

# ODLUM BROWN REPORT

## 10 2021



**ODLUM BROWN**  
Investing for Generations®

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## Following Our (Counter)Intuition

The Odium Brown Model Portfolio<sup>1</sup> had a good summer, appreciating by 6.4% over the three months ended September 15, 2021. That brought the year-to-date gain to a little more than 20%, which is in line with a blended 50/50 Canadian and U.S. benchmark.

### COMPOUND ANNUAL RETURNS\* (Including reinvested dividends, as of September 15, 2021)

	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	20 YEAR	INCEPTION**
<b>Odium Brown Model Portfolio</b>	<b>20.3%</b>	<b>28.3%</b>	<b>12.3%</b>	<b>11.8%</b>	<b>14.5%</b>	<b>11.8%</b>	<b>14.6%</b>
<b>S&amp;P/TSX Total Return Index</b>	<b>20.9%</b>	<b>29.6%</b>	<b>12.3%</b>	<b>10.6%</b>	<b>8.5%</b>	<b>8.5%</b>	<b>8.8%</b>
<b>S&amp;P 500 Total Return Index (\$CDN)</b>	<b>19.4%</b>	<b>28.3%</b>	<b>16.5%</b>	<b>17.1%</b>	<b>19.3%</b>	<b>8.3%</b>	<b>10.6%</b>

\* Except for YTD period. \*\* December 15, 1994.

The so-called “growth” stocks like Microsoft and Costco that did so well in pandemic lockdowns were again among the Model’s top-10 performers in the latest quarter. Many of these stocks continue to bump up against our price targets at higher and higher valuations, yet they are the ones driving performance. This poses a conundrum when considering the added risk that comes with paying higher prices. The margin of safety and prospective returns are naturally lower when valuations are higher, yet it’s also comforting to own high-quality businesses that are performing well in an uncertain world.

When the global economy began to reopen and vaccination rates rose, there was a noticeable shift in the market’s leadership. Value-type stocks, those hit hardest by lockdowns, started to outperform the high-quality growth businesses, and many wondered if it was the beginning of a long-term trend. However, the rotation was short-lived, and value stocks have lost altitude since early May as concerns about the Delta variant have intensified.

Fortunately, the Model is reasonably balanced between the two groups. Many of the Model’s value laggards have greater return potential and, arguably, a better margin of safety. At the same time, we have a decent contingent of high-quality growth businesses with excellent fundamentals and satisfying stock performance. We continue to make modest shifts in the portfolio’s composition to take advantage of market volatility and position the Model for better long-term performance.

We have long counselled the merits of holding great businesses for the long term, and we generally stand by that advice. However, history teaches that the biggest and best businesses aren’t always the best stocks. The strategy loses efficacy when great businesses become too popular and pricey. This normally happens after a long period of strong business performance and valuation multiple expansion. It’s also when investors feel most comfortable. After all, it’s counterintuitive to sell a winning stock that has outperformed for a decade or more.

*Continued on next page*



**Although it may seem counterintuitive to some, we believe that shifting profits from some of our high performers into laggards at lower valuations and with better long-term growth potential will lead to results that may surprise the crowd.**



Consider what came to be known as the Nifty Fifty group of premier growth stocks, such as Xerox, IBM, Polaroid and Coca-Cola, in the early 1970s. They had performed so well as businesses and as stocks that they were often called one-decision stocks: buy and never sell. Investors soon regretted the confidence and comfort they had in these richly priced businesses, as the stocks crashed when inflation accelerated later in the decade. A similar thing happened with technology and other great American blue chip businesses in the late 1990s. After an extended period of outperformance, valuations became so stretched that they had nowhere to go but down; it took many of those popular stocks more than a decade to regain their highs after valuation multiples corrected from extreme levels.

The lesson from history is that price matters. Sometimes it makes sense to sell winners to make room for businesses with better risk and return attributes. The challenge is timing. Cycles tend to run longer than expected, and shifting strategy prematurely can result in poor short-term performance.

Nonetheless, with sentiment and valuations of great businesses today reminiscent of the attitudes and prices paid in the early 1970s and late 1990s, we are gradually and selectively shifting funds to investments that we believe have better long-term risk and return characteristics. Selling winners to buy laggards is uncomfortable, but we believe the better prices we get from executing unpopular trades will yield good results.

Over the last quarter, we swapped our interest in BCE Inc. for a new position in Charter Communications, Inc., and sold a little more than 40% of our position in Albemarle Corporation and our entire stake in Costco Wholesale Corporation to create room for CAE Inc. and TransDigm Group and to increase our holding of Fiserv, Inc.

While BCE provides an attractive dividend yield, we believe Charter will provide better total returns in the long run, as its underlying businesses have greater growth potential. Charter is the second-largest cable company in the U.S., providing cable television, broadband internet and telephone services.

Albemarle has a very bright future as a leading producer of lithium used in the batteries that power electric vehicles. Yet, with the value of our position almost tripling in less than two years, we felt it was prudent to crystalize some profit and reallocate the funds to other investments.

When we initiated coverage of Costco in May 2019, we thought the company could grow earnings at a compound annual rate of 8% over the next two years. Instead, the company doubled that pace because of COVID-19 lockdowns, which caused members to stock up and stay home. Analysts are optimistic that the better-than-expected results will persist, predicting that earnings will continue to

compound at an annual rate of 16% over the next two years. With faster growth, Costco's price-to-earnings valuation multiple has increased from about 30x current year earnings to 43x. Together, the combination of impressive earnings growth and valuation multiple expansion has caused the stock to appreciate by close to 90% since we launched coverage. We still love the business and the company's long-term prospects, but worry that the stock might be priced for a growth rate that is unsustainable. As the world normalizes, businesses that were hurt by lockdowns will likely benefit at the expense of those that were helped by people staying at home.

CAE and TransDigm are aerospace businesses that will definitely benefit as people get out of their homes and resume travelling. The stocks experienced huge recoveries as the world started to open up, but both retreated as some cancelled travel plans due to the Delta variant. We believe this is a temporary setback, and we expect travel to increase considerably over the next few years.

With more than 160 facilities in over 35 countries, CAE provides training products and services to the civil aviation, defence and healthcare markets. While recognized for its full-flight simulator products, over 60% of CAE's business is derived from the provision of services, largely under long-term agreements with airlines, business aircraft operators and defence forces. The company's earnings, cash flows and balance sheet should improve materially as global air travel resumes, and that in turn should yield a much higher share price.

Chances are that the next aircraft you ride uses parts developed by TransDigm. These parts are critical to the performance of the airplane and require regular replacement, providing TransDigm annuity-like revenue streams in the aftermarket business. Once these parts are engineered into the aircraft, they are not easily substituted. As a result, TransDigm is frequently the sole-source provider for many of its aftermarket products. Competition is also limited due to strict regulatory and technical requirements, as well as the small market each unique part commands. Over the next few years, as volumes recover and people become comfortable with flying again, we expect TransDigm's earnings and cash flows to grow considerably.

Finally, we increased our holding in Fiserv by 60%, as the stock has languished despite impressive improvements in the company's underlying businesses. The company is a leading technology provider for banks and credit unions, with offerings spanning account processing, bill payments, digital banking and many other core banking functions. Fiserv's offerings are critical for their clients' businesses, and relationships tend to be very long lasting. Approximately 85% of revenue is recurring, and demand should remain strong for many years as consumers continue to expect better technology from their banks.

Although it may seem counterintuitive to some, we believe that shifting profits from some of our high performers into laggards at lower valuations and with better long-term growth potential will lead to results that may surprise the crowd.



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<sup>1</sup> The Odium Brown Model Portfolio is an all-equity portfolio that was established by the Odium Brown Equity Research Department on December 15, 1994, with a hypothetical investment of \$250,000. It showcases how we believe individual security recommendations may be used within the context of a client portfolio. The Model also provides a basis with which to measure the quality of our advice and the effectiveness of our disciplined investment strategy. Trades are made using the closing price on the day a change is announced. Performance figures do not include any allowance for fees. Past performance is not indicative of future performance.

# Guaranteed Income Options with Annuity Products

For many clients, annuities may provide a solid foundation for guaranteed retirement income. Annuities can range from the simple life annuity to a more complex variable annuity (commonly referred to as a guaranteed minimum withdrawal benefit plan, or GMWB). In this article we will exclusively discuss life annuities.

One of the most common questions we are asked is, “How much income would I receive from purchasing a life annuity?”

## Several factors influence the income received from a life annuity, including the:

- Demographic of the annuitant (e.g., gender and age);
- Type of annuity purchased (e.g., single life or joint life);
- Frequency of income payments received (e.g., monthly or annually);
- Length of the purchased guaranteed payment period;
- Type of funds used to purchase the annuity (e.g., registered, non-registered or pension); and
- Other special features chosen (e.g., indexing).

One of the most important decisions to make before purchasing an annuity is finding a guarantee that suits your circumstances. Choosing a guarantee option ensures that a certain number of payments will be made, regardless of when an annuitant dies. There are many choices available, ranging from a zero guarantee (where payments stop when annuitants die) to options for guaranteed payments to age 90. If an annuitant dies during a guaranteed period, a value representing the remaining guaranteed payments is provided to the estate or named beneficiary. If the annuitant lives beyond the guaranteed period, the annuitant will still continue to receive payments for the duration of their life.

Here is an example of the lifetime monthly income you could receive from an annuity purchased with \$100,000 of non-registered funds, providing a minimum 10-year guarantee.

Guaranteed Life Annuity Income (based on a minimum 10-year guarantee)							
Monthly income from \$100,000 purchase							
Age	55	60	65	70	75	80	85 <sup>1</sup>
Single Life Male	\$391	\$432	\$487	\$561	\$643	\$746	\$876
Single Life Female	\$369	\$406	\$455	\$520	\$594	\$700	\$815
Joint Life Annuity <sup>2</sup>	\$341	\$371	\$413	\$470	\$539	\$649	\$716

Rate source: Cannex Financial Exchanges Limited as of September 15, 2021; assumed non-registered funds with payments starting in one month. Rates subject to change.  
<sup>1</sup> Assume 5-year guarantee for purchase at age 85, as this is the maximum available guarantee period.  
<sup>2</sup> The Joint Life Annuity illustration is based on a male and female of the same age.

Annuities purchased with non-registered funds have an added advantage, as only a portion of each payment is considered taxable income. As listed above, the monthly payment for a joint life annuity purchased for a male and female, aged 75, is \$539. The “taxable” portion of this monthly annuity income payment would be \$72, or \$864 annually. Annuity income may also qualify for the annual \$2,000 federal pension income tax credit, which can reduce or eliminate the tax otherwise payable on the annuity income.

## You may wish to consider a life annuity if you seek:

- Guaranteed income for life;
- Higher monthly income than many other guaranteed income products provide;
- Guaranteed payments without exposure to market volatility; or
- A tax-advantaged income stream. Only a portion of each payment from an annuity purchased with non-registered funds is taxable, and the taxable portion remains level for life in the case of “prescribed” annuities.

To understand the many options for today’s annuity products and whether they may be suitable for your retirement income needs, please contact us through your Odium Brown Investment Advisor or Portfolio Manager.



**RITA AGER, CFP®, CLU, CHS, CPCA, FEA**  
 Insurance Specialist  
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“ To understand the many options for today’s annuity products and whether they may be suitable for your retirement income needs, please contact us through your Odium Brown Investment Advisor or Portfolio Manager. ”

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# Odlum Brown in the Community

**We are committed to supporting initiatives that matter to the communities where our clients and team members live and work, and are thrilled to return as sponsor of these exciting events:**



## Easter Seals BC & Yukon – Drop Zone September 9 – 21, 2021 Throughout BC

Odlum Brown was proud to continue our support for Easter Seals BC & Yukon at Drop Zone events across BC last month. We returned as the Presenting Sponsor of the Vancouver Drop Zone, and were excited to also sponsor the Surrey and Burnaby locations – with rappellers in Kelowna as well!

Across all events, 10 Odlum Brown team members bravely descended skyscrapers to raise funds for children and families with disabilities. We were proud to cheer on our OB Superheroes once again!

Easter Seals BC & Yukon is a trusted charity and established leader in supporting the disabled community. Since 1952, they have helped children and adults address life's challenges and given them tools to build their self-esteem, self-confidence and sense of independence.

**For more information, visit [dropzonebc.ca](http://dropzonebc.ca).**

## Canucks Autism Network – Pro-Am Hockey Tournament October 22 – 24, 2021 Vancouver, BC

The CAN Pro-Am Hockey Tournament brings weekend warriors and corporate teams together with NHL Alumni in support of Canucks Autism Network (CAN). Later this month, the OB Bulls will once again take to the ice in support of individuals on the autism spectrum and their families.



As past winners of the CANley Cup (presented to the top fundraising team), we are thrilled to raise vital funds for CAN again this year. In addition to our fundraising efforts, Odlum Brown is the Auction Sponsor of this wonderful event.

CAN is dedicated to providing programs to individuals on the autism spectrum and their families, while promoting acceptance and inclusion through community engagement and training initiatives across BC and beyond.

**For more information, visit [canproam.ca](http://canproam.ca).**

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