

FP INVESTING

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BUY & SELL

Palmer doesn't expect big slump in China. **FP7**

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BUY & SELL

BIG-PICTURE VIEWS, CURRENT ISSUES, OUTLOOK AND PICKS. BY JONATHAN RATNER



TYLER ANDERSON / NATIONAL POST FILES

Steven Palmer, manager of the AlphaNorth Growth Fund, says now that inflation is under control in China, its economy can be stimulated — good news for Canadian companies.

China poised to grow again

MANAGER PROFILE

Manager: Steven Palmer, AlphaNorth Asset Management

Fund: AlphaNorth Growth Fund

Description: Diversified exposure to Canadian companies with market caps typically between \$100-million and \$1-billion

AUM: \$12.5-million (as of March 31, 2012)

Performance: 10.3% (Q1 2012)

Fees: 2% management, 20% performance above TSX return

The slowdown in China is a major reason why Canadian stocks have underperformed their global peers since the equity rally began in October 2011, particularly those on the resource-heavy S&P/TSX Venture Index.

Some investors are worried the weakness in small caps will continue since Chinese GDP fell to 8.1% in the first quarter of 2012. But Steven Palmer, president and chief investment officer at Toronto-based AlphaNorth Asset Management, insists Chinese growth remains very strong.

"Now that inflation is under

control in China, they have room to stimulate the economy. So I don't expect a significant slowdown in Chinese growth," he said. "When China starts to reaccelerate, that will lead to outperformance by the Canadian market. This is going to benefit small caps in Canada, which are heavily resource-weighted."

Nevertheless, Palmer has reduced the resource weighting in the AlphaNorth Growth Fund to 60% from 80% earlier in 2012. The portfolio manager, who also runs AlphaNorth Partners Fund, a small-cap long-biased hedge fund, remains very bullish on

commodities, but is taking a more balanced approach by adding some consumer discretionary stocks.

In recent days, Palmer has also seen technical buy signals for the TSX Venture index, which tends to bottom around the 1,400 mark.

While small-cap stocks are more volatile than their larger peers, the manager stresses the importance of owning them because they have outperformed large caps since 1950. Small caps also tend to have much higher growth rates, offer investors more selection, and are often inefficiently priced because of limited analyst coverage and investor interest.

"The vast majority of investment returns are a result of portfolio construction and asset allocation," Palmer said. "As a long-term investor, you can't afford not to have an allocation to the best-performing asset class over the long term — small-cap equities."

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BUYS

MOOD MEDIA CORP.
Ticker **MM/TSX**

The position: added to portfolio in 2012.

Why do you like it? Mood Media is the world's largest in-store media specialist for music, video and scent, a business that has high barriers to entry and a loyal customer base. "The recent acquisition of DMX solidifies this market-leading position," Palmer said. "Cost synergies from this acquisition, plus the expansion into digital signage, will be the major catalysts for earnings growth going forward."

Biggest risk: Long-term debt, which some investors believe is a little high.

TRIMEL PHARMA CORP.
Ticker **TRL/TSX**

The position: Recently added to existing long-term position.

Why do you like it? Trimel is going after large markets with multiple drugs. For instance, it's in Phase III trials for a testosterone replacement therapy for men and will soon begin a second Phase II trial for a female sexual dysfunction treatment. It also has other earlier-stage products in the pipeline. "Management is highly experienced and were previously very successful at Biovail," Palmer said.

Biggest risk: Problems with clinical trials.

MANITOK ENERGY INC.
Ticker **MEI/TSX**

The position: Recently added to existing position on weakness.

Why do you like it? Manitok has had strong results drilling for oil in Western Canada and expects production will rise from approximately 2,850 barrels of oil equivalent per day at mid-year to 4,000 by year end, with 55% to 60% of that being oil. Palmer notes this implies cash flow of more than \$50-million for 2013. "The current share price is quite cheap in the context of the current market cap of \$90-million. The company has used conservative commodity price assumptions and has a strong balance sheet. To further lower risk, management has locked in the pricing on a portion of its oil production at \$106.50 per barrel."

Biggest risk: Drilling problems and declining commodity prices.



SELLS

**HORIZONS BETAPRO
U.S. 30 YEAR BOND
BULL PLUS ETF**
HTU/TSX

The position: Has held a short position for several months.

Why don't you like it? Interest rates don't have much room to go lower, Palmer notes. "When rates start moving up, which we believe will begin occurring in 2012, investors will start realizing losses in bonds."

Potential positive: Unexpected problems in Europe or the United States.