The Internet Wealth Builder

Volume 21, Number 44 Issue #21644 December 12, 2016

IN THIS ISSUE

A year of improbable profits	**1**
Lessons from history	**2**
Glenn Rogers visits Cuba	**3**
Glenn Rogers's updates: iShares MSCI Hong Kong ETF, Allergan plc, iShares iBoxx $ High Yield Corporate Bond ETF	**4**
Gordon Pape's updates: UnitedHealth Group, Aecon Group, Badger Daylighting, Lundin Mining	**5**
Your Questions: Rising interest rates	**7**

BUILDING WEALTH

The Internet Wealth Builder

Editor and Publisher: Gordon Pape
Circulation Director: Kim Pape-Green
Layout/Design: Kendrew Pape
Customer Service: Katya Schmied, Terri Hooper

Copyright 2016 by Gordon Pape Enterprises Ltd.
All material in the Internet Wealth Builder is copyright Gordon Pape Enterprises Ltd. and may not be reproduced in whole or in part in any form without written consent. All recommendations are based on information that is believed to be reliable. However, results are not guaranteed and the publishers and distributors of the Internet Wealth Builder assume no liability whatsoever for any material losses that may occur. Readers are advised to consult a professional financial advisor before making any investment decisions.

Reprints: Contact customer service.
Mail: 16715-12 Yonge St Suite 181
Newmarket ON L3X 1X4
Email: customer.service@buildingwealth.ca
Website: buildingwealth.ca/iwb

Next Issue: January 2
Customer Service: 1-888-287-8229

A YEAR OF IMPROBABLE PROFITS

By Gordon Pape, Editor and Publisher

There are only a couple of weeks left in 2016 and it looks like it will end up being a very profitable year for most investors.

The S&P/TSX Composite was up 17.7% for the year after the close of trading on Friday, making it one the top performing indexes in the world. In New York, the Dow, S&P 500, and Nasdaq all established new records last week. At this point, the Dow is ahead 13.4% for the year, the S&P 500 has gained 10.5%, and the Nasdaq Composite is up 8.7%.

These numbers seemed highly improbable back in January-February. North American stock markets got off to their worst start in history. The Dow started the year at 17,590.66 and proceeded to go into a swan dive, falling all the way to 15,503.01 in intra-day trading on Feb. 11. That was a loss of almost 12% in six weeks, making it a full-scale correction. The other North American indexes showed a similar pattern.

But that was the nadir for the year. The markets started to recover in the second half of February and, with an occasional time-out, the rebound continued for the rest of 2016.

Looking back now, let's review the main financial stories of the year and their impact on the performance of the stock and bond markets.

The interest rate moratorium. On Dec. 16, 2015 the U.S. Federal Reserve Board raised its key lending rate for the first time since 2006. It was only a quarter-point hike but it was seen as the start of series of moves that would take the rate to 1% or higher over the course of 2016.

The stock market does not like rising rates and the Fed move was one of the factors depressing share prices in the early part of the year, as investors waited for more shoes to drop. They didn't. Economic indicators continued to be weak and job creation numbers were below expectations, staying the Fed's hand on further hikes. As the months passed without any further moves, it became apparent that there was a de facto moratorium on rate increases.

That contributed to a strong stock market rally, especially in interest-sensitive securities. The bond market also shot up, as rates fell to historically low levels. In many European countries, high-quality sovereign bonds saw their yields fall into negative territory.

Continued on page 2…

Profits – continued from page 1…

That phase is now over. It is widely expected that the Fed will raise its rate by a quarter-point at next week's meeting and that more increases will be coming in 2017. Bond prices have slumped and the shares of interest-sensitive stocks like REITs and utilities have sold off in anticipation.

Assuming the Fed does act next week, we'll be at about the same point we were at in mid-December 2015, with everyone anticipating more hikes to come. We all know how that played out.

Brexit. The news that Great Britain had voted to leave the European Community in a June 23 referendum stunned the world. The result was completely unexpected, as the polls had projected a fairly easy victory for the Remain side (not the only time the pollsters were wrong this year). The Dow fell more than 5% in the days immediately following the vote and most markets around the world followed suit.

But the decline was short-lived. By the end of the month the Dow was almost back to its pre-vote levels and by mid-July it was in record territory. Traders decided that, shocking though the vote was, nothing tangible was going to happen for at least a couple of years. Even now, almost six months later, Britain has not acted to trigger Article 50 of the Lisbon Treaty, which is the first step in opening departure negotiations. Now a British court has ruled that Parliament must first give approval before Article 50 is invoked. This saga is likely to go on for some time.

Trump's victory. Almost everyone, including me, thought the stock market would plunge if Donald Trump won the election. Like so much else in this turbulent year, we were all wrong. Instead, we have experienced what has now become known as the Trump Bump. On Election Day, the Dow closed at 18,332.70. On Dec. 10 it was at 19,756.85, a gain of about 7.8%.

Investors took a close look at Mr. Trump's policies and decided a lot of them would be good for business. They liked his tax cuts, his plans for deregulating the financial sector, his infrastructure spending plan, and his intention to cut red tape. They didn't like his protectionist trade program but they have put their heads in the sand on that one, as least so far.

Interestingly, a month after the election the Trump Bump is still pushing stocks higher and is now poised to merge with the traditional Santa Claus Rally to provide investors with a very prosperous December. What January may bring is another matter, of course.

OPEC. The final big market mover of the year was the Nov. 30 agreement by OPEC to cut output by 1.2 million barrels a day starting in 2017. With another 600,000 barrel cut promised by non-OPEC nations, mainly Russia, that would be a whopping 1.8 million barrels a day of supply gone from the system.

As I wrote last week, I have doubts the real cuts will be anywhere near that level. However, the news provided a big boost for oil and gas stocks, with the S&P/TSX Capped Energy Index up 8.3% so far this month.

Not one of these stories could have been predicted a year ago at this time. All had a significant influence on the markets in 2016. What stories might we be writing about at this time next year? I'll have some suggestions in the first issue of 2017.

LESSONS FROM HISTORY

By Gordon Pape

Donald Trump says his number one priority is protecting American jobs and he doesn't seen to care who gets hit as he pursues that goal.

He has threatened to impose heavy tariffs on imports from Mexico and China and punitive taxes on any U.S. company that shifts production to other countries and then tries to sell the finished product back into the States.

From everything he said before and after the election, it appears that the incoming President is determined to implement these isolationist policies when he takes office in January. But the realties of world trade may thwart him. The whole process of job protection via tariffs may end up being a global game of whack-a-mole.

Last Thursday, The Wall Street Journal published an insightful look by columnist Gregg Ip into the problems past Presidents have faced when they tried to use protectionism to protect U.S. industries. He cited the 1977 example of President Jimmy Carter imposing restrictions on the import of Japanese TV sets.

Continued on page 3…

Building Wealth's The Internet Wealth Builder is published weekly by Gordon Pape Enterprises Ltd. All rights reserved.

History – continued from page 2…

"The result? As Japanese sales went down, South Korea's and Taiwan's went up," he wrote. "When those imports were restricted, imports from Mexico and Singapore went up."

More recently, when President Obama imposed tariffs on the import of Chinese tires in 2009, shipments from that country dropped but imports from elsewhere went up. "The action saved at most 1,200 jobs, a study by the Peterson Institute for International Economics found, at a cost to consumers of $900,000 per job because of higher prices."

What Mr. Trump should really focus on, says the author, is training workers to fill some of the 334,000 manufacturing jobs that are available right now. The President-elect has spoken about providing more money for enhanced job training, especially for veterans, but it has not been a high-profile priority to this point. Trade wars seem to play much better with his base, even though history had shown them to be not just unproductive but destructive.

GLENN ROGERS VISITS CUBA

Contributing editor Glenn was in Cuba recently and came away with a recommendation for a stock that should do well if the relations with the U.S. continue to improve. Glenn is on the boards of Linksoul and Poler Inc. He has worked with private equity and venture groups on a variety of projects leading to successful exits for the investors. He recently was part of a group that sold a large beverage company to Amway. Glenn has worked in senior positions in both Canada and the U.S. and is a successful investor. He lives with his family in southern California. Here is his report.

Glenn Rogers writes:

I just returned from an eventful trip to Cuba. It had been 10 years since I had last visited with my wife and kids while on a year-long sailing trip that brought us near enough to Cuba that it was possible to spend a few days on the island.

Returning this time, we noticed a number of positive changes despite being involved in a serious five-car collision, which took the life of one of the drivers. That same night Fidel died so it was a significant time to be there. There was much less obvious poverty and construction on new buildings and the rehab of old ones was moving along.

I was interviewed on television state side because, given the celebrations in south Florida after Fidel's death, people were wondering what was happening on the streets of Havana. At the time, the Cubans I spoke with seemed to be more concerned about what President-elect Trump would do than what Fidel's death might mean for them. Castro had been stepping back from governing for eight years and given his age there was no real surprise that he had passed. That said, there were no celebrations going on and he was generally thought more of in Cuba than in South Florida, for obvious reasons.

After leaving Havana (on American Airlines' inaugural flight) I went to visit Gordon at his winter home just south of Palm Beach. He suggested I write a column on a company that might benefit from the gradual relaxation of travel restrictions ushered in by President Obama, which will hopefully be maintained by President-elect Trump.

Cuba's tourism sector has been growing steadily over the past decade. Currently Canada is the biggest single market for the island but that will soon change if Americans are allowed to continue to travel there after Mr. Trump takes office.

There is also money to be made in infrastructure, mining, and possibly offshore oil but that will take more time. Tourism is happening now. Airbnb up and running and Starwood hotels has three properties under construction. Major airlines including American, Alaska, Spirit, and Jet Blue are now flying to three different cities on the island from the U.S. But the stock I've chosen to review is Carnival Cruise Corp. (NYSE: CCL), which was the first cruise line authorized to begin selling tours to Cuba.

Of course, Carnival is a huge company so adding Cuba won't necessarily move the needle that much but there are other reasons to like the stock and enhanced Cuba business won't hurt.

A cruise ship is a good way to see the island because there is a shortage of hotel rooms available, which will take a few years to sort out. Good food is also important for travellers are you'll get more and better on a cruise ship than at an island hotel.

Continued on page 4…

 All rights reserved.

Cuba – continued from page 3…

Carnival is one of the world's largest travel companies and if you like cruises then you have likely been on one of their ships. Their brands include Princess, P&O Cruises, Holland America, Cunard, Costa, and many others.

These brands make Carnival the world's largest cruise company with over 100 ships visiting 700 ports around the world. The company serves 11 million travelers annually, which is 50% of the global cruise market. The company plans to add five more ships over the next few years, which will accretive to earnings.

Carnival owns a small line called Fathom that offers seven-day cruises out of Miami with stops in Havana, Santiago de Cuba and Cienfuegos aboard the 704-passenger ship *Adonia*.

In 2015, the corporation's revenues were $15.5 billion (all figures in U.S. dollars) and the earning grew by over 40%. Growth in 2016 has slowed somewhat and the stock has traded poorly until recently. The stock also took a hit when Princess Cruises was found guilty of illegally dumping contaminated oil products into the ocean and received a $40 million dollar fine.

The stock has been trading better lately, along with the rest of the market. Expedia reports that advanced bookings for cruise ships has been very strong, so the next few months look good for Carnival and the other cruise lines.

Revenues for the first nine months of this year were just under $12.5 billion compared to $12 billion last year. Net income increased to $2.2 billion ($2.88 per share, fully diluted) from $1.5 billion ($1.91 per share) due to lower fuel costs and other factors.

The company has been buying back stock and pays a quarterly dividend of $0.35 per share ($1.40 annually). The yield is 2.7% at the current price. S&P has recently raised their opinion from Buy to Strong Buy.

Demographic trends are positive for the travel business in general and Carnival in particular.

Action now: Buy with a target of $60. The shares closed on Friday at $53.34.

GLENN ROGERS'S UPDATES

iShares MSCI Hong Kong ETF (NYSE: EWH)

Originally recommended on Feb. 16/09 (IWB #2907) at $9.74. Closed Friday at $20.60. (All figures in U.S. dollars).

Background: This exchange-traded fund offers exposure to large- and mid-cap companies traded on the Hong Kong Stock Exchange. The portfolio covers about 85% of the Hong Kong market.

Performance: It's been a long time since we reviewed this basket of Hong Kong companies. For several years it traded very well, reaching a high of over $24 in mid-2015, up from the price of $9.74 when we recommended it. Lately, however, the Chinese market has gone the opposite way of the Trump rally since the President-elect started sending out ill-considered tweets suggesting that he would be raising tariffs on Chinese goods.

Outlook: Whether or not Mr. Trump actually goes through with declaring a trade war with China is anyone's guess, and whether Congress would go along with such a plan is also unknown. But the market hates such uncertainties and so do I. We have a nice profit here so let's take it. We can then sit back for a few months to see how things settle out and assess how the Trump administration will deal with the country.

Action now: Sell for a capital gain of 111.5%. .

Allergan plc (NYSE: AGN)

Originally recommended on July 5/15 (#21525) at $307.51. Closed Friday at $192.25. (All figures in U.S. dollars.)

Background: Allergan is an Irish-based pharmaceutical giant that operates globally in over 60 countries. The company has over 30 manufacturing facilities around the world with a significant distribution business in the U.S., selling to outlets like Walgreens, CVS, etc. Its best-known product is Botox.

Stock performance: Pharmaceutical stocks in general and biotech stocks in particular have been trading very poorly for the last few months. First, investors were worried about what a Clinton presidency would mean for drug prices. Now they are worried about whether Donald Trump will be even worse. The President-elect tweeted

Continued on page 5…

 All rights reserved.

Glenn Rogers's updates – continued from page 4…

last week that he believes drug prices are too high, which sent shivers through the sector. The Nasdaq Biotech Index fell more than 3% on the news.

Recent developments: The company reported a third-quarter increase of 4.4% in revenue, to just over $3.6 billion. On a non-GAAP basis, adjusted net income per share (fully diluted) was $3.32, down from $3.41 in the same period of 2015. The decline was due to higher costs for research and development as well as for sales and marketing, the company said.

Despite this, the company instituted its first dividend, a quarterly payment of $0.70 a share to begin in January. As well, the board committed another $5 billion to Allergan's share repurchase program.

Outlook: Not good. I suggest we keep hands off this sector for a while. Down the road there will be some buying opportunities but not until we get some clarity on what's going to happen in this new administration.

Action now: Sell.

iShares iBoxx $ High Yield Corporate Bond ETF (NYSE: HYG)

Originally recommended on Jan. 19/09 (#2903) at $75.99. Closed Friday at $86.49. (All figures in U.S. dollars.)

Background: This ETF is designed to track the performance of an index composed of high-yield, U.S. dollar denominated corporate bonds.

Performance: This high yield bond fund has had a nice move up since I updated it last January at $78.83. The units reached a high of $87.56 in October before pulling back to the current level.

Recent developments: The units continue to provide very good cash flow. Over the past 12 months, investors have received $4.32 per unit, which works out to a yield of 5.4% based on the closing price on Dec. 11, 2015.

Outlook: Normally a rise in interest rates would be bad news for bonds, however high yield issues (often referred to as junk bonds) are a different story. Higher interest rates equate with increased economic activity, which is a good sign for companies that issue this kind of debt. An improving economy reduces the probability of defaults or corporate restructuring and enhances profitability.

That doesn't mean this ETF is risk-free, far from it. But investors who are prepared to assume the risk are being well compensated by the strong cash flow. Also, the fund's effective duration (used to determine its sensitivity to rate changes) is short at 3.96 years.

Action now: Aggressive investors should Buy. This fund should do well under the Trump economic scenario as we understand it, and it offers excellent U.S. dollar cash flow.

- end Glenn Rogers

GORDON PAPE'S UPDATES

UnitedHealth Group Inc. (NYSE: UNH)

Originally recommended by Tom Slee on March 2/14 (#21409) at $76.01. Closed Friday at $160.12. (All figures in U.S. dollars.)

Background: UnitedHealth Group is one of the largest health care insurers in the U.S. It also provides information and technology-enabled health services through its Optum division.

Stock performance: The shares got a big lift after Donald Trump's election in anticipation of sweeping changes to the Affordable Care Act (Obamacare) that would benefit insurers. The stock hit a high of $162.52 on Dec. 2 before retreating a little to the current level.

Recent developments: The company reported strong third-quarter results on Oct. 18. Revenue came in at $46.3 billion, up 12% from the year before. Adjusted cash flow from operations was $3.4 billion, an increase of 22% year-over-year. Net earnings attributable to shareholders were $1.97 billion ($2.03 per share) compared to $1.6 billion ($1.65 per share) in the third quarter of 2015. That's an improvement of 23% on an earnings per share basis and beat analysts' estimates.

The results would have been even better had it not been for a $200 million loss due to policies written on public exchanges under Obamacare. Of that, $120 million was offset by a previously established deficiency reserve, while $80 million flowed through to the bottom line. The company announced earlier this year that it would withdraw from most of the exchange markets in 2017, a move that should give a boost to earnings next year.

Continued on page 6…

Building Wealth's The Internet Wealth Builder is published weekly by Gordon Pape Enterprises Ltd. All rights reserved.

Gordon Pape's updates – continued from page 5…

For the first nine months of 2016, revenue came in at $137.3 billion, up about 21% from $103.5 billion in the same period last year. Net earnings attributable to shareholders were $5.3 billion ($5.51 per share) compared to $4.6 billion ($4.75 per share) last year.

An improved outlook for the rest of this year buoyed investor optimism. Net earnings (using GAAP standards) are now expected to be about $7.45 per share, up from the previous guidance of $7.25-$7.40 per share.

"Our growth indicators are positive as we conclude 2016, and we expect to be well positioned in 2017 to better serve consumers and deliver more value to the health system overall," said CEO Stephen J. Hemsley.

Dividend: The current payment is $0.625 per quarter ($2.50 annually) for a yield of 1.6% at Friday's closing price. The company is also actively buying back its stock, with 8.8 million shares repurchased year-to-date for $1.1 billion, including $137 million in the third quarter.

Action now: The stock remains a Buy. I expect to see a dividend increase by the second quarter of next year as profitability improves with the company's almost total withdrawal from Obamacare.

Aecon Group (TSX: ARE, OTC: AEGXF)

Originally recommended by Tom Slee on Feb. 3/14 (#21405) at C$15.48, US$13.79. Closed Friday at C$15.24, US$11.39.

Background: Aecon is an infrastructure construction company whose credits (with predecessor companies) include the St. Lawrence Seaway, the CN Tower, and the Vancouver Sky Train.

Stock performance: I last reviewed this stock in March when it was trading at $15.4. I said at the time that the company's outlook had brightened and it would likely be a beneficiary of the Liberal government's infrastructure program. The shares reached a high of $19.19 in August but have since pulled back in the light of disappointing financial results.

Recent developments: Third-quarter figures were mixed. Revenue came in at $838 million, down by $37 million (4%) from the same period in 2015. However, net profit for the quarter was slightly higher at $27.4 million ($0.42 per share, fully diluted) compared to $25.6 million ($0.35 per share) a year ago.

For the first nine months of the year, revenue was almost $2.4 billion, up from just over $2 billion a year ago. However, profit was only $17.7 million ($0.29 per share), down from $21 million ($0.35 per share) in 2015.

"Lower demand from commodity and resource related sectors, delays in commitments to and approvals of new pipelines, the slower than anticipated roll out of new infrastructure investments, and the impacts of the Alberta wildfires, have all presented challenges through 2016 that we are overcoming through an increasing transition into market segments that provide significant opportunity and play to Aecon's strengths, namely power, transit, and water infrastructure," said then-CEO Ted McKibbon.

It what appeared to be a surprise move, Mr. McKibbon stepped down as CEO shortly after the results were released, with no immediate successor in place. Executive chairman John M. Beck, a former Aecon CEO, will temporarily take over while a committee of the board works to find a permanent replacement.

Dividend: The shares pay a quarterly dividend of $0.115 ($0.46 per year) to yield 3% at the current price.

Action now: Hold. New purchases are not advised at this time.

Badger Daylighting (TSX: BAD, OTC: BADFF)

Originally recommended on Nov. 23/14 (#21441) at C$32.77, US$27.72. Closed Friday at C$31.39, US$23.85.

Background: This Calgary-based company has developed a proprietary method for excavating, using pressurized water to liquefy soil, which is then removed with a vacuum system and deposited into a storage tank housed on specialized trucks. This method is especially useful in areas where there are extensive underground pipes and cables since it eliminates the danger of severing vital lines.

Stock performance: The share price fell all the way to $19.50 in May but turned around sharply when the company published good second quarter results. The stock has been on an uptrend since and is now trading above its 50-day and 200-day moving averages and close to our original recommended price.

Recent developments: The company released third-quarter results in mid-November. Revenue increased by 1.6% to $113.2 million from $111.4 million for the same quarter in 2015 thanks to improved growth in the non-oil and gas segment of the business.

Continued on page 7…

Building Wealth's The Internet Wealth Builder is published weekly by Gordon Pape Enterprises Ltd. All rights reserved.

Gordon Pape's updates – continued from page 6…

Cash flow from operations was $15 million in the quarter versus $20.7 million in 2015. On an adjusted basis, cash flow from operations was $20.5 million, which was comparable to $20.9 million in the same period of 2015.

Net profit for the quarter was $11.9 million ($0.32 per share), down from $17 million ($0.46 per share) a year ago. For the first nine months of the fiscal year, Badger reported a profit of $21.6 million ($0.58 per share), up from $18 million ($0.49 per share) in the same period of 2015.

The company said that about two-thirds of its revenue is coming from the U.S., which means it is benefitting from the exchange rate differential. Non-energy markets continue to grow in such fields as infrastructure and construction and Badger has been relocating its units to meet the changing conditions.

Outlook: Looking ahead, the company said it expects a general continuation of current trends for the remainder of 2016. Historically, the fourth quarter has seen a seasonal slowdown as construction slows due to the onset of winter weather in northern markets. However, as Badger continues to grow in the U.S., the company expects that the winter seasonal effect will lessen over time.

Dividend: The stock pays a monthly dividend of $0.033 per share ($0.396 per year) to yield 1.3% at the current price.

Lundin Mining Corp. (TSX: LUN, OTC: LUNMF)

Originally recommended by Tom Slee on July 14/14 (#21425) at C$6.27, US$5.75. Closed Friday at C$7.02, US$5.38.

Background: Lundin Mining is a diversified Canadian base metals mining company with operations in Chile, the USA, Portugal, and Sweden, primarily producing copper, nickel, and zinc. In addition, it holds a 24% equity stake in the world-class Tenke Fungurume copper/cobalt mine in the Democratic Republic of Congo (about to be sold) and in the Freeport Cobalt Oy business, which includes a cobalt refinery located in Kokkola, Finland.

Stock performance: Finally, investors have been rewarded for their patience. When we last reviewed the stock in February, it was trading in Toronto at $3.72, having been as low as $2.98 earlier that month. We advised investors with a long time horizon to hold on until base metals prices started to rise. Fortunately that has happened sooner than expected and the shares are now close to their highest level since 2011.

Recent developments: The company announced last month that it plans to sell its 24% position in the Tenke Fungurume copper/cobalt mine in the Congo to a Chinese group for $1.14 billion. The deal is expected to close in the first half of 2017. CEO Paul Conibear said it was a difficult decision but the deal "will enable Lundin Mining to advance its strategy to incrementally grow the company with projects and operations we control, while maintaining a strong balance sheet".

Third-quarter results showed a 6% increase in revenue over the year before, to $374.5 million. The company reported a loss for the quarter of $11.4 million ($0.02 per share), which was an improvement over a loss of $34.6 million ($0.05 per share) in the same period last year.

Subsequently, the company issued guidance calling for increased copper and zinc production over the next three years and lower costs in 2017 at its Candelaria and Neves-Corvo operations.

Dividend: The board of directors has approved Lundin's first-ever dividend, a quarterly payment of $0.03 per share ($0.12 per year) starting in January. The shares yield 1.7% at the current price.

Action now: Aggressive investors may Buy. Higher base metal prices should push up the share price further next year.

YOUR QUESTIONS

Rising interest rates

Q – If interest rates start to rise, what might be the impact on Enbridge? – Stephen B.

A – Enbridge is what we call an interest-sensitive stock. That means its price and yield tend to be affected by rate movements, up or down. Over the spring and summer, when interest rates were falling, the share price rose to a 52-week high of $59.19. The shares dropped back to below $55 after Donald Trump's election victory sparked concerns that interest rates would rise more quickly than expected, based on his economic stimulus plans. The shares have since recovered a little since but are still below their high for the year. Going forward, rising rates will have a downward affect on the stock, however that may be offset by other factors, such as a dividend increase. – G.P.

Building Wealth's The Internet Wealth Builder is published weekly by Gordon Pape Enterprises Ltd. All rights reserved.