about. So are price levels of residential real estate. I lived in the U.S. up until a year ago and it really feels like 2006 in the U.S. You cannot convince anyone that home prices are too high here. Yet the price-to-household-income ratio, typically about 3 across continents and decades and 2.9 now in the U.S., is close to 4.5 in Canada. In Vancouver, it's 9.3. We have pockets of exaggeration in Canada that could correct over the next few years.

**GODIN:** For stock markets, the current environment is still constructive. In my mind, we're still in the early stage of an economic turnaround, especially for the U.S. and European economies. I'm always an optimist for equities. We still live in a world of consumption. As long as humans are willing to consume more, there are opportunities for corporations to earn profits."

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