

Front Street Hedge Fund

Frank Mersch

Commentary

For the quarter the fund generated a return of 1.25% and while it slightly trailed the TSX (+1.70%) overall we are reasonably happy with this return given the weakness of the energy sector. During the quarter the energy sector was down 6.29%; in fact when one looks at medium cap and small cap energy names they underperformed the group. Names such as Crew (- 34%), Seven Generations -22.4%, Torque - 17.4%, Whitecap - 14.9% etc. were just a few names that underperformed. Even the pipeline stocks were down in the quarter. The winning sectors were defensive areas such as Utilities Telecom and Real Estate which in itself is surprising given that rates are on the rise. We believe that the weakness we have seen may have preceded a change to new highs in Canada. At their March lows many resource stocks in energy and the material sector had already corrected 10-20's from their peak. As such, on a market rebound these late cyclical should provide the biggest bang for their buck for investors. Also the March rebound in defensive stocks has pushed the group valuation back to overbought, overvalued. Of all the groups that may see the biggest bump is the oils. We are now entering a period where inventories should start to run down. We are also looking for better refinery as we start the summer driving season. Finally, much of the optimism we started the year with is gone. We also believe that the potential border tax has overly penalized the group as foreign investor exited the group. We see no erosion in fundamentals and in fact see many opportunities in the group.

While we could see a decent bounce in energy, we also continue to favor long time favourites such as Premium Brands, Descartes intertape and CCL Industries. At this point we are slightly underweight the financials, but look for better entry points in the coming months.

Overall we are cautious, optimistic and feel that Canada may surprise in the second quarter.

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