FP INVESTING

BIG-PICTURE VIEWS, CURRENT ISSUES, OUTLOOK AND PICKS.

BRETT BEADLE

Sean Oye, portfolio manager at Vancouver-based Nicola Wealth Management, has his eye on the "zeal for yield" as a potential danger in the current market.

Extra risk calls for tighter vigilance

BY JONATHAN RATNER

Central banks are coercing investors out on the risk curve again since many short-term fixed-income investments have negative real yields, so Sean Oye of Nicola Wealth Management thinks extra vigilance is needed.

"Investors aren't really being compensated for the risks they're taking," he said.

Oye noted that U.S. 10-year Treasuries currently yield about 2.6%, whereas Japanese 10-year government bonds yield less than 60 basis points as Prime Minister Shinzo Abe's inflation dream is coming true, borne out by April CPI print of 3.4%.

"Why would any investor want to buy a 10 year JGB when you are virtually guaranteed a negative real yield?" the manager asked.

The co-portfolio manager of the NWM Canadian Tactical High Income Fund sees risk creeping up in all asset classes, particularly as the "zeal for yield" continues.

He points out the market's low volatility and complacency, as evidenced by the VIX recently hitting a seven-year low, show people are starting to forget about the disruptions of 2008.

"This reduction in volatility has had the effect of reducing the premiums on put and call-option writing strategies," he said.

As a result, the manager is writing options a little closer to the money or at the money to generate annualized double-digit rates of return on those investments. In some cases, he isn't writing options on names at all.

"It's getting more challenging, but being benchmark agnostic has advantages."

Oye's goal is to generate tax-efficient cash flow through both long-only investments and income-generating strategies such as call and put options.

The manager has been increasing the fund's exposure to industrials, which now represent nearly 30% of the portfolio versus about 8% for the S&P/TSX composite index.

"Many of the industrial names we own have the majority of their revenue outside of Canada," Oye said, highlighting his positive outlook on the U.S. economy.

Financial Post

MANAGER PROFILE

Manager Sean Oye, Nicola Wealth Management
Fund NWM Canadian Tactical High Income Fund
Description Uses equities and options to target a yield of 4% higher than that of the S&P/TSX composite
AUM \$58-million (fund); \$2.8-billion (firm)
Performance 1-year: 19.2%; 3-year: 9.1% (as of May 31, 2014)
MER ~0.78%

BUY

GUARDIAN CAPITAL GROUP LTD. (GCG.A/TSX)

The position 3.9% of fund, purchased in Oct. 2013
Why do you like it? Oye is seeing positive developments with this wealth manager's capital allocation as it deploys some of its war chest to fund acquisitions and seed new products. Guardian Capital also still has roughly \$360-million in Bank of Montreal shares after selling some of its stake in recent quarters and 87% of its current share price is backed by BMO stock, cash and other securities.

"Very little value is being given to the asset management business," Oye said, noting it is one of the cheapest asset managers on an enterprise-value-to-AUM basis.
Biggest risks Equity markets sell off; BMO shares decline.

HEROUX-DEVTEK INC. (HRX/TSE)

The position 3.4% of fund, purchased in Oct. 2013
Why do you like it? Oye believes the aerospace industry is in the early stages of a growth story, noting Heroux-Devtek signed a significant contract with Boeing in 2013. "It's the world's third-largest landing gear manufacturer and still doesn't hit the radar of many fund managers because it has a small market cap and share float," he said. "This company could also become attractive to other majors as it nears its \$500-million sales goal for 2019, which the Boeing deal will help them achieve."
Biggest risks Higher-than-expected capex for Boeing 777 contract; a global economic slowdown.

PROGRESSIVE WASTE SOLUTIONS LTD. (BIN/TSX)

The position 4%, purchases in Jan. 2012 via put options
Why do you like it? Oye sees tremendous revenue and earnings growth over the next five years for this fully integrated waste management company.

"It is a highly fragmented market and Progressive can become a consolidator," the manager said, noting 60% of the \$63-billion market is serviced by local companies. He also pointed out that it is highly leveraged to the U.S. economy and there is significant upside if it wins a contract for New York City that it is up for.
Biggest risk A U.S. economic slowdown.

SELL

WESTSHORE TERMINALS INVESTMENT CORP. (WTE.UN/TSX)

The position Recently exited
Why don't you like it? Oye had owned Westshore, which operates a coal terminal in B.C., since April, 2012. He recently sold the position due to its valuation, coupled with low top-line growth prospects and reduced return of capital to shareholders.
Potential positives: Firm raises dividend prior to 2018; purchases or receives management contract for Ridley Terminals.