

**A road map for the stock market:**

Analysis builds on Vern Atrill's offbeat methods

By: Patrick Bloomfield

Monday, September 18, 2000

Section: Financial Post Investing

Column: Inside the Market

Is higher inflation still in the cards, or a "soft" economic landing (as the pundits promise us) or a harder one? Personally, I would not bet the farm on the demise of inflation, looking at the fresh pick-up in U.S. money supply. And I would lay only modest odds on a benign slowdown, keeping in mind the strength of the U.S. greenback against the euro and the potential toll on U.S. multinational profits.

Whichever way things go, there is little harm and, I would suggest, considerable potential in preferring undervalued stocks to overvalued ones. The former can be readily found if one cares to check out the market woodwork. On that one, chartered financial analyst Randall Abramson, vice-president at Toronto-based Strategic Capital Partners Inc., and I readily agreed in a chat last week.

SCPI is an investment dealer-cum portfolio management company with a sister company, Strategic Advisors Corp., which invests mostly in equities. It uses a proprietary methodology known as structural valuation analysis (SVA), that is also the structural engine of an advisory service (The Strategic Action Letter) serving institutions and portfolio managers.

SVA, in essence, draws what Mr. Abramson describes as a road map that helps determine when to buy and when to sell. In particular, it sheds light on some of those down-to-earth stock names that save him from sleepless nights wondering whether others can remain in the stratosphere.

He cites value situations such as off-price retailer TJX Companies Inc. (TJX/NYSE), designer Jones Apparel Group Inc. (JNY/NYSE), or tax accountant H&R Block Inc. (HRB/NYSE).

What particularly interested me was that Mr. Abramson has built on an offbeat methodology that has led to some pretty prescient Canadian calls since Vern Atrill, a physicist and a fine gentleman regrettably no longer with us, began introducing it to us back in the late 1970s and early 1980s.

Mr. Atrill began with his own physicist's recomposition of a company's balance sheet, resulting in a "stability ratio" that acts as a gauge of its efficiency. Too high, and management is not deploying all its capital resources. Too low and there's the likelihood that there is not enough financial strength to enable management to fulfill its mandate.

It all sounded a little curious and abstruse in the beginning. But people began treating its progenitor with more respect when he correctly forecast to a gathering of financial analysts the coming demise of Dome Petroleum Ltd., the darling of Canadian markets in the early 1980s. His successor in title, former brokerage house research manager Ross Healy, president of Toronto-based Strategic Analysis Corp., carries on his work today.

Strategic Analysis also came up with something Mr. Healy calls an earnings efficiency ratio, a kind of hurdle rate of earnings that a company, depending on its balance sheet structure, must earn to generate growth.

From those beginnings, Strategic Analysis also developed valuation zones, or trading ranges, based on a stock's adjusted book value.

What Mr. Abramson has added is a more intimate look at progress of a stock's valuation zones over the most recent 24 months. From that, he feels he can better recognize a "thumb print" of the manner in which the stock trades.

Looking at Dow stocks, for instance, he sees aerospace, instrumentation and technological manufacturing giant Honeywell International Inc. (HON/NYSE) as having recently hit its thumb-print low and being poised for better things.

In Canada, he puts an enthusiastic finger on the way the stock of Canadian Natural Resources Ltd. (CNQ/TSE) has paralleled the company's own relentless adjusted book value growth, not to mention its strong cash flow growth and return on equity.

By contrast, he sees US\$57 as a potential danger signal for the stock of network systems manufacturer Cisco Systems Inc. (CSCO/NASDAQ). Having breached US\$59 this past Tuesday, this technology leader was back above US\$62 on Friday, seemingly headed back toward the rarified Atrillian zone where it customarily trades. Whether or not it will stay there is for another day.