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THE THREATS TO THE MARKET

By Gordon Pape, Editor and Publisher

One economist told The Wall Street Journal last week that the U.S. economic rebound from the pandemic is "without historical parallel".

Consumers are spending pent-up savings at a record rate. Fiscal and monetary support continues unabated. Demand for workers has reached the point where some companies are offering incentives for simply attending a job interview.

The stock markets are reflecting this boom by touching new highs almost daily. Last week the S&P/TSX Composite Index topped 20,000 for the first time and was up 14.4% for the year as of the close on June 3. The Dow is up about 13% year-to-date, the S&P 500 has gained 11.6%, and Nasdaq has added 5.6% despite the pullback in the tech sector.

Continued on next page...

IN THIS ISSUE

No IWB next week.
Next issue: June 21, 2021

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Threats—continued from page 1...

The Journal quotes Stephanie Aaronson, an economist with the Brookings Institute, as saying the fact that the economy has recovered so quickly “has limited the scope for a lot of scarring relative to, say, in the Great Recession.”

So, what could go wrong? Using my social network on LinkedIn and Twitter, I asked people what they believed to be the greatest risk to the current bull market. There were four options from which to choose.

This was not a scientific poll by any means. But I think it provides a good indication of where investor’s minds are right now. About 100 people took part.

The number one worry, by a narrow margin, was inflation at 42%; Although the central banks keep assuring us that any inflation spike will be transitory (the U.S. Federal Reserve Board is adamant about this), the CPI numbers in Canada and the U.S. are moving higher at a worrisome rate. That leads to concerns that the Fed and the Bank of Canada may be forced to increase their target rates sooner than expected. The BoC has already hinted at this. Rising interest rates are notoriously bad news for both the bond and stock markets.

Overpriced stocks came in at number two, at 40%. People keep piling into shares, as the index gains show, but many of them are nervous about the prices they are paying, and with good reason. But most bonds are losing ground this year and cash earns almost nothing, so equities seem to be the only game in town.

Third, and well back on the list, was a resurgence of the pandemic at 10%. It appears that investors believe the worst is over, at least as far as the economy is concerned.

Finally, only 8% of respondents viewed supply shortages as a major threat to the bull market. This is despite all the media coverage of the shortage of computer chips and resulting slowdowns or production cuts in some key sectors, such as the auto industry. The electronics industry is also feeling the pinch and some experts say it could be as long as two years before supply catches up to demand.

All these threats are real. Whether any one of them could derail this runaway bull is doubtful. But any combination of at least two of the items on my list could lead to a market collapse on the order of 2008-09. So, don’t get complacent. Things look bright now, but there are potential problems out there.

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

INVESTOR MISTAKES COME WITH THE TERRITORY

Contributing editor Shawn Allen is with us with his thoughts on investment mistakes and regrets. Shawn has been providing stock picks on his website at www.investorsfriend.com since the beginning of the year 2000. He is based in Edmonton.

Anyone who has been a self-directed investor for any length of time has surely made a few mistakes and/or has some regrets. There are the mistakes of commission, where we have taken a regrettable action, and there are the countless mistakes of omission where there are actions that, in hindsight, we wish we would have taken.

At times, these may weigh on our minds. But the fact is that investment mistakes or regrets are inevitable and there is no point beating up ourselves about it.

Those who leave all their investment decisions to a portfolio manager or advisor have the luxury of someone to blame when things go wrong. But do-it-yourself investors, including those who make use of services like IWB, have to be prepared to live with and forgive themselves for their own mistakes.

The most common mistakes or regrets that we all tend to make are the following:

Selling winners: A popular old adage is that "you can never go broke taking a profit". But Warren Buffett has argued that selling your best stocks can "turn a mountain into a molehill". He has also argued that selling or reducing your biggest winner *simply* because it has become too large a part of your portfolio is akin to a sports team trading their star player because they are too dependent on him or her. Most long-time investors are only too well aware of the regret that can arise from selling winners. As I wrote in IWB #22027 last July, it's not a guarantee but, on average, in investing as in life, winners have a tendency to keep on winning.

Anchoring: A very common cause of investment mistakes is that we tend to fixate on past stock prices such as a high or the price we paid or a price at which we thought about buying but did not. This can lead to such things as a refusal to sell losers or a refusal to buy a stock simply because we failed to buy earlier at a lower price. The cure for anchoring is take a fresh and logical look at the evidence as of now. I wrote about anchoring in more detail in IWB #21809 back in February of 2018.

While we all make mistakes, as investors we should congratulate ourselves for having avoided the biggest mistake of all: Failing to invest over a lifetime.

Continued on page 4...

Mistakes—continued from page 3...

The Toronto Stock Exchange index was in the news last week as it surpassed the 20,000 level for the first time. Ten years ago, on June 1, 2011, it was at 13,528. Twenty years ago, it was at 8,251. Thirty years ago, it was at 3,537. The evidence is very clear that over a lifetime, investing in equities is rewarding.

This is not about to change. The output of the economy is ever more dependent on capital assets of all kinds and ever less dependent on labour inputs. To get our fair share of the output of the economy, it will be increasingly necessary to own capital and the way to do that for most people is to invest in the markets.

Rather than dwell on past mistakes and regrets, investors can only look to the future, safe in the knowledge that as equity investors they are on the right road even if there will be some inevitable potholes. And with IWB's guidance, I think it is fair to predict the road will both lead to a better place and be somewhat smoother.

Investors should also encourage those in their life, especially younger people, not to make the mistake of failing to become investors over their life if they possibly can. It's very easy to get started. The simplest and safest approach for those just starting out is to have their bank set up a monthly investment in a balanced mutual fund. Becoming a self-directed investor or other more sophisticated approaches can come later. The key for non-investors is to avoid the huge mistake of never getting started.

SHAWN ALLEN REVIEWS LULULEMON

Getting back to the topic of winners, today I am adding a winning Canadian headquartered company to our list: lululemon athletica ltd. (NDQ: LULU). The stock is expensive in relation to earnings but its continued growth and success arguably justifies its price. All figures here are in U.S. dollars.

Lululemon NDQ: LULU

Closed Friday at $329.52. (All figures in U.S. dollars.)

BUY

Background: lululemon is well known as a retailer of high quality "athleisure" clothing. The fact that its products are proprietary along with their brand reputation allows them to sell at very lucrative margins. While the head office is in Vancouver and its design activities are headquartered there, lululemon is registered as a U.S. company and trades on Nasdaq and not in Toronto. It has 521 company-operated stores in 17 countries. The locations of the stores are 60% in the U.S., 12% Canada, 11% China, 6% Australia, 3% United Kingdom, and 8% spread over 12 countries.

Continued on page 5...

Lululemon—continued from page 4...

With the pandemic, in 2020 online sales became its dominant channel, accounting for 52% of revenue. Company-operated stores represented 38% of the total and 10% of revenue was from “other” which includes its recently acquired online fitness business. In 2020, 69% of revenue was from women's wear and 86% of revenue was from North America.

Performance: This stock has risen spectacularly over the years and particularly since 2014 when it started the year at $59.03. In 2020 it rose 50%. In 2021 to year-to-date it’s down 5.3%.

Recent earnings: Results for its first quarter ended May 2 were released on Thursday and exceeded expectations. Comparisons to 2020 are less meaningful due to the pandemic but revenue growth compared to the first quarter of 2019 has compounded up at 25% for the two-year period. Adjusted earnings per share over the two-year period also increased at a compounded 25%. Adjusted earnings per share were up 10% for the year in 2020. That performance was achieved largely through cost-cutting as revenues declined modestly with the pandemic.

Recent developments: With the pandemic store closures, the company guaranteed that employees would still be paid. This was in keeping with its brand reputation as a company that lives by more progressive values. During the pandemic, the company was very successful in moving sales to the online platform. In 2020 it acquired MIRROR, an online fitness business, at a cost of $453 million. The net store count was increased by 6% in 2020 and 70% of the net additions were outside of North America.

Dividend: This company does not pay a dividend.

Valuation: At my analysis price of $328, the price to book value ratio is unattractively high at over 16 times – although this may possibly be justified by the high ROE and high growth. The trailing adjusted earnings p/e ratio is very high at 58 but that's partly due to the temporarily lower earnings caused by the pandemic. And the forward p/e based on the company’s projected 2021 earnings is also very high at 48.

The ROE is very strong at 33%. As mentioned, there is no dividend. Revenue per share growth in the past five fiscal years has averaged 18% and earnings per share growth has averaged 20%. This is despite the impact of the pandemic. Overall, while the ROE is proof that this is a very profitable company, the value ratios are not attractive.

Outlook: The company expects to add 40 to 50 company-operated stores in 2021. This will increase the store count by about 9%.

Conclusion: This stock is expensive in relation to earnings but has a strong history of growth that seems likely to continue and to result in a continued high p/e ratio.

Action now: Buy a modest position and continue to monitor. The stock closed Friday at $329.52.

SHAWN ALLEN'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Canadian National Railway TSX: CNR, NYSE: CNI

Originally recommended by Tom Slee on May 6/02 (#2218) at C$12.98, US$8.31 (split adjusted). Closed Friday at C$135.85, US$112.48.

BUY

Comment: Early last month I updated CNR with a recommendation of Buy at $132.33 and noted that I was treating its bid for Kansas City Southern as neutral to valuation. Since then, Kansas City Southern has chosen CN as the successful bidder over CP. Given the high price paid, this acquisition will likely take quite some time to pay off. But ultimately, if the deal is successfully completed, it places CN in a strong position to take advantage of and to facilitate increased trade with Mexico.

Many regulatory hurdles remain and if the deal fails to win regulatory approval, CN will have to pay Kansas City Southern a fee of one billion U.S. dollars. Prior to bidding for Kansas City, CN had reached a high of $149. Subsequently, rail traffic has continued to grow as the economy reopens. This is a complex acquisition deal. Given CN's strong history, I think it is appropriate to trust in management's judgement and continue to own CN or to buy on this dip.

Action now: Buy.

Stantec Inc. TSX, NYSE: STN

Originally recommended by Tom Slee on Aug. 28/06 (#2632) at C$10.24 US$9.23 (split-adjusted). Closed Friday at C$53.87, US$44.65.

HOLD

Background: Stantec is a large Edmonton-headquartered consulting firm offering engineering, architecture, and related professional services. It now has 22,000 employees operating out of 350 office locations on six continents. In 2020, 53% of its revenues were from the U.S., 29% from Canada, and 18% from other international operations which are primarily in the U.K., Australia, and New Zealand.

Performance: After gaining 23% in 2019, Stantec rose 12% in 2020 and it's up 30% in 2021 to date.

Recent earnings: Adjusted earnings per share were up 3% in the first quarter of 2021 and were up 10% for the year in 2020. That performance was achieved largely through cost-cutting as revenues declined modestly with the pandemic.

Continued on page 8...

Ceapro Inc. TSX: CZO, OTC: CRPOF

Originally recommended on Feb 27/17 (#21708) at C$1.57. Closed Friday at C$0.68, US$0.568.

BUY

Background: Ceapro Inc. is an Edmonton-based biotechnology company. It has about 40 employees, which includes a handful of Ph.Ds. It currently produces beta glucan and avenanthramides which are bulk products extracted from oats on a commercial scale and are used as ingredients in the cosmetics industry, including in some popular brand-name anti-aging and skin conditioner creams. Geographically, sales of its existing products are 69% in the U.S., 22% in Germany, and 9% in China, with essentially no sales in Canada.

Management indicates that the future value of the company will be driven by its research efforts rather than its existing bulk products. The existing products are profitable and provide cashflow to fund its research efforts which are described below.

Performance: Since it started trading over 20 years ago, Ceapro's stock price has been very disappointing. While it rose 106% in 2020, ending the year at $0.66, that was from a depressed level as it was down 17% in 2019 and 23% in 2018. And that was after plummeting 71% in 2017. The stock is more-or-less unchanged in 2021 to date.

Recent developments: The company continues to work on its various research efforts as follows:

- A Phase I clinical trial is underway using its proprietary concentrated beta glucan pills as a cholesterol reducing treatment for patients not responding well to the traditional statin drugs. The trial results will be known around the end of this year.

- It has positive results from a study using its concentrated avenanthramides to treat exercise-induced inflammation. This potential nutraceutical awaits a partnership arrangement.

- It has a license and is working on mechanisms to deliver medical cannabis more efficiently into the body.

- It hopes to license out what it describes as its game changing PGX Technology.

- The company is in early-stage research on using its yeast beta glucan as a potential inhalable therapeutic for COVID-19 and other fibrotic end-point diseases of the lung. It is planning a manufacturing facility in Germany.

Recent earnings*:* In 2020, revenues per share were up 16%. Earnings per share have historically been small and fluctuate

Continued on page 8...

Ceapro—continued from page 7...

above and below zero but did increase sharply in 2020 to a reasonably attractive level. Overall, revenue and earnings trends are quite positive in the latest year.

Valuation: Analyzed at a share price of $0.66. After several years of GAAP losses, the company was profitable in 2020. The p/e ratio is not excessive at 25 and the ROE is reasonably good at 9%. The price to book value ratio is not excessive at 2.1. There is no dividend. Overall, the value ratios would support a rating of Speculative Buy and that is without taking account of the potential for its research to pay off.

Outlook: Earnings from its existing two products could suffer in 2021 due to the higher Canadian dollar and lower government grants. The existing products generate positive cash flows that support its research efforts. In the medium to longer term the company expects to benefit from its new products under development. It seems unlikely that revenue will flow from any of these efforts prior to 2022 at the earliest. However, it is possible that they could generate cash earlier through joint venturing on the developments in some cases.

Risks: The larger risks relate to spending money on developing products and processes that might never achieve regulatory approvals or commercial success. There may also be risks due to product liability.

Action now: Buy, but be aware that this is a small company and is a speculative investment.

Stantec—continued from page 6..

Recent developments: Stantec has made five relatively small acquisitions in the past eight months, adding about 600 employees.

Dividend: The dividend was increased by 6% for 2021 to $0.165 per quarter ($0.66 a year). The shares yield 1.2% at the current price. Stantec has a history of increasing its dividend on an annual basis.

Valuation: Based on my analysis price of $54.04, the trailing adjusted earnings p/e ratio is somewhat expensive at 24.1 and is 20.5 based on analyst projected earnings. The price to book ratio is 3.1, and the dividend yield is 1.2%. Stantec retains most of its earnings and currently has an adjusted earnings payout ratio of 29%. The return on equity (ROE), based on adjusted earnings, is 12.7%, which is lower than its historic levels of about 18%. These ratios, in isolation, would support a recommendation of hold.

Outlook: The outlook is relatively strong as Stantec benefits from the reopening of the economy and various government infrastructure programs. Offsetting this, the higher Canadian dollar will be a drag on earnings.

Action now: Continue to hold.

GORDON PAPE'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Equitable Group TSX: EQB, OTC: EQGPF

BUY

Originally recommended by Irwin Michael on Aug. 10/08 (#2828) at C$21.04. Closed Friday at C$139.00, US$115.42.

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 eighth-largest Schedule 1 bank by market capitalization. Equitable Bank serves a quarter million Canadians and employs about 900 people. It also has a digital banking operation, EQ Bank, with its flagship product being the EQ Bank Savings Plus Account.

Performance: The stock hit an all-time high of $153.80 in mid-May before pulling back to the current level.

Recent developments: Equitable Group reported record first-quarter earnings for the period ending March 31, handily beating analysts' expectations.

Net earnings were $69.2 million ($3.97 per share, fully diluted)

compared to estimates of $3.59 per share. That was up from $43.2 million from in the same period of 2020. The year-ago earnings were $26 million, or $1.46 per share.

Revenue for the period after provision for credit losses was $150.9 million, up from $89.2 million last year. Equitable reported a recovery of about $800,000 in previously booked credit losses during the period.

"The ongoing efforts of our team produced outstanding first quarter results," said CEO Andrew Moor. "Customer account openings at EQ Bank increased 92% from a year ago to nearly 202,000 with 28,000 new customers joining us in Q1 helping to drive deposits up by $1.2 billion in just three months.

"Lending surpassed our expectations with no change in our conservative risk management approach but strong asset gathering in conventional commercial, insured multis, wealth decumulation solutions, and a return to market leadership on new originations in alternative single family."

Continued on page 10...

TC Energy Inc. TSX, NYSE: TRP

Originally recommended by Yola Edwards on April 23/06 (#2616) at C$34.07. Closed Friday at C$63.51, US$52.51.

BUY

Background: TC Energy is one of North America's major pipeline companies, with 92,600 km of natural gas pipelines and 4,900 km of oil pipelines. It also owns or has interests in 10 power generation facilities with combined capacity of approximately 6,000 megawatts.

Performance: The stock has been trending higher and is up about 20% year to date.

Recent developments: The company reported a first-quarter loss of $1.1 billion (-$1.11 per share), but it wasn't as bad as it looked. The red ink was due to the cancellation of the Keystone XL pipeline by President Joe Biden. Excluding that and some other specific items, comparable earnings for the quarter were $1.1 billion ($1.16 per share). That was two cents per share lower than a year ago.

"During the first three months of 2021, our diversified portfolio of essential energy infrastructure continued to perform very well," said CEO François Poirier. "Robust comparable earnings and cash generation once again highlight the resiliency of our assets and how imperative they are to the North American economy as we deliver the energy and advance projects vital to our way of life in a safe and reliable manner."

He added: "While we were very disappointed by the revocation of the Presidential Permit for Keystone XL and the resulting after-tax impairment charge, we are well positioned to deliver sustainable, high-quality growth in the years ahead."

Dividend: The shares pay a quarterly dividend of $0.87 per share ($3.48 per year). The current yield is 5.5%.

Outlook: The demise of Keystone XL was a blow to the company, but its other assets are doing well, and it invested $1.9 billion in new projects in the first quarter.

Action now: Buy.

Equitable Group—continued from page 9...

Dividend: The stock pays a quarterly dividend of $0.37 per share ($1.48 annually) to yield 1.1% at the current price.

Outlook: Equitable raised its outlook for fiscal 2021. It now expects to achieve full year-over-year EQ Bank deposit growth of 30-50% (upgraded from 20-30%) and total loan growth of 8-12% (upgraded from 6-10%), including increases in the commercial finance group of 20-25% (from 12-15%). Alternative single-family mortgages are expected to grow 12-15% (from 5-8%) and reverse mortgages to 200%+ (from 100%+).

Action now: Buy. The company is building its business at an impressive rate.

Suncor Energy TSX, NYSE: SU

Originally recommended on June 12/06 (#2622) at C$41.63, US$37.57 (split-adjusted). Closed Friday at C$30.79, US$25.49.

HOLD

Background: Suncor is a Canadian-based global energy company. It is a major player in the oil sands but also owns overseas assets that were acquired some years ago when it merged with Petro-Canada. It also has a wind generation portfolio and owns the largest biofuels plant in the country.

Performance: The energy sector is in the midst of a recovery as oil prices have strengthened in recent months. Suncor is up about 40% so far this year.

Recent developments: It was the difference between night and day. Suncor's first-quarter report in 2020 was awash in red ink as a collapse in oil prices and the onset of the pandemic weighed heavily on production and earnings.

This year, it's a different story. Funds from operations increased to $2.1 billion ($1.39 per share) in the first quarter of 2021, compared to $1 billion ($0.66 per share) in the prior year quarter. Cash flow provided by operating activities, which includes changes in non-cash working capital, was $2.3 billion ($1.54 per share) in the quarter, compared to $1.4 billion ($0.91 per share) in the prior year quarter.

The company recorded operating earnings of $746 million ($0.49 per share) in the quarter, which included an inventory valuation gain of $373 million after-tax. That compared to an operating loss of $421 million (-$0.28 per share) in the prior year, which was impacted by an inventory valuation loss of $446 million after-tax.

The bottom line – profits – showed net earnings of $821 million ($0.54 per share), compared to a net loss of $3.5 billion (-$2.31 per share) in 2020.

Suncor's total upstream production increased to 785,900 barrels of oil equivalent per day (boe/d) in the quarter, compared to 739,800 boe/d in the prior year. Together, the fourth quarter of 2020 and first quarter of 2021 represent the best sequential synthetic crude oil production performance in the company's history.

Dividend and buybacks: Suncor slashed its dividend by more than half in March 2020 and now pays $0.21 per quarter ($0.84 per year) to yield 2.7% at the current price.

The company is actively buying back shares, spending $318 million to purchase approximately 12 million shares, or approximately 1% of the total common shares outstanding.

Outlook: After the quarterly results were released, Suncor issued a detailed strategy outlook which aims at increasing shareholder returns and reducing greenhouse gas emissions (GHG).

The company will focus its planned $5 billion annual capital spending through 2025 on optimizing its integrated value chain and sustaining the base business, while improving its cost and carbon competitiveness, and growing low-carbon businesses, which is expected to deliver an annual $2 billion of incremental free funds flow to the business by 2025.

Continued on page 12...

WHAT'S WITH THE CRA?

For the second time this year, I have received a notice from the Canada Revenue Agency advising me that my user id and password for My Account have been revoked. This is not, I'm assured, the fault of the CRA. Their email says: "This is not as a result of a breach of CRA's online systems, rather your CRA user ID and password may have been obtained by unauthorized third parties and through a variety of means by sources external to the CRA (ex: email phishing schemes). We have taken this precautionary measure to protect your personal information."

Perhaps this is true, but this is the second time this has happened, and I have seen no evidence of abuse in my many other password-protected accounts. If the CRA has such evidence, they should make it public, or convey more details to those involved. This sort of notice leaves everyone in limbo. Should we be changing all our passwords, everywhere?

One other problem. I went through the lengthy process of trying to re-register on the CRA website. The site accepted all my revised information until I got to the last page, which contains all the terms and conditions. At that point, it repeatedly rejected my newly created username/ password, without explanation.

What the heck is going on? If any other members are having similar difficulties, let me know at gpape@rogers.com.

Suncor—continued from page 11...

Suncor says this planned free funds flow growth will be focused on returning significant value to shareholders through increased dividends, ongoing share buybacks, and fortifying the balance sheet through continued debt reduction. In addition, the strategy includes a goal to be a net-zero GHG emissions company by 2050.

Lofty goals. How will the company achieve them? One initiative announced last month is a deal with Alberta utility company ATCO to collaborate on early-stage design and engineering for a potential clean hydrogen project near Fort Saskatchewan, Alberta.

If completed (no certainty at this point) the project would produce more than 300,000 tonnes per year of clean hydrogen, reduce Alberta's CO_2 emissions by more than two million tonnes per year, significantly advance Alberta's hydrogen strategy, generate substantial economic activity and jobs across the province, and make a sizable contribution to Canada's net zero ambition. Both the federal and provincial governments are supporting the plan.

Action now: Hold. The company's output and finances are improving and the plans for the future are ambitious and on target. But another drop in oil prices plus the inherent risk in the fossil fuel industry suggest a cautious approach.