Rickerby Wealth Management

A Memo from the Trenches

June 2023

TD Wealth

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Markets:

Last month I noted that the US markets were doing well but it was large cap technology stocks that were leading the way after a disastrous 2022. As of today, May 29th, 2023, I recently was made aware that just 7 stocks were responsible for 100% of the returns of the S&P 500 so far this year. (The S&P 500 is up about 10% this year having been down 20% in 2022). However, the remaining 493 stocks had cumulatively achieved a 0.5% return this year. So, the headline numbers are masking a different reality for most of the markets. This fact should not come as a surprise. The jump in interest rates with the resulting decline in corporate profits as well as the debate about slowing economic growth and recession SHOULD prompt tepid market returns.

BUT it is also another steppingstone through the economic cycle. It has been almost 18 months since the peak in stock markets on January 2nd, 2022, and though I expect that we "muddle through" the remaining part of 2023, we are also laying the groundwork for the next move up in equity markets. As mentioned in a previous letter... good news is ... 'bad' news and bad news is 'good' news right now. And candidly there has been a little too much "good" news in recent weeks. Economic growth numbers have been a bit too good. New housing construction, a bit too good. Consumer confidence and wage growth, a bit too good. Sorry. GDP growth... not quite as "bad" as we were hoping for. (I know, it's bizarre thinking)

What does that all add up to? A somewhat surprising INCREASE in the Bank of Canada rate in the first week of June, and maybe another increase next month. That said, as mentioned in my end of year newsletter, volatility is the order of the day. We are in the late stage of a business cycle. I believe that we will be fine. We have perhaps been blessed the last two decades. Since the period of 2000 to 2003 ("the tech wreck") when the stock market endured a correction, we experienced a "V" shaped bounce back. There was a lot of pain and drama but, relatively speaking, we got to enjoy dramatic and fast recoveries. Not this time. Sorry. It's probably going to be more like a Nike "swoosh" recovery. Again, this is not cause for panic or over-reaction. We continue to lean on "income" as a source of return and the reality is that these higher interest rates are flowing through to us with higher incomes coming in.

US Stock model

Trimmed a little Coke and added to Walgreen Boots.

Earnings

Banks earning reports were below expected. They took provisions for loan loss issues but so far, their actual loss experience has been modest. Banks do well in a rising interest environment. Basically, banks borrow money with a short-term time frame… and lend it with a long-term time frame. BUT we have an inverted yield curve right now. The central banks have been driving short term interest rates higher but medium and long-term interest rates are in fact lower than short-term rates, so banks have not been able to increase profit margins as much as they want. Add to that, concerns and increasing provisions for loan losses and banks have really been stuck in the mud…

Looking at TD just as an example. TD stock peaked at $108 in Late February 2022. Today (June 9th) the stock trades at $79 and the current dividend yield is 4.85% on the common stock. Even if we continue to stumble along for a handful of months, chances are that few investors will regret having purchased TD common stock at these prices and valuations in the years ahead.

Some good news…

Clients might remember from past emails that I suggested that the increase in interest rates certainly had hurt the current capital values of holding now BUT, that those higher rates would start to flow through to us. In the past I mentioned that recent preferred share dividend resets were occurring, with dividends increasing from the mid 4% range to the mid 6% range.

For example, CIBC preferred series S recently declared an increased dividend and now pays a dividend of 5.875% on a $25 par value. Given the share is currently $21.30, that represents a current yield of 6.9%. – and that is not even including the generous tax credit from Canadian corporate dividends.

Just today I received notification that Capital Power preferred "E" have increased their dividend from 5.24% to 6.63% (on a $25 par value). With a share price on the pref at $21.90, that suggests a CURRENT yield of 7.5% for the next 5 years. When we take into consideration the tax break of dividends that equates to about a

10% pre-tax equivalent. I cannot imagine how that will not prove to be a tremendous return over the next 5 years.

I have previously mentioned that some investors have the TREZ Capital Yield Trust mortgage portfolio and that their dividends have been increased three times in 12 months.

And recently a very broadly held fixed income fund that clients own, the PIMCO Monthly Income fund announced a 12% increase to their monthly paid dividends.

So, in summary, it's nice to see that these higher rates of interest are being reflected in higher income payments and candidly, I expect that to continue through the rest of this year.

Here are a couple of links from those who like to do further reading:

PIMCO

https://www.pimco.ca/en-ca/investments/mutual-funds/monthly-income-fund-canada/cada-cad-unhedged

TREZ

https://www.trezcapital.com/investments/trez-capital-yield-trust-us-cad#distributions

Some items that have had me reflecting...

Recently we hosted Rona Ambrose to a client presentation in White Rock (Apologies if you did not get an invitation, I had a small number of seats available). Rona was the caretaker Conservative leader and Canadian Prime Minister after Stephen Harper's tenure. Although I have read about strains in the relationship between Canada and China in the press in recent years, I was nonetheless taken aback at how passionately and seriously these stresses in fact are when she articulated the current situation. Indeed, she went on to say it's not **IF**, but **WHEN** China invades Taiwan. Again, there was a certainty about this possibility that surprised me.

Many of you will know that I am a regular reader of John Mauldin of Mauldin Economics and in fact he has two or three extra authors in his team including Ed D'Agostino. The attached link I think is a good investment of time for those who want to invest some extra time in reading – Actually there is a 30-minute video included.

Now don’t view these individuals' views or theories with an overly negative view. It's not a case of positive or negative, it's about being pragmatic and to develop an investment approach that can best protects us if these long-term themes unfold.

https://www.mauldineconomics.com/global-macro-update/the-us-must-overcome-its-four-addictions

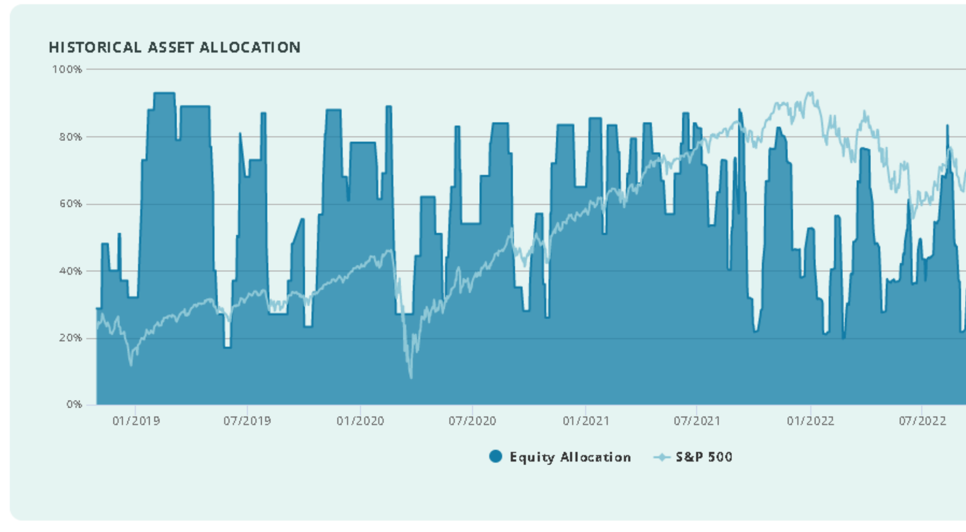
Back in the saddle

A combination of some personal travel and some corporate travel has kept me from the office quite a bit the last 6 to 7 weeks but that's it for me until December. Shamus recently went to Nashville on a business trip which he extended a little for a holiday, and Joanne was off for a couple of weeks because of her kids being back from university and having all of them enjoy a family holiday together before they get some summer jobs. All that to say that the team has been a bit busy although somewhat self-inflicted the last 2 months. So, if you have experienced a slightly slower response recently, apologies, but we are all back to full speed now.

Fund Focus - RTA

Here is some insight on an ETF we have been using for some time, the Purpose Tactical Asset Allocation Fund – RTA. This is a somewhat unique fund insofar as their approach is to actively make asset allocation decisions using index shares, switching between cash, fixed income, and equities. And this is a very active approach. I have this fund selection as a "moderating" risk component to portfolios. I am hoping they deliver below average volatility and that they actual DO try to "market time". They are using "rules-based decision making", which is to say formulas and algorithms as opposed to human judgement, to make these changes. Indeed, you can see from this chart the dramatic switches between equities and fixed income that do occur over short periods of time. Equities have been above 80% and down to about 25% quite frequently. (At the moment they are 50% / 50%) In summary this is a rare fund who would say. "Yes…. We ARE trying to time the market".

This is an ETF that trades on the Toronto Stock Exchange and the MER is 0.75%. I have included a link to the website for those interested to investigate further.



https://www.purposeinvest.com/funds/purpose-tactical-asset-allocation-fund

So that's it for now folks. Until next time.

- Shaun