

## Manager Monitor: David G. Stonehouse

by Jade Hemeon  
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**David G. Stonehouse:** Acuity Investment Management Inc.  
*Makes the conservative world of fixed income investing exciting.*

David Stonehouse, fixed income manager at Toronto-based Acuity Investment Management Inc., manages to make the conservative world of fixed income investing exciting. His primary retail vehicle is Acuity Fixed Income, which he has managed since its inception in November 1998. It has been a top-quartile performer in the Canadian Bond category in both short and long-term time periods.

For the year ended Nov. 30, the Morningstar five-star rated fund showed a one-year gain of 9.9%, well ahead of the category median of 6.2%, with significant outperformance carrying into the longer term. For the five-year period the fund boasted an average annual gain of 8.2%, again marching well ahead of the median gain of 6.4%.

Stonehouse, who has evolved through several incarnations since he graduated with a geological engineering degree from Queen's University in 1988, has a specific strategy for achieving healthy returns. It's a combination of determining the average duration of the fixed income portfolio, based on his expectations for the direction of interest rates, and judiciously jazzing up the asset mix with a portfolio weighting of up to 20% in income trusts.

"We have been successfully using income trusts for almost a decade," says Stonehouse, who has also achieved impressive returns in Acuity Pooled Fixed Income and the fixed income component of various funds within the Acuity stable. "The yields are substantially higher than for the government bonds."

Stonehouse avoids real estate income trusts (REITs) and utility-based trusts, which, like bonds, are highly sensitive to interest rate movements. He also avoids commodity-based trusts, which are tied to unpredictable commodity prices like oil and gas and consequently known for volatility.

"We focus on trusts that will benefit from economic growth and industry-specific trends," he says. "A trust with good business prospects can be a total return enhancer for the portfolio. Trusts also tend to have a low correlation with the bond market, which dampens overall volatility in the portfolio and offers diversification benefits."

On the bond side, the majority of the portfolio is made up of Government of Canada issues with short, medium and longer-term maturities. The average duration is plus or minus one year relative to his benchmark, the Scotia Capital Universe Bond Index.

"Government bonds are the most frequently traded bonds and the easiest to liquidate," Stonehouse says. "Liquidity is one of our parameters, and we make sure we're invested in securities we can easily trade."

High quality government and corporate bonds make up 80% to 100% of the portfolio, and any corporate and provincial bonds must be of investment grade and highly liquid.

High yield or "junk" bonds are not part of the mix, but Stonehouse does invest in Canada Mortgage and Housing Corp. (CMHC) bonds, commercial mortgage-backed securities, pension fund obligations and asset-backed securities such as credit card receivables. He limits foreign bonds due to the unpredictability of currency movements. At most, 10% of the portfolio will be held in foreign securities.

"Getting foreign currency movements right is extremely difficult," he says. "It's a mug's game, even for the experts. From our perspective, foreign bonds are pretty risky. A move in the wrong direction for the currency could wipe out a whole year of bond returns."

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Stonehouse typically holds 30 to 50 securities, and he likes to give them meaningful weight. He generally wouldn't hold more than 3% to 4% of assets in any single income trust or corporate bond, although he would be comfortable having up to 10% in a Canadian government bond.

Although Stonehouse didn't have his sights set on money management when he started out in his career, he has acquired a useful mix of practical and academic experience. After graduating with his bachelor of science in engineering from Queen's, he obtained his MBA from McMaster University's co-op program, which included practical training with Nortel Networks Corp.

In 1992, he joined Nortel as manager of human resource planning, and later became an analyst for the company's massive research and development budget. He then became an analyst on the sales side, and later a manager of strategic planning, deciding which products had the best potential in the evolving telecommunications industry.

Stonehouse spent seven years working his way up the ranks of Nortel, acquiring his CFA designation before he left in 1997. He moved to the Ontario Municipal Employees Retirement System (OMERS) as an equity analyst. In 1998, he joined Acuity's equity team, moving quickly to portfolio manager.

"It was an all-hands-on-deck approach at Acuity, and I quickly picked up fixed income among other things," Stonehouse says. "I've been buffeted by changes and opportunities, but I've stayed malleable."

Since	Fund Name	Total Assets (\$000)	Star Rating
Jun/98	Acuity Pooled Short Term	\$1,350	★★★
Jun/98	Acuity Clean Environmen...	\$12,624	★
Jun/98	Acuity Clean Environmen...	\$45,683	★★★
Jun/98	Acuity Clean Environmen...	\$108,991	★
Jun/98	Acuity High Income	\$614,884	★★★★★
Jun/98	Acuity Pooled Canadian ...	\$11,299	★★★★★
Jun/98	Acuity Pooled Canadian ...	\$36,435	★★★★★
Jun/98	Acuity Pooled Conservat...	\$25,302	★★★★★
Jun/98	Acuity Pooled Fixed Inc...	\$23,707	★★★★★
Jun/98	Acuity Pooled High Income	\$377,767	★★★★★
Jun/98	Acuity Pooled Global Ba...	\$603	★★★
Jun/98	Acuity Pooled Global Eq...	\$2,849	★★★★
Nov/98	Acuity Canadian Balanced	\$25,876	★★★★
Nov/98	Acuity Money Market	\$8,612	★
Nov/98	Acuity Fixed Income	\$30,290	★★★★★
Nov/98	Acuity Canadian Equity	\$46,851	★★★★
Aug/99	Acuity G7 RSP Equity	\$3,332	★★
Aug/99	Acuity Global Equity	\$3,036	★★★
Sep/00	Acuity All Cap 30 Canad...	\$80,894	★★★★★
Sep/00	Acuity Clean Enviro Sci...	\$671	★★★★
Sep/00	Acuity Social Values Ca...	\$22,692	★★★★
Sep/00	Acuity Social Values Gl...	\$6,680	★★★
		<b>\$1,490,428</b>	
Data As At		30 Nov 04	30 Nov 04