HILBERRY GROUP
WEALTH MANAGEMENT

September 3, 2021

The Labour Day Edition

Environment Canada predicts the coming long weekend to finally bring rain. An end to our long summer of draught will be welcome. Hopefully while watching rain on your windowpane you'll need some study time. We're providing an extra dose this week.

Canada's Federal Election Sept 20/2021

With an election looming Sept 20, Canadian politicians are in full song, handing out goodies.

We'll focus on policy arguments this week. Before I do, let me please clarify I am not a card-carrying member of any political party. I have voted for all three of Canada's major political parties during my life (I was a lot younger when I voted NDP). I'm your classic centrist swing voter. Other than fiscal restraint, I am not passionate about single issues. Please do not take any criticism of any political platforms as an endorsement of any other parties. I'm conflicted as to who or what I'll vote for. If I wasn't so aware of my duty to the tremendous sacrifices previous generations have made enabling my vote, I'd be tempted to stay home on Sept 20.

For up-to-date opinion poll tracking go here: https://338canada.com/

Don't I recall past election platforms all contrite budget focused? Wasn't a ballooning deficit (let alone debt) a thing people worried about at one time? Am I that lonely crazy-man on the hilltop yelling at clouds? None of the parties seem focused on who will pay the bills (hint: all of us). Taxes are going to be a thing to worry about. Inflation as well.

This week's live video feed of the devastation from Hurricane IDA up the US Eastern Seaboard has brought the climate front and center into the political landscape. The manhole geysers and stairwell cascades flooding of the New York Subway system got everyone's attention. None of the political parties are denying the climate is changing. Much political capital is focused on the issue.

The Liberal Party brought out their election platform this week. Being in power means having the most resources and control over the election (they called it). Given the short 30-day campaign period, the late delivery seemed odd. Wags speculated the delay was to prevent their rivals time to formulate arguments.

As Canadian energy of all stripes remains an important part of our economy and features in all the party's election platforms in the coming election, we urge clients to walk through the two following research pieces from Amber Brown at our ESG desk and from National Bank's Energy Desk.

'Liberal's election platform narrows in on climate change' – NBF ESG Research Flash Amber Brown Sept 2, 2021

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=a272bb8a-a934-4893-9d72-8bac9f1df718&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

National Bank of Canada 9th Annual Energy Conference Sept/2021

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=f739801d-6b51-4f2e-a2e8-18f675bf3573&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Environment, Social and Governance (ESG) figures large in all party platforms.

To accommodate a desire to measure Environment, Social and Governance (ESG) impacts from policy and corporate actions, a whole new profit-making industry has developed around providing 'ESG Score' rankings. The idea is to apply the alphabetical ranking style used in credit rating agency debt risk scores (US Fed Govt AAA – a company in default D-). Companies with an ESG Score of 'B' and up would equate to an 'investment grade' bond rating. This would permit investment managers to reflect ESG in their investment approach by providing an 'ESG Weighting' for their portfolios, similar to a credit quality weighting in a bond portfolio. Recall that to be analyzed by a bond rating agency, the company being rated must pay for the rating. The rating is expensive (there's that profit thing) meaning small companies can't afford it, meaning they are 'unrated' – implying risky.

Obtaining an ESG score means paying for the ESG ranking analysis. A cynic could point out a relationship between ESG shaming and ESG rating revenues. Not me! A company could tick all the ESG boxes, yet if it hasn't paid for a ranking could show poorly or not at all under an ESG 'screen' approach to investment management. We're already seeing this in action.

NOTE: Some bond managers specialize in low credit quality bonds, understanding that buying a sad story, out of favor bond on the cheap can work out very well if things improve. Keep that thought in mind.

There are issues with the ESG score idea. Unlike the black and white of keeping or losing all one's money to a bond default, the concept of ESG if fraught with grey. If money is involved, someone will cheat. One issue raised on ESG scores is fact-spinning or outright falsification of activities to obtain a higher ESG score, so called *'Green Washing'*. Does planting a tree in Prince George really offset belching smoke from a coal-fired power plant in Mumbai? Does buying carbon credits from a tree-planting company really enable carbon emitters to offset their emissions? How many trees were actually planted? How many then survived over the life span of the tree implied in the carbon sink notion? Was that tree subsequently cut down? Who's getting paid to pay attention? A popular narrative from right-leaning commentators is that there is a lot of green-washing going on.

GREENWASHING: HOW WIDESPREAD IS IT?

https://www.evidenceinvestor.com/greenwashing-how-widespread-is-it/

Canada Emergency Response Benefit (CERB

Another political hot button is Canada's response to COVID-19 recession. The Canada Emergency Response Benefit (CERB) was a Liberal Federal program designed to provide businesses and employees impacted by the early 2020 COVID-19 lockdowns with a temporary guaranteed income. The wage subsidy, rent subsidy and Lockdown Support were set to expire in June 2021. July 30 ,2021 the Federal Govt announced an extension of the various programs in place. Those measures were extended until September 25, 2021. One can't help but note the election called for Sept 20. Co-incidence I'm sure.

https://www.canada.ca/en/department-finance/news/2021/07/government-extends-covid-19-benefits-and-business-supports-to-support-stronger-economic-recovery.html

I don't contest the original idea of CERB. The execution however was in retrospect overly generous. The blame for this largess was placed on the recipients. Corporations who received CERB support – some without need – were pilloried by the same elected officials who made the grants for showing increased profits and dividend hikes.

Once the cheques started to arrive, some workers discovered their income was higher than their wage. Not surprising some decided to take the summer of 2021 off. Employers can't get workers to return. In fairness, COVID-19 Delta Variants could be causing a reluctance to re-enter customer-facing service work. We're not hearing much politico discussion on the issue.

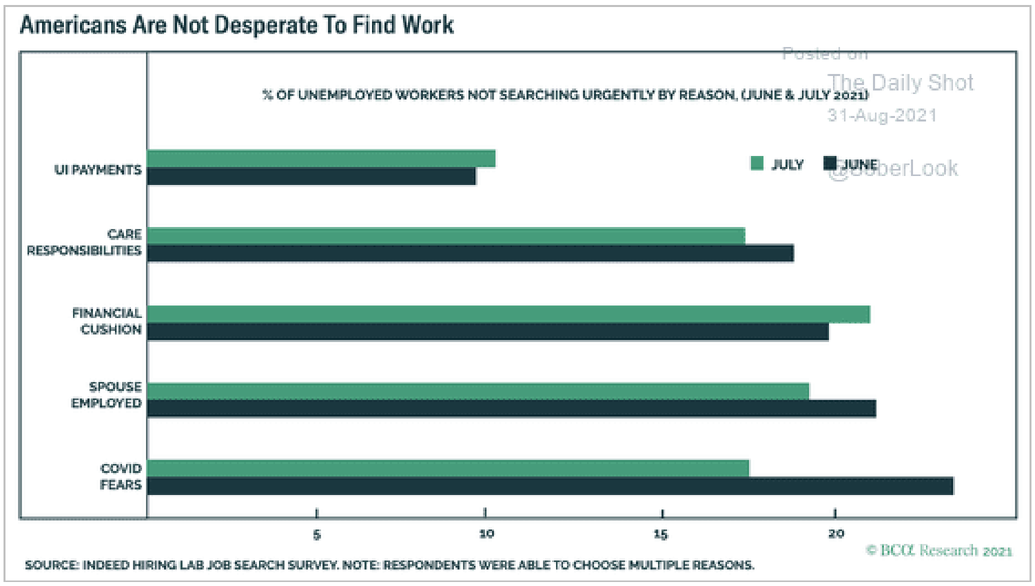
'Job vacancies exceed 800,000 in Canada's labour-starved services industries'

https://financialpost.com/executive/posthaste-job-vacancies-exceed-800000-in-canadas-labour-starved-services-industries

Why are employers having such a hard time to find workers? 'Financial Cushion' is now the main reason for not seeking employment. Is this a live example of the impact of *Universal Basic Income* (https://en.wikipedia.org/wiki/Universal_basic_income) in action?

The WSJ Daily Shot for Aug 31, 2021

United States: Savings glut is having a perverse effect. A financial cushion is now the top reason for not searching for a job urgently.



Source: BCA Research

https://dailyshotbrief.com/the-daily-shot-brief-august-31st-2021/

So, why are unfilled jobs a problem? Employers competing with a guaranteed government paycheck, must pay more per hour to entice their workers back to the shop. Unions love the idea. Progressives claim businesses can afford to pay more. Income inequality, redistribution etc. implies the employer should make less and the employee should make more. Social Justice. That's not how it works. Assuming wage increases stick, employers have three options.

1) Make less money contracting the economy (note: reduced tax revenue).
2) Lay off a portion of the workforce/increase automation (less wages/less tax revenue)
3) Raise prices to their customers.

Slowing economy + rising costs = stagflation. Europe's stalled economy is a clear example.

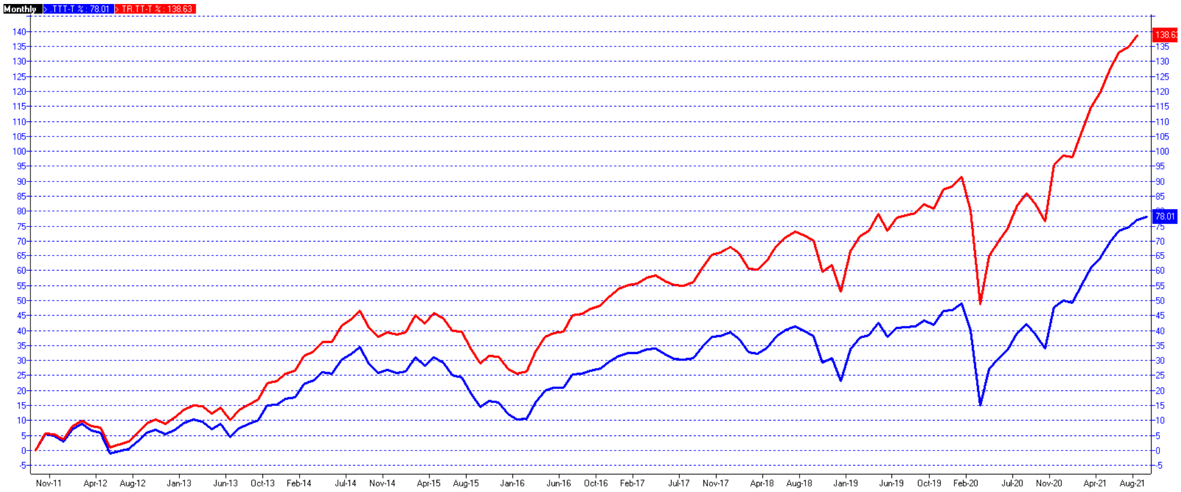
Moving on…

NBF Asset Allocation Strategy: From risk-on to risks on the rise?

See the attached compressed PDF file. Problems opening the file? Let us know.

A revisit of Dividends. Boring is good.

S/P TSX Composite Index (TTT blue) level vs. S/P TSX Composite Total Return Index (TR-TT red) %'g change 10 years - monthly ranges



- TSX Composite Index 10 years: +78.02%
- TSX Composite Total Return Index 10 years: +138.63%
    - Dividends contributed 44% to the total return. 56% came from price

The longer the period of compounding, the more important dividends become:

- TSX Composite Index 20 years:202%
- TSX Composite TR Index 20 years: 413%
    - 51% of the total return came from dividends/49% from price
- TSX Composite Index 25 years: 270%
- TSX Composite TR Index 25 years: 615%
    - Dividends generated 54% of the total return. 44% came from price.

If roughly ½ of the total return derives from dividends, why are they ignored by most investors? Because dividends tend to move in small, boring, repetitive increments. Hard to puff out one's chest over. Doesn't sell much advertising. Boring.

Example Royal Bank of Canada quarterly dividends per share for the past 5 years.

Jan/2016 $0.79 per share for the quarter

- Apr/2016 dividend +2 cents to 81 cents.
- Oct/2016 dividend +2 cents to 83 cents.
- Apr/2017 dividend +4 cents to 87 cents
- Oct/2017 dividend +4 cents to 91 cents

- Apr/2018 dividend +3 cents to 94 cents
- Oct/2018 dividend +4 cents to 98 cents
- Apr/2019 dividend +4 cents to $1.02
- Oct/2019 dividend +3 cents to $1.05
- Apr/2020 dividend +3 cents to $1.08

Dividend income rose 36.7%, handily beating inflation. 2 cent dividend hikes didn't attract much attention. Double to 4 cents? Boooooring.

Notice no dividend hikes since April/2020? In exchange for employee income support under Canada's Fed Govt CERB programme, Canadian banks have been restricted from increasing shareholder dividends. The optics of receiving CERB benefits while increasing dividends were tough politically. The result is Banks sitting on an accumulating cash pile. There should be a lot more cash available for shareholders. The CERB programme is scheduled to end Sept 27, 2021. We expect banks to begin hiking their dividends again this fall. Boring is good.

Staying with the banks and dividends …

There has been much progressive politician heat onto the banks for their receiving forms of aid from the Canadian Fed Govt. The Bank of Canada enhanced liquidity and loosened reserve restrictions which increased profit margins. Banks also qualified for the Canadian Emergency Wage Subsidy (CEWS) programme.

https://www.theglobeandmail.com/business/commentary/article-the-wage-subsidy-a-windfall-for-canadian-corporations/

The Office of the Superintendent of Financial Institutions (OFSI) enforced a 'no-dividend' hike in March of 2020. Made sense at the time. That policy was last revisited and extended in July of 2021. I'm not a bank credit analyst and the OFSI knows more about what's going on than I do but it seemed clear by June/2021 that the banks were clear of business risk. Is there a political element to the continued dividend hike restriction? Is the optics of a CEWS fueled profit boom just prior to an election hard to sell? Seems likely this limitation will be lifted this coming fall…in October…uhm…after that election thing. Progressive ire should be directed at the originators of the largess, IE said Fed Govt. Now apparently the next Big Idea is to make the banks pay 'their fair share', a phrase that rhymes nicely and means little. My fair isn't your fair. Broadly what's fair seems to mean Someone Else Pays. There is no 'someone else', only us (and our great, great, great, grandchildren).

The current Liberal Govt proposes to apply an additional 3% charge on bank profits exceeding $1 billion. Where does that $1 billion figure come from? Probably because it seems like a grotesquely large amount. A more realistic approach would be an additional tax on profit ratios above a notional level beyond which is 'grotesque', but that is harder for politicians to understand and harder to explain to voters. It's all a dumb idea anyway.

Raising bank taxes by 3% might result in reduced profits to shareholders but this is unlikely as the cost is applied to all banks, none having a competitive incentive to eat the cost. The more likely outcome is an increased cost to consumers (re-read the above on job vacancies). If after-tax profits are reduced, the result is lower share prices and less money available for after-tax dividends. If costs go up, consumers pay. Staying with the Royal Bank as one of Canada's most valuable and widely held corporations, and most often used bank, a decline in share price, reduction in future dividends or increased costs directly harms shareholders who are typically RRSP owning, middle-class consumers. You know…the one's politicians are all about helping? Do these ideas reflect desperation over an eventual budget crunch? No talk of spending discipline. Where does this end?

We've been focusing on consumer staples providers over the past year.

https://www.investopedia.com/terms/c/consumerstaples.asp

Many of these companies are solid dividend performers yet are out of fashion. Rather than *Growth At a Reasonable Price* (GARP) Investors have been chasing GAAP (Growth At Any Price) explaining the 100:1 P/Es in the social media stocks.

Dot-com era weight loss returns in U.S. consumer staples: Chart of the Day

Food, beverage, tobacco and household-product makers are almost as far out of favor in the U.S. as they were when the dot-com era ended. Their weight in the S&P 500 Index shows as much. Consumer staples amounted to 5.74% of the U.S. equity benchmark in the last three trading days of August, according to data compiled by Bloomberg. The only lower readings in the industry gauge's three-decade history occurred in March 2000, when its share of the S&P 500 fell as low as 5.35%. "The group offers zero advantage," Strategas Research Partners LLC wrote in a Twitter post Tuesday with a similar chart.

Sincerely,
David Wilson

(used with permission)

Tencent is cheap enough for valuation expert to buy ADRs: Chart of the Day

Tencent Holdings Ltd. looks cheap to Aswath Damodaran, a professor at New York University and the author of four books on company valuation. Damodaran wrote about the Chinese internet company in a blog post Wednesday and noted he had bought its American depositary receipts the day before. The Hong Kong-listed shares underlying the ADRs fell as low as 17.7 times earnings in August, according to data compiled by Bloomberg. The price-earnings ratio was the lowest since February 2005. “Tencent is a more rounded company” than Alibaba Group Holding Ltd., which is more undervalued, Damodaran wrote.

The Damodaran link noted above follows:

“China's Tech Crackdown: Its about Control, not Consumers or Competition!” Dr Aswath Damodaran - Sept,2021

I STRONGLY advise our clients to read Dr. Damodaran’s blog posting. While the above TenCent observation is interesting, his walkthrough of China’s historical and current importance for the world economy is required reading and will be in the test.

http://aswathdamodaran.blogspot.com/2021/09/chinas-tech-crackdown-market-adjustment.html

DISCLOSURE: I do not hold TenCent personally, for family members and have not recommended it for accounts over which I have trading authority. We have clients following the name.

You know COVID is bad when…Texas can't refine oil.

Oxygen Shortage Forces Texas Oil Refinery to Curtail Operations

- Plant in Corpus Christi has cut back some work for four days
- Decision followed 'increased medical field demand' for the gas

By Bloomberg News

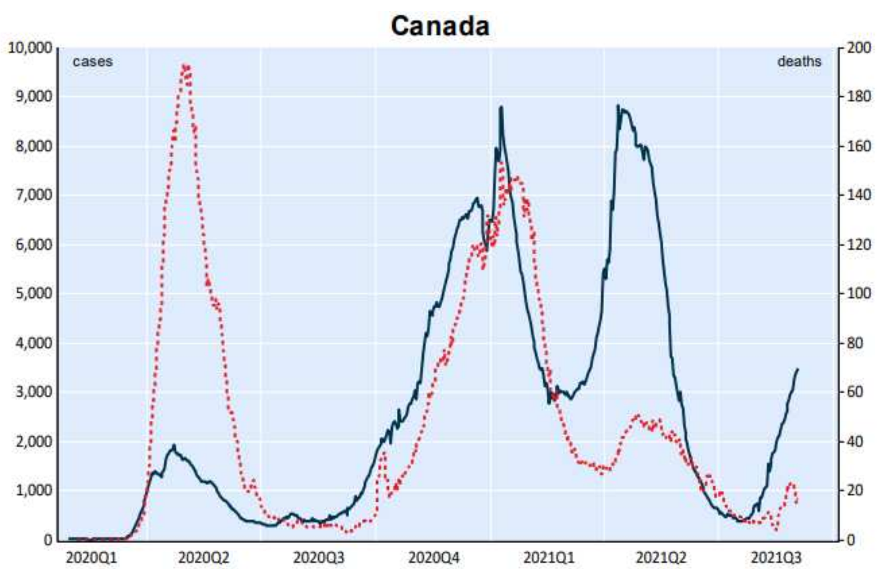
(Bloomberg) -- A refinery in the key oil hub of Texas has suspended some of its operations due to a lack of oxygen supply amid the coronavirus pandemic, with authorities citing increased medical demand for the gas.

CITGO Refining and Chemical Co. will shut down part of its plant in Corpus Christi for four days to Sept. 6, the Texas Commission on Environmental Quality said in a filing. The reason given was a loss of third-party oxygen supply.

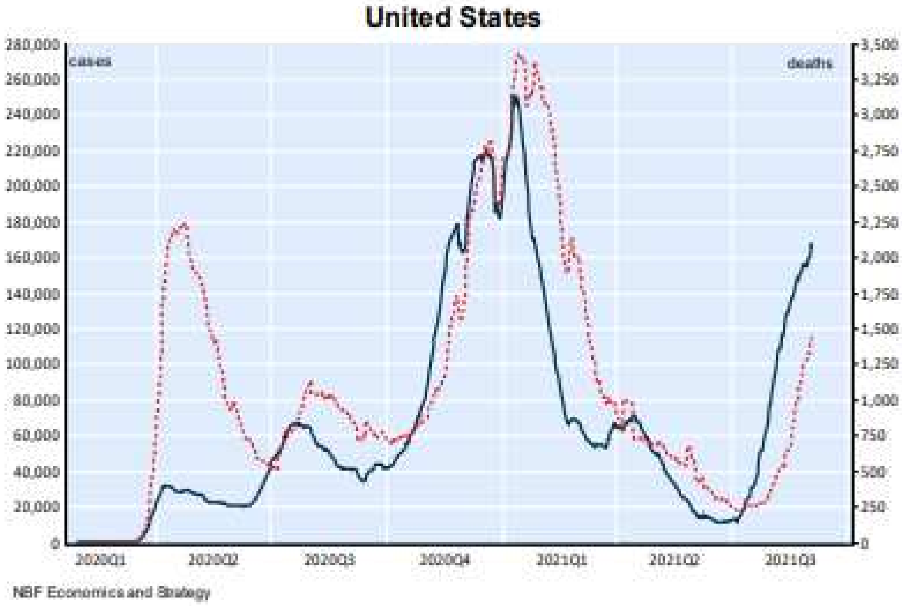
Oxygen supplies have been tightening in parts of the U.S. due to medical use of the gas as Covid-19 patients require intensive care. In recent days, Premier Inc., a supply-purchasing group, said hospitals in the U.S. Southeast were running low on oxygen, with the worst-hit left only 12 to 24 hours worth.

"CITGO West Plant will be shutting down its sulfur recovery unit B-train due to the loss of third-party 02 supply resulting from increased medical field demand," the commission said. 02 is a chemical designation for oxygen.

National Bank's COVID-19 Daily Monitor for Friday Sept 3, 2021



NBF Economics and Strategy



CONCLUSION: Vaccinations = lack of serious illness. Why is this hard accept?

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=b4b29f1c-33a9-45c9-ae40-2a5752007da3&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Have a Great Weekend!

Steve & Anna Hilberry

FOR THE RECORD Sept 3, 2021

DOW INDUSTRIALS:	35,392
S&P 500:	4,537
S&P/TSX COMP:	20836
WTI:	$69.30
LOONIE IN $USD:	$0.7994 $US

September 3, 2021

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