

Better Than Bonds (for now)

Income-oriented investors already know by now that times are different – the level of yield that was prevalent in the bond market 10-15 years ago is no longer achievable. However, things are starting to change. The BoC raised the overnight rate three times to 1.25% following two cuts in 2015, and consensus is expecting one to two additional hikes this year. Since 2017, bond yields have been slowly creeping higher. In the adjacent chart we show the trend in the 10-year Government of Canada (GoC) bond and highlight the long-term downtrend break (in red) and the upward channel (in grey). While the yield is at the lower end of that channel at the moment, we note that this could go higher driven by a rebounding energy patch, rebounding housing market, better trade outcome with the US and more rate hikes. While rising rates tend to have a compressing impact on stock valuations (and thus market returns), we continue to believe that rates have not risen to a level to trigger a psychological shift away from stocks into bonds.

Despite rising bond yields, our belief is that dividend paying stocks present a better opportunity for income-seeking investors than bonds, at least for now. Compared to the 10-year GoC bond that is yielding 2.12%, the S&P/TSX Composite Index dividend yield is at 2.82%, presenting a 70 bp spread above the GoC bond. While the spread spiked in 2008, this phenomenon of stocks yielding more than bonds has not actually solidified until 2011.

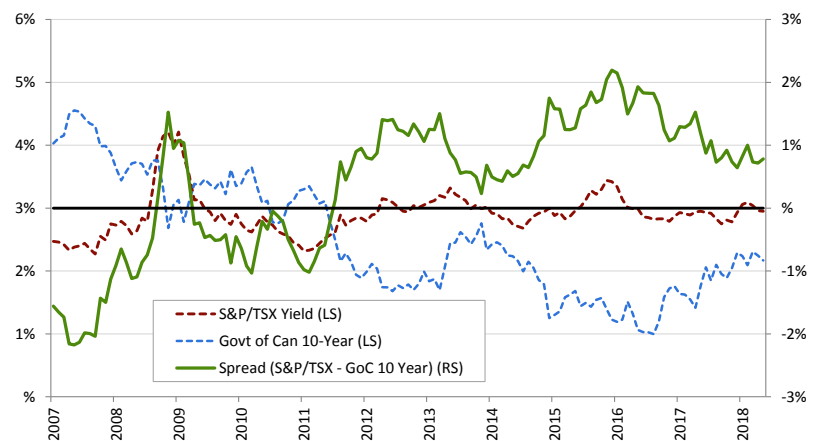
That being said, it is our duty to highlight the difference between the type of income from stocks and bonds. Stating the obvious, stocks are more volatile than bonds. Not only that, but the actual dividend that these stocks pay can also be volatile. If you held any of the energy stocks following the sector's downturn in 2015, you would have realised a string of dividend cuts from the energy companies. Companies need to cut dividends if they have cash flow problems and need the cash for other purposes such as paying down debt, funding new projects or making an acquisition. The good part about dividends is that they can also be increased by the companies paying them, providing investors with inflation protection. On the other hand, bond coupons generally cannot be increased - hence the name "fixed income".

10-year GOC yield at the lower end of its upward channel



Source: Bloomberg, Raymond James Ltd.

S&P/TSX's Dividend Yield > GoC 10-Year Yield, still for now



Source: Bloomberg, Raymond James Ltd.

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Given the inherent risks that come with stocks as opposed to bonds, we advise clients get in touch with their financial advisor in order to set a more appropriate path to achieve the desirable level of income. In the meantime, we revisit the “Better than Bonds” screen in order to help select stocks for income-oriented investors. This report has been done at least three times in the past so you could refer to the most recent (January 11, 2018) for the methodology. If we were to run both the Original and Aggressive screens, we would find the names below.

Original “Better Than Bonds” Screen – Sorted by Dividend Yield

Ticker	Name	Dividend Yield	Market Cap (blns)	3-Month Beta	Net Fixed Asset Turnover	Interest Coverage	Dividend Coverage
SPB-T	Superior Plus Corp	5.6%	\$2.6	0.34	2.6x	4.3x	1.8x
T-T	Telus Corp	4.6%	\$27.7	0.68	1.2x	4.8x	1.4x
NWC-T	North West Co Inc/The	4.3%	\$1.5	0.33	4.4x	7.6x	1.1x
ITP-T	Intertape Polymer Group Inc	4.2%	\$1.0	0.68	3.3x	6.7x	1.4x
NFI-T	Nfi Group Inc	3.1%	\$3.1	0.52	14.2x	9.6x	1.5x
RCI.B-T	Rogers Communications Inc-B	3.0%	\$32.5	0.74	1.3x	4x	1.7x
WJA-T	Westjet Airlines Ltd	3.1%	\$2.1	0.70	1.1x	2.4x	2.3x
CCA-T	Cogeco Communications Inc	3.0%	\$3.2	0.50	1.1x	2.5x	5.9x
QSR-T	Restaurant Brands Intern	2.9%	\$37.1	0.74	2.3x	3x	1.3x
MSI-T	Morneau Shepell Inc	2.9%	\$1.5	0.55	17.9x	7.3x	3.9x
TCL.A-T	Transcontinental Inc-CI A	2.8%	\$2.7	0.60	4.1x	22.5x	4.3x
EFX-T	Enerflex Ltd	2.7%	\$1.2	0.54	3.0x	3.9x	1.3x

Source: Bloomberg, Raymond James Ltd. Priced as at 07/05/2018.

Aggressive “Better Than Bonds” Screen – Sorted by Dividend Yield

Ticker	Name	Dividend Yield	Market Cap (blns)	3-Month Beta	Net Fixed Asset Turnover	Interest Coverage	Dividend Coverage
SPB-T	Superior Plus Corp	5.6%	\$2.6	0.34	2.6x	4.3x	1.8x
MSI-T	Morneau Shepell Inc	2.9%	\$1.5	0.55	17.9x	7.3x	3.9x
TCL.A-T	Transcontinental Inc-CI A	2.8%	\$2.7	0.60	4.1x	22.5x	4.3x
TFII-T	Tfi International Inc	2.0%	\$3.6	0.85	3.8x	4.8x	2.6x
WN-T	Weston (George) Ltd	1.9%	\$13.5	0.62	4.2x	3.8x	3.1x
UNS-T	Uni-Select Inc	1.8%	\$0.9	0.76	26x	3.7x	2.7x
EMP.A-T	Empire Co Ltd 'A'	1.7%	\$6.9	0.56	8.3x	5.1x	2.5x
TIH-T	Toromont Industries Ltd	1.7%	\$4.5	0.77	3.9x	5.5x	2x
MRU-T	Metro Inc	1.6%	\$11.3	0.77	7.8x	6.2x	2.6x
GIL-T	Gildan Activewear Inc	1.6%	\$7.7	0.56	2.6x	12.1x	2.7x
MFI-T	Maple Leaf Foods Inc	1.6%	\$4.2	0.51	3.2x	27.8x	1.7x
SAP-T	Saputo Inc	1.5%	\$17.0	0.82	5.3x	23.6x	2.1x
CAS-T	Cascades Inc	1.3%	\$1.2	0.49	2.3x	5.1x	16.1x

Source: Bloomberg, Raymond James Ltd. Priced as at 07/05/2018.

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