2 Small-Cap Stocks to Outperform the Market

Description

A study conducted by five independent stock-market experts concludes that small-cap stocks can beat the overall market by as much as five percentage points a year. The study, called "Size Matters, if You Control Your Junk," looked at 50 years of U.S. data and 30 years of overseas data, and says that if you want to beat the market, buy small-cap stocks of high quality, as measured by balance-sheet strength, profitability, stability, and growth.

Fortunately, there's no shortage of high-quality small caps in Canada. We look at two worth considering for your portfolio.

Canadian Western Bank

Like many other western Canadian-based companies, **Canadian Western Bank** (TSX:CWB) has suffered from the oil price collapse, and that's been reflected in its share price, which peaked at more than $43 in August. The stock was trading at around $26 on Thursday.

The bank recently reported first-quarter net income of $54.2 million, up 3% compared with the same quarter in the previous year.

Chief Executive Chris Fowler said he is optimistic about the outlook for 2015, despite low crude prices, which he acknowledges have hurt the company, even though its exposure to the energy sector is small at just 6% of outstanding loans.

Fowler expects loan growth of 10-12% this year, along with earnings rising as much as 8%.

"We measure ourselves on performance-based metrics, like revenue growth, loan growth, provisions for credit loss, return on equity, earnings per share, and cost efficiency—metrics which reflect the true performance of CWB Group and have not had a statistically significant correlation to the price of oil," Fowler said at the company's shareholders' meeting.

The bank recently sold its property and casualty insurance division for $197 million, cash that will probably be used for acquisitions, Fowler said, likely in the equipment finance or wealth management

areas, and outside of the bank's core markets of Edmonton and Calgary.

There's no doubt that a recovery in the price of oil would boost CWB's fortunes. Still, the bank's long-term prospects look good, and the share price is expected to recover.

Leon's Furniture Ltd.

Leon's Furniture Ltd. ([TSX: LNF](#)) is a consistently strong performer in the retail sector, with both revenue and same-store sales rising in its latest quarter, partly due to the $700 million acquisition of rival The Brick in 2013.

The furniture and appliance store's quarterly net income rose to $29.9 million in the fourth quarter, a 12% increase from Q4 2013.

Sales in the quarter were $649 million, including $107.2 million of franchise sales, up from $633.8 million, with $110.8 million in franchise sales in 2013. Same-store corporate sales increased 4.3%.

"We are pleased with the increase in profits for both the fourth quarter and 2014 when compared to the prior year," Terry Leon, president and CEO of the family-managed retailer, said in a note to shareholders. "We are also very encouraged by the increase in same-store sales for the fourth quarter and year when compared to 2013."

"Integration and synergies between The Brick and Leon's divisions are progressing as planned," he said. He added that Leon's is in the early stages of a 15-month project to install a new computer system that will improve operational efficiency in both divisions.

Small-cap stocks can be risky and volatile. Nervous investors might instead consider holding small caps in a mutual fund. One of the better small-cap fund performers is the NEI Ethical Special Equity Fund, with has a three-year annualized return of nearly 15% (both Canadian Western Bank and Leon's Furniture are among the top 10 holdings of this fund). The Special Equity fund has the added bonus of falling within the company's socially responsible family of ethical funds.

CATEGORY

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TICKERS GLOBAL

1. TSX:CWB (Canadian Western Bank)

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Date
2025/08/24
Date Created

2015/03/19
Author
dwatt

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