

**Milos:** Hello and welcome to Laketon's continuing series of audio commentaries featuring portfolio managers from Laketon's fixed income and equity teams. My name is Milos Kostich, Vice President, Sales/Strategic Alliances it is my pleasure to have again with us Brad Cann, Vice President and portfolio manager of the Laketon Enhanced Dividend Fund and Andrew Simurda, Vice President & Portfolio Manager portfolio manager of the Laketon Canadian Equity Value Fund.

Whenever stock markets exhibit volatility and prolonged turmoil, clients tend to re-examine their portfolios and specifically the fund choices that they have made.

I would ask both of you how your funds fit into a diversified portfolio and why they can be considered complementary to one another.

**Brad:** Thanks Milos. Our approach to investing with the enhanced dividend fund emphasizes a long-term, value-oriented outlook, which aims to take advantage of the power of compounding dividends over time. Every stock in this portfolio pays a dividend. In times of turmoil in the equity markets, such as we're currently experiencing, we remind ourselves of some the fundamental principles or basics of investing and attempt to keep them top of mind. So, how does the dividend fund fit into someone's portfolio? Well, with these fundamentals in mind, I would say that it is our humble opinion that the enhanced dividend fund should be a core element of someone's asset allocation to equities, that is within their investment wallet, we believe the fund is a good fit in someone's portfolio to the tune of 20 to 30 % of the total investment dollars, keeping in mind an appropriate time horizon and risk tolerance.

Clients may have discovered over the last three to four years of the bull market that their portfolio is no longer that diversified in that some of the high flying commodity or resource exposures may have, with great returns, gotten to be a bigger proportion of their portfolio than they really should be in the long haul. And this would be a great time to re-examine that in light of market activity.

I would repeat here that every security we put in this fund pays a dividend. So by definition, we do not even consider owning some securities, which would otherwise be considered fairly good value oriented investments, solely due to not paying a dividend, and for that reason we would not suggest that investors put all their investment dollars in the dividend fund. They would be missing out on some of the opportunities to diversify and maybe that's a good intro into Andrew's Value fund.

**Andrew:** As Brad alluded to, a well-diversified equity portfolio should have a balance between value and growth. In general, during periods of strong economic growth, growth/momentum strategies tend to provide greater returns, while during periods of slower economic growth or even contraction, value tends to provide better relative returns. Over the last 10 years, growth strategies outperformed during the technology driven bull market of the late 90's and early 2000's and more recently during the commodity bull market that ended in early 2008. Value mandates provided better relative returns in periods surrounding these two periods of time.

As mentioned, for the last three years, growth has outperformed value during the commodity bull market. Since the commodity complex started to correct, we have seen value provide better relative returns since the start of Q3/08. After such an extended period of underperformance by value vs growth and given the very weak economic outlook in the near to mid term, I expect it is values time.

One last point that I would like to remind people about, is that over long periods of time value as an investment style does outperform growth.

In general, the dividend fund should be considered a slightly lower risk investment than the value fund as it focuses on large cap dividend paying value stocks only. The value fund on the other hand does and will invest up to 35% of the portfolio in small cap and mid cap value stocks while the remainder goes into large cap. While dividends are important, they are not a necessity. Portfolio theory would suggest all else being equal, that over long periods of time the value fund should outperform the dividend fund to compensate for the incremental risk involved. As a result, if your clients are risk adverse but want exposure to the equity markets, then a portfolio more focused on the dividend fund would be appropriate for ones value component. However, if your clients focus is longer term and capital growth is the primary objective, then the value fund should make up a bigger percentage of ones value component.

**Milos:** Often clients make choices as to what funds are in terms of the stock holdings and performance history and they base their expectations on these and other factors. Can you give the listeners a sense of what to expect and more importantly, what not to expect from these respective funds when it comes to fund reaction to bull and bear markets and specifically as it pertains to the current pull back in the commodities sector.

**Brad:** What can investors expect from the dividend fund? Well, one way I like to think of it, is in terms of an analogy, say to the car industry. Do I buy a Volkswagon sedan or a Ferrari race car? Obviously, my belief is that the dividend fund is the Volkswagon. Both vehicles may get you to the desired destination or investment goal, yet the "ride" will likely be bumpier though faster in the Ferrari. In my view, the dividend fund and how it's managed takes the steadier approach to reach its goals. So what investors can expect is a ride that makes it easier to sleep at night. Reminding investors it is still predominantly an equity fund. Thus we believe it will help avoid some of the high risk elements of some other investment strategies, but at the expense of giving up some potential returns. People can expect that most of these securities would be large cap, likely names people have heard of or are familiar with. We will also from time to time invest in preferred shares, again, a bit less return but also lessening risk of this fund. So, what not to expect from this fund is investments in high technology start-ups or other kinds of small concept stories that have sometimes the huge potential returns, but come with all the various very risky elements.

Likewise, industry sectors with the history of chopping dividends will not have a large exposure in this fund. So how will this fund act in a roaring bull market? Well in a frothy bull market, one should expect this fund to lag the return leaders due to its conservatism. But the fund should still grow with positive returns due to its equity exposure. And in a bear market, again, because we don't take the huge risks in some of the more speculative securities, we're a little bit more cautious in our investing, that's where we shine and preserve capital, and one would expect that this fund in a bear market would likely go down, but go down materially less than the market. The other analogy I like to use to describe the dividend fund is the old familiar tortoise and hare story. So, I hope that gives investors a sense of what to expect when they own the enhanced dividend fund.

**Andrew:** The value fund utilizes a very strict selection process. This process does not change regardless of what the markets or sectors within the market are doing. We also have a very strict sell discipline which is predicated on our fundamental target prices. We will only buy stocks which have strong balance sheets, which are generating strong free cash flows, that are trading near the bottom end of the historical valuation

ranges and whose business models are sound with strong management teams. As a result, when markets are down and value is to be found, like today, we are buyers of stocks because many good quality stocks will make it through our value selection process. Over the last couple of weeks, we have taken our cash position down from over 10% to 1% today. On the flip side, when stock markets are going up in leaps and bounds, naturally our cash position will increase as many stocks reach our fundamental targets and less and less value is to be found.

In 2007, and early 2008 we were underweight commodity stocks as value could not be found given our selection process. With the significant pull-back in commodity stocks we are now starting to find value in these sectors. As a result, we have added to the materials and energy stocks in recent weeks. However, we are also finding tremendous value in other sectors of the market as well. While I would never try to guess a bottom, the best time to buy is when there is blood in the streets and panic is everywhere, like today. We are buyers of the Canadian equity markets currently as value is to be found.

**Milos:** Brad, there have been a lot of articles lately as to the importance of dividends in an investment portfolio particularly with today's market realities. Can you give us a sense as to why dividends are important to a portfolio and how they can help overall return in good times and bad?

**Brad:** As to your last question Milos, definitely we have seen in the press recently a little more emphasis on the importance of dividends, which we always stress in our investment strategy but we've seen the press pick-up on this. Why are dividends important? Well, in good and bad times, basically, when you look at the stream of dividends on equity securities again even in a diversified portfolio, the dividend stream to investors is a lot less volatile and in generally upward increasing manner, but for sure, a lot less volatile than either the security prices themselves or the cash flows or earnings from the companies. So what dividends do for investors is provide a sense of stability to a portfolio's returns in both good times and when capital gains are harder to come by. With this focus we fall in good company, witness Warren Buffett's recent investments in preferred shares of Goldman Sachs and GE.

The other thing the dividend payments do is often they help put a floor price under the security and therefore, lessen the capital loss potential of the securities. What do I mean floor price? Let's consider an example, suppose a company pays a secure dividend, and due to its history, it is not thought by investors to be on the cutting board. What might be a normal market times a 4% dividend say \$2 on a \$50 stock compared to interest rates of the day say 5%. If the security drops below \$40 along with other securities because of a bear market the math might take the dividend yield to 5 ½ or 6%. It is not an exact science, but then the price will not likely go down much further, because the yield becomes so attractive compared with other investment alternatives. The dividend acts as an alternative for investors to that heavily taxed interest income. So this cushioning acts very differently to those investments where the only return comes from capital gains. One final comment on dividends, it's a sign of a profitable company, since dividends are paid out of after the tax profits, companies that are not yet profitable do not pay dividends.

**Milos:** Thank you Brad and thank you Andrew for your comments and thanks to our listeners for tuning in. We encourage you to tune in next month for our December commentary by available at [www.laketon.com](http://www.laketon.com) the first week of December.