4th Quarter 2020 (Q4) Market Commentary

Introduction

What follows is a recap of all of our internally managed investment mandates, with a specific emphasis on “where it fits” and the recent improvements to each mandate. While we recognize that not all readers are participating in each strategy, we publish the commentaries to give you some perspective on what we are witnessing under the hood. Should the question of “why don’t I own some of that?” occur to you, please raise that with us the next time we connect. As you know, cash inflows/outflows and different start dates mean that no two accounts are exactly alike. You will find your individual results in your personal reporting package.

The Big Picture

We closed out the year with much of the same themes that I espoused on our December 11th, 2020 missive, [The Opportunity Update]() – in short:

Copper is very near its multi-year highs, as is the Semiconductor Index.

Charts courtesy of [StockCharts.com]()

The U.S. Dollar Index continues to peg lower lows and lower highs – a bonus for most things X-USA, with bullish implications for commodities ($CRB below), the developing economies and Canada!

Charts courtesy of StockCharts.com

What is undeniable is that the rotation out of U.S. mega cap stocks continues at the margin, whereas there have been gangbuster money flows into exchange traded funds (ETFs) favouring small to mid cap growth companies and X-USA equities. Our take? Think like Gretzky – skate to where the puck is going to be, not where it has been.

As you are no doubt aware, vaccines are being administered and our expectation is that after the initial stumbles, the pace will pick up. What is unknowable is our post-Christmas infection rate. Most people I know have “bent” the rules, but gatherings were kept to a minimum. What is more worrisome is the impact of the U.K. virus variant. Accordingly, it would not surprise us to get a shakedown in the markets early on in the New Year. If that happens, we intend to use the weakness to allocate resources to COVID victims in anticipation of the eventual recovery.

When we watch the money flows into and out of market/sector based exchange traded funds, it is clear to us that investors are still anticipating the post-pandemic economic recovery. We also find it encouraging that some of the excess enthusiasm is backing off – as I write on New Year’s Eve, CNN’s Fear & Greed Index is pegging in at a slightly neutral/bearish reading of 48, versus an extreme greed rating of 85 a month ago. Again, these are contrarian indicators – when everybody is totally fearful, we need to force ourselves to buy and vice versa.

<u>The Dividend Value Discipline</u>™ – This is our core strategy and it needs little in the way of introduction. It has been in existence since September of 2002. The mandate is attractive to investors that are interested in acquiring “rent cheque (dividend) growers”, for both income and capital gain. Why growers? Please ask me the next time we speak, but in short, over long periods of time they do extremely well.

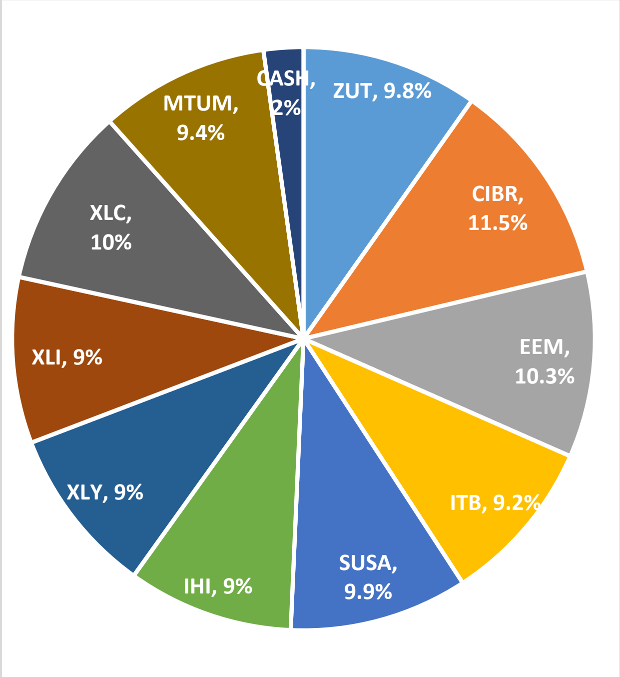
In the unprecedented environment of 2020, we not only upped our capital preservation focus and still pegged in with another respectable year– most “balanced” accounts (those with a fixed income component) saw year-end returns in the 3-5% range, whereas the all equity versions were in the 7-9% range.

As you would expect, our objectives remain unchanged:

- Invest in companies that evidence superior corporate culture are disrupting/reinventing the way business is done, and/or aggregating (purchasing smaller competitors) their way to sustainable double-digit earnings and dividend growth.
- Hold such companies through the inevitable market downturns by focusing on their competitive advantage and thereby the long-term earnings/dividend growth, as opposed to the euphoria and dysphoria of the stock market.
- Generate a consistently growing income and absolute returns of 8%+ per annum over any investment cycle, i.e. peak to peak or trough to trough.

In terms of position changes, those of you who watch your accounts closely will have noted that we upped our exposure in commodity producers, favouring Canadian names via exchange traded funds, and have taken up new positions in American Tower, Williams Sonoma, Northern Trust, CDW Corp., and Amphenol. The latter three are what we would call COVID victim stocks, i.e. we anticipate they will do well as the economic recovery takes hold. Where did the money come from to buy these? COVID beneficiary stocks, which at the margin have probably had their day in the sun. As you would expect, we are always tracking the rent cheque growth and as per the image below, we are pleased to report they have been surprisingly strong ☺. Our expectation is for stronger growth yet as the economy recovers and corporate profitability returns.

<u>The Global Active Macro ETF (GAME) Strategy</u> – I like to think of GAME as the ballast mandate. It tends to do well when others have not, and it has also been a great compass in terms of pointing us to where the puck is going as opposed to where it has been. By way of example, this rules based approach "forced" us to buy base metal producers back in August and emerging markets equities in September (via ETFs), which was early on before most investors recognized the emerging trend.



Who is it for? Given that the turnover is fairly high, we like to see this mandate within registered accounts (i.e. RSP, RIF, IRA, TFSA). This go anywhere strategy is especially appealing to investors that want to move with the market and not get locked into a box, such as say U.S. equities or emerging markets debt. When I site periods in history where the S&P 500 has actually been negative on a 10-year rolling basis, most people understand why not getting locked in is important. That is one of the reasons for generally negative biases towards mutual funds – they have their place, sparingly, in our view.

In terms of what is new, we did tweak the process in late August, whereas the underlying tenants of buying begets buying, selling begets selling, and trends go on far longer than you think they can, remain unchanged. The December 31st, 2020 allocation for our Canadian version is as per the image.

<u>The Tax Advantaged Preferred Share (TAPS) Strategy</u> – As many of you will recall, we used to do preferred shares on a one off basis with a standard transaction cost of 1% to buy and 1% to sell, while anticipating a very low turnover. The ruling by the Office of the Superintendent of Financial Institutions (OSFI) whereby Canadian banks were given a far cheaper avenue to raise capital, necessitated a more streamlined approach. It was evident that the Canadian preferred share market would shrink over time, turnover would increase, and as GICs mature with investors facing a little north of 1% for a 3-year term, buying interest would return to these tax preferred income generators. To deal with those eventualities, we needed a better process. TAPS was an invention of necessity – in an effort to get our clients closer to the original cost estimate, we flat lined the costs at 0.5% per annum, which we see as an absolute bargain. Due to the dividend tax credit, interest equivalent yields of ~7% are the norm, for now. We wouldn't expect it to be that high a year from now.

PREFERRED SHARES HOLDINGS
BANK OF MONTREAL PFD SERIES 40
CIBC NON CUML CL A PFD SER 49
ENBRIDGE INC PFD
ENBRIDGE CUM RED RR PREF S17
FAIRFAX FINL 5YR RR PFD SR M
GREAT WEST LIFECO INC PREF SHS
GREAT WEST LIFECO 1ST PFD SR S
INTACT FIN CORP NON CM C A PFD
MANULIFE N-CUM RR PFD CL 1 S23
NBC NON CUM 5YR PFD SER 38
PEMBINA PIPE FIX CL A PFD S13
POWER FINANCIAL PREF SER-V
TC ENERGY CUML RED 1ST PFD S15
TD BK NON CUM 5Y RST PFD SR 22

Who is it for? Investors whose primary focus is on income, and they are not concerned with capital growth. This strategy is not appropriate for registered accounts as you would nullify the tax advantages.

This is by far our fastest growing platform and since launching it, it is surprising to us how many of our clients have found money under the chesterfield cushions ☺. A snapshot of our December 31st, 2020 model holdings is as per the adjacent image.

The Keep More Income (KMI) Strategy – This is under beta test (Chris and one other client) and was developed for a very specific niche – Canadian tax preferred income coupled with some growth over time. This is a pure Canada only mandate and it is only suitable for Canadian investors in non-registered/taxable accounts. While it is early days, we are encouraged with a weaker U.S. dollar and what it is doing for our commodity prices/producers. You may recall that for the decade prior to the market meltdown of 2008/09, Canada was the place to be. Post that crisis the U.S. has been the place to be for the past 12 years, but it is at least plausible that we are now witnessing a secular shift. The weaker U.S. dollar and investors returning to the X-USA space are certainly evident. All of this begs the question, could it be Canada's time to shine? The best opportunities tend to come from sectors/regions where investors have long given up and thrown in the towel. That certainly describes most of Canada.

The Next Cycle Resource Fund (NCRF) – I started this mandate on January 7th, 2020, again under beta test, with my personal money. My thinking at the time was, we are getting close to the next commodities cycle and I need to develop a mandate for our clients to take advantage of it. Of course COVID hit and down came my doghouse. In truth, I was so overwhelmed with everything else going on and because it was my own money, the NCRF promptly went ignored. The interesting thing was that by August, it was back to making money. That doubled my conviction to the strategy because by then, the weaker U.S. dollar was evident and I knew that there had been a whole lot of future resource production that got shelved during the market meltdown. My take is that supply will not be able to keep up with demand as the economy recovers. Furthermore, the green agenda translates to a lot more materials consumed for producing things like solar panels, wind turbines and Tesla batteries.

Who is it for? Investors with a high risk tolerance, and it is probably better suited to a non-taxable account or slice thereof.

Conclusion

There is no question that the challenges of 2020 brought with it a lot of blood, sweat and tears. The blessing for both us and our clients is that it forced us to get far more efficient throughout our investment platforms and the client relationship side of the business. These realized efficiencies are in keeping with our objective of freeing up more time to address your individual needs and concerns. We are looking forward to both the challenges and the opportunities for 2021.

Our best to you and yours for a happy, healthy and prosperous New Year,

Chris Raper, CIM®, CFP®
Senior Vice President, Senior Wealth Advisor | Senior Portfolio Manager
Private Client Group, Raymond James Ltd.
www.chrisraper.com

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