LAKETON

Laketon Canadian Equity Value Fund

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Milos: Hello and thanks for tuning in….. Laketon's continuing commitment to providing our clients with pertinent and timely information regarding financial markets and our full investment product lineup continues this month. My name is Milos Kostich, and as VP Sales Strategic Alliances here at Laketon, I am happy to have with me today, Andrew Simurda, VP and portfolio manager of the Laketon Canadian Equity Value fund.

Welcome Andrew

Andrew: Thank you

Andrew - there have been some managers that have said recently that growth has become scarce in this current market environment. Could you give the listeners a sense of what constitutes a "value" stock for you ?

Andrew: Milos, back in late October when I last commented on the markets, I pontificated that value as an investment style should outperform growth given the weak economic environment ahead of us. This statement has held true. Looking forward, given the improving but still weak economic outlook, I believe that value investing still has a high probability of providing good relative performance versus growth.

Many different methodologies are used when screening value stocks. I utilize a six-step process that over time has been very effective. The first step focuses on the balance sheet. I look for stocks that have low to moderate levels of financial leverage. I also make sure that any debt repayments are appropriately spread out. This first screen helps avoid situations like we find today, where many companies with high levels of debt, or who have large amounts of near-term debt that needs to be refinanced, are being penalized by the market with lower valuations.

The second step focuses on the cash flow statement. I look for stocks that are currently generating or are about to generate high levels of free cash flows. Another way of saying this is, I look for companies which are trading at a high free cash flow yield. Companies that generate strong free cash flows are able to generate shareholder value by paying an increasing dividend over time, making accretive acquisitions or buy back stock.

The third step is where valuation comes into play. I look for stocks which are trading at or near their historical low end of where they have traded on many different metrics such as Price to earnings, price to cash flows, price to book and enterprise value to EBITDA.

Step four involves talking to management and examining the business model to assess the competitive advantages of the company. We will not invest in companies whose business models are in secular decline regardless of the relative cheapness of the name.

The fifth step is that we formulate a fundamental target price for the company based on the above. This target price then becomes the corner stone for our strong sell discipline. Obviously we are looking for stocks which offer strong upside to our internally generated target price.

The final step is a technical overlay. We use technical analysis to help us with our entry points and exit points on stocks. This helps us avoid in most cases buying stocks that are in a strong downtrend and selling a stock when upside price appreciation remains strong as the stock approaches our target price.

Milos: To help with your outlined stock selection process Andrew, what outside sources of information do you use to arrive at your preferred securities?

Andrew: At Laketon I have a wide range of electronic information sources from which to draw from. I also have full access to all sell side research to supplement my internal analysis. I attend as many industry conferences as possible and I almost always have full access to senior management of companies that I am interested in. I also have the ability to consult four other very knowledgeable Canadian portfolio managers at laketon and our highly regarded fixed income team.

Milos: We've all seen the financial sector worldwide suffer as a result of the credit crisis and other factors. Here at home there have been numerous factors contributing to falling financial stocks. Do you feel that this is a sector that holds long term positives for investors?

Andrew: Milos, as you know I have been underweight Canadian bank stocks for an extended period of time to the benefit of our unit holders. In the short term, I anticipate that the fundamentals for Canadian banks will get weaker. Housing fundamentals in Canada continue to weaken and job losses have only started to spike higher. In simplistic terms, one can argue that our housing and job markets are 6 to 12 months behind the declines seen in the US. I highly believe that for structural reasons the downturn in Canada will not be as severe as the US, but because we entered the downturn later, we will also exit the downturn later. With rising job losses and a weak economy loan loss provisions are about to spike higher. Also, some argue and I agree that existing reserves for loan loss provisions on Canadian bank balance sheets are too low for this point in the credit cycle and this will magnify the loan loss provisions going forward.

With that said, and applying the screening process that I talked to earlier, I believe bank balance sheets are in good shape, I believe banks will continue to generate excess capital, and banks were trading at their lower end of historical valuations before their recent rally. As a result, I believe a lot of these negative market fundamentals I addressed are priced into the stocks. Therefore, mid to long term I am bullish on the bank stocks and I will be looking for share price weakness over the coming months to close my underweight position and potentially go overweight.

Milos: The world economic downturn and global reduction in demand for oil has drastically affected the energy sector among others. What is your view when it comes to the profitability of the energy sector and the future price of oil?

Andrew: Milos, the oil markets remain structurally tight on a long-term basis. However, spare capacity has increased in the short term as demand for oil products has declined given the global economic contraction. This short-term situation has lead to the collapse in oil prices. However, I believe that we have already seen the lows for oil of roughly $35 earlier this year and that a new uptrend is developing. The reasons for this optimism going forward is predicated on supply reductions that have recently more then compensated for the demand destruction. OPEC has had high compliance to recent quota cuts and supply from non-OPEC producing countries is already in steep decline. These supply responses to the weak oil price environment should allow oil to trade in a range between $40 and $55 over the next several months. However, in the third to fourth quarter of this year, I expect oil prices could break out of this trading range to the upside. This prediction is based on my belief that the US economy should stabilize and start to grow later this year in response to the unprecedented fiscal and monetary stimulus. Add to this a recovery in China’s growth rate which shows signs of already commencing. As a result, when building my cash flow estimates and net asset values for oil stocks I use $55 oil for 2009 and $70 oil for 2010. At these prices, Canadian energy companies remain very profitable and generate strong operating cash flows. Also, using these same estimates, oil stocks are trading at the lower end of their historical valuation ranges. As a result, I am bullish on the oil sector mid to long term and have an overweight position today.

The last thing to mention on oils to add to the bullish case is that it is cheaper today to buy oil assets then it is to grow them organically. As a result, I expect mergers and acquisitions within the oil patch to heat up. We have already seen large cap acquisitions with Suncor merging with PetroCanada and there are numerous announcements in the mid and small cap space.

Milos: Could you comment Andrew on the agricultural climate worldwide and how this affects fertilizer demand, particularly Potash.

Andrew: The world's population continues to grow Milos. But more importantly, the eating habits of developing countries are changing as more and more people consume protein. As a result, growth in world crop supplies is needed and this requires fertilizers. The long-term fundamentals remain positive. However, in the short term, the fundamentals for the three main nutrients remain different. For various reasons, our order of preference is nitrogen, then phosphate and lastly potash. As a result, Agrium remains our favorite way of playing the fertilizer names because of its higher exposure to nitrogen and, in our opinion, cheaper valuation.

Why do we least like Potash in the near term? Mainly because potash prices have only started to correct while Nitrogen and Phosphate prices have already seen steep declines.

As global growth started to decline and then outright contract, farmers and buying organizations around the world decreased purchases of potash and started to either draw down inventories or reduced or even stopped applying potash to their fields. This is in response to potash prices reaching dizzying heights of $1000 per ton. At these prices, the economics of applying potash to ones crops to better yield is marginal at best. In order to keep the market balanced and prices high, potash producers around the world cut production. It then became a waiting game to see who would blink first. This waiting game is still in progress however in the meantime Potash Corporation has recently released Q1/09 results that were much lower then expected and also substantially lowered earnings guidance for 2009 all predicated on lowered demand for potash shipments. Also, recent rumblings out of India and China are that these countries are looking to settle potash price contracts at lower levels then the markets assume. If these rumblings become fact, further negative earnings revisions for potash producers are possible.

With that said, Potash Corporation is a world class Canadian company and that long-term fundamentals remain positive for the company. At the right price, which is lower then where it trades today, I would gladly add this stock to the portfolio.

Milos: Andrew given your comments, how have you positioned the Laketon Canadian Equity Value Fund to take advantage of some of the trends and market realities today?

Andrew: Milos, back in late October I commented that it was a great time to buy the Canadian equity market. As a result, I reduced my substantial cash position down to less then one percent. Over the last several months, the markets have developed what I would call a multi–month rolling bottom that has culminated with the beginning of a new up-cycle. In the near term, markets may be ahead of themselves and a correction would be healthy, but mid to long term I remain positive on the outlook for the Canadian equity markets. As a result, my cash position remains low and the sectors that I am finding the most value in today remain the oils, information technology and consumer discretionary. I also recently took advantage of the strong pull back in golds to take my underweight bet off. Lastly, I hope the banks will experience a period of weakness over the next several months. If they do, there is a high probability that I will use that weakness to add to these stocks and reduce my underweight position.

Milos: Andrew, thanks as always for your comments and insight, I hope that we can have you back in the near future…..

Please tune in next month for continued commentary from our portfolio managers …these audio commentaries can be found on our website at www.laketon.com