OUR 40TH YEAR

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♦ Kinross Gold: Buy, Page 7.
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April 2016/Second Report ♦ Single Copy: $10.00

Volume 40, Issue No. 8

THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

MARKET STRATEGY

The bear is growling…

SELL GROWTH BUY DEFENCE

Keith Richards

THERE'S NO OTHER WAY WE CAN describe my current outlook than to say "Bearish". At ValueTrend, we've held a defensive stance through the first quarter of this year. Yes, we missed out on some upside as markets rallied in February and March. However, there is reason behind our madness. Allow me to point out some indicators that encourage a defensive position. Some are technical (crowd and price behavior) indicators, some are fundamental (valuation and economic):

Non-confirmation between industrial & transportation stocks: Charles Dow pointed out 100 years ago that when the companies that make stuff (industrials & technology stocks like Microsoft) aren't shipping that stuff (rail, trucking, air) you have a problem. Right now, as with last March (when we sold out of stocks in a similar manner), the industrials are not being supported by transport's stock movements.

Smart money selling, dumb money buying: Retail investors such as small stock investors and mutual fund buyers are known to make emotional decisions. They buy high and sell low. That's why we call that group "dumb money". Meanwhile, sophisticated traders, large institutions, pension managers, and commercial hedgers are selling. They notoriously call the markets correctly, which is why we call them "smart money". We track these groups independently. Take a guess as to how the smart and dumb money investors are positioning themselves…Hint: it's not looking good for the dummies.

Déjà vu all over again: Been there, done that. That is, we've seen the S&P 500 hit 2130-ish over and over and over for 18 months now. And it's gone as low as 1880 several times (last summer twice, and once this January).

This week the S&P 500 hit just

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***Keith Richards**, from Page One*

under 2080. The implied upside from there is about 3%. Do you know of a catalyst that could drive it through that level? We don't. We think that's the lid for now. The implied downside is about 9% if the S&P hits 1880 again. That's a 3:1 risk to reward ratio. Would you take a $100 bet if all you could win was $3 and you could lose $9? Didn't think so….

The Fed: Fed Chairperson Janice Yellen recently implied that the Fed will NOT raise rates for a while, given poor job numbers and world events. However, she is stuck between a rock & a hard place as far as stimulating growth again – she can't go back on her words spoken in late 2015 to become fiscally tighter. So, don't expect more stimulus in the near term. The market is cut off from its favorite drug.

Seasonals: Sell in May and Go Away. Soon it will be the end of the best 6-month strategy.

Election: In this corner, we have extreme right winger Donald Trump promising to end free trade, build a wall, and start World War 3. In the other corner we have extreme left wing candidate Bernie Sanders, who wants to increase taxes and feed the sense of entitlement like his Canadian PM counterpart has done. Somewhere in the middle we have Hillary Clinton, who is facing an enquiry into alleged email cover-ups, and Ted Cruz who recently posted a video of himself frying bacon by wrapping it around a machine gun and firing it. Would you feel bullish knowing any of these people were in charge of the most powerful economy in the world?

Expect volatility as the reality of these choices set in with investors. The historic pattern for markets during an election year is volatility leading into an election, and bullishness after the election is decided. This makes sense, given the uncertainty that is lifted after that event. Further, whenever a new president or (in Canada's case) prime minister is elected, markets can go through a bit of a "Honeymoon" phase.

World events: More déjà vu from last year. Greece, China, Brazil, Europe, Japan—all in trouble (still). Or how about–ISIS, oil pricing, currencies, bond yields, and immigrant challenges? Lots of issues in the world for the markets to get worried about.

Earnings and Valuation: According to www.multpl.com (chart below), the trailing PE ratio on the market is at the high end of its historic range, at 22.6 times earnings. With the exception of the bubble 2001 and 2008 levels, you will note that trailing PE doesn't like venturing much past the low 20's before reversing. Strength in the markets has been driven to a large degree by these expanding multiples and not earnings growth.

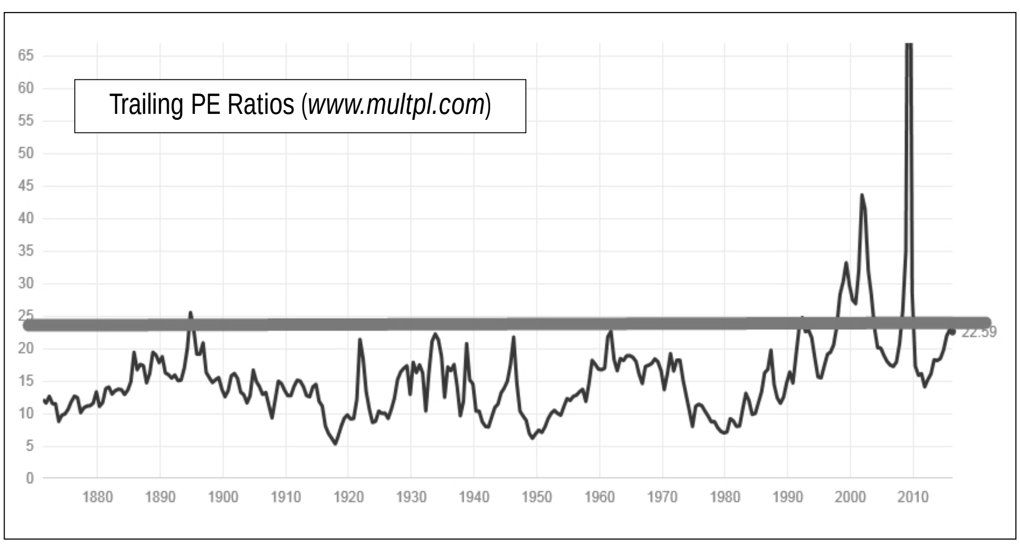
Meanwhile, we enter the current earnings season with the risk that earnings do not support the recent market strength. The result of a disappointing earnings season will very likely lead to weak markets.

Global Debt: Since the financial crisis, many of the advanced economies have prudently reduced private debt, only to significantly increase public debt. Emerging economies and those economies less impacted by the financial crisis, the Bank for International Settlements points out, are now increasing private debt to record levels. As the world struggles with this excessive use of leverage, we believe this represents an additional risk to markets.

OK, so we're bearish. What are we doing about it?

Cash: In the equity platform, we hold cash. Lots of it.

Hedging: We're gradually adding hedge positions to the equity platform. We recently began legging into the Horizons



VIX ETF (HUV-T), which goes up when markets get choppier. We've also bought a bit of the Ranger Bear ETF (HDGE-U.S.), which shorts about 30-40 stocks from the S&P 500. It goes up if markets go down. We're looking to do more hedging by stepping into this type of position a bit at a time. "Slowly, slowly catchy monkey" as the Ashanti (Ghana) proverb goes.

Reducing growth stocks: We have been reducing and expect to continue to trim our growth-stock positions. This includes most of our technology exposure, and all of our consumer discretionary exposure.

Increasing defensive stocks: We recently bought defensive sectors like gold and consumer staples through the SPDR (XLP-U.S.). We're looking to buy further into defensive stocks such as the REIT space, where we've recently acquired a position in Smart Real Estate Trust (SRU.UN-T). We're also focusing on some higher dividend ETF's that play on that theme. We like the BMO Canadian Dividend ETF (ZDV-T). The fancy term for this strategy of selling growth to buy defense is "beta reduction". ▼

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MARKET WISDOM

Winpak remains a buy

STEADY CLIMB

Marc Johnson

We hold a high opinion of Winpak Ltd. It's earning record profits year after year. The company is using its excellent balance sheet and solid cash flow to build the business. Winpak remains a buy, mostly for long-term share price gains.

Repeat business

We regularly review Winnipeg-based Winpak Ltd. in *The Investment Reporter*. Since we published our November 27, 2015 issue, its shares have climbed by 10.3 per cent. The company earned record profits in 2014 and 2015. It's expected to earn record profits both this year and next. The dividends are small and flat. The shares remain a buy, mostly for long-term price gains.

Winpak "manufactures and distributes high-quality packaging materials and related packaging machines. The Company's products are used primarily for the packaging of perishable foods, beverages and in health-care applications." It profits from repeat business. As consumers buy food, drinks and drugs, producers need to package and replace them.

In 2015, Winpak earned a record $99.2 million, or $1.53 a share (all numbers are in U.S. dollars unless preceded by a C). This was up by more than 26 per cent from record earnings of $78.4 million, or $1.21 a share, the year before. Revenue rose by 1.3 per cent, to $797 million. All operating and financing costs as a group fell by 3.2 per cent, to $650 million.

Lower raw material costs mattered most

Lower raw material costs added 24 cents a share to Winpak's earnings. Internally-generated volume growth further raised earnings by another 5.5 cents a share. Foreign exchange movements boosted earnings by 6.5 cents a share. And lower income taxes added 0.5 cents a

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Marc Johnson, CFA, is the editor of The Investment Reporter, an advisory publication that has been providing investors with independent financial advice since 1941.

Investment opinion: Seek cheapskates

It's best if those who handle the shareholders' money—your money—are parsimonious. This leaves more cash to finance the company's growth and to reward you financially.

When cheapskates run your companies, there's usually more money left over to finance growth and reward you. So it pays to seek and buy companies that make a habit of operating frugally.

There are many ways to figure out just how careful managements are with your money. One way is to look at a company's address. Is it in a costly Class A office tower, like Scotia Plaza in Toronto, Place Ville-Marie in Montreal or Bankers' Hall in Calgary? If so, management is spending your money on prestige. Far better if your companies' offices are in nondescript, or even decrepit, low-rent buildings.

When you visit a company's office, check out the decor. Are the walls adorned with original paintings by grand masters? If so, your money is tied up in unproductive assets for the benefit of management. Far better if the company puts up cheap posters. And is the furniture made of costly wood like teak or mahogany? As this involves your money, you should prefer cheap, mass-produced plastic furniture.

Make use of two of our indicators

Also take a look around the parking lot and use our 'High-Low Auto Indicator' (see article below).

And use of our "Sporting Sell Indicator'. Companies that lavish their cash for naming rights on sporting venues have poor records. Consider Enron Corp. Shortly after putting up $100 million for the pleasure of seeing its name over Houston's new baseball park for 30 years, the company crashed amid scandal.

As for other examples, MCI Group (Washington), Fruit of the Loom (Miami), TWA (St. Louis) and PSINet (Baltimore) all put their names on sports venues before going bust. Here at home, Air Canada threw its name around freely in the sports world. It seems that few companies willing to waste cash on naming rights put their shareholders' interest first.

You should also find out if management flies around in corporate jets. Far better if executives fly economy class on commercial airlines. Similarly, does top management spend your money to ride around in chauffeured limousines or do they drive themselves?

And if the company holds conferences, is it at exclusive resorts in exotic locales? You should prefer it if conferences are held at inexpensive locations—preferably cheap hotels—close to home.

Look at your companies' annual reports. Are they printed on high-gloss paper with lots of color pictures of smiling people? If so, that's a strike against the company. We prefer companies whose annual reports are printed on plain paper, have no photos, and discuss what you really need to know.

On a more serious note, does the company make good use of cost-cutting technological improvements to increase profits?

Finally, it often pays to buy companies where management owns a significant stake. Owner-managers are usually more parsimonious than managers who handle other people's money.

The best 'ratio-oid' of all

In our experience, it pays to beware of investments that come with their own special home-made set of financial ratios. You might look on these ratios as 'ratio-oids'. They have a passing resemblance to conventional financial ratios, just as the androids of science fiction have a passing resemblance to human beings.

Cellular-phone firms, for instance, often refer to 'price per POP'. POP measures the population in the company's service area. Trouble is, this ratio fails to distinguish between POP in, say, southern Ontario versus Nunavut. Some cellular areas are apt to be more profitable than others, depending on population density.

Having said that, here's our favorite ratio-oid. It can help rid your portfolio of big-time spenders and replace them with cheapskates. We call it the High-Low Auto-Indicator. Stop by the company's parking lot several times over the course of several weeks. On each visit, add up the number of Cadillacs, Jaguars, Maseratis, Mercedes and so on. Do the same with the Chevys, Hondas, Volkswagons and so on. If the high-priced cars consistently outnumber the low-priced cars, sell.

Marc Johnson, CFA, is the editor of The Investment Reporter, an advisory publication that has been providing investors with independent financial advice since 1941.

Marc Johnson, from Page Three
share. These were partly offset by higher operating costs, which reduced the profit by 2.5 cents a share. Also, more going to non-controlling interests erased two cents a share. The net effect was to raise earnings by 32 cents a share.

Winpak has an excellent balance sheet. For one thing, it holds cash of $165 million. For another, the company remains debt free. Keep in mind, too, that Winpak's cash flow exceeds its needs. In 2015, it generated cash flow of $146.6 million. This exceeded total investment of $54 million and dividend payment of $80.8 million. The excess cash flow of $11.8 million should keep the balance sheet healthy.

Expanding operations

Winpak is planning to expand its manufacturing operations. It writes, "Of particular importance will be the commercialization of the massive technologically-advanced cast coextrusion line which is in the process of being installed at the Company's modified atmosphere packaging facility in Winnipeg." The company is also expanding its rigid container operations in Chicago and its shrink bag operations in Georgia. The company plans to invest more this year. It will also consider making acquisitions.

Winpak writes, "As 2016 begins, the Company is optimistic with regard to the upcoming year. Opportunities in the sales pipeline are signifi-

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MARKET WISDOM

Do balanced funds make sense right now?

EXCELLENT LIQUIDITY

James Kedzierski

When stock markets turn volatile like they did earlier this year, many investors start looking for refuge — a place to put their money simply to preserve it and maybe get a modest return. Many financial advisors suggest balanced funds at times like these.

Rather than take the easy way out by running to balanced funds to reduce volatility in your portfolio, we suggest taking a more detailed look at your financial plan and investment temperament.

In our experience, investors value liquidity and control of their portfolios most. Next comes returns. And even here, most feel their concerns about losses more strongly than their hopes for gains. In other words, they want first to keep what they have and second, to make it grow. Only gamblers want instant rewards.

BALANCED FUNDS DENY YOU CONTROL

Balanced funds give you liquidity. You can redeem and get your cash on three days' notice. But they give you no control over your asset mix. When you need cash, you can't decide whether to cash fixed-income securities or equities, regardless of the condition of the market.

PLAN YOUR CASH NEEDS

Our approach to personal financial planning has always been the same: plan your cash needs for a minimum of five years. Then, prepare for withdrawals using fixed-income securities — bonds, mortgages, GICs and others — maturing when you need the money.

Of course, foreseeing future needs for cash may prove difficult. So keep some extra fixed-income securities or cash for emergencies or investment opportunities.

This approach lets you sell equities or redeem stock funds in a more thoughtful manner than simply withdrawing money when you need it. You can wait for the market to offer an attractive price.

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James Kedzierski is the editor of *Money Reporter*, a leading advisory that covers the best income investments for Canadians.

***James Kedzierski**, from Page Five*

And since you won't need the cash for at least five years, you've got some time for the market to recover from bad times.

Create your own balanced fund

In effect, you're creating your own balanced fund. But you retain control over the asset allocation — not in an attempt to outguess the market, but in accordance with your personal investment needs. Use fixed income for cash flow.

If you rely on balanced funds every time you need money, you'll redeem units representing stocks and bonds combined. And when stock markets are performing poorly, that's a bad time to redeem stocks.

As you age or approach retirement, or if your stomach for the volatility of stock markets weakens, simply lengthen your time horizon.

By that we mean prepare more than five years of future cash flow with guaranteed securities — maybe even 10 years. Gradually redeem some of your stocks and buy fixed-income securities.

How much can you take?

The approach to investing that we outline in this article lets you keep a significant amount of your portfolio in equities, which, over time, will grow in value. And yet, you won't need to sell any of your stocks, or equity funds for five (or 10) years. So you needn't fret about short-term stock-market fluctuations.

Unfortunately, if you invest mainly in balanced funds, you lose the control you need to make our plan work. And you could end up, in

Continued on Page Eight

CN weathers commodity slump well

The stock has been volatile lately, but its earnings and dividend continue to consistently rise.

Railroad stocks got off to a rough start this year. Canadian National Railway Company $80.15 (TSX:CNR), for example, one of our recommended stocks, is a case in point. After trading around $80 in early December 2015, the stock dropped to $69 in mid-January of this year, only to gradually recoup this loss since then. The volatility in the company's shares earlier this year was mostly the result of the downturn in commodity prices, which weighed on investor sentiment.

As a rail and transportation business, after all, CN ships a fair amount of commodities, including coal and crude oil. The company's network of about 20,000 route miles of track spans Canada and mid-America, connecting three coasts: the Atlantic, the Pacific and the Gulf of Mexico.

Despite soft commodity prices, the company managed to increase its profit last year. However, weaker-than-expected freight demand and a stronger loonie prompted a downward revision to CN's outlook for 2016, issued on March 31 2016. CN now aims tto deliver 2016 EPS in line with last year's adjusted diluted EPS of C$4.44 (compared to its January 26 2016 financial outlook calling for mid-single digit EPS growth this year).

CN's positive financial performance in 2015, therefore, is partly reflected by its broad diversification over different areas of the economy. Consequently, while the company suffered in some areas, it more than made up for these weaknesses in other areas. This story may turn out to be similar in 2016, as weakness in the resource sector continues to weigh on results. Overall, though, the company's earnings, and by extension its dividend, should continue to rise as it makes gains in other areas.

The stock trades at a reasonable 17.8 times the $4.44 a share that CN should earn in 2016. The annual dividend of $1.50 a share yields 1.9 per cent. CN is a buy for growth and some income.

Canadian Tire offers value

Despite the deteriorating value of the Canadian dollar and unseasonable weather in the fourth quarter of last year, Canadian Tire Corporation Limited $133.03 (TSX:CTC.A) delivered favourable top and bottom line results for 2015.

Canadian Tire is a family of businesses that includes a retail segment, a financial services division and CT Real Estate Investment Trust. For the year ended Dec. 31, 2016, Canadian Tire made $735.9 million, or $8.61 a diluted share, compared with $639.3 million, or $7.59 a share, in 2014. Excluding unusual items, earnings per share for the latest period were $8.33, up from $7.96 in the prior period. The increase reflected strong retail sales growth at Canadian Tire and FGL Sports, strong gross margin contribution from Canadian Tire, Petroleum's higher per litre gas margins, and increased credit charges on increased gross average accounts receivable in the financial services segment.

The stock trades at a reasonable 15.0 times the $8.85 a share it will probably earn in 2016. Plus, we see considerable hidden value in the company's retail, finance and REIT businesses. The annual dividend of $2.30 a share yields 1.7 per cent.

Canadian Tire is a buy for growth and some income.

MARKET WISDOM

The price of gold has recovered somewhat

FEW SHORTS EYE ON U.S. $

Marc Johnson

THE PRICE OF GOLD HAS RECOVERED somewhat so far in 2016. While you might hold a little gold for diversification purposes, remember its disadvantages.

Gold trades at US$1,254 an ounce. This is far below the peak price of $1,908 an ounce on August 22, 2011. Then again, the price has recovered somewhat and is expected to average $1,225 an ounce in 2016.

One factor working against gold is low inflation and deflation in many countries, such as Japan. This reduces gold's appeal as a hedge against inflation.

A second factor is better government finances in Canada and the U.S. This lessens the risk of debasement of both dollars and the need for gold.

A third factor is that gold produces no income. Worse, one must pay for safe keeping.

A fourth factor working against gold is sales by the International Monetary Fund. Selling gold enables the IMF to raise cash and assist countries.

MORE FACTORS FAVOR HIGHER GOLD PRICES

The price of gold is notoriously cyclical and unpredictable. The industry itself didn't foresee the most recent plunge in the price of gold.

Other factors raise the demand for gold. One is that the U.S. dollar has paused. The price of gold usually moves in the opposite direction of the dollar.

A second is the popularity of gold jewelry. Especially in China and India—which account for 63 per cent of global demand. As middle classes in emerging markets grow, so will the demand for gold.

Third, low interest rates cut the 'opportunity cost' of gold—interest that cash would've produced.

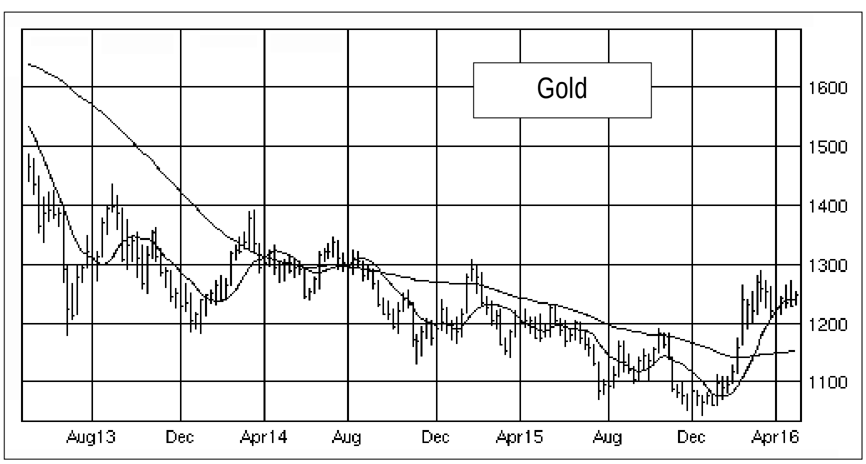
Fourth, some investors distrust paper currencies and prefer to hold gold. Poor finances in Europe raise the risk of debasement of the Euro.

Fifth is higher demand by the 'official sector'. That is, many central banks would rather hold reserves of gold instead of reserves of dollars or euros.

Sixth, moderate gold prices makes it less profitable to produce. It can lead to a shutdown of marginal mines and depress gold scrap recoveries. Lower supply is supportive of gold prices in the long run.

Seventh, there are fewer short sales. Short sellers borrow gold, sell it and hope to replace it if prices are lower. They pocket or lose the difference between the price at which they sell and buy back. With the price of gold rising, short sales lose appeal.

We have seven buys: Agnico-Eagle Mines, Barrick Gold, Goldcorp, Iamgold, Kinross Gold, Newmont Mining and Semafo. Alternatives to stocks include gold exchange-traded funds or gold bullion. Just remember that given gold's disadvantages, it's best to hold only a little. ▼



Marc Johnson, CFA, is the editor of *The Investment Reporter*, an advisory publication that has been providing investors with independent financial advice since 1941.

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***Marc Johnson,** from Page Five*

cant and should provide the impetus for expanding volumes in 2016 and beyond."

Winpak's valuation should improve

In 2016, Winpak is expected to earn a record C$2.78 a share. That represents earnings per share growth of only 4.9 per cent. Based on this estimate the shares trade at an acceptable price-to-earnings, or P/E ratio of 17.5 times. Next year, the company's earnings growth is expected to speed up to 14.7 per cent, to C$3.19 a share. Based on this estimate, the shares trade at a better P/E ratio of 15.3 times.

Two analysts who follow Winpak see it as a 'Strong Buy'. Our own view is that it's a buy. We don't use adjectives such as 'strong' buy or 'weak' buy. But we have seen this company's share price climb steadily over the decades.

WINPAK LTD. C$48.71 (Quality rating: Average; Sector: Manufacturing; TSX—WPK; T: 204-831-2254; www.winpak.com) remains a buy, mostly for long-term share price gains.

Winpak's dividend is a plus

Despite its growing earnings, Winpak has paid a regular yearly dividend of 12 cents a share for years. That yields only a little more than 0.2 per cent. The company, however needs lots of cash to invest (see this page).

While the dividend is small, it's still a plus. Remember, scams, other than Ponzi schemes, never pay cash. Companies that pay even token dividends underline their legitimacy. ▼

***James Kedzierski,** from Page Six*

effect, selling stocks at a poor time — like when markets take a tumble.

Another factor to consider for retirees is to know how much you can reasonably take from your nest-egg each year.

If you wish to keep your capital intact, we recommend taking no more than five per cent of your total — before taxes. Many advisors these days suggest four per cent, some prefer three per cent.

Our advice comes from a realistic expectation of returns of seven per cent on your equities and three per cent on your fixed-income holdings.

If you have 60 per cent of your total in stocks and the balance in bonds, these figures will provide an overall return of 5.4 per cent. ▼

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