CIBC Wood Gundy | Papau Armstrong Schmidt Financial Group

*October 21, 2020*

# Adding New Holdings at a Discount in Q3

We are still positioned somewhat cautiously in our discretionary portfolios heading into the early November U.S. election. Even so, we did manage to make some purchases at attractive prices during the third quarter of 2020 (Q3), which we will discuss below. The COVID-19 pandemic continues, but even with a renewed rise in cases, we are optimistic that summer 2021 will look a lot better than today from a health and corporate earnings perspective. We base our views on better treatments, preventative measures, patchy progress towards herd immunity, and various potential vaccines. We also note that COVID-19 death rates are lower than we had feared in Q1 2020.

The U.S. election is likely to cause some short-term volatility, and we may be able to add some new holdings at attractive prices if that happens. Government and central bank intervention continues to be a key factor affecting equity markets. In Canada, we may see another enormous federal deficit in 2021, as our national debt surges through $1 trillion for the first time. Whether the short run benefits will justify the long run negative consequences is anybody's guess.

As this difficult year comes to an end, we will be watching carefully for more good multi-year investment opportunities for our discretionary portfolios. We believe that we will find those opportunities among high-quality companies that have been negatively affected in the short run by the pandemic, but still have good long-term prospects. There are numerous companies that fit this description with their shares trading well below 2019 levels, including many of the purchases that we will discuss below. We believe that these companies will benefit from a gradually healing global economy in the coming year, and that they will adapt to any continuing health restrictions.

## U.S. Election

Should investors fear the upcoming U.S. election? Historically, it has not made much difference to equity markets which party wins. This time may be no different. Both parties are expected to spend freely in this depressed economic environment, especially on infrastructure. The Democrats are also expected to emphasize renewable energy. Regarding taxation, there are clear differences. The Democrats are expected to raise capital gains tax rates on high earners and also raise corporate tax rates. The Republicans were the authors of a significant corporate tax cut after the 2016 election, which helped equity market performance. There could be some short-term volatility due to tax policy if the Democrats win.

Trade policy could also differ substantially. The current U.S. administration has taken a hard line in trade negotiations with China. While Joe Biden has made occasional aggressive statements regarding China, the Democrats may de-escalate the trade war. If the Republicans win, economic conflict with China could intensify, slowing global growth.

If the election result is contested, like the Bush – Gore election of 2000, we would expect some short-term selling in equities. That could be a buying opportunity if any declines are overdone. The best scenario for equity investors is a clear result on election night, allowing the focus to shift to policy matters. That said, 2020 has not delivered many best-case scenarios. We are prepared to take advantage of any significant volatility, as we continue to be somewhat cautiously positioned in our discretionary portfolios.

## Selected Portfolio Transactions

### *Senior Housing*

For years we have followed various Canadian senior housing equities but have never purchased them until now, mainly because they seemed a bit too expensive. The long-term outlook for senior housing demand is strong, with the number of age 80+ Canadians expected to more than double over the next two decades to around 3.4 million.[1] The pandemic has significantly reduced the valuations of Canadian senior housing equities, creating an opportunity. We responded in late August by purchasing small weightings in two of the best in our High Yield Portfolio only. These businesses are suitable for our High Yield Portfolio, as they pay high dividends and have demonstrated stability over time.

We paid $10.57 for shares of Chartwell Retirement Residences[2] (TSX:CSH.UN), which was trading around $14 at the beginning of the year. Sienna Senior Living Inc.[3] (TSX:SIA) was trading around $18 in early 2020, and we paid $10.67 in late August. At a combined weighting of only 2% in only one of our three models, these are not large positions. We may gain more conviction as the pandemic winds down.

It is clear that senior housing companies have had to spend a lot more than usual on protective equipment and other measures to prevent COVID-19. It is also clear that many new resident marketing tours and move-ins have been delayed. Even so, the needs-based nature of senior housing works 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.

### *Great-West Life*

Great-West Lifeco Inc.[4] (TSE:GWO) is a life insurance company with other businesses including asset management. Great-West shares were trading around $34 prior to the pandemic. We purchased shares in two stages for both the Balanced Portfolio and the High Yield Portfolio. On July 9, we paid $23.20 and on September 14 we paid $26.40. It is now a 2.1% position in the Balanced Portfolio and a 2.4% position in the High Yield Portfolio.

We view Great-West as a conservatively run company trading at an inexpensive price. The dividend of above 6% annually will also be appealing to many clients. Great-West has been criticized for being overcapitalized in recent years, but the company has now begun to make small acquisitions. Growth potential is average, but looking out two years, we do believe that 2022 earnings will significantly exceed 2020 results.

*Restaurant Brands*

On September 25, we added small weightings in Restaurant Brands International Inc.[5] (TSX:QSR) to both the Total Return Portfolio and the High Yield portfolio at a price of $76.38. Shares were trading around $80 early in 2020, so the price has held up relatively well despite the pandemic.

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. Almost all of the restaurants bearing the company's brands are actually owned by franchisees. There are advantages and disadvantages to this business model, but it arguably allows the company to be more profitable and have less capital tied up in running its business.

The restaurant industry has had a terrible time during this pandemic. We believe that Restaurant Brands is well positioned to survive and grow. Quick service restaurants tend to have better options for social distancing, such as drive through windows. In particular, 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 3.5% annually.

*Nutrien*

On August 26, we added Nutrien Ltd.[6] (TSX:NTR) to both the Total Return Portfolio and the High Yield Portfolio at a price of $50.25 per share. The company now has a weighting of around 1.5% in each portfolio. Nutrien was formed in early 2018 when Agrium Inc. and Potash Corporation of Saskatchewan merged. The company is now one of the largest fertilizer producers in the world. Its customers are agriculture businesses such as farmers. In addition to producing potash, nitrogen and phosphate fertilizers, Nutrien now owns and operates over 2,000 retail locations, with most in North America and some in Australia. With shares trading around $52, the stock market values the company at around $30 billion.

We view Nutrien as an improving company with a reasonable valuation. We believe the company will be able to grow its earnings and dividend significantly within the next five years. The company intends to expand fertilizer production, expand its retail network, return capital to shareholders through dividends and share buybacks, and continue reducing corporate costs as planned in connection with the Agrium - Potash merger. Nutrien also adds diversification to client portfolios, as we have minimal exposure to agriculture overall.

*Choice Properties REIT*

We believe that Choice Properties REIT[7] (TSX:CHP.un) is a high quality real estate investment trust that possesses some strong advantages compared to its peers. On July 21, we purchased additional shares of Choice Properties in the Total Return Portfolio and the High Yield Portfolio, paying $12.34 per share. Choice now has a 3.3% weighting in the Total Return Portfolio, 3.3% in the High Yield Portfolio and 1.8% in the Balanced.

Around 56% of Choice's rents come from Loblaw entities, which are predominantly grocery stores and pharmacies. Choice currently provides a cash distribution of around 6.0% annually to unitholders. In the longer term, there are growth opportunities. Some of Choice's land may be redeveloped in the future to add more square footage and more rent. For example, a large urban piece of land containing a single grocery store may potentially accommodate a grocery store and residential towers when the timing is right. We acknowledge that times are tough for commercial real estate investment trusts at the moment. Owning even the highest quality REITs has not been worry-free in 2020. Despite that, we believe we will be holding units of Choice Properties for many years to come.

**Conclusion**

We are now nearing the end of 2020, a difficult year. As mentioned above, our portfolios remain somewhat cautious despite some new purchases at attractive prices in Q3. In this environment, an additional equity market correction could easily happen as we approach the end of the year. We hope to take advantage of any volatility by identifying some additional great long-term investment opportunities.

Thank you for reading our Q3 Newsletter. We look forward to serving you during the rest of 2020 and beyond.

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**APPENDIX “A”**

**DISCRETIONARY MODEL PORFOLIOS**

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] Sienna Senior Living Investor Presentation dated September 2020, page 14.
[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] This company is a client for which a CIBC World Markets company has performed investment banking services in the past 12 months. CIBC World Markets Inc. has received compensation for investment banking services from this company in the past 12 months. CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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[5] 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.
[6] This company is a client for which a CIBC World Markets company has performed investment banking services in the past 12 months. CIBC World Markets Inc. has received compensation for investment banking services from this company in the past 12 months. 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.
[7] This company is a client for which a CIBC World Markets company has performed investment banking services in the past 12 months. CIBC World Markets Inc. has managed or co-managed a public offering of securities for this company in the past 12 months. 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.