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> *A cow for her milk, a hen for her eggs, and a stock, by heck, for her dividends*
> –John Burr Williams

Lorne Steinberg,
MBA CFA
PRESIDENT

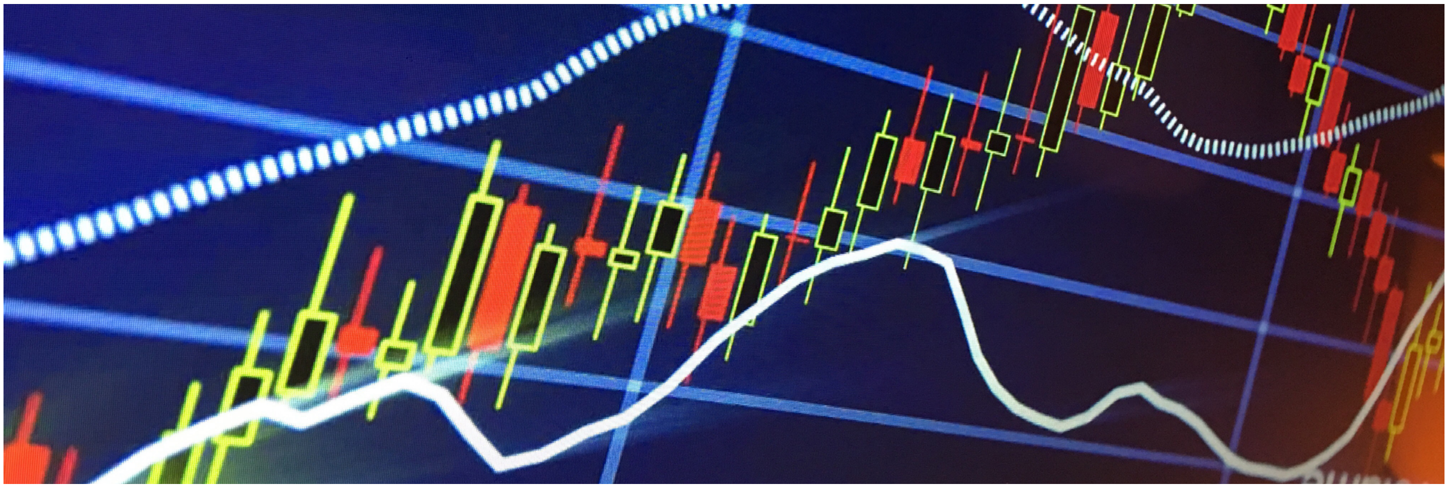
O Canada!

Dear Client,

Over the past decade, the S&P 500 has outperformed its Canadian counterpart, the S&P/TSX, by a wide margin. This is largely due to the performance of the major technology and communication companies such as Amazon, Alphabet, Apple, Meta, and the like.

However, it is interesting to note that over the past twenty-five years, Canadian equities have actually outperformed U.S. equities. The recent underperformance of the Canadian market, coupled with the current disinterest from global investors, has led to a significant valuation discount for the Canadian market.

In terms of breadth, Canada certainly does not offer investors the opportunity to invest in the major global consumer, healthcare, and technology companies that one finds in the U.S. That said, the Canadian market does present its own set of unique opportunities that are hard to find elsewhere, and which are currently on sale.



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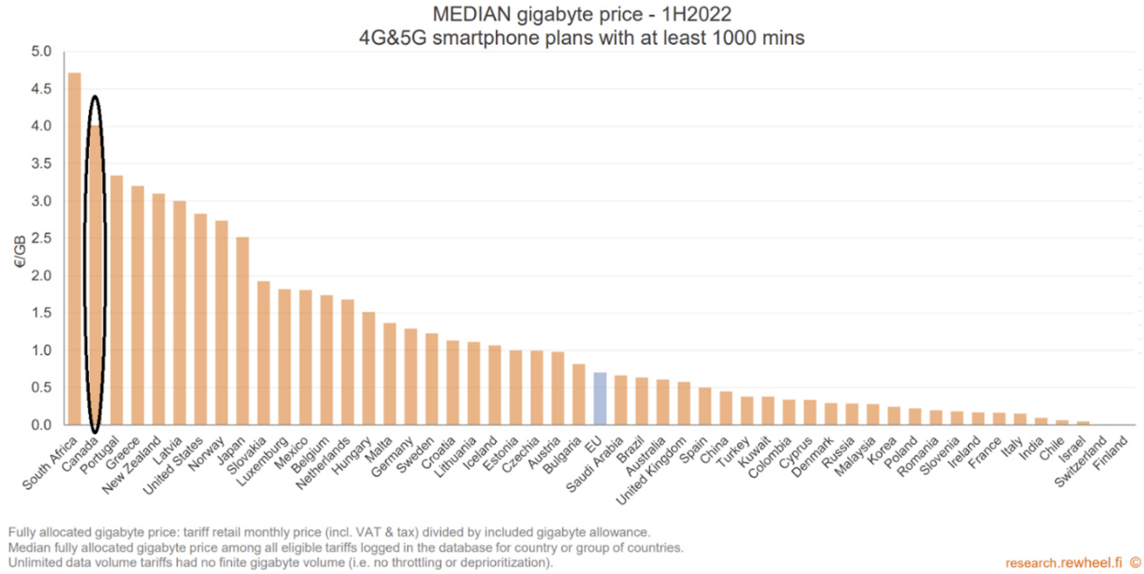
A land of oligopolies

Most Canadians grumble quietly (after all, we are usually polite) whenever we see an ad for a U.S. wireless provider such as Verizon, offering a wireless plan that is far cheaper than what we pay in Canada. In fact, a 2022 report on global wireless pricing concluded that Canada was one of the most expensive markets in the world as can be seen in the chart below.



"Chart sourced from: 'The State of 4G & 5G Pricing - 1H2022 Countries Public Version.' Rewheel Research. [https://research.rewheel.fi/downloads/The_state_of_4G_5G_pricing_17_release_1H2022_countries_PUBLIC_VERSION.pdf]."

If you have ever had the misfortune of being on hold with any of our major wireless carriers in an effort to negotiate your new plan, you may note that, barring a brief teaser rate, you will end up with basically the same price regardless of the carrier.

And how about our banking system? While most Americans have a plethora of banking options, Canadians are largely limited to the "Big 6." Have you checked mortgage or deposit rates recently? Unsurprisingly, the lack of competition results in near identical rates across the board.

The major reason for the lack of competition in telecom and banking is that regulations in both industries limit the ability of foreign competitors to enter the Canadian market. It is this lack of competition that creates the opportunity. As we often say, "We hate being customers of these companies, but we love being owners."

Canada is a growth nation, having seen its population grow by over a million last year – the fastest growth in decades. Protected oligopolies, such as banks and telcos, are some of the primary beneficiaries of this and are very well positioned going forward as a result.

At current prices, the dividend yields of a number of Canadian companies are higher than we have seen in a long time. Here are some examples:

Financial Services

Bank of Nova Scotia	7.1%
CIBC	6.8%
Royal Bank	4.7%
TD	4.8%
Manulife	5.9%
Sun Life	4.6%

Telecoms

BCE	7.6%
Telus	6.4%

Each of these companies has grown their earnings and dividends consistently over the years, and we anticipate this trend to continue. With dividends at these levels, investors do not need much in the way of share price appreciation to realize an excellent return.

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RECENT ACTIVITY

CIBC

As mentioned earlier, the Canadian banks operate with limited competition and, therefore, have been allowed to earn exceptional returns over time with limited risk. The result is that banks are a core holding in our Canadian dividend strategy. One of our largest holdings is CIBC, Canada's 5th largest bank, with $940 billion of assets and about 1,000 retail branches.

While they do have a presence overseas, principally through their capital markets and commercial banking operations, they remain primarily a Canadian-focused bank. About half of their revenues are derived from net interest income, which is the traditional business of banks (i.e. taking in deposits and lending those funds to retail and commercial banking customers). They also have a strong wealth management offering and have enjoyed considerable success over the years within their capital markets operations. Owing to some historical mishaps, the stock has typically traded at lower multiples than the average of its peers, despite delivering industry leading revenue growth over the past several years. The company is strongly capitalized and is well positioned to continue its long-term earnings and dividend growth. With a dividend yield of 6%, the shares offer excellent value.

DOLLARAMA

Dollarama is the dominant "dollar store" chain in Canada, with over 1,400 stores. While there is no shortage of retail competition, the dollar store concept is quite unique. Their offering is a simple one, namely, to provide consumers with everyday items at affordable prices and at price points of $5 or less. Their value-driven approach makes them an attractive destination for all demographics of shoppers, and thus fairly recession-resistant. In addition, the very low-ticket nature of their offering means they are largely Amazon-proof (no one walks into a Dollarama store and then goes home to check the price on Amazon!)

About 40% of what they sell would be termed general merchandise, a similar amount comes from consumable items including food, while seasonal items account for the balance. Among the company's strengths are its buying power, its dominant market share, and its ability to generate significant free cash flow to fund growth.

The company is continuing to expand domestically, but it has also established a toehold in South America through the purchase of a majority stake in Dollarcity, a retailer headquartered in Panama with 350 stores in the region. Earnings growth is being driven by both store expansion and higher price points, the latter of which bodes well for improving margins. The company has preferred to use excess cash for share repurchases versus dividends, and the dividend yield is only 0.3% (but growing). However, Dollarama's earnings per share have doubled over the past five years, as management has executed extremely well.

TELUS

We own each of the three leading telecommunications companies in Canada, who have a combined market share of over 90% within mobile telephony. While their similarities are greater than their differences, there are particular nuances that we find attractive in each. Telus is the fastest growing of its peers, and has also proven to be more innovative. One example is the development of a very successful software and services business (Telus International) of which it remains the largest shareholder. Another is their investments in healthcare technology (Telus Health). As a result of market growth and innovation, we anticipate that the business can generate approximately 5% underlying sales growth as well as some margin expansion, which should translate into double-digit earnings-per-share (EPS) growth over the next few years. The dividend yield is currently 6.5% and is expected to rise in tandem with earnings.

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Bonds: what goes down must come up

Investors holding investment-grade bonds (government and high-quality corporate bonds, such as BCE and Royal Bank) may have noticed that the price of these bonds has fallen. The reason is simply that bond yields have risen, leading to a drop in most bond prices. However, there is a reason that bonds are referred to as "fixed income." Despite the volatility, all bonds are issued at a price of 100 and mature at a price of 100. The coupon rate is fixed, so when an investor buys a bond, they know what the yield will be as long as they hold it to maturity.

With the steep increase in bond yields over the past two years, fixed income investors are once again receiving a reasonable yield for shorter-term bonds. Moreover, since most of these bonds are trading at a discount (below 100), part of the return will come in the form of a capital gain (in taxable accounts), offering a significant after-tax advantage over bank deposits, including GICs and CDs.

High Yield Bonds

A review of the high yield bond market and our high yield fund is available here: High Yield Quarterly.

Final Thoughts

John Burr Williams, quoted at the beginning of this letter, was an American economist who published his seminal work, "The Theory of Investment Value" in 1938. His major contribution to the investment world was his theory that the intrinsic value of a company could be determined by the present value of its future dividends, now known as the dividend discount model. He, like many others, well understood the importance of dividends and their contribution to the total return of an investment portfolio.

One should always exercise caution when investing with dividends in mind, as not all dividends are created equal. Investors are wise to focus on companies with a long history of free cash flow generation, and sustainable, rising dividends vs. those whose dividends are serviced with borrowed money.

When the economy is booming, investors are often focused on growth stocks, ignoring many less exciting businesses which consistently generate steady earnings and dividend growth. However, over the long term, dividends have accounted for over 30% of shareholder returns, while dividend-paying companies have outperformed non-dividend payers.

Equity markets have sold off recently, due in large part to the rise in interest rates. The Canadian market has been among the most negatively impacted. The result is that investors have the opportunity to acquire shares in a number of outstanding Canadian companies that boast a long track record of earnings and dividend growth.

Sincerely,

Lorne Steinberg
President

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