DSR PREMIUM NEWSLETTER

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This is your site and your exclusive newsletter. Please, feel free to share any ideas, opinions, comments, or suggestions with us via email at dividendustries@gmail.com.

JULY 19TH, 2024

Dear DSR member,

It is with great pleasure that we present our weekly premium newsletter which is an important component of your subscription to Dividend Stocks Rock.

You may benefit from viewing our video explaining the differences between the Buy List, our ratings, and our portfolio models. You can retrieve this information in the Videos section of the website.

Referral

Feel free to share our ideas with your friends or associates who may benefit from this information. **We would personally consider any referrals you make on our behalf to be the ultimate compliment for our efforts.**

BUYING IS SIMPLE, BUT IT'S A DIFFICULT PROCESS TO FOLLOW

When I inquire of my members as to what their #1 investing struggle is, there are usually two answers right off the top:

#1 What and when do I buy shares?

#2 What and when do I sell shares?

Over the past couple of years, I'm sure you have gone through all kinds of emotions. The rollercoaster of 2020 led us to a generous year in 2021. Unfortunately, I'm sure 2022 wasn't one of your favorite years, but you probably started to like investing again in 2023. Now halfway into 2024, some are making profits, and some are still lagging. Then, the same question keeps coming up: ***Should I invest at the all-time high?***

I want to dedicate this newsletter to my buying process. It is not perfect, but it is clear and detailed and hopefully helps to minimize errors. I think this is the most important part of successful investing. Without clarity and focus, one can become confused and either err or get stuck in paralysis by analysis.

Have you ever noticed that the most difficult challenges in life often come with very simple solutions?

You want to lose weight? Eat less and focus on healthy foods, and train more.

You want to build a business? Identify a problem and offer a solution.

You want to retire stress-free? Pay yourself first and invest systematically.

You want to travel the world in your 30's? Buy a RV, quit your job and start your adventure!

Those goals are all considered "difficult" to achieve because they require you to follow a simple methodology for a long, long time! Consistency and discipline are the factors many people ignore when pursuing a specific goal.

You must always eat healthy food and work out 4 days a week.

You must work relentlessly to improve your solution and spread your message.

Paying yourself first or going on vacation and fancying yourself with some cool clothes?

All right, my last example was just a crazy trip! Yet it was simple and still difficult to achieve!

Investing is no different. To succeed, you must follow a simple solution. The clearer and more detailed your methodology is, the easier it is to stick to it and avoid mistakes. Plus, when you experience a bad year like 2022 (or maybe what's coming for the rest of this year!), you don't spend as much time doubting yourself because you have invested with conviction. Here is how I screen the market and make my decisions.

50% SCIENCE, 50% ART, 10% MAGIC

A few words before we dive into this topic: investing is a mix of science, art, and magic.

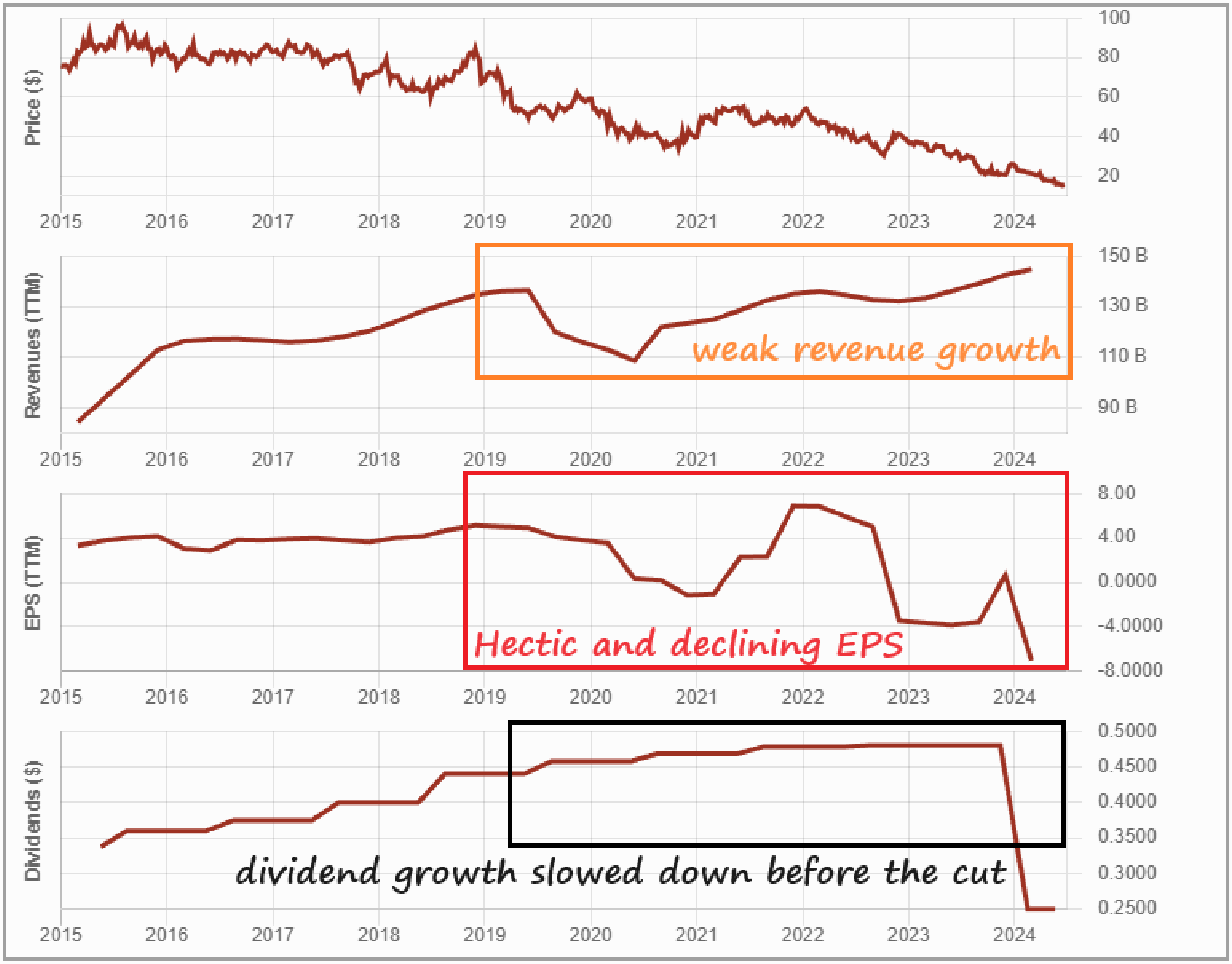
The science will provide you with hard data. Financial metrics will give you a clear picture of what has happened and how any given company stands today. The selection and analysis of those metrics are the foundation of any investing process. Unfortunately, metrics only tell you about the past and the present. They do not tell you much about the future. Those metrics can be found on each DSR stock card web page and within our stock screener. I like to use the graphs included in our DSR stock cards to see the trends on top of the hard numbers. Understanding those trends is key to your success as an investor.

This is where "art" comes into play. The ability to use your brain to project the company into the future is a form of art. Your results in that effort will be only as good as your assumptions. Therefore, a robust financial analysis is important as a first step. You reduce the risk of seeing your understanding of the company's business model and comprehension of the business environment being flawed. The art will design the investment thesis and potential risks. It will be up to you to make your choices at this point. The art is found in our DSR PRO ratings, dividend safety scores, and each DSR stock card web page.

Magic? Ah! Magic is an important ingredient even in a hard and cold topic such as investing. That's why when you add science to art and bring magic in, you get more than 100%.

Dividend Triangle

Walgreens



A long time ago, we used to like WBA at DSR (back in 2013-2014!). But the metrics have changed since then. The company has struggled to grow its revenue and earnings were flat for a while and then actually declined. Walgreens started to slow down its dividend growth policy and eventually cut its dividend.

By looking at the dividend triangle, you would have probably not avoided all the losses, but somewhere before the pandemic, you would have realized their metrics weren't strong. By matching the dividend triangle with your investment thesis, you build a solid investment process. Now, let's see how we can do that!

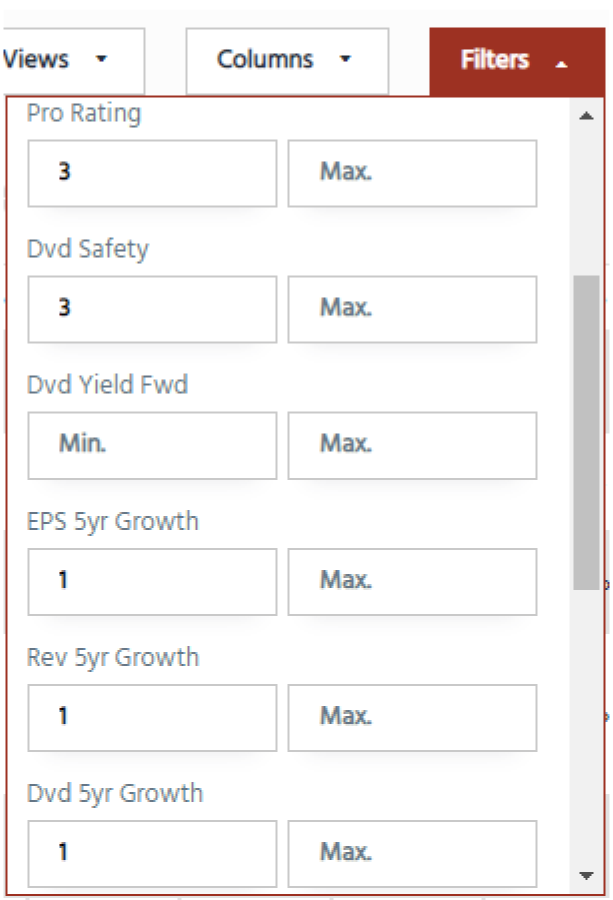
Let us start with science and the dividend triangle.

If you have been with us for a while, you know that I am a big fan of what I call the Dividend Triangle. This methodology's simple focus is on three metrics which will reduce your search time rapidly and help you target companies with robust financials. I start all my searches with a look at companies showing strong revenue growth, earnings growth, and dividend growth over the past 5 years. The detailed explanation is found in our recession-proof workbook which I invite you to read and re-read as necessary.

Download the DSR recession-proof workbook.

You can use the DSR site to find those great companies and it will take you just a few minutes. If you are a DSR PRO, I invite you to use the DSR Filters and Presets fundamental newsletter to create and adjust the Rockstar list to your liking.

In a few simple clicks, you can set the filters and begin hunting for the best stocks:



- Minimum Pro Rating 3
- Minimum Dividend Safety Score 3
- Minimum 5yr EPS 1%
- Minimum 5yr revenue 1%
- Minimum 5yr dividend 1%

By selecting only companies showing positive numbers in the 5yr Rev growth, 5yr EPS growth and 5yr Div. growth columns, you will find those companies with a positive dividend triangle.

This methodology covers all "regular companies", but not REITs and other businesses that use non-conventional metrics instead of EPS. We will address those types of companies later in this letter.

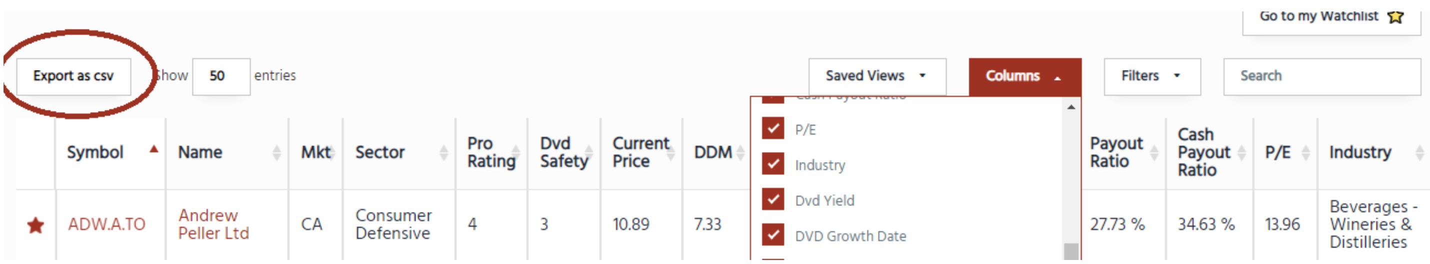
As of July 2023, these simple filters would bring down the dividend universe to 386 candidates for your portfolio. That's way too much!

Since DSR PRO members can save as many research filters as they want, I created an "upgraded" version of my "dividend triangle" search called the "Rock Star List":

- Minimum Pro Rating 3
- Minimum Dividend Safety Score 3
- Minimum 5yr EPS 1%
- Minimum 5yr revenue 1%
- Minimum 5yr dividend 5%
- Chowder minimum of 8 (yield + dividend growth)

This gets the list to 276 candidates as of June 2024 (41 less than last year!). I then slash this list by half to 132 by selecting only companies with a Pro rating of 4. That's obviously still way too many stocks to research. However, you should then filter by sector and look only at the sectors you want more of in your portfolio (you won't look at financials if you already have 4 banks, 3 insurance companies, and 2 assets managers).

You can then, select the "columns" button and add as many financial metrics as you want. While the stock screener is limited to the number of metrics it can display on your screen, you can export the file as a "csv", which is an excel spreadsheet.



You will then be able to search through several metrics and identify the cream of the crop for each sector and each market. And if you are not sure about your own scoring method, we added some powerful tools to the screener with the help of Refinitiv.

Introducing Refinitiv StarMine

As you know, the quality of your research can only be as good as the quality of your information. In 2021, we subscribed to a Refinitiv Eikon terminal to provide you with world-class financial information. The terminal powers our stock screener and most of the DSR financial metrics. On top of that, the Refinitiv Team has created StarMine. From Refinitiv:

"Using StarMine in your investment process is like adding an entire research department of PhD-level experts to your team. Our suite of quantitative analytics and models covers critical areas including value, momentum, ownership, risk, and quality."

We have selected three StarMine scores to help you make better and faster decisions.

StarMine ESG Score

The Refinitiv ESG Combined Score is an overall company score based on the reported information in the Environmental, Social and Corporate Governance pillars (ESG Score) with an ESG Controversies overlay. The ESG score you find in the stock screener shows the combined scoring of the four-factors mentioned above. Here is an example of how 3M's (MMM) Controversies score has fallen because of their lawsuits in 2018 and again in 2020-2021:

- Scoring Measure	2021	2020	2019	2018
ESG Controversies Score	D-	C-	B+	D+

This scoring gives you a particularly good idea that the company is a good corporate citizen. Since MMM kept having problems since 2018 with lawsuits, its ESG scoring is now down to 47.5 (C-).

- Scoring Measure	2021	2020	2019	2018
ESG Combined Score	C+	B	A-	B-
ESG Score (Weight: 100.0%)	A	A+	A	A
Environmental Pillar Score (Weight: 35.8%)	A	A	A	A
Social Pillar Score (Weight: 39.8%)	A+	A+	A+	A+
Governance Pillar Score (Weight: 24.4%)	A-	A	A-	B
ESG Controversies Score	D-	C-	B+	D+

The score you will find in the stock screener is rated from 1 (worst) to 100 (best).

StarMine Credit Score

The current regional 1-100 percentile rank of a company's 1-year default probability is based on the StarMine Combined Credit Risk Model. The Combined Model blends the Structural, SmartRatios, and Text Mining Credit Risk models into one final estimate of credit risk at the company level. Higher scores indicate companies that are less likely to go bankrupt, or default on their debt obligations within the next 1-year period.

The combined credit score includes metrics from three different models:

- Structural: Structural leverage, asset volatility and asset drift.
- SmartRatios: profitability, leverage, coverage, liquidity, and growth & stability
- Text mining: transcripts, Reuters news, filings, research

As you can see, the credit score is a combination of the business finance structure, ratios and how artificial intelligence analyzes the company's news and transcripts. Pretty powerful metrics!

StarMine Value Score

The current regional 1-100 percentile rank of the security is the overall Relative Value Model. Higher scores indicate stocks with the best value when considering all Relative Value model components that are relevant for the stock.

The relative valuation model will use a combination of 6 valuation metrics:

- EV/Sales
- EV/EBITDA
- P/E
- Price/Cash Flow
- Price/Book
- Dividend Yield

Chowder Rule

The Chowder Rule is a simple calculation helping you identify a strong dividend grower. The Chowder Rule identifies a robust growth dividend stock by adding the dividend yield (we use the forward dividend yield) and the 5-year CAGR dividend growth.

	Symbol	Dvd Yield Fwd	Dvd 5yr Growth	Chowder Rule
★	CNR.TO	1.83 %	12.97 %	14.8

In this example, CNR shows a 1.83% forward yield, a + 12.79% 5yr dividend growth rate for a Chowder score of 14.80%. The goal here is usually to set a personal objective. For example, targeting a Chowder score of a minimum of 9-12% (where the yield and the dividend growth could replace each other). Therefore, if you have a higher yield (let us say 5%), you may accept this company offering a 4% dividend growth rate to have a Chowder score of 9%. This should help you for the next section where we focus on dividend growth and not yield. Therefore, if you have a yield of 7%, you should request a 5-year dividend growth rate of a minimum of 2%.

The Chowder score is an interesting metric helping you to find the balance between high yield, low growth and low yield, high growth stocks. I believe a mix of both is optimal. In general, high yield, low growth companies operate with a proven business model in a mature industry. It won't propel your portfolio to the next level, but it should provide you with predictable and generous income. Low yield, high growth companies won't be your favorite dividends to pay the bills, but it will boost your portfolio's total return (think of Alimentation Couche-Tard vs Canadian Utilities or Apple vs Arbor Realty Trust).

Science: Priority to dividend growth, not yield

Now that you have narrowed the number of stocks to consider, it is time to trim that list even further. Throughout the years, most of my best stock picks have been found amongst the strongest dividend growers. When you think about it, it totally makes sense. Those companies must earn increasing cash flows and show several growth vectors to be confident enough to offer a 5%+ dividend increase year after year.

Past dividend growth is a result of several good metrics at the same time. This usually means stronger revenue, consistent earnings growth, increasing cash flow and debt that is under control. We will dig into the other metrics later, but at first glance, a strong dividend grower will likely come with other robust metrics.

While not all my holdings show such strong dividend growth, I always search for the strongest dividend growers when selecting a new stock for my portfolio. In other words, I am trying to maintain my “Chowder score” above 10 for most of my holdings.

Science: Focus on the sector you need

Whenever you isolate certain metrics, you will notice that certain sectors will be generally strong. This is because each sector thrives or faces headwinds at different times. The timing of your research will determine which sector offers you the best opportunities. Unfortunately, **you cannot buy all your stocks from the same sector**. The DSR recession-proof workbook will guide you in this regard.

When you run a stock screener at a specific time, you will likely find many companies from the same sector showing a robust dividend triangle. This only tells you this sector is thriving now. While it does not mean you should ignore it, going on a shopping spree and buying 5-6 stocks from that single sector won’t help you build a well-diversified portfolio.

I would rather buy the best of breed from each sector than buy 4 stocks from the same industry. This will help my diversification and smooth my total returns over time. For example, the fact that I had many tech stocks in my portfolio protected me to some extent from the March 2020 crash. Tech, utilities, and consumer defensive stocks held the fort while my financials, industrials and consumer cyclicals were getting killed. Even more importantly that diversification helped my portfolio bounce back relatively quickly.

Later in December of 2021, I trimmed my position in Apple and Microsoft. Many asked me why I sold shares of my two best performers. The answer is obvious when I looked at my sector allocation: I had more than 30% of my money invested in the information technology sector. I had to sell a few shares to improve diversification. What happened in early 2022? Tech stocks took a deep dive. Let’s be honest; I just got lucky with my timing, but a disciplined investment approach helped me avoid further losses. At the end of 2023, I reviewed my portfolio once more and trimmed more of Apple, Microsoft and also Couche-Tard.

Science: Dividend safety metrics

I will not start the dividend safety metrics with the classic discussion of payout ratios. In fact, I am a big believer that offense is the best defense. If you want to make sure your holdings will continue to increase their dividends, you must look for companies with strong revenues, earnings, and cash flow generation. While we provide the first two metrics, cash flow from operations and free cash flow can be found in the company's quarterly and annual statements. Then, you can move to the dividend growth section of the stock card. It will show you the overall dividend appreciation and the infamous payout and cash payout ratios.

Why I don't use payout ratios among my first filters. I see many investors setting a maximum for the payout ratio (a classic would be around 80% for the maximum acceptable). Such a requirement will effectively cut your list of candidates and will also focus on healthier dividend paying companies. **This is a crucial mistake.** Since the payout ratio is far from being perfect (and sometimes completely out in left field), adding a maximum percentage prevents you from investing in amazing companies. Those companies show high payout ratios, but when you dig a little deeper, you'll find out there is a reason for that high payout ratio, and the company is a true dividend grower.

Let's look at a classic example: The beloved Enbridge (ENB.TO) and its crazy high payout ratio:

Dividend Growth Perspective

The company has been paying dividends for the past 65 years and has had 28 consecutive years with an increase. Further dividend growth is expected to hover around 3%. Management aims at distributing 65% of its distributable cash flow, leaving enough room for CAPEX. Look to their latest quarterly presentation for their payout ratio calculation. Management expects distributable cash flow growth of 5-7% annually. As at November 2023, the company exhibited a DCF per share growth rate of 2%. Enbridge reassured the market with another 3% dividend increase in 2024 (to $0.915/share). This is why we have used more conservative numbers in our DDM calculation that are more in line with the 2020-2022 dividend increases of 3%.

Dividend ($)	3.66
Dividend Yield Fwd	7.65 %
Dividend Frequency	Quarterly
Average 5-Yr Yield	7.40 %
Payout Ratio (%)	127.15
Cash Payout Ratio (%)	90.35

There is some confusion around the cash payout ratio. Here is the formula used by Ycharts:

Common Stock Dividends / (Cash Flow from Operations - Capital Expenditures - Preferred Dividends Paid).

If a company has high Capital Expenditures, they may end-up with a high (or even negative) dividend cash payout ratio. The company, however, will usually finance its CAPEX and use its cash flow to pay its dividends. You obviously want stocks with payout ratios under 80%, but from time to time, more digging will explain high ratios and the dividend will remain safe. We cover all payout ratios in this DSR Fundamental newsletter.

LET US TAKE A PAUSE AND LOOK AT REITS

Since REITs are a different type of corporate structure, they deserve to be addressed separately. At DSR, your best bet is to start with the PRO ratings and Dividend safety scores and then read each stock card individually.

REITs are like MLPs in the sense that they are tax-advantaged investments. They pay no corporate tax, but in return, they must meet certain guidelines. They must invest primarily in real estate and must pay out most of their net income as dividends.

REITs can be good investments because they typically offer above-average dividend yields and can give an investor exposure to real estate without the typical difficulties of owning real estate directly (low liquidity, responsibility for maintenance, etc.).

Equity REITs

Equity REITs own and invest in property. They may own a diversified set of properties, and they generate income primarily in rent payments from leasing their properties.

Mortgage REITs

Mortgage REITs finance property. They generate income from interest on loans they make to finance property.

Hybrid REITs

Hybrid REITs do a bit of both, as they own property and finance property.

REITs valuation

Valuing a REIT is like valuing any stock. Like MLPs, I generally utilize the Dividend Discount Model to value them since most of their profits are paid as dividends.

There are, however, a few key metrics to know.

Net Asset Value is another estimate of intrinsic value. It is the estimated market value of the portfolio of properties, and it can be determined by using a capitalization rate on the current income that is fair for those types of properties. This can potentially understate the value of the properties because properties may appreciate rather than depreciate over time. Compare the NAV to the price of the REIT.

The Funds from Operations (FFO) are far more important than net income for a REIT. Similarly, earnings mean almost nothing for a MLP, and instead it is all about the cash flow. To determine net income, depreciation is subtracted from revenues, but depreciation is a non-cash item and may not represent a true change in the value of the company's assets.

So FFO adds back depreciation to net income to provide a better idea of what the cash income is for a REIT.

Adjusted Funds from Operation (AFFO) is arguably the most accurate form of income measurement for all REITs since it takes FFO but then subtracts recurring capital expenditures on maintenance and improvements. It is a non-GAAP measure, but a very good measure for the actual profitability and the actual amount of cash flow that is available to pay out in dividends.

Overall, it is good to look for REITs that have diversified properties, strong FFO and AFFO, and a good history of consistent dividend growth.

REIT Advantages and Disadvantages

The advantages and disadvantages of REITs are like that of MLPs. They typically have high dividend yields, but their dividend growth rates are generally on the lower side. They rely less on issuing new shares.

Advantages:

-REITs typically have above-average dividend yields.

-REITs serve as good protectors from inflation. If inflation occurs, property values and rents should increase over time, but fixed-interest debt that is used to finance the properties will not.

-Real Estate, if managed conservatively, can be a very reliable investment in terms of cash flow and in terms of dealing with recessions assuming rents are paid by the REIT's tenants.

Disadvantages:

-REITs often have low dividend growth.

-REITs generally utilize debt to add to their property portfolio, but they typically make up for larger debt loads by using that debt for conservative, appreciating assets.

-Since REITs must pay out most of their income as dividends, they have little downside protection from recessions. They may have to trim the dividend if their cash flow dips below their distribution levels. There are, however, some REITs that have developed good track records of consistent dividend growth.

Now let's go back to our buying process and step into the "art" segment.

Art: Understand the business model

Once you have finished with the first screeners including the dividend triangle and spot checks on the dividend safety, you are slowly entering into the "art part" of the buying process. We may still rely on some metrics for the downsides and growth potential issues, but for now, your investing process requires you to become an artist.

If you do not understand how a company makes money and how it will grow in the future, just skip to the next one. We make great efforts to define the company's business model in the name section and you will find more information about it in the investment thesis. The point is to be able to explain what a company does (and how it will grow) to a 12-year-old. If you cannot put it in simple words, chances are you do not fully grasp what is happening. If you cannot, do not feel bad (it happens to me too!) and just focus on the stocks you can fully grasp.

Art: Growth potential and potential downsides

Once we fully understand what a company does (and what it does best!), we can now focus on potential growth and potential downsides. Identifying headwinds and what could go wrong is probably more important than thinking of growth. Being positive about a company at this stage is easy. You have already found companies with strong metrics and the ability to increase their dividends. It is now time to put on your "gloom and doom" hat and look at potential downsides for each company you are considering.

At this point, its half science, and half art. The science part will require that you look at growth trends (the dividend triangle) and identify if it is slowing down or not. Then, you can look at debt over the past 5 to 10 years. Identify if the company keeps borrowing more or if it is paying down on its debt. This will require that you dig inside financial statements to understand the full story. You can also use the current ratio on the stock card.

A current ratio of one means that the book value of current assets is the same as the book value of current liabilities. In general, investors look for a company with a current ratio of 2:1, meaning current assets are twice as large as current liabilities. We have a complete DSR fundamental newsletter about debt here.

A final point about identifying potential downsides is to read the bear theses on the company around the web. Look at why some investors dislike the stock you are about to purchase. This may give you other reasons to pursue additional information.

Once you get really depressed about the stock you were so hyped about earlier, it is time to identify growth vectors. It is better to do it in this order, so you don't paint everything in pink and start looking for unicorns. Too many times investors forget to identify how the company will thrive in the future. It is not that easy. There is competition, recessions, price of raw materials, inflation, etc. Making a clear list of how the company can grow in any environment is crucial. Do not go for the easy "it's a great business" thesis. In a capitalist world, companies either grow and thrive or they mature, slowdown and eventually tumble. Do I have to remind you that JC Penney and Sears were growing and solid stocks at one point many years ago?

Art & Science: Valuation

Valuation does play a major role in the buying process. However, this should not be the single factor that determines whether you buy or not. This is one factor among many. To be honest, I would rather buy an "overvalued stock" with a strong dividend triangle, great growth vectors and lots of potential for the next 10 years than buying an "undervalued stock" that has nothing else but a good yield and a poor valuation.

When I find a company I really like, but the valuation seems to be ridiculous, I will be tempted to put it on a watch list and wait for a while. I usually build this watch list on the side and when I am done with one of my current holdings (the company does not meet my investment thesis anymore), I pull out the watch list and check to see if valuations have changed. Once again, I will choose any "Microsoft" (overvalued, strong growth) over any "AT&T" (undervalued, modest growth) of this world.

At DSR, we use mostly two methodologies to determine the stock valuation. The first one is to consider the past 5 years of price-earnings (PE) ratios and the past 5 years of dividend yield. This will tell you how the stock is valued by the market over a full economic cycle. You can determine if the company shares enjoyed a PE expansion (price grows faster than earnings) or if the company follows a similar multiple year after year. Same for the yield where you can identify an opportunity when a stock offers a better yield than its 5-year average.

Here's a quick trick using the stock screener: You can select the following metrics in the columns:

- Price
- DDM
- Dvd Yield Fwd
- P/E
- P/E fwd.
- Avg 5yr dvd yield
- Average PE 5yr

	Symbol	Name	Mkt	Sector	Price	DDM	Dvd Yield Fwd	P/E	P/E fwd	Avg 5yr dvd yield	Average PE 5yr
☆	ABBV	Abbvie Inc	US	Health Care	137.36	124.32	4.30 %	32.47	12.48	4.50 %	25.15

Then you select a stock you like using the search box for you to quickly see if the stock presents an opportunity or not. You can also look at the graph in the stock card as we provide the 10-year average line.

When you look at stocks offering a yield of over 3% with a stable business model, the dividend discount model (DDM) can be most useful. Keep in mind the DDM gives you the value of a stock based **solely on the company's ability to pay (and grow) dividends.** Therefore, you will find strange valuations when you look at fast-growing companies with low yields (e.g., Visa!).

While the idea of receiving dividends each month is seducing, this is not what makes dividend growth investing magic. It is the combination of capital growth and dividend growth (read total return) that truly generates the magic in your portfolio.

Art: Time to write your investment thesis… and click the buy button!

Let us do a recap of what we have learned so far.

Many investors have difficulty determining which company shares to buy and when to buy them. **At DSR, we focus on businesses with a strong dividend triangle**. This means we are looking at businesses with strong growth vectors for the future, posting consistent earnings growth and with a sustainable dividend growth policy. The stronger the dividend triangle, the stronger the dividend growth policy should be.

When we find such businesses, we dig into their earnings to understand the business model and write down a complete investment thesis. The investment thesis includes both the reasons why we think this company is great and the potential downsides. It is important to fully understand where the company is going and what could possibly go wrong. Then, and only then do we press the buy button.

How much to invest in a new position… how many holdings in a portfolio anyway?

Personally, I like it when my investments matter. For this reason, I try to keep the number of different holdings between 30 and 40 for any portfolio over 100K. If I were starting all over again with a 20-50K portfolio, I'd go with 20-25 positions. I would then add more as I grow my portfolio to 100K.

I also like to have equally weighted positions at the start. If you do the math, a "full position" would equal between 2.50% (40 positions) and 3.33% (30) of your portfolio.

In an ideal world, I would pull the trigger for the full amount right away. It is not proven by any studies but making 1 buy transaction will kill all dilemma and confusion on what to do next. Once I identify my target, I go get it. End of the story. The whole idea of having a clear buy process is to cut the noise, reduce the doubts and improve your conviction level.

If you prefer going with a "half position" and keep the cash for another transaction, you open the door to doubts and paralysis by analysis. You have already done the work so why bother waiting?

Finally, I like to keep 5%-10% of my holdings for speculative plays. Between 2020 and 2021, I used this "play money" to buy Brookfield Property Partners. I later sold it to buy more of CAE (CAE.TO / CAE) in October. Each time I make these trades, I use the profits from my play money to boost my positions in strong dividend growers such as Alimentation Couche-Tard and Telus. Unfortunately, it's not always a success (therefore, it is called a speculative play!). Among my recent failures (so far), I can think of Paramount Global (PARA), previously known as ViacomCBS (VIAC) which was sold with a ~50% loss. I try to keep the same 5-10% of my portfolio value in any speculative play. At the time of writing this newsletter, my speculative plays are worth 4.72% of all my holdings. Keep in mind this is "play money" and it should never replace your main strategy. Always remain cautious!

Understanding the role of each holding in your portfolio

Looking at metrics and writing down your investment thesis will help you select great stocks. However, too many investors focus on the tree (a single stock, a single transaction) and not at the forest (e.g., the portfolio as a whole). By giving a role to each stock in your portfolio, you will be in a better position to know if you can add another risker play (e.g., educated guess or falling knife) or not. If you already have 4 small caps in your portfolio, do you really need a 5th one? Is your volatility tolerance high enough to stomach more fluctuations?

At DSR, I like to categorize companies into three categories:

> *"I can put this stock in a box for 10 years without looking at it".*

Core Holdings: This category should obviously make up most of your holdings. The holding period for these stocks is "forever". Those companies should meet all your investment principles. For example, my investment strategy is built around strong dividend growers. I make sure I study and understand the company's business model and review its financial metrics (especially the dividend triangle) to make sure management will continue to offer a sustainable dividend growth policy. This is the classic "I can put this stock in a box for 10 years without looking at it".

> *"…a strong business model and good metrics, but one thing is off".*

Educated Guesses: I would qualify these companies as almost perfect. Obviously, no companies are perfect and there are risks involved in each investment. Educated guesses usually come with price fluctuations and obvious risks. In other words, they usually show a strong business model and good metrics, but one thing is off. It could be the dividend triangle, higher debt, potential disruption, a strong competitor, a highly cyclical environment, etc. Educated guesses must be monitored with greater attention as their status could change (for the better or for the worse). I usually take educated guesses in industries I understand and where I'm confident I can dig out more information. I'm fully aware of the potential risk and I'm willing to live with them if my investment thesis stands. That's why I call them "educated" guesses.

> *"…a major event putting unreasonable pressure on a stock."*

Falling Knives: Those investments come with high risk and the real possibility of losing even more money. I also call Falling knives speculative plays. By definition, a falling knife is a stock that has dropped rapidly on the market. There is usually a major event putting unreasonable pressure on the stock. We are talking about a stock falling 20-30% faster than the rest of the market. If the market is down 20%, you'll find falling knives among companies falling by 40-50%. While catching a falling knife is always dangerous, picking stocks from a falling industry could be a better idea. If you can select some of the most resilient, best-performing companies in a shaky industry, chances are the rebound may pay off.

Do you really need falling knives and educated guesses?

As you enter the decumulation phase, one could question the relevance of having anything but core holdings in their portfolio. I tend to agree. By getting stricter in your selection criteria and by raising your minimum requirements for specific metrics, you bolster your portfolio strength and ensure the generation of income "forever".

It may happen that you have a few educated guesses in your portfolio though. Some could go from "core holdings" to "educated guesses" as the market or the environment changes.

I had an interesting discussion with Claudia, a DSR PRO member since January 2021, about the weight of each stock in a portfolio. Depending on your risk tolerance, you could decide to keep a higher weight for "core holdings" and smaller weightings for non-core holdings.

For example, if you determine that Canadian banks are part of your core holdings, you could decide to have 4-5% in stocks like Royal Bank but reduce your exposure to the tech sector as you don't feel as comfortable and put a limit of 2-3% in stocks like Apple or Microsoft. **It doesn't hurt much if you lose 50% of a position that is only 2% of your portfolio. When you look at the bottom line, you only lost 1% of your portfolio value. Other, stronger stocks may compensate for that loss.**

> *« It is up to you to determine your own classification based on your knowledge and experience".*

Please note that I selected companies in this example on purpose. Depending on your comfort level with a specific sector, industry, or company, you may see a stock as a core holding while your neighbor may see it as an educated guess. Therefore, just because I see my shares of Apple and Microsoft as my core holdings does not mean that you should see them the same way. After all, both stocks were down by double-digits in 2022. Can you stomach this type of volatility? It is up to you to determine your own classification based on your knowledge and experience.

If your focus is the income generated by your portfolio, you might also want to identify your stock weighting by the amount of income it generates instead of its value. For example, imagine you have $200,000 invested in Apple, which generates $1,200 in dividends per year (0.60% yield). And you also have $100,000 invested in Enbridge generating $6,500 in dividends per year (6.50%). Your exposure to Enbridge in terms of a source of income is much more important than Apple.

Making sure your portfolio is well diversified by weight and by weight of income is very important at retirement.

DIFFERENT STOCKS, DIFFERENT CATEGORIES

I believe this newsletter will be particularly useful for you in managing your portfolio, but also for you to understand the subtlety behind DSR ratings. In a general, DSR ratings read as follows:

5 = Exceptional Buy - A strong business model, several growth vectors, and an undervalued price.
4 = Buy – It's a good company, and the short-term upside is good, but not exceptional.
3 = Hold – A classic "right company at the right price".
2 = Sell – If we were you, we would seriously consider selling this one.
1 = Screaming Sell – Enough said.

As is the case for any metric, a stock rating must be put in context. Some companies are rated as a "buy" as they have solid values, a proven and resilient business model, and they would be "eternal buys" as they could be part of a core portfolio (e.g., foundation stocks you likely will hold forever).

It could also be rated as a "buy" to catch an opportunity. There could be a lot of great reasons for an opportunity: a bad quarter, a sector under pressure, future growth potential that hasn't materialized yet, etc.

Finally, a handful of companies could reach the bottom and become speculative plays. There is a high risk, and high potential reward. However, it's not because it's rated a "buy" that it will generate a profit. Especially in this case. As you can see, a buy rating could represent three very different meanings. As is usual, a metric is nothing without its context.

Why would you want to categorize your stocks?

Whenever you click on the buy button, we feel we have made a good trade. If not, we wouldn't have made it. But we don't buy all our stocks for the same reasons as mentioned in my introduction. Classifying your holdings in three different categories will help you manage your risk. In other words, you make sure you are not filling your portfolio with free falling stocks for the sake of picking one that will surge and make you look like a genius.

Investing is not about your ego. Let's make this clear: we all make mistakes. I've been known to invest with conviction for the past 19 years, but that doesn't ensure a perfect track record. As an investor, I own my mistakes and try to learn from them. The stock market has its own way of humbling us.

What protects me from making too many mistakes is how I categorize my stocks. I have "forever stocks" categorized as core holdings, and I also have educated guesses, and falling knives. The proportion of your holdings matter. For the first 11 months of 2022, I made around $5,000 on Alimentation Couche-Tard and lost around $3,000 on Sylogist. However, ATD is only up 18% while SYZ lost about 50%. How have I been able to "save the day" with ATD? Because Couche-Tard shows a strong dividend triangle and is one of my core holdings. Therefore, it's one of my largest holdings and a foundational stock in my portfolio. Sylogist is a small cap in the tech world coming with its fair share of volatility. Let's look at how it translates in a portfolio.

Core holdings (60%+)

This category should obviously make up most of your holdings. That's why I mentioned 60%+. It's a guideline, not a strict rule, but it shows the importance of having a strong core. You don't build a 60-story building on a weak foundation. The holding periods for these stocks are "forever". These companies should meet **all** your investment principles. For example, my investment strategy is built around strong dividend growers. I make sure I study and understand the company's business model, review their financial metrics (especially the dividend triangle) to make sure management will likely continue to offer a sustainable dividend growth policy.

This is the type of company that isn't selected for its amazing growth potential, but rather for its business model relevance in the future. In other words, does it make sense to think this company will be around in 20 years from now? Some companies haven't proved that they can survive that long, let alone increase their dividend yearly along the way.

Core holdings should be your high conviction investments. When elaborating the investment thesis, there shouldn't be a "this company is great for XYZ, ***BUT there is this that annoys me***". An obvious example would be comparing Fortis (99% regulated assets, 49 consecutive dividend increases) with Algonquin (AQN) (highly leveraged with bad recent quarters). One could be classified as a core holding and the other, either a falling knife or at best an educated guess.

The key here is to invest as much money as possible in those core holdings, those "sleep well at night" stocks. They will sometimes feel like they are boring investments, but they will get the hard work done. I almost never look at Fortis' price. I almost forget it's in my portfolio. Why? Because I know I don't have to think about this one since it's so solid. I obviously review FTS' quarterly results, but I'm skimming through a lot faster than I would when reviewing AQN's earnings.

Educated guesses (max 30%)

Some investors will prefer to have a small exposure to educated guesses and that's totally fine. I like to invest in companies with a strong growth potential due to my age and my financial situation allows it. This allocation will change over time.

I would qualify those companies as almost perfect. Obviously, no companies are perfect and there are risks involved in each investment. Educated guesses usually come with price fluctuations and obvious risks. In other words, they usually show a strong business model with good metrics, but one thing is off. It could be the dividend triangle, higher debt, potential business disruption, a strong competitor, a highly cyclical environment, etc. Educated guesses must be monitored with greater attention as their status could change (for better or for worse). I usually take educated guesses in industries I understand and where I'm confident I can dig out more information if required. I'm fully aware of the potential risks and I'm willing to live with them if my investment thesis stands. That's why I call them "educated" guesses.

Falling knives (max 10%)

I've assigned a maximum of 10% for this category, but for many investors these stocks shouldn't even be considered. These investments come with high risk and the real possibility of losing money.

I also call Falling knives speculative plays. By definition, a falling knife is a stock that drops rapidly on the market. To pick a recent example Algonquin could have been seen as an educated guess that turned into a falling knife. There is usually a major event putting unreasonable pressure on the stock.

We are talking about a stock falling 20-30% faster than the rest of the market. If the market is down 20%, you'll find falling knives among the companies falling by 40-50%.

There are two types of falling knives. The stock that is freefalling due to specific concerns around the company. For example, not all utilities dropped when AQN reported its bad quarter. The fall is directly attributable to the company's financials and perspectives. The overall stock market is not doing that great and the utility sector has been under pressure due to higher interest rates, but what is happening to AQN is directly related to their specific situation.

The other type of falling knives could be found when there are global uncertainties around a specific sector. REITs and tech stocks will include several falling knives in 2022. It was also the case with the oil & gas industry in 2020.

While catching a falling knife is always dangerous, picking stocks from a falling industry could be a better idea. If you can select the most resilient, best performing company in a shaky industry, chances are the rebound will pay off.

CAN A STOCK CHANGE CATEGORIES?

Definitely! As our world is in constant evolution, companies evolve, adapt, or fail constantly. When I bought shares of Apple the first time in 2014 it was based on an educated guess (the company struggled to grow sales and many thought Samsung would eat them alive with their smartphones). It's a great story where Apple became a core holding after proving it can create new revenue streams and continue to be a strong player in the smartphone industry.

Those categories help me understand the risk inside my portfolio and the potential losses I'm exposed too. While I was very excited by Sylogist's growth potential, the company was no match for the strong dividend growers like Couche-Tard, Apple, Microsoft, or National Bank. There was a huge gap between SYZ's dividend triangle, market cap, diversification, and potential (upside and downside) compared to some of my core holdings. For this reason, the four companies mentioned above represented 33% of my pension plan while SYZ represented 1.63% before I sold it. Losing money on SYZ and then selling it hurt my ego more than my portfolio. That was the point of using this strategy to protect my portfolio from large losses.

SUMMARY

Here is my process in a few steps:

#1 Use a stock screener based on the dividend triangle to prepare your buy list.

#2 Highlight stocks with stronger dividend growth over the past 5 years.

#3 Select only the sectors you are interested in and understand.

#4 Select stocks with strong dividend safety.

#5 Dig inside each company to understand their business model.

#6 Do further research to identify potential downsides (risk) and potential upsides (growth).

#7 Look at valuations to determine if it is an immediate buy or if you should add the stock to a "watch list".

#8 Write down your investment thesis and click on the buy button.

****at all times, make sure your investment thesis is backed by a strong dividend triangle****

Since you are a DSR member, you can save lots of time in applying this process by using our DSR PRO ratings and Dividend Safety Scores. Both scoring methodologies are based on the above processes. Briefly, you then have our opinion on any stocks. It is a great start to select companies that meet certain screening standards and then, and only then, do your own personal due diligence.

I'm also leaving you with a methodology to build your own stock checklist. The checklist is an effective tool to rapidly select or discard a stock for your portfolio.

Cheers,

Mike.

HOW A STOCK CHECKLIST CAN MAKE YOUR LIFE EASIER

One thing I always try to avoid is indecision. Having too many options and not knowing which one will give me the best outcome makes my head spin. I consider my opportunities, I analyze them, and I look for more information. I want to make the best decision, yet I'm often completely in the fog. I need some guidance to secure a clear plan. Without a straightforward strategy, you may suffer from paralysis by analysis. Don't worry as I may have a solution for that.

Last year, we had an evening when many of our good friends came over for supper, and one of them asked me how to become confident. I was at first surprised by the question as I never really gave any thought to how and why I have become confident in most of what I do. It turned into an interesting conversation where I tried to explain the pathway that led me to conviction in my actions. This is how I came to realize that I have developed a technique to move forward efficiently and with certainty.

We face many challenges and must make many decisions. Instead of spending hours and hours trying to figure out which way to go, I've worked on building simple but effective decision-making mechanisms. Those mechanisms help me with all the major decisions in my life. In general, a clear set of questions helps me make life changing decisions within minutes. Obviously, I don't always make the right choices, but I never regret them. Why? Because I know I made the best decision I could at that time, and I can certainly learn from my mistakes.

This personal introduction to confidence leads to the relevance of having a stock checklist for your investment decisions. As an investor, we will inevitably make decisions that will greatly influence the nature of our retirement. In many cases, we may hesitate to act as we fear making the wrong investments. We don't want to lose money, we don't want to miss out on our retirement, and we want the life we always dreamed of having.

What?

When you watch an interview, you'll notice that the best interviewers will ask open-ended questions. The key here is to let guests answer as freely as they can. Through open-ended questions you can explore many topics and you will likely end-up with unexpected and refreshing content. This is not what you want with a checklist. The point of this list is to make sure the stock you are looking at qualifies for your portfolio. You work hard for your money, and you want to make sure you buy only the best companies possible. The checklist will help you avoid investor's bias and will discard companies that could potentially hurt your portfolio. We are looking at building a list of closed-ended questions that will improve the speed and quality in your decision-making process.

Why?

Answering “yes/no” questions could seem limiting, and this is exactly the purpose of this exercise. This quick tool is here to help cut down the noise and make you invest with more conviction. It is convenient and clear. After reviewing your checklist, the stock will either belong in your portfolio or not. Then, you may either move on or press the buy button. No more doubts or dilemmas!

How?

The checklist will be more efficient once you have done your complete stock analysis included in the first section of this newsletter. Once you have selected great companies, you can quickly decide whether you should add them to your portfolio by going through the checklist or not. While you could start your buying process with the checklist, some items will be more difficult to answer at the beginning of the process. Personally, I would rather know the company inside out before going through the final checks. The process of validating through a checklist will increase your confidence in buying but it will also support your conviction in holding your position through challenging times.

Now, let’s look at what should be on your checklist!

ITEMS ON YOUR LIST

The idea here is not to overload you with 50 items to check each time you want to analyze a company. I’ve tried to keep the list as concise as possible. I’ve regrouped the items under a few themes, and I will explain why each question matters. You’ll find a printable check list at the end of this newsletter.

Allocation / Role

First things first, it’s important to define what will be the role of your next investment. Some investors look for income, others for stability and some for growth. Knowing the function of each investment in your portfolio will help you reach your financial goals faster and will reduce your level of concern during market fluctuations. Here are a few questions you should have on your list:

How much in terms of percentage of my portfolio do I want to invest?

I like to have equally weighted positions in my portfolio. However, I also want to let my winners run in the market. This may create some distortion in my portfolio (with my largest holding now at ~10% of my portfolio). For a new position, I will always start with an equal weight. For example, if I have 100K invested across 19 stocks, I’ll make sure that my 20th position is 5% of my portfolio (100/20 = 5%).

In which sector or sub-sector is this company operating?

Once you determine which sector and/or sub-sector (labelled “industry” in the DSR stock screener) the stock is in, you’ll know what place this company will have in your portfolio.

What is my current exposure to this sector or this sub-sector?

When I look at my current portfolio, I am over exposed to the information technology sector. I will then discount any new stock I find interesting in this sector unless I’m willing to sell one of my current positions.

What does this company bring to my portfolio that I don’t already have?

You want to pick the best of each sub-sector and not all the companies from the best sub-sectors. This is how you avoid “diworsification”.

What role (growth, income, safety) will this company play in my portfolio?

Define exactly what this company should bring to your portfolio. How does it help you reach your goals?

Dividend

A DSR checklist wouldn’t be a good list without a section about dividends. Since we are all dividend growth investors, I put this section before any other metrics.

Has the company cut its dividend in the past 10 years?

You certainly do not want to hold dividend cutters in your portfolio. If you must answer “yes” to this question, make sure you can explain why it was cut and how the company will grow the dividend going forward. Some exceptions apply but remember: “hope” is not a successful investing strategy.

Has the company paid a dividend for a minimum of 5 or 10 years?

I prefer to use 5 years to make sure I don’t discard young but promising dividend growers. What I like about a minimum of 10 years is that you can usually see how the company reacted during an entire economic cycle (cycles normally average between 5 and 8 years in length).

Does the company have a consistent record of raising their dividend?

Do I need to say more? I want companies that constantly increase their dividend. It’s a good indicator that the business is growing, that the dividend is safe, and that my investment is protected against inflation.

Does the company show a minimum of 3% annualized dividend growth rate over the past 5 years?

As I just mentioned, I want to make sure my dividends provide me with an inflation hedge.

What is the 5-year annualized growth rate and last year's annualized growth rate?

This will tell you a lot about the previous trend vs. what just happened last year. If the recent dividend increase is smaller, it may be time to enhance your research efforts.

What's the Chowder score?

The Chowder score will sum the company's yield with its 5year average dividend growth. It will give you a good indication of the company's dividend potential (low yield, high growth and decent yield, medium growth will score well).

Safety

We wouldn't go far in the investment world if we didn't care about our investment's safety. In this section, I'll focus on questions that will tell me about the dividend safety and the company's balance sheet.

What is the payout ratio?

First things first, let's look to see if this number is scary or not. I won't discard a high payout ratio (above 100%), but I would certainly investigate to understand why the company is showing such numbers. For more information on payout ratios, please read our DSR fundamental newsletter on the topic.

Has the payout ratio (or cash payout ratio/FFO payout ratio) increased in the past 5 years?

It's one thing to see dividends growing, but the company must be able to afford those increases. If the payout ratio increases year after year, it will eventually mean that the dividend growth rate will slow down.

Has the company contracted for more debt or issued more shares/units? If yes, why?

Many companies will grow through acquisitions. While it's often a great strategy, total debt must remain under control. If the company decided to issue more equity to finance acquisitions, it's also important to revisit the EPS or FFO per share to make sure those actions have not diluted the value per share.

What's the company's Refinitiv Credit Score?

For this one, you can use another type of metric or analysis, but I like to use what is provided in the DSR stock screener. The Refinitiv Credit score provides an easy-to-understand number from 1 to 100 that will tell you if the company has a solid balance sheet or not. Among the highest rated stocks, you will find companies with little to no debt such as Gentex (GTNX) and Franco Nevada (FNV.TO) or companies with lots of liquidity such as Apple (AAPL) and Microsoft (MSFT).

Growth

As you know already, I'm a big fan of offense being the best defense. In the investing world, this means I would rather select healthy companies showing solid growth potential than a mature business that is slowly, but surely declining (even if it means the yield is better!).

Has the company shown positive revenue growth over the past 5 years?

Revenue growth is the perfect expression of growing companies. If your revenue doesn't increase, then it will be hard to generate more profit and pay a higher dividend. If there is a huge jump (or decline), it's time to pull-up the quarterly report and see what the story is behind the movement. Maybe there was a new product launch, an acquisition or a divestiture or some other definable activities to explain the changes in revenue.

Has the company shown positive EPS growth over the past 5 years?

You can see the dividend triangle building up here. After revenue growth, it's time to talk about earnings! For both revenue and EPS, I would add a follow-up question to see if the company has shown improvement over the past 12 months. Maybe there was a big jump 3 years ago and now it's back to a flat line.

Has the company shown positive cash from operations growth over the past 5 years?

Since EPS doesn't tell you everything, I would also look at the cash from operations trend. If you combine revenue, EPS, and cash flow, you will be in a very good position to know if the company is growing or has stalled its growth.

DSR TOOLS YOU CAN USE

You are obviously not alone in this journey. At DSR, we have created tools that will help you answer all these questions rapidly. Here are a few ways to make your life easier and make investment decisions faster.

Stock Screener

You can build a stock screener answering almost all those questions for you. If you are a PRO member, you can also save that view and call it the "DSR checklist". We provide 40 different metrics under the "columns" menu. You can verify the dividend triangle, the dividend safety, and the credit scoring (on top of the Chowder score!) within seconds. If you want to avoid searching through "weaker" stocks, put some minimums in the filters and that should clean out most of the marginal stocks.

Be careful about being too picky when you look at metrics only. Sometimes, a bad year could explain a lot and "kill" many metrics. Keep your mind open when you perform your analyses.

Take a short-cut: Portfolio models & Buy List

If you are looking for a good starting point for your portfolio, I'd suggest you go directly into our portfolio models. This is what I did when I received my pension fund from my former employer. I selected the 100K CAD portfolio (I had 108K to invest), and then picked most of the holdings to build my core portfolio. Then, I double-checked the Mike's buy list to identify a few timely opportunities. My portfolio was built within a few hours.

Go Further: DSR PRO Portfolio Builder & DSR PRO Quarterly Report

The DSR PRO portfolio builder is a great help to create, analyze, and manage your portfolio. Within minutes, you'll get your sector allocation, your PRO rating, and the Dividend safety score. You can also shift directly to the stock screener view and see only your positions. Mix that with the "DSR checklist" screener view and you'll review your entire portfolio rapidly. The DSR PRO quarterly report will then provide you with additional information on why the company is doing well… or why it is struggling.

DSR STOCK CHECKLIST (available in fillable PDF in the fundamentals)

ALLOCATION / ROLE		
What % do I want to invest?	%	
Sector and industry	Sector:	Industry:
Exposure to this sector? This industry?	Sector:	Industry:
What this company brings to my portfolio?		
Role played by this company		
DIVIDEND		
Dividend cut in the past 10 years	YES	NO
5 year or 10 years + of dividend history	YES: years	NO
Consistent dividend increases (min 3yr)	YES	NO
Minimum 3% div growth rate over 5 years	YES	NO
5-year and 1-year annualized growth rate	5 years:	1 year:
What's the Chowder score?		
SAFETY		
What is the payout ratio?		
Did the payout ratio increase over the past 5 years?	YES	NO
More debt or more shares/units?	YES	NO
If yes, why?		
Refinitiv Credit Score		
GROWTH		
Positive 5-yr revenue growth	YES	NO
Positive 5-yr EPS growth	YES	NO
Positive 5-yr cash from operations growth	YES	NO