The Dividend Value Discipline™
Market Commentary
1st Quarter 2011

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Fully invested accounts within **The Dividend Value Discipline™** closed out the quarter with positive returns in the 2.5% to 3.5% range on a year-to-date basis, putting us solidly on track with our objectives:

1. income every month
2. a process where you buy ***only*** those securities which become attractive on a "go forward" basis
3. absolute returns of 8% each and every year

As you may be aware, no two accounts are exactly alike, due to our ***"buys only"*** process and different start dates. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly report.

Picking up from where I left you last on **The Opportunity Update** recording of March 10, 2011, we have certainly had a market correction over the past month, coupled with a lot of worrisome world events – namely, the earthquake and tsunami in Japan, toppling of governments in the Middle East, and more European debt problems. Notwithstanding all of the above, the S&P/TSX Composite Index and the S&P 500 Index both closed out the month of March essentially where they started, and yet they were down some 6% at one point mid-month!

That resilience supports our thesis that we are in a very strong long-term bull market, and corrections will continue to be brief and shallow. As I outlined on the recording, history supports that position. Since 1933, bull markets from trough to peak have averaged 39 months – we are now 24 months in, with March 2009 marking the bottom of the worst bear market in 70 years. During those bull markets, corrections of 10% or more are rare. There is usually only one per cycle and we had one in the May/June 2010 period. When you think about investing in 10-year Government of Canada bonds at say 3.4%, with the risks of future inflation, earnings yields of 7% and 8% for stocks start to look pretty attractive. The good news is that there are still lots of attractive opportunities.

Our major decisions last quarter, and rationale thereof, are outlined below:

The first event was our initial purchase of personal care and nutrition company **Nu Skin Enterprises Inc.** Its vision is to become the world's leading direct marketing company, thereby eliminating the "middle man". Return on equity has recently ramped to an impressive 30%, and growth requires little in the way of capital investment. Dividend growth has averaged some 10% annually over the past decade. Senior executives and directors own over $200 million worth of Nu Skin, or 11% of the shares outstanding. That's the good news – the bad news is that 30% of their business is in Japan and of course when we bought it, the earthquake had not yet happened. Not surprisingly, the stock has come off and we see that as a better opportunity.

In mid-January we initiated a position in steel manufacturer **Nucor Corp.** Operating primarily in the U.S. and Canada, it is one of the lowest cost producers in the world. Its largely non-union employees ascribe to the company's highly variable compensation scheme. They are the best paid in the industry and the most productive. Senior managers collectively own over $60 million of Nucor shares, $20 million of which is owned by its CEO. Amongst its peers, Nucor is the only company with an A-level credit rating. Its dividend has grown in each of the past 38 consecutive years, and at an average growth rate of 26% annually over the past decade.

In February, we axed two positions from the program. First to go were the shares of **First Capital Realty Inc.** at $15.61. The sell decision was driven by rising interest rates. Like all real estate companies, rising interest rates are a headwind that has the effect of reducing cash flows to shareholders. Furthermore, the price was very close to what we believed the company to be worth. The sell decision resulted in a gain just shy of 70% for a 22-month hold period. Please note that we continue to hold First Capital Realty bonds and intend to keep doing so. Next on the chopping block were the **Russel Metals Convertible Debentures**. We sold them due to valuation concerns at $122.79 per $100 of face value, locking in a 25% gain for a 14-month hold period.

In late February, we added "bond surrogate" **Canadian Real Return Bond Index iShares**, bought for its exposure to Canadian federal and provincial **real** return bonds. These are bonds that are indexed to inflation… the only kind of government bonds that we are currently interested in owning. Liquidity and frictional buy/sell costs were the reasons for purchasing iShares over individual bonds.

Next was our purchase of lumber, plywood and pulp producer **West Fraser Timber.** At a macroeconomic level, this industry has been kicked in the shins over the last two years – translation: costs have been cut to the bone and any uptick in pricing drops straight to the bottom line. Company wise, it approaches great culture status, with ample evidence of promotion from within, long tenure amongst senior managers, and bonuses that are actually aligned with shareholder interests. Insiders own over 20% of the shares outstanding, led by its long-serving CEO. Financially, the company is strong, having recently restored its dividend to pre-recession levels. The stock is already up some 30% from our initial purchase price and our current intention is to buy more shares over time.

You may recall that I was extremely bullish on the natural gas sector when I left you on the last edition of **The Opportunity Update**. That day, I initiated a position in one of North America's largest natural gas distributors, **Spectra Energy Corp**. The company's financial position is strong, and getting stronger. It has an investment grade credit rating and debt leverage is on the decline. Insider ownership has increased by almost 50% over the past 12 months. Of course we also like the near 4% dividend yield.

Then on March 11th, I chose to sell natural gas producer **Peyto Exploration**, which may seem illogical to say the least. The decision was based on valuation – we sold it for more than we believed it to be worth. We see better value propositions within the energy complex. For those of you who were participating in the program in March 2008 (the original purchase date), your overall result gain was roughly 50%.

On March 15th, we chose to sell **International Business Machines Corp**., realizing a gain of 15% for a short hold period of just seven months. Our thinking was the money would be better allocated to more defensive positions with higher dividend yields, like Spectra Energy mentioned above.

On March 17th, we made the difficult decision to sell **Cenovus Energy Inc.**, a company we continue to admire – just not at the current price. As was the case with Peyto, we see better value propositions elsewhere.

Our last trade of the quarter was the purchase of the **iBoxx High Yield Corporate Bond iShares**, which has an 8% yield, albeit in U.S. dollars. With a Canadian dollar currently north of $1.03 U.S., and many institutional & hedge funds managers short the U.S. dollar, we see little currency risk, and the yield is the overall mitigating factor.

Looking ahead to this quarter, we remain cautious in the short-term, notwithstanding the late March recovery. We are entering it in a far more defensive position than the previous quarter. That puts us in a great position to take advantage of any market weakness. Our thesis remains unchanged – we are in a long-term bull market.

Yours truly,

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