INVESTMENT WEEK

Middlefield trust: Oil and gas companies have 'unheard of' levels of cash

Five companies in portfolio

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Dean Orrico, manager of the Middlefield Canadian Income trust

Dean Orrico and Rob Lauzon, managers of the £183.7m Middlefield Canadian Income trust, are feeling confident in their home market of Canada with 95% invested in the country, up from about 70% two to three years ago.

The trust has the ability to invest in Canada as well as the US, although as the name suggests the managers tend to put the majority in the Canadian market. Even so, the current mix, which sat a 95.9% Canadian and 4.1% US as of the end of May, is regarded as quite bullish.

"We feel so strongly about the outlook for Canada that we think this is the best allocation of capital," said Orrico.

Two key areas of the market the managers like are energy and real estate, which make up about 30% and 20% of the portfolio, respectively.

Oil and gas companies had previously been suffering from a lack of investment in Canada, according to the managers, who they said was partly because Justin Trudeau, the nation's prime minister, is "the most aggressive and environmentally focused" leader they had ever seen.

However, since Russia's invasion of Ukraine, Trudeau has started to "make some overtures about supporting, or at least not doing anything to hurt" the industry.

Canada is the fourth-largest energy producer in the world and as countries look to shift their reliance on Russian gas, the managers expect companies in the nation to be a long-term beneficiary.

"These companies are going to be producing such high levels of cash flow that they are going to be able to maintain current levels of production, increase their dividends and increase their buybacks," said Orrico. "We think virtually every one of the five gas producers in our portfolio will be in a position to be debt free, come the first quarter of next year. This is unheard of."

The managers highlighted the trust's largest holding, Canadian Natural Resources, which makes up about 5.2% of the portfolio. Orrico said it had increased its dividend by an average of 22% over the last 22 years, with the most recent increase being 30% - an increase he expects the next one to maintain.

The manager went on to say they take a "barbell approach" to traditional energy generation and renewables. They have about 15% in both at the moment but would expect it to sway toward renewables as technology improves.

Rising real estate

Another big bet for the managers is real estate, of which they have significantly more than the S&P/TSX Composite High Dividend benchmark, which only has about 5% in the sector.

The managers are positive on real estate in general due to its reliable income, however they shift allocations within the area depending on macroeconomic factors. At the moment, they are feeling most confident in the residential sector, which is seeing rent increases of 8-10% this year.

The trust holds a number of apartment REITs that are trading on a discount, which they think represent good value due to the high levels of immigration into the country and low levels of housing.

Separately, after some analysis, they remain confident in industrial real estate. Orrico noted the recent announcement from Amazon that they had expanded too quickly in this area gave him pause for thought.

However, they determined the supply-demand dynamics were still favourable because that every other retailer is still "in the cycle of expanding", and Toronto, which is the second largest real estate market in the North America, has a less than 1% vacancy rate.

The manager added that deglobalisation will be another positive factor.

"Retailers are now going to start basically onshoring a lot of their activities," he said, noting that he was hearing directly from real estate brokers that companies are looking for more space.

The trust is trading on a 16.3% discount, according to Morningstar. It has returned 40.2% across three years, compared to the IT North America sector, which returned 35.8%, according to FE fundinfo.