

TD Wealth



# QUARTERLY REVIEW

*3rd Quarter*

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# Wells on Wealth Group's Investment Philosophy.

The Wells on Wealth Group has an Investment Philosophy fundamentally imbedded around five basic tenants:

- 1) Know what you own
- 2) Know how much risk you are taking
- 3) Know what your total costs are
- 4) Know what your net performance has been
- 5) Know what your goals are for the money

With these tenants in mind, a history of our equity exposure to the legalization of recreational Cannabis is worth reviewing.

First, let us review some background information...

**A timeline of some significant events in the history of medical marijuana in Canada:**

<https://london.ctvnews.ca/mobile/medicalmarijuana/a-timeline-of-some-significant-events-in-the-history-of-medical-marijuana-in-canada-1.3858860>

Here, you can read a historical timeline ranging from 1922 through 2014. Most interesting.

**Next, "We will legalize, regulate, and restrict access to marijuana.":**

The Liberal Party fundraising website, <https://www.liberal.ca/realchange/marijuana/>

**Then, Liberals 'committed' to legalizing marijuana:**

Trudeau: <https://www.ctvnews.ca/mobile/politics/election/liberals-committed-to-legalizing-marijuana-trudeau-1.2588260>

Josh Elliott, CTVNews.ca / Wednesday, September 30, 2015

**And now, "Recreational marijuana will officially become legal in Canada on Oct. 17, 2018."**

<https://www.google.ca/amp/s/globalnews.ca/news/4285946/marijuana-legal-date-october-17-canada-trudeau-confirms/amp/>



# CANNABIS – Is it a Weed or a Flower?

Our involvement in purchasing Cannabis stocks begins with my son, Bryan, who is following in my footsteps into the investment business. In the fall of 2016 after Justin Trudeau's majority election victory it became very evident that legalization of the recreational use, not just for medical purposes, of Cannabis would become law.



Our weekly team investment meetings are usually free flowing affairs with every participant making comments and bringing forth suggestions. Bryan suggested looking at Cannabis stocks. His knowledge and research on this industry led him to believe the potential for growth would be much bigger than anyone had thought. Not only in Canada, but around the world there was increased discussion about legalization for both medical and recreational purposes and the first companies established in this space would have a huge advantage.

One Canadian company had just been promoted to the S&P TSE60 index, Canopy Growth (symbol WEED) and it was Bryan's suggestion we purchase stocks in our portfolios, even though they may be very risky, a complete and outright speculation. As Chairman of our investment committee, I proceeded to outline all the reasons why this was not a good idea. At \$4.00 the valuation was through the roof. Its sales to equity ratio was so low it could hardly be calculated: it really wasn't the type of equity risk (speculation) we generally take in the portfolios.



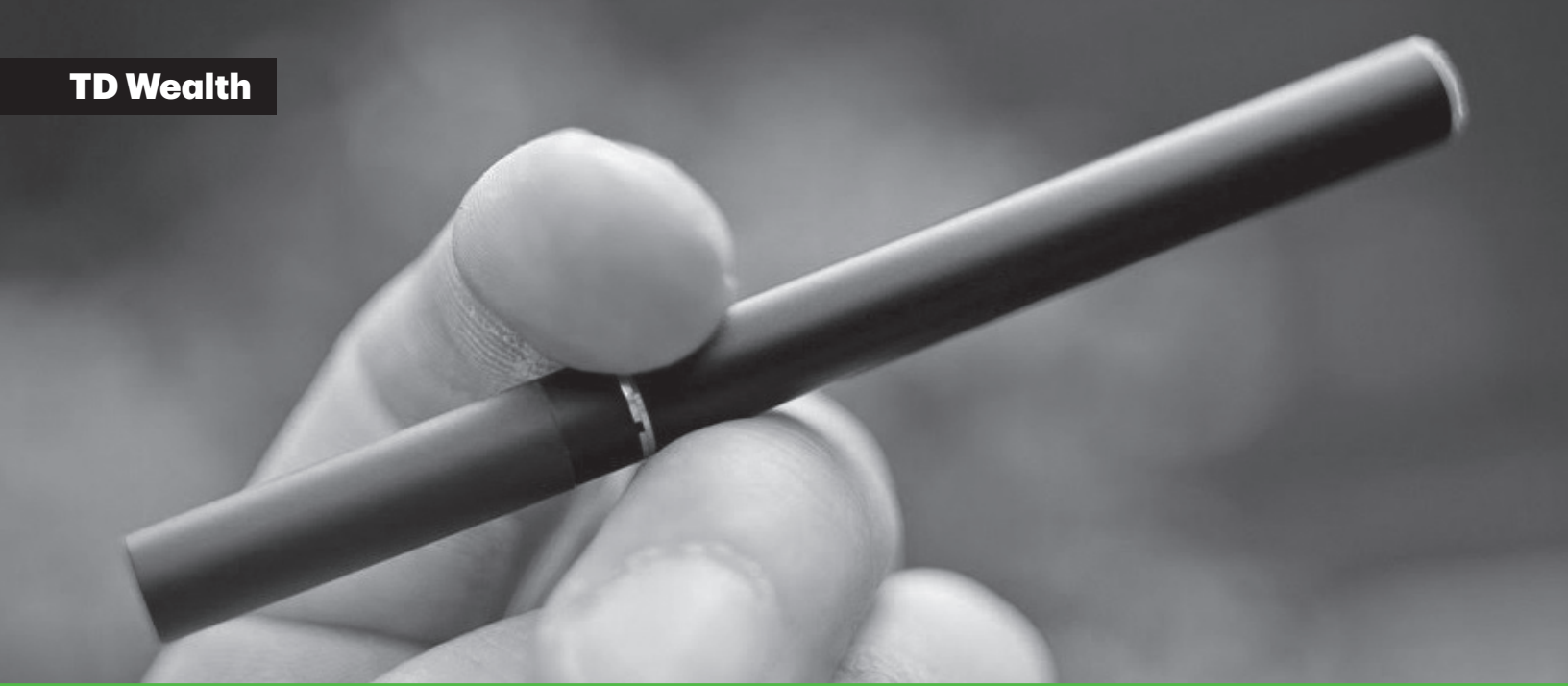
My skepticism was based on experience. I served as a Governor of the Alberta Stock Exchange (ASE) from 1997 through 2001. The heart and soul of this exchange was small speculative oil and mining stocks. While serving on the ASE Board, I was privy to how many companies failed and how few succeeded in their pursuit of growth. Over the course of my 45-year investment career I had seen many speculative bubbles come and go. But, I had also seen how much money could be made if the investment was done properly.

For months, Bryan gathered information on everything to do with the Cannabis Industry, from examining the application forms Health Canada required to become an LP, Licensed Producer, to interviewing existing black-market participants. Bryan's conclusion: Cannabis is an existing industry, already huge, legal or not, yet.



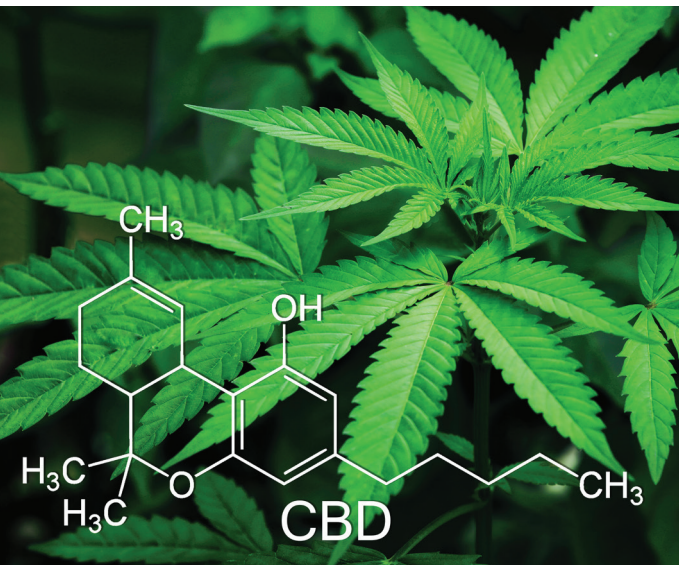
The US election of November 2016 included a vote on Cannabis legalization on numerous state ballots, which ended in a green light for legalization in several states, especially embraced by the massive population of California. It was only a matter of time before Canadian Cannabis stocks started to move. He convinced me to take a position in the industry, but I only agreed under the condition that the position had to be very very small and it could only be in one stock. We chose Canopy Growth (WEED), because it was the only stock at the time that met our S&P TSX60 listing requirement and had the liquidity necessary for us to trade.

To purchase any speculative stock requires an exit strategy. Unlike, for example, Royal Bank of Canada stock, investors, as opposed to speculators, anticipate holding on to these types of stock for years, if not decades. Canopy Growth was and remains a speculation. It is imperative that you have a plan to exit a speculative stock position. I said to Bryan and our investment committee (Cindi North and Laurence Mah) that regardless of price, we would start selling the position as the date of recreational legalization approaches. We agreed that 2% our 100% Canadian Equity Portfolio would contain WEED. The process of buying the position covered about three months starting in January of 2017. Our average cost was about \$11.00 per share.



As a Portfolio Manager your job is not one sided. You must manage the investments as they rise in value and as they fall. The rise in the value of WEED presented a problem. As the stock value rose as compared to the rest of the equity holdings, its percentage of the portfolio also rose. Before long, it represented 4% of the holdings, not 2%. Should we sell some of the position and rebalance back to 2%? Or, do we decide to reduce the other holdings in

our portfolio if they also have moved by fractional amounts to keep WEED at its new 4% weight and let the position run? We let it run. This decision was not taken lightly, but comes with years of experience. Every time WEED has made a substantive move in price, whether up or down, we have had to decide. Sell into strength and rebalance, or let it run.



Now, in addition, the \$47 Billion in market value of the existing listed Cannabis stocks has not gone unnoticed. It has started attracting other players, namely American Cannabis companies to list their shares and raise capital on Canadian exchanges. This is creating additional supply of available Cannabis investment opportunities, which places downward pressure on existing Canadian Cannabis stocks.

By June 5, 2018, with legalization set for Wednesday October 17, we decided to start the selling process. With the media speculation and worldwide focus on the first major industrialized country to legalize cannabis, we feel it is very prudent to continue the process of reducing our position of WEED to about 4% from its current 11% (\$65) of our 100% Equity Portfolio.

**There is an old saying on Wall Street:**

“Bulls make money. Bears make money. Pigs get slaughtered.”

We feel the debut of legal recreational Cannabis may be quite underwhelming on October 17, 2018.

## Comments on other current issues

- 1) West Texas Intermediate oil pricing is rising (72 US\$ per barrel) but the price of Western Canada Select is still showing a huge discount (32US\$ per barrel). When you are locked into a single buyer (USA), that buyer can dictate the price.
- 2) Canadians now own the TRANSMOUNTAIN PIPELINE. By a quirk of timing the shareholder vote accepting the Government of Canada's offer passed 30 minutes after the Federal Court of Appeals rejected the National Energy Board's (NEB) approval of the project. This throws more uncertainty and further drama into an already messy situation. I believe that this will ultimately be solved, and shovels will be in the ground by late 2019. Be sure and tune in for the next cliffhanging episode of this ongoing Canadian Soap Opera.
- 3) As of printing, the North American Free Trade Agreement (NAFTA) is no longer and is replaced by the United States-Mexico-Canada Agreement (USMCA). Full details of the new agreement, 34 chapters and 12 side letters, can be found at: <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/united-states-mexico>. Canada received assurances on auto trade, while it appears dairy got thrown under the bus, as I speculated in my June 2018 newsletter. The dark cloud of uncertainty over the past year has been lifted with the new agreement. Now, I anticipate the Bank of Canada may steadily raise interest rates.

Sincerely,

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Vice President, Portfolio Manager and Investment Advisor  
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