HILLSDALE
INVESTMENT MANAGEMENT INC.

US Small Cap Equities: A Breadth of Opportunity

Presentation to the Montréal CFA Association
February 22, 2007

Confidential

Thesis

For the first time in 20 years, the US Small Cap market combines higher growth, lower valuation, less risk and greater breadth than the Canadian equity market.

Yet, small cap strategies are typically under represented in institutional asset allocation frameworks and US small cap strategies are drastically under represented in Canadian asset allocation frameworks.

Traditional optimization might conclude: Why bother?

	Canada SC PRI *	Russell 2000 PRI
Dec-94	-7.99%	-3.18%
Dec-95	13.00%	26.21%
Dec-96	25.79%	14.76%
Dec-97	13.76%	20.52%
Dec-98	-7.24%	-3.45%
Dec-99	18.43%	19.62%
Dec-00	3.86%	-4.20%
Dec-01	3.20%	1.03%
Dec-02	-4.29%	-21.58%
Dec-03	33.04%	45.37%
Dec-04	5.83%	17.00%
Dec-05	8.87%	3.32%
Dec-06	6.70%	17.00%
Annualized Rtn	8.61%	9.10%

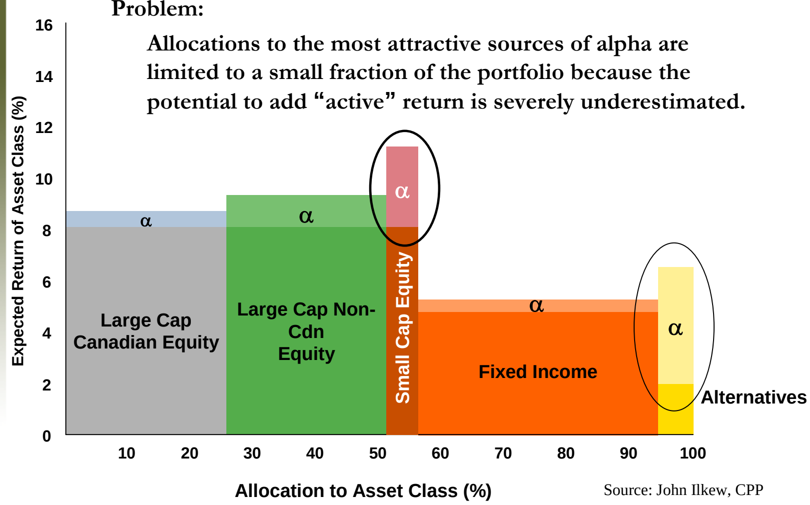
Sources: Bloomberg

* TSE200 to May 1999 S&P TSX SC onward

Traditional Approach to Asset Allocation

Problem:

Allocations to the most attractive sources of alpha are limited to a small fraction of the portfolio because the potential to add "active" return is severely underestimated.



Source: John Ilkew, CPP

Given equal skill, a manager's IR will be higher if the strategy's breadth is larger

$$IR = IC*\sqrt{BR}$$

BR is the strategy's breadth. Breadth is defined as the number of independent forecasts of exceptional return we make per year.

IC is the manager's information coefficient (skill).

Thus,

IR(US)>IR(Cdn) if BR(US) >BR(Cdn)

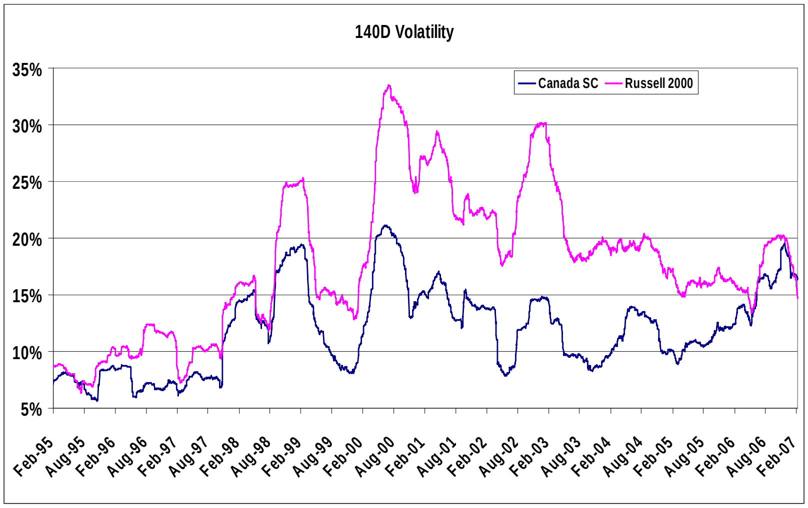
The US has over 30% of the Russell Global Small Cap names and 6X the breadth of Canada

RUSSELL GLOBAL SMALL CAP 7000

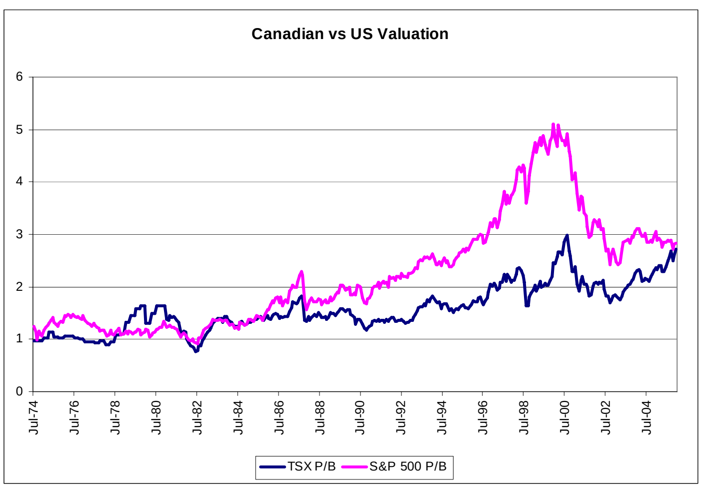
Country	% of Total Holdings
UNITED STATES	30.38%
JAPAN	17.77%
UNITED KINGDOM	5.96%
CANADA	5.11%
TAIWAN	3.21%
INDIA	2.76%
KOREA, REPUBLIC OF	2.63%
AUSTRALIA	2.32%
FRANCE	2.32%
ITALY	1.88%
GERMANY	1.86%
CHINA	1.73%
HONG KONG	1.67%
SWITZERLAND	1.45%
SWEDEN	1.35%
Total	82.40%

Source: www.russell.com

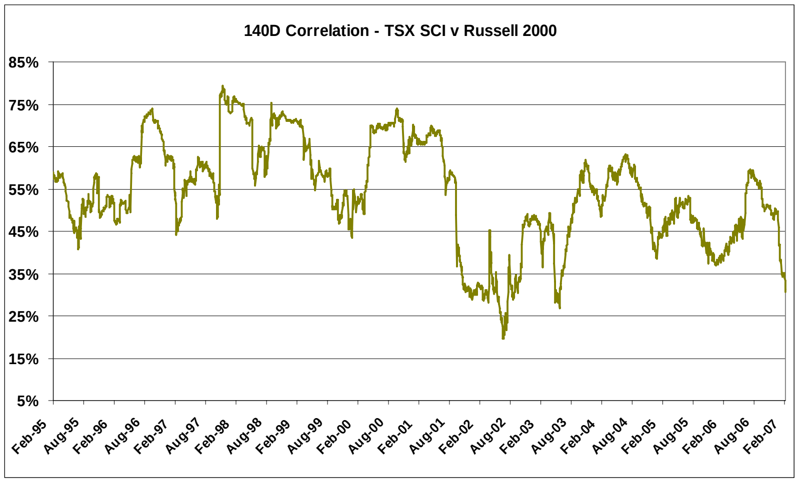
Typically available at higher risk, US small cap volatility is now equal to Canadian



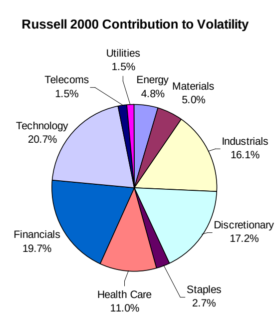
Typically available at a premium, US valuations (large cap) are now equal to Canadian

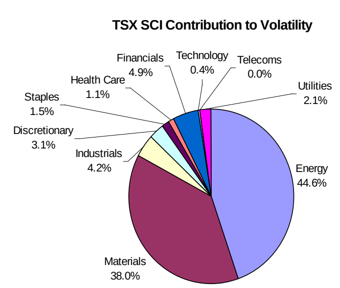


Typically highly correlated, US small cap stocks are now near historic lows vs. Canadian

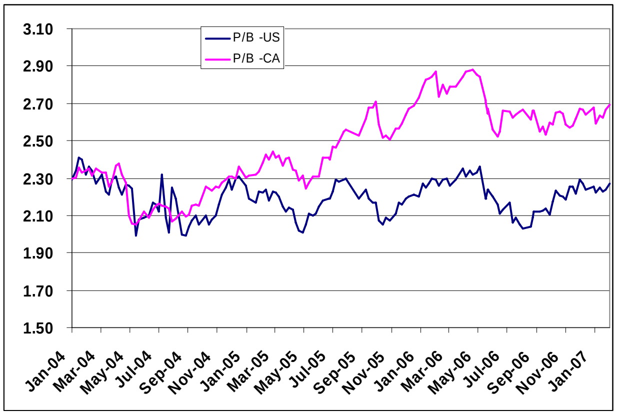


Risk in the Canadian market has clustered in 2 sectors while risk in the US is evenly distributed



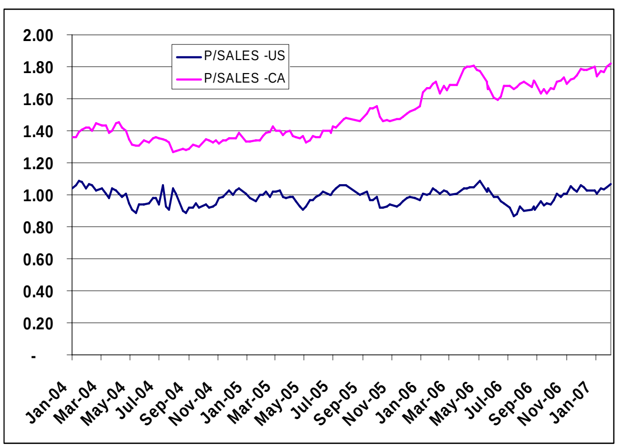


US small cap stocks now trade at a discount on book value to Canadian small cap stocks.

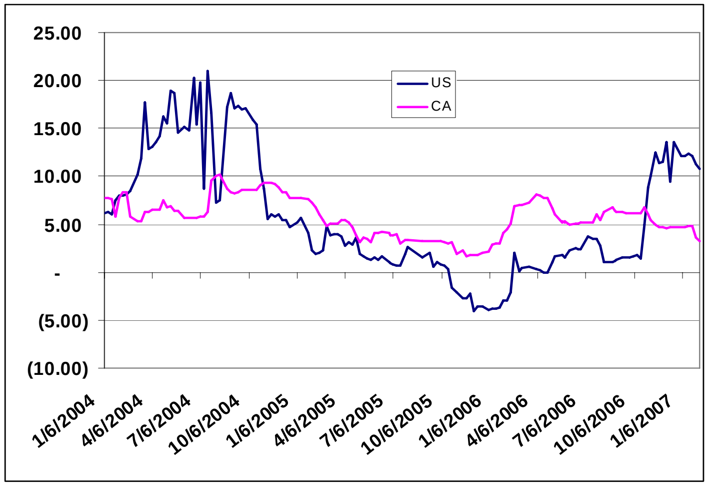


Source: Ford Investors, CPMS – Cap weighted

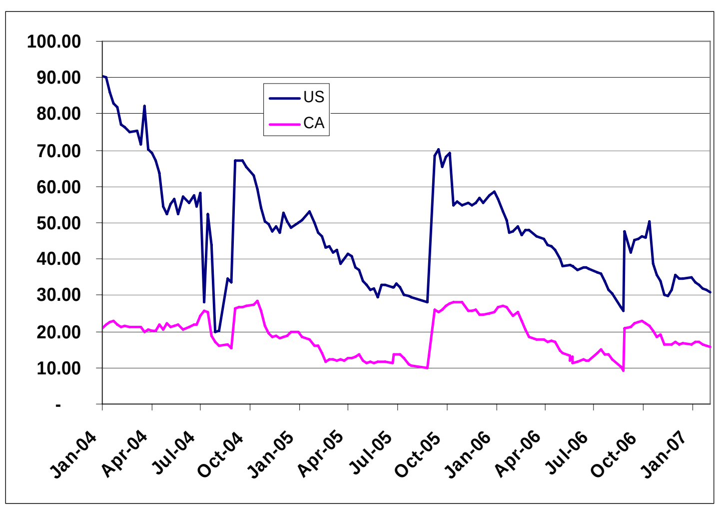
US small cap stocks trade at a discount on sales to Canadian small cap stocks



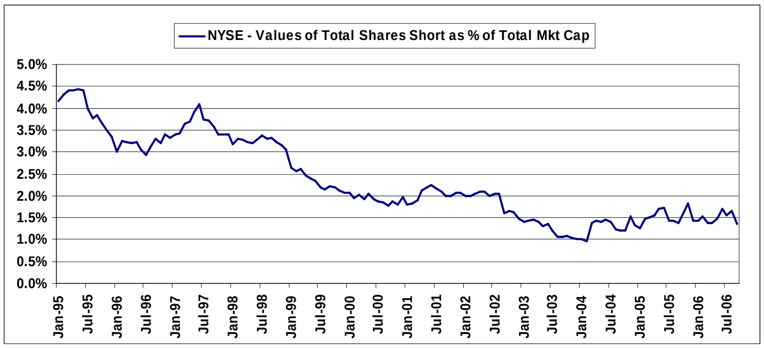
US small cap stocks have higher reported quarterly operating earnings growth



US small cap stocks have higher estimated annual earnings growth



US market sentiment is positive.



A high IR in the US requires a broad factor set,

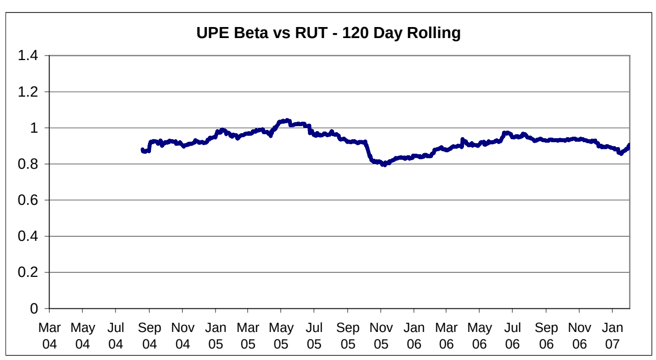
Fundamental	Growth, Value, Income, Profitability, Leverage
Expectations	Consensus, Variability, Surprise
Price Risk	Regression, Volatility, Higher Moments
Technical	Moving Average, Oscillators, Stochastic, RS
Macro	Financial, Economic Time Series
Sentiment	Short Selling, Insider Trading, Options, Governance
Market Impact	Bid/Ask Spreads, Volume, Liquidity Measures

a forecast made of orthogonal factors…

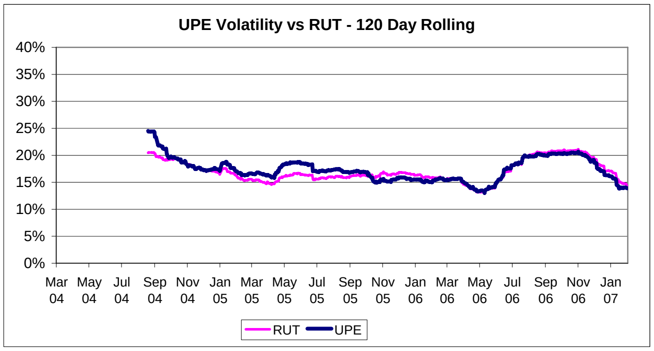
Factor Screens **Market Cap Screen: $250 mil to $6 bil**

Total Rank by %	Factor Category Weighting as %	GICS	Expectational 40.6%	Technical/ Trading 12.5%	Value 18.8%	Growth 4.7%	Risk 4.7%	Profitability 3.1%	Earnings Quality 9.4%
Names to Buy:									
1%	Interwoven Inc	45	39%	0%	15%	2%	22%	2%	27%
3%	Heidrick & Struggles	20	13%	23%	18%	1%	34%	6%	27%
6%	Brooks Automation Inc	45	87%	11%	3%	0%	22%	2%	9%
7%	Hibbett Sports Inc.	25	23%	4%	28%	2%	2%	37%	45%
11%	GAMCO Investors, Inc.	40	118%	11%	19%	22%	1%	0%	7%
12%	United Therapeutics	35	59%	1%	13%	2%	43%	1%	8%
16%	Credence Systems Corp	45	47%	4%	1%	2%	2%	16%	9%
Names to Sell:									
43%	Sealed Air Corporation	15	44%	9%	21%	2%	2%	1%	2%
46%	Weight Watchers Intl	25	49%	12%	46%	1%	1%	0%	43%
47%	Masco Corporation /DE/	20	21%	0%	23%	0%	0%	0%	1%
59%	Noble International Ltd	25	31%	2%	33%	1%	1%	2%	23%
65%	NIC Inc	45	20%	10%	29%	0%	0%	2%	76%

a reasonable beta policy



..and a risk budget.



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Pourquoi?

