

DM Monthly Report

MAY 2016

PORTFOLIO ACTIVITY

In April, we took advantage of price weakness in Alphabet Inc. (more commonly known by its product name "Google") to establish an initial position in the DM Foreign Equity Portfolio.

FEATURE STOCK

CVS Health Corp. (CVS)

In its first quarter earnings report, CVS posted a significant jump in sales, helped by growth in both prescription claims and specialty drug sales in its pharmacy-benefits division. Revenues were also boosted by recent acquisitions in its drugstore component, most notably the addition of 1600 Target Corp. pharmacies, which CVS now operates, and by the purchase of Omnicare Inc., a firm that dispenses drugs to nursing homes and other specialized healthcare providers. Though consumers know CVS for its many retail outlets, the firm's growth is increasingly driven by its large pharmacy benefits division which manages prescription drug coverage for health insurers. The company has been attracting new clients in this area based on its demonstrated ability to reduce overall drug expenditure at a time when several manufacturers have been pushing through significant price increases. So far this year, CVS shares have returned roughly 9.5%.

WHEN IN DOUBT, GO TO THE SOURCE

One of the most important steps in our equity investment process is the management meeting, as no amount of financial analysis can replace the insight gleaned from sitting with an executive team or having a one-on-one phone call with a CFO or company president. Recently, we put these efforts to good use with Canadian mortgage lender, Home Capital Inc. Toward the end of last summer, HomeCap revealed that it had been hit by fraud when one of its mortgage broker clients falsified borrower income information to enhance loan qualification. Assuming the situation was analogous to the aggressive lending practices that helped spark the subprime crisis of 2008, several US investors began to bet heavily against HomeCap, so much so that it became one of the most shorted names on the TSX. As the stock fell, we stepped up our contact with the company (see chart below), both to ensure that our investment thesis remained valid and to gauge whether the selling stampede was overdone and thus a potential buying opportunity. Through these discussions, we learned that:

- the offending paperwork was contained within a relatively small subset of the company's 4000+ mortgage broker network;
- it didn't appear that any of the borrowers intended to default on mortgage payments or principal, they merely wished to expedite home purchases; and
- of the files in question that the company had reviewed to that point, more than 90% were sound and would be eligible for renewal.

Armed with this information, along with management's forthrightness and transparency in our discussions, we significantly increased our allocation to HomeCap when it traded down to the mid-20's. When the stock later rallied by more than 50% from its January low, we brought its weight back down, locking in a material gain in both the DM Small Cap and DM Canadian Portfolios.

