The Forticus Lifestyle Fund

2020 - Review Quarter 1 and Quarter 2

The FLF is a dividend growth investment (DGI) business, initiated in 2015 to fill the pension gap.

Summary

+ Dividend income reached The Goal set for 2023 – to fill the pension gap.
+ Update: The Pension Gap Model.
+ Freezers, cutters, suspenders and a drifting currency exchange rate did impact.
+ New Goal: Increase dividends collected in dollars by 23%.

Overview

In the first quarter of 2020, dividend income reached both

an alltime high, and

The Goal set for one year after retiring: to cover 40% of household expenses.

In 2014, retirement was scheduled for 2023. Plan A was replaced by plan B in 2018. A major audit of the family‘s master plan retired us in 2019. Now, one year after retiring the fund is on track.

The portfolio‘s market value reached an alltime high mid of January. With Covid-19 the market finally got its long awaited chance to let off some steam. Market value of the fund mostly recovered by end of June.

Share buys in the first quarter projected an increase of dividends in the second quarter. Lowered outlooks in reponse to Covid-19 let to divdend freezes, cuts and supenses, plus a negative trend in currency exchange rates sent income to below the pension gap amount.

Capital and Yield

The parameters to track capital are: Capital Base, Inflation Basis, Cost Basis (on Cost) and Market Value. All four include the cash position. Overall weighted yield is tracked for all four.

Capital Base	all deposits made to the broker account,
Inflation Basis	the Capital Base corrected for inflation, annually, Jan. 1st, used to protect the base‘s purchasing power from withdrawals.
Cost Basis	cost of holdings plus available cash. used to track the cash position in percent and holdings in units of full position equvalents (FPE), should stay above Inflation Basis.
Market Value	a virtual number, includes tax and health insurance 50% off capital gains, used against Inflation Basis to limit withdrawals, should stay above Cost Basis.

On January 1st, inflation basis was 1.3% above capital base.
While accumulation had begun in 2015, two thirds of deposits were contributed in 2019.

The annual budget audit raised a deposit of 5% to the capital base in March.

Market value was	19%,	1%,	14%
above inflation basis on	Jan 1st,	Mar 31st,	Jun 30th.

In 2019 we had opened a second broker account for tax matters, and split holdings into high and low-to-non yielders. All are maintained as one portfolio.

I‘d prefer to state a forward yield but messed up the spreadsheet. So its dividends received in Q2 over capital of June 30th:

	Capital Base,	Inflation Basis,	Cost Basis (oY),	on Market Value
Portfolio overall	3.0%	3.0%	2.9%	2.6%
Account #1	3.6%	n.a.	n.a.	3.7%
Account #2	1.2%	n.a.	n.a.	0.65%

Dividend Income

Dividends of Q1 were 7% over Q4/2019 and Q2/Q1 was -2.7%.

Stock buys in Q1 should have led to an increase of income in Q2. The projected increase was not recorded.

Of the negative 2.7%, some 0.6% can be related to a worsened currency exchange rate.

In Q1, 14 holdings routinely payed a higher dividend.

In Q2, 12 holdings routinely payed a higher dividend.
Exxon Mobil (XOM) declared the same dividend for Q2, a freeze.
Suncor (SU.TO) raised by 10.7% in Q1, but in Q2 cut back to half of 2019/Q4.
Kontoor Brands (KTB) did not pay.
Simon Property Group (SPG) did not pay and announced lower dividends for Q3 and Q4.

The broker withholds 15% tax on dividends. Another 12% are claimed by our country and payed out of the checking account. The remaining 85% will be (re)invested, until needed to fill the household‘s cash buffer.

Dividend Forecast

On basis of the current pandemia situation, more dividend cuts and suspenses should be taken into account. I take dividends of Q2 as forecast plus a motivation to turn cash into income.

Disney (DIS) will not pay a dividend for H1 in July, announced in May.
DIS is in the account with a limit on dividend income, so I do not mind for now but will keep an eye on analyst reports.

Lowe‘s (LOW) declared the same dividend for Q3, a freeze.

Looking back 10 years, the USD/EUR rate varried between 1.05 and 1.40. The next goal for dividends income could be to raise the amount of dollars to achive some margin of safety for the pension gap. Based on the current exchange rate of 1.14 some 23% more dollers might cover a an exchange rate of 1.40.

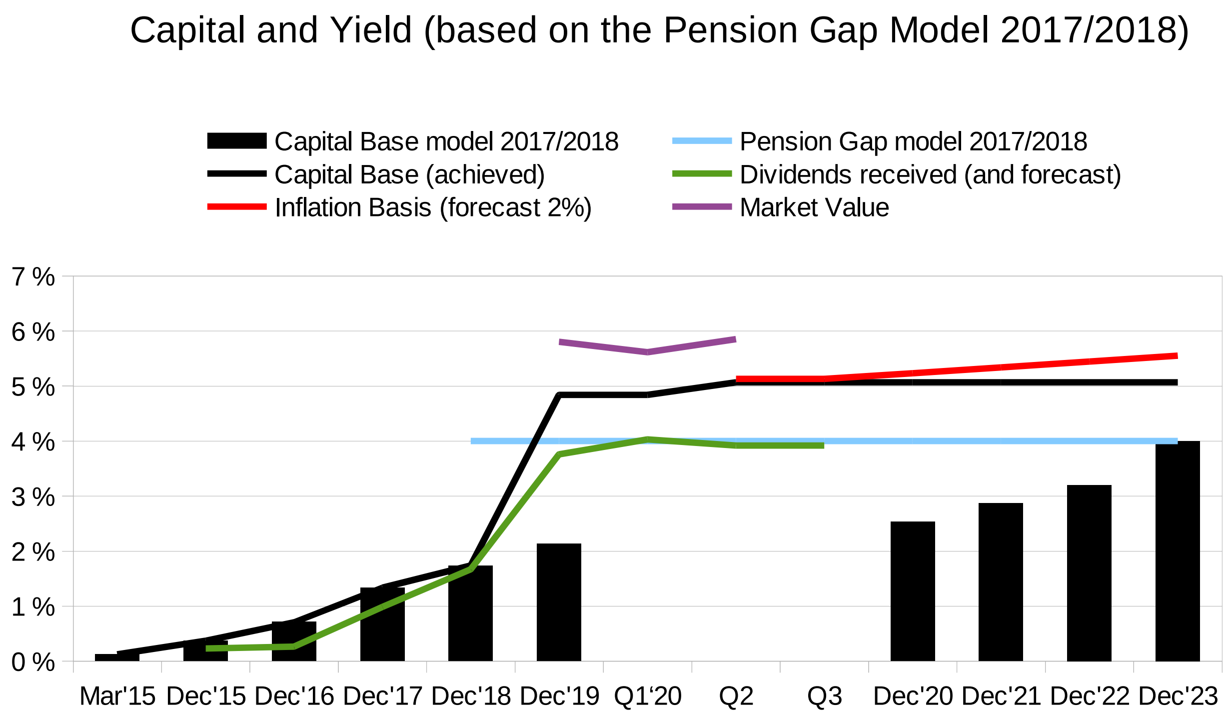
Cash invested and dividend growth can be assumed to add up to such 23% until 2023.

(for next review: place forward DGR guesstimate here)

The Pension Gap Model

The following chart shows capital and dividends on basis of a modell from 2017/2018.

In this scenario, the blue line represents the amount of money needed before tax, to fill the pension gap. The black columns show the model's accumulation plan towards 2023.
All data are scaled to 4% of the projected capital base of 2023.



The black line indicates the achieved capital base. The red one shows inflation dasis and magenta the market value. The Cost Basis, not shown, sits between Capital Base and Market Value.

The green line shows dividends received with an indication towards Q3.

This year the Capital Base reached a level 25% higher than required by the original model. This allows to run the portfolio a bit growthier and at an average yield on cost below 4%.

The red line appears a bit steep. I will review the data. However, at an compound average dividend growth of 7%, income eventually will reach escape velocity around 2023/2024, when the green line at a steeper slope grosses the red line.

Transactions

On Jan. 29th, two remaing lots of CSCO and PG were transfered to the high yielder account.
Same day I added to CSCO, PG, XOM, SPG, PFE, IBM, RY.TO, TD.TO und SU.TO.
Then this account was out of cash.
In March, fresh cash was contibuted to the high yield account.

On March 23rd, positions were opened for GOOGL, V and MA
Same day I added to BRK.B, LOW, DIS, UNH, AMZN, AAPL.

Q2: no transactions. KTB flagged to close, since autumn 2019.

End of June there were 48 holdings with a target of 40 within 2 years.
10% cash remain.

Portfolio Structure

Portfolio structure per weight on cost, June 30th (no changes since March 31th):

Supersectors	
Defensive	36%
Sensitive	30%
Cyclic	24%
Cash	10%
Sum	100%

CR (S&P)	cost basis
AA- … AAA	35%
A- … A+	39%
BBB+	8%
BBB (MO, CVS, T, GIS)	9%
BB-/B+ (KTB)	0,1%

CCC Years	cost basis
50 …	17%
25 … 49	15%
13 … 24	13%
5 … 12	36%
AMZN, BRK.B, GOOGL	6%
0 (CVS, GIS, KTB)	4%

The quality of the structure by

supersectors	is	satisfying.	The defensive supersector should grow to 50%.
credit rating	is	good.	CVS, GIS on hold. MO, T are on fill to full position.
CCC years	is	expandable.	Concentrate adding to 13+ years.
sectors (next page)	is	mixed.	Healthcare, Technology and Financials sum up to 42%. Investigate an emotional bias of the fund manager.

There are some restrictions in place to reduce possible risks of dividends and subsequent impact on stock price, e.g. minimum credit ratings for Financials (AA-), CCC years for Industrials (25), ”do not add to freezers”, and more. With the ongoing crisis, I lifted ”do not add” from BBB to BBB+ and ”do not open” from BBB+ to A-. Yet, MO and T still are on ”add ”.

Sectors		Sorted by cost basis, underlined = 1 FPE
Cons. Staples	10%	MO, KO, PG, HRL, PEP, GIS, HSY
Consumer Retail (1)	5%	CVS, AMZN, TGT
Healthcare	17%	PFE, JNJ, AMGN, ABBV, GILD, UNH, MDT
Utilities	5%	D, DUK, SO, NEE
Telecom & Media	7%	DIS, T, GOOGL
Technology	13%	AAPL, IBM, CSCO, MSFT, V, MA, TXN
Industrials	3%	MMM
Energy	7%	XOM, SU.TO, CVX
Cons. Discr.	5%	LOW, VFC, MCD, NKE, KTB
Financials	12%	TD.TO, RY.TO, BRK.B, BLK, TROW
REIT	6%	SPG, O, NNN
Basic Materials	0%	
Cash	10%	

Quality Management System (QMS)

There are several layers of quality management for the portfolio.

+ Walks in the forests to discuss ideas either with my wife or my self.

+ A written document titled ”Bussiness Plan of the Stock Portfolio”, which is reviewed and adjusted once a year. It includes general guidelines and milestones for upcomming years based upon walks in the forests. A section ”Emergency Exit” shall support heirs to a well-considerd close if so required.

+ Quarterly reviews of the portfolios by analyzing spreadsheets and diagrams. Often presented in the forests, rarely reported in print. Notes from walks help the quality of the bussiness.

+ A set of rules and targets, partly integrated in the spreadsheet.

Rules and Targets

The following were indroduced or changed:

Credit Rating

Score		use a blend of S&P and Moody‘s.	
Minimum general	to open	raised from BBB+ to A-	for new positions
	to add	raised to BBB+,	exceptions are MO and T
Minimum Financials		AA-	
Trigger	to close	BBB- and below,	KTB flagged

Full Position Equivalent		a unit for Euro per full postion, 1.0 FPE, used to allocate cash and weightings on Cost Basis, example: 1 FPE sold for a loss of 40% becomes 0.6 FPE.
1.0 FPE for 2020	revised Q1	Euro/FPE raised by 25% to 1/32 of Cost Basis, to steer the number of holdings (48) towards 40.
FPE buy limit	revised Q1	from 0.25 to 0.2 * (FPE / stock / 3 months) (Euros unchanged)

Portfolio Structure Targets	weighted by cost basis	
No dividend payer	≤ 4 FPE, used also to keep any experimental moves in frame.	
Credit rating (blend)	≥ A- / A3	80%
CCC years	≥ 13	70%
	≥ 25	if CR ≤ A-
Supersector Defensive	reach	50%.
Sectors	≤	20%

External parameters	which influence portfolio management
Cash Buffer	a number of years of cash outside the portfolio to cover the pension gap plus other provisions. A guesstimate in 2019 of 8 was specified to 5 (2021-2025).

Scoring of Fundamentals

Annually, twelve parameters from annual reports get scored, biased towards growth of intrinsic value of the companies. It forces my to check the fundamentals of holdings at least once per year and allows comparison within and accross sectors. The method is still under development. Recently, I described it in a blog post at seekingalpha.com.

As a guideline, companies should score 6 ouf 12 to qualify as a low grow high income stock. Cycling bussinesses, e.g. oil/energy, seem to hover below 5 of 12.

Conclusions

In 2020/Q1, dividend income reached the benchmark to fill the pension gap, originally projected for 2024/Q1. The cash position of 10% turned into additional income and dividend growth should stablize income above the gap level by 2021. Dividends will be (re)invested until needed to fill the household‘s cash buffer, currently assumed for 2022. However, …

… the currency exchange rate may work against the plan.

Dividends in dollars should be increased by 23% within three years.

Herewith set as a new benchmark.

For Quarter #3:

Review freezers, cutters and suspenders, and flag them to sell, hold or add.

Determine and integrate some more parameters, e.g. a DGR forecast and weighted beta.

Save spreadsheets each quarter, if not per month, as a backup and to enable audits of past activities and decissions.

Disclosure
Long stocks as mentioned in this document, until not.

Disclaimer
I am a retail investor. You are to free to try out the methods or stocks described in this document and you are free to blame yourself, if in consequence you go bankrupt.