

Mackenzie Maxxum Dividend Growth:

Commodity stocks will continue to cause pain for this fund.

BY PHILIP LEE

Given that this fund focuses on dividend-paying stocks, its struggles over the past few years come as no surprise. With significantly less commodity-related exposure than its peers in the Canadian Focused Equity category, the fund's performance has been, and will continue to be, hampered by market leadership from these stocks. While manager Bill Proctor and his team faced stiff headwinds, we think the high-quality large-cap stocks that they've stuck with should see better days ahead.

Over the past few years, the rally in commodity stocks has wreaked havoc on management's strategy, which focuses on stable businesses that generate more predictable cash flows and pays dividends. Management likes such companies because they can grow in most economic environments. But, very few names from the energy and materials sectors fit these criteria.

Among the cyclical names the fund does own are Petro-Canada, EnCana Corp. and Canadian Natural Resources, all of which have performed well. But the fund missed the big run-ups of Potash Corp. and Suncor; the former doesn't pay a dividend while the latter focuses on capital-intensive oil sands projects.

Instead, like many dividend-focused funds, financials make up a significant chunk of the portfolio – currently about 40% of assets. This sector has been battered by a contraction in global credit markets – the deepest cut came from Citigroup Inc. Although the fund no longer owns this beleaguered bank, this former top 10 holding lost more than 50% of its market value by the time management exited the position.

We like the flexibility that management has to invest abroad since dividend-paying stocks in Canada are highly centred on financial names. A couple of U.S.-based names that have done well are supplemental health and life insurance provider Aflac and pharmacy retailer and benefits manager CVS Caremark Corp.; both sport double-digit returns over the past 18 months. The foreign holdings have kept the fund out of the Canadian Dividend and Income category, instead relegating it to the Canadian Focused Equity group. However, the latter is not a perfect yardstick since most funds in that group don't focus on dividend payers.

Either way, fund performance has been sub-par over the past few years. Its three-year 5.7% annualized return is four percentage points short of the median fund and lags the median Canadian dividend fund by a slightly wider margin. But to the fund's defence, the top-performing dividend funds have exposure to dividend-free high fliers such as Potash and Research In Motion. Disappointing performance will likely persist if markets advance on narrow leadership. However, if the demand for cyclical names wanes, the fund should do much better. Until then, dividends should provide it with a bit of a cushion.

OF NOTE

The fund owns all six of Canada's big banks. Management made the right move by making TD Bank, Royal Bank and Scotia Bank the largest holdings (roughly 18% of the portfolio). The fund only had a low single-digit exposure to CIBC and Bank of Montreal in the aggregate.

The fund has roughly 9% of its assets in income trusts. Management believes that the ones it owns are in sustainable businesses, despite losing tax advantage in 2011.

The fund currently has about 30% exposure to foreign securities – this should remain since management believes stock valuations are more attractive abroad.

The managers tactically hedge the portfolio's foreign currency exposure. But the rising Canadian dollar has had a negative impact on the fund's performance over the past few years.

With the exception of a greater foreign equity exposure in this fund, it is managed in a highly similar fashion to Mackenzie Maxxum Dividend. This fund has a marginally greater tilt toward growth.

The fund's 2.36% management-expense ratio is three basis points below the category median.

The fund currently pays a monthly distribution of \$0.05/unit, representing a yield of roughly 3%. If performance continues to suffer, the fund will either have to reduce the payout or continue paying distributions in the form of a return of capital. If this persists, there would be an erosion of the asset base.

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