Rates, Rates, Rates…

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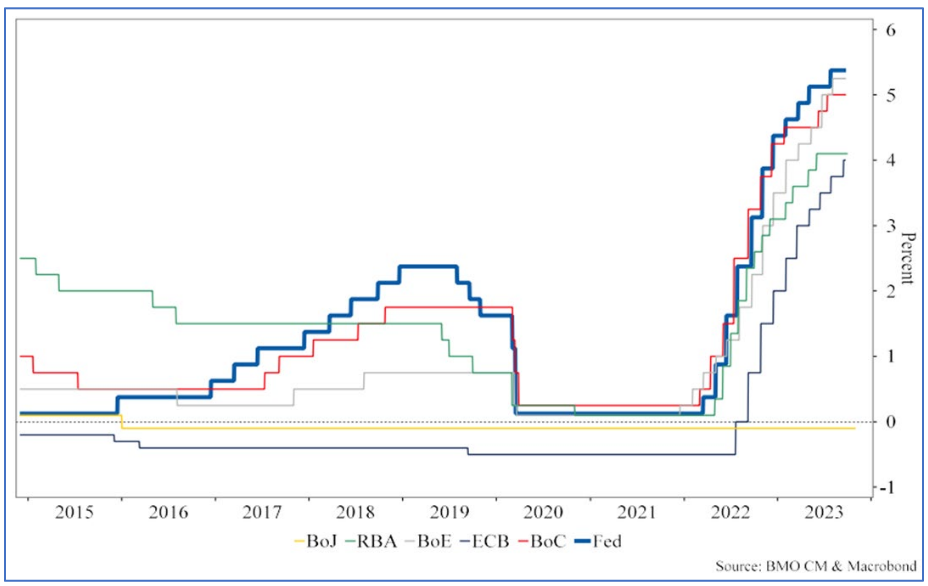
Recent Interest Rate Changes

There are many aspects of our lives that are affected by interest rates. The biggest effect for most people is their mortgage rate, as housing debt is generally one's largest interest-bearing obligation. The prime rate is also impactful if you have a line of credit or run a business and have a loan outstanding. In financial markets, interest rates are very consequential. They impact direct costs for consumers, businesses and governments that borrow, as well as banks that borrow and lend. They also affect many financial assets as their prices are related, and somewhat derived, from a theoretical risk-free interest rate. The absolute level of interest rates is normally a function of long-term inflation expectations, growth projections, and bond supply and demand dynamics. Given structural changes to these factors, interest rates have been volatile over the last two years and increased considerably after a 40-year downtrend. Short-term policy rates controlled by central banks have been ratcheted higher over the last 18 months to try and tame inflation, as seen in the graph below. The only outlier is the Bank of Japan as that economy has struggled with deflation for two decades, but the rest of the western world has been struggling with inflation and rapidly increasing short term interest rates. The problems for the economy and financial markets are the velocity in the move in short term interest rates, and the uncertainty of the future path of rates.



Macro Consequences

Perhaps even more consequential and problematic for financial markets are rising longer-term interest rates, especially the 10-year United States Treasury bond. Longer-term rates are not influenced by central banks, but rather on market factors of supply and demand for government bonds. In fact, voicing his frustration at how the bond market was pricing bonds in the 1994 bond market crisis, one interesting United States political commentor, James

Carville, once said that if he could be reincarnated, he "would like to come back as the bond market. You can intimidate everybody". He was referring to the consequential reaction from bond traders and investors as longer-term bond yields were rising in the early 1990's in response to the fiscal and monetary instability and uncertainty at the time. The principle is the same: rates for longer-term debt, especially in the United States (over $40 trillion US dollar debt market) which functions as the world's reserve currency, are extremely impactful for all asset prices and the global economy. The United States government is currently running a 6% budget deficit, spending 6% more than they receive in revenue annually. While the United States economy could weaken, and inflation fall further from recent declines, solving some debt sustainability problems, it appears unlikely that fiscal deficits will decline in the short-term. The pricing in of higher long-term interest rates, compressing equity risk premiums, and higher discount rates, have been leading to lower asset prices. The 10 year United States Government Bond is at its highest rate in the last ten years as illustrated in the graph below. It is in everyone's interest (pun intended) that this trend does not continue. The short-term outlook appears worrisome, as growing debt clashes with higher interests, geopolitics, and economic uncertainty.

Some comfort, however, should be taken from the fact that various sectors of the stock market have been incorporating the "higher for longer" interest rate narrative and now present good value, though not without some pain as those sectors have re-priced. Investors should remember that, in the long-term, stocks are good inflation hedges, and their dividends will continue to rise – providing some buffer should rates rise further from here.

In conclusion, investors should expect further volatility in prices, as the stock market continues to adjust to a new interest rate regime. If you are concerned about your higher mortgage rate or line of credit, do know that higher rates are causing stress throughout all financial markets. However, they are also providing you with higher yielding assets from your fixed income and dividend paying-stock investments. As your dedicated team of portfolio managers, we are committed to monitoring the behaviours of the markets with intentions to maximize your returns in any economic environment, and for the long-term.

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Portfolio Commentary – Parkland Corporation

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Last year, BCV added a new position to client portfolios, a company called Parkland Corporation. We wanted to use this edition of The Blue Chip Report to provide an overview of the company and to explain the rationale for making this investment.

Parkland is an independent marketer and fuel distribution company. They operate an extensive retail fuel and convenience store network under the following brands: Chevron, Ultramar, Esso, Fas Gas, and Pioneer. The commercial segment delivers bulk fuel, heating oil, propane, lubricants, and other petroleum products to industrial and residential customers across North America. Their supply segment provides fuel distribution through third-party contracts and fuel storage. They also own and operate a refinery located in British Columbia.

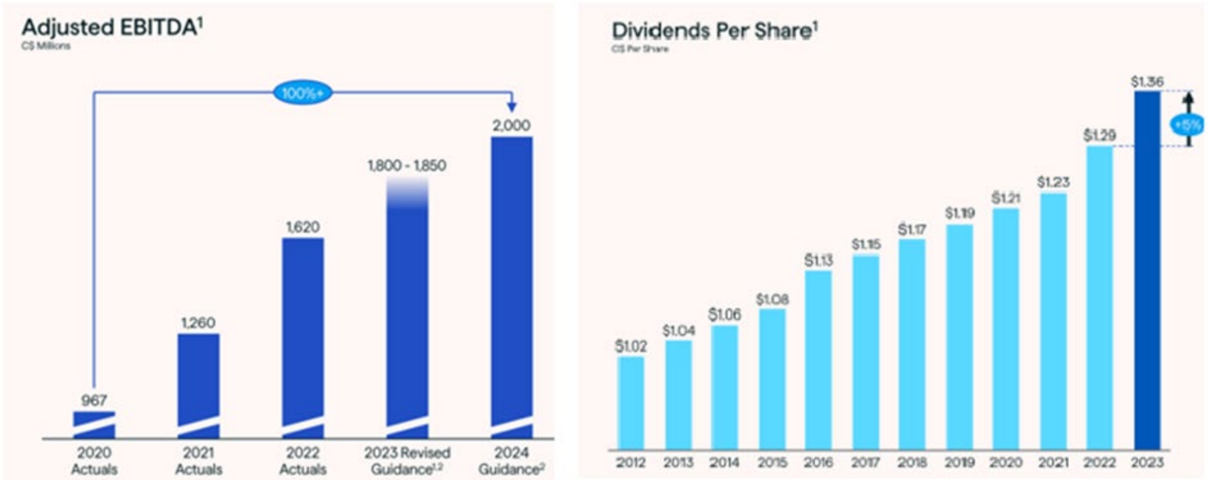
Over the last recent years, investors became concerned with the increasing adoption of electric vehicles and declining North American fuel consumption; as a result, Parkland's share price became deeply discounted from company fundamentals. BCV appreciated the company's strategic transition, competitive advantages, and superior execution and proven business model.

Parkland's strategic transition is focused on developing, diversifying, and decarbonizing. The company emphasized growing their retail convenience segment to offset traditional declines in fuel demand. They are targeting for retail to comprise 55% of EBITDA in 2030 compared to 45% of EBITDA in 2018, and for refining to comprise 40% of EBITDA in 2018 to 15% of EBITDA by 2030 (EBITDA stands for earnings before taxes interest depreciation and amortization, which is a proxy for cash flow).

Stand-alone convenience stores are being built, which is a convenience store without fuel. They have rebranded formerly acquired sites to a brand called "On-The-Run," which are seeing a 30% lift in same store sales volumes. They introduced a loyalty program called Journie Rewards, which has accelerated same-store sales growth and has provided insight into data customization by providing personalized offers to customers. Journie is becoming one of the top retail loyalty programs in Canada. Other initiatives include partnering with quick-service restaurants to promote fresh food offerings, launching higher-margin proprietary convenience products, optimizing store formats, and investing in digitalization.

Parkland has also been growing internationally both organically and through acquisitions. In the Caribbean, financial results have been exceptional in Parkland's commercial/wholesale business, where Parkland has used its supply advantage to provide shipping, logistics and storage infrastructure to serve customers across multiple industries. Countries in the Caribbean are also growing faster than in North America, which has contributed to strong fuel and convenience same store sales volumes.

Parkland has demonstrated superior execution on financial targets. In 2021, Parkland laid out a target to double their EBITDA by 2025. Parkland recently announced that they met this target one year earlier than expected. Growth has been accelerated through organic growth across all business segments, company divestitures, synergies captured from acquisitions, and operational cost savings. Additionally, Parkland has a history of growing its dividend and returning capital to shareholders. Analyzing the company's merger and acquisition history, they have been able to deliver synergies ahead of targets while paying down debt. Looking at the company's history, from 2016 to 2022, fuel volumes have grown by 20% per year, adjusted gross margin has grown by 22% per year, adjusted EBITDA has grown by 23% per year and distributable cash flow per share has grown by 10% per year. Year-to-date, Parkland has returned 38%. We are confident that Parkland is a solid investment to add to client portfolios at this time.



Source: Company Reports 2023

BCV's Online Client Portal - SideDrawer

Dale Hawthorn, CPA, CA

President & Chief Operating Officer

As communicated in the last editions of the BCV Blue Chip Report, BCV is offering clients the opportunity to access their client statements and other pertinent information electronically on our new client portal hosted by SideDrawer. If you have received an onboarding email directly from SideDrawer, please use that email to setup your access to the platform. If you have misplaced your onboarding email from SideDrawer or somehow did not receive one, please use the following steps to get your access:

1. Visit http://bcv.sidedrawer.com.
2. Enter your email address. The email used for your access configuration is the one provided to BCV during our initial information gathering process in signing up as a client with BCV. If you do not know which email address to use, please contact SideDrawer support at support@sidedrawer.com.
3. You will then be asked to create a password. Please do so in accordance with the requirements noted.
4. Save the link in #1 above to reference in the future when accessing your information.

If you have more than one set of statements (for example: a personal and corporate set of statements), both will be accessible on the right-hand side of the dashboard (they appear as circles that can be clicked on which brings you to the details for that entity).

If you have any questions or require further assistance, please contact SideDrawer support at support@sidedrawer.com.

If this is your first time receiving a BCV quarterly statement (ie: you are a new client to BCV within this quarterly reporting period), you may not yet be set up. However, please know that we are working to have this access provided to you as soon as possible and be on the look out for your welcome email from SideDrawer.

Thank you for your continued trust and support and we look forward to enhancing your experience with BCV.