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# WEALTH *builder*

## SEPTEMBER WAS A LOSER – AS USUAL

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**By Gordon Pape, Editor and Publisher**

“April is the cruellest month,” wrote poet T.S. Eliot in the opening line of *The Waste Land*.

Not for investors, however. That honour belongs to September, and the month just finished lived up to it. Everyone fears October, the month of the 1929 crash that ushered in the Great Depression. But historically September is the worst month to have money in the markets.

According to Yardini Research, whose tracking goes back to 1928, the S&P 500 has been in the red 50 times in September, versus 42 gains. The average loss in the down years was 4.6%, compared to gains of 3.2% when the market was up. Overall, the average annual loss for September was 1.9%.

By contrast, much feared October was up in 54 of those years and down in only 39. The average annual gain

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No IWB next week. Next issue Oct. 18

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wasn't impressive, at 0.4%, but that was better than September, February, and May.

So, what happened this year? A repeat of the historical pattern. The S&P 500 lost 215 points or about 4.8%. That was slightly worse than the historical loss in down years and was the worst month since the pandemic plunge in March 2020.

It wasn't alone. All the major North American indexes were down for the month. The Dow dropped more than 1,500 points, or 4.3%. The Nasdaq 100 was off 893 points (5.7%).

Here at home, the S&P/TSX Composite fell 512.65 points, or 2.5%, a much better performance than its US counterparts.

Why? Largely because of energy stocks. A year ago, they were pariahs. Low oil prices and increasing concern over global warming resulted in many people dropping them from their portfolios. Quebec's Caisse de depot et placement announced last week it will divest all oil stocks from its portfolio by next year.

That's in line with popular opinion but it will likely cost the fund some profits. During September, the S&P/TSX Capped Energy Index rose 18.11%. Since energy is one of the largest components of the TSX, that goes a long way to explaining why Toronto outperformed New York in September.

But that was one of the few bright spots.

Overall, September was pretty much a washout.

That's history. What now? The S&P 500 opened October with a big gain on Friday and the other indexes rode along. History suggests that, while October can be a volatile month, it will normally outperform September.

That suggests sitting tight and not making any dramatic portfolio moves. That said, I wouldn't advise taking new positions at this time. I continue to be concerned about a long-overdue correction. The timing is unknown, but it will eventually happen.

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## Your Questions

### TFSA quandary

**Q** - I have a TFSA, just because I heard it's the thing to do with our money. I am 72, husband 73. I really don't understand how the account works. Do I get a bonus of some kind? Do I pay when I take money out?

At our age, do I cash out our RRIF and put it in there? I'm sorry, but I just don't get it. Thank you for any advice you can give us. – June and Ron S., Burlington, Ontario

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# TAXING TIMES FOR CANADIAN BANKS



**By Gavin Graham,  
Contributing Editor**

The Canadian federal election has come and gone, leaving the parties in almost the same position as before the campaign. The Liberal minority government was returned with two or three fewer seats, which were lost to the NDP and the Parti Quebecois (PQ).

Despite running a much better campaign than pundits had anticipated, the Conservatives and their relatively new and untried leader Erin O'Toole failed to gain any ground on 2019's result in terms of seats won. However, some observers feel that they may be following the path taken by Stephen Harper, who went from Official Opposition status in 2004 to a minority government in 2006 as voters became more familiar and comfortable with his electoral platform.

Regardless of what the future holds in terms of electoral outcomes, one definite result of the Liberals being returned to power seems to be higher taxes on Canadian banks and financial companies. They have proposed an increase in the federal income tax rate on banks and insurance companies of from 15% to 18% that would earn more than \$1 billion a year as well as a temporary (supposedly) Canada Recovery Dividend to be paid by banks and insurers.

The justification for introducing these measures was the extensive government support programs during the COVID-19 pandemic. These included the Canada Emergency Wage Subsidy (CEWS) and the Canada Recovery Benefit, which prevented bankruptcies and credit losses, and “insulated our financial sector from the worst of the pandemic.”

The background briefing from the Liberals as part of their policy program noted the operating income of Canada's six largest banks has increased by more than 17% since the beginning of the pandemic. The banks and insurers contribution to the Canada Recovery Dividend would be developed over the next few months in collaboration with the Office of the Superintendent of Financial Institutions (OSFI) and run for a four-year period.

Together with the rise in corporation tax, the Liberals estimate the measures would generate at least \$2.5 billion a year for the next four years.

Should investors be concerned about the increase in taxes for the financial sector, which is the largest in the S&P/TSX Composite Index, comprising over one-third of its market capitalization? While share prices are supposed to represent the future stream of income generated by a company, and any reduction in that income stream by higher taxes or

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**Banks—continued from page 3...**

operating expenses should theoretically reduce the value of the shares, many other factors contribute to the valuation of companies on public markets.

Financials, whether in Canada, the US, Europe, or Asia, usually sell at relatively low valuations compared to many other sectors. This is due to the perception, generally acknowledged to be correct, that banks and insurers are low growth companies, as their reliance on the state of the economy and the shape of the yield curve in the bond market means that it is difficult for them to grow much faster than the underlying economy's rate of Gross Domestic Product growth.

In mature developed countries such as North America, Europe, and Japan, this usually means GDP is around 2-3% per year. Banks and insurers earnings per share (EPS) growth rate is a little higher, at 5-8% annually. When technology or healthcare companies can grow their EPS at 15-35% per year, the bank's lower rates obviously do not appear particularly attractive. As a result, the financials will sell at a discount to the market's price/earnings valuation.

The S&P 500 sells at 26.7 times 2020's earnings while the S&P/TSX sells at 19.3 times. By contrast, the Canadian banks p/e ratios for 2020-21 range from 10-12 times earnings, while US banks such as JPMorgan, Bank of America, Wells Fargo, and Morgan Stanley are selling at p/es between 10-14 times. Credit card issuers Visa and Mastercard sell at 42

and 51 times 2021 earnings, but they do not have credit losses or massive balance sheets to contend with and the market treats them as financial technology companies with the appropriate rating.

The Liberal party's proposed tax increases for the financial sector means that, on average, each of the six major banks and three life insurers making over \$1 billion would each be liable for an additional \$275 million in taxes each year. That's by dividing \$2.5 billion by the nine institutions, although obviously the larger companies would pay more proportionately than the smaller ones. Using a p/e ratio of 11 times, this would imply a \$3 billion reduction in the valuation of each bank or insurer.

For some perspective, Royal Bank's market capitalization now is \$182.2 billion, TD is \$151.5 billion, and Bank of Nova Scotia is \$95.1 billion, so this would represent between 1.6% and 3.2% of their valuation.

The three banks have increased in value by 36%, 37%, and 44% respectively over the last twelve months as the economy has recovered from the effects of COVID -19 and provisions for credit losses have fallen sharply. Therefore, it becomes apparent that investors should not be overly concerned about the increased taxes.

Of more concern would be a continuation of the freeze on increasing dividends,

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# GAVIN GRAHAM'S UPDATES

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

## RBC Group TSX, NYSE: RY

**BUY**

*Originally recommended by Gavin Graham on June 8/15*

*(#21521) at C\$79.58, US\$63.95. Closed Friday at C\$126.11, US\$99.82.*

**Background:** RBC is Canada's largest banking group by balance and market capitalization, with leading positions in retail and commercial lending, asset management and investment banking.

**Performance:** The stock is essentially unchanged over the last three months, which included the election campaign and the Liberal's tax proposals. But, it is up over one-third in the last year and 60% since being recommended in 2015.

**Recent developments:** For the quarter ended July 31, RBC reported net income of \$4.3 billion, up \$1.1 billion (34%). Earnings per share were \$2.97, up 35%. The sizeable increase was largely due to the release of \$638 million in credit loss provisions compared to an increase of \$280 million in the same quarter the previous year, making a turnaround of \$918 million.

Pre-provision, pre-tax earnings of \$5 billion were up 6%, on higher loan volumes and record investment banking revenues. Return on equity (RoE) was 19.6% and its Tier 1 Capital Ratio was 13.6%.

**Dividend:** Due to the COVID restrictions imposed by OSFI, the quarterly dividend remained unchanged at \$1.08 per share, equal to a 3.4% yield.

**Action now:** Trading near an all-time high, RBC remains a Buy for its market leading positions and the likelihood of a dividend increase once the OSFI removes the cap. Trading at a forward p/e of 11.5 times and at 2.05 price/book, it remains good value.

### ***Banks—continued from page 5...***

which has been in place since the beginning of the pandemic. However, if the logic of the government's policies is followed through, if the banks are healthy enough to pay an additional \$2.5 billion a year in taxes, then they should certainly be healthy enough to start raising dividends again.

Let's look at the most recent third-quarter results to July 31 for the three banks in the IWB's recommended list.

# TD Bank TSX, NYSE: TD

**BUY**

*Originally recommended by Tom Slee on Feb. 12/07 (#2706) at C\$34.98, US\$29.80. Closed Friday at C\$85.37, US\$67.60.*

**Background:** TD is the sixth largest bank in North America by total assets, market capitalization, and number of branches, of which it has more in the eastern US than in Canada. It is also one of the world's leading on-line financial firms, having a minority stake in the largest US discount broker, Charles Schwab from its sale of TD Ameritrade to Schwab last year.

**Performance:** The stock is up 37% over the last year although down slightly from the last update in June. It's more than doubled since it was recommended by Tom Slee.

**Recent developments:** Reported net income for the third quarter was \$3.5 billion (\$1.92 per share), up 58% compared to the previous year. Adjusted net income was \$3.6 billion (\$1.96 per share) up 56%. Canadian retail income increased 68% to \$2.13 billion on a 9% increase in revenue, largely due to an \$851 million decrease in provisions for credit losses (PCLs).

US retail income increased 92% to \$1.3 billion on a 5% increase in revenue and a \$993 decrease in

PCLs. The contribution from Charles Schwab fell to \$197 million from \$317 million on lower trading volumes.

**Dividend:** The quarterly dividend of \$0.79 per share is equivalent to a 3.8% yield, the highest since the depths of the first wave of the COVID pandemic eighteen months ago. As with RBC and Scotiabank, the dividend should be increased once the cap imposed by the OSFI is removed.

**Action now:** TD remains a Buy for its US and on-line financial exposure as well its strong positions in retail and commercial lending. At a price/book ratio of 1.6 and a price/earnings ratio of 10.8 times, it is selling at its cheapest valuation in several years.

## Questions



Our team of experts have your answers! Send your questions to [gpape@rogers.com](mailto:gpape@rogers.com)

# Bank of Nova Scotia TSX, NYSE: BNS

**BUY**

*Originally recommended by Tom Slee on Jan. 17/11 (#21102) at C\$56.83, US\$57.34. Closed Friday at C\$78.65, US\$62.18.*

**Background:** Scotiabank is the most internationally oriented of the Big Six chartered banks, with over 35% of its earnings derived from its overseas operations. These are primarily in Latin America, where the four countries of the Pacific Alliance, Mexico, Colombia, Peru, and Chile, have been the focus of the group's strategy. It has particular strengths in corporate lending and asset management and is usually the lowest cost operator in the banking sector.

**Performance:** Scotiabank has been the best performer amongst the Big Six over the last year, up 44%. But this still leaves it as the worst performer over longer periods, as the market applies a discount to its large overseas operations, even though they are both higher margin and faster growing than the Canadian and US market.

**Recent developments:** The bank saw a continued strong recovery in the third quarter, with net income up 91% to \$2.5 billion (\$1.99 per share) while adjusted net income rose 96% to \$2.56 billion (\$2.01).

Canadian operations adjusted net income of \$1.08 billion is now 4% above the last pre-pandemic quarter, on revenue up 6.5%. But international banking's \$493 million income is a remarkable 19% below the same period last year, showing the effect of COVID on such tourism dependent economies as Mexico and the Caribbean.

With central banks in Chile and Mexico raising interest rates in the third quarter, Scotia's net interest margin (NIM) will improve, and it expects retail loan growth in the region will accelerate in the fourth quarter. CET1 is at 12.2% and RoE at 15.6%.

**Dividend:** Scotiabank pays a \$0.90 quarterly dividend, giving it the highest yield amongst the major banks at 4.6%, which again should increase once the OSFI restrictions are lifted.

**Action now:** Scotiabank is a Buy for its international exposure, strong Canadian corporate presence, and strengths in asset management. It is the cheapest of the big Canadian banks at a p/b of 1.5 and a p/e of 9.9.

# THE AGNICO-KIRKLAND DEAL

**By Gavin Graham**

Canada is about to have a new number one gold mining company, but many investors aren't happy with the deal.

On Sept. 28, Agnico Eagle (TSX, NYSE: AEM) announced an agreed merger with Kirkland Lake Gold (TSX: KL). It's an all-stock deal, with Kirkland shareholders receiving 0.7935 of an Agnico share for each Kirkland share.

That's a 1% premium to Kirkland's trailing 10-day average price, similar to the Barrick Gold/Randgold combination two years ago. It values Kirkland at \$13 billion.

While the news had leaked out before deal was announced, and Kirkland's price had risen, the nil premium combination was regarded as disappointing by some investors. As a result, Kirkland's share price fell almost 8% to \$50.06 a share on the announcement.

This seems to be an overreaction. The combined companies will be by far the largest gold miner listed in Canada, with Agnico adding Kirkland's three mines to its existing nine properties. More importantly, Kirkland's Macassa and Detour properties are in the same north-eastern Ontario/north-western Quebec Abitibi region as Agnico's La Ronde and Malartic mines. The companies estimate they will save \$800 million over the next five years

from combining their operations.

The combined company will roughly double Agnico's reserves to 48 million oz. The estimated production in 2021 will be 2.5 million oz. The combined company will be capitalized at \$24 billion.

Kirkland has been transformed from an unsuccessful junior to one of the best performing gold miners over the last five years. New management installed by major shareholder Eric Sprott, led by CEO Tony Makuch, made two successful acquisitions: Newmarket Gold for \$1 billion in 2016 and Detour Gold for \$4.6 billion in 2019.

Newmarket's Fosterville mine in Australia proved to be one of the highest grade and most profitable discoveries in the last decade, and Kirkland's share price rose almost 550% between 2016 and 2019. While the takeover of the open pit Detour Gold last year was not as well received, with Kirkland's price off 10% since the deal, analysts are now coming to appreciate the quality of its assets.

Long standing Agnico CEO Sean Boyd is moving upstairs to become executive chair and Mr. Makuch will become CEO of the combined company.

When questioned why Agnico was moving away from its successful model of developing its own new mines to make what could be considered a risky

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***Agnico-Kirkland—continued from page 8...***

acquisition, Mr. Boyd responded: “We haven’t increased the risk profile of the business, What we’ve actually done is put two low risk businesses together.”

And Mr. Makuch was enthusiastic about the growth potential for the Abitibi mines noting: “Nobody’s trying to fix a problem here. We’re trying to create a better company.”

Two-thirds of Kirkland shareholders have to vote in favour of the deal and there is a \$450 million break fee payable by Kirkland to Agnico if another miner

decides to muscle in with a higher bid. The deal requires a simple majority of Agnico shareholders to vote in favour. Subsequent to the merger, Agnico shareholders will own 54% of the combined company and Kirkland 46%.

**Action now:** Agnico shareholders should vote in favour of the deal, which will make the new Agnico one of the few gold companies large enough to be of interest to index funds and generalist investors. As well, the benefits will be lower costs, greater growth potential, and enhanced reserves. AEM closed Friday at C\$64.46, US\$50.99.

***Questions—continued from page 2...***

**A** – First let me say that opening a TFSA was the right thing to do, even though you’re not sure why. With all the savings options we have in this country (RRSPs, RRIFs, TFSAs, LIFs), it’s very easy to get confused about which choice is best.

At your age, the TFSA is the only plan to which you can make contributions. RRSPs must be collapsed by the end of the year you turn 71, and new contributions to RRIFs and LIFs aren’t allowed.

There are two major differences between an RRSP and a TFSA. A contribution to an RRSP generates a tax deduction, but any money withdrawn is taxed. There is no deduction for a TFSA contribution, but the money can be taken out at any time tax-free.

This makes a TFSA a good choice for seniors who qualify for the guaranteed income supplement (GIS). Most income, including RRSP/RRIF withdrawals, reduces the amount you receive from a GIS payment. A TFSA withdrawal doesn’t do that.

Unless you are in a low tax bracket, I would not advise taking capital from a RRIF to put into a TFSA because you’ll be taxed on any RRIF withdrawal. Rather, use the TFSA for any other savings you have. If you don’t need all the money from your required RRIF withdrawals, put it there (up to the legal contribution limit).

Don’t keep the TFSA money in a low-interest savings account. The whole idea of the plan is to invest in securities that pay a decent return, which will be tax-free to you. You’ll find lots of ideas in this newsletter.

If you want to know more, I’ve written two books on TFSAs. They should be available on the Amazon and Indigo websites. – G.P.



# GORDON PAPE'S UPDATES

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

## Gilead Sciences NDQ: GILD

**HOLD**

*Originally recommended on March 2/20 (#22009) at \$69.36. Closed Friday at \$68.56. (All figures in U.S. dollars.)*

**Background:** Gilead is an American biotechnology company that researches, develops, and commercializes drugs. The company focuses primarily on antiviral drugs used in the treatment of HIV, hepatitis B, hepatitis C, and influenza. It also has a drug that is used for treating patients with COVID.

**Performance:** The stock fell as low as \$56.56 in December but has gradually edged higher since and is up about 15% year to date. It is slightly below our original recommended price.

**Recent developments:** Second-quarter results showed a 21% increase in revenue over the previous year, to \$6.2 billion. This was primarily due to the high demand for Verkury, the trade name for remdesivir, which is used to treat COVID-19. (Donald Trump received it when he was hospitalized with the virus.) Verkury sales were \$829 million for the quarter. The company noted that sales of Verkury are generally affected by COVID-

19 related rates of infections, hospitalizations, and vaccinations.

Total product sales excluding Verkury increased 5% to \$5.3 billion for the quarter compared to the same period in 2020.

Gilead reported diluted earnings per share of \$1.21 compared to a loss of \$2.66 a share in the prior year. The company generated \$2.3 billion in operating cash flow during the quarter.

As of June 30, Gilead had \$7.4 billion of cash, cash equivalents, and marketable debt securities compared to \$7.9 billion as of Dec. 31, 2020.

**Dividend and buybacks:** The stock pays a quarterly dividend of \$0.71 a share (\$2.84 a year) to yield 4.1% at the current price. As well, the company spent \$43 million on share buybacks during the quarter.

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## Descartes Systems Group TSX: DSG, NDQ: DSGX



*Originally recommended on Oct. 30/17 (#21739) at C\$37.83, US\$29.45. Closed Friday at C\$102.06, US\$80.75.*

**Background:** Descartes provides on-demand, software-as-a-service solutions focused on improving the productivity, performance, and security of logistics-intensive businesses. Customers use its solutions to route, schedule, track, and measure delivery resources; plan, allocate, and execute shipments; rate, audit, and pay transportation invoices; access global trade data; file customs and security documents for imports and exports; and complete numerous other logistics processes. The company's headquarters are in Waterloo, Ontario and Descartes has offices and partners around the world.

**Performance:** The stock recently hit an all-time high of \$111 before retreating to the current level.

**Recent developments:** Descartes' second-quarter results for fiscal 2022 were in sharp contrast to those of Badger. Revenue was up 25% to \$104.6 million for the three months to July 31, from \$84 million in the same period last year. For the first half of the 2022 fiscal year, revenues were \$203.4 million, up 21% from \$167.7 million from a year ago. Note that Descartes reports in US dollars.

The revenue increase translated into a big gain on the bottom line. Net income for the quarter was \$23.2 million (\$0.27 a share) compared to \$10.5 million (\$0.12 a

share) last year. Net income for the first six months was \$41.6 million (\$0.48 a share), up from \$21.6 million (\$0.25 a share) in the first half of fiscal 2021.

“We continue to focus on helping our customers thrive in the face of an increasingly dynamic, complex global trade landscape, and in turn our customers continue to trust us with more of their business” said CEO Edward J. Ryan. “The challenges and opportunities faced by our customers can vary for shippers, carriers, logistics service providers and customs authorities, but all parties need to connect and collaborate in real-time. Our Global Logistics Network does just that, helping our customers seamlessly exchange information and leverage data with a growing number of tailored, value-added applications for each participant to manage the lifecycle of shipments.”

**Acquisitions:** The company continues to grow by acquisition. On May 7, Descartes bought Portrix Logistics Software GmbH, a provider of multimodal rate management solutions for logistics services providers. The purchase price was approximately \$25.2 million.

On July 8, the company acquired GreenMile, LLC, a provider of cloud-

**Continued on page 13...**

# Badger Infrastructure Solutions

**TSX: BDGI, OTC: BADFF**

**SELL**

*Originally recommended on Nov. 24/14 (#21441) at C\$32.77, US\$27.72.  
Closed Friday at C\$34.33, US\$27.00.*

**Background:** This company was previously known as Badger Daylighting, with the off-putting trading symbol BAD. It changed its name and symbol in May after receiving shareholder approval. However, the business remains the same.

Badger is North America's largest provider of non-destructive excavating services. It does work for contractors and facility owners in a broad range of infrastructure industries, such as energy generation, electricity and natural gas transmission networks, roads and highways, telecommunications, water and sewage treatment and general municipal infrastructure. Its customers typically operate near high concentrations of underground power, communication, water, gas and sewer lines, particularly in large urban centres where safety and economic risks are high and therefore non-destructive excavation provides a safe alternative for certain customer excavation requirements.

The company's key technology is the Badger Hydrovac, which is used primarily for safe excavation around critical infrastructure and in congested underground conditions. It uses a pressurized water stream to liquefy the

soil cover, which is then removed with a powerful vacuum system and deposited into a storage tank. Badger manufactures and designs its truck-mounted hydrovac units.

**Performance:** After hitting a peak of \$46.58 in March, the stock has been in decline and is now only slightly above our original recommended price.

**Recent developments:** Last spring, the company was optimistic about its prospects for 2021. In its forecast for the full year, it projected significant improvements as the economy recovered from the effects of the pandemic.

So far, it's not working out that way. Second-quarter results were disappointing and contributed to the stock's steady decline in recent months.

Revenue for the quarter was up only marginally, to \$135.6 million compared to \$134.5 million in the same period last year. Worse, Badger lost about \$2.8 million (-\$0.08 per share). Last year's second quarter produced a \$1.7 million profit (\$0.05 per share). For the first half of fiscal 2021, the company lost \$17.8 million (\$0.51 a share). Gross profit

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**Badger—continued from page 12...**

margin was 19.2%, a big drop from 34.5% in 2020.

Hardly numbers to inspire confidence.

CEO Paul Vanderberg tried to put a positive spin on what was clearly a rough quarter.

“We were encouraged with the second quarter revenue improvement from 2020 and from the first quarter, with some regions trending towards 2019 levels,” he said. “However, the revenue recovery has been uneven regionally and from month to month. As a result, our direct costs ramp up to support anticipated activity for the summer construction season and COVID-19 recovery, outpaced revenue growth and compressed gross margins in the quarter.”

**Dividend:** The stock pays a monthly dividend of \$0.0525 a share (\$0.63 annually). The yield is 1.8% at the current price.

**Outlook:** The company says it continues to see growth opportunities and reiterated its optimistic goals for the next five years. We’ve been very patient with the stock and the company’s technology seems to be well suited for the times. But it never seems to make significant progress and the dividend isn’t high enough to provide the incentive to hold on.

**Action now:** Sell at a modest profit.

**Descartes—continued from page 11...**

based mobile route execution solutions for food, beverage, and broader distribution verticals. The purchase price was approximately \$29.2 million, net of cash acquired, which was funded from cash on hand, plus potential performance-based consideration of up to \$10 million, based on GreenMile achieving revenue-based targets over the first two years post-acquisition.

**Dividend:** Descartes does not pay a dividend, preferring to use the money for expansion.

**Outlook:** Descartes is a company in the right place at the right time as the economic impact of the pandemic has played havoc with international trade and transportation, increasing demand for its services.

**Gilead—continued from page 10...**

**Outlook:** Veklury provided a big boost to revenue and profits in the quarter but as the pandemic fades, demand for the product will probably do so as well. Sales of its other drugs showed only minor gains – in fact, sales of its HIV products decreased by 2%, to \$3.9 billion.

There doesn’t seem to be a lot of upside potential at this point, but the yield is attractive and helps put a limit on the downside.

**Action now:** Hold.