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# Weekly Commentary

Issue **No. 31** | **JULY 20, 2020**

*By Charles Marleau, CIM*

# Logistics, Logistics, Logistics

There's an age old saying that the **"three most important factors in retailing are location, location, and location."** Historically, this has made perfect sense as the primary goal of any retailer is to generate instore traffic. Attributes like major thoroughfare access, parking, mall attractiveness and proximity to public transit formed an important list of considerations when determining an optimal location.

Sadly, the Covid-19 pandemic has had a devastating impact on traditional "brick and mortar" retailers. In 2020 alone, iconic brands like Brooks Brothers, J.C. Penney, Aldo, J. Crew and Pier 1 have filed for bankruptcy protection. With more store closures sure to follow and with the exacerbation of the stay-at-home economy, the way we shop for everything from apparel, shoes, electronics, and household products has possibly changed forever.

In my last letter *(FedEx and Walmart: U.S. Powerhouses Fueled by E-commerce, July 13)*, I wrote about the emerging winners that will benefit from the explosion in e-commerce. From a Canadian perspective, I made mention of shipping/transport companies like Cargojet (air freight) and TFII International (ground transport). I further highlighted that rapidly growing, technology-focused, stalwarts like Shopify, Lightspeed, and Kinaxis are well positioned to capitalize from the boom in e-commerce. Of course, the overwhelming beneficiary has been Amazon.

The Amazon success story has ushered in a new era where consumers have grown accustomed to shopping from the comforts of home and having items delivered to their doorstep in an astoundingly rapid fashion. Major retailers like Walmart and Target have responded by enhancing their own e-commerce infrastructure to better compete. Smaller retailers that recognize the changing retail landscape are equally upping their games. As consumer increasingly shop by "clicking" on their iPhones and iPads, we are seeing a ballooning demand for logistics, which encompasses the warehousing, order processing, and physical delivery of goods. As online shopping proliferates, the key to success for any retailer will revolve around its logistics capability.

In two recent letters, I wrote about two companies we hold in the Palos-Income Fund; WPT Industrial REIT (TSX: WIR-U) and Dream Industrial REIT (TSX: DIR-U). WPT is a Canadian based real estate investment trust that invests in industrial properties in the United States while Dream Industrial focuses on the Canadian market. With industrial focused portfolios and a tenant base that is dominated by logistics-oriented businesses, both WPT and Dream find themselves insulated from exposure to vulnerable portfolios that focus on properties reliant on the retail, commercial and office space sectors. As e-commerce players scramble to build out their logistics capabilities, the demand for the industrial space that is required to accommodate the need for more fulfillment centers, will rise dramatically.

Strengthening demand for fulfillment centers will create a highly competitive environment for industrial space. The industrial REIT sector should benefit from its focus on a sustainable, high-quality portfolio of tenants who first and foremost, will have the capacity to pay the rent. Increasing scarcity should further result in a growing willingness for tenants to sign longer-term leases and accept a rise in rent obligations. Considering the dramatic changes we are seeing as retailers transition from the traditional “brick and mortar” retailing landscape to online shopping, it may be a matter of time before we see a new retailing mantra of **logistics, logistics, and logistics**!

*Disclaimer: Palos Funds are shareholders of DIR-U, WIR-U.*

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| Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1] | FundServ | NAVPS | YTD Returns |
|---|---|---|---|
| Palos Income Fund L.P. | PAL100 | $7.34 | -8.19% |
| Palos Equity Income Fund - RRSP | PAL101 | $5.30 | -6.35% |
| Palos Merchant Fund L.P. (Dec 31, 2019) [2] | PAL500 | $1.71 | 20.15% |
| Palos WP Growth Fund - RRSP | PAL210 | $8.19 | 6.99% |
| Palos-Mitchell Alpha Fund [3] | PAL300 | $8.22 | -20.80% |
| S&P TSX Composite (Total Return with dividends reinvested) | | | -3.73% |
| S&P 500 (Total Return with dividends reinvested) | | | -0.89% |
| S&P TSX Venture (Total Return with dividends reinvested) | | | 17.08% |
| **Chart 2: Market Data [1]** | | | **Value** |
| US Government 10-Year | | | 0.63% |
| Canadian Government 10-Year | | | 0.53% |
| Crude Oil Spot | | | US $40.59 |
| Gold Spot | | | US $1,810.00 |
| US Gov't10-Year/Moody BAA Corp. Spread | | | 269 bps |
| USD/CAD Exchange Rate Spot | | | US $0.7364 |

[1] *Period ending July 17, 2020. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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