



Northern Exposure

March 25, 2005; Page C1

Canadians joke that their country can be a bit boring (in a nice sort of way, of course). Its stock market, at least, isn't.

Shares of energy and basic-materials companies, which have been buoyed by higher prices for oil and other commodities, represent more than a third of the total value of the Toronto Stock Exchange's S&P/TSX composite. Another third: financial-company shares, which have been lifted by still-low global interest rates.

The result: the TSX composite is up 50% during the past two years. Factor in the strength of the Canadian dollar against its U.S. counterpart and the index has risen 83% in U.S. dollar terms.

But for the most part, even internationally minded U.S. investors haven't taken part in the rally. The main benchmark followed by international mutual funds aimed at developed markets is the Morgan Stanley International EAFE index. It includes markets in Europe, Australasia and the Far East -- but not Canada. A typical response from international fund managers is that putting money in Canada is really the job of their firms' U.S. managers. (Insert 51st state joke here.)

But the benchmarks that U.S. portfolio managers are trying to beat typically are comprised wholly of U.S. stocks. A big bet on Canada gone awry could put a fund well behind its peers, and there goes the year-end bonus.

At this point, taking a big swing at Canadian stocks could easily end up being painful. The Federal Reserve increasingly is worried about inflation, and that may mean the unusual global economic combination of rising commodities prices and low interest rates is destined to end. Canada's investing sweet spot could easily go sour. Even so, there may be opportunities.

Not just mutual funds, but many hedge funds have shunned Canada. Arun Kaul, principal at Toronto hedge fund Hillsdale Investment Management, reckons that the hedge-fund presence in the Canadian stock market is between one-sixth and one-third of what it is in the U.S. market. With less hedge-fund participation, there also is far less trading -- average holding periods for Canadian stocks are nearly double that of their U.S. counterparts.

For investors who complain that the proliferation of U.S. hedge funds has made it hard to find any good ideas, Canada might be worth a look. Plus, the doughnuts are better.