

Report on Business



Vito Maida, founder of Patient Capital Management: 'The real value [now] we think is in U.S. health care.' FRED LUM/THE GLOBE AND MAIL

STRATEGY

Why this value investor is loading up on cash

Vito Maida thinks equity valuations are dangerously high in Canada and could be in for a serious correction

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The Canadian stock market is more vulnerable to a major pull-back than its U.S. counterpart, warns one of Canada's more successful money managers of the past decade.

"We think that valuations in Canada, in particular, are at a very dangerous level," said Vito Maida, founder of Toronto-based investment firm Patient Capital Management Inc. "Equities in Canada have, I think, gone to levels that are not attractive today, and could be in for a serious correction."

The probability of a market downturn "in the next 12 months is high," but the timing is hard to predict, said the 51-year-old investor. "These things can go on for some time. ... We think the commodity boom has gotten to excess. I would use the word frothy."

The market is "not [yet] at extreme bubble peaks," but it is "absolutely possible" to retest the market lows of March, 2009, said Mr. Maida, whose portfolio managed to gain 4.5 per cent before fees in 2008, even as global stock markets were crashing. "We are probably close to or slightly above the valuations that existed in 2007 and 2008 before the crash."

While he believes the U.S. market, where he is now mostly invested, is less worrisome than Canada's, he is cautious on North American markets in general. "If you look at the long-term average dividend yield of the S&P 500 Index, it is closer to 3.5 to 4 per cent," he said. "Today, the yield is under 2 per cent. That tells us that the aggregate markets are overvalued by

MAIDA'S STOCK PICKS

WELLPOINT INC.

(WLP-NYSE)
Now: \$66.46 (U.S.)

WellPoint, the largest U.S. health insurer, benefits from its strong brand names, such as Blue Cross and Blue Shield, but is trading at less than 10 times trailing earnings. "It has an extremely strong balance sheet, while management has been terrific in returning capital to shareholders," Mr. Maida said. "They have reduced shares outstanding by 25 per cent over the last two years from share buybacks." The company just announced its first quarterly dividend of 25 cents a share. Mr. Maida's target is more than \$80 a share.

U.S. BANCORP

(USB-NYSE)
Now: \$26.15 (U.S.)

This diversified financial services firm, which has a solid balance sheet and a strong reputation among consumers, is growing by acquiring troubled regional banks. "We think it is the best-managed bank in the United States," Mr. Maida said. "Their capital ratios are the strongest in the industry." The company trades below 10 times normalized earnings, and is likely to be one of the first U.S. banks to raise its dividend once it gets the nod to do so from the federal government. Mr. Maida's target is \$35 a share.

DIAGEO PLC

(DEO-NYSE)
Now: \$71.76 (U.S.)

A global leader in the spirits business, Diageo owns strong brand names such as Guinness, Baileys, Smirnoff and Johnnie Walker. It trades around 14.5 times earnings, and pays a dividend of 3.2 per cent. While some investors worry about the company's slowing growth in Europe, the spirits maker enjoys exceptional growth opportunities in emerging markets such as China and India. Mr. Maida's target is more than \$90 a share.

a substantial degree."

Mr. Maida, who oversees \$125-million in assets, has raised cash levels to 55 per cent in the portfolio he runs for wealthy individuals and foundations. A year ago, he began managing the Horizons AlphaPro North American Value ETF, where he has boosted cash to 25 per cent, the maximum allowed by the fund's prospectus.

While his approach lags in rising markets, it outpaced North American indexes from inception in March, 2000, to the end of 2010. During that period, his portfolio posted an annualized 8.3-per-cent return before fees, compared with 5.6 per cent for the S&P/TSX Total Return index and a 3.2-per-cent loss for the S&P 500 Total Return index in Canadian dollars. After fees of 1.7 per cent for most accounts,

his return averaged 6.6 per cent annually.

"He is trying to preserve capital, while still trying to deliver attractive returns," said Dan Hallett at HighView Financial Group. "There are few who have been as successful as he in that context. ... While it may rub people the wrong way to hold cash in a rising market, at least now you could look back over the last 10 years and see that it has served his investors well."

Mr. Maida describes himself a deep-value investor who looks for stocks trading substantially below their intrinsic value. He became concerned about risk after witnessing the October, 1987, market crash when he was a junior small-cap analyst with pension fund manager OMERS just after he earned his MBA. He saw poorly managed and fi-

nanced companies lose 90 per cent of their value.

"It really made the value philosophy and the whole notion of never losing money and paying attention to risk embedded in my investment philosophy," he said. His cash levels averaged a lofty 80 per cent from 2000 to 2008, but he pared them down to about 30 per cent in 2009 when he went bargain hunting amid the market carnage.

Since starting Patient Capital in March, 2000, he has owned only about 30 stocks. "The only one that is not working out for us is Nokia," said Mr. Maida, referring to the world's largest cellphone company, which has been losing market share to rivals. But he is still hanging onto its stock, saying he believes that Nokia's recent alliance with Microsoft Corp. in the smart phone

market will help engineer a turnaround.

Mr. Maida's current bearish view on commodities contrasts with his call in the late 1990s when he was a manager at TriMark Financial Corp. His Canadian stock funds were 25- to 30-per-cent invested in resource stocks. And he owned gold bullion purchased at \$225 to \$250 (U.S.) an ounce.

His funds lagged because of his early call on resources and he was fired. But he was vindicated as resource stocks and gold bullion turned into big winners over the past decade. He admits, though, that he never envisioned gold surging above \$1,400 an ounce, and would not buy the metal now. "We think gold is overvalued and frothy," he said.

Mr. Maida, who runs concentrated portfolios of under 20 companies compared with the 40 to 60 holdings that are common in most mutual funds, said his investment process is the same as it was in the 1990s, when it led him to the resource sector.

"The real value [now] we think is in U.S. health care" because stocks of companies in that sector have been punished over the past couple of years because of uncertainty about health care reform, and government regulation, he said. He owns such names as Pfizer Inc., Johnson & Johnson and Stryker, a medical technology company.

"We purchased them when prices got driven down, but the businesses - and that is the key part - didn't get affected as badly as people thought. So margins stayed where they were. Growth is intact. Regulation hasn't been as onerous as people had anticipated."