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CONSERVATIVE PORTFOLIO GAINS 7%

By Gordon Pape, Editor & Publisher

Many investors want to reduce the amount of risk in their portfolios, especially as they grow older. Of course, less risk means less return potential but that's a trade-off they are willing to accept.

That's why I created this Conservative Portfolio just over five years ago, in September 2011. The objective was to preserve capital while earning a target return of two percentage points more than the yield on a five-year GIC from the major banks. The current RBC rate is 1.2% so at present we are aiming for 3.2% per year.

Here is a look at the securities we hold with some comments on how they performed since my last update in mid-April. Prices are as of mid-day on Oct. 14 except for the PIMCO fund, which is at the close of trading on Oct. 13.

iShares Canadian Short Term Bond Index ETF (TSX: XSB). This short-term bond ETF was added to the portfolio in April. It provides regular monthly cash flow of about $0.055 per unit and is very low risk. However, it won't provide much of a return either. It's strictly a defensive holding.

iShares Core Canadian Short Term Corporate + Maple Bond Index ETF (TSX: XSH). This is another short-term ETF. It was added to the portfolio in the fall of 2013 to provide some exposure to Maple Bonds, which are Canadian-dollar bonds from foreign issuers such as Bank of America, JPMorgan Chase, and Goldman Sachs. The unit price is has not budged since the last review in April, but we received monthly distributions totalling about $0.30 during the period so we came out slightly ahead.

iShares Canadian Universe Bond Index ETF (TSX: XBB). We added this ETF to the portfolio in September 2015 when it was trading at $31.37. Over the latest six months, the units added $0.36 and we received distributions of $0.4349 per unit for a return of 2.5% during the period.

PIMCO Monthly Income Fund (PMO005). We added this global fixed-income mutual fund in October 2013. It offers monthly cash flow and places a strong emphasis on capital preservation. Since the last review, the unit value has gained $0.42 and we received distributions totalling about $0.25 per unit.

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Conservative portfolio – continued from page 1…

BCE Inc. (TSX, NYSE: BCE). BCE continues to be a strong performer for us. The stock has gained $0.96 since the last review and we received two quarterly dividends of $0.6825.

Enbridge Inc. (TSX, NYSE: ENB). Enbridge shares continued to recover after taking a hit in 2015. They gained $4.47 in the latest period plus we received two distributions totaling $1.06 for a total six-month return of 10.4%.

Brookfield Infrastructure Limited Partnership (TSX: BIP.UN, NYSE: BIP). The units of this Bermuda-based limited partnership split three-for-two in September. Investors received one additional unit for each two previously held, with fractional units rounded up. We held 35 units at the time of the split, so we now have 53. Our base cost per unit dropped to $19.15 following the split. Meanwhile, the share price has continued to move higher.

We received interest of $6.18 on the cash invested at 2.25% in high-interest savings account at EQ Bank.

Following is a summary of where we stood at mid-day on Oct. 14. The initial book value of the portfolio was $10,000. At the time of my last review the value of the portfolio, including dividends/distributions, was $13,710.86. Brokerage commissions are not factored in and the Canadian and U.S. dollars are treated as being at par for ease of calculation. (This only affects one security, as the distributions from BIP.UN are paid in U.S. collars.)

IWB Conservative Portfolio (a/o Oct. 14/16)

Security	Weight %	Total Shares	Average Cost/Share	Book Value	Current Price	Market Value	Retained Income	Gain/ Loss %
XSB	16.1	80	$28.41	$2,272.80	$28.32	$2,265.60	$22.01	+ 0.7
XSH	16.8	120	$19.72	$2,366.80	$19.68	$2,361.60	$72.97	+ 2.9
XBB	13.7	60	$31.52	$1,890.95	$32.08	$1,924.80	$41.81	+ 4.0
PMO005	10.3	100	$14.01	$1,400.70	$14.40	$1,440.00	$40.77	+ 5.7
BCE	12.9	30	$39.93	$1,197.76	$60.44	$1,813.20	$136.66	+62.8
ENB	12.4	30	$31.17	$935.10	$57.86	$1,735.80	$232.21	+110.5
BIP.UN	16.9	53	$19.15	$1,015.20	$44.77	$2,372.81	$96.93	+143.3
Cash	0.9			$115.71		$121.89		
Totals	100.0			$11,196.02		$14,035.70	$643.36	+31.1
Inception				$10,000.00				+46.8

Comments: The portfolio added a little over 7% in the latest six-month period, thanks to a strong performance from our equity positions. Since inception in 2011, we have a total return of 46.8%. That's an average annual compound rate of return of 7.85%, which continues to be well in excess of our target.

Changes: The bond weighting at this point is 56.9% and 5.2% of our assets is in cash (retained income plus cash reserve). That's a good balance for a portfolio of this type so we will not make any changes at this time.

We'll keep our total cash of $765.25 in our EQ account, which now pays 2%. I'll review the portfolio again next April.

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POLITICAL STORMS AHEAD

Contributing editor Gavin Graham is with us this week with a look at the political storms that are brewing in Europe. Gavin has had a long and successful career in money management and is a specialist in international securities. He held senior positions in financial organizations in London, Hong Kong, and Toronto. He currently is chief strategy officer at Integris Pension Management, a provider of personal pension plans for incorporated individuals. He divides his time between Toronto and the U.K.

Gavin Graham writes:

As I write, the remnants of Hurricane Matthew are dumping hundreds of millimetres of rain on the luckless Atlantic Provinces and Newfoundland after wreaking a trail of destruction in the Caribbean and up the U.S. East Coast.

The storm is a reminder that even the wealthiest and most

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sophisticated countries are at the mercy of major natural disasters. The damage and disruption caused by Matthew were extensive. However, it is worth noting that the death toll in the U.S. was small compared with the thousand or more unfortunate Haitians who lost their lives. That showed once again that decent infrastructure and precautions taken in time, such as evacuation, can mitigate the worst effects of a hurricane or typhoon,

In a similar fashion, the effects of a major financial crisis, whether domestic or international, can have a devastating impact on the economies of those countries with inadequate regulations and controls. Look back to 2008. The U.S. sub-prime mortgage crisis culminated in the bankruptcy of Lehman Brothers and the subsequent U.S. recession was the most severe since World War II. However, the worst effects were felt in Mediterranean Europe, where the mistakes of the European authorities contributed to the meltdown of the Greek economy and 25% unemployment rates in Spain and Portugal. To continue with the hurricane metaphor for a moment, the deforestation and abysmal infrastructure in Haiti combined with lack of precautions caused far more damage than in the better built and prepared U.S. coastal states.

European banks face heavy weather

In the same way, the rapid write-down of bad debts by the U.S. banks and their recapitalization with TARP funds has made them much better able to resist any further financial shocks than the Eurozone banks. For political reasons, Europe's banks were not forced to write down debt as aggressively. The solution to the banks' need for further capital, thought up by the European authorities, almost defies belief. Determined that the banks should not be bailed out at the taxpayers' expense again, the European Commission required lenders to the banks to bear part of the pain of any losses. This is the so-called "bail in" provision, as opposed to a government (taxpayer-funded) bailout.

The bail-in rules meant that every bank depositor in Cyprus was initially due to have 10% of their money confiscated when the Cypriot banks needed to be rescued in 2013. Common sense prevailed (partially) and depositors with under €100,000 were exempted from this scheme, but the blow to confidence was enormous. I mentioned when writing about it at the time that the same approach could be applied to other Eurozone banks that got into trouble, and now we are very close to that point.

Italian tragedy

The country where this situation is approaching is not Greece, which as we were constantly reminded during its debt crisis, represents only 2% of the EU GDP. It's not even Portugal or Spain, both larger countries but not at the heart of the Euro project. No, the looming banking crisis is occurring in Italy, one of the original six members of the European Union in 1955. It has the fourth biggest economy in the EU and the third biggest in the Eurozone after Germany and France.

Recent reports indicate that approximately 20%, or one in five, of Italian bank loans are non-performing. Any attempt by the Italian government under Eurocrat Matteo Renzi to rescue the banks by bailing them out is prohibited by the new banking regulations adopted after the crisis. A bail-in would mean millions of small Italian investors who own bank bonds could face a 10% haircut, as in the Cyprus case.

Exempting small investors would cost too much. Also, it would prevent the banks, including the world's oldest continuously existing bank, Banco de Monte dei Paschi, which is over 500 years old, from raising enough capital to restore their balance sheets.

Signor Renzi has called a constitutional referendum for the first week in December to attempt to pass reforms of the Italian Senate and Parliament to give him more executive authority to take needed action. He has stated he will resign if he loses. With the burgeoning banking crisis, and existing levels of discontent due to high unemployment and non-existent growth (Italian GDP is less than 10% higher than when it joined the Euro 17 years ago), many observers think he stands a good chance of losing.

German angst

Of course it's not only Italian banks that are having problems. Deutsche Bank (NYSE: D), Germany's largest bank, has been threatened with a US$14 billion fine by the U.S. Department of Justice for unloading mortgage backed securities ahead of the financial crisis.

The size of the fine at one stage last week was larger than Deutsche's equity market capitalization, as panicked investors drove its share price down to levels not seen since the early 1990s. Deutsche's shares had come under pressure earlier this year when worries spread over losses, and its so-called Co-co (CO-contingent) bonds, which force owners to accept some of the bank's losses, plummeted as that possibility became more likely. Deutsche has responded by selling its U.K. insurance business and is contemplating floating part of its very profitable asset management business.

While German Chancellor Angela Merkel has apparently ruled out helping Deutsche at the moment, it is hard to see how Germany's largest bank could be allowed to go

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under, especially as Frau Merkel has national elections next year. Her Christian Democrat party has been doing very badly in recent state and local elections. One reason is concern over the 1.2 million immigrants from the Middle East that she unilaterally allowed to stay in Germany last year. That has led to the rise in popularity of the AfD party, originally anti-euro and now anti-mass immigration as well. However, any rescue of Deutsche will lead to howls of protest from Italy and the other Club Med countries, which have not been allowed to bail out their own banks.

Political establishments under attack

France has a Presidential election in May next year. The current President, Francois Hollande, is so unpopular that he may not even get into the second round of voting. Spain is still struggling to form a government after two elections this year. In this context, the success of the Leave vote in the U.K in the Brexit referendum in June becomes easier to understand.

Britain's Conservative party rapidly chose a new leader in Theresa May and its Labour opposition is in disarray under the hapless leadership of left-winger Jeremy Corbyn. The policies being pursued by the new Conservative leadership mark a distinct break with those of former Prime Minister David Cameron.

Theresa May stated at the beginning of October that Article 50, which starts the two-year process of leaving the EU, would be triggered by the end of March 2017. She also said that control of immigration by the U.K. was non-negotiable. This is the so-called "hard landing" that investors have feared. The pound sold off sharply, hitting a 31-year low against the U.S. dollar, as people realized that Brexit did actually mean the U.K. was headed towards the door and will leave the EU by March 2019. The bottom line here is that the Conservatives have been clever and ruthless enough to take charge of the wave of popular discontent that is sweeping the western world. Other parties, in other countries, may not be so lucky or skillful.

It is in this light that the remarkable resilience of Donald Trump's support should be seen. While the revelations of more crude and sexist rhetoric by Mr. Trump have led to much condemnation, and it appears Ms. Clinton emerged as the winner of the first two Presidential debates, the fact that her lead over Mr. Trump is not 15% at this stage of the campaign is telling. While it still appears likely that she will win in November, especially given her lead among Hispanics and African Americans, there is a substantial mass of what she memorably described as "the deplorables" that are so disenchanted with the existing set-up that they will take a chance on a perceived outsider with no political experience and numerous flaws.

One of the features of the Brexit campaign was the high voter turnout, the most for 24 years. It was especially noticeable amongst people who had never voted or not voted for years, or even decades. Sufficient anger or indignation could motivate many citizens to do the same over the next year, whether in November in the U.S., December in Italy, May in France, or October in Germany.

Investors should be prepared for more unexpected events. Meanwhile, avoid all Eurozone banks and hedge European currencies, both the euro and sterling, if investing in the global multi-nationals that are based there.

My recommendations Vodafone (NYSE: VOD), Unilever (NYSE: UL), and Diageo (NYSE: DEO) are naturally hedged as most of their revenues come from outside Europe, in U.S. dollars or currencies that should appreciate. Investors can also buy a hedged Europe ETF such as the iShares MSCI Europe IMI Index ETF (CAD-Hedged) (TSX: XEH) or a mutual fund investing in such companies. This would offset the drag caused by securities that are denominated in euros or pounds.. The U.S dollar will be regarded as a safe haven for the near future, even if Donald J. Trump is elected in November.

GAVIN GRAHAM: A DIFFERENT WAY TO INVEST IN GOLD

With political uncertainties rising and currencies under pressure, it makes sense to look at gold again. I currently have three gold stocks on our Recommended List. One, Franco Nevada (TSX, NYSE: FNV) is a royalty play. The others, Goldcorp (TSX: G; NYSE: GG) and Agnico Eagle (TSX, NYSE: AEM) are more conventional gold miners, albeit with high quality properties in politically safe jurisdictions.

Today, I'd like to add another stock that represents a different and unconventional way to play rising precious metal prices. The company is First Mining Finance and it trades on the TSX Venture Exchange under the symbol FF. It's also listed on the over the counter market in the U.S. as FFMGF. Here are the details.

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Background: First Mining Finance was listed in April 2015 “to take advantage of the lowest mining equity valuations of the last 20+ years”, as it states in its presentation. It aimed to do so by acquiring at a fraction of the cost high quality mineral projects that have had millions of dollars invested on exploration and development. The exceptionally severe bear market in junior mining stocks over the last four years made this possible.

The plan was to use management’s expertise to acquire and hold assets until First Mining is able to monetize them in the form of resales, joint ventures (JVs), royalty structures, or a combination of all of these.

Management: The success of this model obviously depends upon the management having credibility. It does. The company chairman is Keith Neumeyer, founder of both First Quantum Minerals and First Majestic Silver, of which he is currently president and CEO.

First Majestic has a market capitalization of $1.6 billion and is the second largest primary producer of silver in Mexico. In the second quarter (to June 30, First Majestic produced 4.7 million silver equivalent ounces (SEO) for revenue of US$66 million and operating earnings of $9.9 million ($0.04 per share). The stock price quadrupled this year to over $20, allowing the company to sell 5.25 million shares at $10.95 to raise $57.5 million in May.

First Mining’s CEO is mining engineer Chris Osterman, whose 30 years of experience include major discoveries in Mexico, Bolivia, and Mongolia. The president is geologist Patrick Donnelly, whose experience includes corporate development roles with two copper companies and a spell as a base metals analyst on Bay Street.

Recent developments: Having raised $36 million in April 2015 through its listing on the Toronto Venture Exchange, First Mining wasted no time in using its shares as acquisition currency. It bought Coastal Gold and its Hope Brook project (944,000 oz. indicated and inferred) in Newfoundland for $11.2 million in May and Gold Canyon’s Springpole and PC Gold’s Pickle Crow in Ontario for $67.8 million in September, adding another 6.4 million indicated and inferred oz.

It then picked up three small Quebec mines (Duquesne, 10% of Duparquet, and Pitt) from Clifton Star and Brionor for $20.1 million in February and March 2016, adding another 1.17 million oz. and $11million in cash.

All of these deals were done with the stock price between $0.40 and $0.50. With the rise in the gold price, First Mining’s share price doubled.

The company did its most recent deals in Ontario in May at $0.80 and $0.75 per share respectively for Chalice’s Cameron project ($19.2 million for 1.57 million oz.) and Tamaka Gold’s Goldlund, its biggest deal so far at $59.2 million. First Mining does not include Goldlund’s reserves in its own numbers yet. A May assessment by WSP Canada for Tamaka estimated were 3.28 million oz.

Why we like it: In eighteen months, First Mining has used its shares to acquire measured and indicated reserves of 6.55 million oz. and inferred reserves of 3.54 million oz. That gives it a market capitalization of $440 million at $0.80 per share. Furthermore, it has been bargain basement shopping, with the acquisitions bought at a price averaging $8.03 per oz. of gold, compared to their valuation of $31.40 at First Mining’s present share price.

Nonetheless, this puts First Mining at a valuation barely half that of the $60 per oz. average of gold developers and valuations for the largest developers such as Gold Standard, Osisko, and Golden Queen of between $150 and $250 per oz. At this stage, First Mining is actually the sixth largest gold developer amongst the 50 or so gold exploration and development stocks. Its 10 million oz. of reserves puts it behind only such well-known companies as Pretium, Novagold, and Exeter Resources. And, as mentioned, this excludes Goldlund’s 3.3 million oz., which would move it up to fifth largest, overtaking Vista Gold.

All of its acquisitions are good quality properties, in politically stable, mining friendly jurisdictions (Ontario, Quebec, Newfoundland). All have infrastructure already in place or easily accessible and co-operative relationships with First Nations and local communities. They are low cost to maintain while negotiations to realize their value take place and have been acquired at once in a generation low prices of under $10 per oz. of gold.

The company also owns a dozen Mexican exploration properties in prospective areas valued at $8.4 million on the balance sheet.

Risks: First Mining is not an operating company and has no source of revenue other than its ability to issue shares, although it also acquired $14.5 million in cash through its acquisitions. In August, the company issued 33.75 million units at $0.80, consisting of one share and one half of a warrant exercisable at $1.10 for three years, to raise $27 million. Following the placement, First Mining has $36.5 million in cash and $2.9 million in debt, so it should be able to fund itself for the foreseeable future.

In the six months to June 30, First Mining recorded a loss of $8.35 million ($0.02 per share), of which $4.7 million

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was share-based payments to management, who don't take salaries.

As a development company there is no dividend, although the management's intention is eventually to pay one, once its projects have been monetized.

Liquidity: First Mining trades 1.9 million shares a day on the TSX Venture exchange and, impressively, 1.4 million shares a day on the OTC market in the U.S., giving a combined daily liquidity of 3.4 million shares. Management and directors own 3.2% of the company and First Majestic owns 2.9%.

Action now: First Mining Finance is a Buy for leveraged exposure to rising gold and precious metal prices, through a portfolio of good quality, low risk mining assets acquired at very low prices. However, because of the nature of the business and the volatility of the gold market, this investment is only recommended for those who can tolerate risk in return for potentially high rewards.

- end Gavin Graham

GORDON PAPE'S UPDATES

SPDR S&P Dividend ETF (NYSE: SDY)

Originally recommended on April 9/12 (IWB #21214) at $56.33. Closed Friday at $82.08. (All figures in U.S. dollars.)

Background: This ETF tracks the performance of the S&P High Yield Dividend Aristocrats Index. Only stocks that have raised their payout for at least 25 straight years qualify for inclusion so it's a pretty high-powered club. Some of the names in the top holdings will be familiar such as AT&T, IBM, Caterpillar, and Chevron. Others are less well known, like HCP Inc., AbbVie Inc., and People's United Financial Inc. In total, the fund holds 110 positions. The ETF is operated by State Street Global Markets.

Fund performance: This ETF continues to perform well for us. Over the year to Sept. 30, it gained 24%. The three-year average annual compound rate of return was 12.4%.

Distributions: The fund pays quarterly distributions, which vary from one period to the next. The two more recent payments (June and September) were about $0.50 per unit. Combined with a year-end 2015 payout of $3.17, we have received cash totalling $4.63 over the past 12 months. The current 30-day yield is 2.4%.

Key metrics: The fund has total assets of $14.2 billion. The expense ratio is 0.35%. The price earnings ratio of the portfolio is 21.14.

Analysis: This ETF represents the elite of U.S. dividend paying stocks. Any company that has been able to increase its payments for at least 25 years, including through the crash of 2008-09, has achieved something very special. This track record suggests these companies should continue to outperform the broad market going forward.

Outlook: This fund is somewhat interest-sensitive because of the nature of its holdings, so it could experience a small setback if the U.S. Federal Reserve Board raises its target rate in December, as many now expect. However, the long-term outlook continues to be positive.

Action now: Buy.

iShares S&P/TSX Canadian Dividend Aristocrats Index ETF (TSX: CDZ)

Originally recommended on April 9/12 (#21214) at $22.29. Closed Friday at $24.91.

Background: This fund invests in Canadian stocks that have increased their dividends for at least five consecutive years and have a market cap of $300 million or more. There are 70 positions in the ETF with the biggest weightings in small to mid-cap companies such as Russell Metals, Gibson Energy, Exchange Income Corp., Northview Apartment REIT, and Corus Entertainment.

Fund performance: This ETF is coming off a decent year, with a gain of 10.2% over the 12 months to Sept. 30. The three-year average annual compound rate of return to that point was a less impressive 6.5%.

Distributions: Payments are made monthly, with the level adjusted every three months. For the June-September period, the monthly distribution was $0.0859, which would work out to $1.03 over a full year if maintained. On that basis, the current yield is 4.13%.

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Gold – continued from page 6…

Key metrics: The fund has total assets of $948 million. The expense ratio is 0.67%. The portfolio consists of 75 positions. The p/e ratio is 15.16.

Analysis: This is much more of a small/mid-cap portfolio than its U.S. counterpart although if you scroll through the list of holdings you'll find some large companies including the major banks. Because it invests only in Canadian stocks, there is less diversification than in SDY. On the plus side, Canadian company dividends qualify for the dividend tax credit.

Outlook: This fund should continue to generate decent cash flow but will likely continue to underperform SDY on a total returns basis.

Action now: Buy.

iShares MSCI EAFE Index ETF (CAD-Hedged) (TSX: XIN)

Originally recommended on March 18/13 (#21311) at $19.68. Closed Friday at $22.32.

Background: This ETF is the Canadian-dollar hedged version of a U.S. fund (NYSE: EFA) that tracks the MSCI EAFE Index, which covers Europe, Australasia, and the Far East. Most of the assets are invested in the U.S. version.

Fund performance: Recent results have been unexciting. Over the year to Sept. 30, the fund gained only 3.87% and the three-year average annual compound rate of return has been 4.9%. The American version (EFA) has a better one-year record at 6.45% but the three-year average annual return is a meagre 0.37%.

Distributions: The fund makes semi-annual payments, in June and December, and they vary significantly. The June distribution this year was $0.34 per unit. Payments over the past 12 months have totalled about $0.526 per unit for a yield of 2.36% based on the current price.

Key metrics: The fund has total assets of $1.2 billion. The expense ratio is 0.5%. Japanese stocks are the number one holding at 23.42% of assets, followed by the U.K. at 18.14%. No other country has more than a 10% position.

Analysis: Slow growth has been a drag on world markets and events such as the Brexit vote have not helped investor confidence. There is no reason to expect a fast turnaround from these conditions.

Outlook: I don't expect much change in performance over the next year, with returns in the 3% to 6% range.

Action now: Hold if you want to maintain continued exposure to global stocks. Otherwise, sell.

iShares Core S&P/TSX Capped Composite Index ETF (TSX: XIC)

Originally recommended on March 25/12 (#21212) at $19.58. Closed Friday at $23.12.

Background: XIC tracks the performance of the S&P/TSX Composite Index, which reflects the total Canadian stock market.

Fund performance: The units went into a deep slump at the start of this year, tracking the downward trend of the overall market. At one point in late January they were trading below $19. However, Canadian stocks have since recovered and this ETF has gained about $4 per unit since that time. For the 12 months to Sept. 30, it shows a return of 14.14%. The three-year average annual compound rate of return is 7.91%.

Distributions: Distributions are paid monthly. The amount varies but recently payments have been about $0.165 per unit (about $1.98 annually). The distributions are tax-advantaged, divided between dividends and capital gains over the past two years.

Key metrics: Assets under management total about $2.6 billion. The management expense ratio is a very low 0.06%. The portfolio holds 247 securities.

Analysis: The recent strong performance of the TSX has boosted the returns on this fund well beyond its normal range. That's great for investors but probably not sustainable over the long term.

Outlook: Although it appears the TSX has been running ahead on hope, a resurgence in the energy sector sparked by the latest talk of oil production cuts could enable this ETF to continue its above-average returns for a while yet.

Action now: Buy.

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