Canadian General Investments

Canadian stock picking for the long term

Investment companies

Canadian General Investments (CGI) is a TSX- and LSE-listed investment company that provides actively managed exposure to Canadian equities. CGI's NAV total returns have outperformed its S&P/TSX Composite Index benchmark over five years and the shares have additionally benefited from a narrowing discount during 2014. Well-established growth in the US economy is helpful for the Canadian market, while the negative effect of its above average energy exposure is arguably balanced by a lower P/E rating and, for CGI, by an underweight position in this sector. CGI also offers a 4.1% dividend yield and scope for further narrowing of the discount.

12 months ending	Total share price return (%)	Total NAV return (%)	S&P/TSX Composite C$ (%)	FTSE Canada C$ (%)	FTSE World C$ (%)	MSCI Canada C$ (%)
31/12/11	(12.3)	(11.4)	(8.7)	(9.9)	(4.2)	(10.0)
31/12/12	3.4	10.8	7.2	7.7	14.4	7.5
31/12/13	22.0	20.9	13.0	13.3	33.0	13.6
31/12/14	13.3	8.5	10.6	12.1	14.2	11.4

Note: *Twelve-month rolling discrete total return performance.

Investment strategy: Canadian stock picking

CGI targets broad exposure to Canadian equities, selecting stocks using a bottom-up approach based on fundamental research. Macro views influence stock selection but the manager does not target specific sector or geographic allocations. If suitable opportunities to access broader investment themes are not identified in the Canadian market, within certain restrictions, exposure can be gained through foreign equities. A well-diversified exposure is maintained and new investments typically represent 1.0% to 1.5% of the portfolio. CGI's long-term approach is reflected by annual portfolio turnover of below 30% since 2010. Total return expectations rather than yield drive investment decisions, which gives the portfolio a growth bias. Leverage is provided by C$150m nominal preference shares.

Market outlook: Steady progress expected

Canada's GDP growth has rebounded from its Q114 slowdown and steady growth is predicted through 2015 benefiting from the US recovery and the support of a weaker Canadian dollar. Although global macroeconomic risks exist, Canada appears likely to be relatively resilient. While oil price weakness creates headwinds for the energy sector, the overall impact on the economy should be mitigated by associated currency weakness, which benefits export sectors. Canadian stock market valuations seem less stretched than world markets in general, potentially leaving greater scope for the market to move higher.

Valuation: Narrowing discount, steady dividends

Energy sector related weakness in the Canadian market has probably contributed to a recent widening in CGI's share price discount to NAV to 30%. This followed a period of narrowing from February 2014 after the board announced the intention to pay steady to rising quarterly dividends. Based on the C$0.12 quarterly dividend run-rate in 2014, CGI yields 2.6% and the C$0.28 final special dividend paid pushes this up to 4.1%.

14 January 2015

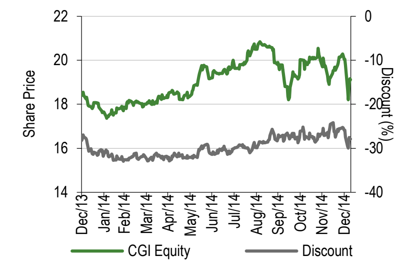
Price	**C$18.70**
Market cap	**C$390m**
AUM	**C$703m**

NAV*	C$26.52
Discount to NAV	29.5%
Yield**	2.6%
Yield***	4.1%

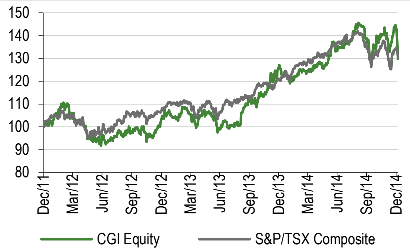
*Including income as at 9 January 2014. **FY14 total, excluding special dividend. ***FY14 total, including special dividend.

Ordinary shares in issue	20.9m
Code	CGI
Primary exchange	TSX
Secondary exchange	LSE
AIC sector	North America

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low	C$20.85	C$17.37
NAV high/low	C$29.40	C$24.95

Gearing

Gross*	26.0%
Net*	24.8%

*As at 30 September 2014.

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Edison profile page

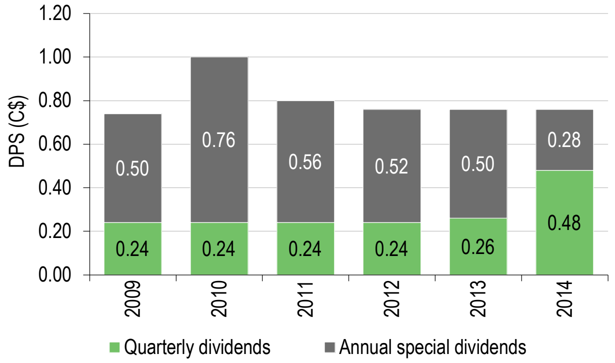
Exhibit 1: Company at a glance

Investment objective and fund background	Recent developments
Canadian General Investments' investment objective is to provide better than average returns to investors by investing in a diversified portfolio of primarily Canadian equities. It aims to achieve this through prudent security selection, timely recognition of capital gains/losses and appropriate income-generating instruments.	9 December 2014: C$0.28 special dividend declared; FY14 total dividend C$0.76. 22 October 2014: Q4 dividend maintained at C$0.12. 12 August 2014: Interim results to 30 June 2014.

Forthcoming		Capital structure		Fund details	
AGM	April 2015	Mgmt. expense ratio	1.62% (2.68%) – see below	Group	Morgan Meighen & Associates
Preliminary results	February 2015	Net gearing	24.8%	CEO	Jonathan A. Morgan
Year end	31 December	Annual mgmt fee	1.0% of gross assets	Address	10 Toronto Street, Toronto, Ontario, Canada M5C 2B7
Dividend paid	Mar, Jun, Sep, Dec	Performance fee	None		
Launch date	January 1930	Company life	Indefinite	Phone	+1 416 366 2931
Continuation vote	N/A	Loan facilities	C$150m preference shares	Website	www.mmainvestments.com

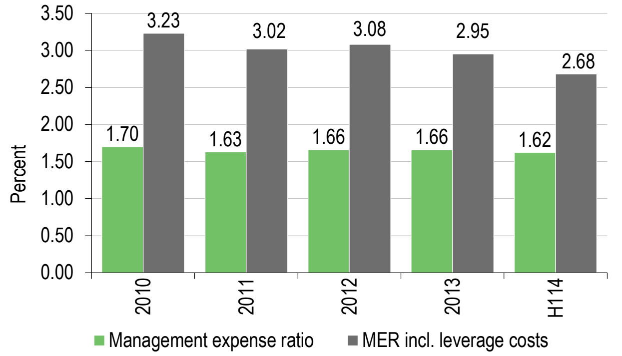
Dividend policy and history

CGI revised its dividend policy in 2014 and intends to pay steady to rising quarterly dividends. Special dividends are also declared annually.

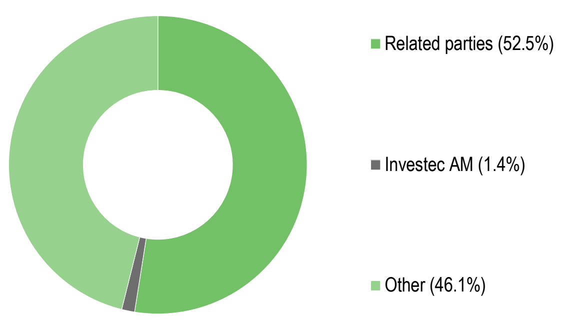


Management expense ratio (MER) and history

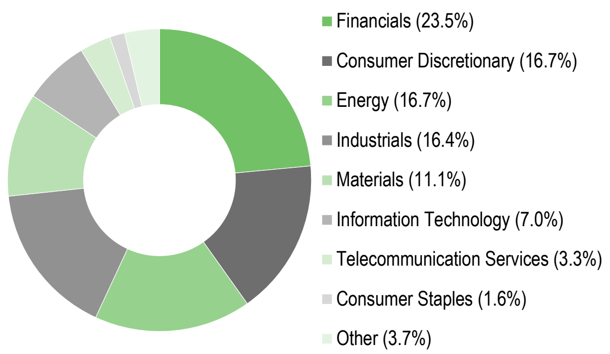
CGI pays a monthly management fee at 1.0% pa of gross assets. Leverage costs include preference share dividends, interest and financing charges.



Shareholder base (as at 6 January 2015)



Distribution of portfolio (as at 31 December 2014)



Top 10 holdings (as at 31 December 2014)

			Portfolio weight %		Active weight %
Company	**Country**	**Industry**	**31 December 2014**	**31 December 2013**	**31 December 2014***
Dollarama	Canada	Consumer Discretionary	6.1	4.7	5.7
Enbridge	Canada	Energy	4.2	3.4	1.9
Canadian Pacific Railway	Canada	Industrials	4.1	3.1	2.4
Bank of Montreal	Canada	Financials	3.2	2.8	0.7
West Fraser Timber	Canada	Materials	3.1	1.5	2.8
Air Canada	Canada	Industrials	2.8	2.2	2.6
Element Financial	Canada	Financials	2.8	2.9	2.6
Royal Bank of Canada	Canada	Financials	2.8	2.6	-2.8
Open Text	Canada	Information Technology	2.7	2.0	2.3
Yahoo!	US	Information Technology	2.6	1.7	N/A
Top 10			**34.4**	**26.9**	

Source: Canadian General Investments, Bloomberg, Edison Investment Research. Note: *Based on unmodified market cap index weightings.

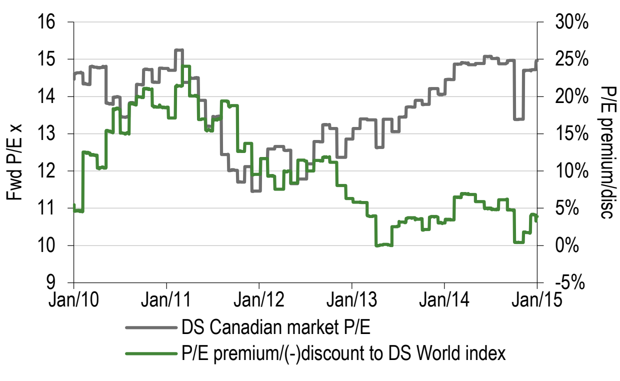
Market outlook: Steady progress expected

Similar to the US, Canada's GDP growth slowed in the first quarter of 2014 but has since rebounded. The IMF predicts a steady pace of economic growth in Canada on an annual basis and its latest forecasts are for 2.3% GDP growth in 2014 and 2.4% in 2015 following 2.0% growth in 2013. Exports are anticipated to benefit from the strengthening economic recovery in the US, which is Canada's major export market, as well as the recent weakening of the Canadian dollar, which also has the potential to stimulate investment.

Exhibit 2 illustrates the steady re-rating of the Canadian stock market from mid-2012 to mid-2014, with the forward P/E multiple rising from 11.7x to 15.1x and, after a brief correction in late 2014, the forward P/E multiple returned to this level, sitting above the 10-year average of 13.8x but still below its 16.2x high. The resources sector has contributed to this rise and the P/E multiple of the Canadian market, excluding resources, currently stands at 13.9x. The Canadian market is currently trading at a 4% premium P/E multiple to world markets, which does not appear overly stretched when compared with its 0% to 25% range and 11% average over the last five years. Excluding resources, the Canadian market P/E multiple is at a 3% discount to world markets.

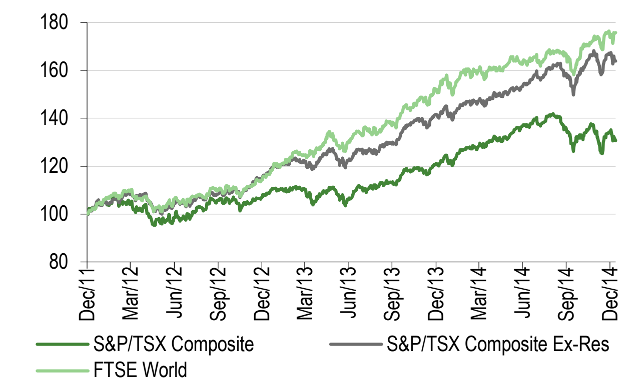
Exhibit 3 illustrates the major contribution of the resources sector to the relative underperformance of the S&P/TSX Composite Index compared with world markets over the last three years.

Exhibit 2: Canadian market P/E ratio over five years



Source: Thomson Datastream, Edison Investment Research

Exhibit 3: Canadian and World indices over three years



Source: Thomson Datastream, Edison Investment Research

The outlook for steady GDP growth provides a favourable backdrop for corporate earnings and, while Canada would not be immune to an overall slowdown in the global economy, its reliance on the US economy means that major macroeconomic uncertainties concerning risks of slowdown in Europe, China and Japan probably present a lesser risk than for many other regions. Canadian stock market valuations appear less stretched than world markets in general, potentially leaving greater scope for the market to move higher. Although recent oil price weakness creates headwinds for the energy sector, associated weakening of the Canadian dollar relative to the US dollar should partly mitigate any direct effect on earnings, as well as providing a further boost to Canada's manufacturing and other export sectors.

Fund profile: Focused on Canadian equities

Launched in January 1930, Canadian General Investments (CGI) is a TSX- and LSE-listed closed-end fund focused on medium- to long-term equity investments primarily in Canadian corporations. Its objective is to provide better than average returns to investors through prudent security selection, timely recognition of capital gains/losses and appropriate income-generating instruments. Performance is compared with the S&P/TSX Composite Index, although this is not used as a benchmark for asset allocation. Since 1998, with the issuance of its Series 1 preference shares, CGI has employed gearing with the aim of enhancing returns to common shareholders. CGI has been managed since 1956 by Morgan Meighen & Associates (MMA) and it is majority owned by directors of MMA. D Greg Eckel, senior vice-president of MMA, is the portfolio manager responsible for the management of CGI's investment portfolio.

The fund manager: D Greg Eckel

The manager's view: Attractive prospects remain

Greg Eckel acknowledges the negative absolute impact of the recent fall in the oil price on the portfolio's energy sector holdings, but notes CGI's underweight and relatively diversified exposure to the sector with a bias towards pipeline companies such as Enbridge and TransCanada, whose earnings are linked to oil volumes rather than price. He favours companies with production growth prospects and lower-cost operations that are less affected by prices, as well as exploration companies such as Peyto Exploration that are focused on natural gas, which has different price drivers to crude oil. Rather than looking to take advantage of recent share price falls to increase exposure to energy stocks, Eckel expects to maintain CGI's underweight position while rebalancing exposure away from services and exploration companies that are most exposed to the decline in the oil price. The expectation that airlines will be beneficiaries of lower energy prices has led Eckel to add to CGI's holding in Air Canada.

CGI's most significant active overweight positions are in consumer discretionary and industrials sectors, which are represented by the portfolio's two largest holdings. Both sectors are seen by the manager as beneficiaries of recent weakness in the Canadian dollar due to their relatively high levels of international sales. The largest holding, Dollarama, now represents over 5% of the portfolio and, while the manager may trim the position to bring exposure below this level, the investment case is unchanged. He sees it as a unique retailer capable of delivering steady medium-term organic growth through adding new stores while continuing to grow its dividend. Canadian Pacific Railway has delivered an operational turnaround over the last three years and is implementing a growth strategy aiming to double profitability over the next four years.

While CGI's exposure to the materials sector is similar to the index, a preference is retained for chemicals stocks including Methanex and paper & forestry stocks such as West Fraser Timber. The manager has recently increased the position in the latter and it has become a top 10 holding. Canada's timber and lumber industry is seen as benefiting from long-term Chinese demand growth and in the nearer term from the US housing recovery, as well as a weakening Canadian dollar. While metals & mining stocks exhibited signs of recovery earlier in 2014, Eckel remains cautious on their near-term prospects and retains an underweight position, most notably in the gold sector.

While CGI's exposure to the information technology sector has only increased modestly over the last year, two stocks in the sector have moved into the top 10 holdings. The first is Open Text, an enterprise software and services provider that was added to CGI's portfolio around three years ago after a change in management. The increased weighting is a result of a strong share price performance driven by Open Text delivering strong organic growth, and the manager sees potential for this to continue. The second is US-listed Yahoo! (CGI's largest foreign equity holding), which was initially purchased in 2013 with a small increase in the position in 2014 ahead of the flotation of Alibaba, in which Yahoo! had a 23% stake.

Asset allocation

Investment process: Bottom-up with top-down overlay

CGI's investment process is primarily based on bottom-up stock selection in the Canadian market. The manager first seeks to identify individual companies with attractive investment potential then assesses broader industry and global trends affecting those companies. Where broader investment themes are identified and suitable opportunities cannot be identified in the Canadian market, exposure can be gained through foreign equities (predominantly US listed) with the restriction that CGI's investment corporation status requires at least 85% of its gross revenues to be derived from Canadian sources. CGI aims to mitigate risk through maintaining a well-diversified portfolio. New investments typically represent 1.0% to 1.5% of the portfolio and holdings larger than this reflect investment gains. A long-term approach is taken and annual portfolio turnover has been below 30% for the last five years. CGI's ability to pay dividends from capital gains as well as dividend income means that investment decisions are driven by total return expectations rather than yield.

Current portfolio positioning

CGI's sector and geographic allocations are not benchmarked against the index and, as illustrated in Exhibit 4, there are significant deviations from the benchmark. While portfolio turnover is low and the manager indicates it is likely to remain below 15% in 2014, sector exposures have varied over the past year. The composition of the top 10 holdings (see Exhibit 1) has altered noticeably over the last 12 months with four of the 10 having changed, reflecting contrasting performances as well as share purchases and sales. Compared with a year earlier, following the sale of Catamaran, there are no longer any healthcare stocks in the top 10 and two information technology stocks, Open Text and Yahoo!, have entered the top 10. There has been a modest change in portfolio concentration, with the top 10 stocks representing 34% of the portfolio at end December 2014 compared with 30% a year earlier. The manager reports that the portfolio yield is currently around 1.7% compared with the yield on the S&P/TSX Composite Index of 3.0%, which suggests there is a degree of growth bias to the portfolio.

Exhibit 4: Portfolio, benchmark and relative sector weightings

	End December 2014	End December 2013	Change	S&P/TSX Composite Index weight	Active weight vs benchmark	Portfolio weight/index weight
Financials	23.5	21.9	1.6	35.7	-12.2	0.7
Consumer Discretionary	16.7	15.1	1.6	6.4	10.3	2.6
Energy	16.7	19.1	-2.4	22.0	-5.3	0.8
Industrials	16.4	13.8	2.6	8.7	7.7	1.9
Materials	11.1	12.2	-1.1	10.6	0.5	1.0
Information Technology	7.0	6.4	0.6	2.3	4.7	3.0
Telecommunication Services	3.3	3.7	-0.4	4.9	-1.6	0.7
Consumer Staples	1.6	1.5	0.1	3.7	-2.1	0.4
Utilities	1.1	1.8	-0.7	2.2	-1.1	0.5
Health Care	1.0	3.2	-2.2	3.5	-2.5	0.3
Cash & Cash Equivalents	1.6	1.3	0.3	0.0	1.6	N/A
	100.0	**100.0**		**100.0**		

Source: Canadian General Investments, Edison Investment Research.

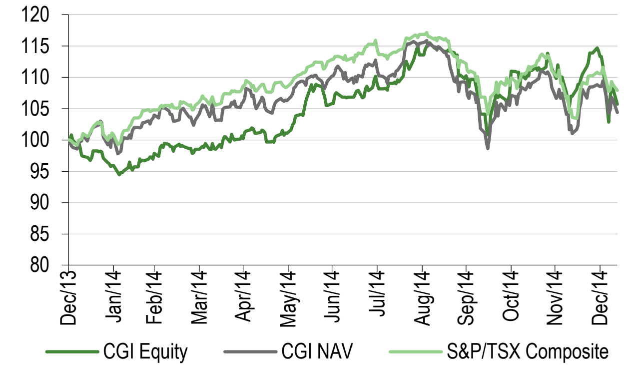
As at 31 December 2014, similar to a year earlier, CGI's largest exposure was the financials sector with an increased 24% weighting, although this also represented the largest underweight position, 12 percentage points lower than the index. Over the last 12 months, the other most significant increases in exposure have been to industrials and consumer discretionary sectors, leaving these two as CGI's largest active overweights with exposures eight and 10 points higher than the index. The greatest reductions in exposure have been to energy, healthcare and materials.

Performance: Outperformance over five years

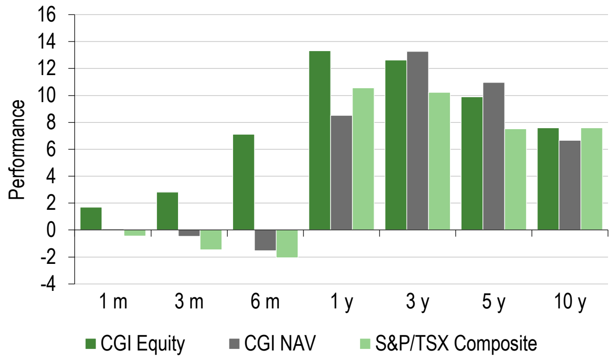
As illustrated in Exhibit 6, CGI's NAV total return has outperformed its S&P/TSX Composite Index benchmark over three and five years, while underperforming modestly over one and 10 years. Helped by a narrowing of the discount, CGI's total share price return has outperformed the benchmark over one, three and five years and is similar to the benchmark over 10 years. Exhibit 7 illustrates 10-year relative performance with CGI's underperformance during the 2008 global financial crisis outweighing its outperformance from late 2004 to mid-2007. The manager broadly attributes the weaker performance between mid-2007 and mid-2009 to CGI's overweight small-cap and underweight potash sector exposures. Since mid-2009, CGI has delivered a broadly positive or stable relative performance.

Exhibit 5: Investment company performance to 31 December 2014

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



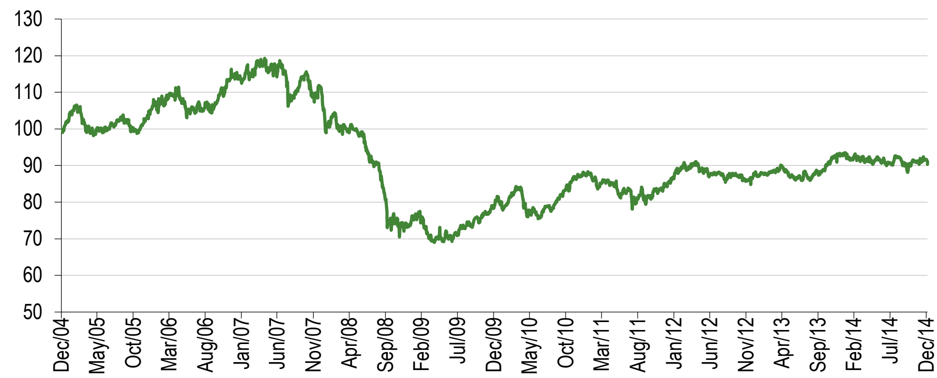
Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 6: Share price and NAV total return performance, versus benchmarks (percentage points)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Composite	2.1	4.3	9.4	2.5	6.7	11.5	(0.1)
NAV relative to S&P/TSX Composite	0.5	1.0	0.5	(1.9)	8.6	17.0	(8.4)
Price relative to FTSE Canada	2.0	3.4	7.2	1.1	4.5	15.7	(1.7)
NAV relative to FTSE Canada	0.4	0.1	(1.5)	(3.2)	6.3	21.3	(9.9)
Price relative to FTSE World	2.0	(1.4)	0.2	(0.8)	(17.8)	(9.9)	11.6
NAV relative to FTSE World	0.3	(4.5)	(7.9)	(5.0)	(16.4)	(5.5)	2.3

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-December 2014 and indices C$ adjusted. Geometric calculation.

Exhibit 7: NAV total return performance relative to benchmark over 10 years

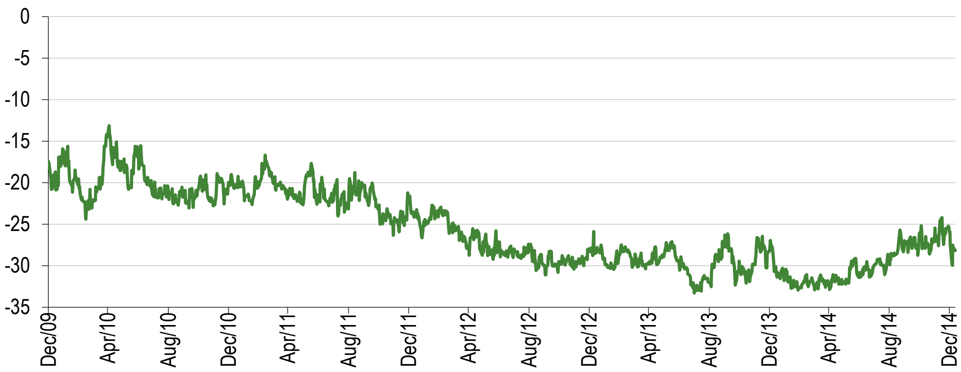


Source: Thomson Datastream, Edison Investment Research

Discount: Evident narrowing in 2014

CGI's share price discount to NAV widened from 13% in May 2010 to 33% in August 2013. Although fluctuating somewhat, the discount was still at this level in February 2014 when the board announced the intention to pay steady to rising quarterly dividends. As illustrated in Exhibit 8, the discount subsequently followed a narrowing trend, reaching 25% in November, although widening again to 30% in December. There is no specific discount control mechanism in place, with CGI's status as an investment corporation restricting it from repurchasing shares to manage the discount.

Exhibit 8: Share price discount to NAV over five years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

CGI has 20.9m common shares in issue and structural gearing is provided by C$150m nominal cumulative, redeemable Class A preference shares. C$75m nominal 3.90% Series 3 preference shares are redeemable in June 2016 and C$75m nominal 3.75% Series 4 preference shares are redeemable in June 2023. CGI is authorised to issue an unlimited number of common shares, while its investment corporation status restricts it from repurchasing shares. CGI does not have any credit facility in place. At 30 September 2014, CGI had gross gearing of 26.0% and net gearing of 24.8%.

CGI pays a monthly management fee at a rate of 1.0% pa of the market value of CGI's investments net of cash, portfolio accounts receivable and payable. The fee covers portfolio management and the provision of administrative services. No performance fees are payable. The officers of CGI receive no compensation directly from CGI. In the first half of 2014, the management expense ratio (MER) was 1.62% excluding preference share dividends, interest and finance charges (more comparable with the UK ongoing charge) and 2.68% including these costs (see Exhibit 1).

Dividend policy

From 1999 to 2013, CGI paid a flat C$0.06 per share quarterly dividend supplemented by an annual special dividend. In February 2014, a change in dividend strategy was announced, with the intention to pay steady to rising quarterly dividends, and the quarterly dividend was increased to C$0.12 per share. Year-end special dividends will continue to be paid but will be de-emphasised. The board believes that paying a greater proportion of distributions through the quarterly dividends should provide shareholders with greater reliability as to their expected dividend income and potentially greater scope for share price appreciation. Four quarterly dividends of C$0.12 per share were declared in 2014 with a final special dividend of C$0.28 per share, bringing total dividend payments for 2014 to C$0.76 per share, in line with 2012 and 2013 distributions (see Exhibit 1).

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Peer group comparison

Exhibit 9 illustrates a closed-ended peer group comparison across a selected group of funds investing primarily in Canadian equities. CGI's NAV total return is ahead of the peer group average over one, three and five years. In terms of risk-adjusted returns, CGI's Sharpe ratios of 1.2 and 1.1 over one and three years are higher than peer group averages. CGI's share price discount to NAV is at the higher end of the peer group and, while considerably wider than the 14% average, is at a similar level to two other funds. CGI's 1.66% FY13 management expense ratio is at the top of the peer group range, as is its 26% net gearing. CGI's 2.6% dividend yield, which reflects only the quarterly dividends, ranks it at the median of the peer group but below the 3.9% average. Including the C$0.28 per share special dividend, CGI's FY14 dividend yield is 4.1%.

Exhibit 9: Canadian equities peer group as at 12 January 2015

% unless stated	Market cap C$m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	MER	Net gearing	Dividend yield
Canadian General Investments	390.1	3.0	15.9	45.3	1.2	1.1	(28.0)	1.66	126	2.6
Canoe EIT Income Fund	1,127.0	4.9	4.2	32.2	1.8	0.9	(12.1)	1.37	105	9.9
Central Fund of Canada	3,725.5	0.2	(34.8)	5.6	(0.7)	(0.6)	(7.5)	0.31	99	0.1
Economic Investment Trust	506.0	1.8	48.9	47.0	0.7	1.6	(26.7)	0.36	113	0.7
Middlefield Canadian Income	202.6	0.8	14.4	62.1	0.3	0.4	(1.0)	1.37	87	4.9
Mint Income Fund	245.1	(18.5)	(16.1)	3.8	0.0	0.4	5.2	2.31	115	8.2
United Corporations	932.0	10.6	40.5	58.4	2.9	2.6	(28.7)	0.47	103	1.1
Average	**1,018.3**	**0.4**	**10.4**	**36.4**	**0.9**	**0.9**	**(14.1)**	**1.12**	**107**	**3.9**

Source: Morningstar, Edison Investment Research. Note: TR = total returns, MER = management expense ratio excluding preference share dividends, interest and finance charges. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

The board comprises seven directors, four of whom are independent of the investment manager. The non-independent directors are Vanessa Morgan (chairman of CGI and president and CEO of MMA), Jonathan Morgan (president and CEO of CGI and executive vice president of MMA) and Michael Smedley (executive vice president and CIO of MMA). The independent directors are James Billett, James Cook, R Neil Raymond and Richard O'C Whittall. The average length of service as a director is 14 years and there have been no changes to the board composition since 2005.