

## Ben Cheng

Catapult Financial Management Inc.

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### Manager Monitor

Michael Ryval

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### Income-focused manager is finding bargains among U.S. junk bonds.

In managing two income-oriented funds, Ben Cheng focuses on cash flow from investments, whether it's distributions or interest income. "Over the cycle, or three to five years, we try to derive 70% of our returns from income," says Cheng, manager of IA Clarington Tactical Income, whose multiple versions include the monthly-pay Series T6.

Given that emphasis, Cheng has acquired a number of U.S. high-yield bonds that he believes are mispriced. These securities represent about half of the fixed-income weighting, and it's growing.

A case in point is a high-yield issue from MGM Mirage. Admittedly, the Las Vegas-based hotel and casino operator is highly leveraged. But the debt issue is secure because the ratio of debt to cash flow is only three times, says Cheng, 43, the Toronto-based head of Catapult Financial Management Inc.

While the MGM security is rated B-plus, or junk, it is yielding 8.5% and represents good value. "Do I think that, in the worst case scenario, someone will pay three times cash flow for MGM's business? Absolutely," says Cheng, who is also president and chief investment officer at Aston Hill Financial Inc., which is headquartered in Calgary.

"I understand that the company has a lot of debt, but we are first in line," Cheng adds, noting he is value-oriented in security selection. "We are No. 1. I'd rather be side by side with Bank of America or Deutsche Bank, as opposed to ranking well behind them. That's why a lot of that sector is mispriced. Over the next while, we will increase our weighting."

The IA Clarington Global Income mandate has a 45%-45% blend of fixed income and equity, and 10% cash. The key difference between this fund and IA Clarington Tactical Income is that the global fund has most of its equity allocation outside Canada.

A Toronto native, Cheng has worked in the industry since he graduated in 1989 from the University of Toronto with a bachelor of commerce, specializing in finance and marketing. Initially, he worked as a Canadian and U.S. equity analyst for Perpetuity Asset Management Inc., a private-client wealth manager.

In early 1992, he landed a job as a corporate-credit analyst at Sceptre Investment Counsel Ltd. As a member of the bond-management team, Cheng also ran some small portfolios for insurance companies and dealt with a real-estate-bond portfolio that Sceptre acquired in the wake of the 1990s real-estate collapse.

In October 1997, Cheng joined the former BPI Financial and ran its corporate and Canadian bond funds. In August 1999, when CI Financial Inc. acquired BPI, the corporate bond fund was merged into the high income fund, which became one of Cheng's prime responsibilities.

Cheng was also co-manager, with Eric Bushell, of CI Signature High Income and CI Signature Dividend. During Cheng's tenure, both funds were honoured with Canadian Investment Awards in their respective categories.

In 2005, Cheng left CI Financial and was hired as managing director at Fortress Investment Group, a New York-based firm that specializes in hedge fund strategies and private equity investments. But Cheng tired of commuting to the head office, and in early 2007 teamed up with friend and business partner, Eric Tremblay, who had founded Aston Hill.

Through its subsidiary, Catapult Financial, Cheng began managing IA Clarington Tactical Income in July 2008. Since it merged in June 2009 with IA Clarington Diversified Income, its track record was reset. The fund returned 11.7% for the six months ended Feb. 28, compared with 5.6% for the median fund in the Tactical Balanced category.

## Ben Cheng: Catapult Financial Management Inc.

In September 2008, Cheng began managing IA Clarington Global Income. The Series T6 version of the fund returned 27.6% for the 12 months ended Feb. 28, compared with 23.4% for the median fund in Global Neutral Balanced category.

Catapult manages about \$1.5 billion in assets, including about \$500 million for institutional clients. Among the newest products is IA Clarington Aston Hill Tactical Yield, a closed-end fund, which will start trading in mid-April. It will consist of stocks, income trusts and fixed income, including high-yield corporate debt.

With a view to diversity, Cheng has about 100 equity and fixed-income names in each fund. Turnover in the Canadian income fund was fairly high, at 92.4% for the year ended June 30, 2009. It was considerably lower in the global income fund, at 27.6% for the same period.

In selecting equities, Cheng chooses names on a measure of free-cash yield, or distribution, divided by the security's standard deviation, or volatility. Businesses that meet his criteria include Yellow Pages Income Fund.

The telephone-directory provider is converting to a corporation, and expects to pay a 12.4% yield. "Earnings will bottom out in the second quarter, and its online business continues to grow at 20% to 25% a year," says Cheng, adding that he expects the stock, now at \$6, could reach \$7 within 12 months. "Meanwhile, we're getting paid 12.4% to wait."

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### About the Author

Michael Ryval, a regular contributor to Morningstar, is a Toronto-based freelance writer who specializes in business and investing. Among the other publications in which his articles appear are Investment Executive, The Globe and Mail and FORUM.