Volume 24, Number 28 **Issue #21928** **July 29, 2019**

IN THIS ISSUE

NFI's woes	1
A challenging market	2
Buy short-term insurance	4
Gordon Pape's updates: Tata Motors, Sandstorm Gold Royalties, UnitedHealth Group, TFI International	5
Gavin Graham's updates: Vodafone	7
Your Questions: Investment dilemma; GIC coming due	7
Housekeeping	8

BUILDING WEALTH
The Internet Wealth Builder

Editor and Publisher: Gordon Pape
Associate Publisher: Richard N. Croft
Website: www.buildingwealth.ca
Copyright 2019 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.

No IWB next week.
Next issue:
Aug. 12

Customer Service:
1-888-287-8229

NFI'S WOES

By Gordon Pape, Editor and Publisher

NFI Group (formerly known as New Flyer) should be in the sweet spot of Canadian industry right now. The company builds energy-efficient buses that run on everything from natural gas to electricity.

Its products are in demand across North America as more municipalities opt for low emission or emission-free technology to meet mass transit demands.

But somehow, things aren't going right for this Winnipeg-based company. The stock (TSX: NFI) has been in free-fall for much of the past year, dropping from $52 last September to $30.94 on Friday, a loss of 40%. The dividend remains uncharged at $0.425 per quarter ($1.70 per year), providing an attractive yield of 5.5%. But the sharp decline in the share price has many investors worried.

So, what's happening? Earlier this month the company released its second-quarter report on deliveries, orders, and backlog and it offered some insights into the problems plaguing NFI.

The company revealed that deliveries of all products in the second quarter was down 11% year-over-year to 1,029 vehicles or, as the company refers to them, "equivalent units" (EU).

CEO Paul Sobrey blamed "New product launches, catch-up from ARBOC's chassis supply disruption, some internal and external supply delays, missed production days and postponed customer acceptance inspections." (ARBOC is the trademark for one line of NFI vehicles.)

He expressed confidence that deliveries would pick up in the second half, but the company adjusted its full-year guidance downwards. It now expects to deliver 4,260 EUs this year, a decrease of 150 EUs, or 3.4%, from previously reported expected deliveries

Second-quarter profits, to be released Aug. 13, will be impacted by the delivery slowdown.

Even more alarming is the dramatic drop in new orders, which are down 52% year-over-year from 6,303 (firm and options) in 2018 to 2,997 in the second quarter of this year. The company expects more bids in the second half but cautions that "the individual awards are expected to be smaller in size with fewer options or shorter contract terms as transit agencies develop plans for future battery-electric vehicle adoption".

Continued on page 2…

 All rights reserved.

NFI – continued from page 1…

Another worrisome sign is that the backlog is declining. At the end of the second quarter, NFI's total backlog was 9,997 EUs (valued at $4.82 billion) compared to 10,587 EUs (valued at $5.16 billion) at the end of the first quarter.

The company also reported problems with its new US$28 million KMG Fabrication plant in Kentucky, which makes parts and components. The operation has been slow to reach operational goals and the company has replaced top management and "deployed additional resources to improve operational execution and efficiencies". But NFI acknowledged that the Kentucky plant will be a drain on earnings until at least 2020.

All in all, it's a very discouraging picture of a company that should be doing much better. Perhaps management will get this sorted out, but the financial results for the rest of this year are not likely to offer reasons for optimism. The yield is very attractive, but the risk of a further decline in the share price is significant.

Action now: Sell. We recommended this stock in March 2013 at C$10.50, US$10.04. It closed Friday at C$30.94, US$23.73. We have a profit of 195% in Canadian dollar terms. The downside risk is greater than the upside potential at this stage, so it is time to ring the till.

Follow Gordon Pape on Twitter @GPUpdates and on Facebook at www.facebook.com/GordonPapeMoney

A CHALLENGING MARKET

By Richard Croft

In my last column, I talked about a market melt-up that could see the S&P 500 break the 3,000 level. It happened. The S&P 500 broke 3,000 on July 11 and stayed above that level until July 16. It briefly pulled back but then broke through that level again on July 23. It closed Friday at 3,025.86.

This represents new record highs for U.S. equities but not the panic updraft that would indicate a top. However, with the S&P 500 near all-time highs and not able to crack the 3,000 level with any conviction, we may see a pause after the July 30-31 U.S. Federal Reserve (Fed) meeting.

Here's what we know. On the positive side, the U.S. Administration is fixated on the performance of the stock market. That's good politically, because the President can link his economic agenda to the wealth created by a robust U.S. equity market. Those are powerful talking points during what looks to be a challenging run in 2020. Moreover, if going into 2020 the market is at all-time highs, President Trump can play the market sell-off fear card should poll results begin to favour the Democrats.

To further support higher stock prices, Trump has the ear of the Fed, whose rate cut initiative should provide short term support for equities. That is a positive unless you think the Fed knows something that market participants don't.

Currently, Fed members are echoing concerns that slowing global growth could morph into the U.S. economy. A potential rate cut could be an insurance policy to immunize the U.S. economy from being impacted by the global slowdown. To that end, I suspect the Fed will cut rates by 25 basis points (bps) at the end of July, which removes the 25 bps hike that occurred last December. I initially thought a July cut would be the beginning of a series of rate cuts but now I'm not so sure.

When you look at history, I cannot recall a time when slowing global growth caused the U.S. economy to slip into a recession. All past U.S. recessions were caused by domestic disruptions, not the result of external forces. Based on that thesis, we may not see further rate cuts unless the Fed falls prey to Trump's bully pulpit or the rate setting Federal Open Market Committee (FOMC) sees something domestically that investors don't.

On the surface, the U.S. economy is enjoying record low unemployment, rising wages, GDP expanding at close to 3%, and low inflation. The U.S. economy looks to be hitting on all cylinders. If you buy into the view that a U.S. recession is unlikely to be caused by external forces, then why stimulate economic activity? Especially when U.S. industry is awash in cash and financing is readily available based on the Financial Conditions Index (FCI), the abundance of stock buybacks, and a robust IPO market.

The FCI chart on the next page is provided by the St. Louis Federal Reserve. It illustrates the five most widely used financial conditions indexes and a volatility index. The indexes used include the St. Louis Fed Financial Stress Index (STLFSI), Chicago Fed National Financial Conditions Index (CNFCI), Bloomberg Financial Conditions Index (BFCI), Kansas City Financial Stress Index (KCFSI), Goldman Sachs Financial Conditions Index (GSFCI), and CBOE (Chicago Board Options Exchange) Volatility Index (VIXA).

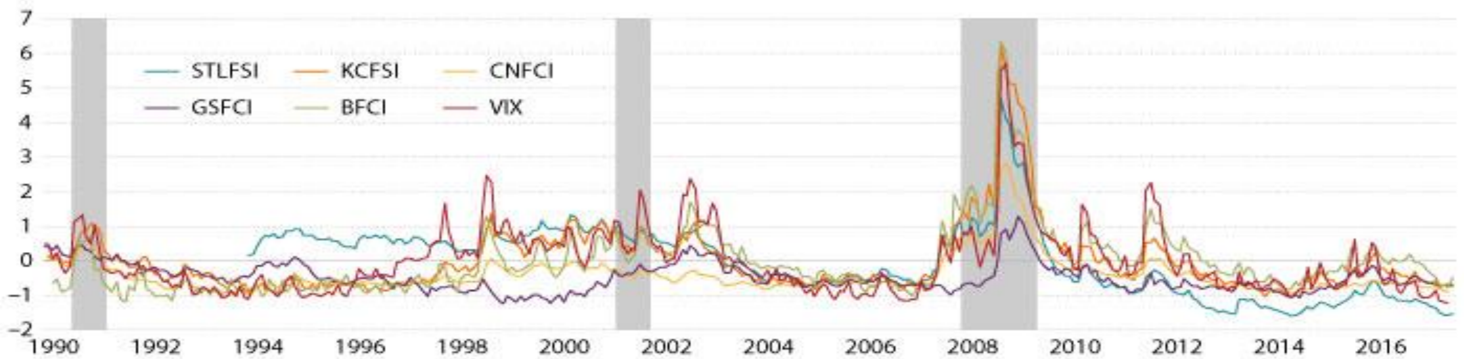
Continued on page 3…

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

Challenging – continued from page 2…

According to the St. Louis Fed, for comparative purposes, "each index is normalized by subtracting its respective mean and then dividing by its standard deviation, which transforms the data to the same scale and units." Although many financial conditions indexes incorporate the VIX, it is shown for comparison purposes only. The VIX is a measure of market expectations for near-term volatility conveyed by S&P 500 index option prices. It is used to gauge investors' tolerance for risk.

Within the FCI, deviations above zero signify financial markets are tightening – heightened stress – while deviations below zero signify financial markets are loosening. Financial markets began to tighten in 2007 before the Great Recession and peaked mid-recession. Given that all the FCI components are in negative territory and nothing stands out from the economic data, I must assume that the Fed is being jawboned into action by Trump's twitter feed.



More disconcerting is the fact that U.S. equity markets, as they often do, overreact. Markets are pricing in (23% probability) rate cuts equalling 50 bps with a 98% probability of a 25 bps cut in July. While more difficult to measure, it also appears that markets believe the Fed will provide a put option for U.S. equity investors. They may be right but providing a foundation for the market to rise without any fundamental underpinning will cause significant pain when the music stops. And with the Fed funds rate at current levels, there is little room to maneuver should the need arise.

Investor sentiment

Another metric posited by bulls is investor sentiment. Viewed as a contrarian indicator, investor anxiety typically propels stocks higher. Analysts argue, correctly, that bull markets typically climb a wall of worry and, based on investor sentiment, there is more than enough anxiety to go around. Bull markets rarely end when we see high levels of negative sentiment but rather bulls capitulate when investors' fear gauge is muted.

Continued on page 4…

CBOE Volatility Index

Chart provided by TradingView

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

Challenging – continued from page 3…

Normally, I would agree with that point of view. However, I'm not convinced that the fear level is as high as many would have you believe. While the VIX at 14.45 is not an extreme reading, it has been trending lower as the market has risen. By no stretch is the VIX indicating the enhanced level of fear that other sentiment indicators are portraying.

I would be more sanguine if the market were not near all-time highs. But the VIX suggests to me that we could experience a sharp move either up or down over the short term (i.e. one or two months). An up move would fall within my melt-up scenario, discussed in my last article. Should we experience that scenario, it would be time to take some chips off the table.

The other scenario, which is equally likely, would see the markets sell off following the rate cut. My anticipated 25 bps cut may disappoint, which could dampen investor resolve leading to profit taking. A 50 bps cut would initially result in a sharp upward trajectory (the melt-up scenario). Then, as investors digest the implications, they may question what the Fed knows.

Like I said, this market is hard to read. Readers who bought the S&P 500 March 292 calls should hold the position until we see whether the Fed cuts rates at the end of July. I would look to exit the position should the market rally on the back of a rate cut. We can always re-enter the position later. But at this stage, your pocketbook would be well served by reducing risk.

BUY SHORT-TERM INSURANCE

Based on my concerns, I would look to buy some short-term insurance for your portfolio. My approach would be to take a small position in the iPath Series B S&P 500 VIX Short-Term Futures ETN (NYSE: VXX, price US$21.64). VXX provides exposure to a daily rolling long position in the first and second month VIX futures contracts and reflects views of the future direction of the VIX index at the time of expiration of the VIX futures contracts comprising the Index. Bottom line, it is the easiest way to replicate the short-term performance of VIX.

Some words of caution are required. VXX is a complex short-term trading vehicle. It is six times more volatile than the S&P 500 index, often experiencing 2% to 5% daily price swings. This is not a long-term hold and you should look to exit the position once we see the market's reaction to the July 31 rate decision.

Continued on page 5…

Chart provided by TradingView

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

Insurance – continued from page 4…

Because it is so volatile, a small amount of VXX can provide short term protection for your U.S. equity exposure. If your portfolio is split 50-50 between equities and bonds, we are only trying to protect some of the equity exposure.

If we also assume that 50% of your equity exposure is invested in U.S. stocks, that would translate into 25% portfolio exposure to U.S. equities. In that scenario, you would only need a 3% to 4% position in VXX to provide some protection for your U.S. assets.

Think of VXX as short-term insurance. If U.S. equities rally after the rate cut, VXX will decline in value. That doesn't necessarily mean your portfolio would be down, as your U.S. assets should rally along with the market. If the market sells off after the rate cut, VXX should rise in value, offsetting some or perhaps all, the losses in your U.S. equity position.

Richard Croft has been in the investment business for more than 40 years and is the founder of R.N. Croft Financial Group. As a global portfolio manager and option specialist, his focus is helping investors clarify their goals and risk tolerances, leading to an appropriate risk-adjusted portfolio. He can be contacted at rcroft@croftgroup.com.

GORDON PAPE'S UPDATES

Tata Motors (NYSE: TTM)

Originally recommended on May 29/17 (#21721) at $37.07. Closed Friday at $10.57.

Background: Tata is India's largest car manufacturer and also owns Jaguar Land Rover. The shares trade on the New York Stock Exchange as American Depository Receipts (ADRs).

Performance: This is not a pretty picture. The stock appeared to have broken out of its long slump in April when it rebounded to over $17 but then it hit the skids again and is now trading near its 52-week low.

Recent developments: First-quarter 2020 results (to June 30) came in much worse than analysts' expectations. The company lost almost 37 billion rupees (US$535.9 million), compared to a loss of 19 billion rupees in the same period last year. Revenue fell 7.7%.

The company said the domestic auto market in India has declined "sharply and significantly". Reuters reported this is due to a credit squeeze in the country plus higher insurance costs. Management said the focus is now on doing what it can to protect "the long-term success" of the business.

When I first recommended the stock in May 2017, I warned it would not be a big profit maker immediately and advised patience and a long time horizon.

Patience is a good discipline most times but here we're facing some significant and potentially long-lasting problems. The size of the losses has stunned even close observers of the company and there is no indication of any relief on the horizon.

Action now: Take your loss and sell. The company may emerge as a winner in the future but for now this is dead money.

Sandstorm Gold Royalties (TSX: SSL, AMEX: SAND)

Originally recommended on Aug. 8/16 (#21629) at C$7.60, US$5.77. Closed Friday at C$8.48, US$6.45.

Background: Sandstorm is a gold royalty company that provides upfront financing to mining companies that are looking for capital. In return, it receives the right to a percentage of the gold produced from a mine, for the life of the mine. The business concept is similar to that of Franco-Nevada, but on a smaller scale.

Performance: I recommended this stock August 2016 as a Buy for aggressive investors at C$7.60. It did not do well initially, falling as low as $3.18 at one point. However, gold prices have firmed, and this stock has rebounded. It has been especially strong in the past two weeks.

Recent developments: The company's first-quarter results weren't impressive. Sandstorm sold 14,071 gold equivalent ounces (GEO) in the quarter, down from 14,685 in the same period the year before. Revenue was $18.2 million, down from $19.5 million in 2018 (note that the company reports in U.S. currency). Despite this, net income increased to $2.5 million from $0.4 million in the prior year. This was partly due to certain non-recurring items that were recognized during the first quarter of 2018, including a $4.5 million non-cash impairment charge relating to the Gualcamayo royalty. Other factors impacting the increase in net income included a $1.2 million gain on the revaluation of the company's investments.

The overall impact of the results was a big shrug. The share price didn't twitch.

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…

So, what happened to drive up the stock this month? A one-sentence press release announcing that Sandstrom had sold a record 16,400 gold equivalent ounces during the second quarter. That's almost 17% more than in the first quarter, at a time when gold prices were at their highest level since 2013.

The impact of this on the bottom line won't be known until the company releases second-quarter results, expected shortly.

Acquisition: In January, the company spent $32.8 million to acquire a 0.9% net smelter returns royalty on the precious metals produced from the Fruta del Norte gold project in Ecuador, which is currently under construction and owned by Lundin Gold Inc. The royalty covers a land package of more than 644 square kilometres in size, including all 30 mining concessions held by Lundin Gold.

Buybacks: The stock does not pay a dividend, but the company has an active buyback program which entitles it to repurchase up to 18.3 million shares. Since last fall, 7.9 million shares have been bought. There are 178.5 million outstanding shares.

Action now: Hold. The company is showing progress, but the p/e ratio is very high at this price level. For aggressive investors only.

UnitedHealth Group Inc. (NYSE: UNH)

Originally recommended by Tom Slee on March 2/14 (#21409) at $76.01. Closed Friday at $252.94. (All figures in U.S. dollars.)

Background: UnitedHealth Group is one of the largest health care insurers in the U.S., serving more than 140 million people globally, across all its business lines. It also provides information and technology-enabled health services through its Optum division. The company employs some 320,000 people.

Performance: The stock hit a 52-week low in the $219 range in March but has rebounded strongly since on the strength of good financial results.

Recent developments: UnitedHealth released second-quarter results earlier this month that beat expectations. Among the key take-aways:

- Total revenues of $60.6 billion grew 8% year-over-year.
- Earnings from operations increased 13% to $4.7 billion.
- Net earnings of $3.42 per share grew 15% year-over-year.
- Adjusted net earnings of $3.60 per share grew 15% year-over-year.
- Return on equity in the quarter was 25.1%.

Strong growth in policy coverage helped to fuel the big revenue increase. The company said that it is serving 615,000 more people with commercial benefits than at this time last year.

The bottom line was boosted by a 110 basis points improvement in the operating cost ratio, to 13.9%. The company said this reflected the deferral of the health insurance tax and continued effects of productivity advances and operating cost management disciplines.

Based on the strong first half results and confidence in the remainder of the year, the company increased its full year net earnings outlook to $13.95 to $14.15 per share, and adjusted net earnings to $14.70 to $14.90 per share.

Dividend and buybacks: The dividend increased by 20% in June to $1.08 per quarter ($4.32 per year). The stock yields 1.7% at the current price. For investors who bought at the time of our original recommendation, the yield is an impressive 5.7%.

The company continues to aggressively buy back stock. In the second quarter, 6.4 million shares were repurchased for $1.5 billion, bringing year-to-date purchases to 18.2 million shares for $4.5 billion.

Action now: Buy.

TFI International Inc. (TSX: TFII, OTC: TFIFF)

Originally recommended by Tom Slee on June 11/12 (#21220) at C$17.49, US$17.06. Closed Friday at C$40.37, US$30.67.

Background: This company is a North American leader in the transportation and logistics industry. It operates across Canada, the United States, and Mexico offering package and courier service, truckload and less than truckload haulage, logistics, and other services.

Performance: Last October I recommended selling half your position at $42.46 for a profit of 143%. Since then the stock has traded as low as $33.36 but in the past few months the shares have risen and are now above the $40 range.

Recent developments: Last week, the company released second quarter results that were in line with analysts' projections. Revenue was up slightly to $1.34

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…

billion. Adjusted net income from continuing operations was $102 million ($1.18 per share) compared to $89.9 million ($0.99 per share) in the same period last year.

For the first half of fiscal 2019, TIF reported adjusted net income from continuing operations of $160.1 million ($1.94 per share), up from $140.3 million ($1.54 per share). CEO Alain Bedard said the results set new quarterly records "even during challenging freight environments".

Dividend and buybacks: The stock pays a quarterly dividend of $0.24 per share ($0.96 annually) to yield 2.4% at the current price.

The company announced an amendment to its normal course issuer bid (the technical term for share buybacks) that allows it to purchase up to seven million shares for cancellation until Oct. 1. The previous maximum was six million. As of June 30, the company had repurchased 5.6 million shares under the bid at an average cost of $39.72 per share.

Action now: Buy. The company has momentum working in its favour.

GAVIN GRAHAM'S UPDATES

Vodafone (NDQ: VOD)

Originally recommended by Gavin Graham on Sept. 19/16 at $28.99. Closed Friday at $18.25. (All figures in U.S. dollars unless otherwise stated.)

Background: Vodafone is one of the largest telecom companies in the world with over 400 million subscribers, the majority of which are mobile customers. It is one of the three largest mobile operators in Europe, the Middle East, and South Africa, and has a potential 140 million households in Europe as potential customers for its bundled offering.

Performance: Despite the potential benefits of the recent acquisition of Liberty Global's European operations, investor sentiment has soured on the additional debt being taken on. Vodafone is down 32% since July last year and is selling near a five-year low.

Recent developments: Vodafone showed declining revenue in fiscal 2019 (year ending March 31), with group revenue coming in at €46.7 billion, down 6.2% from the fiscal 2018. The company was €7.6 billion (€0.2905) in the red for the 12 months, primarily due to writing down its stake in Vodafone India after completing the merger with Idea Cellular.

Vodafone reported a fractional increase of 0.3% in organic service revenue but said it was held back by increased competition in Italy and Spain and what the company described as "headwinds" in South Africa.

Dividend: The company paid dividends totaling $1.009 in the 2019 fiscal year. However, it cut its dividend by 40% in May.

Action now: The acquisitions from Liberty Global should be transformative over the longer term, but in the short term, the additional cost has led to concerns over the sustainability of the dividend. New management, led by CEO Nick Read, may reset the dividend to a more appropriate level. It's time to take our losses on this one. Sell.

YOUR QUESTIONS

Investment dilemma

Q - My husband and I would like your advice. We invested in the stock market in 2008 when we were in our late 20s and make a little money. Then, about four years ago, we rolled some of that money into buying a small four-unit apartment building that has been working out well for us. The apartment building covers its costs and is starting to make a small income.

Our five-year mortgage term is up next year and our financial planner has suggested we take out our initial investment ($30,000) and put it towards something else. We are wondering what our smartest course is:

1. Leave it in the building and try and pay down the mortgage faster so we can have more income.

2. Take out the $30,000 and put it on our home

Continued on page 8…

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

Your questions – continued from page 7…

mortgage (we have about $120,000 left on our mortgage – currently making regular small extra payments on principal).
3. Take the $30,000 and look to invest it in something else that would generate a passive income.

We are in our late 30s with two young children. We have no debt beside mortgages, have built up RRSPs, will have two defined benefit pensions and have relatively healthy RESPs set up for our girls. We have worked hard to get to this position and don't want to miss an opportunity but also don't want to make a misstep! Any advice would be appreciated! – Allison M.

A - For starters, make sure the financial planner does not have a vested interest in your decision. If he's a fee-for-service advisor, no problem. But if he sells products, like stocks and mutual funds, he may be looking to add to his commissions. Ask the question.

The safest route is paying down the mortgage. Whether it's on your home or the apartment building depends in part on the rate you are being charged for each. But you should keep in mind that interest on the rental loan is tax deductible whereas interest on your residence is not. All things being more-or-less equal, I would pay down the home mortgage first.

Investing the money may earn you a better return but it raises your risk exposure considerably. Only you can decide if that's a gamble worth taking.

Bottom line, I'd opt for a mortgage paydown. But then I'm a very conservative person. – G.P.

GIC coming due

Q - I have a $35,000 one-year BMO GIC coming due this month. I owe lots of shares in different companies, but I am enjoying the security associated with my GIC. I would like to purchase a two-year this time. What do you suggest?

Also, I am thinking, maybe, of putting some of that money in a Vanguard ETF. I am looking at their Growth ETF. Which one do you think is best? – Kathie S.

A - We're talking apples and oranges here – the safety and low return of a GIC or the risk but potentially higher return of a stock ETF. Before you make any decision, you need to decide on your priorities.

For GICs, you won't get much of a return at any of the big banks. BMO is currently offering 1.6% on a two-year investment. You'll find much better returns small institutions like Oaken Financial (2.85%) or EQ Bank (2.65%). Both are CDIC insured.

If you want to invest in an ETF there are lots of good ones around. The Vanguard Growth ETF Portfolio (TSX: VGRO) is very new (launched in January 2018) and has an unimpressive one-year return of 4.4% (to June 30). By contrast, the BMO Low Volatility Canadian Equity ETF (TSX: ZLB) posted a gain of 11.75% over the same period. – G.P.

HOUSEKEEPING

The following securities have been deleted from our on-line Recommended List. Sell advisories were issued some time ago so this notice is for record-keeping purposes only.

Merus Labs International. Recommended March 30/15 by Ryan Irvine at $2.72. Sold May 15/17 at $1.62.

Parex Resources. Recommended July 28/13 by Ryan Irvine at $5.38. Sold May 11/15 at $9.65.

Polaris Minerals. Recommended April 30/07 by Irwin Michael at $9.90. Sold May 30/16 at $1.35.

Silver Wheaton. Recommended Sept. 19/10 by Gordon Pape at $25.75. Sold July 20/15 at $17.78.

The Caldwell Partners International. Recommended Feb. 24/13 by Ryan Irvine at $1.04. Sold Aug. 22/16 at $1.16.

Westport Innovations. Recommended June 17/12 by Glenn Rogers at $29.70. Sold Oct. 27/14 at $6.63.

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