The Internet Wealth Builder

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HARNESSING THE POWER OF DIVIDEND GROWTH

By Adam Mayers, Contributing Editor

Over the last decade, as interest rates have fallen, dividend-paying stocks have proven why they deserve a place at the heart of all balanced portfolios.

The trend of rate cuts continued this year – and more may be in store. A third of all global sovereign bonds now yield less than zero, which means that at maturity you get back less than you paid. Not much of a deal!

So, it is impossible to generate adequate income without a portfolio that includes high-quality stocks to offset the diminishing returns of bond holdings.

But how to choose and what to look for?

The fact that a company pays a dividend is a good sign. It says it is financially stable. If the payments go back far enough, it tells you which downdrafts the company has weathered. Since the decision to pay a dividend is made at the beginning of the year, before the money has been made, management's decision to set the funds aside means it has confidence in its business.

But while a high dividend yield is often a good sign of quality, that's not always the case and it is not the only reason to buy a stock.

Dividend yield is calculated by dividing a company's annual dividend payment by its share price and, while a high yield means more in your pocket, it can sometimes be a warning. It may indicate a company's share price has fallen, which pushes the yield up. The decline in share price may be due to business conditions and could be a sign that investors believe the dividend will be cut.

Some recent examples of cuts include Torstar, which publishes the Toronto Star. In October, it suspended its dividend. Mighty General Electric cut its dividend twice in 2018 and now pays a penny a share per quarter. Vodafone, the British telecom giant cut its dividend by 40% in May. All three are going concerns, but all face business challenges and need the cash for their operations. The yields on their stocks approached double digits before they were cut.

So, it pays to dig a little deeper and keep an eye on things beyond the yield. These include:

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BUILDING WEALTH

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- What portion of profits does the company pay out? This is known as its payout ratio.
- How often is the dividend increased?
- By how much on average is it increased?
- How sustainable is the payment if conditions change?

One of my favourite stocks (updated last month) is McDonald's Corp. (NYSE: MCD), a dividend and performance champion. McDonald's ticks all four boxes.

Its payout ratio has been between 48% and 72% for the past decade and is currently at 61%. This means McDonald's is paying 61% of its profits to shareholders and retaining the rest for investment in its business. Should profits fall, it has a cushion that will allow it to keep paying the dividend.

McDonald's has increased its dividend in each of the last 10 years by an average of 8.9% a year. If that growth stays the same, it means its dividend will double on average every eight years. That's quite a payday.

When it comes to sustainability, McDonald's has raised its dividend every year for the past 42 years. That means it has done so through every big market event, from the crash of '87, through the dotcom collapse in 2000, and the 2008 financial crisis.

CAE (TSX, NYSE: CAE), the Montreal-based global flight simulator and pilot training company, is another favourite and an IWB recommended stock. It has a current yield of 1.23% and a payout ratio of 33% based on its trailing 12 months earnings. The payout ratio is much lower than McDonald's because CAE is a growth stock and reinvests more of its profits back into its business.

On the other hand, CAE's average annual dividend increases over the last 10 years are better than McDonald's, at 13.6% a year. That indicates CAE is unlikely to cut its dividend any time soon.

If you don't need the income and reinvest the growing stream of dividends through Dividend Reinvestment Plans (DRIPs), your returns are supercharged. That's because you receive dividends on dividends, a compounding power that Albert Einstein once called the Eighth Wonder of the World.

An analysis a few years ago by Guinness Atkinson Funds in the U.K. suggested that dividends provide between 30% and 40% of investment gains in the short and medium term. Guinness Atkinson reviewed the total returns of all the companies in the S&P 500 Index from 1940 through 2012. It found that for an average holding period of one year, dividends accounted for 27% of total returns. Over three years, they accounted for 38% of returns. After five years it was 42%.

The study pointed out that many non-dividend-paying stocks are also excellent performers and there is no one size fits all.

At a recent Mindpath conference for investment advisors, Sri Iyer, Head of Equities for Guardian Capital Group, talked about Guardian's filtering software, which screens for high dividend payers with the highest sustainability factor.

Guardian manages a dividend ETF for Horizon Funds, which we will look at more closely below. Among his favourite dividend champs: McDonald's, Apple (NDQ: APPL), Costco (NDQ: COST), ADP (NDQ: ADP), and Mastercard (NYSE: MA)

Mr. Iyer rated Canada's banks and insurance companies as very strong with sustainable payments and singled out the Royal Bank as his top pick.

This doesn't mean the other banks are bad bets. The Big Five and their predecessors have a dividend track record that goes back more than 150 years. Bank of Montreal (TSX, NYSE: BMO) began paying dividends in 1829 and BMO Financial Group is the longest-running dividend-paying company in Canada, paying out 40% to 50% of its earnings in dividends over time.

The Bank of Nova Scotia (TSX, NYSE: BNS) followed in 1832. TD (TSX, NYSE: TD) has paid dividends since 1857, the CIBC (TSX, NYSE: CM) since 1868, and Royal Bank (TSX, NYSE: RY) since 1870.

The Guardian Capital model sees a higher probability that European telecoms may cut their dividends as growth slows. Mr. Iyer sees a similar risk for some higher yielding U.S. based mortgage backed securities. That doesn't mean it will happen.

"A higher probability just means that the risk is growing," he said.

There are many Canadian dividend funds. They tend to be weighted towards Canadian banks and utilities. The two below have a U.S. and international focus, which adds diversification, and hold many well-known multinational names. The components of both have good current yields, hold companies with a history of dividend increases, and have strong sustainability scores. When conditions change they are likely to fall least and recover first.

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ADAM MAYERS RECOMMENDS TWO ETFS

Horizons Active Global Dividend ETF (TSX: HAZ)

Closed Friday at $23.54.

Background: This actively managed ETF aims to provide regular dividend income and modest long-term capital growth by investing in some of the world's best dividend paying stocks. It is sub-advised by Guardian Capital.

Guardian looks at three fundamental drivers in making its selections: dividend growth, payout ratio, and sustainability of the payout.

Performance: The ETF has a current annual yield of 2.19%. The ETF's total return year-to-date is 19.87%. The three-year average annual total return is 8.94% and the five-year is 9.51%, according to Morningstar Research.

It has performed well against its peers. Year-to-date, the fund is ranked 31st out of 1,654 similar funds. It had similar top 10% ranking between 2016 and 2018.

Holdings: The holdings are dominated by U.S. companies and many are IWB favourites. Geographically, 77% of the stocks are in the U.S. and 7% are Canadian. Another 15% are in Europe and 1% are in Australia.

The holdings are widely diversified over 11 sectors, with no one area more than 15%, or less than 5%. The largest sectors are consumer defensive (15%), followed by industrials (14%) and financial services (13%).

The top five holdings are Microsoft, Mastercard, Nestle, McDonald's, and Medical Properties Trust. The Royal Bank is among its top 10.

Mr. Iyer said Guardian is playing a long game with this fund, with blue-chip global brand power. The ETF offers good capital gain potential as well as a steady stream of income.

Key metrics: The fund was launched in 2010, has $185.1 million in assets under management, and comes with a management fee of 0.65%.

Action now: Buy.

iShares Core Dividend Growth ETF (NYSE: DGRO)

Closed Friday at $41.26. All figures in U.S. dollars.

Background: The iShares Core Dividend Growth ETF tracks an index of U.S. companies only. The companies have a history of sustained dividend growth and are broadly diversified.

This ETF is designed as a core holding for income seekers.

Performance: Year-to-date, the ETF's total return is 25.8%. The three-year average annual total return is 14.96% and the five-year return is 11.97%. The ETF has a trailing 12-month yield of 2.29%.

It has also performed well against its peers. Year-to-date, it is ranked 9th of 1,215 similar funds. It had a similar ranking between 2016 and 2018.

Holdings: The holdings are more weighted towards banks, financial services, and healthcare, rather than consumer defensive and industrials, which is the Horizons ETF model.

The top sectors are financial services (21%) and healthcare (13%), followed by industrials, technology, and consumer defensive at 10% each.

The top five holdings are Apple, Microsoft, JPMorgan Chase, Johnson & Johnson, and Chevron. The first four are IWB recommended U.S. stocks.

Key metrics: The ETF was launched in 2014 and has $9.4 billion in assets. The management fee is 0.08%.

Action now: Buy.

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ADAM MAYERS'S UPDATES

Medtronic Inc. (NYSE: MDT)

Originally recommended June 10/19 (#21922) at $97.11 Closed Friday at $111.39. (All figures in U.S. dollars.)

Background: Medtronic is the world's largest medical device company with a market capitalization of $150.75 billion. It was founded in Minnesota in 1949 and gets 60% of its sales and profits outside the U.S. It employs 86,000 people, of which more than 10% are research scientists. This ensures a steady stream of new products.

Medtronic operates in four segments. Heart management devices, such as pacemakers, make up 38% of sales. Stapling, wound closure products, and imaging devices are another 29%. Robots, implants, and tools for things relating to the musculoskeletal system and brain are 26%. The remaining 7% is from the diabetes group which makes insulin pumps and other consumables.

Performance: Medtronic shares are up 15.8% since being recommended in June and have increased 36.4% year-to-date.

Recent developments: Medtronic's second quarter earnings, released Nov. 19, beat analysts' expectations. The bottom line was boosted by strong performance in its unit that makes surgical instruments.

Medtronic has been beefing up this part of its operations through acquisitions. In May, it bought Titan Spine Inc., a privately held company that makes titanium spacers that are inserted between the vertebrae during spinal fusion surgery. The purchase complements the acquisition of Mazor Robotics at the end of 2018. Mazor is an Israeli specialist in robot-assisted spinal surgery, which is a safer, less invasive, and precise alternative to the traditional open spine surgery.

Net sales for the quarter rose 3% to $7.71 billion, beating estimates of $7.66 billion. Excluding extraordinary items, the company earned $1.31 per share, topping the average estimate of $1.28.

Dividend: Medtronic raised its dividend with the July payment to $2.16 annually. It is the 42nd year in a row of dividend increases. The new rate yields 1.94% at current prices.

Key metrics: Medtronic's strong performance has pushed up its trailing 12-month p/e ratio to a lofty 31.9. That means high expectations are built into its share price. Part of that confidence is based on the fact that Medtronic has a 14-quarter string of upside earnings surprises.

Outlook: Medtronic continues to grow organically and its investment in R&D through its scientific staff is a hidden asset.

It continues to benefit from the trends of first world aging and emerging market growth. These tailwinds are raising sales and profits and offer investors rising dividends, safety, and growth.

Action now: Buy for long term gains.

Brookfield Renewable Partners (TSX: BEP.UN, NYSE: BEP)

Originally recommended on March 18/19 (#21911) at C$41.80, US$31.35. Closed Friday at C$61.96, US$46.45.

Background: Brookfield Renewable Partners is one of the world's largest publicly-traded renewable power companies with operations in 30 countries where it owns hydro, solar, and wind generating facilities. It continues to expand, adding generating power in North America, China, India, and other emerging markets.

Performance: The stock has taken off in recent weeks and is up $13.42 from my last review in August when I rated it as a Buy at $48.54.

Recent developments: On Nov. 11, Brookfield Renewables announced it is following the lead of its stablemate, Brookfield Infrastructure Partnership, in creating a new Canadian company, to be known as Brookfield Renewable Corporation (BEPC). The existing partnership will distribute one class A share of BEPC for every four units currently held – effectively a tax-free share split. The new company will be listed on the Toronto and New York stock exchanges. Brookfield expects to complete the process in the first half of 2020.

The class A shares will be structured with the intention of providing an economic return equivalent to the partnership units, including identical distributions, and will be exchangeable, at the shareholder's option, for one BEP unit.

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One significant advantage for Canadians is that the dividends from BEPC will be eligible for the dividend tax credit if the shares are held in a non-registered account.

The unit price had been moving higher prior to the announcement, perhaps in anticipation that Brookfield Renewables was going to go the same route as Brookfield Infrastructure. They continued to rise after the announcement was made.

Action now: Hold. This is good news, but the big run-up in the share price suggests we should pause and see how this all shakes out.

MORE 2019 WINNERS

By Gordon Pape, Editor and Publisher

Two weeks ago, I looked at five of our recommendations that beat the performance of the major stock indexes this year. Here are five more winners. Prices are as of mid-day on Nov. 28.

Firan Technology Group Corporation (TSX: FTG, OTC: FTGFF). This little-known small-cap company was recommended by contributing editor Ryan Irvine in late 2015. It is a global supplier of aerospace and defense electronic products and subsystems, with facilities in Canada, the United States, and China. The company reported strong third-quarter results, with sales up 12% year-over-year and net income up 176% compared to the same period in 2018. The stock ended last year at $2.11 and is now at $3.72, for a year-to-date gain of 76.3%.

Descartes Systems Group (TSX: DSG, NDQ: DSGX). The U.S.-China trade war has caused a lot of grief to farmers, manufacturers, and consumers, but not everyone has been a loser. Descartes provides businesses with up-to-the-minute software to facilitate customs clearance, tariff calculations, and all the other details importers and exporters have to deal with these days. The stock ended 2018 at $36.03. It has been on the rise all year and is currently at $57.23 for a year-to-date gain of 58.8%.

Agnico Eagle Mines (TSX, NYSE: AEM). Despite its recent pull-back, this has been a good year for gold and for most mining stocks. This recommendation from contributing editor Gavin Graham has been one of the leaders. It finished 2018 at $55.10 and is now at $77.83, for a gain of 41.3%.

Intact Financial Corporation (TSX: IFC, OTC: IFCZF). Intact is Canada's largest property and casualty insurer, covering one in five Canadians. It was originally recommended by retired contributing editor Tom Slee in 2012. The company has enjoyed a good year, with third-quarter net operating income of $1.91 per share, up 18% from last year. The shares ended 2018 at $97.31 and now trade at $137.71 for a year-to-date gain of 42.8%.

CGI Group (TSX: GIB.A, NYSE: GIB). Ask most Canadians what this company does, and they'll shrug. Savvy investors know about it, however. Montreal-based CGI is one of the largest consulting firms in the world and its share price has been steadily rising for several years. The stock finished 2018 at $83.50 in Toronto and was trading at $110.58 at the time of writing, for a year-to-date gain of 32.3%. More details in an update elsewhere in this issue.

GORDON PAPE'S UPDATES

Brookfield Asset Management (TSX: BAM.A, NYSE: BAM)

Originally recommended on April 6/97 (#9713) at C$4.09 (split-adjusted). Closed Friday at C$76.85, US$58.41.

Background: Brookfield Asset Management has more than 100 years of history of owning and operating assets with a focus on real estate, renewable energy, infrastructure, and private equity. Total global assets under management are worth $385 billion.

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Performance: The stock continues to act more like a high-tech start-up than a well-established conglomerate. The shares are up more than 45% so far this year.

Recent developments: The company reported third-quarter net income of almost $1.8 billion ($0.91 a share) compared to $941 million ($0.11 a share) last year (the company reports in U.S. dollars). The big jump in quarterly results was due in part to new acquisitions coming on stream and a deferred tax recovery.

For the first nine months of the fiscal year, earnings were $6.7 billion ($3.73 a share), up from $6.5 billion ($2.56 a share) in 2018.

The major development of the quarter was the acquisition of a 61.2% interest in Oaktree Capital Management. Oaktree is a global investment manager specializing in alternative investments. It had $120 billion in assets under management as of June 30. The firm emphasizes an opportunistic, value-oriented and risk-controlled approach to investments in credit, private equity, real assets, and listed equities. It has over 950 employees and offices in 18 cities worldwide.

The acquisition brings Brookfield's total assets under management to over $500 billion.

What others say: In a research note., RBC Capital Markets called the Oaktree deal "highly complementary" to Brookfield's business and said it "serves to enhance BAM's overall Asset Management franchise value". The firm raised its target price on Brookfield's shares to US$63 (about C$83) from US$57. It rates the stock as "Outperform".

Dividend: The quarterly dividend is US$0.16 per share (US$0.64 a year) to yield 1.1% at the current price.

Action now: Buy for long-term growth.

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$8.89, US$6.73.

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: Gold has been trading in a narrow range in recent weeks, but good third-quarter results pushed up the price of the stock to an all-time high of $9.47, before it pulled back to the current level.

Recent developments: Sandstorm recently reported record third-quarter results. The company sold 17,289 gold equivalent ounces (GEO) in the quarter, up more than 20% from the same period a year ago. The average cash cost per GEO was $288, resulting in cash operating margins of $1,203 per ounce. The comparable operating margin last year was $960. (Note that the company reports in U.S. dollars.)

Revenue was $25.8 million, a 49% year-over-year advance. Earnings were $6.2 million, up from $2.1 million in the same period last year. The big jump was driven partially by an increase in gold prices and by a $2 million increase in gains recognized on the revaluation of the company's investments.

The company said it expects to sell between 63,000 and 70,000 GEO this year. Management forecasts this will rise to 140,000 ounces in 2023.

Dividend and buybacks: Sandstorm does not pay a dividend. However, the company has been buying back shares under a normal course issuer bid. During the third quarter, 2.4 million shares were purchased and cancelled.

Outlook: The company expects to double its sales by 2023. If the price of gold holds at current levels or moves higher, the effect will be a huge boost to the bottom line, which should be reflected in the share price.

Action now: Buy.

CGI Group (TSX: GIB.A, NYSE: GIB)

Originally recommended on Aug. 19/12 at C$24.42, US$24.66. Closed Friday at C$110.07, US$83.14.

Background: Montreal-based CGI is the one of the largest independent information technology and business process services firm in the world. The company delivers an end-to-end portfolio of

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capabilities, from IT and business consulting to systems integration, outsourcing services and intellectual property solutions. It employs about 77,500 professionals in offices and delivery centres across the Americas, Europe, and the Asia Pacific region. It reported revenue of $12.1 billion in fiscal 2019.

Performance: The stock continues to move up and touched an all-time high of $109.77 this month.

Recent developments: The company reported impressive fourth-quarter and full-year fiscal 2019 results (to Sept. 30).

For the quarter, revenue was a touch under $3 billion, up 5.7% from the same period last year or 7.7% in constant currency terms. For the full year, revenue was $12.1 billion, a 5.3% year-over-year jump (5.9% in constant currency).

One of the driving forces in the revenue jump was the acquisition last April of Acando, an IT management and consulting services firm in Northern Europe and Germany. The acquisition added more than 2,100 consultants from five countries across Europe, notably in the major metro markets of Stockholm, Oslo, and Hamburg.

Adjusted net earnings for the quarter were $329.5 million ($1.21 per share, fully diluted) compared to $309.8 million ($1.09 per share) in same period of 2018. For the full fiscal year, adjusted earnings were $1.3 billion ($4.70 per share), up from $1.2 billion ($4.19 per share) in 2018.

Return on equity for the year was 18.5%, compared to 17.3% in 2018. For the year, the company booked $12.6 billion in contract awards, representing 104% of revenue. The backlog at year-end was $22.61 billion, up from $22.58 billion at the end of fiscal 2018.

Dividend and buybacks: The stock does not pay a dividend. During the year, the company invested a total of $1.1 billion to purchase for cancellation 12.5 million Class A shares, at an average price of $90.37. Under the current normal course issuer bid, an additional 13.3 million shares can be purchased before Feb. 5, 2020.

Outlook: With its large backlog, CGI appears poised to continue its impressive performance in 2010.

Action now: Buy.

Canadian Apartment Properties REIT (TSX: CAR.UN, OTC: CDPYF)

Originally recommended on July 14/14 (#21425) at C$22.90, US$21.32. Closed Friday at C$55.44, US$41.69.

Background: CAPREIT, as it calls itself, is one of Canada's largest residential landlords. It is a growth-oriented real estate investment trust. As of Sept. 30, it managed 63,478 suites and sites across Canada, the Netherlands, and Ireland and owned 59,844 suites and sites across Canada and the Netherlands.

Performance: CAPREIT was first recommended in July 2014 at $22.90. It was last updated in October as a Hold at $56.22. The units have pulled back a little since and closed on Friday at $55.44 in Toronto.

Recent developments: The REIT reported solid third-quarter results, which were in line with analysts' expectations. Normalized funds from operations (NFFO) came in at $89.5 million ($0.558 per unit), compared to $77.9 million ($0.54 per unit) in the same period last year. The NFFO payout ratio was 62%, very low for a REIT and an indication for unitholders that the distribution is safe.

Year to date NFFO was $249.8 million ($1.591 per unit), up from $218.9 million ($1.539 per unit) in 2018.

Portfolio occupancy as of Sept. 30 was 98.2%.

The REIT's balance sheet continues to strengthen. Debt to gross book value was reduced to 36.74% as of Sept. 30, from 39.37% as of 2018 year-end. This was due to increases in the fair value of investment properties and proceeds from an equity issue that was used to repay debt.

Distributions: Monthly payments are $0.115 per unit ($1.38 per year), to yield 2.5% at the current price.

Outlook: The big run-up in REIT prices appears to be over for now. It was fuelled by interest rate declines earlier in the year, but it appears that rates are going to remain stable for the next few months at least.

Action now: Sell half.

This is a well-managed trust that has done well since it was recommended but at this point it looks to be fully valued. We have a capital gain of 142% to this point.

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YOUR QUESTIONS

Florida property

Q – Just wondering if I can make any money by buying a rental property in Florida. – Gojko B.

A – Many people do it but there are a lot of considerations for a Canadian. Among them:

Can you get a mortgage? U.S. mortgage lending requirements are very strict, and some financial institutions will not lend to non-residents. Before you make an offer on any property, make sure you can arrange financing.

Are you prepared to file U.S. tax returns? Renting a Florida property means you'll have to collect state sales tax and file a federal tax return, which for non-residents can be a hassle. My advice is to get an accountant who can handle all this for you – although of course that will add to the expense.

Who will manage the property? Unless you can find a 12-month renter, someone will need to take care of the property while it is vacant (usually during the summer, which is hurricane season).

Can you make a profit? Check out the rental rates on comparable units in the area you are considering. Do the math to determine if you can make a few dollars after all the expenses have been figured in. **–** G.P.

RESP for condo?

Q – Can we use some of my daughter's RESP money (she is in university full time) to put a down payment on a two-bedroom condo where she can live and pay mortgage each month by renting one of the rooms? Any tax implications? She has $15,000 income each year plus RESP withdrawals. I know we would have to co-sign for her mortgage, but it would be in her name. Isn't this a good start to her financial future? – Correne G.

A – The rules governing RESP withdrawals are very broad. In essence, if you can prove the money is being used to further a student's post-secondary education, it will qualify. Clearly, a student attending a college out of town needs a place to stay. Fees for living in a dorm would be acceptable, so by extension should the cost of any housing.

That said, there is no specific rule on the issue you raise. The organization that holds the RESP is responsible for ensuring the money is used for educational purposes, but these companies don't often ask questions beyond ensuring that the student is duly registered in a qualifying school.

But because this is a capital expense, it is a gray area. I suggest your first step is to talk to the company that administers the RESP and see if they would allow the funds to be withdrawn for the down payment. If they agree, go ahead. – G.P.

HOUSEKEEPING

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

George Weston Ltd. (TSX: WN). Recommended Aug. 24/15 by Gordon Pape at $110.55. Sold June 18/18 at $105.41.

Saputo Inc. (TSX: SAP). Recommended Sept. 25/11 by Gordon Pape at $20.29**.** Sold Nov. 30/15 at $32.83.

Trinidad Drilling (TSX: TDG). Recommended April 10/11 by Gordon Pape at $10.00. Sold Dec. 7/15 at $2.00**.**

WiLAN Inc. (TSX: WIN). Recommended Aug. 7/11 by Ryan Irvine at **$6.99**. Sold Dec. 14/15 at **$1.50.**

PRICE NOTICE

A reminder that the price of a one-year membership in the Internet Wealth Builder will increase by $10 (plus tax) on Jan. 1. The new rate will be $219.95 plus tax. Quarterly and monthly rates will be adjusted accordingly.

You can beat the increase by renewing before year-end, no matter when your membership expires. Call 1-888-287-8229 or go to www.buildingwealth.ca/subscibe.

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