The Dividend Value Discipline™
Market Commentary
4th Quarter 2013 (Q4) – as of December 31st

As we finish off 2013, I am struck by just how much has changed in the last 12 months. The adjacent December 2012 magazine cover says it all – we started 2013 with fear running amok, yet ultimately, the "market" has the last word. All that worry produced a stunning return for U.S. stocks, as the S&P 500 Index finished up at 29.60% for 2013, proving once again that markets do indeed crawl a wall of worry. The commodity-centric TSX Composite Index here in Canada had a less impressive year, albeit still positive, at +9.55%.

Thankfully, we did not start off the year in the bearish camp. We know all too well that the consensus view is usually wrong. That stance allowed fully-invested accounts within **The Dividend Value Discipline™** to post returns for 2013 in the +11% range, with December 31st marking a new month-end high water mark. In addition, this was our 10th full calendar year (out of 11) with positive returns for the program. Due to differences in start dates and the timing of cash flows, no two account returns are exactly alike. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly reporting package.

As you would expect, our objectives for the program remain: (1) income every month; (2) buy only those securities which become attractive on a go-forward basis; and (3) returns of +8% each and every year. Operationally, we continue to tweak our investment processes in a constant effort to improve the risk/return equation. Over the last six months, we have poured considerable energy into improving our research processes and embracing the skills of our new analyst Alex Vozian, CFA, who joined the team in July. That focus is already bearing some fruit. Yes, returns have improved, but equally important, we have upgraded our investments from a wide moat/great culture perspective, a subject I addressed in the September 2013 recording of **The Opportunity Update**, which is available at www.tinyurl.com/TheOppUpdate.

The major transactions over the past quarter, complete with our rationale, are as follows:

On the sell side, in early December we parted ways with **MarketAxess Holdings Inc.**, where we locked in a substantial gain over a short six month hold period, due to our belief that the stock had become fully valued. The "Street" has aggressive expectations for MarketAxess and we became concerned with their recently reported flat trading volumes and market share statistics, which were well off their summer peaks. From our perspective, it will be very hard for them to meet or beat the lofty earnings expectations when they report in January, and thus there was considerable downside risk. Accordingly, we chose to exit our position and lock in the gain.

The last sell all decision of 2013 occurred in mid-December, when we exited **Spectra Energy Corp.**, booking a nice gain over its nine month hold period. Notwithstanding the fact that we see Spectra as a wide moat company, the now well-established trend of higher U.S. long-term interest rates points to a major headwind for utility-type companies. Spectra could be affected in two ways. First, their cost of capital would go up (and utility companies are very capital intensive), and second, investors may see higher yielding bonds as an alternative (safer) route to income and thus be inclined to sell their Spectra shares. Given the above, along with the deteriorating relative strength of its shares, we chose to book our gains.

Turning to the new acquisitions, in mid-October, we bought an initial stake in Canada's leading integrated oil and gas producer, **Suncor Energy Inc.** Our decision was motivated by the modest economic moat it has created from its integration of upstream oil production and downstream refineries. In effect, this moat insulates the company from some of the inevitable oil price volatility. There has also been a change in management's thinking, as Suncor is no longer interested in growth for growth's sake. Since 2011, it has become increasingly focused on profitable growth. We are of the opinion that there are still a lot of efficiencies to be gained through debottlenecking and process improvement. That bodes well for us as shareholders and has translated into

growing free cash flow. Some of that cash flow is getting pumped into share buybacks and dividend increases. The dividend yield has grown at almost 14% per annum over the last three years. We expect more of the same.

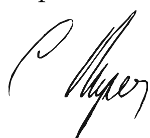
The next addition to the program was the highly efficient steel producer, **Steel Dynamics Inc.** Theme-wise, this was an obvious play on the re-industrialization of America, but there is more to like. Steel Dynamics is a low-cost producer due to its vertical integration of source materials and technologically advanced mills. This should be read as "energy efficient" and let's not forget that America has some of the cheapest energy on the planet. The company is run by former executives of Nucor, one of the companies profiled in Jim Collins' must read book, **Good to Great**. They obviously learned a few things at Nucor, as Steel Dynamics can boast of its market-leading steel production per man-hour. Culture-wise, they have an impressive history of hiring from within. The median tenure of executives is 18 years. As the company is only 20 years old, that is quite impressive. In addition, 50% of executive compensation comes from a company-wide bonus pool that incentivizes employees to continue improving operational efficiencies.

We also bought an initial stake in oil and gas producer **ARC Resources Ltd.** What caught our attention was the recent insider buying. Digging further, we saw impressive results coming out of their significant Montney region plays (read: low cost). Through technical expertise and constantly improving efficiencies, ARC has developed a narrow economic moat. Its executives have a median tenure of 13 years and their compensation is performance-oriented, with approximately 79% variable.

Our final buy of the year was on the defensive side, namely **Medtronic Inc.**, the world's largest medical technology/therapy company. With a mission to alleviate pain, restore health, and extend life, more than 9 million people are treated annually from their procedures, treating cardiac and vascular diseases, diabetes, and neurological and musculoskeletal conditions. Culture-wise, Medtronic's strong suit is commitment to innovation, and they have proven time after time that they can continuously create an impressive stable of new products. From a global/demographic perspective, we see an increasing demand for Medtronic's products as the largest portion of the world's population moves into their senior years. Its growing free cash flow provides the fuel for future dividend increases and share buybacks.

Looking ahead to 2014 and keeping with Warren Buffett's advice of "be fearful when others are greedy", one can't help but wonder when a market correction is coming. Optimism is running high, so this is not the time to throw caution to the wind. Program participants will note an "upgrading" theme within **The Dividend Value Discipline™** over the last six months. The quality of our companies has never been higher – wide moats and great culture are now the norm. That focus, coupled with the healthy cash levels at present will enable us to take advantage of any near term weakness. Longer-term, our view is that the re-industrialization of America will continue to drive better than expected economic performance there, and it is a mistake to get overly bearish.

As we close out 2013 and on behalf of my team and me, thank you. We appreciate your business and see our responsibility to you and your families as a profound privilege. All the best for 2014!



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