AUGUST 2021

Cardinal Update

The Power of Dividends

Inflation worries are pervasive in the news today and we share some of these concerns. We can all see higher prices in food costs, used cars, appliances, and, of course, the value of homes.

Recent readings of inflation in Canada have shown over 3% year over year increases and measures in the US have shown over 5% year over year increases. Covid-19 has caused many of these pressures given disruptions to supply chains and dramatic changes to consumption patterns. While some inflation will subside in the coming months as supply chains improve, there will also be continued pressures from major items such as the price of services (wage inflation) and the high price of shelter. Inflation is notoriously hard to predict, but if it continues to come in hotter than expected, what is the best way to protect and build wealth?

Are bonds protecting you from inflation? Current Government of Canada bonds are yielding 0.5%, 0.8%, and 1.15% over 2, 5, and 10 years respectively. U.S. government bond yields are similar. Likewise, given strong profitability, ample liquidity, and good balance sheets, high quality corporate bonds are also providing meagre protection versus inflation. If you subtract the rate of inflation from the interest rates you arrive at the real interest rate. At current rates of inflation, these bonds are actually providing a negative real return. In other words, the cost of living is rising faster than the interest rates you are receiving from bonds purchased today.

What about stocks? Firstly, a disclaimer: dividend paying stocks are not bond alternatives. Stocks are generally more volatile and have no assurance that you get your principle back on a stated date. With that said, we believe that investing in high-quality, dividend paying, and dividend growing companies alongside a dose of patience creates a greater likelihood that your wealth can keep up with inflation. The core tenet behind this belief is that great companies create value; bonds merely return value. Great companies can create value by reinvesting their free cash flow at a return above their cost of capital (increases with inflation). By consistently reinvesting, companies can grow their profitability and therefor their value over time faster than the rate of inflation. It also allows for these companies to continually grow their dividends year after year. It is this growing stream of dividends that can steel your conviction to hold onto investments through inevitable market turmoil.

The stream of dividends from our portfolios is meaningful. Our Canadian Equity mandate currently yields over 3% and experiences annual dividend increases in the 6-10% range. Our Foreign Equity mandate has a lower yield at 2.2% but experiences higher annual dividend increases in the 8-12% range. This easily outpaces the current bond yields and the growth more than offsets inflation. On a longer timeframe, the power of a great company consistently growing its dividend is even more evident. Royal Bank's current dividend of $3.44/sh provides an annual 6.4% yield on your cost-base 10 years ago and a 21.5% yield if you purchased it 20 years ago. Honeywell's current dividend of $3.72/sh provides an annual 7.4% yield on your cost-base 10 years ago and a 15% yield if you purchased it 20 years ago. We believe that a concentrated portfolio of great dividend raising companies is the ticket to protect and build wealth through all periods including the potential for high inflation.

COMPANY FOCUS: ALIMENTATION COUCHE-TARD

Alimentation Couche-Tard (ATD) is one of the largest convenience store operators in North America and also has a growing presence in Europe and Asia. Best-known for their Circle K brand, ATD has a network of over 12,000 stores plus licensing agreements with over 1,800 stores in 14 other countries. ATD has a strong track record of making prudent acquisitions and successfully integrating the new stores into their existing network. Given its expertise and scale ATD is able to apply best practices and utilize buying power when adding acquisitions to their store base.

The shift to electric vehicles (EV) is both an opportunity and a risk for ATD. ATD is the only U.S. convenience store operator in Norway and thus it has been able to test new offerings in a country that is well-ahead in the energy transition. ATD has over 4,500 EV charging points in Norway at Circle K locations and in residential homes and has expanded its in-home charging business across Europe. ATD has opened new stores dedicated to EV charging and is working to ensure that its in-store offering drives additional purchases while customers await their charge. EV charging stations are now being rolled out in Quebec and California, two regions that have seen high adoption rates due to strong consumer subsidy and infrastructure programs.

DIVIDEND INCREASES

Bank of America	16.7%
Wallgreens Boots Alliance	2.1%
Wells Fargo	100.0%

(During the period July 1, 2021 and July 31, 2021)

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