AlphaDelta Growth of Dividend Income Class
Quarter 3, 2020, Commentary

Hello everyone,

This is the quarterly advisor update of the **AlphaDelta Growth of Dividend Income Class** ("GoDI" or the "Fund") from SciVest Capital Management Inc., the sub-advisor of the Fund.

Attached to this commentary is the GoDI Portfolio Disclosure as of the end of the quarter. The first page of the Portfolio Disclosure shows all of the current stock holdings of the Fund, as well as some descriptive dividend and valuation characteristics for each portfolio holding – plus overall portfolio averages. The second page of the Portfolio Disclosure shows a number of relevant pie charts depicting overall GoDI portfolio characteristics such as sector, market capitalization, dividend yield and dividend growth "bucket" exposures. We also publish and post on our website a *monthly* version of the GoDI Portfolio Disclosure document (http://scivest.com/strategies/manager-commentary).

Portfolio Income and Income Growth:

The two primary **objectives of the Fund are to provide its shareholders with: (i) a consistent, and above average, annual distribution yield; *and* (ii) growth in the absolute level of distributions per share through time (i.e., income growth)**.

We attempt to deliver on these Fund-level objectives by investing in a global portfolio of equities which, on average, pay a higher than average dividend yield and which are growing their dividends per share at a relatively high rate (in the context of their current yield). As shown in the September 30th Portfolio Disclosure, **across the Fund's current holdings, the weighted average gross dividend yield is 5.0% per annum** (versus 1.9% for the Russell 1000 Index and 2.3% for the MSCI World Index) **with impressive double-digit trailing 1, 3 and 5-year dividend growth rates of 11.2%, 13.7% and 15.5%, respectively**.

This 5.0% average portfolio dividend yield is well covered by company earnings and cash-flow. Specifically, the 5.0% average dividend yield compares to a portfolio weighted average forward earnings per share yield of 10.9% **(i.e., 218% dividend coverage by earnings)** and forward cashflow yield of 15.2% **(i.e., 304% dividend coverage by cash-flow)**. Note that both of these coverage ratios use forward-looking analyst estimates for earnings and cash-flows which now fully reflect analyst forecasted impact of the COVID-19 Pandemic and related recession on corporate earnings and cash-flow.

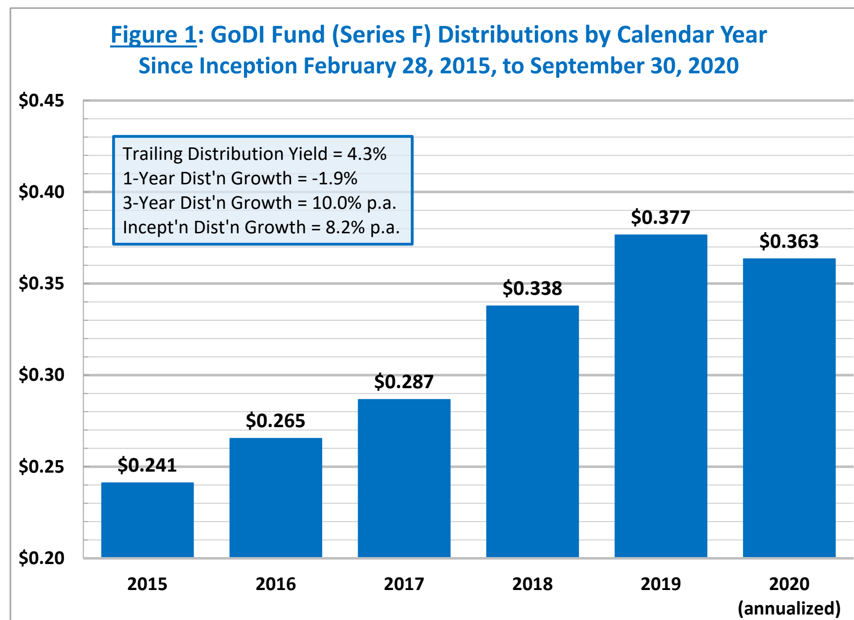
The Fund has a distribution policy whereby it distributes to its shareholders on a month-end basis *every dollar* (and no more) of dividend income (net of any dividend withholding taxes) accrued by the Fund during the month. As a result, monthly income varies with the dividend cycle of the Fund's holdings, but the distributions perfectly reflect the true dividend income received by the Fund. Thus, the Fund does not experience the typical net asset value per share "grind" that other dividend funds experience when their distributions are set higher than the net income they actually receive. And, since the Fund distributions are

a true reflection of the underlying income received by the Fund, they can be used to judge the true income generation and income growth capability of the Fund.

At the Fund-level, **the trailing 12-month distribution yield of the Fund (Series F shares) as of September 30th is a solid and above average 4.3%**. The primary reason why these Fund-level distributions are less than the average dividend yield of Fund's holdings is because we subtract dividend withholding taxes from the Fund's distributions so that they reflect the true after-tax income generation of its underlying holdings. Nevertheless, due to the Fund's corporate structure, its distribution yield is also quite tax efficient in investor hands as compared to most other income alternatives.

Furthermore, the Fund's trailing 12-month 4.3% distribution income yield has been growing at a rate much faster than the inflation rate through time. Specifically, **the trailing 12-month Fund-level distribution per share has experienced 10.0% per annum growth over the past three (3) years and 8.2% per annum growth since the inception date of the Fund** (for Series F shares). We consider 8.2% per annum income growth as substantial, especially in the context of a relatively high and diversified current income yield of 4.3%, and considering it includes a period that we have coined "Dividend Armageddon". Any income growth rate higher than the inflation rate represents real growth in income purchasing power – one of our primary objectives.

To further illustrate this distribution growth effect over time, Figure 1 below shows the total distributions for the Fund (Series F shares) for every calendar year since the inception date of the Fund. Again, note that these distributions per Fund share reflect true underlying income and income growth resulting from the Fund's portfolio of dividend-paying equities (that themselves have grown their dividends per share).



As 2020 starts to wind down, the annualized year-to-date 2020 distribution is currently trending slightly below the magnitude of the 2019 full-year distribution. This is, of course, a result of the COVID-19 induced "Dividend Armageddon" which the equity markets of the World have endured. We have discussed this in detail in prior commentaries; although, we note here that approximately 1-in-5 of all dividend paying, large-cap, North American equities have either cut, suspended, or eliminated their dividends since the beginning of the year. In this context, a year-over-year annualized fall of only 1.9% in calendar-year Fund-level

distributions is well contained compared to the average dividend-paying equity within the North American equity markets (especially, after noting that we held more cash during the spring and summer market volatility than normal thereby pulling down dividend income and dividend income growth).

Overall, the **current Fund distribution yield of 4.3% compares very favourably with the September 30th yield of 0.56% per annum on the benchmark 10-year Government of Canada bond**. Even with more than 8x the yield of the 10-year bond, **the Fund's income has grown at a rate of 8.2% per annum since inception – whereas, of course, a 10-year bond's income does not *ever* grow**.

Current Portfolio:

The **GoDI portfolio is, as always, very different from global equity benchmarks with a current Active Share of 93.4%**. This means that 93.4% of weights of our portfolio holdings do not overlap with the MSCI World Index benchmark (alternatively, only 6.6% of the weights of the GoDI portfolio holdings overlap with the MSCI World Index). As a result, the GoDI portfolio should **provide significant diversification and differentiation** within an otherwise diversified portfolio.

The September 30th GoDI portfolio is itself well diversified across sectors and industry groups with **the largest sector allocation (Financials) currently at 30.6%**. In order of size, we have the following sector exposures: 30.6% Financials, 16.7% Health Care, 10.2% Communication Services, 8.1% Energy, 6.6% Information Technology, 4.8% Industrials, 4.4% Consumer Staples, 3.5% Real Estate, 2.0% Consumer Discretionary, 1.4% Utilities, and 0.8% Materials. In addition, the Fund holds 7.0% in the "Other" sector category, which represents the Fund's investment in the AlphaDelta *Canadian* Growth of Dividend Income Fund.

On an individual stock holding basis, we currently hold a **diversified portfolio of 47 equity positions** (not including the Fund's holding in the AlphaDelta Canadian Growth of Dividend Fund which itself holds another 25 individual equity holdings). As of the end of the third quarter, the top 10 individual equity holdings represent 36.5% of the Fund's assets and are in descending order of size: Broadcom Ltd (AVGO, 5.3%), Abbvie Inc (ABBV, 5.2%), Brookfield Property Partners (BPY.U, 3.5%), Lincoln National Corp (LNC, 3.5%), Manulife Financial Corp (MFC, 3.5%), Prudential Financial Inc (PRU, 3.5%), Bristol-Myers Squibb Co (BMY, 3.3%), Morgan Stanley (MS, 2.9%), Enbridge Inc (ENB, 2.9%), and ViacomCBS Inc (VIAC, 2.9%). (See entire September 30th GoDI portfolio attached hereto.)

A byproduct of our growing income investment strategy is that the GoDI portfolio typically has much better (i.e., cheaper) valuations than the overall equity markets – that is, **the GoDI portfolio has a high "value style exposure". In particular, the September 30th portfolio weighted average 12-month forward price-to-earnings ratio is 11.7x (versus 22.3x for the Russell 1000 Index and 20.0x for the MSCI World Index) and the average 12-month forward price-to-cash-flow ratio is 8.3x (versus 14.9x for the Russell 1000 Index and 12.4x for the MSCI World Index). In other words, the GoDI portfolio is 35% to 50% *less expensive* than the overall global equity markets based on forward-looking earnings and cash-flows.** Note that these valuation ratios include analyst expectations with respect to the progression of the COVID-19 Pandemic.

Portfolio Changes and Movers:

During the third quarter we **eliminated our positions** in Celanese Corp (CE), Discover Financial Services (DFS), Grupo Financiero Banorte SAB (GBOOY), NetApp Inc (NTAP), and Union Pacific Corp (UNP). Amongst these eliminated positions, Grupo Financiero Banorte SAB suspended its dividend which is grounds for elimination

from the GoDI portfolio. We also eliminate positions when their forward-looking dividend growth becomes less promising (due to a number of potential reasons) and/or their valuations become excessively high (and thus dividend yields low). In addition, we **decreased (by at least 0.5%) our existing position** in Brookfield Property Partners (BPY.UN), Fiera Capital Corp (FSZ), LyondellBasell Industries (LYB), Marathon Petroleum Corp (MPC), and Skyworks Solutions Inc (SWKS).

During the third quarter, we **initiated new positions** in Algonquin Power & Utilities (AQN), British American Tobacco PLC (BTI), General Dynamics Corp (GD), Keyera Corp (KEY), L3Harris Technologies Inc (LHX), Pembina Pipeline Corp (PPL) and Power Corp of Canada (POW). We also **increased (by at least 0.5%) our existing positions** in Altria Group Inc (MO), Bristol-Myers Squibb Co (BMY), and Nexstar Media Group Inc (NXST).

Amongst the GoDI portfolio holdings that were held through the entire quarter, the five (5) **highest returns during the third quarter** (in descending order) were: Corning Inc (GLW, 26.0%), Lowe's Corp (LOW, 23.2%), Brookfield Property Partners (BPY.UN, 22.5%), ViacomCBS Inc (VIAC, 21.1%), and Abbott Laboratories (ABT, 19.5%). Amongst the GoDI holdings that were held through the entire quarter, the five (5) **lowest returns during the third quarter** were: Valero Energy Corp (VLO, -25.0%), Marathon Petroleum Corp (MPC, -20.3%), Bayer AG (BAYRY, -19.7%), Pembina Pipeline Corp (PPL, -15.1%), and Citigroup Inc (C, -14.8%).

Q3-2020 Dividend Announcements:

Since income and income growth are the Fund's primary objectives, each quarter we report those Fund holdings which declared dividend changes during the prior calendar quarter. Recall also that one of our fundamental beliefs is that, if we can select stocks which consistently increase their dividends into the future, then price appreciation *must* eventually follow – that is, **long-term price appreciation is a *consequence* of consistent earnings and dividend growth**. We believe that: **"if you get the dividends right, then you *will* get the share prices right sooner or later."**

Amongst our current 47 GoDI holdings, **during the calendar quarter ending September 30th, 2020, we received 5 declared dividend increases averaging an announced increase of 6.8% quarter-over-quarter** ("QoQ") **and 8.3% year-over-year** ("YoY"), relative to those already known at the end of the prior calendar quarter.

No.	Company Name	Ticker Symbol	Current Ind Div Yld (% p.a.)	QoQ Div Increase (%)	YoY Div Increase (%)
1	Altria Group Inc	MO	8.9	2.4	2.4
2	Lowe's Cos Inc	LOW	1.5	9.1	9.1
3	Ping An Insurance Group Co	PNGAY	2.9	6.7	13.5
4	Skyworks Solutions Inc	SWKS	1.4	13.6	13.6
5	Unilever PLC	UL	3.1	2.3	2.7
	Average		**3.6**	**6.8**	**8.3**

Market Commentary:

It now appears that "Dividend Armageddon" has run its course, and we are beginning to see an expanding number of dividend *increases* again, albeit generally at more conservative levels than in recent years. Despite the recent flare-up in COVID-19 cases (the "second wave"), we do believe that the worst is over

for dividend investors and this trend of expanding dividend increases will continue and gain momentum as we progress through the next several quarters.

Surprising many, the US and Canadian equity markets continued to advance during the third quarter – continuing their incredible bounce off their March 23rd COVID-19 induced bottom. The third quarter gains, however, were once again concentrated within the growth stock segment of the equity markets pushing the relative performance of growth versus value stocks further into uncharted, never-before-seen, territory.

As noted in the last commentary the S&P 500 Index return is now *heavily biased* by a select few stocks. For example, the FANMAG stocks – Facebook, Amazon, Netflix, Microsoft, Apple, Google/Alphabet – are up year-to-date by an average 39.8% through October 31, 2020. And, these six (6) stocks now represent well over 20% of the entire S&P 500 Index. Not only do these stocks represent all of the year-to-date (through October 31) gains of the S&P 500 of +1.2%, the S&P 500 Index would still be down materially without them, as FANMAG stocks have contributed approximately +9% to the year-to-date return of the S&P 500.

This index concentration problem is a symptom of a bigger, more important, systemic issue – the historic underperformance of US value stocks relative to US growth stocks, which we have been writing about for several quarters now. This is relevant to the GoDI Fund because, as a consequence of our process to simultaneously *maximize* dividend yield, dividend growth and dividend safety, the GoDI portfolio generally has a significant value style bias – as well as, of course, a significant dividend yield exposure. In fact, we have shown in prior commentaries that, while **the GoDI Fund possesses approximately 3x more *Dividend Yield style* exposure than the Russell 1000 *Value* Index, it also possesses approximately 3x more *Value style* exposure than the Russell 1000 *Value* Index. While the underperformance of US Value stocks relative to US growth stocks was historic prior to the COVID-19 Pandemic, the COVID-19 Pandemic has "turbo-charged" the return disparity to levels never-before-seen, including during the technology bubble of the late-1990's.**

To highlight this disparity, we reproduce and update the value versus growth graphs from the last commentary. **Figure 2** shows that **year-to-date through October 31, 2020, US *large-cap value* stocks have underperformed *large-cap growth* stocks by 33.7%** (as judged by the Russell 1000 Value Index versus the Russell 1000 Growth Index); **and, year-to-date US *small-cap value* stocks have underperformed US *large-cap growth* stocks by 39.3%** (as judged by the Russell 2000 Value Index versus the Russell 1000 Growth Index). **Figure 3** shows the value versus growth spreads over the past several years. **Between January 1, 2017 through October 31, 2020, US *large-cap value* stocks have underperformed *large-cap growth* stocks by 95.8%, and US *small-cap value* stocks have underperformed US *large-cap growth* stocks by 113.8%** (no, these numbers are *not* typos).

Keep in mind that the Russell 1000 Value Index and the Russell 1000 Growth Index sum to the Russell 1000 Index which itself represents approximately 94% of the US total equity market capitalization and 63% of the World's total equity market capitalization. Thus, **it is hard to understate the economic importance of these value versus growth spreads. During the past 3.8 years, approximately half of the US stock market is essentially flat in price (value stocks), while the other half is up over 100% (growth stocks). Yet, finance academics have shown that value stocks significantly outperform growth stocks in most times periods, and in the long-run, in almost all security markets.**

Figure 2: Relative Performance of the Russell 1000 Growth Index, Russell 1000 Value Index and Russell 2000 Value Index – January 1, 2020, to October 31, 2020.

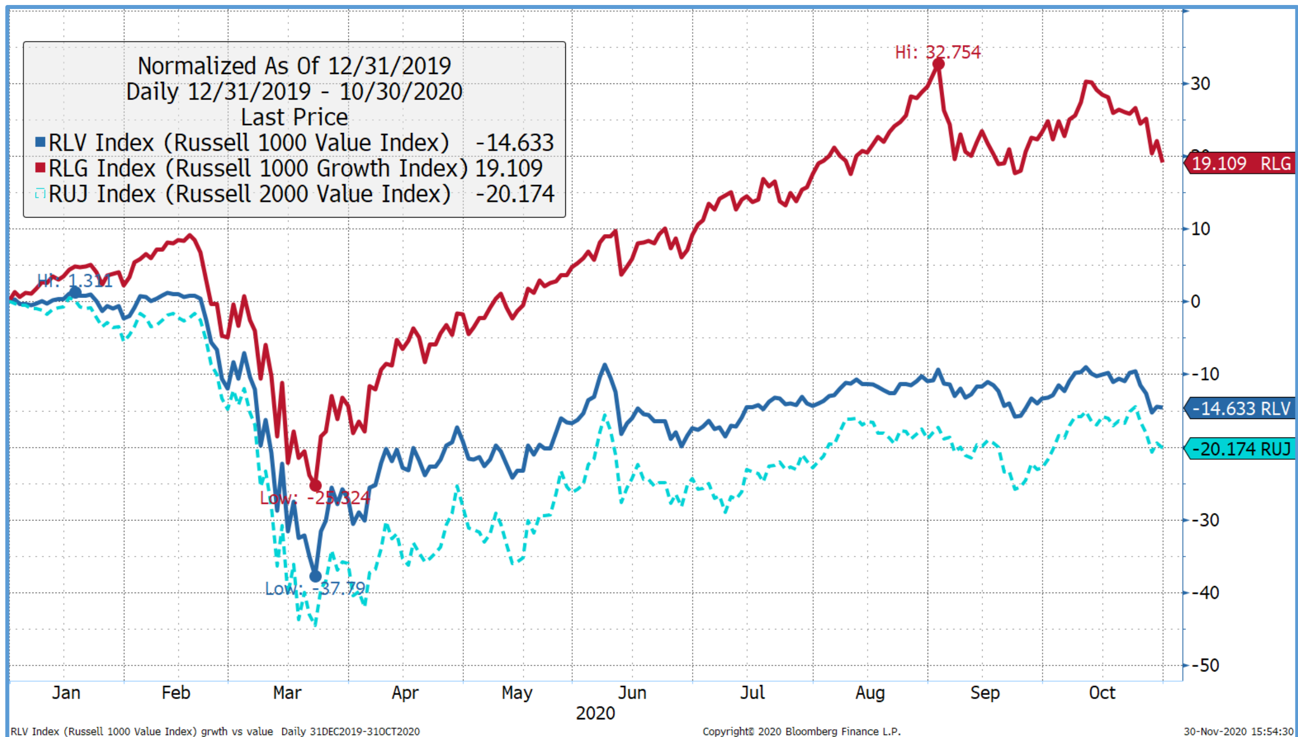
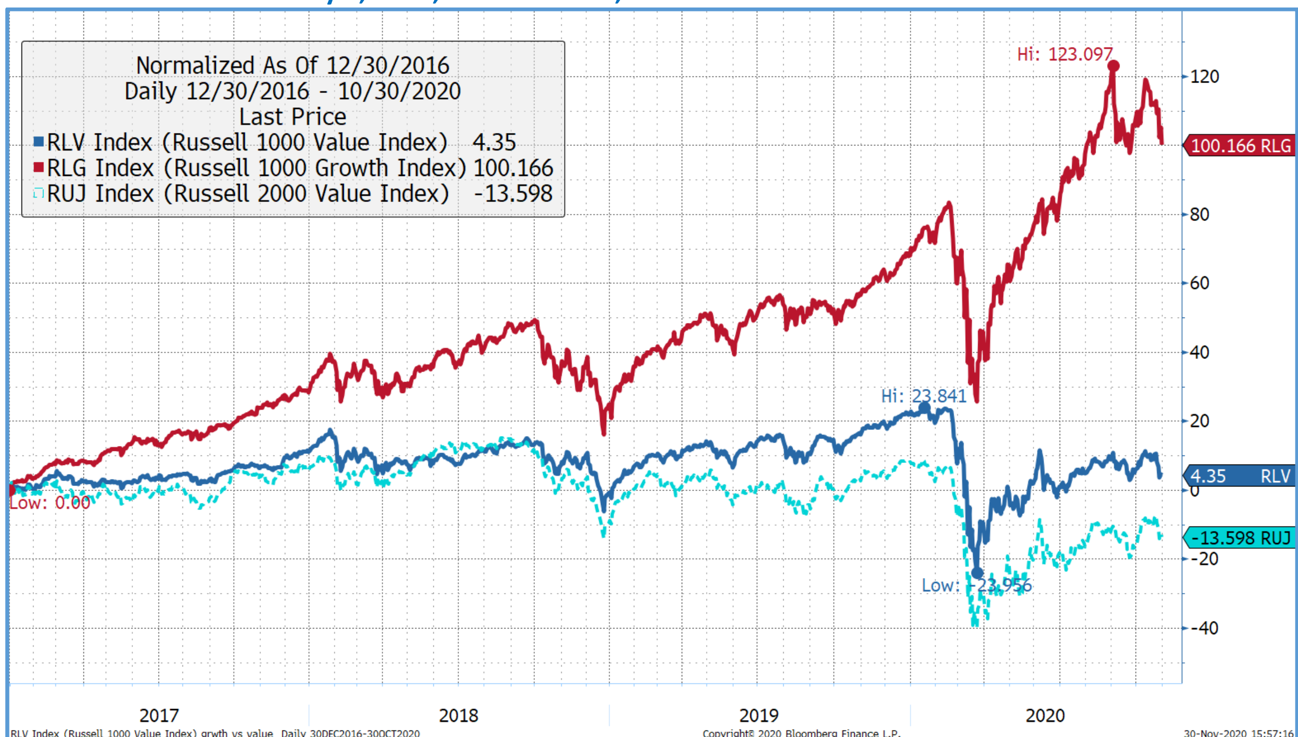


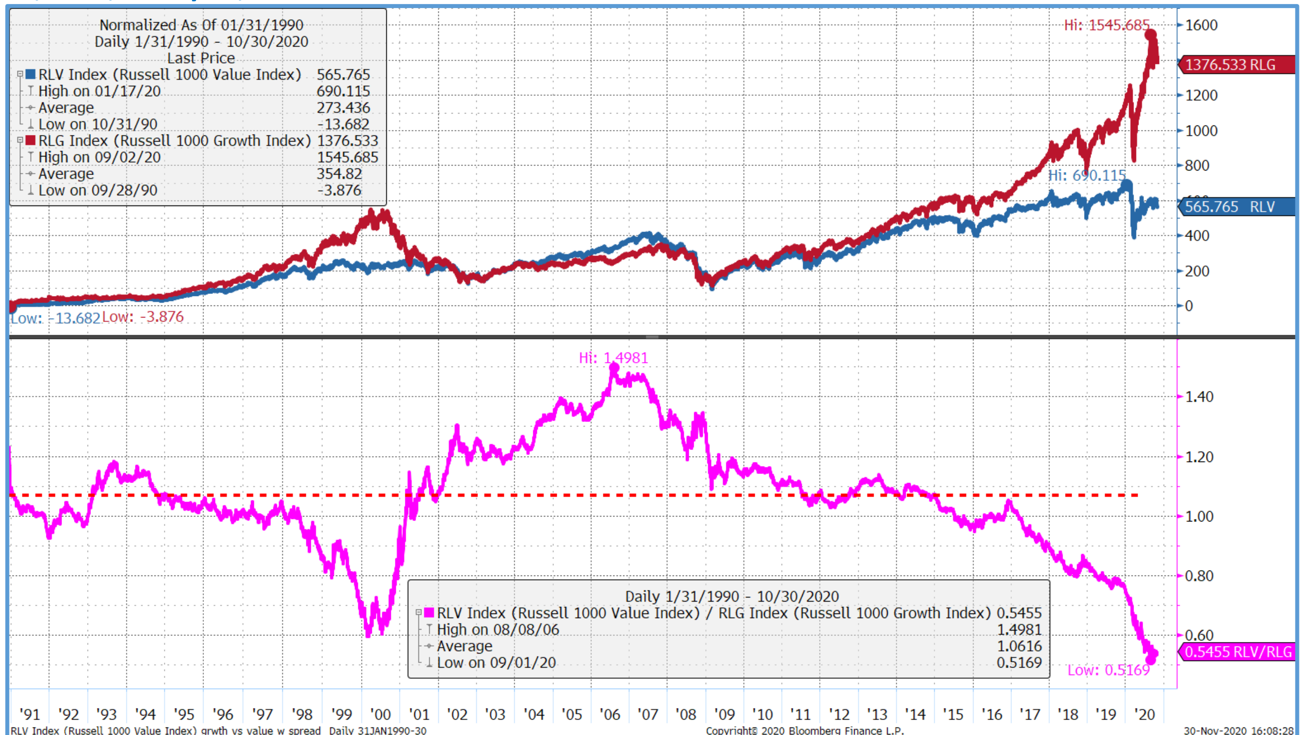
Figure 3: Relative Performance of the Russell 1000 Growth Index, Russell 1000 Value Index and Russell 2000 Value Index – January 1, 2017, to October 31, 2020.



To further illustrate the longer-term importance of the recent underperformance of value relative to growth, **Figure 4** plots the Russell 1000 Value Index relative to the Russell 1000 Growth Index from January 31, 1990,

through October 31, 2020, to intentionally include the technology stock bubble of the late-1990's. The bottom half of Figure 4 shows (the purple line) the *ratio* of the Russell 1000 Value Index price level to the Russell 1000 Growth Index price level. The average of the value-to-growth price index ratio (the red dashed line) over the entire 30-year period of time is 1.06 (i.e., the Value Index was on average slightly higher than Growth Index), with the value-to-growth index ratio drifting around this average level for the majority of the past 30-years. However, it is easy to observe two (2) extreme Growth Index outperformance periods and one (1) extreme Value Index outperformance period.

Figure 4: Relative Index Levels of the Russell 1000 Value Index Versus Russell 1000 Growth Index – January 31, 1990, to July 31, 2020.

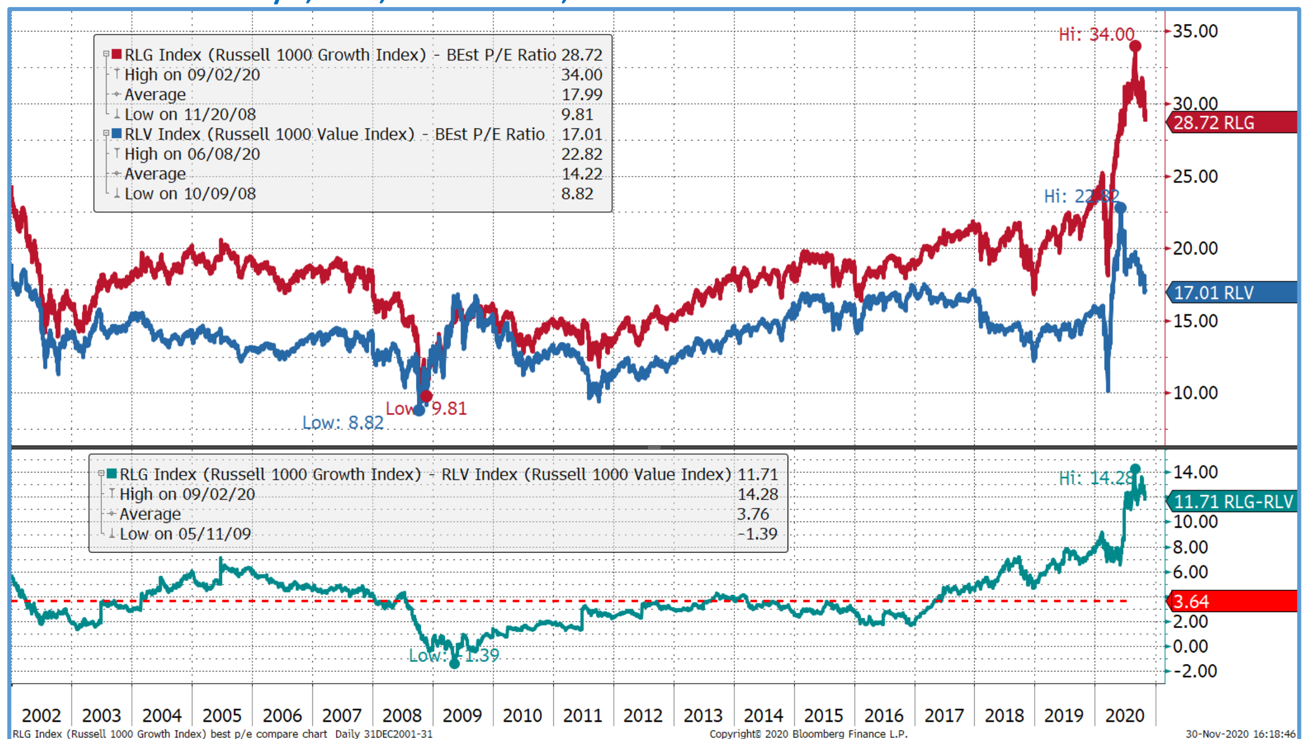


The first extreme Growth Index outperformance period was, of course, the technology stock bubble of the late-1990's whereby the Growth Index massively outperformed the Value Index from early 1998 through March of 2000. During this period, we saw the value-to-growth index ratio compress from roughly average at 1.036 at the beginning of 1998 to a low of 0.594 in the middle of March 2000. That is, the price of the Value Index was trading at only 59.4% of the price of the Growth Index. Amazingly, **over the next year the entire Growth Index outperformance resulting from the late-1990's technology stock bubble was unwound with the value-to-growth index ratio returning to its long-term average by mid-March of 2001 – only 12-months after hitting its low.** Over the subsequent five (5) years, the Value Index continued to rise relative to the Growth Index driving the value-to-growth index ratio up to a 30-year high 1.498 in August of 2006. From the bottom of the value-to-growth index ratio (0.594) in March 2000 to the top of the value-to-growth index ratio (1.498) in August 2006, there was a cumulative 250% increase in the value-to-growth index ratio – or, alternatively, a roughly 50% cumulative fall in the Growth Index versus a cumulative 75% rise in the Value Index. This was an incredible 6-year run for the Value Index relative to the Growth Index that was setup, to a large extent, by the growth stock bubble of the late-1990's.

However, from that mid-2006 value peak forward, on average the Growth Index has outperformed the Value Index. The value-to-growth index ratio retreated from its high of 1.498 in August 2006 to roughly its long-term average by early 2009. From 2009 through 2016 the value-to-growth index ratio traded somewhat around its long-term average. Then, **from December 2016, shortly after Donald Trump got elected as President of the United States, the value-to-growth index ratio went from approximately its long-term average of 1.050, to a new *all-time low* of 0.517 on September 1st, 2020 – well below its prior all-time low of 0.594 at the peak of the late-1990's technology stock bubble. This current period of value underperformance, using almost all definitions, is now the largest and the longest in recorded stock market history.**

What above valuations? **Figure 5** shows the 12-month *forward* P/E ratios (using 12-month forward-looking analyst expected EPS) for the constituents of the Russell 1000 Growth Index relative to the constituents of the Russell 1000 Value Index for the 18+ year time period from January 1, 2002, through October 31, 2020. Currently both growth stocks and value stocks currently are carrying higher than average forward P/E ratios. However, value stocks at 17.0x forward earnings are only moderately higher than average (14.2x), while at 28.7x forward earnings, growth stocks are extremely expensive by historical standards (average of 18.0x). Note that higher valuations across the entire equity market are currently justified by historically low interest rates. Nevertheless, **the valuation *spread* between value and growth stocks is the highest since 2002 by a large margin** – highest since the peak of the technology stock bubble when many growth stocks had negative earnings (unlike the large growth stocks of today which are generally profitable).

Figure 5: Forward P/E Ratio of Russell 1000 Growth Index Constituents and Russell 1000 Value Index Constituents – January 1, 2002, to October 31, 2020.



In the last commentary, we stated outright for the first time that **the current value versus growth spread now constitutes a "growth stock bubble."** Furthermore, we stated in the last commentary that **"this time is *not* different, and history *will* to some degree repeat itself. We believe that a long period of significant**

outperformance of value stocks (especially those value stocks that pay respectable dividends) relative to growth stocks is highly probable at some point in the near-to-medium-term future. We believe that we may ultimately experience a period very similar to the unwind of the last growth stock bubble in the early 2000's…"

We continue to stand by these statements and overall forecast. In fact, **we believe that the graphs above show that the "great rotation" *may* have already begun**. We will not know for some time if this is indeed the beginning of the great rotation, and, unfortunately, once we know for sure that the great rotation has begun a fair proportion of the value versus growth move may have already taken place. As shown above, the entire excess return of the technology stock bubble of the late-1990's was unwound in only 12 months, despite taking several years to build – and, markets nowadays move substantially faster than in prior decades. That is, **the initial phase of the great rotation may be quick and violent.**

We continue to believe that when the current growth stock bubble unwinds, it will be similar to the unwind of the technology stock bubble of the late-1990's, with one potential difference. Given the economic backdrop and recent COVID-19 vaccine news, we believe that, unlike the early 2000's, the overall US equity market indexes may actually continue to advance (despite being dominated by the super-mega-cap growth stocks which will be weak). While we believe that *within* the overall market index that growth stocks may be flat-to-down in price, value stocks could be up in price substantially. That is, unlike the early 2000's, we do believe that the overall equity market could advance higher, even though growth stocks may be under pressure. This is because, unlike the early 2000's, we are now *exiting* a recession as opposed to *entering* a recession, and because interest rates are now the lowest in history and expected to remain extremely low for the foreseeable future.

As a result, this quarter again, we re-iterate that we believe that the time for positioning for the "great" value-growth rotation is *now*. The GoDI Fund has 3x the value exposure (and 3x the dividend yield exposure) of the Russell 1000 *Value* Index and thus is one of the few investment products available in Canada that is well positioned to capitalize on any such value-to-growth rotation.

Always remember our primary message: **"Growing income", as opposed to "fixed income", is the only means of maintaining the purchasing power of your (or your client's) income stream over the years and decades to come**.

If you would like more information regarding the **AlphaDelta Growth of Dividend Income Class** and its current portfolio (including the up-to-date presentation piece), please feel free to contact me directly or alternatively contact AlphaDelta Management Corp. (www.AlphaDelta.com).

Thank you for your continued interest in the Fund,

John J. Schmitz

John J. Schmitz, Ph.D., CFA