THE INVESTOR'S DIGEST INTERVIEW

For CIBC fund, big-cap equities seen as primary growth driver

After the tech bubble, Stephen Gerring bet that equities would recover. The S&P/TSX Composite Index has zoomed since bottoming out in September 2002. That's why Mr. Gerring, who runs the CIBC Monthly Income Fund for TAL Global Asset Management, has almost doubled his equity holdings since 2002.

Stephen Gerring's pride and joy is his Italian motorcycle — a 1966 Ducati 250 Monza. But he's long since stopped riding it.

"I think I might kill myself if I got on it again," says the 50-something Mr. Gerring, who rode the bike for 20 years before putting it away in 1990.

Nevertheless, Mr. Gerring, who runs CIBC's Monthly Income Fund, still dreams of taking his Ducati out of storage on a Sunday morning, starting it up and letting it turn over at a nice clip. In fact, he's in the process of getting it restored.

"I like the sound of a bike," he says. "And the Ducati is an elegant piece of machinery."

And although his prized possession is now 39 years old, Mr. Gerring would never think of giving it up.

"Anyone can buy a new bike," he observes. "But to remain loyal to your old bike is something special."

Born and brought up in Toronto, Mr. Gerring has over 33 years' experience in the investment industry.

Lest folks see you as a middle-aged Marlon Brando in *The Wild One*, it's important to note that you really are a serious, responsible guy.

Well, I do spend a lot of time reading — particularly, mystery fiction (Georges Simenon, Colin Dexter). I also like biographies — mainly because they teach you so much. In fact, I recently finished Bill Clinton's biography. In addition, I've started reading literary classics — books like Pearl S. Buck's *The Good Earth.* Why do I read so much? It gets me out of myself. I spend so much time poring over business research that I find it nice to escape momentarily into another world.

Rather than buy a new bike, you've stuck with your `66 Ducati. In picking stocks, you also like the tried and true.

We do. Because the fund is designed to pay out a consistent monthly distribution, but preserve unit value, we tend to avoid the flashier industries such as high-tech and health care. In fact, we now have no holdings in either sector. And although we like royalty trusts and REITs, we're not so crazy about income trusts in more fickle sectors such as food and retailing.

You list as one of the fund's aims, the preservation of unit value. How do you do this?

By diversifying through asset classes. Instead of limiting yourself to equities, you also hold cash, preferred shares and bonds. Another way to preserve unit value is by structuring your bond holdings. If, for example, you think interest rates are on the way up, you can shorten your bond duration. You can also keep your portfolio intact by opting for large caps, instead of small ones. Because big companies tend to be more stable, a large-cap portfolio is usually less volatile than a small-cap one. Then, too, large caps are more likely to pay dividends. And because we're set up to pay out a consistent monthly distribution, we only buy stocks that pay dividends — and healthy ones at that. Of course, large caps are much more liquid than small caps.

How has the Monthly Income Fund fared?

Very well, I'd say. When we last spoke to *Investor's Digest*, at the end of August 2002, we had $650 million in assets under management. That number has now climbed to $4.4 billion. Why the sevenfold jump? I think it's our strong performance. As of Dec. 31, 2002, our four-year annualized return was 9.60 per cent. By the end of August 2005, it had climbed to 13.36 per cent. Our performance since inception has also improved. At the end of 2002, it was 10.52 per cent; at the end of August 2005, 12.79 per cent. Of course, our asset mix has changed as well. Three years ago, 19 per cent of our portfolio was in cash, 32 per cent was in bonds, 15 per cent was in preferred shares and 34 per cent was in equities. By August 31, 2005, however, cash had dropped to 15 per cent; bonds, to 14 per cent and preferred shares to five per cent. But equities had nearly doubled to 66 per cent.

You must have felt that equities were going to boom.

We did. And they've done just that — so much so that they've outperformed all other asset classes. Just look at the S&P/TSX Composite Index. In the fall of 2002, following the tech bubble, the index bottomed out near 6,100. Now, it sits around 11,000.

At 38 per cent of your equity portfolio, financial services is your largest weighting. Why?

Because it has a great track record. Banks, after all, have proved to be a superb combination of growth and yield. Their earnings increases have been consistent. And their yields currently top three per cent — a return now comparable to that on 10-year Government of Canada bonds. Meanwhile, banks keep benefiting from the ever-increasing amount of money that an aging population must sock away for retirement. The banks also benefit from Canadians' unprecedented high levels of consumer indebtedness.

Oil and gas takes up 28 per cent of your equity portfolio. That's more than the sector's current weighting (26.5 per cent) on the TSX.

But if you exclude our holdings of Enbridge and TransCanada PipeLines, in which we both have heavy weightings, our oilpatch exposure drops to 20.8 per cent. So we're not really as bullish in the sector as we seem. Still, we think energy remains important. In fact, we believe it will become even more so. For one thing, the world's population is growing. Moreover, energy production can barely keep pace with current demand in India and China. And per capita energy consumption in both countries is still low. Then, again, oil isn't suddenly going to go out of style. Energy isn't the same as women's fashions — in vogue one month and out of step the next. Yes, we'll eventually switch to alternate energy sources — fuel cells, wind power and the like. But we aren't going to do so overnight.

Many energy outfits are slowly depleting their reserves.

But not Canadian Oil Sands. COS, which owns a 35.5 per cent chunk of Syncrude, can lay claim to 60 years of proven and probable reserves. And because the tarsands are literally at its feet, the company need not spend a penny on exploration, but has only to dig up what's already on-site. True, COS's yield is low — but only because it's been shovelling cash into its facilities expansion. Now that the expansion is 90 per cent complete, the yield should start rising. In fact, we see it going up sharply in 2006. Another COS plus? Syncrude's strong management. That company is made up of eight energy plays — some of them, like Petro-Canada and Imperial Oil, quite big. So in owning a stake in Syncrude, COS gets the benefit of managers with years of oilpatch experience.

Thanks to its purchase of Banknorth this spring, TD now has a New England footprint. Yet several of TD's rivals have stumbled badly in the U.S. What makes you think TD won't do the same?

First, Banknorth boasts seasoned executives. Second, TD did a good job structuring the Banknorth deal. Also, TD can lay claim to both good management — and because of its strong retail focus — a low risk profile. Overall, we like Canada's Big Five banks. Although our banking industry is growing, it's still characterized by stable competition. Moreover, in the Office of the Superintendent of Financial Institutions, the industry has the benefit of good oversight.

You own CN Rail. Yet, a little over a decade ago, few folks considered rail carriers to be good buys.

But that's all changed. Railways are now viewed as solid investments — primarily because they're under better management. Indeed, CN is now the most efficiently run rail carrier in North America. We also like Canadian Pacific Railway, even though it's less efficient than CN. Still, over the next few years, CP and CN should show good earnings growth. In the interim, both carriers are benefiting from increased commodities exports to China. Yes, railways are economically sensitive — and, as such, particularly vulnerable to a recession. But we don't foresee an economic downturn in the near future.

Dofasco is Canada's largest maker of flat rolled steel. Yet, steel is a cyclical business.

But it's also a necessary one. A growing economy needs steel. And Canada's economy is growing. Moreover, much of Dofasco's output, such as galvanized steel, is value added. So the company gets a higher return than if it churned out only the basic product — that is, hot roll. True, Dofasco, like its North American rivals, must contend with cheap imported steel. But most imports aren't valued added. So, the company, because of its high-end focus, takes less of a beating than you might think. Then, too, Dofasco is more focused on long-term contracts, than on the spot market. And it's in the spot market where homegrown steelmakers are most vulnerable to foreign competitors. In the meantime, Dofasco boasts an attractive dividend yield of three per cent. And thanks to its recent purchase of Quebec Cartier Mining, it can now lay claim to a secure, long-term supply of iron ore. Dofasco is also one of the best-managed steelmakers in North America.

Enbridge and TransCanada PipeLines are two peas in a pod. So why make TranSCan, and not Enbridge, a top pick?

Because TransCanada boasts a dividend yield of 3.4 per cent — and Enbridge, a payout of only 2.7 per cent. Moreover, TranSCan, through Cameco and BPC Energy, has a stake in nuclear energy. And nukes are increasingly becoming part of the energy solution. Of course, as pipeline operators, both TransCan and Enbridge stand to reap rewards from expansion in the tarsands. The two companies are also well positioned to benefit from the planned development of gas deposits in the Arctic.

STOCKS STEPHEN GERRING LIKES

Canadian Oil Sands Trust
(COS.UN-TSX; $123.20)
Phone: 403-218-6200

TD Bank Financial Group
(TD-TSX, $57.83)
Phone: 800-9832265

Canadian National Railway Co.
(CNR-TSX; $81.96)
Phone: 800-319-9929

Dofasco Inc.
(DFS-TSX; $45.25)
Phone: 800-363-2726)

TransCanada PipeLines Ltd.
(TCA-TSX; $52.60)
Phone: 800-361-6522

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