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ETFS FOR UNCERTAIN TIMES

By Gordon Pape, Editor and Publisher

In uncertain markets, such as we are currently experiencing, income investors need to focus on three key points. They are:

Cash flow: Never forget your main objective is income. The day-to-day price movements of the underlying securities are secondary. As long as they are able to generate the cash you require, don't get hung up on either price gains or losses.

Safety: Stay away from high-risk securities. They have no place in an income portfolio. The time to take calculated risks is when you are building your asset base, not when you are relying on it to help provide the income you need to maintain your lifestyle.

Diversification: Ensure your portfolio is well balanced. Don't overload any one sector, no matter how promising it may look at the time.

Exchange-traded funds (ETFs) are a good way to meet these three goals. They enable you to spread your risk over a large portfolio of securities and many offer very attractive yields. Here are some that are worth considering in the current environment. All are on our Recommended List. Prices are as of the close of trading on Sept. 4.

BMO Equal Weight Utilities Index ETF (TSX: ZUT)

Originally recommended: Jan. 28/16 at $14.12
Current price: $21.27
Annual payout: $0.84 (trailing 12 months)
Yield: 3.9%
Risk: Moderate
Website: www.etfs.bmo.com

Comments: This ETF has been designed to replicate the performance of the Solactive Equal Weight Canada Utilities Index net of expenses. The portfolio includes such securities as Northland Power, Boralex, TransAlta Corp., Hydro One, Canadian Utilities, and Emera. This is a sound portfolio of companies that derive much of their revenue from regulated contracts. Several of the stocks are in the green energy sector, which has been performing well this year. These include Innergex Renewable Energy, TransAlta Renewables, Algonquin Power and Utilities, and Brookfield Renewable Partners.

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The fund was up 9.2% for the year as of the end of August. The 10-year average annual compound rate of return to that time was 8.42%.

Monthly distributions this year have been running at a rate of $0.07 per unit ($0.84 a year), to yield 3.9%. The management expense ratio is 0.61%.

Action now: Buy.

Harvest Brand Leaders Plus Income ETF (TSX: HBF)

Current price: $9.33
Originally recommended: Aug. 18/17 at $8.84
Annual payout: $0.65
Yield: 7%
Risk: Moderate
Website: www.harvestportfolios.com

Comments: This fund offers an equal-weight portfolio of 20 large companies selected from the world's Top 100 Brands. Holdings include household names like Visa, Nike, The Walt Disney Company, Apple, Microsoft, and PepsiCo. None of these companies is going out of business, no matter how bad conditions get.

The fund was marginally in the black for 2020 as of the end of August. The five-year average annual compound rate of return to that point was 10.86%.

Monthly distributions are $0.054 per unit ($0.648 annually), for a yield of 6.9% at the current price. The management fee is 0.75%.

Action now: Buy.

CI First Asset Tech Giants Covered Call ETF (CAD Hedged) (TSX: TXF)

Current price: $19.00
Originally recommended: Feb. 23/17 at $13.92
Annual payout: $1.40 (trailing 12 months)
Yield: 7.4%
Risk Rating: Higher risk
Website: www.firstasset.com

Comments: Technology has been the driving force behind the surge in stock market prices since the March plunge. At this point, the sector may be overvalued, and we saw some profit-taking last week, which caused the price of this ETF to drop. But the tech giants remain strong, and that's where this fund invests. Major holdings include Apple, Amazon, Facebook, Alphabet, and Microsoft, along with up-and-coming stocks such as Zoom Video Communications.

The managers use a covered call strategy to generate additional cash flow for investors, thus the attractive yield of 7.4%. Distributions are paid quarterly and can vary considerably. The latest payment, in June, was for just over $0.48 per unit but the March payment was only $0.33. If you need steady cash flow, this may not be the fight ETF for you.

Returns have been impressive. As of the end of July, the ETF was showing a year-to-date gain of 11.9%. The five-year average annual return to that point was 16.3%. The management fee is 0.65%.

This fund is higher risk than the others mentioned in this article, but the cash flow is good and there is potential for above-average capital gains.

Action now: Buy for aggressive investors.

iShares Core Canadian Universe Bond Index ETF (TSX: XBB)

Current price: $33.64
Originally recommended: Dec. 15/04 at $29.49
Annual payout: $0.852 (forward 12 months)
Yield: 2.5%
Risk Rating: Low
Website: www.ishares.ca

Comments: This bond fund needs no introduction. It's been one of our core investment selections for almost 16 years. It's not a shoot-out-the-lights fund and never will be. Instead, it provides steady monthly cash flow and offers stability to your income portfolio, even in the toughest times. As a reminder, this ETF tracks the broad Canadian bond market, including government and corporate issues.

As of Sept. 4, the fund was showing a year-to-date gain of just over 8%, but that's an aberration caused by the steep drop in interest rates in March. A better performance determinant is the 10-year average annual compound rate of return of 4.14% to the end of August.

Distributions are paid monthly and are currently running at a rate of $0.071 per unit ($0.852 annually). There is no guarantee they will continue at that rate however; the managers review the payout every three months and adjust the distribution as necessary.

This is a very inexpensive fund to own – the management expense ratio is only 0.1%.

Action now: Buy.

GORDON PAPE'S UPDATES

Fidelity U.S. Monthly Income Fund (FID1330)

Type: Mutual fund
Portfolio composition: Balanced
Series: B
Current price: $18.12
Originally recommended: Sept. 29/16 at $19.63
Distributions: $0.60 a year
Yield: 3.3%
One-year return: 1.47%
Three-year average annual return: 5.77%
Risk: Medium
MER: 2.23%
Website: www.fidelity.ca

Comments: This fund invests in large-cap U.S. stocks including familiar names like Johnson & Johnson, Walmart, JPMorgan Chase, Walt Disney, and Microsoft. It pays monthly distributions of $0.05 per unit, to yield 3.3% at the current net asset value (NAV).

The fund was launched in November 2012 and initially performed well, with double-digit gains in each of its first three years. But recent results have been underwhelming. The fund has posted only one double-digit year since 2015 (an 11% gain in 2019) and is fractionally in the red year-to-date. The three-year average annual compound rate of return to Aug. 31 was 5.67%.

The fund has a hefty management expense ratio of 2.23%, which is a real drag on returns. The yield is decent, but you can do better from an ETF like Harvest Brand Leaders. The bottom line is there are superior options available elsewhere.

Action now: Sell.

Sentry U.S. Monthly Income Fund

Type: Mutual fund
Portfolio composition: Balanced
Series: A
Current price: $15.88
Originally recommended: Sept. 29/16 at $13.78
Distribution: $0.45 per year
Yield: 2.83%
One-year return: 3.8%
Three-year average annual return: 7.5%
Risk: Medium
MER: 2.25%
Website: www.ci.com

Comments: The Sentry funds have been taken over by CI, although the Sentry management team remains in place. This fund's mandate is similar to that of the Fidelity fund, but the portfolio composition is somewhat different. About 50% of the assets are in large-cap U.S. equities, such as Alphabet, Amazon, Berkshire Hathaway, and MasterCard. About 6% is invested in Canadian stocks, with Brookfield Asset Management the number one position. Another 6% is in income trusts and 37% is in bonds and cash.

This fund has a better record than the Fidelity entry over the past one and three years and was ahead by 1.7% year-to-date as of the end of August. However, the annual yield is about half a point lower. The MER is about the same.

Of the two, this would be the better choice, but neither one is a superior performer in my view. Given the high MER, I suggest a switch to an ETF.

Action now: Sell.

CI Cambridge Global High Income Fund (CIG6803)

Type: Mutual fund
Portfolio composition: Balanced
Series: A
Current price: $10.96
Originally recommended: April 23/13 at $13.29
Annual payout: $0.72
Yield: 6.57%
One-year return: 1.6%
Three-year average annual return: 3.0%
MER: 2.32%
Risk: Moderate
Website: www.ci.com

Comments: The fund has changed its name since the original recommendation by adding the word Global. But the mandate remains the same – to provide above-average monthly income from a portfolio of international bonds and stocks. This is a fund of funds, investing its assets in five other Cambridge portfolios. According to the website, 46% of the fund is in Canadian government and corporate bonds, with 13% in foreign government bonds. Canadian and international stocks make up the rest of the assets, so the weighting is clearly to the fixed income side.

At first glance, this looks like an attractive place for your money, with a yield of almost 6.6%. But look more closely

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and you'll quickly be aware that that most of that cash flow is your own money coming back. The fund's net asset value (NAV) has steadily declined in recent years, from $12.22 on Sept. 1, 2017 to $10.96 now. So, while the cash flow has held steady at $0.06 per unit monthly, the value of your units has dropped. Think of it as a yield trap. Toss in a MER of 2.32% and the net result is a fund that needs to be replaced.

Action now: Sell.

GAVIN GRAHAM'S UPDATES

Cogeco Inc. (TSX: CGO; OTC: CGECF)

Type: Common stock
Current price: C$92.60, US$60.05
Originally recommended: April 30/15 at C$54.14; US$45.60
Annual payout: $1.90
Yield: 2.1%
Risk: Low
Website: www.cogeco.ca

Comments: Cogeco is controlled by the Audet family through multiple voting shares and its Cogeco Communications (TSX: CCA) subsidiary. It is the second largest cable operator in Ontario and Quebec with 1.8 million subscribers and the ninth largest U.S. cable operator with 1.1 million subscribers through its Atlantic Broadband subsidiary.

Cogeco's purchase of Metrocast's cable assets in five eastern U.S. states in January 2018 for $1.4 billion increased its subscriber numbers in the States by 40%. The Quebec government pension fund, the Caisse de Depots et Placements, took a 21% stake in the enlarged Atlantic Broadband for US$315 million. On Sept. 2, cable consolidator Altice USA (NYSE: ATUS) made an unsolicited (read hostile) offer to purchase Cogeco for $10.3 billion. The intention is to add its Atlantic Broadband operations to its U.S. business, while selling the Canadian operations to Rogers Communications (TSX: RCI), which already owns a 41% stake in Cogeco and a 33% stake in Cogeco Communications. Cogeco shareholders would receive $106.53 per share and Cogeco Communications shareholders would get $134.22. The Audet family, which controls 60% of the votes at Cogeco through its multiple voting shares and 82% of the votes at Cogeco Communications, immediately rejected the bid, saying that the family "has already indicated it does not intend to sell its shares and will not support the proposal." Quebec Premier Francois Legault told a Cogeco-owned radio station: "There's no way we'll let this Quebec company move its headquarters to Ontario." Rogers responded by saying if the deal goes through, the Cogeco head office would remain in Quebec.

Andrew Willis, writing in The Globe and Mail, made the point that Altice's CEO Dexter Goei has made a career of successfully persuading families that owned media assets to sell them when they initially seemed uninterested. The best example of this was getting the Dolan family who owned Cablevision Systems, the cable provider for New York and surrounding areas, to sell to Altice in 2016 for US$17.7 billion. Apparently, the argument that convinced them to sell was that cable's best days were behind it and the family would need to re-mortgage the company to invest in the technology to keep pace with larger rivals.

Mr. Goei knows the Audet family well, and in fact sold their failing Portuguese cable operations in 2012 to Altice, after Cogeco had written off $600 million over the six years it owned it.

Similar to Cablevision, expansion for Cogeco is effectively impossible in Canada and requires large acquisitions similar to Metrocast deal in the U.S., where it will be competing against larger and better financed rivals including Altice.

While Cogeco is a jewel in the Quebec corporate scene and has the support of the Caisse through its co-investment in Atlantic Broadband, Mr. Audet, who is 68, may decide to take the $800 million that the family would receive in the deal and focus on his philanthropic activities.

Several commentators felt that the initial offer was an opening bid and a higher price might be required to get the deal done. By going hostile and public, Rogers and Altice may be attempting to force the issue. When Quebec cable operator Videotron was being bid for by Rogers in 2000, Quebecor came in as a Quebec-based white knight, so perhaps a similar deal may happen now.

Action now: The share price of Cogeco has jumped 17% to over $92, although this is still 15% below the value of Altice's bid. The current price is 71% above where we initially recommended buying Cogeco, although below the all-time high of $107.88 which was reached last year.

The chance of the Audet family being unwilling to sell or the Quebec government blocking the merger is sufficiently great to make it worth taking our profits now. Sell.