The Dividend Value Discipline™
Market Commentary
1st Quarter 2013 (Q1) – as of March 31st

As we close out the first quarter of 2013, we are hard on the heels of one of the biggest "buying stampedes" in U.S. stock market history, with the Dow Jones Industrial Average hitting multiple new all-time highs in recent weeks and the S&P 500 Index finally topping its previous closing high of 1566 (hit back on October 9, 2007) on the very last trading day of March. It makes you wonder, what ever happened to that U.S. fiscal cliff we were supposed to drive off of last November? Once again, the overriding fear masked the opportunity.

Here in Canada, the stock market returns continue to lag behind those in the U.S. We are into year three of that phenomenon. As of March 31, 2013, the S&P/TSX Composite Index (TSX) is still 16% shy of its June 2008 all-time high of 15,155 and more recently, shy some 11% of its March 2011 high water mark. For Q1 2013, the TSX pegged in with a return of +2.3%, versus the S&P 500 at +9.5%, in CDN$ terms.

I am pleased to report that fully invested accounts within **The Dividend Value Discipline™** returned approximately +3.5% net of fees on average for the first quarter of 2013. We are mindful of the need for catch up, given our substandard performance in Q4 2012. We are now within 1% of the program's October 2012 all-time month-end high.

Due to differences in start dates and the timing of cash flows, no two account returns are the same. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly reporting package. To recap, our objectives for the program as are follows:

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

Given the "buying stampede" noted above, it won't surprise you that we have been less active – in essence, attempting to be greedy when others are fearful and fearful when others are greedy.

Turning to the major sell decisions over the past quarter, we sold our remaining position in **Digital Realty Trust** (DLR) in late February, booking a gain of some 30% since our original purchase back in July 2011. As usual, the sell decision was driven by a number of factors, including the following:

- The company's latest earnings report was weaker than we anticipated, with no improvement in sight
- The above caused us to lower our estimate of the company's worth
- Investor demand for the stock was waning
- We saw the real estate investment trust space as "lofty", as investors are continually chasing yield

In mid-March we sold our position in the **iShares iBoxx High Yield Corporate Bond Fund** (HYG), locking in a gain of 7% since our original buy date back in August 2012. We saw the high yield space as extended (in the short-term) and the opportunity to convert U.S. dollars to Canadian at $1.0218 was just too good to pass up.

In addition to the outright sells, we attempted to "feed the greed" by trimming positions in **Monsanto**, **Husky Energy** and **Calfrac Well Services**.

In terms of purchases, in mid-February we added the **BMO High Yield U.S. Corporate Bond Fund Hedged to CAD$ ETF** (ZHY) to the portfolio as a "high yield surrogate". The corporate bond space continues to suffer from a lack of product, liquidity and high transaction costs. Accordingly, ZHY makes for a prudent option. It is

listed on the Toronto Stock Exchange, has broad diversification from its ~300 underlying securities and is hedged against currency risk. By buying ZHY, we mitigated the frictional costs associated with individual bonds.

Towards the end of March, we bought an initial stake in gold and silver financier **Silver Wheaton** (SLW). SLW is in the business of financing mine production in return for the streaming revenues from silver production of those mines. The net result is that SLW buys the silver its partners find at a low, fixed cost (currently at less than $5/oz.) and then sells it as it gets produced – note that the current price of silver is at almost $30/oz. As a streaming company, SLW doesn't have the same recurring capital expenditure obligations that its mining partners do have to develop their mines. The company went public in 2004 and thus far the results have been impressive – SLW is currently worth some $11 billion, despite having less than 30 employees on staff. Return on equity over the past 2 years has averaged over 20%, which would make a vast majority of mining companies blush. The company has a large amount of capital at its disposal and has shown its acumen at deploying it. Its latest dividend policy is to pay out exactly 20% of its cash flow – in the last quarter that translated to a 50% increase in the quarterly dividend, which is up more than 100% from a year ago. Notwithstanding our lower than usual yield at purchase (albeit a variable 1.74%), with that kind of compounding it won't take long before the dividend yield becomes increasingly meaningful.

And speaking of dividends, program participants will be glad to know that during the last 90 days, the following companies boosted their dividends or announced intended increases: **Qualcomm** (+40%), **Deere** (+11%), **Colgate** (+10%), **Boston Pizza** (+4%), and **ShawCor** announced a special dividend of $1 per share. Hoo-haa, we love those rent cheques!

Looking ahead, we are in good shape cash-wise and "ready to deploy" as opportunities present themselves. In our sights are a railroader, a logistics operator, a waste operator, a drug distribution company, an asset manager and one lonely Canada-based life insurer. I look forward to reporting on some of those by the time I record the next edition of **The Opportunity Update** in early June.

Yours truly,

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