The Dividend Value Discipline™
Market Commentary
2nd Quarter 2015 (Q2) – as of June 30th

As we turn the page on the first half of 2015, North American equity markets continue to struggle. At the close of business on June 30, 2015, the TSX Composite Total Return Index posted a whopping return of +0.42%, while the S&P 500 fared a little better at +1.96% (in local currency) - both on a year to date basis (YTD). **The Dividend Value Discipline™** experienced a volatile 2nd quarter with April down ~3%, May up ~3%, and June down ~2.5%. Most of that volatility was attributable to the Canadian dollar/U.S. dollar exchange rate differentials. By the end of June, our returns pegged in at ~4.5% YTD. We continue to have ~70% of our portfolio denominated in U.S. dollars and/or hedged to U.S. dollars.

As you know, differences in start dates and the timing of cash flows translate to "no two accounts 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 Dividend Value Discipline™** remain unchanged: Income every month, buy only those securities which become attractive on a go-forward basis, and returns of +8% net to you by December 31, 2015 and every year thereafter.

Turning to the major transactions for the quarter, we sold precious metals royalty streamer **Silver Wheaton Corp (SLW)**, and booked a loss of just over 5% for a 2 year hold period. The sell decision was prompted by our review of SLW's fourth quarter earnings report where we spotted a couple of red flags, i.e. "significant contributions to improve social license" and "as yet unresolved audit issues with the CRA". In a nutshell, our perception of downside risk had gone up and we feared untoward developments, leaving us with little to no margin of safety. Accordingly, we exited for greener pastures.

Next was the sale of well-known software developer **Microsoft Corporation (MSFT)**, where the stock price had risen to a level that, to us, represented fair value. We bagged a 48% return over a 36 month hold.

The final sale was a humbling one – precious metals miner **Yamana Gold Inc. (YRI-T)** was sold marking a loss of 21%...thankfully it only made up ~1.5% of the overall program as opposed to our usual 4-5% allocation. There is no question, I held YRI far too long – there are no excuses, the responsibility is mine. The only comfort I can give you is that I bought it, owned it and sold in lock step with you. With that humbling apology out of the way, you may be surprised to hear that we continue to see exposure in the gold sector as attractive. Here's why – unlike oil, gold prices have been amazingly stable this year. The industry is making good progress on cost cutting and the investor base remains fearful (a great contrarian indicator). Add in the seemingly ever increasing geo-political concerns and it is not hard to make a case for owning at least one gold producer.

To that end, we opted for **Newmont Mining (NEM)** - a much higher quality gold miner from both an operational and technical perspective. We are impressed with what their new CEO has accomplished during his 2 years at the helm - we now have a full year of under-promising and over-delivering on quarterly earnings results. NEM scored well on our culture test; the company continues to focus on sustaining low 'all-in' costs, which translates to considerable opportunity should gold prices stabilize at these levels or, even better, rise. We are also mindful of the "hedge" qualities of the gold complex, which should help us should we find the Canadian dollar strengthening and the U.S. dollar weakening.

Continuing with that line of thinking, after the loonie's run to ~.84 USD$ in the month of April, and even though we still see the U.S. dollar as higher over time, we started asking ourselves, "what if we are wrong?"; how do we protect ourselves against a strengthening Canadian dollar, if in fact it happens? Our conclusion is that it will be very difficult, if not impossible for the Canadian dollar to rally over a prolonged period without a corresponding rise in oil prices. Furthering that reasoning, we concluded that if we buy beaten up oil producers with strong balance sheets and decent dividends, when oil prices do turn north we will win twice, i.e. the currency and the stock. In the meantime, we get paid to wait.

Accordingly, we are once again the owner of oil and gas producer, **ARC Resources Ltd. (ARX-T)**, a company that not only survived the 2008/2009 oil collapse, but did so while continuing to pay its regular dividend. ARC has secured a lot of land in some of the best parts of the world class Montney region, which translates to low cost production. They raised equity earlier this year, strengthening their balance sheet. If an energy producer can have a moat, ARC's is within their technical expertise and their land base. Our take is that management is "all in", as the median tenure is north of 15 years and their performance based compensation plan translates to 80% of remuneration being variable. At the time of purchase, the dividend yield on ARC was ~5%. In other words, we get paid to wait for the eventual turnaround in oil prices.

Oilfield service provider (mainly fracking) **Canyon Services Group Inc (FRC)**, was a similar line of thinking - in April and May of 2015, we began to note some stability within the oil and gas complex. North American production was levelling off and gasoline demand was much stronger than anticipated. Recognizing the cyclical nature of the industry, we started thinking about how to take advantage of the next up leg and, perhaps more importantly, when to take advantage of it; what if we are too early? To mitigate some of that risk, we focused our efforts on great culture companies with minimal debt loads and we wanted the confidence that the company we chose could withstand a longer than expected period of lower prices. FRC fit the bill on both fronts. We also see the "fracking" business as a secular growth business, even if the weak oil environment persists. Here's why - the drive to lower costs will push more companies, and more countries, to adopt even greater fracking intensity. Finally, we find the management of FRC to be "more prudent that most" and fully engaged. We certainly appreciate how they have grown the company at an aggressive rate while keeping debt levels to a minimum. They are well positioned to weather the downturn, and our expectation is that they will emerge from this period stronger than ever. Of course, we expect the stock to follow suit.

Moving south of the 49th parallel, in the final days of the quarter we took up initial stakes in **PNC Financial Services Group, Inc. (PNC)** and **St. Jude Medical, Inc. (STJ)**. PNC has over 2,700 branches operating in 19 states, and addresses needs in retail and business banking, residential mortgage banking, real estate finance and asset-based lending, wealth management, and asset management. PNC proved to be the most interesting investment candidate from our study of the U.S. banking sector – we like management's focus, tenure, and results driven compensation structure. Their scale gives them an adequate moat and we see the shares as undervalued with a growing dividend. Turning to our other new acquisition, STJ is a U.S. healthcare company focused on the world's most expensive epidemic diseases: heart failure, heart rhythm disorders, vascular disease, structural heart disease, chronic pain, and movement disorders. It operates in over 100 countries and has 16,000+ employees worldwide. St. Jude caught our attention earlier this year when we noticed its shares were underperforming its peers due to competition related fears. We see those fears as overblown and evaporating. STJ got "passes" on our three "M"s: Management tenures are long, they hire from within, there is a huge insider ownership stake and compensation is results driven. Moat considerations included the huge barriers of entry (highly regulated industry), intellectual property, and strong relations with physicians. As for Margin of Safety, our take is that STJ is trading at a significant discount to fair value, and we like the increasing rent cheque: Dividends have increased by a median 9% growth rate since 2011.

As we look to Q3, we first recognize that we are now in the dog days of summer – the weakest time of the year. We are predisposed to see that as an opportunity. Accordingly, we are leaning slightly more bullish within **The Dividend Value Discipline™**, and we expect our allocation in dividend paying stocks will be back at the 70% level by fall. The Greece dilemma is in the process of being resolved, U.S. employment continues to exceed expectations, and consequently U.S. consumers, a key driver of global growth, are starting to accelerate their spending.

Yours Truly,

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