

NATIONAL POST

OUTLOOK REMAINS CAUTIOUS; MANAGER SEES OPPORTUNITIES IN U.S. EQUITY PERFORMANCE

Jonathan Ratner, Financial Post, Wednesday, April 11, 2012

Despite improving economic numbers out of the United States and substantial progress being made on the European debt crisis, the outlook for stocks remains hazy because a large number of potential pitfalls remain, said Gaelen Morphet, Empire Life's chief investment officer.



Gaelen Morphet, cfa
Senior Vice-President &
Chief Investment Officer

As a result, the veteran value manager, along with co-manager Lieh Wang, is taking a more cautious approach to the equity markets.

Ms. Morphet points out that the warm late-winter weather has positively skewed economic data on housing, manufacturing and employment. "We've kind of borrowed from the spring, so we may see weaker numbers going forward," she said.

The portfolio manager also notes that some of the economic improvement is the result of various forms of stimulus. "I still think there is a question mark as to how much of the improvement in the United States is actually organic and can be self-sustaining," Ms. Morphet said. "As long as that is an unanswered question, I think markets are going to be volatile."

Investors also have questions about how deep the European recession will be and how successful the Chinese will be at cooling their economy while also avoiding a major slowdown.

Ms. Morphet's portfolios are always fully invested and very diversified, but her exposure to U.S. stocks is currently the highest it has ever been.

"It doesn't mean we don't like Canada, but we simply see a lot of great opportunities in the United States," she said. "Given what the U.S. has gone through on the economic side and the significant equity under-performance for more than a decade, we see opportunities on the upside exceeding the downside."

BUYS

**BANK OF MONTREAL TICKER BMO/TSX CLOSE
\$58.11, DOWN 24¢**

The position: Recently added to existing position.

Why do you like it? Morphet continues to like Canadian banking stocks and considers them among the least expensive names in the country. While her favourites are Royal Bank and Toronto-Dominion Bank, she notes BMO is currently the most undervalued company in the sector.

Morphet estimates BMO is trading at a 30% discount to its long-term value of \$76 per share. It also has a very favourable yield of roughly 4.75%, with a possible dividend increase later in 2012.

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Biggest risk: Any disappointment with its Marshall & Ilsley acquisition; negative financial industry news related to regulation or a global financial failure.

CINEPLEX INC. TICKER CGX/TSX CLOSE \$29.05, DOWN 43¢

The position: One of the portfolio's largest positions.

Why do you like it? Cineplex has 66% of the Canadian cinema market. "It is also one of the most successful in North America, with more box office revenue per screen than any other franchise in Canada or the United States," Ms. Morphet said.

She adds Cineplex's revenues have grown at a compound annual growth rate of 17.8% over the past seven years, its balance sheet is strong and a dividend increase is expected later in 2012.

Biggest risk: A rapid decline in box office and concession sales.

PFIZER INC. TICKER PFE/NYSE CLOSE US\$21.99, DOWN US6¢

The position: One of largest U.S. positions in the portfolio. **Why do you like it?** Many U.S. health care stocks, including Pfizer, remain undervalued relative to other sectors and are cheap on a historical basis, Ms. Morphet notes.

Pfizer is currently reviewing its business model, a process that includes selling off several businesses. "In addition to the divestitures and reorganization of the business, strong expense control and positive product news should lead to better earnings and cash flow generation," Ms. Morphet said.

Biggest risk: Any delays in positive product announcements.

SELLS

CANADIAN PACIFIC RAILWAY LTD. TICKER CP/TSX CLOSE \$73.26, DOWN \$1.40

The position: Recently reduced exposure.

Why don't you like it? CP shares have done well since Bill Ackman's Pershing Square took a 14.7% stake in the railway and called for a leadership change to address the company's lagging productivity.

"We believe that the stock price is already discounting a great deal of the target operating ratio improvement and better earnings recently," Ms. Morphet said.

Investors vote on the company's board on May 17. Potential positive New management moves in and delivers better-than-expected results.

MANAGER PROFILE

Manager: Gaelen Morphet, Empire Life

Fund: Empire Elite Equity Fund

Description: Large-cap equity fund designed to protect and grow wealth

AUM: Total equity mandates ~\$4-billion

Performance 1-year: -5.01%; **3-year:** 12.45% (as of Feb. 29, 2012)

MER: 2.54%