Stocks Still Too Pricey for Top-Performing Canadian Hedge Fund

By **Kristine Owram**

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- ‘I’m not excited,’ head of McLean Asset Management in Toronto
- VIX products could leave investors ‘permanently impaired’

One of Canada’s best-performing hedge funds says stocks are still expensive after last week’s correction and he sees little to get excited about.

“Right now we’re still nowhere close to an equalization in interest rates with equity markets,” said David McLean, managing director at Toronto-based McLean Asset Management Ltd. His C$60 million ($48 million) ROMC Fund was a winner in the 2017 Canadian Hedge Fund Awards for best five-year return in the equity category with an annual gain of 18 percent. The fund also won in 2016.

His goal is to find stocks with double-digit earnings yields, which are the inverse of the more commonly used P/E ratio and measure the rate of return on an investment. The earnings yield on the S&P 500 Index today is 4.7 percent.

“2009 was exciting when earnings yields on the S&P 500 and pretty much every stock market everywhere were above 10 percent,” McLean said. “Today I don’t see any area that’s bombed out so no, I can’t get excited.”

He’s seeing some opportunities in U.S. health care, transportation and advertising, and recently took a long position in Hong Kong-based cargo shipper Seaspan Corp., but isn’t a “general buyer of any one asset class today.”

Permanently Impaired

McLean is particularly unenthused about Canadian stocks, even though the benchmark S&P/TSX Composite Index generates a slightly higher earnings yield than the S&P 500 at 5.5 percent.

“Canada is concentrated in areas that don’t much interest us,” he said, pointing to commodity stocks, which make up about 30 percent of the benchmark. “We’re looking for stable businesses that have the option to buy back stocks, issue handsome dividends or invest for growth.”

That would typically describe the Canadian banks, which make up 35 percent of the S&P/TSX, but he believes U.S. banks are more attractive because of their lower leverage.

McLean is also adamantly opposed to the complex volatility products that have been blamed for last week’s market rout, which sent the S&P 500 into official correction territory. Some of these products bet on low volatility and plunged when the VIX spiked from 11 to the 30s in just over a week.

“You’re packaging a product that’s a derivative of a derivative of a derivative. Where does it end?” he said. “Unless the VIX comes back down to a level of around 10, these people are permanently impaired, their savings are permanently impaired.”