

# MoneySense

FOR CANADIANS WHO WANT MORE

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## SMART STOCKS

Six of Canada's brightest investors give us their picks (and pans) for the months ahead. One tip: don't buy Nortel

BY GEORGE KOCH

**T**HESE ARE TRYING TIMES TO BE AN investor. If you stuck with Old Economy stocks over the past year, you saw your holdings stagnate. But if you joined the rush into technology shares, your hopes for instant dot.com wealth blew up this spring when the Nasdaq, the world's premier exchange for tech stocks, plunged 32% from mid-March to mid-April.

So where does a smart investor go from here? To find out, we asked six of the smartest investors we know, including a couple of economists, a pair of fund managers, one of Canada's top securities analysts, and a respected portfolio manager, to tell us what they see on the horizon. Our goal wasn't to canvass the usual suspects, but to interview people who, for the most part, aren't covered in the popular press.

We hoped to find independent thinkers, and we succeeded. Our experts' views ranged from the ultra-bearish to the mildly bullish. Some believed in active stock selection, others in indexing, and one argued that you should be out of the stock market, period.

If there was one common sentiment, it was the belief that the fat, easy returns of the past few years are over. Throughout the coming year, and the coming decade, investors are going to have to be smart and selective to make money. But despite the threats that hang over the market—rising interest rates, a slowing economy—it's still possible to amass and protect wealth. Here are six expert views that can give you a head start on building your own portfolio in the years ahead.

### Peter Puccetti

Founder and Manager

The Goodwood Fund, The Goodwood Capital Fund  
Toronto

PETER PUCCETTI, 34, IS THE SAME AGE AS MANY Internet entrepreneurs, but don't turn to the former financial analyst and investment banker for an enthusiastic endorsement of the latest hot tech stock. Puccetti believes much of the tech sector is overvalued, and he's hoping to benefit from the correction he sees ahead.

Puccetti's disdain for high-flying Internet companies reflects his belief in value investing—the strategy of taking positions in undervalued but sound companies and holding them until the market recognizes their worth. While value investors have been dismissed over the past couple of years as hopelessly out of date, Puccetti thinks a value-oriented, bargain-shopping strategy is still the approach that makes the most sense for the serious investor. “Over the long run, value investing has done better than any other style,” he contends.

Puccetti has the personal numbers to back his claims. He runs The Goodwood Fund, which has thrashed the TSE 300 index for the past three-and-a-half years, generating a net compound annual return of 33.4% since its founding in October 1996. The fund is what's known as a hedge fund or market neutral fund, which means that it attempts to make money in good markets and bad through a combination of strategies—most notably, taking “short” positions in



assets. And Puccetti doesn't hesitate to go big on companies he really loves, investing up to 10% of the mutual fund and 15% of the hedge fund in a single stock.

"I'm trying to add value through good stock selection," says Puccetti. "If you look all over the indices, you can find stocks trading at low multiples that are also good companies." In particular, he looks for companies that have low debt, high free-cash flow and some special market advantage that positions them to grow rapidly.

Consider Canadian Medical Laboratories Ltd. (ticker symbol CLC), which trades on the Toronto Stock Exchange. The firm performs blood work and other lab tests for doctors. What's so exciting about that? Well, Ontario requires such labs to be licensed, creating a significant barrier to other companies that might be tempted to enter the market. And the province also sets fees, which means that the more efficient a lab is, the more money it will make.

Canadian Medical, which controls about a third of Ontario's medical laboratory market, has the size to achieve the needed efficiencies. It's already operating with 44% margins and it's expanding into other areas as well, notably the rapidly growing business of testing new medications for pharmaceutical giants. Puccetti thinks Canadian Medical, which was trading at about \$17.25 in midsummer, is worth \$30. "Buying the stock now gives you a play on Ontario's biggest lab business, plus a new side to the business with a very high growth rate attached to it," he says.

Puccetti also likes Future Shop Ltd. (FSS on the TSE), a Vancouver-based home electronics, computer and appliance retailer. It was trading at around \$23.25 in midsummer, less than three times the earnings Puccetti forecasts for 2000. Comparable U.S. retailers trade at 30 to 40 times earnings. Even at less exalted multiples, Puccetti thinks Future Shop could become a \$45 to \$60 stock.

While Puccetti is buying Future Shop, he's skeptical of what many people have touted as the future. For much of the past year, he's put a small portion (about 8%) of his portfolio into shorting the Nasdaq 100 and much of the Internet sector in the belief the high-tech bubble will burst. And he's also shorting the TSE/S&P 60, consisting of many of Canada's largest companies. "We're not against technology as such," he says, "but we are against overvaluation." He thinks the share prices of many tech stocks—including Nortel, which makes up a big portion of the TSE index—have grown past the point they can be justified. For a value investor like Puccetti, it's time to get out. ■

stocks it doesn't own, in hopes prices will fall. The fund is intended only for sophisticated investors and, depending upon your province of residence, can require a minimum investment of as much as \$150,000. To tap into a wider audience of investors, Puccetti and partner Ted Rabin recently founded a mutual fund with a similar philosophy. The Goodwood Capital Fund requires a minimum investment of only \$5,000, and its value has grown from \$10 per unit at its launch in January to \$12.45 by midsummer.

Puccetti stresses that both funds are intended to be used only as minor components of a well-diversified portfolio of traditional stock and bond investments. Instead of minimizing risk, the goal of his funds is simple: to beat the market by making sizable bets on what he perceives as particularly good value investments. To increase investors' leverage, the hedge fund borrows against its

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