

A good time to be in Canada

Why take on the currency risk of U.S. stocks?

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Willem Hanskamp and David MacNicol are enthusiastic about Canadian energy stocks.

The combination of a strong Canadian economy, robust commodity prices and an ascending Canadian dollar puts Canada in a particularly sweet spot for investors, says Montreal-based Willem Hanskamp and Toronto-based David MacNicol, members of the investment policy committee of C.F.G. Heward Investment Management Ltd./Heward MacNicol Asset Management Ltd.

Hanskamp and MacNicol specialize in the private client area. They have global mandates and can select from both value and growth stocks for portfolios they manage.

Within Canada, their focus is on big cap energy stocks such as EnCana Corp. and Imperial Oil Ltd., as well as select base metal stocks.

"Money goes where it is treated best," says Hanskamp. He points out that the Canadian economy is in good shape relative to the other G7 countries. Canada

continues to create jobs, in contrast to Europe and the United States. Also, Ottawa is running an "unexpectedly" large fiscal surplus of some \$9-billion, whereas the United States, Europe and Japan are running fiscal deficits.

Canada's strong natural resource base is another reason why Hanskamp and MacNicol like their home base. Commodities are still in demand, thanks mainly to the ongoing strength in China, says Hanskamp.

"Throw in the strong Canadian currency versus the U.S. dollar and the case for Canadian dollar investments becomes more compelling," says Hanskamp. There is a clear currency risk for Canadians buying U.S. stocks. "Even if the U.S. stock market goes up, the gains could be offset by a declining U.S. dollar."

The two managers have sold most of their U.S. stocks. They are also unenthusiastic about Europe, "with its lacklustre economic growth," says Hanskamp. Besides Canada, the two managers are overweight Asia -ex Japan. The economy in China, which has been such a strong driver of regional and global growth, is slowing modestly from a high rate of growth, says Hanskamp

The forecast is for China to produce a growth rate of 8% to 8.5% in 2005, versus the expected 9% for 2004. "Prospects for a soft economic landing for China are good, which is positive for the global economy," he says. Within Asia, the two managers still like India, despite its political upset earlier this year. "The economy is rapidly transitioning from a primary to an industrial/commercial base," says Hanskamp. They continue to play India

through an exchange-traded fund, India Fund (IFN/NYSE). As a play on the region, they still like the Asia Pacific Fund (APB/NYSE).

"We are currently neutral on Japan," says Hanskamp. "Japan is showing some cyclical weakness, but it is only that, and not the beginning of another serious long-term deflationary spiral that we witnessed in the country starting in 1990," he says.

Turning to their portfolio, the two managers are enthusiastic about Canadian energy stocks. "Earnings and cash flow per share estimates still do not reflect the price of oil at historically high levels," says MacNicol.

He is reiterating a "buy" on:

- EnCana Corp. (ECA/TSX), which closed recently at \$62.34 and has a 52-week range of \$62.81 to \$45.25. This Calgary-based senior energy producer specializes in heavy oil and natural gas. This stock was one of their picks in this column on July 30, when it traded at \$58.85. Since then, the company has taken the important step of selling its British interests held under Encana (U.K.) Ltd. to Canada's Nexen Inc. for about US\$2.1-billion in cash. The company expects to record an after-tax gain of more than \$1-billion on this sale, which is slotted to close in early December.

EnCana has stated that it will use this cash to strengthen its balance sheet and expand its stock buy back program, says MacNicol. "This is positive for stock holders." The stock trades at roughly 13 times estimates of 2004 earnings per share and 10.5 times EPS estimates for 2005. They still like Canadian integrated Imperial Oil Ltd. (IMO/TSX) \$70.15 (\$73.17 - \$51.12). It was one of their picks in this column on July 30, when the stock traded at \$64.22.

The two managers have sold their holding in U.S.-based integrated ChevronTexaco Corp. (CVX/NYSE) US\$52.65 (US\$56.07 - \$36.58). "We made money on this stock -- and why take the currency risk when there are excellent Canadian energy companies?" says Hanskamp.

Turning to other materials stocks, the two managers are highlighting:

- Alcan Inc. (AL/TSX) \$59.60 (\$66.08 - \$50.71). This Montreal-based major global aluminum producer is showing good earnings growth, says MacNicol. The stock trades at 18 times 2004 EPS estimates and 12 times 2005 EPS estimates.

- Inco Ltd. (N/TSX) \$44.90 (\$54.10 - \$38.75). Based in Toronto, this major nickel producer is expected to produce only modest earnings growth in 2005 due to the ongoing costs of developing the Voisey's Bay nickel-copper-cobalt deposit in Labrador. "There are considerable capital costs associated with this and the project has had some setbacks, but the prospects are substantial," says Hanskamp. The stock trades at roughly nine times 2005 EPS estimates.

In the golds, the two managers are picking:

- Newmont Mining Corp. (NEM/NYSE) US\$48.35 (US\$50.28 - US\$34.83). This Denver-based miner has a Canadian subsidiary, Newmont Mining Corp. of Canada Ltd. (NMC/TSX) \$57.87 (\$65.83 - \$48.11). The Canadian stock is exchangeable any time for one common share of the U.S. parent. "These two stocks trade in tandem," says Hanskamp. "Newmont Mining Corp. is one of the largest unhedged gold producers in the world and can therefore take full advantage of the rising bullion price." It has a low cash cost of some US\$233 per ounce. Consensus EPS estimates for the parent are US\$1.08 for 2004 and US\$1.40 for 2005.

- They also like Australian-based conglomerate BHP Billiton Ltd., which has an American depository receipt (BHP/NYSE) US\$21.76 (US\$22.09 - US\$15.50). This company has oil and gas, coal, aluminum, gold and other metal interests. Consensus EPS estimates are US\$1.70 for 2004 and US\$1.93 for 2005.

The two managers have lightened their interest in Canadian diversified mining company:

- Teck Cominco Ltd. (TEKb/TSX) \$30.58 (\$31.85 - \$16.11). The stock of this Vancouver-headquartered base metals,

gold and metallurgical coal producer "has done extremely well and we took some money off the table," says MacNicol.