HILBERRY GROUP
WEALTH MANAGEMENT

July 08, 2022

"Summer's here and the time is right for dancin' in the streets"

Another one bites the dust.

'TSX-listed crypto lender Voyager files for bankruptcy week after it halted withdrawals' Financial Post

https://financialpost.com/fp-finance/cryptocurrency/crypto-lender-voyager-digital-files-for-bankruptcy-2

'Why This Crypto Crash Is Different' Coindesk

https://www.coindesk.com/layer2/futureofmoney/2022/06/29/why-this-crypto-crash-is-different/

Crypto's aren't the only area where investors lost their minds…

'*You can't vape with us'* Chartr.Com June 24, 2022

Yesterday (June 23, 2022*) the FDA announced that **Juul** cannot **sell its e-cigarettes** in the US anymore — a huge blow for a company that was recently one of the most highly-valued startups in all of America.*

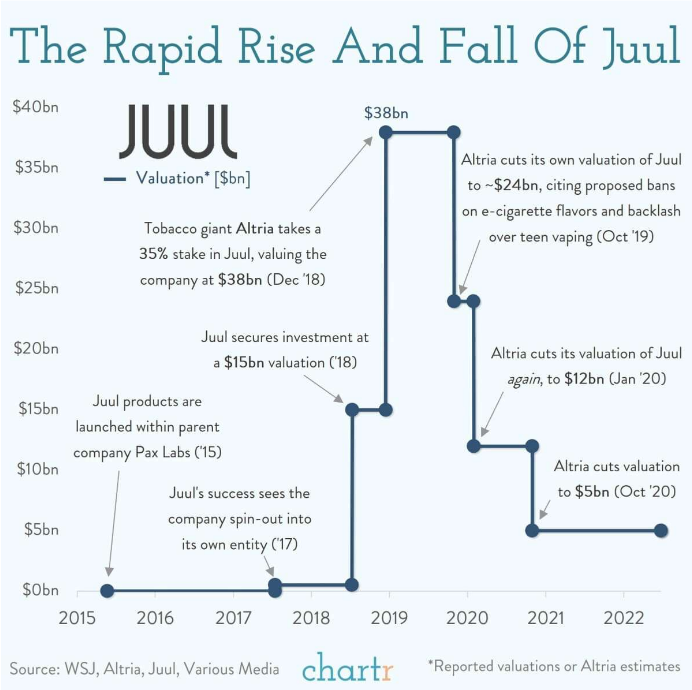
***Juul** was the brainchild of two graduate students of product design at Stanford who wanted to make cigarettes that were healthier, better smelling... and cooler. They succeeded.*

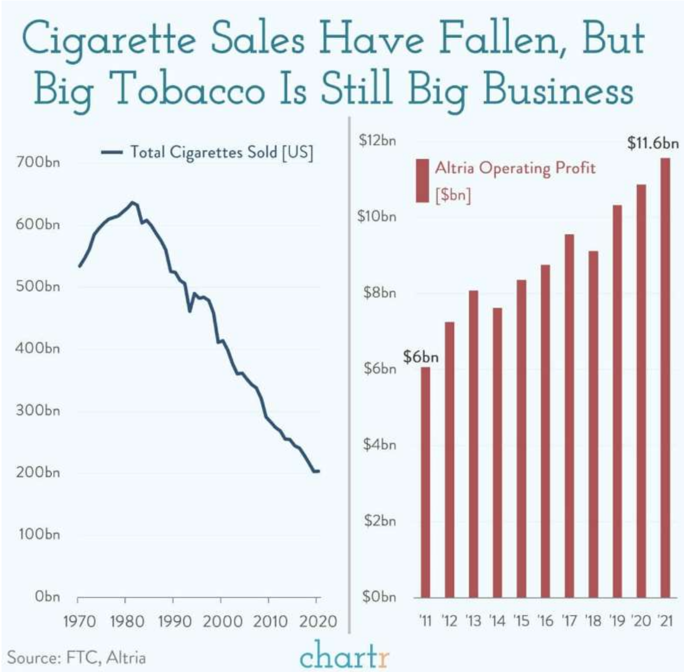
After launching in 2015 it took just a few short years for Juul's e-cigarette to hit the big time. Its USB-stick-looking vaporizer came in flavors like mango, creme and mint and teenagers loved them. By late 2017 they had 20% of the e-cigarette market. One year later they had over 70%. Juul seemed unstoppable, and big tobacco took notice.

Up in smoke

Juul Labs had been spun out of its parent company, and had notched a substantial valuation in *private markets as its sales exploded. Then tobacco giant **Altria** — which owns storied cigarette brand Marlboro among many others — made Juul Labs an offer; **$12.8bn** for a **35%** stake, valuing Juul at $38bn, and making it one of the most valuable startups, or even private companies, in the US.*

At the time Altria's offer probably looked half-sensible. In hindsight it might be one of the worst-timed acquisitions ever. Juul's popularity, particularly with teenagers, brought a regulatory investigation almost immediately, and a ban on some of its most popular flavors swiftly followed.





See the full story here:

https://read.chartr.co/newsletters/2022/6/24/up-in-smoke

Tobacco was deemed a dying industry. Phillip Morris US a division of Altria Group (MO-NYSE) is the biggest of Big Tobacco. How has Altria's stock performed over the past 20 years?

$10,000 invested July 5, 2002, would have acquired 935 shares at $10.70. Reinvesting all dividends and distributions results in an ending share count of 6,721 shares. At the July 5, 2022 closing market price of $41.72, the compounded market value would be $280,420.

NOTE: The summer of 2002 values were at the upper ends of the 1995-2005 ranges. Feb/2000 MO traded as low as $4.33 per share. You could have acquired it again at $6.41 in March/2002 as investors reacted to Federal and State lawsuits that predicted the end of smoking. We're not cherry picking the start point. It just happens to be 20 years ago.

This study also assumes the Kraft Foods spin-off which occurred in 2007 was sold and reinvested into shares of MO. Kraft Foods went on to become another wonderful investment.

Current dividend per share is $3.60 X 6,721 MO shares held = $24,195 annual income. Current income represents 241% cash income yield on the original 2002 $10,000 investment (!!). Over the past 10-years MO has returned 108% total return (excludes the Kraft bits)

To be clear, I personally shun profiting off the addiction of smokers. We sold our interest in Phillip Morris Tobacco when the parent company Altria spun off it's Kraft Food division in 2007 and haven't held it since. Still…its interesting to review.

Takeaway: Be careful in assessing an investment's prospects via its political correctness

'Chaos is a Ladder' Josh Brown

https://thereformedbroker.com/2022/07/02/chaos-is-a-ladder/

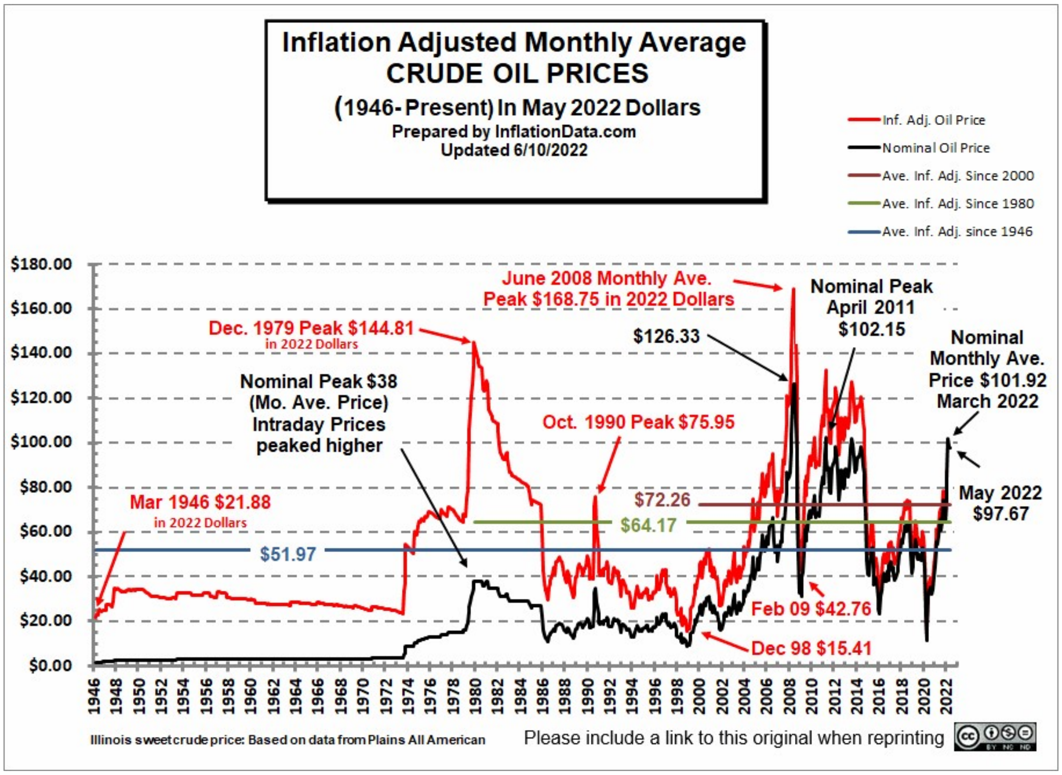
'A Welcome, a Reintroduction, and an Update on Ukraine' Peter Zeihan

https://www.youtube.com/watch?v=Wfm3_8lCY1M

The cure for high energy prices is high energy prices.

Q: When will demand destruction occur?

A: Not yet.



https://inflationdata.com/articles/inflation-adjusted-prices/historical-oil-prices-chart/

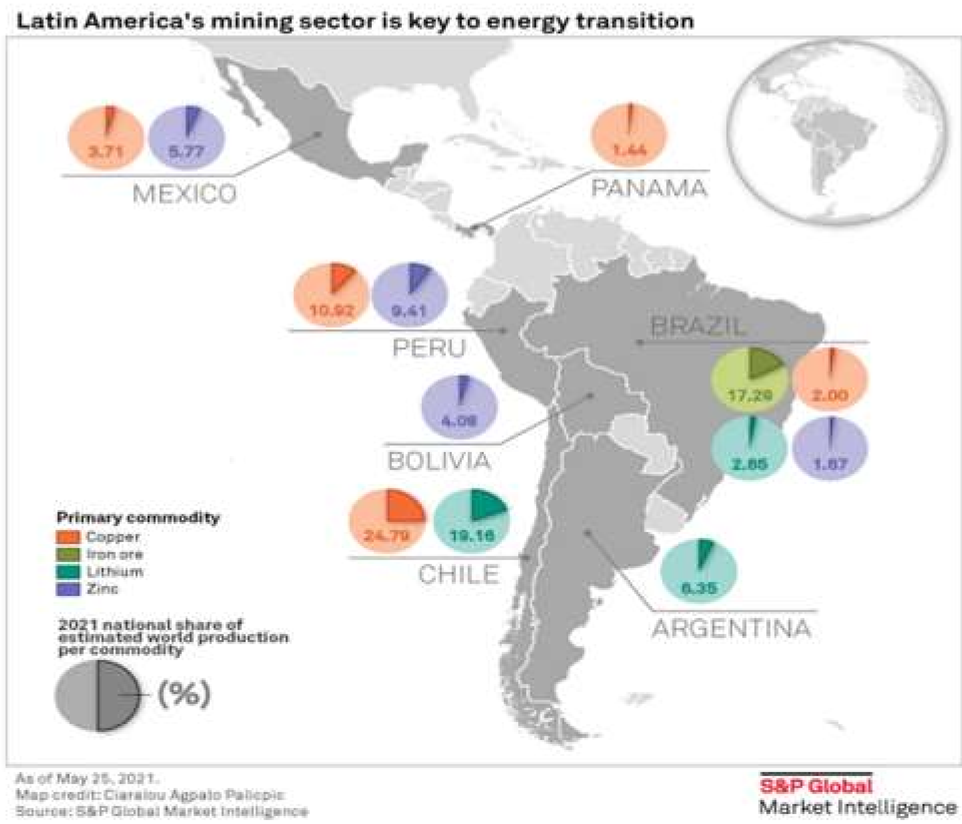
While oil prices are above the 76-year 2022 inflation adjusted average cost of $51.97 (blue line) they're still well below the June 2008 inflation adjusted highs of $168.75 (red line). The above chart does not factor the decline in energy consumption per unit of GDP (energy intensity) of the US economy. The more efficiently any commodity is used, the less impactful changes in the per unit price are. **Bottom line: We think oil prices can, and will, go higher before 'demand destruction' occurs in this business cycle. What might alter that view? A sudden sharp drop in demand (2020 COVID lock downs redux) or a sudden sharp in increase in supply (rapprochement with Russia). For more on demand destruction…**

The Oil Market Is In The Process Of Testing The Lower Band And Why It's So Important For Energy Investors

https://hfir.substack.com/p/the-oil-market-is-in-the-process

And on commodity supply changes and inflation…

‘Resource nationalism sweeps Latin America’ NBF Geopolitical Briefing



Source: "Turmoil casts doubt on Latin America's mining of energy-transition minerals," S&P Global, June 28, 2021

See the attached report in the PDF links section.

Staying with energy and the green transition…

We’ve been following hydrogen. Good news?

Shell to start construction of renewable hydrogen plant in Netherlands – Reuters - July 6, 2022

https://www.reuters.com/business/energy/shell-start-construction-renewable-hydrogen-plant-netherlands-2022-07-06/

For a succinct summary of the Green Tech issues the following appears in this Friday’s NBF Energy Desk notes:

Peter Zeihan on wind and solar. If you’re looking for a good summer read, Peter Zeihan’s new book ‘The End of the World Is Just Beginning: Mapping the Collapse of Globalization’ is worth checking out. Zeihan devotes a chapter to energy and the following were some interesting comments around “greentech”:

"Fossil fuels are so concentrated that they are literally "energy' in physical form. In contrast, all greentechs require space. Solar is the worst of the bunch: it is roughly one thousand times less dense than systems powered by more conventional means. Consider America's Megalopolis, the line of densely packed cities from Boston in the north to the Greater DC area in the south. Collectively, the coastal cities of this line comprise roughly one-third of the American population on a tiny footprint. They also happen to be positioned on patches of land with very low solar and wind potential. The idea they could generate sufficient volumes of electricity locally is asinine. They need to import it. The closest zone with reasonably good solar potential (not "good," "reasonably good") is south-central Virginia. That's an inconvenient six hundred miles away from Boston, and Boston would be last in line for sips of electricity after D.C., Baltimore, Philadelphia, New York City, Hartford, and Providence. It isn't simply an issue for cities located in cloudy, still locations. It is a problem for cities everywhere. Every technological development that has brought us to our industrialized, urbanized present must be reevaluated to make today's greentech work. But by far the biggest challenge is the very existence of cities themselves."

"The entirety of the global electricity sector generates roughly as much power as liquid transport fuels. Run the math: switching all transport from internal combustion to electric would necessitate a doubling of humanity's capacity to generate electricity. Again, hydro and nuclear couldn't help, so that ninefold increase in solar and wind is now a twenty-fold increase. Nor are you even remotely done. "

"Greentech in its current form simply isn't able to shave more than a dozen or so percentage points off fossil fuel demand, and even this achievement" is only possible within geographies fairly perfect for it. A few places with good greentech potential have attempted to replace half of their preexisting conventional power generation with greentech, but working around issues of grid capacity and intermittency and transmission results in a quadrupling of power prices."

More on Bank of Nova Scotia. What do current prices imply?

Herd mentality is a powerful emotion in humans. It is a mistake to give 'the market' too much credit for rational thinking. Example: Last year's Bitcoin mania. The reward of sharply rising prices induces others to rush to buy risk assets. All boats are lifted in the rising tide. Ridiculous companies will trade at ridiculous prices. Great companies will trade at high prices. Avoiding the worst of the excess is half the battle. Never confuse a bull market for brains.

Doing the math of implied prices during such times will not, repeat not, shield you from losses when the greed balloon pops, as it always has. It will probably reduce the degree of loss (or not). Once that balloon pops, prices decline sharply, destroying that unsupported and unfounded wealth in the ridiculous companies. That sinking feeling applies to the great companies as well, taking them from high prices to fair prices, maybe even down to cheap (great) prices.

As the saying goes *"Bear markets return stocks to their rightful owners".* During bear markets, the adults who show up with their calculators (1st) and their wallets (2nd) will find great companies trading at fair to maybe even great prices. The deeper the panic the greater (cheaper) these companies will be.

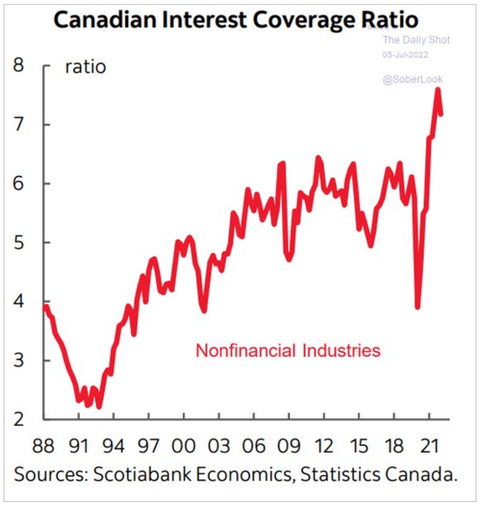
But how do you know when prices have bottomed? You won't. You don't have to. It can be helpful though to examine what prices are implying.

- **Stock prices for the companies we own are already pricing in a lot of economic pain. We've featured Bank of Nova Scotia recently, for no particular reason other that it's very familiar name to most Canadians. Here's an implied price exercise.**
    - Example: Bank of Nova Scotia (BNS-TSX). Someone was willing to sell BNS on Monday this week (to a willing buyer) at a new 52-week low of $73.62 down from the 52-wk Hi of $95.00.
    - At Monday's prices BNS traded at 8.68 X 2023 projected earnings. This means for each $8.68 paid we expect to receive $1 in earnings. This equates to an 11.52% earnings yield and the implied rate of <u>price growth</u> of the investment. If earnings are flowing in at 11% of paid, why on earth would I not demand at least an 11% per year increase in what I'm will to sell it for? Otherwise I'd just continue to own it?
    - BNS pays a cash dividend of $4.12 per share per year. Based on Monday's price this represented 5.51% cash income yield to a buyer (and what today's seller is giving up).
    - We historically see the share price reflecting the earnings growth and the dividend is gravy. Not bad.
    - While we don't know when, or even if that 11.5% price return will occur, I view a 5.5%, and growing, cash dividend income as attractive.
    - In March/2009 at the depths of the stock market swoon BEFORE the Great Recession brought on by the US Sub-Prime mortgage collapse, BNS hit a low of $25.28.
    - Here are BNS Great Recession calendar year earnings per-share. This is what investors were trying to calculate prices on in March/2009.
        - 2008 EPS: $3.06. 2009 EPS: $3.31.
    - The 2008-09 earnings tell us investors pricing BNS at an extreme low of $25.28 in Mach/2009, were pricing BNS at 8.26 X the 2008 earnings (that they knew were posted) and at 7.63 X 2009 earnings (that they were guessing at and came in higher than expected).
    - In 2009 BNS paid $1.96 per share annual cash dividend (today BNS pays $4.12 cash dividend).
    - Let me remind…BNS current projected earnings for 2023 are $8.61 per share. 260% higher than 2009's bum numbers. Current dividend is 210% higher. The March/2009 seller got $25.28 and gave up an awful lot of future growth and cash dividend income.
    - Q: *"What is the optimum holding period?"* A: *"Forever"* Warren Buffet.

The above clarifies that investors are currently pricing BNS <u>as if it was</u> <u>already in the depths of a 2009 housing-bust/credit collapse</u>. As I don't think we're facing anything like the 2009 Credit Bust, I believe prices have over reacted = BUY. Why are investors so willing to sell a great company? Blame the internet. Does what you read every day lately give you a good feeling in your gut. Does it make you want to buy? (The answer is no). We're seeing similar results for many of our favorite companies. I am not willing to sell at such times. I prefer to buy.

As to the general level of risk a Canadian Bank faces from their larger borrowers…

Canada: The corporate interest coverage ratio remains higher than normal, suggesting that the business sector has ample reserves and can withstand an economic slowdown.



Source: WSJ Daily Shot July 5, 2022

Canadian non-financial industries have a record coverage of their interest obligations. We don't think selling here is wise.

Public Pressure for Gun Legislation Up After Shootings

July 4th saw yet another mass shooting in the US, this time from a 21-year old on a rooftop randomly shooting into the crowd watching July 4th Parade in Highland Park, Illinois a suburb of Chicago. Clients have asked if US political leaders will do anything. Gallup produced the results or a survey compiled before the Highland Park shootings (there are so many of these events, we're resorting to labelling by their locations). The American public appears to have had enough.

https://news.gallup.com/poll/394022/public-pressure-gun-legislation-shootings.aspx

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD July 08, 2022

DOW INDUSTRIALS:	31,308
S&P 500:	3888
S&P/TSX COMP:	18997
WTI:	$104.48
LOONIE IN $USD:	$0.7708 $US

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