November 2020

IN THIS ISSUE

BE PREPARED BY KNOWING WHAT TO EXPECT

Mike Preto, CFP®

My family and I completed a major home renovation a year ago. This was our first and I was dreading it. I had heard all the stories: double the budget, double the estimated time to complete and good luck keeping your marriage together! In the end, we got through it relatively unscathed. Yes, there were some tough moments, but in the end the project went quite well: we were on time, 10% over budget (most of which was our doing), and we are very pleased with the outcome. I wonder what my perception of the same experience would be had I been expecting a painless project.

We do a lot of research here at **Hillside Wealth**, some of which is absorbing what other Portfolio Managers and Economists whom we respect are observing and how that may impact the financial landscape. Some will say that we are going to get inflation, others see deflationary risks as a greater concern. Some might say that there's going to be a great buying opportunity in the Bond market while others will say to run as far away from Bonds as possible. The point is that many well respected, smart and experienced folks expect completely different outcomes, so the exercise is all about gathering commonalities from their work and using that to build your own knowledge and conclusions.

There are currently three common themes that we are comfortable putting the Hillside stamp of approval on. The first is that owning a meaningful position in Gold makes a lot of sense. The argument here is straightforward; as central bankers across the globe print more and more money, owning something with a scarce supply is a good bet. Couple that with low or negative real interest rates, therefore no lost opportunity in owning a metal that doesn't generate any cash flows, and the asset class having gone virtually nowhere in the last 9 years and you have some pretty obvious tailwinds that could help us on our journey.

The second is that at some point, of course no one knows when, owning bonds is going to make you look silly. Jason spends a fair amount of time explaining this further on in the letter, so I don't want to steal his thunder. Essentially bonds have been a great place to be for the last 40ish years during which time interest rates have been dropping and the price of bonds rising. At some point that tide is going to turn and start to push against us as opposed to moving us along nicely.

The third is that there's going to be a lot of volatility for the foreseeable future. We have a market that reacts to tweets, policy decisions (or lack

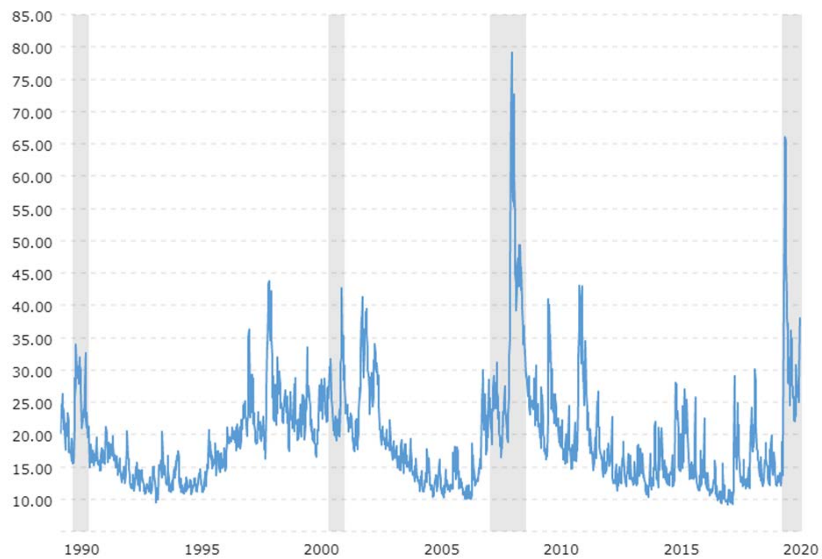
REFERRALS: THE HIGHEST COMPLIMENT

At Hillside Wealth, we take referrals from existing clients as one of the highest compliments. The responsibility of knowing that can recommend us to family and friends is one we don't take lightly.

We are currently accepting new clients primarily by referral from existing clients. If you have family or friends who would be a good fit for our specialized wealth management services, please feel free to get in touch.

thereof) from Governments and Central Banks and when a vaccine will be available. You throw in stock markets and debt levels that are at or near all time highs and interest rates at all time lows, passive investors that are forced to buy or sell depending on how their investors are feeling that morning, who can now trade while going to the washroom, and you have yourself quite the forecast.

The **Cboe Volatility Index®**, or **VIX® Index**, is a common measure of expected volatility. Simply put the VIX is a real-time market's expectations for volatility over the coming month. It measures the level of risk, fear or stress in the market. Here's what it looks like historically:



Source: www.macrotrends.net

The grey lines represent recessions (yes we are currently in one), and as you would expect the VIX activity is heightened during these times. We have systems in place to continue to drive returns, even if we are faced with a prolonged bout of volatility, so we are absolutely equipped to navigate through this. We don't need markets to be calm, we just need a system to allow exceptional companies to exist and then have capitalism reward those exceptional companies over time.

You might be wondering why we're choosing to broadcast this potentially unsettling message. The answer is very simple: we want you to expect it so that you are better prepared to handle it when it comes. Many investors, even those with experience, make unwise decisions when faced with adversity. These poor decisions can cost people a tremendous amount of money which could've otherwise been used to realize their Big, Meaningful Dreams.

We have a commitment to protect your future and we will do whatever we can to honour it, even if that means preparing you for

HILLSIDE WEALTH IN THE FINANCIAL POST

See what Jason had to say in this November 3, 2020 article: For Canadian investors, Oval Office is wrong place to look for answer to sluggish returns

a potentially rough part of the journey. Whether we are renovating or managing money, knowing what to expect will better prepare us to handle it.

PORTFOLIO UPDATE: FREE CASH FLOW | CASH IS KING

Jason Del Vicario, CFA

At Hillside we believe that data drives decisions and that discipline consistently generates exceptional results. At the end of the day we are charged with allocating our client capital into investments that we feel will provide an excellent risk adjusted return.

We've discussed in the past how focusing on companies that consistently generate above average returns on invested capital without employing copious amounts of debt enables us to do this. We've discussed how we screen, identify and manage a database of exceptional companies. However, we've never really discussed how these options fit in the context of the available options we have for our investment dollars… namely: cash, bonds & stocks.

First, we need to define 'return.' As investors we are concerned with how much a given investment yields us either in the form of dividends, interest payments or capital appreciation (something goes up in value). Over time the actual return we receive will mirror the underlying returns/fundamentals of the investment however in the short term there can be large differences. Once we can define profit then we can define return and the best way to define profit is the Free Cash Flow (FCF) of a given company or investment generates. Free Cash Flow is defined as the cash left over after a company/investment pays for its operating expenses and capital expenditures known as CAPEX. This is also sometimes referred to as the 'shareholder yield.' It is very difficult to manipulate because at the end of the day cash is cash. This cash can be used as follows:

1. Leave as cash on the balance sheet
2. Pay down debt
3. Re-invest into the business
4. Acquire other businesses
5. Buy back shares
6. Pay out as dividend

We can also use the concept of FCF to help us understand that value of a given investment and to compare with other investment options. **Free Cash Flow yield** is simply the cash an investment generates expressed as a function of the market value of the investment or: **FCF/MarketCap**.

A number of readers have indicated to me that they like when I use the house analogy to explain complex financial metrics and concepts so let's revisit this illustration.

WATCH JASON ON BNN MARKET CALL

Don't miss Jason's next guest appearance on BNN Bloomberg's #Marketcall on December 17th at 9:00 am PT (noon ET).

Jason will discuss North American Growth Stocks. The full episode will be available online shortly after airing.

Please check with your local tv service provider for your local channel or access to the live stream online.

Let's imagine we invest in a $1m rental property. The property yields $4k/month in rental income, we pay $10k/year in expenses and are in a 50% tax bracket.

Free cash flow: [$48k (rent) - $10k (expenses)] * 0.5 (tax rate) = $19,000.

Is this good?... how does this compare with other investment options?

Intuitively it makes sense for us to compare the return ($19k) with the amount we invested ($1m). Doing this we calculate the FCF yield of 1.9% ($19k/$1m).

How can we increase the FCF yield on this house? There are two ways… we can either increase the rent or decrease the value of the home. If the rent stays the same but the value of the house drops 50%, our FCF yield doubles to 3.8% but we're not going to feel very good about this given the value of our investment dropped 50%. We'd feel a lot better if the rent doubled and the house remained worth $1m! The two important factors to consider are the **level** of the FCF yield and **growth** in FCF.

For this discussion we're going to leave out the impact of inflation but I think we can all appreciate that if inflation is running at 2%, our nominal return of 1.9% quickly becomes -0.1% in real terms. **Real return is the nominal return minus inflation.**

Going back to our questions: is this good?... how does this compare with other investment options?

Let's explore those 'other investment options.' Notwithstanding Wall Street's relentless efforts to complicate the investment landscape there are only a handful of investment options: cash, bonds, stocks, real estate and commodities.

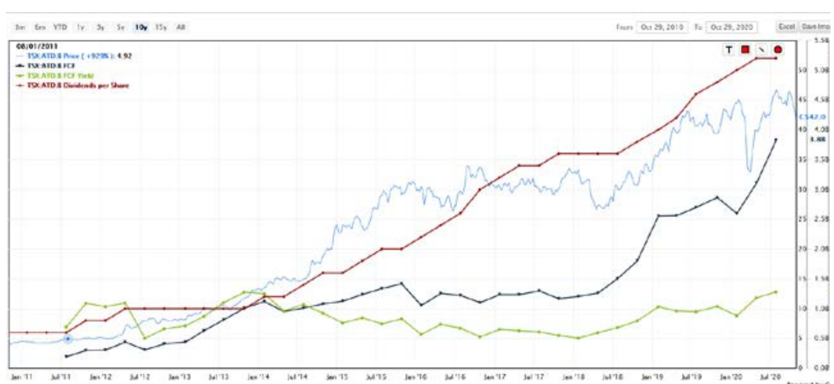
Cash and bonds are often characterized as 'fixed income' and as the name indicates the income these investments pay is fixed and therefore offer zero growth of cash flow. With interest rates pinned close to 0% we can see these investments offer us negligible return and zero growth of cash flow.

Investment	Income Yield	Income Growth
1-year GIC	0.80%	0%
5-year GIC	1.20%	0%
5-year government of Canada Bond	0.38%	0%
10-year government of Canada Bond	**0.63%**	**0%**
30-year government of Canada Bond	1.22%	0%

If we take our same $1m and invest it in a 10-year Government of Canada bond, we will receive $6300/year each year for 10 years. If we lose half to taxes and lop off another 2% for inflation we see that our real return falls well into negative territory AND our $1m depreciates significantly in terms of purchasing power. While GICs do not fluctuate in value, bonds do and will move in response to changes in interest rates and inflation. If rates/inflation move up, the value of bonds go down and vice versa. While we wouldn't rule out the prospect of negative rates, we can all agree rates can't go much lower and thus the huge tailwind of falling rates (and rising bond prices) is largely behind us at this point.

So now what about stocks? Warren Buffet says that when we look at stocks or buying shares in businesses that we should think about the prospect in the context of us buying the entire business. Let's look at a company we own in its entirety: Alimentation Couche Tard (ATD.b). The company was founded in 1982 with a single convenience store and now is the second largest convenience store operator in the world with over 15,000 stores. If we were to buy the entire company it would cost us $45.6B which we derive from multiplying the number of shares outstanding by the price of the shares… otherwise known as the market capitalization. Is this a good investment?... we probably would like to know what sort of assets and earning power we'd get for shelling out $45.6B. We see that their most recent trailing twelve months FCF is $3.8B. From above we can calculate the FCF yield as follows: $3.8/$45.6 = 8.33%. Not only is this 13 times the return of the 10-year GOC bond noted above but the kicker is this amount has been growing by 25% per year compounded over the past 10 years. ATD.b's FCF was $261m in 2010. In 2010, the market cap was $3.4b which worked out to a FCF yield of 7.7%.

I like charts. Here is ATD.b over the past 10 years showing dividends (red), FCF (black), FCF yield (green) and the stock price (blue).



Source: https://www.gurufocus.com/new_index/

Metric	2010	2020
Market Cap	$3.4B	$45.6B
FCF	261m	$3.8B
FCF growth (compounded)		25.5%
Dividend/share	$0.03 (0.94% yield)	$0.28 (0.66% yield)
Dividend growth (compounded)		25.0%
Stock Price	$3.16	$42.00
Stock Price ROR (compounded)		29.5%

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Now this is where it gets fun. If we had bought the company in 2010 for $3.4B and held shares until now we would be earning $3.8B A YEAR today in free cash flow or more than 100% of our original investment plus this cash flow is growing. Going back to our house example, this would be like us earning $1m/year in rental income per year 10 years after buying the house AND the rental income is growing at ~20-25% per year. So right now we can put our money in 10 year GOC bonds and get a 0.63% ROR that won't grow for the next 10 years or we can put it into shares of ATD.b which are yielding 8.3% and have shown a consistent history of growing that cash flow.

Looking backwards is easy… what about looking ahead 10 years? Let's say that ATD.b's growth slows by 60% and they 'only' grow by 10%/year for the next decade. This means their FCF will grow from $3.4B to $8.8B. If we assume the FCF yield is stable at 8% then the value of the company will rise to $118B ($8.8B/0.08). Ignoring dividends, this would work out to a 10%/year compounded ROR. This is 15 times the return offered up by the 10-year GOC bond noted above excluding the magical effects of compounding. More importantly, to the extent that inflation remains below 10% our wealth not only keeps pace with inflation but beats it. Furthermore, given the current tax regime, our wealth can compound tax free (really tax deferred) as we don't pay taxes on this gain until we sell and even then only 50% of the gain is taxable.

Let's compare the two hypothetical $1m investment options. Let's assume that ATD.b's FCF slows 60% and their FCF compounds at 10%/year over the 10-year period. Let's also assume the dividend keeps pace and also grows at 10%/year. So for ATD.b we assume that of the 10% ROR, 1% comes to us as way of dividend with the rest as capital appreciation (stock rises in value to reflect the growing FCF).

Security	10 year GOC Bond	ATD.b
Interest/FCF yield	$6,300	$80,000 of which ~$6,600 received as dividends
$ yield	0.63%	8.00% (0.66% div yield)
Growth in income/FCF	0%	10% (25% historically)
Total Income Received	$63,000	$116,000 (dividends)
Taxes paid	$31,500	$35,000
After tax income received	$31,500	$81,000
Value of Investment yr. 10	$1,000,000	$2,360,000
Total return	$31,500 or 3.15%	$1,441,000 or 144%

So why would anyone in their right mind buy bonds? Good question. Really good question. Historically bonds paid a reasonable yield (4-10%) and holders benefitted from generally falling interest rates which gave them a capital gain on top of the yield. Bonds also generally zig when equities zag which reduces the risk in a portfolio if we define risk in terms of volatility as most do.

But we must look forward and owning bonds going forward will yield a 0-2% ROR with no growth in income stream and unlikely to protect our capital in the face of inflation. We are going to leave this discussion for another day and will finish with a list of the securities we own and their corresponding FCF yields. FCF yield Is the valuation metric we most favour.

In summary, the FCF of a company is the amount of cash that it generates over and above its expenses and ongoing capital expenditure (CAPEX) requirements. It is the cash leftover for shareholders and can be distributed in the ways noted earlier in this article. As shareholders it is our cash and we rely on management to make intelligent capital allocation decisions on our behalf. We can compare the FCF to the value of the company to determine the FCF yield which in turn we can compare with other investment options such as Government Bonds, Corporate Bonds, Real Estate investments etc etc. With that in mind, please find a list of all the securities we presently own and their corresponding FCF yields and 10-year FCF growth rates. For those companies that haven't been around for 10 years, shorter time frame FCF growth rates are noted.

Security	FCF Yield (FCF/Market Cap)	FCF Growth (10 year unless otherwise noted)
Rational AG	1.3%	5.8%
A2 Milk Company	3.9%	44.8% (1 year)
Amazon	1.8%	28.1%
Alimentation Couche Tard	8.3%	25.5%
Biogen	13.6%	22.4% (5 year)
Berkshire Hathaway	4.3%	9.6%
Boyd Group Services	5.4%	28.6%
Check Point Software	7.6%	10.4%
Canadian Pacific Railway	1.9%	17.1% (5 year)
Constellation Software	4.4%	30.8%
Dollarama	5.3%	27.2%
Evolution Gaming AB	2.0%	85.7% (5 year)
Facebook	2.5%	28.3% (5 year)
Heico Corp	3.0%	16.8%
HeadHunter Group PLC	2.9%	-4.1% (1 year)
Kakaku.com	3.0%	19.6%
Kirkland Lake Gold	5.1%	65.5% (1 year)
Lightspeed POS	Negative FCF	n/a
MasterCard	2.4%	20.2%
Microsoft	3.2%	7.2%
Novo Nordisk	4.9%	14.0%
OpenText	8.8%	19.7%
Rightmove PLC	2.5%	20.0%
Ross Stores	2.2%	18.1%
Biosyent	7.1%	15.0% (5 year)
Tucows	1.00%	16.9% (book value growth)

OCTOBER 2020 PERFORMANCE RESULTS

An overview of our three portfolios to date.

Performance to October 31, 2020	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	5 Yr**	Inception **	Added Value vs. Benchmark**
Hillside Conservative Growth*	**3.13%**	**-2.88%**	**2.75%**	**4.46%**	**6.46%**	**6.77%**	**7.40%**	**2.84%**
HCG Benchmark[1]	*2.32%*	*-1.34%*	*5.13%*	*4.13%*	*4.49%*	*5.03%*	*4.56%*	
Hillside Balanced Growth*	**1.13%**	**-3.92%**	**3.71%**	**3.00%**	**6.41%**	**7.66%**	**9.08%**	**4.18%**
HBG Benchmark[2]	*1.72%*	*-1.38%*	*6.36%*	*4.09%*	*4.70%*	*5.57%*	*4.90%*	
Hillside Focused Growth*	**1.00%**	**-3.31%**	**11.73%**	**2.46%**	**4.74%**	**6.32%**	**7.86%**	**2.22%**
HFG Benchmark[3]	*-3.14%*	*-2.55%*	*10.55%*	*1.56%*	*3.91%*	*6.87%*	*5.64%*	

Past performance is not an indication of future returns.

* Performance is presented gross of fees. **Inception: Sept 2, 2014. Results beyond 1 year are annualized.
[1] Hillside Conservative Growth Benchmark: 100% Vanguard Conservative ETF
[2] Hillside Balanced Growth Benchmark: 100% Vanguard Balanced ETF
[3] Hillside Focused Growth Benchmark: 100% Vanguard All-Equity ETF

Source: SIACharts.com

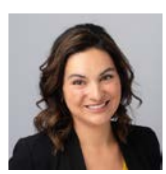
The performance presented in this portfolio report is hypothetical and does not represent a specific client account. Details regarding actual returns of an investment account are available from the client's advisor.

Performance is calculated using month-end market values of the model portfolio. Since we use a model portfolio to calculate performance there are no client-initiated cash flows (deposits/withdrawals) to account for. Performance is calculated by dividing the change in the model portfolio's market value by the model portfolio's market value at the beginning of the performance period. Also, all income generated by the portfolio's holdings are held within the model portfolio in cash and is accounted for in the portfolio's month-end market value - this results in a total return measure of the model's performance.
Returns for periods less than 1 year are shown as periodic returns while returns for periods greater than 1 year are annualized. Returns do not include fees and actual returns experienced by an investor may differ from those shown. Past performance is not a guarantee of future results.

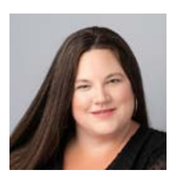
Michael Preto, B.Comm., CFP®, CIM Portfolio Manager
HollisWealth, a division of Industrial Alliance Securities Inc.
Insurance Advisor.
Hollis Insurance Agency
Direct: 604-895-3329
Mike@hillsidewealth.ca

Jason Del Vicario, B.Sc., CFA Portfolio Manager
HollisWealth, a division of Industrial Alliance Securities Inc.
Insurance Advisor
Hollis Insurance Agency
Direct: 604-895-3367
Jason@hillsidewealth.ca

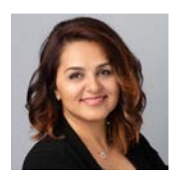
Amanda Baxter
HollisWealth, a division of Industrial Alliance Securities Inc.
Direct: 604-895-3324
Amanda@hillsidewealth.ca



Sabrina Del Vicario, B.Comm.
Business Development Manager
Direct: 604-895-3324
Sabrina@hillsidewealth.ca



Heidi Marsall
Associate Investment Advisor
Direct: 778-484-5455 (Kelowna)
Heidi@hillsidewealth.ca



Rozita Tehrani
Executive Assistant (to Mike & Jason)
Direct: 604-895-3349
Rozita@hillsidewealth.ca