‘The Big Money isn’t in the Buying and Selling. It’s in the Waiting’ – Charlie Munger (RIP)

The Travelers Insurance Co (TRV-NYSE-$179.86) weekly – 3 years.

Source: Refinitiv, NBF, Hilberry Nov 30, 3023

In essence, the insurance industry is a leveraged bet on returns vs risk. Given regulatory parameters, most of the ‘return’ part of that equation comes from bond yields, meaning insurance company earnings are sensitive to bond yields. As liabilities are a combination of predictable risk and constant cash income liabilities to annuitants, if yields fall while liabilities remain more or less constant = earnings down. Yields up = earnings up. We’ve been predicting rising inflation would lead to rising interest rates, explaining our enthusiasm for the sector. We hold Manulife, Sunlife in our Canadian dividend portfolio and Travelers in our US dividend portfolio. The recent rise in bond yields has lifted earnings in the sector. The stock prices are up.

Travelers is trading at Q1/2022 prices. 2023 Earnings per share declined 11% over last year, perhaps explaining investor caution. We think they're missing a turn in earnings. 2021 was the last annual totals available for stock valuing in Q1/2022. Comparing to 2021, projected 2024 premiums per share look to be up 36.4%, investment income will be flat, underwriting up 67% and earnings look +21.6%. Carrying these projections 3-5 years forward we arrive at earnings rising 36%. Investors have historically valued Travelers around 15 X annual earnings. While there is no guarantee that historical average ratio will maintain. There's also no guarantee it won't. We think investors will eventually recognize and pay for higher earnings. We think 50% higher prices in three to five years would be about right. We think these are solid numbers for a conservative investment. But we're 'boring'. Over the last year, the FAANG stocks have risen +94% from their annual lows (back to previous highs). Getting that one right could have made your retirement, but you'd better been right as the FAANG stocks dropped 47% from the Nov/2021 highs into the early 2023 lows. No thanks.

"Scotia Bank research update: NBF Nov 28, 2023. Gabriel Deschain
Q4/23 First Look – Padding PCLs + revenue shortfall generate large EPS miss"

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=a1709f42-40fc-4d4d-9873-0d5241828c85&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

We are on record saying the Canadian Banks look attractive. We provided our background work on the banks in previous Readings and at our recent seminar. Favoring 4 banks, we featured the Bank of Nova Scotia as an example of what we saw as good value with attractive income. Our Scotia analysis used the closing price on Friday Oct 20, 2023 as our value point with the stock price around $56 . To clarify, we added to all four banks including Scotia Bank prior to and after that date, so please don't construe too much precision into those values. NBF's award winning bank analyst Gabriel Deschain updates Scotia this week. As you wade through Mr. Deschain's work you will come across some industry-speak.

TD provides a handy summary of financial industry terms.

https://www.td.com/document/PDF/ar2012/AR2012_Glossary_E.pdf

PCL. Provision for Credit Losses – PCLs count as a 'loss' for income purposes reducing earnings. History says Canadian banks typically set aside more money for losses than is required. The banks typically recoup loan value by either working with the borrowers or foreclosure that exceeds the conservative estimate of the impaired loan. As the entire loan was typically written off as a loss under a PCL, recouped values (amounts exceeding the original PCL provision) now count as 'profit'. This explains the sometimes-frightening volatility in bank earnings going into and out of a recession. The PCL phase is unnerving, only vindicated (maybe) as the economy improves.

The 2007 Credit Crunch saw the collapse of Bear Sterns, Lehman Bros. Washington Mutual and the shotgun marriage of Merrill Lynch to Bank of America. Those US titans of finance didn't get it right. The Credit Crunch led to the 2009 Great Recession.

With the US experience in the background, buying into Canadian banks' 2008-09 loan loss provision surge required a careful analysis of fundamentals. Bank of Montreal (BMO-TSX-$110.92) hit a split-adjusted high of $72.54 in Feb/2007. That extreme high was followed by an extreme low during the Great Recession panic. BMO's stock price hit a low of $24.05 in Feb/2009 for a peak-to-trough decline of -66.8%. Yes, you CAN lose money in bank stocks.

With a Feb/2009 projected annual cash dividend of $2.80 per share, the implied market price yield was 11.6% (not a typo). Investors were pricing BMO's risk as a going concern, dismissing the bank's ability to maintain that dividend. We disagreed and bought. It was a tough trade for clients. It also led to eye-popping returns. 12 months later by Feb/2010 the stock price had doubled to over $50 and never looked back. The current cash dividend per share is $5.80 or 24% yield on that Feb/2009 price. No, it wasn't easy, yes it could have worked out differently and the next time WILL be different – although not necessarily worse!

Disclaimer: I hold Bank of Montreal, Bank of Nova Scotia, Bank of Commerce and TD Bank personally, for family members and for client accounts over which we have trading authority. We have traded in all four securities within the past 60 days.

Follow up on small modular nuclear reactors (SMR).

We've been following the SMR sector, anticipating it would show promise as a partial solution to electrical power generation demand. We recently featured a Wired story on small modular reactor nuclear technology in Utah facing challenges.

https://www.wired.com/story/first-small-scale-nuclear-plant-us-nuscale-canceled/

For an ongoing resource for this technology consider bookmarking this site:

https://www.world-nuclear-news.org/Articles/Idaho-SMR-project-terminated

We featured **NuScale (SMR-$3.05)** in last week's notes. We are not recommending it for our conservative clients and do not hold stock personally. The shares were trading around $2.50. The stock is up 22% from last week's coverage (!!). No, we're still not buying it. Peter Zeihan had similar optimism on SMR technology. He updated the sector this week with a down-beat assessment.

Modular Nuclear Reactors Are Not the Future of Energy – Peter Zeihan Nov 28, 2023

https://www.youtube.com/watch?v=yXUdalkdniM

We're still interested in, but not invested in, the space. The technology may still have promise.

Airloom Energy We came across this new development in potential wind power. Rather than using skyscraper sized towers holding massive wind blade turbines, use a cable 30 feet off the ground! Airloom is not publicly traded at this time. We have no financial interest in the name. https://airloomenergy.com/

Have a Great Weekend

Steve & Anna Hilberry

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Wealth Management Advisor, CIM

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FOR THE RECORD December 1, 2023

DOW INDUSTRIALS:	36,203
S&P 500:	4,593
S&P/TSX COMP:	20372
WTI:	$76.10
LOONIE IN $USD:	$0.7410 $US

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