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A 'better way to play the market' - use a long-short strategy

The Canadian stock market still has legs, but investors should not expect the robust double-digit returns of recent years that have been fuelled by rising commodity prices and takeovers, says *hedge fund manager Arun Kaul*.

"We are still in an upward trend," said **Mr. Kaul**, a portfolio manager with **Toronto-based Hillsdale Investment Management Inc.**

"We are in the later stages of the business cycle so earnings growth is starting to slow down," he said in an interview.

"But the cycle is not over, and we don't see the Canadian market approaching a recession in the near term. I don't think we are in a bear market."



Moderately bullish on the Canadian market, **Arun Kaul of Hillsdale Investment Management Inc.** says a long-short strategy is a good bet in the late stages of a cycle. (*Tim Fraser/The Globe and Mail*)

Mr. Kaul said he also does not believe the United States is headed for a recession in the near term, or even early next year. "The U.S. Federal Reserve Board has now started to reduce rates, and it does change the picture slightly," he said.

"Most previous recessions have been caused by the Fed raising rates and growth slowing. This time we've had the Fed reduce rates while growth has been fairly positive."

Using a long-short strategy is a "better way to play the market" in the late stages of the cycle, said the co-manager of **Hillsdale Canadian**

Long Short Fund and the Hillsdale Canadian Performance Fund.

"You are able to capture the opportunities on both sides," said Mr. Kaul, who uses a quantitative strategy to pick stocks and holds his positions on average for a year. "As earnings slow down, there are opportunities on the short side to pick up companies that are having greater difficulty generating earnings."

The **Hillsdale Canadian Long Short Fund** has 35 per cent of its assets in short positions, and that is expected to increase going forward, he said. Over the three years ended Aug. 31, the **Hillsdale Canadian Performance Fund** - a long-only fund - posted an average annual return of 20 per cent compared with **Hillsdale Canadian Long Short Fund**, which garnered a 13-per-cent return.

Mr. Kaul is moderately bullish on the Canadian market, but is not expecting the annualized returns of 18 to 20 per cent of recent years. "If you look at the overall market today, earnings growth is running at about 10 per cent, and 10 per cent is still solid earnings growth," he said.

Earnings growth in energy and materials companies are respectively running at 8 per cent and flat, while the highest growth rates in the mid-teen range are in the consumer discretionary, consumer staple and financial sectors, he said.

Mr. Kaul's picks are as follows:

LONG

Shaw Communications Inc. (SJR.B-TSX) The cable television company is highly profitable with a 30% year over year earnings growth, while its stock trades at 11 time price to cash flow.

Yesterday's close \$24.93, up \$0.32



Manitoba Telecom Services Inc. (MBT-TSX).

The telecommunications firm has strong profit margins, stable earnings growth in the mid-teens, and its stock trades at a "reasonable multiple" of six times price to cash flow, he said.

Yesterday's close \$48.53, up \$0.04



SHORT

SNC-Lavalin Group Inc. (SNC-TSX).

The engineering company's profit margins are "fairly low" at about 7 per cent, while there has been a sharp rise in debt-servicing costs, he said. SNC, which traded at 12 times cash flow when the cycle began, has become "expensive" as it trades at over 20 times cash flow now, he said. He expects the stock to trend lower in the next three to 12 months.

Yesterday's close \$44.29, up \$0.69

