CIBC PRIVATE WEALTH MANAGEMENT | Papau Armstrong Schmidt Financial Group

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Finding Opportunities and Taking Profits During Q1

North American equity markets performed well during the first quarter of 2021 (Q1), despite mixed news regarding the pandemic and elevated valuations for many equities. We continue to execute our strategy of investing in high-quality companies at attractive valuations. During Q1, we made several new investments. We are also beginning to trim some holdings that have gained substantially and no longer appear as attractive as they did at lower levels.

In this Q1 Newsletter, we will highlight some of the recent purchases and sales in all three of our discretionary portfolios: the Total Return Portfolio, the High Yield Portfolio and the Balanced Portfolio. With the recent large moves in equity markets, we have been a bit more active than usual.

Taking Profits in Lumber Producers

In mid-2020, we identified potential undervaluation in the forest products sector. Lumber futures were trading in the US$350-400 range, despite low interest rates and projected high housing demand from the millennial demographic. At that time, in the Total Return Portfolio, we added to West Fraser Timber Co. Ltd.[1] (TSX:WFG), a low cost North American lumber producer, at a price of $39.89 per share. In the High Yield Portfolio and the Balanced Portfolio, we purchased Weyerhaeuser Co. (NYSE:WY) at US$19.84 per share. Weyerhaeuser is a lumber producer but is also one of the largest private landowners in the U.S. with massive timberland holdings.

A year has passed, and lumber prices are far higher. Lumber futures have been trading around US$1,000 on a consistent basis, having more than doubled. We recently sold our remaining West Fraser shares out of the Total Return Portfolio at $103.13. We also recently sold our Weyerhaeuser shares out of the High Yield and Balanced Portfolios at US$36.64 on April 7 and US$36.93 on April 12 respectively. The percentage gains on these positions have been exceptional.

The demand for new homes around North America may remain strong. Even so, the forest products industry tends to be cyclical, and in cyclical industries the right move from an investment perspective is often to sell when the industry is doing great and buy when the industry is suffering.

Taking Profits in Brookfield Property

In May of 2020, we purchased additional units of Brookfield Property Partners L.P.[2] (TSX:BPY.UN) for all three of our discretionary portfolios at a price of $14.89 per unit. We were already holding positions in

Brookfield Property at a cost of $22.50 in the Balanced Portfolio and $23.50 in our other two portfolios. We chose to buy more because we viewed the units as heavily discounted relative to their long-term potential. At that time, fears around commercial tenants not paying were very high.

Even so, relative to other commercial real estate investment trusts (REITs), Brookfield Property has some major advantages. These include some very high quality properties in major international cities, as well as financial support from its parent company Brookfield Asset Management Inc.[3] (TSX:BAM.A).

In recent months, dissatisfied by the low valuation of the Brookfield Property units, the parent company decided to take Brookfield Property private. This resulted in a large gain in the unit price. We realized this gain in early April by selling the Brookfield Property units out of all portfolios at a price of $22.19 We were also happy to receive both the December 31 and March 31 dividends after this deal was announced. These two large quarterly dividends alone paid out roughly 3.5% of the unit price.

We will maintain some exposure to these assets through Brookfield Asset Management, which also has substantial exposure to renewable energy and infrastructure. Our most recent purchases of Brookfield Asset Management were at a price of $52.08 in both the Total Return Portfolio and Balanced Portfolio on February 8. We did not add the company to the High Yield Portfolio, as it only pays a small dividend.

Adding to Restaurant Brands in the High Yield Portfolio

On April 8, we added to our Restaurant Brands International Inc.[4] (TSX:QSR) holdings in the High Yield Portfolio. We paid $83.29 per share.

The company owns three of the world's most prominent quick service restaurant brands, namely Burger King, Tim Hortons and Popeye's Louisiana Kitchen. Its business model is based on franchising.

The restaurant industry has had a difficult time during this pandemic, but the quick service business model with drive through service and other adaptations has proven durable. We believe there will be a lot of demand for new Popeye's franchises as the pandemic winds down. It has been one of the hottest fast food brands in recent years. It will be far easier for prospective franchisees to secure good commercial real estate locations in the next couple of years. Restaurant Brands has better than average growth potential and also pays a dividend of around 3.2% annually.

Adding to Sienna Senior Living in the High Yield Portfolio

For years we have followed various Canadian senior housing equities, but we did not purchase any of them until their share prices dropped substantially in 2020. The long-term outlook for senior housing demand remains strong, with the number of age 80+ Canadians expected to more than double over the next two decades to around 3.4 million.[5]

In mid-2020, we purchased small weightings in two of the best senior housing equities in our High Yield Portfolio only, namely Chartwell Retirement Residences (TSX:CSH.UN) at a price of $10.56 per share, and Sienna Senior Living Inc. (TSX:SIA) at a price of $10.67 per share. They both pay high dividends and have demonstrated stability over time. We recently added more shares of Sienna in the High Yield Portfolio at a price of $14.62 per share.

We expect the needs-based nature of senior housing to work in favor of these companies over the long-term. Most of their residents are unable to live independently at this stage of their lives. There are increasing numbers of Canadians who are reaching that stage of life each year. Senior housing is their best option, and Chartwell and Sienna are two of the best operators with good multi-decade track records.

Adding to Kimberley-Clark in the High Yield Portfolio

On April 8 we purchased more shares of Kimberley-Clark Corp. (NYSE:KMB) at a price of US$137.23. The company now has a weighting of approximately 2% in the High Yield Portfolio. Kimberley-Clark is a high quality consumer staples company that sells its products globally and has been in business for more than 100 years. Its brands include Kleenex tissues and Huggies diapers. The shares currently yield around 3.3%, and the company has increased its dividend every year for decades. We view Kimberley Clark as a high-quality company at a reasonable valuation that we can hold in the portfolio for years.

Adding to Gold in the Balanced Portfolio and Total Return Portfolio

On April 13, we purchased additional units of IShares Gold Bullion ETF (TSX:CGL.C) at a price of $18.91 per unit in both of these portfolios. Gold prices have come down recently, giving us what looks like a decent entry point. We are in a period of massive currency creation around the world. Gold price movements can be very unpredictable, but over long periods of time, gold helps protect against inflation, and can sometimes rally even when equities are declining.

Adding to Pfizer in the High Yield Portfolio

We now own shares of Pfizer Inc. (NYSE:PFE) in all three of our discretionary portfolios, with our most recent purchase being an addition of more shares in the High Yield Portfolio on April 8 at a price of US$35.97. While Pfizer is involved in one of the more successful pandemic vaccines currently, we are more focused on other factors. Pfizer is a high-quality pharmaceutical company with numerous successful products, earnings growth potential, and a dividend of around 4% annually. Its balance sheet is very strong. In 2020, Pfizer reorganized its business to increase future growth potential by divesting various generic medications. The company fits our philosophy of buying high-quality companies at reasonable prices.

Adding to Howard Hughes in the Total Return Portfolio

On February 8 we purchased more shares of Howard Hughes Corp. (NYSE:HHC) in the Total Return Portfolio at a price of US$92.96 per share. This follows our November 2020 initial purchase of shares at US$69.20. Our reasoning is quite simple regarding this U.S. property developer. They have lots of valuable land in various areas including Hawaii, Texas and Nevada, including entire master-planned communities that they control. The pandemic temporarily suppressed their property sales, cutting revenues sharply, and driving the stock lower. We see this as transitory. There is plenty of demand for U.S. real estate with low interest rates, and a millennial demographic that is in the process of buying housing.

The company's shares were at around US$130 pre-pandemic, and they could potentially return to these levels. At the time of writing, shares were trading above US$100. We have been watching it for years as a potential buy, waiting for the right price. Due to this past research, we were comfortable enough to buy the shares after the severe decline.

Conclusion

We have devoted this Q1 edition of our Newsletter to discussing certain transactions in our discretionary model portfolios. Our philosophy of buying high-quality businesses trading at undervalued prices has proven to be durable, and we continue to look for opportunities that fit this philosophy.

As always, we look forward to communicating with you and answering any questions you may have about your personal circumstances, our discretionary model portfolios or other topics of interest. Thank you for reading our Q1 Newsletter, and thank you for your business.

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APPENDIX "A"

DISCRETIONARY MODEL PORTFOLIOS

We encourage clients to contact us for more information regarding our three fully discretionary model portfolios, namely the Total Return Portfolio, the High Yield Portfolio and the Balanced Portfolio. Our research efforts are now primarily devoted to finding investment ideas that will suit the criteria established for these portfolios and contribute to their returns.

1) Our Total Return Portfolio is focused on providing clients with an average annual return of around 8-10%, consisting mainly of capital gains and dividends.

2) Our High Yield Portfolio is focused on providing income-seeking clients with an average yield of 4%, plus around 2-3% of annual capital growth.

3) Our Balanced Portfolio is a more conservative portfolio that typically consists of approximately 50% fixed income investments and 50% equity investments.

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[1] CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
[2] CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
[3] The equity securities of this company are limited voting shares. CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months. This company is a client for which a CIBC World Markets company has performed non-investment banking, securities-related services in the past 12 months. CIBC World Markets Corp., CIBC World Markets Inc., and their affiliates, in the aggregate, beneficially own 1% or more of a class of equity securities issued by this company.
[4] CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months. CIBC World Markets Corp., CIBC World Markets Inc., and their affiliates, in the aggregate, beneficially own 1% or more of a class of equity securities issued by this company.
[5] Sienna Senior Living Investor Presentation dated September 2020, page 14.