A ‘sullied by MPT*’ RRIF Portfolio

For most wealth managers/advisors, the ‘I’ in RRIF causes a mental malfunction. G. Pape’s column about his RRIF in the Report on Business in late August 2021 was typical. Pape started out fine: “the portfolio should generate income to provide cash for the annual withdrawals” (Pape does not actually tabulate total annual income produced, though, nor put his securities in order of annual income produced to be reviewed. I do!). But then he veers into the wrong lane. “This means focusing on securities with good yields”, he writes. The portfolio is then larded with bonds, high yield equities, balanced ETFs (more bonds and chaff), REITS and preferreds. This is not the correct path. High yields do not build wealth. (R=Y+G) Return equals yield plus growth (adjusted for valuation, cyclical p/e). Growing yields drive wealth. **Knowing the subtle difference between a good yield and growing yield is fundamental**. Pape does not seem to be aware of yield growth, its effect on price nor of the optimal mix of yield and dividend growth.

Because he’s infected with modern portfolio theory (* MPT), there are four other deviations[1] Gordon Pape, for instance, maintains that his portfolio “is lower risk”. But what’s risk? Is risk really the fear “that a major stock market crash would make life very difficult for those who rely on their RRIFs for income”? No! Risk is not volatility! A RRIF is a long-term, pension-like vehicle. Charlie Munger: **“It’s nonsense that a stock’s volatility is a measure of risk.“** [1]from fundamentals

Third - The ‘modern’ approach to asset allocation is built on false axioms. The assumption, for instance, that bonds are safe is woefully wrong. Bond prices fluctuate also. In fact, when bonds are in a fund, bonds lose their guarantee of money back at maturity. With building cash flow, dividends (earnings, if you wish), an individually owned, quality, growth company “become progressively less riskier than bonds”(W. Buffett). A rising flow of sound dividends makes the company more valuable. This will, in turn, also drive the stock price higher.

Diversification - Does holding thousands of securities (19,602 in the Pape’s XBAL ETF alone) make Pape’s portfolio safer? Certainly not. What’s safety? Most often, **safety is** in the price paid, the quality of the few individually owned companies and the rising long-term future cash flow. “The market”, Jack Bogle said, “is a giant distraction from the business of investing”. As time moves along, with growing income/yield, hits on original RRSP capital to become much smaller.

Fifth - The market is not perfectly efficient. None the less, following along with the mistaken belief that the stock market is efficient, Pape has been buying securities, both stocks and bonds, when they are expensive . . . in bubble territory. **Valuation matters greatly**. *“Beta, modern portfolio theory and the like - none of it - makes any sense to me.” Charlie Munger.
✓How did I invest for my retirement in 1996? I bought a few quality companies with long duration dividend growth records for a sound stream of growing income.

The MAGIC double-double **RRIF**

As a company's cash flow (earnings, dividends) increases the firm becomes more valuable, intrinsic value rises (retained earnings) and hence the company's stock price goes up. Cash flow (not p/e) is the ultimate test of value. We must hold for this.

In recent years, over 50% of my own required minimum RRIF withdrawal came from income generated from growing dividends. Yields are now double digit And our capital, still growing, is well over twice the RRSP amount started with in 1996. With growing income strategy, there's a double-double: rising dividends drive capital growth. This works. We've done it for years. Find out how and why. Dividend growth investors go well beyond preservation of capital concerns and continue to build capital in a RRIF. A RRIF should be just a continuation of your RRSP and hold the same premium common stocks. There is really <u>no decumulation stage</u> in our retirement strategy as we spend mostly income and the growth of our capital portion. I hold no ETFs: they're full of chaff[2]. I own no bonds. Instead, I select a few individual, long duration dividend growth stocks. In the last ten years, the compound annual <u>dividend</u> growth rate (CAGR) of the 32 fine companies I follow was 7.8%. This drove price CAGR to 8.0% annually. Return = yield * growth, adjusted for expensiveness. Conflate yield growth and capital growth. Here return could average 15.8% (7.8% + 8.0%). [2]Quality is safer!

Five ways to explore the power of dividend growth:

✓ YIELD GROWTH: → After ten years, for example, Telus' yield grew to 9% from 5% (on 2011 price of $13 and 2020 dividend of $1.17). After two decades, Fortis' yield rose to 22% (2001 price of $9 and 2020 dividend of $1.94). Do ETFs give double digit yields?
✓ TOTAL from PORTFOLIO: → Look at dividend growth this way also: annual rising dividends over the last decade on our $200,000 inheritance around the turn of the century, provided: $26,376. $27,971. $28,516. $29,376. $31,119, $33,011. $35,448. $37,416. $39,661. $41,800. And, the capital value has more than tripled. ♦ OVERALL TOTAL: →
✓Here's a third way to show dividend growth: total dividends after ten years on $12,500 invested in: BCE $8,484. Emera $7,700. Royal Bank $7,618. TRP $6,766. Fortis $5,832.
✓ YEAR-BY-YEAR → If you are thinking of buying a stock, "you should examine the growth rate of their earning and dividends over a period of, say, ten years.[1]" Here's a bank example going back 20 years. From 2000, the dividend per share per year was: 76¢, 87¢, 96¢, 98¢, $1.10, $1.32, $1.50, $1.74, $1.92, $1.96 in 2009 and 2010, $2.05, $2.19, $2.39, $2.56, $2.74, $2.96, $3.05, $3.28, $3.54 and $3.60 in 2020. What a terrific growing retirement income. No ETFs do this. You must buy a few (Keynes) individual top-notch growth stocks ([1]Jarislowsky) by "following sound principles of selection that are related to <u>the value of the securities and not to their market price</u>". (Ben Graham's 1963 speech)
To win you must act differently. You must flout modern portfolio theory.
✓From 1996, when I retired, CNR's dividend went from 6½ cents to $2.32 per share. That's up 15.4% a year. This drove the price up from $4.32 to $136 a CAGR of 14.8%. Growing dividends are powerful.
"With dividend growth investing, eventually, **the income portion alone** is more than investors in most other strategies will realize. Lowell Miller, *The Single Best Investment*, p.44

As Arnold Bernhard, the founder of Value Line put it in 1958: “the growth of dividend paying ability is of significance in the determination of a stock’s quality or general safety”. Note this fact too: “If you look for companies that can raise dividends year after year without milking operations, you will automatically be led to high quality stocks.” E. Faltermayer, Fortune, October 1990. And John Maynard Keynes in his General Theory of 1939: “Focus on the prospective yield of an investment over a long period of years.” Or Lowell Millar on page 44 of his The Single Best Investment: “With dividend growth investing, eventually **the income portion alone** is more than investors in most other strategies will realize