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Where this Canadian micro-cap manager is finding shelter from the broader market

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Alex Etsell, senior portfolio manager and partner at Toronto-based Hillsdale Investment Management Inc. The Globe and Mail

Money manager Alex Etsell is a big fan of micro-cap stocks, but he doesn't think investors should choose just one or two to diversify their portfolios.

Instead, the senior portfolio manager and partner at Toronto-based Hillsdale Investment Management Inc. believes a "well-chosen" basket of these smaller companies can help reduce risk and potentially provide additional growth as part of a diversified portfolio.

"What's great about the micro-cap space is these names tend to be uncorrelated to each other and the broader market," says Mr. Etsell, who co-manages the $110-million Hillsdale Canadian Micro Cap Equity Fund alongside Chris Guthrie, the firm's chief executive officer and founding partner. "They're wonderful to own in the context of a larger portfolio."

Alongside Mr. Guthrie, Mr. Etsell oversees about $4.5-billion of his firm's $6.8-billion in assets, which includes different Canadian, U.S. and global equity strategies. He sees a lot of potential in the micro- and small-cap sectors today.

One reason is the less expensive valuations comparewith to many large-cap stocks. He notes the S&P/TSX SmallCap Index is trading at about 11 times forward earnings compared with 15 times for the S&P/TSX Composite Index and 26 times for the S&P 500. The weaker Canadian dollar compared to the U.S. dollar also benefits these smaller companies, many of which generate revenue in U.S. dollars.

Still, Mr. Etsell warns micro caps – which he defines as companies with a market cap of about $25-million to $500-million – can be volatile. It's why he recommends owning a select group of profitable and growing higher-quality names and being nimble getting in and out as warranted.

With this strategy, his Hillsdale Canadian Micro Cap Equity Fund returned 25 per cent last year compared with an 18.8-per-cent return for the S&P/TSX SmallCap Index.

The fund's three-year annualized return was 13.4 per cent (versus 4.2 per cent for the index), and its five-year annualized return was 19.3 per cent (versus 8.9 per cent for the index). The fund's 10-year annualized return is 13.5 per cent (compared with 6 per cent for the index). All performance numbers, including the index, are based on total returns as of Dec. 31.

The Globe asked Mr. Etsell to discuss three stocks he owns and likes right now, and one he recently sold:

Name three stocks you own today and why.

Firan Technology Group Corp. FTG-T -1.22% decrease, the Toronto-based supplier of aerospace and defence electronic products, is a stock we bought in August, 2022, at around $2.20 a share. It's trading at around $8 a share now, so it's been a great holding for us. It's been growing organically and through acquisitions, and is still inexpensive compared with some of its peers, which is due largely to the fact that it's a small-cap name with less attention than some of the larger players like CAE Inc. in Canada.

Firan has some favourable thematic tailwinds today with the increase in defence spending. One of its more recent contracts was for firefighting aircraft components, another area with increased demand. About 80 per cent of the company's revenue is in U.S. dollars, so it will benefit from the weaker Canadian dollar compared with the U.S. currency.

Orbit Garant Drilling Inc. OGD-T +4.72% increase, a Val-d'Or, Que.-based gold-drilling services company, is a stock we bought in October, 2024, for 69 cents a share. It's a true Canadian micro-cap name, currently trading around $1 a share with a market cap of about $35-million.

Most of its services are provided to large gold companies in Canada. The price of gold is trading close to record highs and we're getting some exposure to that through a small, growing company with an inexpensive valuation. It's a good value opportunity in the gold space today. We have several investments in other service providers and small exploration and production companies in Canadian Micro Cap Equity Fund to increase our gold exposure.

Medexus Pharmaceuticals Inc. MDP-T +2.26% increase, a Canadian biotechnology firm, is a stock we bought in November, 2024, at about $2.40 a share. It's currently trading at around $4 a share. The Canadian biotech space doesn't get enough attention despite the talent and skills we have here. Canada is also a reasonably inexpensive place to hire and manufacture in the biotech sector. I don't think investors understand these factors very well.

It's a great name with an inexpensive and appealing valuation. There's a risk that comes with drug approvals that can weigh on biotech stocks, but the company recently received a fairly significant approval from the U.S. Food and Drug Administration for one of its products, so that gives it a lot more visibility moving forward.

Name a stock you sold recently.

Givex Corp. N/A is a Canadian payments company we sold in October, 2024, after it was acquired by Shift4 Payments, Inc. FOUR-N +1.30% increase for $1.50 a share. We sold it before the deal closed in early November. (Our typical process in these situations is to evaluate both the offer and the likelihood of a competing bid before exiting the position before the closing).

We bought a small position in this stock for about 50 cents a share a year earlier. A potential takeover was in the back of our minds when we bought it. The micro-cap space is a place where bigger companies go to shop for growth. It's another reason why it's a great place for investors to be.

This interview has been edited and condensed.