THE INVESTOR'S DIGEST INTERVIEW

For McLean Budden U.S. fund, cheap share prices are a major plus

Since the dot-com crash, U.S. equities have been in a funk. But that bothers Bruce Murray not one whit. He rather likes the low prices at which U.S. companies now trade. Indeed, it helps make his life a little easier, given that he's co-manager of the McLean Budden American Equity Fund

Bruce Murray will tell you it was great to grow up in Paris — Paris, Ont., that is.

"You knew everybody. They knew you. There was freedom to roam. There were forests and farms. It was tough to get into trouble," says Mr. Murray, who co-manages the American Equity Fund out of Toronto for McLean Budden Ltd.

Of course, Paris may have also been a tad tame, Mr. Murray admits.

"My dad told me that when his grandfather lived in Paris, there were 5,280 people. And when I left in 1970, there were 5,280 people."

Educated in public schools, Mr. Murray earned an honors B.A. in economics from the University of Waterloo where he made the varsity swim squad four years in a row.

In 1972, his team won the 800 yard freestyle at the spring meet of the Ontario University Athletic Association Married with three children, Mr. Murray has 30 years' experience in investments.

You were bitten by the stock bug at a young age, you say.

In junior high, to be precise. I bought my first stock, Western Decalta Petroleum (now defunct) in grade seven. And I sold it two years later when I bought Algoma Steel, which I tendered to Canadian Pacific in 1974. CP was just one of several companies that would buy and sell Algoma. Of course, few of my classmates were into stocks. My father, however, was. So I talked to him almost every day about investments. I also read the business pages of *The Globe and Mail.*

For what type of investor is your fund best suited?

For all types. Yes, we're a long-term play. And we do focus on large caps — specifically, high quality household names. But we will at times lean towards growth or value, depending on the market. As such, we consider ourselves to be a core portfolio holding.

Since the dot-com crash, U.S. equities have been in a funk.

Which is why they make good buys. Indeed, a lot of big names — once pricey — are now cheap. Take General Electric. Before the crash, it traded at roughly US$50 a share. Now it's around $33. Pfizer is also a bargain. In fact, since 2000, it's dropped almost 50 per cent.

What's another good reason for buying U.S. equities?

Greater diversification. America represents 50 per cent of global equity capitalization; Canada, a mere two per cent. In the U.S., moreover, you have global leading outfits like Colgate and Microsoft. There are no equivalents in Canada. True, we've got a good smattering of resource companies. Inco, Teck-Cominco and EnCana readily come to mind. But our leading industrial players, such as Dofasco, are fast disappearing.

What dangers in the American market should Canadians be aware of?

The trade imbalance, the government deficit and sky-high consumer indebtedness. If Washington suddenly starts focusing on debt repayment, the economy could slow down, giving corporate profits a real whack. The U.S. would then find itself in much the same position as Canada was in the early '90s when debt repayment was the flavor of the month.

How would you describe yourselves?

As stock pickers, not sector players. In the '90s, we were out of the oilpatch altogether. We also had no utilities. The two sectors just didn't have the stocks we were looking for. Moreover, there were better investment opportunities elsewhere — in high-tech, heavy industry and consumer products. But the energy sector has turned around. And utilities are much stronger. So we now have holdings in both. In the oilpatch, for example, we own Valero, a major North American refiner. And in utilities, we own Duke Energy, a regional power provider.

Many stock funds typically hold 150 to 200 names.

Yet, we usually have no more than 50. We're simply too choosy. Our analysts, however, follow a much larger number — typically 150 stocks. And for one, they assign both a

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buy and a sell target. If a stock approaches its buy signal, we'll decide if we'll add it to our portfolio. And if a stock in the fund approaches its sell target, we'll discuss whether we should reduce our position or cut it entirely. But we aren't rigid in applying this rule. Often, a stock whose price is rising, is usually one whose fundamentals are improving. So there's sometimes justification to boost its target price to keep it in the fund.

But doesn't this system result in a lot of volatility?

Not really. Our turnover reflects market conditions. In the late '90, when things were hot, our turnover was roughly 80 per cent a year. But now that things are much calmer, turnover is closer to 30 per cent. In the meantime, we've done well. Our current dividend yield is 1.9 per cent; that of the S & P 500, 1.8 per cent. As of Jan 31, we had an annualized compound return of 6.3 per cent. The S & P, by contrast, limped in at 0.37 per cent. Currently, we have US$500 million in assets.

What things do you look for in the companies you buy?

No. 1? Strong management. Do the folks in the corner office have a good track record? Have they delivered on their promises, done what they've said they've done? No. 2? A good return. Is there evidence — or are there expectations — of above-average earnings growth? No. 3? A strong balance sheet. Are debt levels low? Is cash flow robust? The latter isn't necessarily an ironclad requirement. If a company has lots of investment opportunities, its free cash flow may not necessarily be strong. In picking stocks, we prefer, if possible, to meet management face to face. It's just easier to judge people when you're looking them in the eye, than when you're reading their reports. And sizing up people is important. Indeed, we've actually rejected companies after meeting them face to face. And our action, more often than not, has been borne out by events.

You take a team approach to stock picking. In fact, as many as 18 people can be involved in the process.

Which might seem to make things unwieldy. But a team approach does help reduce volatility. After all, there will be less likelihood the fund will be pushed or pulled in any one direction. Then, too, with many different voices, you get the benefit of multiple perspectives, along with a thorough airing of ideas.

STOCKS BRUCE MURRAY LIKES

Pfizer Inc.
(PFE - NYSE; $25.54)
Phone: 212-573-7851

Transocean Inc.
(RIG - NYSE; $73.58)
Phone: 713-232-7750

Motorola Inc.
(MOT - NYSE; $21.72)
Phone: 847-576-5372

Alcoa Inc.
(AA - NYSE; $30.25)
Phone: 412-553-4545

Exelon Corp.
(EXC - New York; $55.44)
Phone: 312-394-7398

There are many global pharmaceutical outfits out there. So why make Pfizer your top pick?

Simply put, it's cheap. The average stock on the S & P now trades at roughly 16 times estimated 2006 earnings. Pfizer, by contrast, trades at only 12.5. times earnings. Moreover, its medicine chest is first-rate. Lipitor, its anti-cholesterol treatment, is the world's best selling drug. And several other of its offerings are also top sellers. Then, too, because these drugs are targeted at an aging population, their popularity is likely to continue. True, it's been rough going for the drug industry over the last little while. Competition has been fierce. And patent expirations have been hard to swallow. But we still think that over the next few years, Pfizer will be able to grow its annual earnings at eight to 10 per cent.

Two years ago, you could rent an offshore oil rig for less than US$100,000 a day. Now the daily rate tops $450,000.

Which is great for Houston-based Transocean, the world's leading outfit for offshore drilling. Indeed, given that the average well takes three to four months to drill, Transocean can only rake in the cash. Couple that with the rising tempo of global oil and gas exploration and this company is sitting pretty. Of course, it doesn't hurt that Transocean's rigs are the most technically advanced in the world. In the meantime, the company can lay claim to having just signed three new multi-year contracts.

Motorola is a leading maker of cell phones. Yet, a few years ago, it dialed a wrong number.

It failed to make the switch from analogue to digital, thereby ceding top spot to Nokia. But Motorola is back on line. Under Ed Zander, its new CEO, it has refocused and restructured. Indeed, profitability now outpaces sales. And as China's No. 1 vendor of cellphones, Motorola has clearly regained market share. Meanwhile, the company should continue to do well, given ever-increasing cellphone usage in both China and India. Indeed, in a few years, it's likely that annual sales of handsets around the globe will hit a billion.

In a little over seven months, aluminum has soared to US$1.12 from $0.76 a pound.

Which is one reason we bought Alcoa, the world's aluminum maker. Another reason? The company's strong management. Not only has Alcoa been much more profitable than rival Alcan, it's done a better job of entering high-end markets, such as aircraft-grade aluminum. Alcoa is also better situated in the sourcing of alumina — a prime ingredient in the metal's manufacture.

Illinois is poised to deregulate electricity prices.

And that's good news for Exelon, one of America's largest electric utilities. And Exelon is big. With annual revenue of more than $15 billion, it keeps the lights on for 5.2 million customers in Illinois and Pennsylvania. And as the largest owner of nuclear power plants in the U.S., Exelon should do well as nuclear energy becomes increasingly more cost-efficient. The company's nuclear know-how should prove particularly useful, now that it's merging with Public Service Enterprise Group. Not only is PSEG a major producer of nuclear power, it's also one of the largest utilities in America. In fact, the merged company, if OK'd by regulators, will boast $79 billion in assets and a service area of more than 18 million people.

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