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As resources gain steam, money managers offer their picks

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After hibernating in a three-year bear market, resource stocks are waking up.

Money managers are warming to the sector, which has been spanked over the past few years amid a slowdown in the Chinese economy. With materials – otherwise known as metals and mining – and energy among the best performing areas in the Canadian market so far this year, resource plays are gaining attention again.

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We asked four money managers for their stock picks in today's market.

John Stephenson, Stephenson & Co. Capital Management

China's economy appears to be stabilizing, says John Stephenson *[http://stephensonfiles.com/]*, founder of Stephenson & Co. Capital Management and author of *The Little Book of Commodity Investing*. "China has been a drag on all resource plays, but particularly the materials sector."

Following a flurry of stimulus measures, the Chinese economy grew 7.5 per cent in the second quarter, slightly beating consensus, and up from 7.4 per cent in the previous quarter.

"Things can still go wrong in China ... but because of that stability, or perceived stability, all of a sudden materials look pretty attractive because they are cheap," Mr. Stephenson said.

"I am slightly more optimistic on materials than energy stocks," he said. Valuations of the latter have been driven higher recently because of geopolitical tensions in the Middle East and Ukraine, he added.

"I think base metals or industrial metals are where things are at. Most people are seeing this world as improving – at least from a global economic perspective – and it is clear that the United States is once again starting to become the driver of global growth," he said.

The valuations of base metal stocks are "very cheap," with many trading at 70 per cent of net asset value, said Mr. Stephenson. In his newly launched hedge fund, he holds Lundin Mining Corp., his preferred copper play, and Teck Resources Ltd.

"Teck is a significant copper player, but they also have coal, which is frankly a bit of a dead weight for now," he acknowledged. "But I do think that is also turning around in an improving global forecast."

Robert Gill, Lincluden Investment Management

Another stock-picker bullish on certain "well run" resource companies is Robert Gill, *[http://www.lincluden.com/about/meet_the_team.aspx.html]* a portfolio manager with Lincluden Investment Management. While China's economy no longer chalks up double-digit growth rates, "it doesn't necessarily mean that the appetite for commodities there will weaken," he said.

"You are seeing a transition in China's economy, moving away from fixed-asset investments to more of a consumer-driven growth model. With that, there is going to be a push on several commodities, in particular oil and gas and copper," Mr. Gill said.

Among resource names, he likes copper and gold producer First Quantum Minerals Ltd. "Their five-year average return on equity [ROE] is 17 per cent, which is very high when compared to peers and the TSX average."

He is also upbeat on energy giant Suncor Energy Inc. "ROE is respectable at 12 per cent, and has averaged 17 per cent over the past 10 years. They have also been growing their free cash flow, increasing their dividends and buying back stock."

Shares of Canadian uranium producer Cameco Corp. have suffered since Japan's Fukushima nuclear disaster in 2011 and the country's decision to take its reactors offline, but it's a "contrarian play" worth considering, Mr. Gill said. "You have seen two reactors in Japan cleared for a restart [likely in early 2015]... China and India are developing new reactors, and that will push out demand."

Steven Palmer, AlphaNorth Asset Management

Steven Palmer *[http://www.alphanorthasset.com/index.php?section=our-team]*, president of AlphaNorth Asset Management, is also upbeat on the resource sector, but prefers the junior plays that can offer higher potential.

The TSX Venture Exchange bottomed in June, 2013, when "sentiment was at its worst, and it was very hard for these companies to get financed," he recalled. "There was no interest in junior resources, but now there is more interest. I have noticed that there are more financing deals getting done."

Prices have climbed this year for commodities such as crude oil, which has been trading around $95 (U.S.) a barrel for West Texas Intermediate, and industrial metals such as aluminum, nickel and zinc. Among precious metals, the price of palladium, which is used in catalytic converters that clean car exhaust, has enjoyed a strong rally. These metals "are being impacted by the accelerating global growth, and the stocks are going to improve because of that," Mr. Palmer said.

He sees upside potential in Blackbird Energy Inc., which has a significant land package in Alberta's Montney oil and gas play. "They plan to drill that before the end of the year, and there are pretty high odds it will be successful," said Mr. Palmer, who tries to buy companies with specific advantages rather than rely on rising commodity prices.

He also owns Sintana Energy Inc., which has projects in Colombia. Sintana has partnered with oil giant Exxon Mobile Corp., which is footing the initial drilling to earn 70 per cent of the unconventional resource play in the Middle Magdalena basin. "If Exxon is drilling it, then they are expecting something significant," he said.

Norman MacDonald, Invesco Canada Ltd.

Norman MacDonald *[https://www.invesco.ca/publicPortal/portal/retail.portal?_nfpb=true&_windowLabel=portlet_resourceCenter_pm&portlet_resourceCenter_pm_actionOverride=%2Fportlets%2FresourceCenter%2FproductResources%2FportfolioManager%2FpmDetail&portlet_resourceCenter_pmpmCode=MACDONALD_NORMAN&_pageLabel=resourceCenter_portfolioManagers_landing_page_label]*, who runs a resource fund at Invesco Canada Ltd., has been trimming oil names that have rallied this year. He now sees opportunities in certain natural gas and precious metals stocks.

"There was so much short-term money that piled into natural gas names at the beginning of 2014, and this money exited just as quickly" because of the cooler summer, said the value-oriented portfolio manager.

Mr. MacDonald, who looks for companies with quality assets and a strong management team, is a big fan of Crew Energy Inc., which comprises nearly 10 per cent of his fund. Crew has been selling assets to focus on the Montney shale gas basin in British Columbia, he noted.

"The market hasn't caught up with how the company has transitioned into a really high-growth Montney natural gas and liquids company," he said.

Shares of Torex Gold Resources Inc., which has a project in Mexico, also have potential, he said. Once the gold mine is finished, Torex should have one of the lowest operating structures in the business, he noted.

The problem with the commodity space is that investors are often short-term focused, so it is always going to be volatile, he said.

"I try to use that volatility to help me. If you buy them [resource stocks] at very reasonable multiples and use very conservative long-term commodity prices like I do, your margin of safety is protected."

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