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October 21, 2021

New Opportunities and Some Profit Taking in Q3

North American equity markets have performed well during 2021, despite facing numerous risks. Rapid appreciation in some of our holdings now means that their prospects for further large gains are somewhat reduced. We decided to take profits in certain holdings during the third quarter (Q3), and we will discuss the details below. We also found some attractive new holdings to buy during the quarter.

While we are pleased with the performance of our discretionary portfolios, we will remain vigilant about inflation, higher interest rates, overvaluation in some sectors, and an inevitable reduction in fiscal support from governments. A correction in equity prices in the coming months could actually be a healthy development to decrease speculation and re-establish value in some sectors. We still have the capacity to add some new holdings if a correction occurs.

After discussing the broader picture in depth last quarter, we will devote the majority of this Q3 edition of our Newsletter to the changes in our three discretionary portfolios during the quarter.

<u>Adding Amazon and Salesforce</u>

We have been searching diligently for additional opportunities in the technology sector beyond our existing holdings in Apple Inc. (US:AAPL) and Alphabet Inc. (US:GOOGL). There are several high-quality companies in the sector that we would like to own, but most of them seem overpriced.

On June 9, we initiated a position in Salesforce.com Inc. (US:CRM) in the Total Return Portfolio at a price of US$237.97 per share. On October 7, we added to that position at a price of US$276.65 per share. Also on October 7, we initiated a position in Salesforce in the Balanced Portfolio at a price of US$276.65 per share. Salesforce now has a weighting of approximately 2.3% in the Total Return Portfolio and 1.1% in the Balanced Portfolio.

Salesforce has become a dominant cloud-based provider of customer relationship management software. The company's software is an integral part of operations for numerous large customers. We expect earnings and revenues to grow at 10% or more per year for the next several years. The expectations for Salesforce are lofty, but we believe that the company will meet them.

On August 17, we added shares of Amazon.com Inc. (US:AMZN) to the Total Return Portfolio at a price of US$3,274.46 per share. In addition to a dominant online retail platform, the company offers on-demand cloud computing through its Amazon Web Services subsidiary and also owns several other complimentary businesses. Like Salesforce, Amazon is expected to grow its revenues and earnings at a fast pace, and we believe that growth will occur.

Amazon and Salesforce look like reasonable holdings, given their strong competitive positions in their respective industries. In recent months, the selection of high-quality equities that look attractive to us has narrowed, and we have been doing as much selling as buying. As high-quality businesses that add industry diversification to our portfolios, we believe that holding small positions in Amazon and Salesforce will provide satisfactory returns to clients. We note that neither company fits the objectives of the High Yield Portfolio, as neither pays a dividend.

Partial Sale of Canadian Natural Resources

For any investments linked to oil and natural gas, we now must consider the declining number of large institutional investors who will participate in the sector, as well as the multi-decade global trend towards renewable energy. We recently completed a partial sale of our holdings in Canadian Natural Resources Ltd. (TSX:CNQ)[1] in both the Total Return and High Yield Portfolios. We had purchased Canadian Natural shares in mid-2020, after the pandemic-related crash in oil prices. Our entry point was $24.66 in both portfolios. In hindsight, that price appears exceptionally cheap, but we acted with some trepidation at the time, given the uncertain course of the pandemic and the crash in oil prices.

On October 4, we sold part of our Canadian Natural holdings at a price of $47.96 in both portfolios. The shares nearly doubled from our purchase price, and clients collected a dividend during the hold period. We continue to hold a 1.5% weighting in Canadian Natural shares in the Total Return Portfolio and a 1.1% weighting in the High Yield Portfolio. It is quite possible that the shares rise to much higher levels. Energy prices often do well later in economic cycles and energy companies often perform well during times when investors are concerned about inflation. Canadian Natural is well-managed, has made several good acquisitions within the past decade, and has been able to maintain a solid dividend payout during a challenging time, unlike many of its oil and gas producing competitors.

Looking at our portfolios more broadly, we intend to opportunistically reduce our exposure to oil and natural gas production in the coming years while increasing our weightings in renewable energy. Brookfield Renewable Partners LP (TSX:BEP.un) is an example of a renewable energy holding that we already own for clients. This transition towards more renewable energy investments will be challenging to properly execute. We want the transition to be profitable to clients, such as it has been with our partial sale of Canadian Natural. Many of the best renewable energy companies already look fully valued, meaning that future shareholder returns could be mediocre. It also appears that oil and natural gas will remain critical to the global economy for decades.

Other Transactions – Total Return Portfolio

On October 7, we added a small position in metal streaming company Wheaton Precious Metals Corp. (TSX:WPM)[2] at a price of $47.54 per share. This company, formerly known as Silver Wheaton, has been a holding in the past, with good results. Wheaton Precious Metals makes upfront payments to miners for the right to purchase a stream of future metal production at a low fixed cost. We believe it offers decent earnings and dividend growth in the coming years at an attractive price today. It seems to us like an attractive way to add some more commodity exposure in case inflation stays high.

We added to our existing position in Restaurant Brands International Inc. (TSX:QSR)[3] at a price of $77.96 per share on October 7. The company now has a weighting of approximately 2.5% in the Total Return Portfolio. The company owns three of the world's most prominent quick service restaurant brands, namely Burger King, Tim Hortons and Popeye's Louisiana Kitchen. The restaurant industry has had a difficult time during the 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. Restaurant Brands has better than average growth potential and also pays a dividend of over 3% annually.

On October 7, we purchased a small position in shares of medical device company Becton Dickinson & Co. (US:BDX) at a price of US$244.35 per share. It is a high-quality, large-capitalization company that typically raises its dividend every year. It has been in business for over a century and currently manufactures a variety of medical devices in areas such as medication delivery and diabetes care. With a strong balance sheet and a reasonable valuation, it will likely be a multi-year holding in the portfolio.

On September 28, we took profits in two Total Return Portfolio holdings that we had acquired at much lower prices during the past 18 months, namely casino company MGM Resorts International (US:MGM) and meat producer Tyson Foods Inc. (US:TSN). Our original purchase price for MGM was US$17.83 in late May 2020. Shares had sold off sharply due to the pandemic's effect on travel and casinos. The rebound was swift, and we sold out of MGM in two stages: at US$42.72 on June 14, and at US$45.12 on September 28. There is nothing wrong with the company, but it is somewhat riskier than our typical holding, and we view it as fairly valued at recent prices. Tyson was purchased in mid-October of 2020 at US$58.49, when it looked very undervalued to us, and we disposed of the shares less than one year later at US$77.60. The Tyson investment was an opportunity to capitalize on undervaluation rather than a long-term core holding in the portfolio.

Other Transactions - High Yield Portfolio

Over the summer, Pfizer Inc. (NYSE:PFE) experienced a short-lived spike in its share price from US$40 to just above US$50 and then back down again. We trimmed our position in the High Yield Portfolio on August 20 at US$49.32. The company now has a weighting of around 1.6% in the portfolio. While Pfizer is involved in one of the high-profile 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 significant dividend. The uncharacteristic share price volatility could relate to the difficult task of estimating the sustainability of revenues from the current vaccination campaign. We have been purchasers of the company's shares for all three of our portfolios around the US$35 price level.

On August 20, we trimmed part of our position in Blackstone Inc. (US:BX) at a price of US$113.36. Blackstone is a global private equity firm and alternative asset manager. The company is very profitable, and its business is performing well. To us, the shares appear to be fairly valued at these levels, with limited room for large upside. For context, our purchase price was US$50.19 in September of 2019, just over two years ago, so we have realized a large gain plus a significant dividend. We continue to hold a small 1.0% High Yield Portfolio weighting in Blackstone after this sale.

On July 28, we purchased shares of Newmont Corp. (US:NEM)[4] at a price of US$61.57. The company is one of the world's largest gold miners, with mines on multiple continents. The valuation appears reasonable, and the company has increased its dividend payout to the point where it yields almost 4% annually. We have often held weightings in precious metals in the Total Return and Balanced Portfolios, but this is the first time that we have owned a gold miner in the High Yield Portfolio. A 1.3% weighting in Newmont gives the portfolio some additional diversification and protection from inflation.

Conclusion

We have devoted most of this Q3 edition of our Newsletter to recent transactions within our discretionary portfolios, including some profit taking, and the purchase of several attractive new holdings. With some sectors of the equity markets appearing overvalued in recent months, we are attempting to avoid the highest-risk areas of the market and focusing on high-quality companies with strong multi-year outlooks.

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 Q3 Newsletter, and thank you for your business.

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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.

[1] 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. 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.
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[3] 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.
[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.