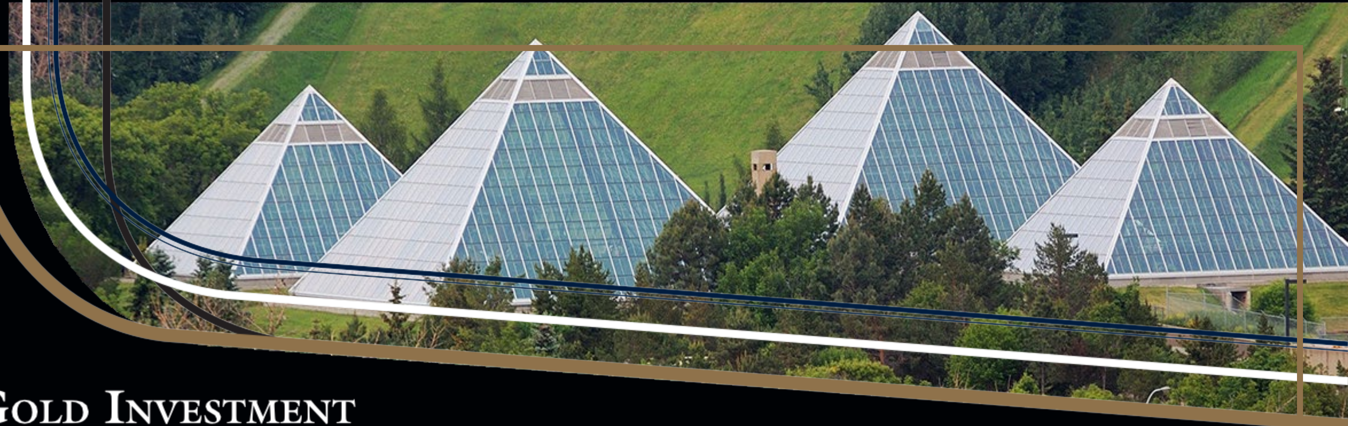


GOLD INVESTMENT
PORTFOLIO MANAGER

Investment Letter

Q2-22 Investment Letter (No. 60)

July 28, 2022

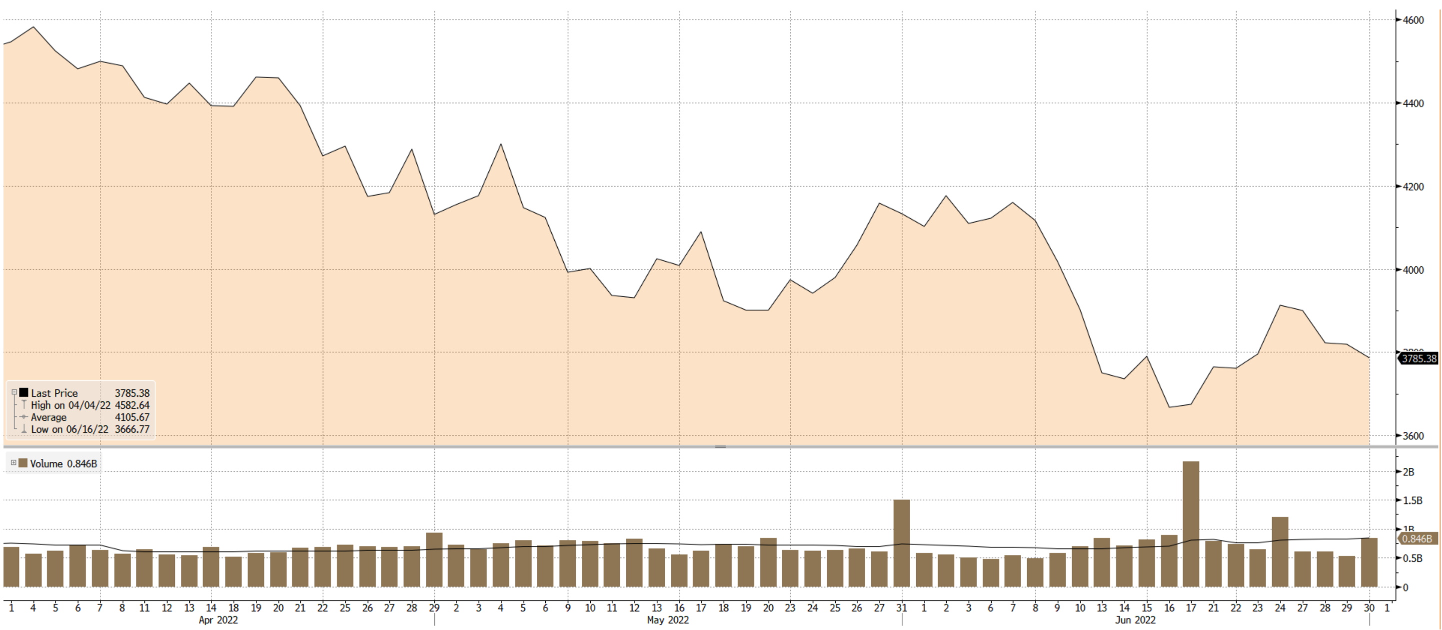
OVERVIEW

Dear Clients and Friends,

We are pleased to provide this quarterly report for the period ended June 30, 2022. This report will be divided into three sections: (1) Market Recap, (2) What's New and (3) Commentary.

MARKET RECAP

The S&P 500 Index (in USD) declined 16.63% for the three month period ending June 30, 2022. The Index hit a high of 4,582.64 on April 4, 2022 and a low of 3,666.77 on June 16, 2022.



The S&P/TSX Composite Index declined 14.15% in 2022's first quarter. The Index reached a high of 22,085.60 on April 4, 2022 compared to its low of 18,717.12 on June 23, 2022.

The Canadian Dollar quoted in USD (CADUSD) declined 2.99% during the first quarter of 2022. CAD/USD closed at 0.7768 on June 30, 2022, reached a high of 0.8009 on April 5, and hit a low of 0.7666 on May 12.

WHAT'S NEW

ACCOUNT CONTRIBUTIONS

There are many benefits to contributing to your investment accounts, especially in the midst of a pull-back in the markets:

- Increase your savings for retirement, emergencies, children's education, home purchases, or other purposes.
- We target securities that are deeply discounted or provide the most value in our opinion. Cash deployed in this manner has the potential to generate large growth when markets recover and return to a growth phase.
- Take advantage of *dollar cost averaging,* where securities are purchased at a discounted price to lower your average cost and thereby increase your overall gain.
- Some contributions may generate additional grant or bond payments from the government when deposited to education or disability savings plans (subject to contribution room and government grant/bond conditions).

There are many convenient ways you can deposit to your investment accounts. You can make a bill payment (not e-transfer) through your online banking, electronically sign a form for a one-time pull from your chequing account, or write a cheque. You may make a one-time deposit or set up automatic recurring deposits with a frequency that works well for you. We remind all clients to check their contribution room for any registered account before making a contribution. For instructions or assistance with any of these methods or help checking your room with Canada Revenue Agency, please contact our office and speak with our client experience team.

ACCOUNT BENEFICIARIES

A beneficiary is a person or entity that the holder of an account designates to receive the assets in the account, typically, in the event of the account holder's death. If you do not wish to designate a beneficiary for your accounts you may list your estate. Certain registered accounts can have a beneficiary of your choice listed, including all types of retirement savings plans, all types of retirement income funds, and tax-free savings accounts. Typically, the most tax efficient beneficiary for estate planning may be your spouse or common-law partner. You have the option to list your estate, one beneficiary, a primary and secondary beneficiary, or multiple beneficiaries with different allocations. It is important to consider any legal will you have in place and ensure that you do not have conflicting instructions in your will and on your accounts, as this can cause delays with estate settlement. If you are a client with Credential Qtrade Securities (Aviso Wealth), you can check each account's beneficiary designation on your monthly statement. Please contact our office if you would like to check or update your beneficiary designations.

2022 "KYC" REVIEWS

As per GIM's ongoing obligations to conduct annual "Know Your Client" ("KYC") reviews, you may receive communication from our admin department to schedule a review with one of our portfolio managers. Investment reviews are a great way to keep us informed on your personal and financial circumstances so we can best serve you. If you wish to speak with someone or have a change in your circumstances, please do not hesitate to contact our office.

COMMENTARY

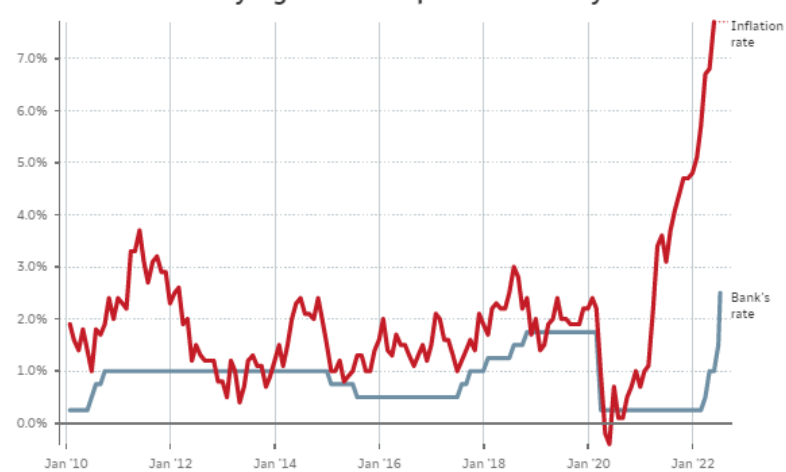
Part 1. We don't really want to talk about this, but we will…

Inflation and interest rates. This is the third letter to clients where we talk about inflation and interest rates. However not talking about this subject is like talking about the Oilers' performance without mentioning Connor McDavid.

On July 13, 2022, our central bank, the Bank of Canada (BoC) raised its discount rate by a whopping 1.00%. Usual interest rate moves are 0.25% and the last time the BoC did a 1.00% move was in 1998, 24 years ago. A 1.00% rate hike means the Bank of Canada didn't just see smoke, they saw a raging forest fire. In our opinion this is a sign there are more interest rates hikes on the way.

Chart 1:

Bank of Canada trying to catch up with runaway inflation



Source: cbc.ca[1]

Canada's June 2022 inflation is 8.1%. The last time inflation was this high was in 1983, almost 40 years ago. The culprit this month is mainly food and energy (gasoline), namely the things that we all need to live on. Inflation is the worst in Atlantic Canada, with the

[1] www.cbc.ca/news/business/bank-of-canada-rate-hike-1.6518161

provinces there seeing 8.2% for Newfoundland & Labrador and as high as 10.9% for Prince Edward Island. [2, 3]

Table 1 – 8.1% inflation in Canada for June 2022

The Consumer Price Index rises at a faster pace in eight provinces , 12-month % change

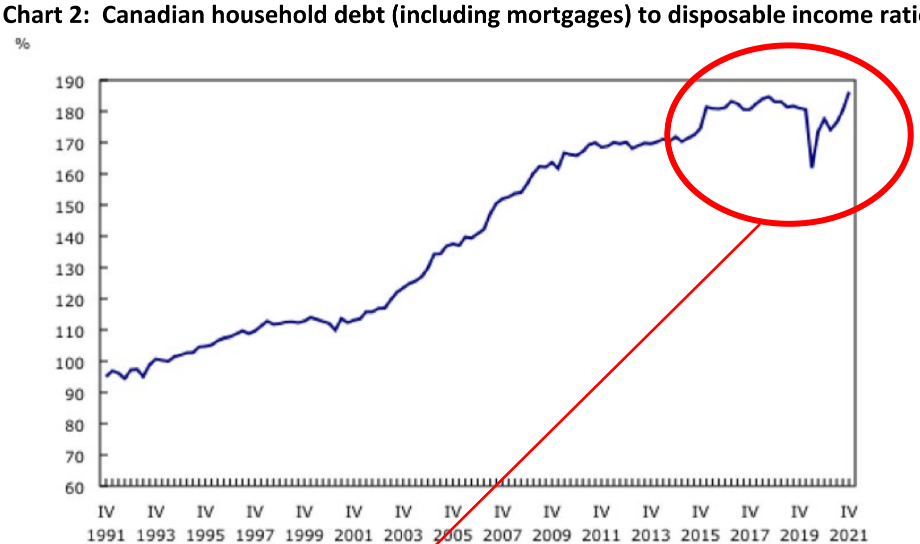
	May 2022	June 2022
Canada	7.7	8.1
Newfoundland and Labrador	8.0	8.2
Prince Edward Island	11.1	10.9
Nova Scotia	8.8	9.3
New Brunswick	8.8	9.1
Quebec	7.5	8.0
Ontario	7.8	7.9
Manitoba	8.7	9.4
Saskatchewan	7.0	8.1
Alberta	7.1	8.4
British Columbia	8.1	7.9

Source: StatsCan [4]

One of the problems of rising interest rates is going to be its impact on consumer behavior. The average Canadian's household debt, including mortgages, has been rising since 1990, powered by falling interest rates.

As interest rates went down from 1990 to December 2021, Canadians took on more and more debt. As of December 31, 2021, the ratio of consumer household debt to disposable income hit an all-time high of 186.2%. In plain English, for every dollar a household earns after paying taxes there is $1.86 of debt.

Chart 2: Canadian household debt (including mortgages) to disposable income ratio



Source: www150.statcan.gc.ca/n1/daily-quotidien/220311/cg-b004-png-eng.htm

No good choices. The average Canadian household has almost $2 of debt for every dollar of after-tax income. People will have to *choose between the necessities of life or paying the mortgage* if interest rates and inflation keep going up.

In our opinion, an approximate 1:1 ratio of household debt to disposable income is much more conservative. Unfortunately, as a country, we are almost double that ratio, which means there is no extra money for the increased cost of living. Food suppliers of

[2] https://www.cp24.com/news/inflation-rate-accelerates-again-reaching-a-new-39-year-high-1.5994782#
[3] https://www.statcan.gc.ca/en/subjects-start/prices_and_price_indexes/consumer_price_indexes
[4] https://www150.statcan.gc.ca/n1/daily-quotidien/220720/cg-a005-eng.htm

Canadian grocery stores are warning of further price increases with *"no relief in sight for sky-high grocery bills."* [5]

Many of our clients remember the 1970s to 1980s and 20% interest rates, and how difficult it was to survive that period. We are going to state the obvious, as painful as it is: It is not pleasant for someone to lose their house because they can't afford the mortgage anymore.

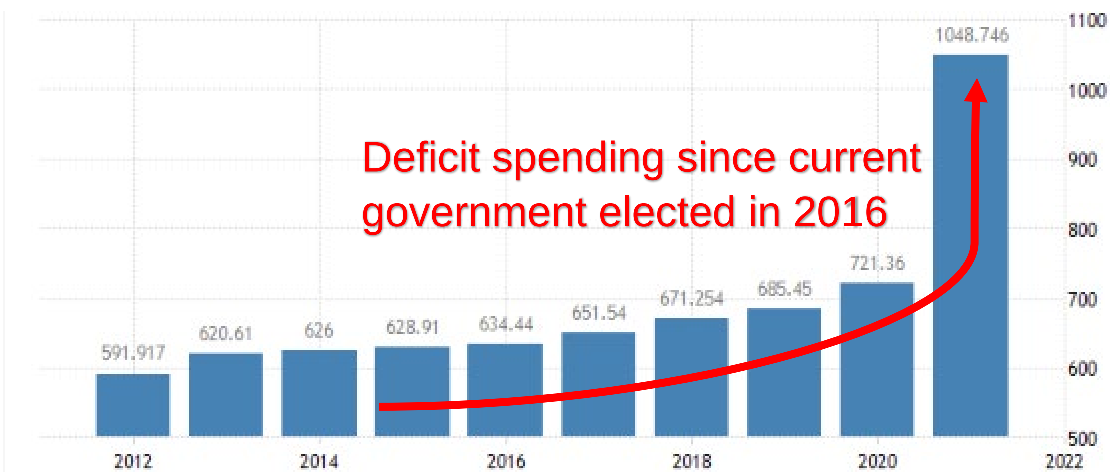
BoC rationale. Our central bank has come under criticism for its inability to forecast inflation. In an interview after the large 1.00% interest rate increase BoC Governor, Tiff Macklem, said *"Front-loaded tightening cycles, typically, lead to softer landings. The other way to put that is, more gradual tightening cycles that end up having to take rates even higher end in bigger slowdown. So, we are deliberately front-loading our policy response. Our objective is to get inflation back to target with a soft landing, and a front-loaded policy response gives us the best chance of achieving that."* [6]

We are not economists, but it has been long established that inflation is caused by the federal government printing money out of thin air. [7] This is what famed Economist Milton Friedman meant by *"Inflation is always and everywhere a monetary phenomenon."* We know the government and media are blaming the war in Ukraine, supply chain, weather, etc. but the simple fact remains that inflation is caused by running the printing presses.

Therefore, to our non-economist minds, inflation should be tamed by 2 things. Firstly, the Government of Canada needs to stop over-spending because that results in printing money. Secondly, and at the same time, the Bank of Canada has to raise interest rates.

Unfortunately, as the next chart shows, we do not think the Government of Canada is going to cut back on its deficit spending. GoC debt increased to CAD $1,048.75 Billion in 2021. We understand countries had deficits from the 2020 pandemic, but the current administration in Ottawa was elected in 2016 and has never had a year where they were not in deficit.

Chart 3: Government of Canada debt has gone parabolic since 2016



Source: tradingeconomics.com/canada/government-debt

Inflation really took hold after a lag period. Likewise, a cut back in deficits will have a lag period before it helps cool inflation – something we do not think the feds are prepared to do. This therefore leaves just the BoC to do all the heavy lifting to get inflation under control.

In 2021's federal budget speech the Minister of Finance, Chrystia Freeland, said *"In today's low interest rate environment, not only can we afford these investments, but it would also be short-sighted of us not to make them."* [8] The word **investments** in this case is a euphemism for a large deficit – that is, printing money out of thin air.
What the Minister of Finance surely knows is such deficit spending is inflationary, which will mainly hurt Canadians on modest or fixed incomes or homeowners who have to refinance their mortgages at higher rates. Any benefits from increases in support programs for

[5] www.cbc.ca/news/business/food-price-inflation-1.6519456
[6] Financial Post, July 13, 2022. Exclusive: Tiff Macklem on the Bank of Canada's surprise rate hike, wrestling inflation and its forecast miss
[7] www.hoover.org/research/inflation-true-and-false#
[8] theprovince.com/opinion/jerome-gessaroli-were-paying-the-price-for-artificially-low-interest-rates

vulnerable or low-income Canadians are now being wiped out by inflation.

Summary:

The Bank of Canada has been left to do all the hard work of controlling inflation. Bank of Canada Governor, Tiff Macklem, has been on the job for 2 years and he is being unfairly criticized for the BoC's handling of inflation. In reality, inflation was caused by the government running the money printing presses. It just took a lag period to finally show up. More interest rate increases are coming and there will be a lag period before the effects of rising rates show up in the economic data.

The stress on homeowners is very real. Earlier, the mortgage market was pricing in an unpleasant but manageable 1.5% *increase* in mortgage renewal costs. As of the week ending July 15, 2022, the market expects mortgages will cost an *additional* 4.5% in rates at renewal over the next 6 months. Households have to pass a stress test before being approved for a CMHC insured mortgage and that threshold is expected to now be 6% for variable rate mortgages and 7% for fixed rate mortgages. [9] What does this mean for sellers of houses? It means a buyer can only qualify for a smaller mortgage, which points to the price of houses is going down. Many Canadians rely on ownership of their house to fund a major portion of their retirement, so this is not good news.

Part 2. Investing to survive economic shocks and inflation

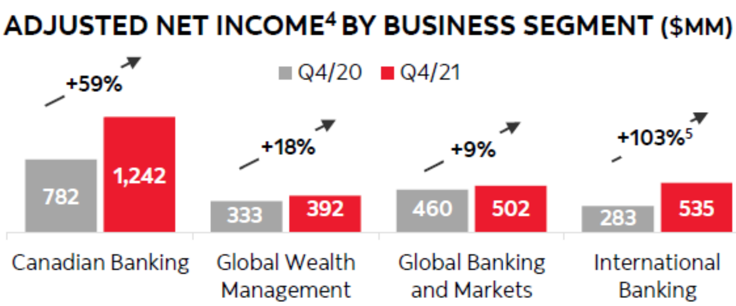
Here is an example of how we will guide clients through the current bear market and inflationary environment (subject to a review of our clients' risk tolerance and other factors). We are going to revisit one of our favorite long-term names, The Bank of Nova Scotia or Scotiabank ("BNS").

We first wrote about Scotiabank in Q1 2018, which was right in the midst of the craze for marijuana stocks. At that time, we said true investing is not get-rich-quick. It is get-wealthy-in-a-sustainable-manner.

Canadian banks are not public services. They are regulated but they are private companies and have a duty to shareholders. Scotiabank's 2021 annual report is 248 pages. We'll condense this to a few key metrics to focus on.

1) How did BNS do in the pandemic? Well, the answer is they did very well. The bank made $9.955 billion for the fiscal year end October 31, 2021. That's almost $830 million in net profit per month or $27.27 million a day, every day, for 365 days. For us shareholders, the net profit translates into $1.97 per share.

Chart 4: 2020 vs. 2021



Source: Scotiabank

2) Credit quality. Banks can (and have) made costly mistakes. But banks will survive if they get one thing right, and that is ***credit***. Credit is the banks' lending process and if they make bad credit mistakes then that is universally the one certain thing to cause a bank to fail. Many consumers will complain about how hard it is to get a loan from their bank, but as shareholders we want our bank to be scrupulous in lending out money only to borrowers who meet the standards required for a loan. Typically, for every $1.00 of credit write-off the bank needs to have over $10.00 of additional loans to make up for that loss. This is why banks are so conservative about lending.

[9] BMO focus, July 15, 2022

Let's take a look at the Provision for Credit Losses ("PCL"), which is the accounting charge taken against net profit for bad debts.

Table 2 – Provision for Credit Losses ("PCL")

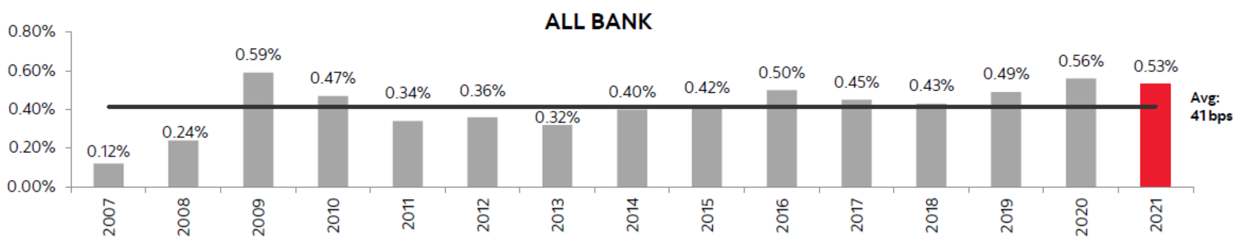
Fiscal year end Oct. 31	2019	2020	2021
PCL ($ millions)	$2,876	$5,929	$1,808
Comment	Pre-pandemic	Pandemic	Normalizing

Source: Scotiabank 2021 annual report, p.19

The start of the pandemic in January 2020 saw the bank's credit loss provisions rise as many customers, such as commercial and business accounts, saw a drop in revenues, which impacted their ability to pay their loans. The good news is that PCLs began normalizing once we began to come out of the pandemic in 2021. This is a good testament to the ability of Scotiabank's management to make appropriate credit risk decisions.

The past 3 years, including the period of the pandemic, did not see a material spike in the Impaired PCL ratio, which is the ratio of Impaired PCLs to total loans. This is excellent.

Chart 5 – Historic Impaired PCL Ratio



Source: Scotiabank

3) Return on Equity ("ROE"), dividend growth & valuation. What drives Scotiabank's share price? The first one is ROE, which is the return that comes from the use of shareholders' money. This is the ratio of net profit to shareholders' equity, the higher the better. The second comes from dividend support. We pay keen attention to dividends, as these are financial rewards to shareholders (namely our clients). In particular we like to see the bank doing so well that they increase their dividends over the long term – which is a rising paycheque to all of our clients. The third item is valuation – namely, how expensive or cheap the stock is. The cheaper the stock, if it has a high sustainable ROE & dividend growth, the more we like it.

Table 3 – ROE, dividends & valuation

Fiscal Year	2019	2020	2021	Notes
ROE	13.9%	10.4%	15.0%	ROE maintained in double digits
Dividend per share	$3.49	$3.60	$3.60	Dividends growing, see next paragraph
Dividend yield	4.9%	5.8%	5.2%	Dividend to Oct 31 share price
P/E ratio	11.2	10.2	10.5	Share price to fully diluted EPS

Source: Scotiabank 2021 annual report, MD&A (p.26) & www.scotiabank.com

The table above shows ROE has achieved double digits in the last 3 years, including the pandemic period.

What the table does not show is BNS rewarded its shareholders after its 2021 year-end. There was a 11% dividend increase in Q1 2022, where the dividend increased from $0.90/quarter to $1.00/quarter ($3.60/year to $4.00/year). This gets even better. For Q2 2022, shareholders were rewarded by a further 3% dividend hike as the dividend was increased by 3 cents to $1.03/quarter ($4.12/year). [10] The dividend growth and history for BNS is impressive and has continued through good times and bad, including through the COVID19 pandemic. You can see this in the next table.

[10] https://www.scotiabank.com/ca/en/about/investors-shareholders/equity-investors/common-share-data.html

Table 4 – Dividend & dividend growth

Fiscal Year	2010	2011	2012	2013	2014	2015	2016	Comment
Dividend	$1.96	$2.05	$2.19	$2.39	$2.56	$2.72	$2.88	Annual for fiscal year end Oct 31 except as noted

Fiscal Year	2016	2017	2018	2019	2020	2021	2022E	Comment
Dividend	$2.88	$3.05	$3.28	$3.40	$3.60	$3.60	$4.12*	* Dividend is annualized from Q2 2022 onwards

Source: Scotiabank [8]

Summary. The current 2022 bear market in the Canadian stock market has taken the shares of BNS from $90.85 on January 1, 2022, to $73.60 on July 18, 2022, a 30% drop year-to-date. The combination of reasonable valuations (high dividend yield, modest P/E), high and up-ticking ROE, and regular dividend increases makes owning BNS particularly compelling. BNS has demonstrated it is capable of surviving world wars, pandemics and economic shocks since its inception and we see no reason it won't prosper through the current inflation cycle.

Scotiabank has been in business since 1832, longer than Canada has been a country. Scotiabank declared its first dividend on July 1, 1833 and has never missed an annual dividend payment since that date – an outstanding outcome for shareholders. [11]

We don't have to go back to 1832 to make our point. A purchase of 100 shares of BNS on January 1, 1990 would have cost you $1,625. That's a reasonable amount most retail investors can afford. BNS also has a dividend reinvestment program where dividends are automatically used to purchase additional shares. If you reinvested all the dividends back into the shares, here is what your holdings will look like on July 18, 2022:

Chart 6 – Bloomberg Total Return Jan. 1, 1990 to July 18, 2022

Source: Bloomberg

Dividends: each "D" is a dividend

Total Return 6,600% = 13.78% annual compound

From Jan. 1, 1990 to July 18, 2022 you would have received $6,370 of dividends – this paid for your initial purchase almost 4-fold. If you had re-invested the dividends, your investment is worth over $107,000 on July 18, 2022 – a 66-fold increase. Put another way, your total return including reinvesting dividends is over 6,600% over 32.5 years, which works out to a compounded annual growth rate of 13.78%.

[11] https://www.scotiabank.com/ca/en/about/investors-shareholders/equity-investors/dividend-history-and-stock-split.html

Summary. This tremendous return illustrates the power of compounding for a blue-chip dividend growth company with high/expanding ROE over the long term.

Part 3 - Conclusion

Canada's inflation rate is a horrific 8.1% for June 2022. If we want our investments to keep up with the cost of living, the answer is to buy high quality dividend growth stocks. All clients with an equity component to their portfolio will own BNS, either directly or indirectly through Exchange Traded Funds. The recent pullback in the share price makes BNS all the more compelling.

However, we are not recommending you run out and buy BNS on your own. You should have a conversation with our portfolio managers about your risk tolerance and other factors and we remind you that a direct holding of BNS is for clients with a sufficiently long investment horizon.

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Thank you for entrusting us with your investments. As always, we welcome your questions and comments. You can contact GIM by telephone: 1.888.436.9955, fax: 1.866.541.7947 or email: invest@gold-im.com.

Yours truly,

GOLD INVESTMENT MANAGEMENT LTD.

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