

## Why Canadian Small Cap Is Beautiful

**“A Significant Size Premium Emerges, Which is Stable through Time, Robust to the Specification, More Consistent Across Seasons and Markets...”<sup>1</sup>**

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<sup>1</sup>“Size Matters, If You Control Your Junk” by Cliff Asness, Andrea Frazzini and Ronen Israel, AQR Management, Jan 2015

## Why Canadian Small Cap Is Beautiful

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- Size Is A Major Differentiator in Canada
- Small Cap Breadth Creates Opportunities for Skillful Managers
- Neglect Effect Also Provides for Market Inefficiencies
- Provides Diversity In Fundamental Drivers
- US and Cdn Small Cap Stocks Are Complements
- Capacity Aware and Liquidity Management Are Critical
- Market Outlook Favors Canadian Small Caps

## Appendix

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# Breadth Is Important For The Success of Active Management

## The Magic Formula of Active Investment Management

### The Fundamental Law of Active Management

$$\text{Information Ratio} = \text{Manager's Skill} \times \sqrt{\text{Breadth}}$$

Relationship Between  
Forecasts and Actual  
Outcomes

Number of Independent  
Forecasts of E (R)

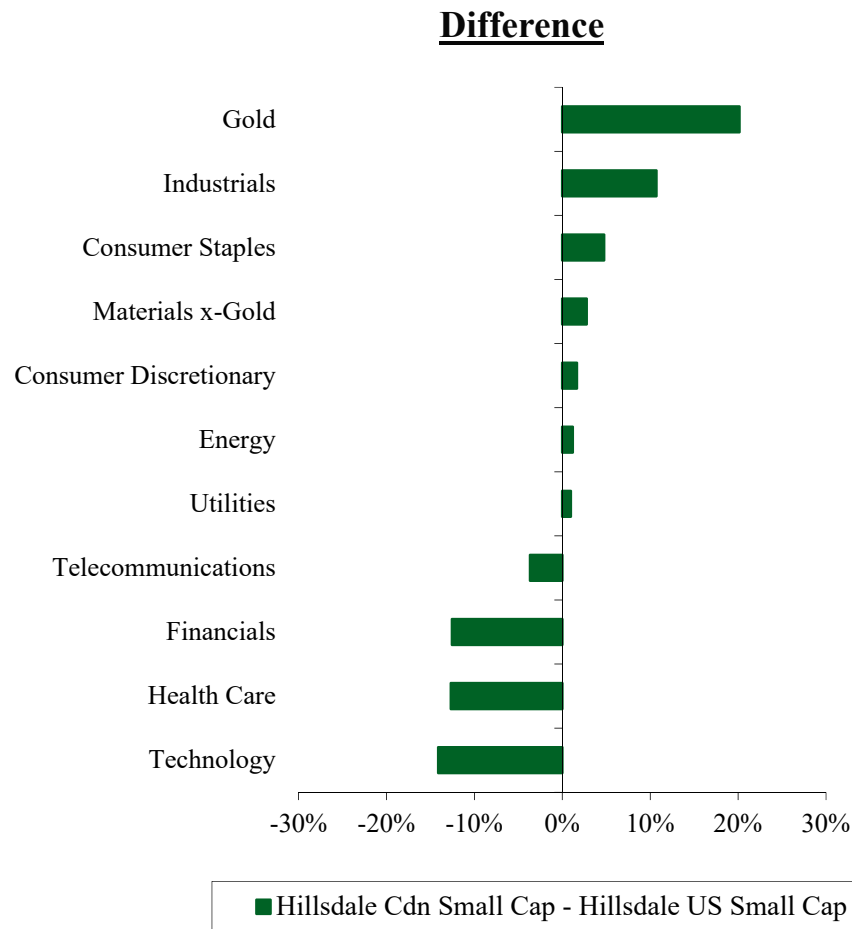
*Information Ratio* = (Excess Return)/(Tracking Error)

*Tracking Error* = Standard Deviation of Excess Return

# US Small Caps Are An Excellent Complement to Canadian Small Caps

## Sector Weights

Hillsdale Cdn Small Cap vs. Hillsdale US Small Cap, March 31, 2016



	Hillsdale Cdn Small Cap	Hillsdale US Small Cap
<b>Gold</b>	<b>20.1%</b>	<b>0.0%</b>
<b>Industrials</b>	<b>24.8%</b>	<b>14.1%</b>
<b>Consumer Staples</b>	<b>12.1%</b>	<b>7.3%</b>
<b>Materials X-Gold</b>	<b>8.8%</b>	<b>6.0%</b>
<b>Consumer Discretionary</b>	<b>8.6%</b>	<b>6.9%</b>
<b>Energy</b>	<b>1.8%</b>	<b>0.6%</b>
<b>Utilities</b>	<b>3.0%</b>	<b>2.0%</b>
<b>Telecommunications</b>	<b>0.4%</b>	<b>4.0%</b>
<b>Financials</b>	<b>8.1%</b>	<b>20.7%</b>
<b>Health Care</b>	<b>1.2%</b>	<b>13.9%</b>
<b>Technology</b>	<b>7.5%</b>	<b>21.6%</b>

## Small Cap Has Superior Attributes To Private Equity

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Criteria	Micro Cap	Small Cap	Private Equity
Liquidity	Higher	High	Lower
Time and Resource Commitment	Lower	Low	Higher
Valuation	Market	Market	Estimated
Manager Universe	Narrow	Wide	Narrow
Breadth	Broad	Broad	Limited
Transparency	High	High	Low
Fees	Average	Average	High

# Why There Is A Small Cap Effect

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# Why There Is A Small Cap Effect

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## Why There Is A Small Cap Effect

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- Neglect
- Reversals
- Value
- Earnings Surprise
- Residual Risk
- January Effect
- Transactions Costs
- Risk
- Irrational Investor Behavior

# Why A Small Cap Effect (Premium?)

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## A Behavioral Approach

### Irrational Investor Behavior

- Biased Decision Making
- Overconfidence
- Overreaction

*“A Psychologist Is A Man Who Watches Everyone Else When A Beautiful Girl Enters the Room.”*

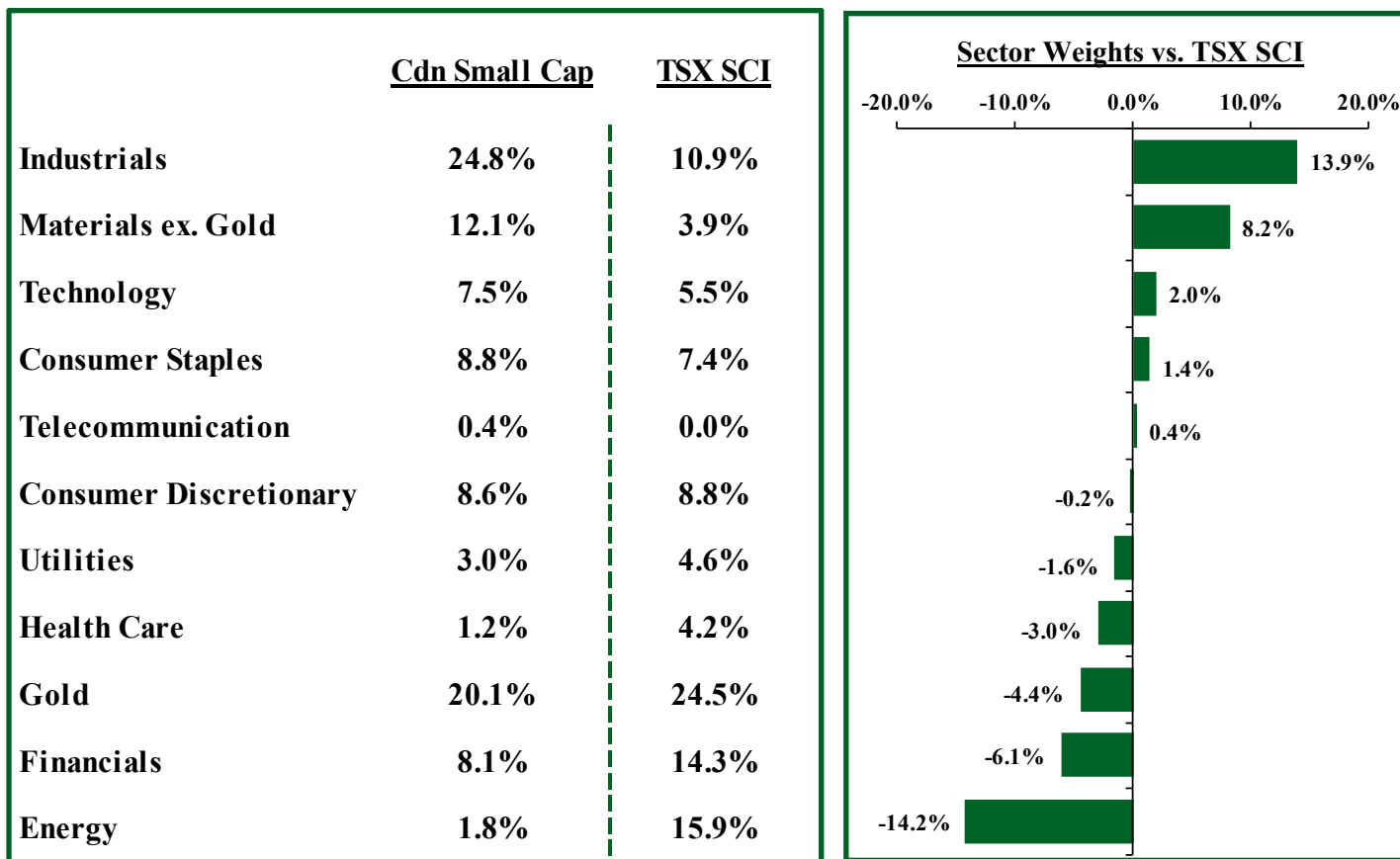
## Why Small Cap Is Beautiful

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- There Has Been Significant Alpha (Excess Return) In Active Investment Management of Small Cap
- There is Still A Compelling Case for the Persistence of This Alpha
- There is Enormous Breadth (i.e. Choice) in the Small Cap Stock Universe
- Canadian and US Markets Are Good Offsets At the Sector Level
- Small Cap Managers Compliment Large Cap Managers Diversifying Your Sources of Excess Returns
- Very Attractive Valuations

# Sector Weight Comparison: Canadian Small Cap vs Composite

Sector Weights vs. Index, March 31, 2016



12 Investments in the Hillsdale US Performance Equity Fund and the Hillsdale Cdn Micro Cap are accounted for by allocating their individual stock holdings on a weighted basis.  
Source: See Footnote 1.

## Lessons Learned

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- The Small Cap Effect: Small Capitalized Stocks Perform Differently Than Large Capitalized Stocks Over A Market Cycle
- The Small Cap Return Premium: Smaller Companies Have on Average Higher Returns Adjusted for Risk Relative to Larger Companies
- Compelling Case For Excess Returns or Alpha
- Broader and Complimentary Opportunity Set
- Small Cap Managers Compliment Large Cap Managers Diversifying Your Sources of Excess Returns
- Persuasive Reasons for Alpha Potential to Persist
- As Good, If Not Better, Than Private Equity
- Attractive Market Outlook

## Footnotes and References

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### **Footnote 1**

All data presented is from Hillsdale's proprietary database unless indicated otherwise. This database consolidates information from over 30 vendors to support Hillsdale's research, portfolio management and reporting activities.

### **Footnote 2**

Performance and other data in this presentation are shown for illustrative purposes only. Back tested returns are based on a quantitative testing where stocks are selected based on Hillsdale's proprietary stock selection systems. All back test returns are shown gross of fees and are calculated in Canadian or US dollars as indicated. No representations are being made that the investment process will achieve similar returns on a going forward basis. Investors should not consider the data included in the presentation as an indication, assurance, estimate or forecast of future results. Actual returns may differ materially from the returns shown for reasons including, but not limited to, investment restrictions and guidelines, fees and other expenses, cash holdings, timing of trade execution and fluctuations in the market.

## Institutional Investment Services

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**Harry Marmer**, BBA, MBA, CFA, Executive Vice President and Partner joined Hillsdale Investment Management in 2008. Prior to joining Hillsdale, Mr. Marmer led the Canadian institutional investment business of Franklin Templeton Investments and before that the institutional business of the Russell Investment Group. He was also a principal and co-head of Mercer's Canadian Investment Consulting Practice. Mr. Marmer is a frequent conference speaker and has authored more than 47 articles. His book, *Perspectives in Investment Management*, was published in September 2002. He has served on a number of professional and industry boards and was past president of the Toronto CFA Society. Mr. Marmer received the Volunteer of Distinction Award from the Toronto CFA Society and was awarded the Society's Research Award. He has an MBA and a BBA, finance and investments, York University.