Reproduction without permission is illegal

Update Edition

THE INCOME INVESTOR

Volume 19, Number 17 **Issue #2117** **September 16, 2021**

IN THIS ISSUE

Not all bond ETFs are losers 1

Gavin Graham updates Johnson & Johnson, Intact Financial, Cineplex 3

Correction: Slate REIT 4

Editor and Publisher: Gordon Pape
Associate Publisher: Richard Croft
Associate Editor: Mike Keerma

Copyright 2021 Gordon Pape Enterprises Ltd.
All material in The Income Investor is copyright Gordon Pape Enterprises Ltd. and may not be reproduced in whole or in part in any form without written consent. All recommendations are based on information that is believed to be reliable. However, results are not guaranteed and the publishers and distributors of The Income Investor assume no liability whatsoever for any material losses that may occur. Readers are advised to consult a professional financial advisor before making any investment decisions. Contributors to The Income Investor and/or their companies or members of their families may hold and trade positions in securities mentioned in this newsletter. No compensation for recommending particular securities or financial advisors is solicited or accepted.

Reprint permission: Contact customer service

Phone: 1-888-287-8229

Email: customer.service@buildingwealth.ca

Next issue:
September 30

NOT ALL BOND ETFS ARE LOSERS

By Gordon Pape, Publisher and Editor

It's been a rough year for bonds and most of the ETFs that hold them. People are dumping their bond funds and in many cases switching the money to equities, which they perceive as being safer. That's certainly been the case so far in 2021 as North American stock indexes have soared to record levels.

According to the Investment Funds Institute of Canada, $362 million was pulled out of ETF bond funds in July (the last month for which figures were available at the time of writing). However, bond mutual funds showed an increase of just over $2 billion in net sales.

Why the difference? In part, because many mutual fund investments are tied to pension plans where a designated percentage of new contributions are allocated to bond funds.

The ETF numbers are a more accurate reflection of how investors feel about bond funds at this time, because they can be bought and sold by simply picking up the phone or tapping a computer key. So, let's look at some our recommended bond ETFs and see how they're performing.

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

Current price: $32.16
Originally recommended: Dec. 15/04 at $29.49
Annual payout: $0.816 (forward 12 months)
Yield: 2.5%
Risk Rating: Moderate
Website: www.ishares.ca

Comments: This fund tracks the broad Canadian bond market, including government and corporate issues. So, what you're seeing is a reflection of what is actually happening across the entire bond spectrum in this country.

It's not as bad as some people seem to think. The fund is down 2.24% year to date, as of Sept. 14, according to the Blackrock website. The one-year loss to Aug. 31 was 1.77%.

Continued on page 2…

Reproduction without permission is illegal

Bond ETFs - continued from page 1…

No one likes to lose money, of course, but those numbers aren't as bad as the general perception might suggest. I view this ETF as a long-term core fixed income position. If the stock market suffers a sharp correction, you'll be happy you own it.

Action now: Hold.

iShares Core Canadian Short Term Bond Index ETF (TSX: XSB)

Current price: $27.83
Originally recommended: Sept. 24/03 at $28.62
Annual payout: $0.564 (forward 12 months)
Yield: 2.0%
Risk: Low
Website: www.ishares.ca

Comments: Short-term bond funds are less exposed to interest rate movements, either up or down. That means we should expect a better performance from this fund than from XBB in a time of rising rates. That's exactly what we're seeing. The fund is down a mere fraction (-0.05%) year-to-date and actually shows a one-year gain of 0.45% to Aug. 31.

Not exciting numbers, but this fund isn't meant to be exciting. It's designed to provide stability for portfolios.

Action now: Hold.

iShares Canadian Corporate Bond Index ETF (TSX: XCB)

Current price: $22.06
Originally recommended: Jan. 21/09 at $18.77
Annual payout: $0.672 (forward 12 months)
Yield: 3.0%
Risk Rating: Moderate
Website: www.ishares.ca

Comments: This ETF invests in a portfolio of investment-grade Canadian corporate bonds with a maturity of at least one year. You might expect corporate bonds to be more vulnerable in times like these, but that's not proven to be the case. This fund is down 1.16% year-to-date and is fractionally ahead over the 12 months to Aug. 31.

The forward yield, which is based on the current monthly distributions, is a reasonable 3%.

Action now: Hold.

iShares Convertible Bond ETF (TSX: CVD)

Current price: $18.78
Originally recommended: March 23/17 at $19.14
Annual payout: $0.852 (forward 12 months)
Yield: 4.5%
Risk: Moderate
Website: www.ishares.ca

Comments: There seems to be a general impression that all bond funds are losing money this year. Not true. This one is ahead almost 6% so far in 2021 and shows a one-year rate of return of 9.58% to Aug. 31. Not as good as the TSX perhaps, but very respectable.

Convertible bonds offer a play on both the stock and bond markets. They're convertible into common shares of the issuer at a set price. If the stock price rises to above the exchange rate, it drives the price of the bond up.

The current top holding is Morguard Real Estate Investment Trust convertibles at just over 10% of the portfolio. Morguard has not been a stellar performer recently but the number two position, Northwest Healthcare Properties REIT (9.95% of the portfolio), has been quite strong. Other top holdings include convertible bonds from Chemtrade Logistics Income Fund, Wildbrain Ltd., and Alaris Equity Partners Income Trust.

Action now: Buy.

Granted, CVD is an exception, and most bond ETFs are in the red year-to-date. But if you check their charts, the majority have moved off their 2021 lows. With the stock market looking pricy and a correction long overdue, I wouldn't be too quick to dump these ETFs from your portfolio.

Follow Gordon Pape's latest updates on Twitter: http://twitter.com/GPUpdates

Reproduction without permission is illegal

GAVIN GRAHAM'S UPDATES

(Note: prices are at the close on Sept. 14.)

Johnson & Johnson (NYSE: JNJ)

Type: Common stock
Current price: $164.80
Originally recommended: Oct. 27/10 at $63.81
Annual payout: $4.24
Yield: 2.6%
Risk: Moderate
Website: www.jnj.com

Johnson & Johnson is one of the largest healthcare and consumer product companies in the world, employing 136,500 people and with revenues of between $88-90 billion expected for 2021 (figures in US dollars). Its three divisions comprise Consumer, Pharmaceutical and Medical Devices.

In the six months to June 30, Consumer revenues rose 5.3% to $7.3 billion. Pharmaceuticals (including its single dose COVID-19 vaccine) rose 13.3% to $24.8 billion and Medical Devices was up 32.7% to $13.6 billion, making a total increase of 16.9% to $46.7 billion. Sales are divided virtually evenly with $23 billion in the US and $22.6 billion internationally.

Net earnings grew 32.4% to $12.5 billion ($4.67 per share). Sales in Consumer sales were driven by skincare products such as Nutrogena and Aveeno. Pharmaceuticals were led by Stelara for inflammatory diseases and Darzalex for multiple myeloma offset. Those gains were offset by falls in Remicade for arthritis. Medical Devices benefited from postponed procedures due to COVID-19.

J&J failed in its attempt to strike down the $2 billion award to plaintiffs claiming asbestos in its Baby Powder caused ovarian cancer. There are rumours that it may spin off its liabilities into a separate company, which would then file for bankruptcy, a tactic employed by other companies such as Georgia Pacific.

Its longstanding CEO, Alex Gorsky, is stepping down after nine years, to be replaced by long time J&J veteran Joaquin Duato, at present responsible for supervising its supply chain. Under Gorsky, J&J carried out its largest ever merger, buying Swiss biopharmaceutical company Actelion for $30 billion in 2018. Research & Development increased 60% under Gorsky's tenure to $12 billion this year.

The dividend was increased 3.7% to $1.06 quarterly in the last twelve months. The stock yields 2.6%.

Action now: J&J remains attractive with a 24.77 p/e ratio. Sell half to lock in a gain of 158.3%. Retain the rest of your shares for exposure to attractive areas such as healthcare and consumer products that benefit from demographic trends.

Intact Financial Corp. (TSX: IFC, OTC: IFCZF)

Type: Common stock
Current price: C$173.67, US$137.44
Originally recommended: April 20/11 at C$49.98
Annual payout: $3.32
Yield: 1.9%
Risk: Moderate
Website: www.intactfc.com

Comments: Intact is the largest Property/Casualty (P/C) insurer in Canada, with almost 20% market share after the acquisition of the Canadian operations of UK insurer RSA, a deal which closed this month. It also purchased the UK and Irish operations, splitting RSA's assets with Scandinavian insurer Tryg, which purchased the Norwegian and Swedish assets. Intact consistently writes profitable insurance on its book, which has enabled it to outperform the industry in terms of profitability and CEO Chares Brindamour aims to outperform the industry return on equity (RoE) by 5% per year over time.

In the six months to June 30, Intact increased its direct premiums written by 17% to $6.8 billion. The number was helped by the addition of RSA's Canadian business from June 1, which increased its premium base 70%. Net income tripled to $1.1 billion ($3.58 per share) and the combined ratio (costs as a percentage of premiums) was 87.8% a 4.1% improvement form the first half of 2020. Book value per share, probably the best indicator of progress for insurers, was up 44% to $77.67 per share.

Intact and Tryg's Danish joint venture sold RSA's Danish business in June to Alm Brand for $2.52 billion, of which Intact will receive half. The proceeds to be used to repay debt and general corporate purposes when the deal closes mid-2022.

Continued on page 4…

Reproduction without permission is illegal

Updates - continued from page 3…

While Intact's dividend remains constrained by Office of the Superintendent of Financial Institutions, it should increase from its present 1.9% yield once restrictions are lifted.

Action now: Intact has more than tripled since the original recommendation a decade ago. Investors should Sell Half to lock in the exceptional profits, reflecting Intact' s steady growth by successful acquisitions and the transformative nature of the RSA deal. It's worth retaining a position as the cost savings from the merger of the Canadian operations of RSA and the ability of Intact management to raise the UK's lower profitability should ensure further growth.

Cineplex Inc. (TSX: CGX)

Type: Common stock
Current price: $13.31
Originally recommended: Feb. 25/09 at $13.72
Annual payout: $0
Yield: 0%
Risk: High
Website: www.cineplex.com

Comments: Cineplex is the largest operator of cinema complexes in Canada, with over 1,600 screens comprising 70% of the market. It also operates a media business that provides advertisements for office buildings. It also runs electronic gaming facilities and amusement arcades called Rec Rooms, where customers can play up to 100 video games.

In December 2019, Cineplex accepted a takeover bid from UK-based Cineworld. It's one of the largest international cinema operators with over 9,500 screens in the US, UK, Ireland, and eastern Europe. The offer was $34 a share, a premium of over 40% to Cineplex's pre-bid share price.

We recommended selling the stock for a total gain of 148%, but those shareholders who retained their shares to accept the bid have seen a collapse in the Cineplex share price to as low as $4.32 in October last year, as Cineworld reneged on its bid once COVID-19 closed down the industry in March 2020.

Cineplex has launched legal proceedings against Cineworld, whose large debt load makes its survival in its present form uncertain.

In the meantime, with the reopening of cinemas from June onwards in Canada, even with capacity substantially reduced due to social distancing measures, Cineplex reported revenues of $64.9 million for the second quarter ending June 30. However, it recorded a loss of $103.7 million against $98.9 million in the same quarter the previous year.

For the six months to June 30, revenues of $106.3 million were down 65% from $304.8 million in 2020, when cinemas were open essentially for the whole of the first quarter. Encouragingly, losses were reduced 29% from $272.4 million in 2020 to $193.4 million in 2021. Box office revenue per patron was flat at $10.44, while concession revenue was up 9% to $7.40 per patron, showing people were still ready to eat overpriced popcorn.

With Cineplex having raised $250 million in 7.25% bonds this year, its survival until attendance returns to nearer its pre-COVID levels is assured. With an attractive slate of films scheduled for the rest of 2021, including some holdovers from last year like No Time to Die, the new James Bond movie, as well as decent attendance for existing releases such as Disney's Jungle Cruise, The Suicide Squad remake, and Ryan Reynolds' video game set caper Free Guy, the outlook is much brighter than at virtually any time since COVID struck.

However, it's impossible to forecast how willing patrons will be to return to cinemas, especially with the recurrence of new variants of COVID such as Delta. And remember, cinemas' primary audience comprises 16-24 year old's, who have the lowest vaccination rates amongst the population. That makes the outlook extremely uncertain, plus the dividend has been suspended.

Action now: Sell at market, which will result in close to breakeven from the original recommendation, plus over 50% in income over the period.

CORRECTION

In the last issue we ran an update on Slate Retail REIT. Slate has changed its name to Slate Grocery REIT and its symbol to SGR.UN. My apologies for the confusion. – G.P.