INFORMED INVESTOR NEWSLETTER

April 2022

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MEASURED GENEROSITY IS SUSTAINABLE

Michael Preto, CFP®, CIM®

Debt is used to finance purchases which the buyer can't afford to pay for today. Individuals, Governments, and companies all use debt with perfectly good intentions. For individuals, it could be to buy a house so you have a place to live. For Governments, debt could be used to help society navigate the lockdowns imposed to fight off Covid. Companies may use debt to acquire another company or expand operations to increase profits.

Debt is a useful tool which, if used properly, can help build a strong financial future. On the flip side, if used irresponsibly, debt can destroy a perfectly good one. In a decreasing rate environment, the flip side has a higher probability of showing up.

Canadians have been living through a decreasing interest rate environment for ~40 years. Ever since the Global Financial Crisis of 2008, rates have been incredibly low, as illustrated in this graph:

It's easy to understand why lower rates encourage borrowing; but the more you borrow, the more exposed you are to rising interest rates. We don't know if the interest rate tide has officially turned, but if it has then rates could start a steady climb for decades to come. Predicting the future is a dangerous exercise, while preparing for the future is a wise one.

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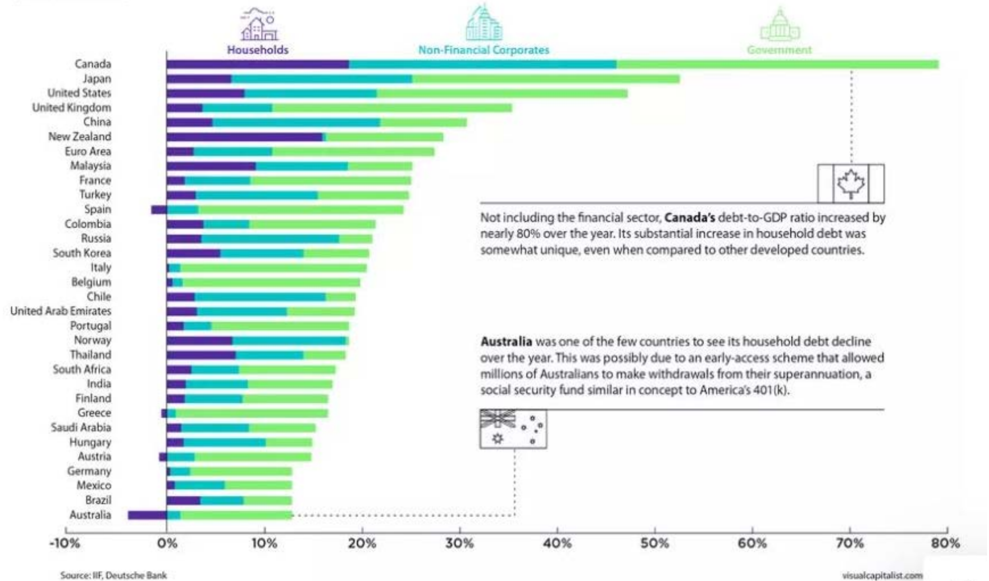
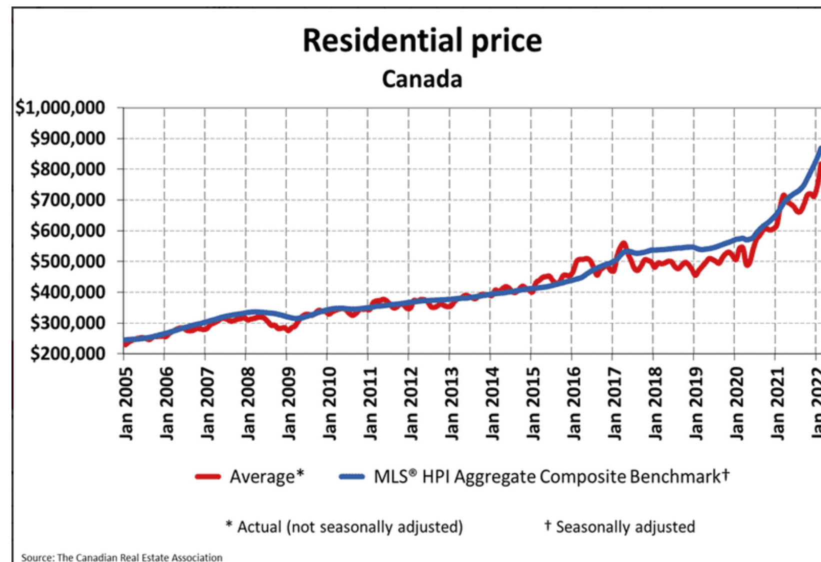
The Canadian Government, consumers, and the corporate sector all piled on debt at a record pace. If taking on the most amount of debt relative to their country's economy was an Olympic Sport, Canada won Gold and the 2nd place country wasn't even close.

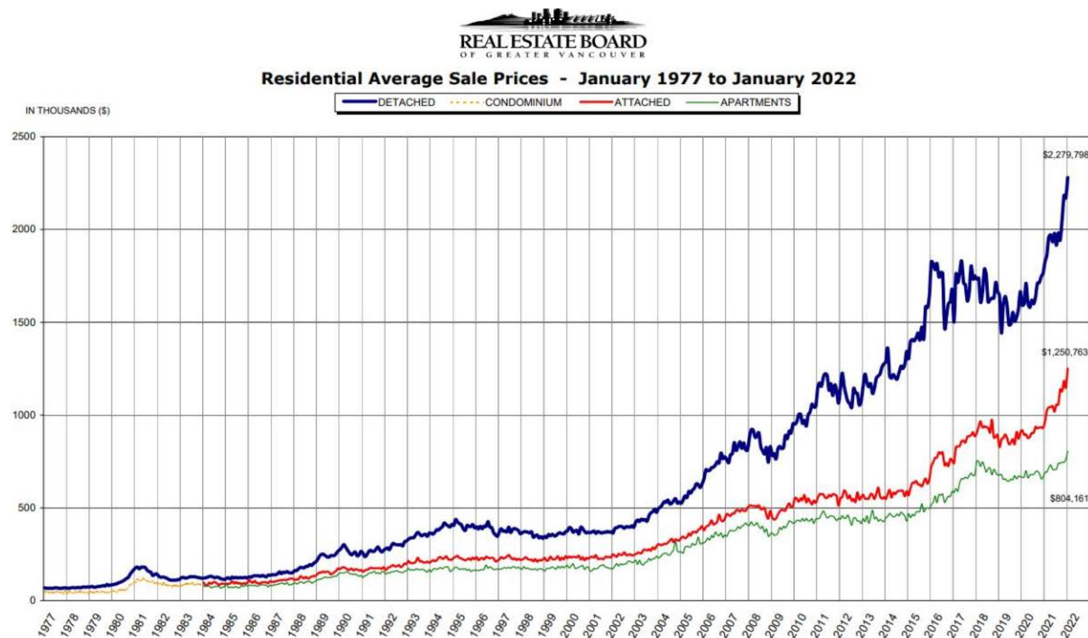


Canadians seem more keen to predict a future of lower rates than they are in preparing for one where rates are higher. This is likely because they are having to borrow more to keep up with the real estate market.

Low interest rates are a tailwind for real estate, while rising rates are a headwind. It's no coincidence the price of Canadian Real Estate has increased at a record pace:



And Vancouver prices have helped push the Canadian averages up for sure:



In early 2021 you could've taken on a 5-year fixed mortgage rate of 1.69%. Today, the same product would cost you 4.15%. If you were to borrow $1m and want to pay it off over 25 years, your monthly payment @ 1.69% would be $4,089. At 4.15%, your payment would be $5,361: a 30% increase in just over a year. Yes, you can still get a variable rate, which moves up/down along with current interest rates, at ~2%. But with central banks expected to raise interest rates to fight off the current inflationary environment, they are expected to rise quickly in the short term.

The situation we find ourselves in with respect to debt and real estate is unprecedented. This doesn't mean you shouldn't buy real estate or help your kid(s) do the same. It does mean you should do so carefully. Measured generosity is sustainable is a core philosophy of ours here at Hillside which helps provide some parameters to affordability. The amount of debt you choose to take on is a measure of generosity- you are being generous to yourself by buying something today which you can't afford to pay for outright. If you carefully measure how generous you're being to yourself, or family, your level of generosity will be sustainable.

Rather than use today's rates to measure your affordability use a higher rate which may come to roost down the road. Anyone who is taking on a mortgage in Canada must pass certain affordability ratios which determines how much they're able to borrow. In 2018, the Government mandated the use of artificially elevated interest rates to "stress test" the borrower's ability to handle a rising rate environment. Currently, the stress test rates are either 5.25% or 2% above the rate offered to you by the lender. This higher rate forces Canadians to borrow less than they otherwise could and is a good first step. We would recommend taking it a step further by pretending the higher stress tested rate is your actual interest rate. This forces you to have a higher mortgage payment than is necessary and so if rates do continue to rise, you are already living that reality and so you're prepared for it.

You may be thinking of helping your child(ren) or family members get into the real estate market. Applying the same measured approach with respect to how much you give, or lend, them with respect to your own target retirement date and lifestyle will ensure you're doing so sustainably. The process here is simple- set up a meeting with us to review your retirement planning targets. We will review

your targets, run your plan at today's market values and then measure the size of your Dreampool, representing surplus funds which are not needed to hit your retirement targets. Right now, more than ever, you want to measure twice before you cut a big cheque.

If your dream is to renovate, buy your first home, buy a vacation property or help your loved ones get into the real estate market, then we want to help you realize it and we commit to doing so while protecting your future.

PORTFOLIO UPDATE: THE BENEFITS OF GOING AGAINST THE GRAIN

Jason Del Vicario, CFA®

By now our clients are aware that we are laser focused on high-quality, predictable businesses. While we'll keep highlighting and exploring what this means in future newsletters, I'll take a break this month(!) and instead focus on something that occurred to me recently: that someone observing our holdings may have questions regarding the quality of our holdings because of stock price. The casual observer might point to some of our positions and proclaim 'wait; penny stocks are anything but high quality, surely they are speculative, I see we own 'penny stocks'… what gives?!'

While I'm somewhat surprised no one has said this to my face (or in the comments section on a screen…sigh) I am sure a few have thought it. So, let's break this down: YES, we own 'penny stocks' (as in stocks that trade for less than $1); but NO, they are ***not*** speculative *simply because of pricing*. Below are the stocks we own that appear on your statements as less than $1CAD. These are real businesses, producing real products/services, which in turn lead to cash flows, building cash positions, and in some cases - even dividend payments. Speculative penny stocks generally have an 'idea' with revenues (maybe), negative earnings and the constant need for capital. The equity holder hopes the idea becomes reality and profitable. Hope isn't an investment strategy at Hillside.

Business	Country	Price (HKD)	Price (CAD)	Market Cap (CAD)	Net cash per share (CAD)	ROIC	PE	Dividend Yield
Snack Empire	Singapore	$0.25	$0.041	$32.8m	$0.028	17%	26	n/a
Plover Bay	Hong Kong	$3.60	$0.578	$630.3m	$0.03	80%	24	3.8%
Perfect Shape Medical	Hong Kong	$5.29	$0.848	$1.05B	$0.09	30%	17	10.2%

*source: www.gurufocus.com | data as of April 8, 2022

As we can see, all the above companies are profitable, have net cash on their balance sheets, but for Snack Empire pay a dividend and are sizeable businesses (market caps over $0.5B CAD). Whenever I talk about Constellation Software I usually hear 'oh but the shares are $2,000/share so obviously I've missed the boat.' We don't pay attention to share price but rather the underlying business economics. CSU is a $44B market cap company. If they split their shares 10 for 1, the price would be $200/share and it would still be a $44B company but with 10x the number of shares outstanding. If they then split 100 for 1, the price would be $2/share and the company still worth $44B. Similarly, if Plover Bay reverse split their shares 1 for 10 the price would be $29HKD (or $4.73CAD) but still worth $630.3m CAD. The price of the stock can be a rough guide for business quality but as we can see above one must go beyond passing judgement based purely on stock price alone.

Fun fact: Snack Empire has over 250 locations and as of 2020, they have sold close to 63m XXL Crispy Chickens! More information about the brand can be found by clicking here.

BYE-BYE MYPORTFOLIO+

Don't forget - myportfolio+ will no longer be available after September 30th.

For assistance with the new (and improved!) client portal, please contact Amanda.

(cute cat pic for attention!)

THE HILLSIDE FACTOR(Y) FOCUS: NOT ALL GROWTHS ARE CREATED EQUAL

In one of his annual shareholder letters, Warren Buffett compared three different growth stories – the great business (i.e., See's Candies) increases profits without significant capital investment; the good business (i.e., FlightSafety) reinvests a fair amount of capital to grow earnings power at an attractive rate of return; the gruesome business (i.e., airline) generates inadequate returns on the capital that finances a rapid growth.

This may not be so intuitive but faster growths are not always better for shareholders at least. What Buffett was referring to as a major consideration in this regard is what it takes to grow compared to the opportunity cost (or the cost of capital). In an extreme case, if it has become too "expensive" to grow the business, rational investors would want to hope for the business not to grow at all.

Simply put, not all growths are created equal in the business world. At Hillside, we are fully aware of this. By developing proprietary analytics, we endeavor to stay away from "the gruesome" (i.e., the value-destroying growth) and to dig out "the great" and "the good." A few examples from our portfolios – we believe that asset-light operators, such as Tobila Systems, Check Point, Plover Bay, can increase their earnings without much capital reinvested; some other companies like Credit Acceptance, Constellation Software, and Alimentation Couche-Tard depend more on retained earnings to grow – their management teams primarily concentrate on returns on capital when deploying capital for either organic investments or acquisitions.

Aside from capital efficiency, predictability and cash conversion are the other two major factors that concern us here. We focus on market leaders in secular-growth industries propelled by long-term, structural shifts instead of cyclical or seasonal factors. For example, Bouvet is one of the top choices for digitalization projects among private and public enterprises in the Scandinavian region. Moreover, we favor highly recurring/repeatable and highly cash-generative revenue models. For example, Perfect Medical benefits from its contract sales to "lock-in" customers and collect prepayments ahead of the services provided for the customer.

Lastly, as equity investors are long-term by definition, we would applaud any initiative supporting the sustainability of future growth even at the expense of near-term results. Rightmove provided significant discounts to support its customers during the spring and summer of 2020 when the UK property market was temporarily closed, causing the company's top-line and bottom-line to drop YoY by 29% and 36% but potentially contributing to the robustness of the customer relationship and the healthiness of the industry at large. Last year, Games Workshop, another Hillside holding

company based in the UK, decided to pay a discretionary bonus equally to all employees to reward their contributions to the significant increase in profitability. The bill totaled more than GBP 10 million, representing nearly 10% of the earnings for the fiscal year. But we think that our 10% "loss" is well spent on driving employee loyalty and talent retention in the long run.

MARCH 2022 PERFORMANCE RESULTS

An overview of our three portfolios to date.

Performance to March 31, 2022	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	5 Yr**	Inception **
Hillside Conservative Growth*	**-8.38%**	**-1.63%**	**-4.50%**	**3.41%**	**6.75%**	**6.72%**	**7.20%**
HCG Benchmark[1]	*-5.26%*	*-1.04%*	*-2.62%*	*0.58%*	*5.29%*	*4.97%*	*4.71%*
Hillside Balanced Growth*	**-9.62%**	**-1.52%**	**-4.79%**	**5.61%**	**8.18%**	**8.15%**	**9.50%**
HBG Benchmark[2]	*-4.86%*	*-0.47%*	*-1.63%*	*2.12%*	*6.75%*	*6.09%*	*5.55%*
Hillside Focused Growth*	**-12.29%**	**6.29%**	**-4.29%**	**1.96%**	**9.84%**	**7.66%**	**9.41%**
HFG Benchmark[3]	*-5.37%*	*2.54%*	*-0.30%*	*4.00%*	*10.43%*	*9.52%*	*8.21%*

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.

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Hillside Wealth Management is a personal trade name of Michael Preto and Jason Del Vicario.

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.