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THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

SMALL-CAP STOCKS

Five small-cap strategies for

STAYING THE COURSE

David Graham, CFA

LIKE THEIR LARGER-CAP cousins, small-cap stocks gyrated widely in price through August, after touching fresh highs in July.

The BMO Small Cap Blended Index was up 15.6% year-to-date between January 1 and July 19, but had fallen to negative territory YTD by about Aug. 21. By the end of August, the small-cap index was ahead a meagre 3.0% YTD.

In our opinion, investors need to be cautious for the rest of the year, watching employment growth, house prices, and consumer spending for any signs of weakness. The US Federal Reserve Board (Fed) is widely expected to cut rates at its Sept. 18, 2007, meeting. But even if it does, some may say it comes as "too little, too late," and concerns about a slowdown could continue.

We are not necessarily negative about the market. But we feel market volatility could continue until investors feel more confident.

Small caps could be affected more than large caps in this environment. Typically, investors seek out more liquidity in times of confusion, and historically, small-cap companies have been squeezed when credit gets tighter, as it has been recently, because smaller companies need capital to grow.

The most recent valuation data available show that at the end of June 2007, the BMO Nesbitt Burns Small Cap Index was selling at 18.45 times trailing earnings (based on companies with positive earnings only), compared with 17.07 times for the S&P/TSX Composite Index. Historically, small caps have tended to trade at lower valuations than large caps (about a 10% lower average price-earnings ratio since 1996), and so there is less valuation support if the overall market goes lower.

As the managers of the Renaissance **Canadian Small Cap Fund**, we have been using strategies such as the following to meet these challenges.

☛ ***Reducing exposure to less liquid names.*** Any stock that seldom trades could be vulnerable, particularly if it might need capital.

☛ ***Not relying on leveraged buyouts.*** We may still see some corporate buyouts, but in our opinion, this game is over for awhile.

☛ ***Being wary of natural gas exposure.*** Natural gas used to be a commodity identified as available only from North American sources. But now that gas can be liquefied and shipped by tanker, it has become a global commodity. Greater accessibility has put a lid on domestic natural gas prices and is likely to affect many Canadian companies

☛ ***Look for good dividend or distribution yields***. We continue to have about 15% of our portfolio invested in income trusts, including **Liquor Stores Income Trust**, **Cineplex Galaxy Income Fund**, **Ag Growth Income Fund**, **Bird Construction Income**

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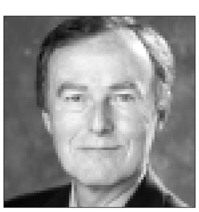

David Graham is vice president of Canadian equities at CIBC Asset Management and manager of the Renaissance Canadian Small Cap Fund

david.graham@cibc.ca

Fund, and **Primaris Retail REIT**. So long as the cash flow fundamentals look solid, and the distributions remain stable, we believe the yields will help minimize the risk.

☛ ***Looking for companies with a niche or franchise*** that will help them through an economic slowdown.

In keeping with our previous comments, our top holding, which we've mentioned in past *MoneyLetter* articles, continues to be **Stantec Inc.** (TSX: STN). This engineering firm is involved in various infrastructure projects, focusing on five core areas: urban land; buildings; environmental; transportation; and industrial. It is strongest in Western North America (about 25% of its revenues come from Alberta and 35% from California) but has made several acquisitions in the Eastern US and Canada in the past few years.

The company has a market capitalization of $1.6 billion and trades at about 23 and 19 times the consensus 2007 and 2008 estimated earnings per share (EPS), respectively. We continue to be positive about the outlook for infrastructure spending in North America and believe Stantec will benefit from it.

We recently added **Atrium Innovations Inc.** (TSX: ATB), a niche manufacturer of the active ingredients used by cosmetics and skincare companies in their anti-aging and other products. Atrium also supplies vitamins and other nutritional products to healthcare professionals.

The company intends to license its proprietary active ingredients as well as making acquisitions. We believe the company will benefit as the aging population uses more of these products. Atrium is valued at 20 and 15 times consensus estimates for 2007 and 2008, respectively.

Another addition to the portfolio was **Allen-Vanguard Corp.** (TSX: VRS), which supplies counter-terrorism protective products for use in the event of chemical, biological, nuclear, or explosive activities. Allen-Vanguard is a subcontractor to US aerospace giant **Lockheed Martin Corp.** and defense contractor **General Dynamics Corp**.

The company produces a key component for sophisticated electronic jamming devices used by various military forces. With its strong order backlog, the company expects 2008 revenues of $500 million and earnings before interest, taxes, depreciation, and amortization (EBITDA) of $160 million.

Finally, **Descartes Systems Group Inc.** (TSX: DSG) is another of our portfolio holdings. Descartes provides online software solutions for trucking companies, airlines, ocean carriers, and freight forwarders, which use them to bid on, initiate, and track shipments. Revenue for the company comes on a per-transaction basis, and over 90% of revenue is recurring.

With increasing monitoring and filing of international shipping into the US, we believe Descartes stands to benefit, because it offers shippers a low-cost standardized approach to both completing the shipment and filling out the bureaucratic forms.

The company has a strong balance sheet, having raised $23 million in equity earlier this year. At 14.3 and 14.8 times the January 2008 and 2009 estimated EPS, respectively, Descartes offers good value.

As you can see from these examples, while the small-cap end of the market is vulnerable during the ups and downs of volatility, diligence in selecting and monitoring stocks can smooth the ride.▼