

Acuity Canadian Small Cap

Morningstar Quicktakes™ Report

Jordan Benincasa
03 Aug 06

Acuity Canadian Small Cap

This growth fund makes a splashy debut in the Canadian Small Cap category.

Acuity Canadian Small Cap is off to a great start since its inception in July 2005, having generated a 33% return that has trounced most of its competitors in the Canadian Small Cap Equity category. Investors shouldn't construe this as beginner's luck though. This retail fund mimics Acuity's institutional small cap offering, which has performed outstandingly since December 2002. Furthermore, Acuity's investment team has established a superb track record with its other managed funds. As such, we believe this is one of the more attractive offerings in the small cap universe.

The firm's institutional product, Acuity Pooled Canadian Small Cap, has been on a tear since its inception less than four years ago. Thus far, its cumulative return of 343% has blown away its benchmark, the BMO Nesbitt Burns Small Cap Weighted Index, which has returned 110% for the same period. Even after adjusting its fees to those of the retail version, it has dominated the small cap scene, ranking in the top quartile 90% of the time over all one-year periods.

We also like Acuity's tight and experienced management team. The firm has not seen any portfolio manager leave in nearly a decade. Also, the average tenure of Acuity's portfolio managers is about nine years. This is encouraging since the firm uses a team approach to portfolio management for all its retail and institutional offerings. As such, management can take full credit for maintaining the highest number of funds earning Morningstar's top rating of five stars every month since last December.

The team is willing to pay up for growth, as evidenced by the portfolio's higher valuation measures. In addition, management is attracted to smaller companies than the average small cap fund. These stocks tend to be more sensitive to broader economic news. That said, this small cap offering may feel the pinch more than larger cap offerings during a weakening economy.

The portfolio is presently overweight in energy and materials relative to its benchmark and peers. Co-manager Hugh McCauley is a firm believer in the long-term prospects of these sectors. He particularly likes Guyana Goldfields (GUY/TSX), a gold exploration and development company that operates in South America.

This newcomer has performed quite well in the small cap arena thus far. Investors willing to accept the volatility normally found in this area should seriously contemplate owning this attractive offering.

Morningstar Rating

Fund Not Rated
(as of 30 Jun 06)

Strategy

Acuity uses a team approach to portfolio management. Each portfolio manager is responsible for covering two or three sectors. The team employs a bottom-up approach based on fundamental analysis and abides by a growth-at-a-reasonable-price (GARP) investment style. They seek stocks that demonstrate earnings growth that the market has not priced properly. From a quantitative perspective, the team looks for stocks that reinvest free cash flows back into the business, thus increasing its intrinsic value. Qualitatively, management likes companies that have developed a unique product or service, a well entrenched distribution network or a strong brand name, to name a few.

Management

Ian Ihnatowycz is the founder, president, and CEO of Acuity Investment Management. He provides strategic direction for all of Acuity's underlying offerings. Co-manager Hugh McCauley has been with the firm since 1996. He obtained an engineering degree and MBA from McMaster

Acuity Canadian Small Cap

Of Note

- ▶ The fund's 2.91% MER is 15 basis points higher than the category median.
- ▶ The best one-year return of Acuity's institutional small cap offering is a whopping 119%, while its worst year is still a decent 25%.
- ▶ This offering doesn't receive a Morningstar Rating because it has less than three years of history. However, Acuity Pooled Canadian Small Cap is a five-star fund.
- ▶ With only \$65 million in assets under management, the team has the ability to invest in microcap companies, which tend to fall under the market's radar.

About the Author

Jordan Benincasa is a fund analyst with Morningstar Canada. He is presently completing a joint LLB-MBA degree at the University of Windsor and holds a bachelor of environmental studies (honours) degree from York University. He is currently working toward his Chartered Financial Analyst designation.

University. Co-manager David Stonehouse is also lead manager of Acuity's fixed-income offerings. Prior to joining, he was a senior analyst at OMERS. Warren Fenton, who has been with Acuity since 1999, covers merchandising and consumer stocks. Martin Grosskopf focuses on the energy and material sectors. Prior to joining, he was a consultant in the areas of environmental and quality management.