

Now is not the time for ninth-inning heroics

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Financial Post

Monday, August 14, 2006

Jonathan Wellum's return to AIC Funds has not been easy. In his first incarnation as lead manager of the flagship AIC Advantage Fund, Wellum could do no wrong. In the 1990s, the fund's heavy focus on financial services worked out well, giving advisors an "advantage" over those recommending more diversified Canadian equity funds.

Wellum left in 1999 to establish Georgian Capital with four partners. In 2002, AIC's billionaire founder, Michael Lee-Chin, persuaded Wellum to return to AIC as chief investment officer.

Unfortunately, performance of many of its funds has been disappointing and redemptions have taken their toll.

In March, 2002, AIC assets under management topped out at a whopping \$15.4-billion, according to the Investment Funds Institute of Canada. As of June, 2006, the figure had slumped to just \$8-billion.

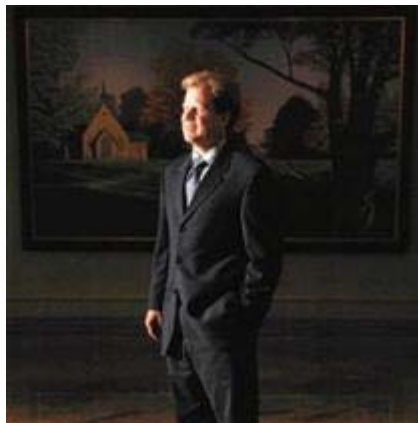
In an interview with several Post writers, Wellum had no difficulty identifying the problem. He attributes it to "our underweight in all commodity sectors." Lack of exposure to materials, oil and gas has "made it tough slugging for us," coupled with "our virtual non-existence in the income trust market."

Those are big sectors to be missing out on when they're as hot as they've been. In June, energy made up 31% of the TSX composite index, passing financial services (29%) to become the index's single-largest weighting, says Rudy Luukko, fund analyst for Morningstar Canada. Materials make up another 17% of the index, so "AIC Advantage is absent from two of the three largest industry sectors, including the largest one."

But the last thing Wellum wants to do is jump into the resources sector in what may prove to be the ninth inning. He insists redemptions are slowing and believes AIC will be a great spot for investors wishing to take money off the table from resource plays elsewhere.

Lee-Chin is holding firm, as one would expect of a fund company inspired by the "buy good businesses at good prices" approach of Berkshire Hathaway Inc.'s Warren Buffett.

That philosophy is summed up in AIC's famous slogan: Buy, Hold and Prosper. Naturally, that has been twisted by some wags into variants where the word Prosper is replaced by "Suffer" or "Perspire."



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AIC's Jonathan Wellum does not believe in diving into energy at this late stage when the sector may be at its peak. He advises patience, although he concedes that not all clients are willing to stick it out.

"Believe me, we've heard them all," Wellum grimaces. He concedes AIC's much-vaunted discipline has not resulted in a payoff lately. He and Lee-Chin intend to stay the course but not all advisors wish to emulate their patience. Alternatives beckon and redemption schedules for funds sold in the 1990s have wound down; the artificial constraint of redemption fees is no longer a reason for clients to stay put.

This is a problem with which most other fund companies are also grappling.

Wellum is waiting for the day when the commodity bull market cools. If it does, rival funds swollen with commodity stocks could fall and AIC might shine again. "If there's a pullback we'll gap up quickly."

But in case that day is tardy in arriving, AIC has hedged its bets beyond mutual funds. Wellum is also chairman of Copernican Capital Corp., 51% owned by AIC. It sells structured products to brokers who might never consider AIC mutual funds. One innovative Copernican product is a global financial infrastructure trust, reminiscent of the wealth industry focus of the Advantage funds.

Copernican has raised \$200-million in two years but that's just a fraction of the billions still riding on AIC mutual funds.

AIC is not alone in finding itself temporarily out of favour. Ivy Canadian Fund is similarly on the outside looking in underweighting the energy sector, though it does at least have a 7% position. Trimark Canadian is just 5% in energy and 8.5% in materials.

It's tempting to draw a parallel to 1999 when Buffett, Trimark and other deep-value investors were out of favour for not participating in the technology and dot-com bubble.

If resources turn tail the way tech did in 2000, the Ivys and AICs of the world could look good. "If it turns and it turns quickly they may look like stars," agrees Toronto-based fund analyst Dave Paterson.

Conscientious advisors like Martin Kosterman of Oakville-based Fiscal Agents are all for giving fund managers enough time to prove themselves over the long run. But he concedes not all clients are that patient. "The reality is honest-to-goodness stock pickers aren't rewarded any more," says Kosterman. For now, he prefers to keep any AIC money with the less-concentrated AIC Diversified Fund.

With \$1.7-billion in it, that's AIC's largest, says Morningstar's Luukko. But over the year ended June 30, 2006, the fund has also been "punished" for subpar performance, and assets are down 20%.

Investors are happier with James Cole, manager of AIC Canadian Focused Fund. It's been top quartile over five years and advisors have rewarded it with 30% more assets in the past year, Luukko says.

"What this says to me is investors and their advisors are not anti-AIC per se in terms of the entire fund complex. They're anti subpar performance."

Fund analyst Dan Hallett doesn't buy the "not in energy" excuse. He suspects the omission is based not on fundamentals but simply because such managers made high-level calls to stay out of those sectors.

Neither AIC nor Mackenzie's Ivy funds are on Hallett's recommended list. However, performance is not the reason for his call. Some of Trimark's Canadian equity funds have also disappointed but remain on his recommended list.

Hallett also likes Kim Shannon's C.I. Canadian Investment Fund. It's also on Dave

Paterson's recommended list, along with O'Shaughnessy Canadian Equity, Saxon Stock and AIC Canadian Focused.

Paterson thinks advisors should take a total portfolio approach, so "we don't get into these sorts of discussions where a fund is underperforming so let's dump it."

That's also how RBC Investments advisor Nathan Mechanic views the current environment. He's selling some Canadian equity funds because his portfolio approach is calling for more global equities and monthly income or dividend products.

AIC also has products in those areas but so do all its rivals. If it is to prosper under Wellum, the turnaround may have to happen in its original niche. Until another rotation of sectors occurs, it will be playing at a disadvantage.

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