



Stealth superstars: Canada's best fund managers

"Mutual Funds" by Suzane Abboud

Is there such a thing as a good fund steered by a mediocre or even poor manager? It can happen. As a matter of fact, you could be sitting on such a fund without knowing it. Fund managers tend to hop around from company to company, so a fund that has a stellar record may no longer be run by the people responsible for that record. As an investor, your problem is that there's no guarantee the new manager is as good as the departed one. In many cases, people who buy into a fund with a strong record are disappointed by its future performance — and often the culprit is a change in the people at the top.

To avoid being blindsided by a change of management, you should check to make sure that any fund you buy is still being run by the people responsible for its past results. To aid in your research, let me share with you my findings about who I think are the best people in the Canadian asset management industry. I've listed this elite group in **The magnificent seven**.

The trickiest part of compiling this list was making sure I was comparing apples to apples. To do so, I reclassified fund managers based on the behavior of their funds over the last five years. This proved revealing, since the Investment Funds Standards Committee (IFSC), which slots mutual funds into broadly accepted categories, sometimes classifies managers in a way that distorts their true performance. Look beneath the surface and you find that some managers who may be classified as, say, Canadian equity managers are actually small-cap managers, and so on.

To properly classify managers, I calculated the historical correlation of each fund with different indexes. If, for instance, a fund showed more correlation with the small-cap index than the large-cap index, I placed the manager in the small-cap category, regardless of the fund's IFSC classification. If there was no strong correlation with either the small or large-cap index, I put a manager in the diversified category. I performed a similar

analysis to distinguish between value investors and growth investors. The result was a system of nine categories, covering Canadian bonds, Canadian equities, U.S. and global equities.

After I had every manager classified properly, I recalculated what his or her results would have been before subtracting management fees. Since the purpose of my exercise was to find the best managers, not the best funds, it was important to put all managers on equal ground, by measuring their performance before costs.

Next, I shortlisted all the managers who reported above-average returns for the past one-year, three-year and five-year periods. From that shortlist, I excluded the least consistent managers, managers who assumed too much risk or those with low risk-adjusted returns (RAR). Managers who failed any of those rigorous criteria did not make it to **The magnificent seven**, which explains why I have listed only seven managers, even though my universe included nine categories. No manager in the U.S. or Canadian small-cap category made the grade.

I rejected managers who were concentrated in a single sector or who departed from their funds' mandates to achieve their results. I was particularly concerned about managers who took advantage of the energy boom to boost their results. There's nothing wrong with buying oil stocks, but it's important to differentiate between a manager who achieves good results by selecting strong companies in a variety of areas and a manager who achieves results by riding a single-sector wave. The former is more consistent, the latter may be just lucky.

In the Canadian Bonds category, Michael McHugh of Dynamic Income Fund topped my list. Unfortunately, his fund charges 1.87% in annual fees. I believe bond investors are better off with the ultra-cheap **iUnits Canadian Bond Broad Market Index Fund**.

In the Canadian Equity (Diversified) category, Kim Shannon of CI Canadian Investment Fund has a very consistent record. Like the vast majority of her peers, she follows a value-oriented style, which has given her fund a boost, since this style has been in vogue since 2000. However, much of her success is the result of her undoubted prowess at stock picking.

In the Global Equity category, Peter Cundill rules. I particularly like his emphasis on Japan. Japan's banking crisis is nearly over and the country is all but out of its deflationary spiral. Cundill's fund is a conservative way to play the Japanese recovery.

In the Large-Cap Canadian Equity category, I selected two managers. One was Michael Stanley, who topped my list of managers who followed a blend of both growth and value styles. The other was **Mark Thomson**, who headed my list of pure value managers. I didn't pick a top growth manager, because there are few, if any, managers who practice a growth style in the Canadian market.

In contrast, the U.S. market is loaded with such managers, perhaps because the **S&P 500 Index** is heavily weighted with growth stocks in technology, health care and industrial sectors. As a result, U.S. large-cap funds tend to follow either a growth-oriented approach or a strategy that blends growth and value aspects.

Robert Jones of Goldman Sachs heads my list of growth-oriented managers. He is a proponent of quantitative stock selection methods — picking stocks by the numbers, in other words. Many investors think that large-cap growth stocks will lead the last phase of this bull market, as they have in other bull markets. If, like me, you buy that theory, Jones's fund is a reasonable investment.

At another end of the U.S. equity spectrum, Francis Chou of Chou Associates stands out as a unique fund manager. He usually gets labeled as a deep-value manager, but his fund's performance is not highly correlated with the value index and some of his holdings are arguably not cheap. As a result, I am more comfortable classifying him as a diversified U.S. equity manager. But by whatever standards you judge him, he is simply outstanding. Even better, his fund is relatively cheap, with a management expense ratio (MER) of less than 2%.

From the November 2005 issue.

The magnificent seven

Our select list of Canada's top fund managers by category

Manager	Five-year return*	Five-year RAR*	Index return	Five-year std. dev.	Consistency	Category	Fund name	MER
Michael McHugh	10.81%	11.79%	8.08%	0.93%	73.33%	Canadian Bonds	Dynamic Income	1.87%
Kim Shannon	21.26%	39.92%	-1.05%	2.51%	68.33%	Canadian Equity (diversified)	CI Canadian Investment	2.38%
Michael Stanley	9.50%	11.74%	-2.66%	3.23%	68.33%	Large-cap Canadian equity (diversified)	GGOF Canadian Growth	2.54%
Mark Thomson	17.37%	26.89%	-2.66%	2.92%	70.00%	Large-Cap Canadian equity (value)	Beutel Goodman Cdn. Equity	1.45%
Francis Chou	25.36%	31.15%	-6.80%	3.44%	70.00%	U.S. equity (diversified)	Chou Associates	1.77%
Robert Jones	-3.83%	-4.41%	-6.80%	3.81%	55.00%	U.S. equity (growth)	Elliot & Page American Growth	2.54%
Peter Cundill	15.73%	18.39%	-5.05%	3.31%	63.33%	Global equity	Mackenzie Cundill Value	2.55%

Source: Fundata Canada Inc. and FundScope

*RAR is risk-adjusted return. Both returns and RAR are calculated before deducting management fees