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GOLD'S RECORD RUN NOT OVER

By Gordon Pape, Editor and Publisher

Many years ago, I attended an investing conference in the U.S. One of the sessions featured a world-renowned gold expert who predicted the price of the precious metal would hit US$2,000 within a year. At the time, gold was trading at about US$700 an ounce.

His arguments were impressive, and his charts made his prediction seem inevitable. I just didn't believe it. The catalysts he cited that would drive gold up that far that fast just didn't ring true.

Over the years, I have heard many similar predictions from gold bugs, some putting the price of the metal as high as US$10,000 an ounce. I have always been sceptical.

Until now, that is. The pandemic has created a perfect situation for gold. At the start of the outbreak, I recommended that all portfolios hold 5-10% of their assets in gold. I continue to maintain that advice.

Last week, gold moved through the US$2,000 level. Now the only question is how high is up?

The Bank of America is targeting US$3,000 an ounce within the next 18 months. The price is being driven by historically low interest rates, massive fiscal and monetary stimulus programs, and purchases by central banks.

"It's just astonishing and breathtaking and you have to sort of pinch yourself sometimes to sort of realize that it's actually happening," Michael Hartnett, BofA's chief investment strategist, said.

The bank includes three IWB recommendations among its top picks in the gold mining sector: Barrick Gold, Agnico Eagle Mines, and Franco-Nevada.

Goldman Sachs is more conservative but sees a price of US$2,300 within 12 months. MarketWatch reported that a GS team led by Jeffery Currie said the price is being driven by "a potential shift in the U.S. Fed toward an inflationary bias against a backdrop of rising geopolitical tensions, elevated U.S. domestic political and social uncertainty, and a growing second wave of COVID-19 related infections."

Among traditional gold bugs, expectations are much higher. I have seen forecasts in the US$6,000 an ounce range by 2025.

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Given the historic volatility of gold, any price target is a guesstimate at best. We could easily see a short-term pullback at this point as profit-taking sets in. But the long-term fundamentals suggest gold is going to trend higher over the next few years. Here's why:

Low interest rates. One of the negatives about owning gold is that it pays no interest. These days, that doesn't matter. An estimated US$15 trillion worth of sovereign bonds are trading at negative rates right now. If you factor in inflation to arrive at real rates of return, that figure rises dramatically. In a negative rate environment, gold becomes even more attractive.

Massive government stimulus. Governments around the world have been running up huge deficits in an effort to keep the economy running with a wide range of stimulus programs, ranging from guaranteed income to rent relief. These deficits are increasing national debt at a rate not seen since the Second World War. That gives politicians a powerful incentive to put pressure on central banks to keep interest rates low for years to come. Higher rates would raise the cost of servicing the debt to unacceptable levels.

Inflation risk. The stimulus programs and the quantitative easing being employed by many central banks (which really amounts to printing money) raises the spectre of inflation down the road. It won't happen in the short term – there's too much slack in the economy. But once the pandemic is behind us, the massive increase in the money supply we are witnessing poses a serious risk of price inflation, which would benefit gold.

Weak U.S. dollar. Gold is priced in U.S. dollars. This means when the dollar weakens, as it has been doing for the last few weeks, it automatically pushes gold higher. Given the uncertainty surrounding the coming election and the mismanagement of the COVID crisis, the downward pressure on the dollar is likely to continue.

Geopolitical concerns. As if the pandemic and the resulting recession weren't enough, the uncertainty created by the growing U.S.-China trade disputes, the trend to deglobalisation, and on-going tensions in the Middle East would be enough to drive many investors to gold. None of these problems are going away any time soon.

Put it all together and logic suggests gold is going to move higher over the next few years. If you don't have some gold stocks or funds in your portfolio, it's time to act.

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STOCK PICKS FOR GARDENERS

Contributing editor Adam Mayers has been spending a lot of his spare time in the garden, and that led him to look at some of the companies whose products he uses. He reports on them this week. Adam is a former Business Editor and investing columnist at The Toronto Star. His website is adammayers.com. He lives in the Toronto area. Here is his report.

Adam Mayers writes:

Like many of my friends, I was out in the garden early this spring. While snowflakes were still falling I was raking and bagging. Next came mulch in the front and back flower beds. As the weather improved, a small vegetable garden in a newly built planter. My wife expanded the hanging basket collection and I stocked up on bird seed.

As the pandemic has limited options for travel and entertainment, more people are seeing their home with fresh eyes. They are investing in improvements, sprucing things up with paint and new accessories and expanding gardens. It is something to do and something to enjoy under these unusual circumstances.

This has all been good news for Home Depot, Loew's, and Walmart, whose shares are up double digits this year. The shares of grocers such as Metro, Sobey's, Costco, and Loblaws have also been strong performers.

Digging a little deeper into the food chain are two companies that rarely make the news. However, both make your garden grow and ensure your grocer has fresh produce. Their products are evergreen, and their businesses are well established. They have manageable debt and a history of rising dividends. Their large market capitalizations mean they can withstand turbulence, and both will benefit from the stay at home trend. Here is all you need to know.

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The Scotts Miracle-Gro Company (NYSE: SMG)

Closed Friday at $158.47. All figures in U.S. dollars.

Background: Scotts was founded in Ohio in 1888 to sell grass seed and its product lines have expanded over time. They now include a variety of lawn care products, including seeds, weed and pest control, potting and garden soils, and mulch. Miracle-Gro is a best-selling water-soluble plant food.

Scotts also benefits from powerful distribution channels which include partnerships with the largest North American home and garden retailers. This year I was all Scotts. The seed and mulch came from Home Depot, the Miracle-Gro from our local garden centre, and the 20-packs of suet for the bird feeder from Canadian Tire. Canadian Tire also sells Scotts brand grass seed and related products.

Scotts has another emerging business which is less in the limelight. In October 2014, it formed the Hawthorne Gardening Co., to provide fertilizers for hydroponic cannabis growers. As Canada's cannabis industry has matured and the U.S. industry has developed, Scotts has become a main source of liquid nutrients, growing media, and lighting for hydroponic growing.

Performance: Scotts shares have doubled from their mid-March low of $76.50 to the current price**.** Year-to-date the shares are up 49.2% versus a gain of 3.7% for the S&P 500 index.

Recent developments: The shares rose 11% on July 29 as Scotts released blockbuster third-quarter 2020 earnings. The company beat expectations for revenues and profits and raised its full-year outlook, announced a special $5 dividend and an increase in its quarterly dividend.

"Our results this year continue to exceed our most optimistic expectations," said CEO Chris Hagedorn said in a conference call.

"We continue to see gardening as the driving force, even though we are weeks past what would normally be the peak of that season. We've seen strong double-digit improvements in every retail channel."

The company saw significant acceleration in sales beginning in May – the first week of that month set a sales record. Entering August, consumer purchases are up 23% year-over-year with increases in every product category.

Third-quarter sales rose 28% to $1.49 billion. Net income was $202.8 million with earnings per share rising 13% to $3.57. The Hawthorne cannabis segment saw sales rise 72% to $303 million.

Mr. Hagedorn said consumer research has revealed that buyers are spending more time in the garden as a way to cope with the uncertainties surrounding the coronavirus. About 10% of buyers are new to the practice of growing and cultivating plants.

Scotts sees annual growth of 26-28% this year. Hawthorne sales are expected to rise 55-60%, with better things ahead as more states legalize cannabis.

Dividend: The dividend was increased 7% to $0.62 quarterly, effective with the September payment. At current prices, that gives a yield of 1.56%. The special dividend is also payable in September to shareholders of record as of Aug. 27.

Action now: Buy. The stock carries a high p/e ratio of 25.9 but has strong prospects for growth and income.

Nutrien Corp. (TSX, NYSE: NTR)

Closed Friday at C$47.45, US$35.48. All figures in U.S. dollars except TSX share price.

Background: Nutrien is the world's largest producer of agricultural fertilizers. This includes nitrogen and phosphates, which it sells in bulk and at the retail level to farmers.

The Saskatchewan-based company was formed in 2018 from the merger of Agrium Corp. and Potash Corporation of Canada. Potash Corp. was a globally dominant fertilizer producer, while Agrium offered a retail network of about 2,000 stores. This network dominates in North America and Australia and is expanding in Latin America. The merger provided a way for the companies to compete with large producers in Belarus and Russia.

Performance: Nutrien's shares are down 24% year-to-date, falling to a low of $36.30 in March, before rebounding to their current level. Its p/e ratio is 21 at the current price.

Recent developments: The company lost $69 million in the three months ended March 31 although revenue rose 12.6% to $4.19 billion.

Dividend: The $1.80 annualized dividend yields 5.1% and seems secure.

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Gardeners – continued from page 3…

Discussion & Outlook: Nutrien has strong fundamentals. While the business is at the bottom of the cycle, it stands to rebound as conditions improve.

The consensus is that fertilizer prices are at historic lows but are unlikely to fall further. The next big leg will be up. The company believes prices will start recovering in the second half of this year. Results to be released this week should provide better guidance.

In a recent research note, RBC Dominion Securities analyst Andrew Wong said he expects Nutrien to continue generating strong free cash flow as prices gradually recover.

He notes that Nutrien is the most diverse and vertically integrated player in the business, with an attractive earnings profile and a solid balance sheet. As oil prices rebound, it should also gain as farmers plant more corn, which is used for ethanol, a gasoline additive.

Mr. Wong expects Nutrien's payout ratio to fall to sustainable levels as higher prices generate excess cash and that it will buy back shares and increase dividends as conditions improve. He also expects Nutrien to acquire more retail outlets in North America and continue an aggressive expansion in Brazil.

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Action now: Nutrien is a buy for long term gains. (Disclaimer: I owned Agrium and continue to own Nutrien.)

A BIG GAIN FOR CANADIAN SOLAR

By Adam Mayers

The shares of solar energy companies have been on the rise as investors have taken a fresh look at an often-volatile sector.

I spoke to John Cook, CEO of Greenchip Financial Corp., to put this in context and update Canadian Solar Inc., my recommendation made this spring. Greenchip is a green energy investing pioneer and holds Canadian Solar in its Greenchip Global Equity Fund. Here is the update.

Canadian Solar Inc. (NDQ: CSIQ)

Originally recommended March 14/20 (#22011) at $16.80. Closed Friday at $25.32. (All figures in U.S. dollars.)

Background: Canadian Solar, based in Guelph, Ontario, is one of the world's largest manufacturers of solar panels. It was founded in 2001 and has operations in 24 countries. This includes two manufacturing plants in Ontario and others in China.

Canadian Solar has delivered over 38 gigawatts (GW) of solar capacity and has 10 GW of projects in its pipeline. Its original focus as a low-cost manufacturer of solar panels has evolved to include a second business, which is building turnkey solar power plants for utilities and large commercial power users.

Performance: The shares hit a low of $12 on March 16 and have doubled since then. They are up 13.6% in the last month and over 50% since being recommended.

Recent developments: Canadian's Solar's first-quarter results released May 28 beat estimates for revenue and earnings. Revenue rose 70% to $826 million. Net income was $110.6 million, or $1.84 per diluted share, compared to a net loss of $17.2 million in the first quarter of 2019.

The company held $1.04 billion in cash and cash equivalents in the quarter. Shipments of solar panels increased 41% year-over-year and gross margin rose 480 basis points to 27%.

Discussion & Outlook: The rising share price has as much to do with secular trends and industry developments, as it does with Canadian Solar's strong performance, says Mr. Cook.

"Investors are realizing that solar companies add up to more than their current valuation," he says.

One thread is a spate of dual stock market listings that has raised awareness and interest in the sector and its major players. A handful of solar companies already listed in New York are seeking to list in China as well.

This includes Canadian Solar, which has been a member of the Nasdaq exchange since 2006. On July 27 it said it is seeking a listing on the science and innovations board either in Shanghai or the Shenzhen Stock Exchange, a process that will take 18 to 24 months. The shares jumped 8% the day of the announcement.

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The increased attention has highlighted the fact that most of the value attributed to Canadian Solar comes from its main business, which is the manufacture of solar panels. This largely ignores the value of its growing business of building power plants. Canadian Solar closed the sale of a Japanese solar plant this winter. Since then it has signed commitments for two plants in Texas and two more in Brazil.

A related tailwind is that utilities are looking for more carbon-free sources of power, leading to a rising demand for these solar power plants.

Mr. Cook says a third trend is government initiatives that will increasingly favour solar. For example, U.S. presidential challenger Joe Biden has a $2 trillion energy platform that includes incentives for green energy.

Despite these positive themes, Canadian Solar's trailing 12-month price to earnings ratio sits at 5.8. That suggests the potential for an attractive upside.

Dividend: The company does not pay a dividend, but has a share repurchase program.

Action now: The stock is a buy for investors comfortable with the sector's volatility. (Disclaimer: I own Canadian Solar.)

GORDON PAPE'S UPDATES

Equitable Group (TSX: EQB, OTC: EQGPF)

Originally recommended by Irwin Michael on Aug. 10/08 (#2828) at C$21.04. Closed Friday at C$81.11, US$48.24.

Background: This company provides mortgage lending services to individuals and businesses in Canadian urban markets, with a focus on entrepreneurs and new Canadians. It carries on operations through wholly owned subsidiary Equitable Bank, Canada's ninth-largest Schedule 1 bank, with total assets under management of over $31 billion. Equitable Bank employs about 900 people.

Equitable Bank also has a digital banking operation, EQ Bank, with its flagship product being the EQ Bank Savings Plus Account.

Performance: The shares hit a low of $44.57 in March. They have recovered somewhat but are well below their 52-week high of $121.87.

Recent developments: After a weak first quarter, Equitable reported much improved results for the second quarter. That prompted RBC Capital Markets to commend management for doing "a good job navigating a challenging quarter".

The company reported increases in interest income on both residential and commercial loans compared to last year. Total interest income was $277.5 million.

Provision for credit losses in the first half of the year increased to $44.5 million, from $11 million a year ago.

Second quarter net income attributable to common shareholders was $51.4 million ($3.05 per share, fully diluted). That was slightly below analysts' expectations and down from $52.8 million ($3.15 a share) in the same period of 2019.

EQ Bank, the company's digital platform, showed strong growth. Deposits were up 46% year-over-year and the customer base increased 52% to approximately 124,000.

The company's financial position looks sound. The CET1 Capital Ratio was 14% at the end of June, the top end of management's target range. That compares with 13.5% at March 31 and 13.1% at the same time in 2019. Liquid assets were $1.9 billion (6.4% of total assets) at June 30 compared to $1.6 billion (6.0% of assets) a year ago.

Dividend: The stock pays a quarterly dividend of $0.37 per share ($1.48 a year), to yield 1.8% at the current price. That's up 12% from a year ago but a planned dividend increase for this year is on hold due to an April directive from the Office of the Superintendent of Financial Institutions ordering federally-incorporated banks to suspend dividend hikes and share buybacks.

Outlook: Equitable is performing better than expected but it's going to take some time for financial institutions to recover from the economic slowdown and near-zero interest rates.

Action now: Hold.

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

Originally recommended on Aug. 19/12 at C$24.42, US$24.66. Closed Friday at C$95.71, US$71.55.

Background: Montreal-based CGI is the one of the largest independent information technology and business process services firm in the world. The company, founded in 1976, delivers an end-to-end portfolio of 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 has recovered from its March low of $67.35 but it still below its Jan. 1 level.

Recent developments: It's a sign of the times when a company can get a thumbs-up from investors and analysts while reporting weaker year-over-year results.

That's the case with CGI, whose third-quarter 2020 financials beat expectations.

Revenue was just over $3 billion, down 2.2% year-over-year or 3.5% in constant currency. Cash provided by operating activities was $584.8 million, up $209.6 million from last year, representing 19.2% of revenue.

Adjusted net earnings were $308.4 million ($1.18 per share), down from $337.2 million ($1.22 per share) the year before.

Bookings were $2.8 billion, indicating strong customer demand despite the severe economic slowdown. That was only slightly down from $2.95 billion a year ago. The backlog at the end of June was $22.3 billion.

CEO George Schindler said he expects market and business conditions will improve over the rest of this year.

The company had cash of $1.4 billion at the end of June along with about $1.5 billion in its revolving credit facility. This is a company that has grown by acquisition and is in active discussions with a number of companies now.

Dividend: CGI does not pay a dividend.

Outlook: The latest results were better than expected but the coronavirus is still having a strong impact on business activity. Retain positions but don't add to them unless there is a big price retreat.

Action now: Hold.

TFI International Inc. (TSX, NYSE: TFII)

Originally recommended by Tom Slee on June 11/12 (#21220) at C$17.49, US$17.06. Closed Friday at C$59.13, US$44.17.

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: The stock hit an all-time high after posting strong second-quarter results.

Recent developments: I reviewed this stock in July, so this is a just a quick update on the company's second-quarter results. Revenue and earnings were down from a year ago but were ahead of expectations. In a report to investors, RBC Capital Markets said the company "did an impressive job of managing the downturn" and cited management's favourable outlook for future growth.

Revenue for the quarter was $1.1 billion, down from $1.3 billion a year ago. Adjusted net income was $92.1 million ($1.04 per share), compared to $102 million ($1.18 per share) in 2019. Net cash from continuing operating activities was $227.9 million versus $141.4 million the prior year quarter.

Dividend: The shares pay a quarterly dividend of $0.26 ($1.04 per year), to yield 1.6%.

Outlook: Continues to be good.

Action now: Buy.

iShares Convertible Bond Index ETF (TSX: CVD)

Originally recommended on Feb 18/19 (#21907) at $18.16. Closed Friday at $17.30.

Background: This ETF invests in a portfolio of Canadian convertible bonds, meaning they can be exchanged for stock at a specified price.

Performance: The price dropped to $13.12 in March. It has recovered somewhat but is still below its price at the start of the year and down 4.7% from the original recommendation.

The fund's performance is tied in part to the performance of the TSX, since the bonds it holds are convertible to

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common stock. The TSX is off 3.3% year-to-date as of the time of writing, while this fund is down 4.1%, including dividends.

Key metrics: The fund was launched in June 2011 and has about $97 million in assets. It has 37 holdings. The MER is 0.49%.

Cash flow: Distributions are paid monthly and are currently running at $0.067 per unit. The forward yield based on the current distribution is 4.7%.

Outlook: The cash flow is good, but this fund has shown itself to be too volatile for conservative investors. Switch to a more stable bond fund, like XBB (see below).

Action now: Sell.

iShares Canadian Core Bond Index ETF (TSX: XBB)

Originally recommended on March 5/07 (#2709) at $29.44. Closed Friday at $34.01.

Background: This ETF is designed to replicate the returns of the total Canadian bond universe, including government and corporate issues.

Performance: The fund has had a strong year and was up 8.87% for 2020 as of Aug. 5. That won't continue, however. A better measure is the 10-year average annual return of 4.46%.

Key metrics: The fund was launched in November 2000 and has $4.8 billion in assets. There are 1,333 positions in the portfolio. The effective duration (a measure of interest rate risk) is 8.56 years. The MER is very low at 0.1%.

Cash flow: Distributions are paid monthly, currently at a rate of $0.071 per unit. At that level, the forward yield is 2.5%.

Outlook: The big gains this year were made several months ago, when central banks slashed interest rates as part of moves to bolster the economy. Future upside is limited, unless rates go negative. However, the fund provides portfolio stability and decent cash flow.

Action now: Hold.

A BOND FUNDS WARNING

Bonds should be a core component of all portfolios, but few investors understand the market well enough to buy individual issues. As a result, most of our bond holdings are in mutual funds or ETFs.

That's fine in most circumstances. But there are risks involved, particularly as it relates to corporate bond open-ended mutual funds. They own about 23% of all Canadian corporate bonds denominated in Canadian dollars

This month the Bank of Canada published a study which looked at 188 funds. It concludes that many bond funds depleted part or all of their cash buffers in March, leaving them vulnerable in event of another bond market sell-off. The cash buffers provide the liquidity needed to meet redemption demands from fund holders.

The authors, Guillaume Ouellet Leblanc and Ryan Shotlander, looked at what happened to the bond fund market when COVID fears took hold in March and warn that it could mean trouble if a second wave of the virus sparks another sell-off.

"Concerns about the economic impact of the pandemic created a shock wave in financial markets in March 2020," the authors write. "Spreads of Canadian corporate bonds widened significantly, causing the value of bond fund assets to fall. A large share of investors reacted by exiting these funds to raise cash. Net redemptions reached $14 billion in March, amounting to around 4.5% of assets under management."

It could have been much worse. Models indicated that, based on the losses being incurred at that time, redemptions could have reached $30.7 billion, or 9.5% of total assets. If that had happened, fund managers would have had to either suspend redemptions or sell assets at a distressed rate, further exacerbating the market's decline.

The authors said the March result would have been worse had it not been for quick moves by the central bank to calm the markets along with action to ease funds' borrowing limits and efforts by fund managers to discourage redemptions.

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But they warn: "If bond funds face another wave of large redemptions, they may be more vulnerable because they have already used part of their cash buffers. By rapidly rebuilding those buffers, bond funds can help avoid future forced sales of assets that are less liquid. The Bank will continue to monitor these funds and how they can affect fixed-income market liquidity."

As things stand right now, the study suggests that the current cash holdings of bond mutual funds would be enough to cover monthly redemptions equivalent to those in October 2008 but not those in March 2020.

That means that if there was another run on corporate bond mutual funds now, it would create a serious problem for investors.

"If redemptions were to accelerate in the near term, fund managers with low cash buffers may be forced to sell less-liquid assets, thus amplifying asset price declines and contributing to deterioration in market liquidity," the study says. "By rapidly rebuilding their cash buffers, fund managers can help avoid such undesirable situations."

Investors in corporate bond mutual funds need to be aware of this redemption risk scenario. This is not a suggestion to sell, but rather to take a close look at the asset mix in any fund you hold. If the cash position is very low, the fund could be at risk in a major bond market sell-off.

YOUR QUESTIONS

Mawer fund

Q – I retired a few years ago and want to reduce my overall portfolio risk. The Mawer Global Balanced Fund looks like a good choice in terms of its performance, risk, and volatility, however the MER seems high. I would like to know your thoughts on this fund, and any possible alternatives. Thank you for your help. – Steve A.

A – You won't find a much better choice. This one gets a five-star rating from Morningstar and an A+ from Fund Library. Very few funds can match that. The fund has generated an average annual return of 9.6% to June 30 since it was launched in 2013. It has only lost money once, in 2016 when it was down a fractional 0.6%.

About 60% of the assets are in stocks, with the rest in bonds and cash. The fund is well-diversified geographically, with 18 countries represented in the portfolio.

You mention that the MER (management expense ratio) seems high. Actually, it is 1.09%, which is very inexpensive for an equity mutual fund. You're getting a lot of value for your money with this one. – G.P.

Looking at ETFs

Q – What is your opinion of the stability and suitability of XUT for an elderly mother in the near term?

Also, given that XBB, has been one of your core holdings to date, do you see continuing to hold that ETF? – Ann A.

A – XUT is the trading symbol for the iShares S&P/TSX Capped Utilities Index ETF. It invests in a portfolio of 16 Canadian utility stocks, including Fortis, Brookfield Infrastructure, Emera, and Algonquin Power.

These are defensive stocks, with minimal upside but limited downside risk.

The fund has a steady track record with a five-year average annual return of 9.75% to June 30. I would rate it as low-risk, but it has posted some down years, most recently in 2018 when it was down 8.2%.

The current monthly distribution is $0.095 per unit. If that were to continue over the next year, the yield at the current price would be 4.3%.

If you're looking for a defensive fund with a good yield for your mother, this would be a good fit.

XBB is the symbol for the iShares Core Canadian Universe Bond Index ETF. I regard this as a core bond holding for all portfolios. It offers stability to a portfolio and has generated an average annual compound rate of return of 4.4% over the past decade. – G.P.