The Dividend Value Discipline™
Market Commentary
2nd Quarter 2013 (Q2) – as of June 30th

If it was not clear at the end of Q1, it is certainly clear today – you can lose money on bonds. To wit, the yield on 10-year U.S. Treasuries has jumped from a low of ~1.6% to a high of ~2.6% over the span of the last two months. That drove the surrogate iShares Barclays 7-10 Year Treasury Bond Fund ETF (exchange traded fund symbol: IEF) from a high of $109.05 down to a closing price of $102.50 at the end of June. Put another way, if you had $1,000,000 invested in IEF on May 1, 2013, and then sold it on June 30th, you would have walked away with $942,511 (after dividends). To be clear, I do expect a short-term bounce in bond prices, but investors need to understand that the decades long bull market in government-guaranteed bonds is over.

As far as stocks are concerned, despite the mid-June shakedown in U.S. equities, it is important to recognize that the S&P 500 Index still put in a respectable 2.4% gain for the quarter. Canadian stocks continue to significantly underperform, with the TSX Composite Index down 4.9% for Q2, putting its year-to-date return at -2.4%. Incredibly, it is still 14.2% off of its February 2011 month-end value (roughly the high-water mark post the 2008/09 debacle) – translation, many Canadian investors are hurting…badly. Over the aforementioned timeframe, fully-invested accounts within **The Dividend Value Discipline™** have returned close to +12%.

While we did not escape Q2 unscathed, fully-invested accounts within **The Dividend Value Discipline™** are still in the black on a year-to-date basis, with most returns in the +2.0 to +2.5% range, net of fees. 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. Our objectives for the program remain unchanged: (1) income every month; (2) buy only those securities which become attractive on a go-forward basis; and (3) absolute returns of +8% each and every year.

Not surprisingly, our transition to investments south of the border continues. We exited Q2 with 44% U.S. exposure, compared to 33% at the end of Q1. We recognize (and see investors as underappreciating) the industrial renaissance that is going on in the U.S., due to its newfound status of "the cheapest energy on the planet". Yes, unemployment is high in the U.S., but so are the number of unfilled private sector jobs – we have a skills mismatch, not a collapsing economy.

What follows are the major transactions since our Q1 report, and our thinking at the time those decisions were made:

In early April we sold the last of our **Aimia 2017** bonds over "not much upside left" concerns, booking a gain of +26% for the period held. Not only was there very little yield left, but we were also concerned about the pending CIBC Aeroplan renewal agreement negotiations and some potentially aggressive accounting issues.

Our next move was the purchase of previously-owned pipeline operator **Spectra Energy Corp.** Spectra is one of the largest natural gas mid-stream operators in North America, and therein lies the opportunity. We see the movement of natural gas as a secular growth story; they have a good start, with some 22,000+ miles of natural gas, liquids, oil pipelines and almost 305 billion cubic feet of natural gas storage. Insider ownership continues to rise and of course we find the current 4% dividend attractive and sustainable.

Then we took up a stake in **Great-West Lifeco Inc.** (GWO), which has been part of the Canadian landscape for more than 100 years. Employees operate within a "disciplined autonomy" workplace culture. The management team has been promoted internally – that is how you enhance a great culture organization. Recently GWO purchased Irish Life for €1.3B ($1.75B CDN). Not only did they buy it on the cheap, but they financed almost 40% of the purchase by issuing 10-year bonds at 2.35%. When comparing those bonds to Great-West Life's common shares (4% dividend yield and history of growing dividends), they look pale in comparison.

In April, after the price of gold collapsed by over $250 per ounce (and our **Alamos Gold Inc.** shares traded to a low of $10.40), we decided to reduce our gold exposure on the next inevitable bounce to the upside. We sold the Alamos shares a week later at an average of ~$13.50 per share (some 30% higher), realizing a 15% loss, which translated to a -0.5% hit to the overall portfolio. As we see it, the significant breakdown in gold prices translates to too much opportunity cost to carry, notwithstanding the potential upside from here. Space will not permit me to give a full exposé on this complex sector – if you are interested in my take, please call and book some time.

Still on the sell side, in early May, we exited our position in **Calfrac Well Services Ltd.** My thinking at the time was based on the macro climate for oilfield services, as opposed to concerns with Calfrac. With oil inventories building and the seasonally weak period for energy stocks right in front of us (June to October), I expected to be able to buy the company cheaper throughout the summer months – thus far, I have been just plain wrong.

Our next new purchase was electronic bond trade facilitator **MarketAxess Holdings Inc.** Incredibly, most of the world's bonds are still traded over the telephone. MarketAxess has set out to change that, and are making great strides as they sign up traders to their electronic platforms. They have garnered over 12% of the U.S. high grade bond market and their emerging market business (~20% of overall revenues) grew at +40% last year. Additionally, the company has recently hitched its wagon to one of the world's largest ETF providers, Blackrock.

Next up was the purchase of pharmaceutical distributor **AmerisourceBergen Corp.** Its "economic moat" is its sheer scale, which it is perpetually focused on expanding, most recently announcing a partnership with Walgreen's. It has many of the great company hallmarks, including a strong history of succession planning, long management tenures and a workforce that is passionate about driving health care costs down.

Finally, we added the leader in off-price apparel and home fashions retail, **TJX Companies Inc.**, which you may know from its Winners and HomeSense stores. With more than 3,000 stores globally, apparel manufacturers and wholesalers actively seek TJX out when they are caught with excess inventories. Yearly dividend increases have been the norm, and we see it as a company with superior fundamentals and a great management team.

On the less-exciting fixed income side, we added two Exchange Traded Funds as bond surrogates. First up was **iShares U.S. Preferred Stock Index Fund**, as it is well diversified, has an attractive yield of 5.7% (based on our purchase price), plus we seized the opportunity to purchase U.S. dollars at a favourable rate. On the Canadian side, we added **iShares HYBrid Bond Index Fund** for much of the same reasons, with a yield of close to 5%.

Looking ahead, we do expect some sloshing around during the dog days of summer. It has traditionally been a time for weaker equity prices and we see that as an opportunity. Happy belated Canada Day!

Yours truly,

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