The Dividend Value Discipline™
Market Commentary
2nd Quarter 2012 (Q2)

In my Q1 report, I noted that after an extremely volatile second half in 2011, volatility had all but disappeared…it's back! Post a robust Q1, the world's renewed focus on Europe triggered global market setbacks in Q2. It won't be surprising to most that we have given back some progress over the last 90 days, despite our best efforts. Fully invested accounts clocked in with year to date (YTD) returns in the +3.0% to 3.5% range, our year over year numbers are in and around the +10.0% mark, and our "setback" in Q2 was in the 1.0% to 1.5% range.

Those participants who have joined the program recently (or those who have added considerable cash) have experienced lesser results, although generally still positive. While frustrating in the short term, we continue to believe that the "buys only" approach is the path to reaching our objectives for **The Dividend Value Discipline™**:

(1) income every month
(2) buy only those securities which become attractive on a go forward basis
(3) +8% net returns each and every year

As per our usual course, your individual results can be found on **The Progress Monitor**, which is included in your quarterly reporting package.

As a side note only, the TSX Composite closed out Q2 at -6.42% with the YTD at -3.0% and a year over year of -12.81%. Those numbers for the S&P 500, in CDN$ terms were: -0.82%, +8.53% and +8.96%, respectively. It is not hard to see that our USD$/U.S. equity exposure has continued to serve us well.

In terms of notable market moving events in Q2, Europe has had its share of the limelight (ad nauseam), whereas the bigger (and underreported) story was the world finally recognizing that we are awash in oil. While I have written and spoken about the winners and losers within that dynamic over the last 90 days[i], most readers will appreciate that a declining oil price environment is not particularly good news for Canadian investors. The TSX Composite's energy component makes up +25% of the index, whereas most other sectors are closely related to the success of the energy industry, i.e. banks, retail and the like.

How did we get here? The market is basically functioning as it should, i.e. scarcity plus demand created high prices and thus producers invested to produce more. Today they have basically "caught up" while at the same time the high prices were slowing the economy and curbing demand. As I write, oil production within North America is growing at double digit rates, oil inventories are at 22 year highs, the oil based drilling rig count is at a 25 year high – throw in an economy that looks softer each day and we continue to be biased to the downside on oil prices. As a result, we have been busy reducing and realigning our energy exposure. Our focus is on "pockets" that can continue to do well in this lower price environment. For example, pipeline suppliers, refiners and those companies that can help producers reduce the cost of production.

Along those lines, our first decision of the quarter was the acquisition of **Poseidon Concepts Corporation**, which is a company devoted to helping oil and gas producers reduce costs with innovative fluid handling systems. Poseidon has first mover advantage in this arena, as they basically revolutionized the fluid handling aspects of the hydraulic fracturing process, while simultaneously lessening the environmental impact. Dig deeper and you will find the company has significant insider ownership and an extremely flat organizational structure. Based on our initial purchase price, our dividend yield, paid monthly, is north of 7% per annum. Shortly thereafter, we sold our position in oilfield drilling technology provider, **Pason Systems Corporation**, booking a +27% gain for a 29 month hold period. The decision was prompted by the prospect weaker oil prices coupled with the fact that land based oil drillers were operating at record numbers. Our take was there was only one way to go…down. Throw in the fact that Pason has a huge market share and we simply couldn't find any catalysts which would have driven the stock north.

In late May, we acquired a position in wireless technology provider **Qualcomm Inc**. If you own a smart phone you are using their products. The good news is that smart phone penetration in the U.S. is only at some 35% and a mere 8% in China. History tells us that once a technology penetrates 10% of the population it will go to 90% within five years – if we get half way there it is going to be great. The most attractive thing about Qualcomm is that it does not matter who wins the smart phone war – Google, Apple or some distant player – they all use Qualcomm's technology and given their passion for research, our bet is that it is going to stay that way. With almost $20 billion in annual income anybody that wants to take them on better have some very deep pockets.

Also in May, we sold our position in **Southern Copper Corporation,** booking a loss of 6.8%. Given that it was less than a 3% weighting in the program, it cost us 0.2% in terms of program performance. Much like our thought process with steel producer Nucor, which we eliminated in Q1, Southern Copper was amongst the vulnerable in any global economic slowdown and the opportunity cost of owning it, rather than having cash at the ready for more resilient buying opportunities, just seemed too great.

In June, we chose to exit our position in U.S. **iShares iBoxx High Yield Corporate Bond Fund**, locking in a small gain of 2.3%. Our thinking was to capitalize on the weaker Canadian dollar and convert predominately interest income into capital gain. In a similar vein, we sold **iShares Barclays Treasury Inflation Protected Securities Bond Fund** with a gain of 10.5%. The price had increased to a level where the real (i.e. after inflation) yield to maturity was actually negative and we suspect lower oil prices will lessen inflation's bite. Again, we wanted to take advantage of the favourable U.S. dollar/Canadian dollar exchange rate, which enhanced our return.

Our last move of the quarter was to acquire an initial stake in **Microsoft Corporation**, a buy prospect I highlighted on the May 31/12 edition of The Opportunity Update. You can listen at www.tinyurl.com/TheOpportunityUpdate. In short, we have watched Microsoft transform itself over the last 10 years. While the stock price is essentially the same, the value proposition has changed considerably. The company no longer issues stock options, as it sports a near 10% earnings yield and a dividend that has grown at double digit rates over the last five years. Ten years ago, we would have been hard pressed to give the company a passing grade on the culture front. Our opinion today is that it has passed from good to great, under the leadership of CEO Steve Balmer. The icing is the catalysts going forward in terms of new product launches. We expect to add to our position as the story develops.

To sum up Q2 - 2012, it is certainly not unusual in the 2nd and or 3rd quarters of the year to experience tougher markets. I can cite numerous examples in years gone by where we have been flat or negative at the end of Q2 and/or Q3, only to meet or exceed our 8% benchmark by year's end. Given the cash we have on hand, coupled with a plethora of solid investment prospects, I expect 2012 to wrap up in similar fashion. Enjoy your summer!

Yours truly,

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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.

[i] The Strategist – May 2012 www.tinyurl.com/TheStrategist.
The Opportunity Update – Recorded on May 31, 2012 www.tinyurl.com/TheOpportunityUpdate.

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Canadian Investor Protection Fund
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