

Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to ensure you are well informed. We sift through the noise and only bring you important topics of discussion and planning points useful to you.

We believe Knowledge Pays and we want our knowledge to pay for you.

ALTERNATIVE INVESTMENTS – WHY ALL PRIVATE DEBT FUNDS ARE NOT CREATED EQUAL

The receivership of private debt manager Bridging Finance and the Ontario Securities Commission's allegations of fraud against its principals has dominated Canadian business news in May. The company oversees ~\$2 billion in loans, predominantly to small- and medium-sized Canadian businesses. If the court appointed receiver cannot realize full value for the loan portfolio, unitholders could face losses.

Since the 2007-2009 global financial crisis, central banks around the world effectively pinned interest rates at or close to 0%, pushing fixed income investors to explore new areas of the investment markets to achieve yields sufficient to meet financial planning goals. **Private debt is one area that had benefitted greatly** and Bridging Finance was one of the key benefactors of this 10+ year 'reach for yield'. The opaqueness of private markets increases the risk of fraud, at least relative to public markets.

Similar to stocks, **a highly experienced financial advisory team can help reduce the risk associated with investing in alternative investments** by identifying risk factors that may or may not be difficult to identify. Hindsight is 20/20 but there were some red flags that increased the risk associated with investing in Bridging Finance's funds, including a husband and wife top management team and significant investor inflows into a small subsector of the Canadian debt market over a short period.

Is the Alternative Investment Business Case Rational?

We ask these questions when performing due diligence on alternative investments.

- *Do the past and expected returns make sense given the risks?*
- *Does the manager have a competitive advantage due to experience or scale?*
- *How has the manager dealt with bad/defaulted loans in the past?*
- *Are past returns durable if the industry attracts significant investor inflows?*

The Assets Backing the Loans Matter

Bridging Finance is an asset-backed lender. The assets supporting their loans generally consisted of accounts receivable, inventory and equipment. While these types of assets have tangible value, their valuation is subjective and can be somewhat lower in a default/liquidation scenario. At Steele Wealth Management, we prefer alternative investments that **directly hold liquid assets like stocks or real estate or hold loans backed by easy to value and monetize assets such as real estate**. That does not mean there is not a place for other types of asset-backed lending but due to their unique risks, these funds should not be the core of your alternative investment portfolio.

With historically high equity market valuations and historically low fixed income yields, a diversified set of alternative investments remains an important ingredient in a diversified portfolio.

Current Rates & Data

Govt of Canada

90 day	0.09%
1 year	0.19%
2 year	0.32%
5 year	0.94%
10 year	1.56%
30 year	2.15%

U.S. Treasury

90 day	0.01%
1 year	0.04%
2 year	0.17%
5 year	0.84%
10 year	1.65%
30 year	2.36%

Canada Prime Rate

2.45%

U.S. Prime Rate

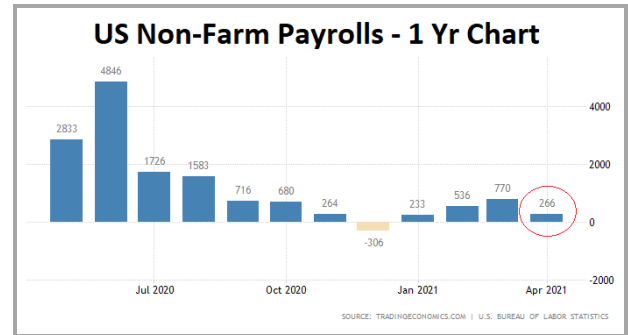
3.25%

Exchange Rates

CAD/USD	0.826
USD/EUR	1.208
JPY/USD	109.6

ECONOMIC TIDBITS US ECONOMIC/JOB RECOVERY STALLS & CANADIAN DOLLAR HITS A SIX-YEAR HIGH

• The recovery in US employment stalled in April, with non-farm payrolls coming in at 266,000, well short of the 1 million expectation. The miss was shocking considering the US economy was further untethered from COVID-19 restrictions in April. Enhanced unemployment benefits, persistent COVID-related health fears and an imbalance in job supply/demand are key reasons for the shortfall.



• The Canadian dollar has rallied over 20% over the past year, hitting a six-year high of \$0.83 in May. This rally is supported by abnormal strength in many made-in-Canada commodities including oil, lumber, gold, copper, nickel and others, as well as Canada leading the developed world in government spending (as a % of GDP), which is inflationary and increases the odds of an interest rate hike in Canada.



LE JIT A “JUST-IN-TIME” RUNDOWN OF OUR CURRENT INVESTMENT THEME

COVID-19 Vaccines Are Helping Tame the Pandemic But May Be Necessary for Several Years

- **Pfizer (PFE)** and **Johnson & Johnson (JNJ)** are two ideas related to this theme.
- **Pfizer** is a leading global pharmaceutical company and developer of arguably the best COVID-19 vaccine available today. Despite its highly competitive COVID-19 vaccine, Pfizer trades at a reasonable valuation of ~20x trailing earnings versus the S&P 500 and US Health Care sector at ~32x and ~30x trailing earnings respectively. Pfizer's vaccine should provide a temporary but significant boost to earnings that many companies will not experience in 2021. Contrary to investor expectation, Pfizer recently offered its opinion that its vaccine will be in high demand and contribute meaningfully to earnings for several years.
- **Johnson & Johnson** is the world's largest healthcare company and is in the early stages of rolling out its COVID-19 vaccine. JNJ shares trade at ~29x trailing earnings, above its historical average but below the broader equity market and health care sector. While it is unclear whether JNJ's vaccine will pay off considering it, like AstraZeneca's, is associated with rare blood clots, JNJ should experience strong demand for health care consumables as the COVID-19 pandemic continues as well as after the pandemic when countries push to clear surgical and diagnostic backlogs.

Key risk points: Both companies offer COVID-19 vaccines, which face long-term demand uncertainty as well as regulatory uncertainty. Both stocks are also vulnerable to overall equity market sentiment.

JEANNINE'S TIP O' THE MONTH Client Insights Webinar – Navigating the Longevity Economy

We invite you to register for a webinar hosted by Raymond James Ltd. featuring guest speaker Dr. Joseph Coughlin, Director of MIT's AgeLab. Dr. Coughlin is known for his levity so while the subject matter may be heavy, the webinar is sure to be light! The conversation will explore how demographic trends are set to transform how various age groups will live in the not-so-distant future and how to plan for these changes.

[Click Here to Register!](#)

This newsletter has been brought to you by Steele Wealth Management

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