Larry Sarbit

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Despite the current gloom, this U.S. equity veteran remains enthusiastic about finding opportunities.

At a packed road show held recently in Toronto, Larry Sarbit's enthusiasm for stock-buying opportunities in the United States was palpable.

"We're going to do something different for you and make you a lot of money," says Sarbit, "but it will take a while. In the next five years, I will be very happy with these stocks."

Sarbit is the founder and chief investment officer of Sarbit Advisory Services, the Winnipeg-based sub-advisor of the $363-million IA Clarington Sarbit U.S. Equity.

Sitting down for an interview following his presentation, Sarbit expanded on his value investing philosophy. "We're not a 'di-worsified' plethora of stocks, we're not an index," he says. The fund currently holds a concentrated portfolio of 21 stocks, within its general range of 15 to 25.

Sarbit looks for high, sustainable returns on invested capital, taking into account such factors as depreciation of plant and equipment. Other criteria include free cash flow and the availability of excess capital that doesn't have to be reinvested.

Sarbit says his investment decisions are all about finding terrific companies with high degrees of certainty of return. Not shy about holding cash to patiently wait for bargains to emerge, the fund currently has a cash position of 24%, a drop from 36% back in June 2010.

Historically, Sarbit recalls holding more than 90% in cash when he was a the fund manager AIC Ltd. in the early 2000s, because he couldn't find any investments that met his strict value criteria.

CVS Caremark Corp., with an 8.5% weight in the overall mandate, is among Sarbit's select list of current picks. The company is the largest retail pharmacy chain in the U.S. and operates more than 7,000 retail pharmacies. "They think they'll be getting 40 million new prescriptions that will come from Obamacare," says Sarbit, according to the company's estimates of 32 million newly insured people.

As well, the company is expected to increase its dividends and generate US$25 billion in free cash flow over the next five years. "It's a very predictable business," says Sarbit, "and you have a huge demographic tailwind in the industry."

Coinstar Inc. is another favoured top holding. The company owns and operates coin-counting and entertainment machines, as well as self-service DVD kiosks in the U.S., Canada, Mexico and the United Kingdom. "Coinstar has over 31,000 machines. Nobody can compete with them," says Sarbit.

The company's long-term goal includes introducing vending machines for coffee and other products, and rolling out 50,000 to 60,000 machines. "I think it is a growth business," says Sarbit. "We've just started to make money here."

The sector weights in IA Clarington Sarbit U.S. Equity are "accidental," Sarbit says. He downplays the benefits of imposing sector constraints, favouring instead a strictly bottom-up approach. "Risk management is finding a company that isn't going to blow up on you, that is highly predictable, and buying it at a cheap price."

Another risk-management strategy that has worked out well for Sarbit is hedging of his U.S.-dollar exposure back into Canadian dollars. "We got lucky," says Sarbit, referring to the Canadian dollar's sharp gains versus the greenback in recent years.

Larry Sarbit:

Sarbit, 59, draws on extensive experience in U.S. equity investing. He holds a bachelor of arts degree from the University of Winnipeg and an MA from York University, in geography. After a short period of university teaching, he joined the then named Richardson Securities as an analyst in 1979. In 1987, he moved to I.G. Investment Management Ltd. and managed what is now Investors U.S. Large Cap Value for 10 years.

In 1998, he left I.G. Investment to join an affiliate of AIC Ltd., where he managed the Aderes brand of funds. In August 2000, these funds were merged into AIC mutual funds and Sarbit became the fund manager of AIC American Focused. Sarbit left AIC in March 2005 to start his own firm.

Sarbit's relationship with IA Clarington Investments Inc. began in October 2008, when he sold his mutual-fund company Sarbit Asset Management Inc. to IA Clarington's parent, Industrial Alliance Insurance and Financial Services Inc.

Subsequently, IA Clarington decided to swallow up the small Sarbit fund operation, while retaining Larry Sarbit's portfolio-management services. In June 2009, the track record of the former Sarbit U.S. Equity came to an end when it was merged, along with one other IA Clarington fund, into a third fund formerly managed by Nevada-based Louis Navellier. The surviving fund, renamed IA Clarington Sarbit U.S. Equity, was handed to Sarbit.

Sarbit's team includes one analyst on a part-time basis, a recently hired full-time analyst, and Sarbit's brother-in-law, Harvey Berkal, a former litigation lawyer and investigative journalist. The in-house research includes hands-on meetings with companies, connecting with contacts in the U.S., and quantitative screening.

Sarbit acknowledges that the U.S. economy is in rough shape. "It will take five to 10 years to recover," he says. Unfazed, he will go about his business of focusing on the strength of individual companies and pursuing opportunities where others fear to tread. "You get to buy bargains when people are scared, when things are gloomy. We're taking advantage of this opportunity."

About the Author

Diana Cawfield is an award-winning writer who has been a regular Morningstar contributor since 2000. Her numerous publication credits include the Toronto Star, Advisor's Edge and Chatelaine, as well as the Canadian Securities Institute's online educational services.