The Dividend Value Discipline™
Market Commentary
1st Quarter 2010

Market Commentary

The objectives for **The Dividend Value Discipline™** remain unchanged – income every month, an acquisition process where we buy **only** those securities which become attractive on a "go forward" basis, and absolute returns of 8%+, each and every year.

Investor attitudes within the first quarter of 2010 were volatile – nervous excitement gave way to bearish sentiments and finally, optimism was regaining some ground as we closed out the quarter. The net result was a "churning to sideways" market, where one had to buy and sell opportunistically to make much progress. While it is not as easy as the "buy and hold" days, it is the hand we are dealt and we continue to operate accordingly.

Most program participants posted returns in the +3% range. If you recently joined the program your results will be less, although still positive. As you are aware, no two accounts are exactly alike, due to the ***"buys only"*** process and different start dates. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly reporting package.

Major Equity Transactions Since December 31, 2009

On the sell side, our first major transaction of the year was the sale of energy producer **Encana** at $35.65 per share. Although we like the company, we just couldn't see the price getting much better in the near term. Thus far we have been right. Using a similar rationale, we chose to sell **Crescent Point Energy** in mid-February, just north of $38.00. Both trades were highly profitable and both firms are good (if not great) companies. Please don't be surprised if we end up owning them again.

The next sale was nitrogen fertilizer producer **Terra Industries**, a company which has had several suitors over the past year. In early February, suitor CF Industries announced they were discontinuing their fight for control and within days, Norwegian fertilizer producer Yara International made an all cash offer of $41.50 per share which was supported by the Board – good as done, I thought. Faced with sitting around for the last 2% for the next few months, we opted to sell at $40.71, which was very close to what we believed Terra to be worth. Post that sale, CF came back with another offer (stock and cash) equivalent to $47.40, and of course the stock moved up accordingly. Yes, it was frustrating, but we attempt to focus on progress not perfection. We remain grateful that our original buy price was just over $35.00 per share and we collected a $7.50 dividend during the hold period.

In early March, we sold the last of our **Overseas Shipholding Group** at $45.00 per share (with sizeable gains) when the company announced a secondary equity offering which would dilute our ownership interest. Apparently the rest of the investment crowd has caught on, as the stock closed out the quarter below $40.00.

Canfor Pulp Income Fund was next. We sold the last of our position at $11.80 per unit. Our rationale was simply, "Can the news get much better?" Closed plants and tight inventories have led to record high pulp prices. Plants are now coming back into production. Canfor has been a painful ride and we are extremely grateful to have exited with a modest gain. We are also thankful for having the tenacity to hold the position through the worst of the commodity bust. It is hard to believe that the units actually traded to a low of $1.30 per share in March of 2009. What a difference a year makes!

With respect to new equity positions, in late January we acquired a sizeable position in global medical supplier **Becton Dickinson**, a company that was surfaced by our in-house analyst, Howard Ma. Becton gets very close to "great company" status – they hire from within, have a flat organizational structure, are passionate about what they do, and have significant and diverse insider ownership. We find the value proposition compelling

and we see it as basically a recession-proof business because its products are used in essential medical care. The company is based in the U.S. but over half of its revenues are from international sources, including higher growth regions in Asia and Latin America. The 2% dividend appears modest until you consider that over the past 5 years, that dividend has grown at 17% per annum.

The last new equity position to be added was insurance broker **Arthur J. Gallagher & Co.**, purchased on February 19th at $23.17, with a 5% dividend yield. Arthur J. Gallagher is an insurance broker as opposed to an underwriter – in other words, far less risk in our opinion.

Major Fixed Income Transactions Since December 31, 2009

By the third week of January, we eliminated our long term government bond exposure by selling the **Canadian Long Bond Index iShares**. Our rationale – we did not (and still don't) see a double dip recession coming anytime soon and our deflationary concerns have given away to inflationary concerns, making long term government guaranteed bonds unattractive.

On February 25th, we effected a tax motivated sale in all non-registered accounts with a simultaneous buy of the **Progress Energy Series A Convertible Debentures** at $103.10, in all registered accounts. The non-registered holders realized a capital gain which is only one-half taxable. If they were to hold the debentures to maturity, the capital gain would disappear and the interest income would have been taxed at the full rate. Doing the math, a non-registered holder would make approximately 2% (annualized) over the next 18 months, after tax. Thus, the value proposition was fast becoming unattractive in non-registered accounts. In registered accounts, the approximate 4.5% yield to maturity continues to be a reasonable value proposition.

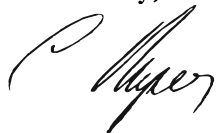
On March 16th, we sold all of our **First Capital Realty Inc. Series D Convertible Debentures**, when it became apparent that the company would likely choose to pay the semi-annual interest payments in common shares, as opposed to cash. Simply put – this was not our objective in owning same.

Finally, in the last days of the quarter, an uptick in interest rates and front page news on increasing mortgage rates gave us the impetus to bolster the fixed income side of our program. On March 25th & 26th, we acquired positions in **Rona Inc. bonds** maturing in October 2016 (5.12% annual yield to maturity), **First Capital Realty Inc. bonds** maturing in January 2017 (5.34% annual yield to maturity) and **Yellow Pages Income Fund bonds** maturing in April 2014 (5.23% annual yield to maturity).

Our final act was to secure a position for non-registered accounts only in the **Claymore Canadian Preferred Share ETF**, an "exchange traded fund" that is focused on providing dividend income through a collection of preferred shares. Our objective here was to replace the income from the aforementioned sale of Progress Energy debentures. When you factor in the dividend tax credit, its 5% yield equates to almost 7% on an interest-equivalent basis, for most investors.

Looking ahead, we expect the markets to grind sideways to slightly up. Our strategy of concentrating on income and compelling value propositions, while keeping a wary eye on investor demand, will continue.

Yours truly,



Chris Raper
Vice President, Portfolio Manager
Raymond James Ltd.

www.chrisraper.com

The information contained in this report was obtained from sources believed to be reliable, however, we cannot represent that it is accurate or complete. The views expressed are those of the author and not necessarily those of Raymond James Ltd.