

Empire Life Portfolio Update – Dividend Growth Fund

By Doug Cooper, Sr. Portfolio Manager, Canadian Equities
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Dear Customer:

In the context of the extreme equity market volatility during the first half of 2020, and as the lead manager of the Empire Life's Dividend Growth Fund, I would like to outline some key insights on the fund.

(1) Fund positioning - more defensive

We feel very good about how the fund is positioned. Since becoming lead manager in June of 2019 – and prior to the COVID-19 global pandemic – we made the fund more defensive by opportunistically acquiring high quality businesses in Canada and globally at attractive valuations. We focused on businesses that are well positioned to sustain and grow their dividends over the long run.

(2) Healthy cash levels prior to COVID-19 and today

The fund had a healthy level of cash at the start of the year which allowed us to take advantage of the COVID-19 related equity market sell-off in February and March of 2020.

Cash levels have increased since the equity market lows at the end of March 2020. We think this is prudent in the context of the strong equity market rally since the end of March 2020. Also, over the past few months, equity valuations have expanded well above pre-COVID-19 levels. While unprecedented levels of monetary and fiscal stimulus globally is supportive of higher equity valuations, there remains a number of risks on the horizon, namely the possibility of a second wave of COVID-19 in the fall, and related to this, productivity challenges from social distancing restrictions, trade wars, and the U.S. Presidential election. If we experience an equity market pull back, the fund is well positioned with a healthy level of cash and a more defensive positioning versus last year.

(3) We are seeing value in Canada

We are seeing meaningful value in Canada, in particular with Canadian banks and the more defensive areas of the energy sector, including pipelines where valuations are at decade lows and dividend yields are at decade highs. We anticipate strong absolute total returns from these areas of the Canadian equity market over the medium term.

(4) The fund's global exposure has increased

While we see a lot of value in Canada, we have populated the fund with a number of high quality global companies and Canadian domiciled global businesses, which collectively generate more than half of the fund's total revenue. The fund's global exposure provides diversification away from Canada's more cyclical economy.

(5) A challenging first half in 2020 for Canadian dividend mandates

It is important to highlight that during shorter periods of time, Empire Life's Dividend Growth Fund, and more broadly, the Canadian Dividend and Income Equity category, can perform very differently than the S&P/TSX Composite Index if there is a divergence in performance between dividend paying sectors and non-dividend paying sectors. This was certainly the case in the first half of 2020.

On the dividend paying side, Canadian banks, which comprise ~20% of the S&P/TSX Composite Index, underperformed in the first half of 2020. During this time period, Canadian banks were down ~15.5%¹ versus a ~7.5% decline for the S&P/TSX Composite Index. Likewise, pipeline stocks in Canada, which constitute nearly 8% of the S&P/TSX Composite Index were down 19% in the first half of 2020².

While on the non-dividend paying side, gold stocks and information technology stocks, which collectively make up over 20% of the S&P/TSX Composite Index, have outperformed substantially, posting returns of +35% and +62%, respectively, in the first half of 2020³. This has made it a challenging first half in 2020 for Canadian dividend mandates; however, as mentioned above, we are seeing significant value in Canadian dividend paying sectors, including Canadian banks and pipelines, and more broadly across the fund's Canadian and global holdings, which we anticipate will be supportive of strong absolute returns over the long term.

In summary, we feel very good about how Empire Life's Dividend Growth Fund is positioned, consisting of high quality companies trading at attractive valuations. We aspire to own companies with strong management teams, high earnings visibility, conservative capital structures, and attractive medium term growth prospects that can steadily grow dividends over the medium term. When bought at attractive valuations, these are the types of companies that we believe are best positioned to outperform their peers and generate attractive risk adjusted returns over the long run.

As always, thank you for your ongoing support.

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¹ Source: Bloomberg - S&P/TSX Composite Banks Industry Group GICS Level 2 Index

² Source: Bloomberg - S&P/TSX Composite Oil & Gas Storage & Transportation Sub Index

³ Source: Bloomberg - S&P/TSX Composite Information Technology Sector GICS and S&P/TSX Composite Gold Sub Industry GICS

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