The Dividend Value Discipline™
Quarterly Market Commentary
3rd Quarter 2015 (Q3) – as of September 30th

The third quarter of 2015 was a tough one – volatility reached levels not seen since the first quarter of 2009, the venerable Dow Jones Industrial Average fell -7.58%, and the quarter as a whole has been booked as the 5th worst over the past decade.

We have not come away unscathed, yet we are grateful to still have our heads above water. Returns for fully invested accounts in **The Dividend Value Discipline™** pegged in at ~+1% on a year-to-date basis, as at September 30th. To give you some perspective, the TSX Composite Index here in Canada is down -7.53% over the same time frame, while the S&P 500 Index in the U.S. continues to outperform the TSX marginally, coming in at -5.29% (both of these figures are in local currencies and include dividends). 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 each and every year.

In an effort to better share our thinking with you, we have decided to present the major buy/sell decisions thematically as opposed to chronologically. Here's why – as we move through these tough market conditions, we all need to remember that we will come out the other side. As you know, we have held a pretty defensive hand for most of the year now, ultimately moving to a 55% equity (stock) allocation during the summer - the lowest we have been in years. Eventually, we need to move to a more offensive position in order to take advantage of the cheaper prices/better value propositions. Obviously, we don't have a time machine, so it is a process – not an on/off switch. As we closed out the quarter, we started that process and are currently at "the bottom of the second inning".

We sold a number of companies because we believed the stock price was fully reflecting the underlying value of the company. HVAC distributor **Watsco Inc.** was the first of these sales - sold towards the end of July for a gain of +18% over a seven month hold. Hazardous waste disposer **US Ecology Inc.** also got the axe for a gain just north of +24% over an 11 month hold. We agonized over selling **Costco Wholesale Corp.**, a company we have immense respect for, yet see as fully valued. We exited it with an overall gain of +38% over a 14 month hold.

In the wrong headed/wrong timing department, and notwithstanding the virtues we extolled about **Newmont Mining Corp.** on the June 30th commentary, we sold it in late August notching a loss of just over 23% for a three month hold…yes, we grimace as we write this. In short, we continue to see money flow out of the gold complex and that phenomena just couldn't compete with the positive things we were seeing at Newmont. When China devalued their currency in August and the price of gold barely moved, the jig was up and it was time to face the music – the evidence had changed and we needed to change. We also sold our long-time position in **Monsanto Co.** for a gain just shy of +40% over a five year hold. Our analyst, Alex Vozian, finally convinced me that this name was far more cyclical than I thought it to be, notwithstanding the enormous barrier to entry and eye popping returns on invested capital. Finally, we exited our position in drug distributor, **McKesson Corp.** – the rub here was not so much of a company problem, rather an avalanche of selling in the drug sector after it had been "a go-to area" for a very long time. Accordingly, we felt it was imperative to reduce our healthcare exposure, lest we get overrun by the avalanche. We booked a 10% loss over an 8 month hold.

Moving to the new acquisitions, we significantly upped our financial services allocation over the quarter, as the delay of the U.S. interest rate hike created a further opportunity to add quality names "on the cheap". In that camp, we revisited **U.S. Bancorp**, the fifth-largest commercial bank in the United States and one of the best performing/broadly diversified financial institutions anywhere – at least that is our take. The company scored a whopping 92% on our proprietary culture assessment. Most of its senior executives have been promoted from within, have long tenures and have sizeable insider ownership. We like their rigorous, performance-driven compensation policy, and we see U.S. Bancorp as one of the most cost efficient, risk focused, and profitable banks amongst its peer group. Their focus on shareholders is evident – they have a policy of returning up to 80% of earnings to shareholders in the form of dividends and common share repurchases. We also returned to **Great-West Lifeco Inc.** as the stock had recently sold off, which made for an attractive risk/reward profile. While most Canadians will be familiar with the company, it is important to understand that it is a global player – it has a 30% market share in Group Life in Europe, and it underwrites 21% of individual life insurance sold through retail banks in the U.S.. Great-West Lifeco gets high marks on the corporate culture front – the management team has a deep understanding of the business and many have been developed and promoted from within. Financially, we see conservative thinking and prudent risk taking. The rent cheque (dividend) has a history of growing and currently offers a 4% yield.

In the "defensive acquisitions" camp, we purchased **Dollarama Inc.**, Canada's largest dollar store operator. With Canada's softening economic outlook, Dollarama is in a great position to grow – thrift is "in"! At 970 stores and counting, they are in the business of saving Canadians money on everyday items. Culture-wise, we find management both passionate and disciplined – the latter is evidenced by their strong return on invested capital. Moat-wise, they have carved a retail niche that is difficult for independents to compete in, and of insufficient size for the Wal-Mart's of the world to be interested in. Dollarama generates a lot of free cash flow, which should pave the way for a steady stream of dividend increases in future years. The pattern has already been established, as dividends have doubled in the 2011 to 2015 timeframe. Continuing with the defensive theme, we jumped across the big pond by buying a stake in the exchange traded fund **Vanguard FTSE Europe** (symbol: VGK), where the top holdings include many familiar names; i.e. Nestle, Novartis, and HSBC Bank. The macro drivers that made this trade attractive include the European Central Bank's cheap monetary policy, which has translated to a lower Euro, and in turn, helps corporate earnings. The record low interest rates means a dearth of income opportunities and consequently it makes any dividend-heavy companies increasingly attractive. On top of all this, European companies are evidencing a modest return to growth, while individual and institutional equity ownership are at multi-year lows. This is a bullish scenario and VGK's current income of ~3% is more than enough rent while we wait for the eventual upside.

Moving to more "growth/offensive" type positions, we bought a stake in **Sherwin-Williams Co.**, a name that is probably familiar to you. They develop, manufacture and distribute paint and related products to the professional, industrial and retail markets throughout North and South America. Penetration-wise, they have almost 5000 outlets. They also have a lot of control over distribution and pricing of their branded products, which has translated to stunning returns on invested capital – these guys have a moat! Management-wise, they passed the muster with high marks for long tenures, insider ownership and hiring from within. At the macro level, we expect the company to benefit from increasing U.S. home construction. The rent cheque is barely acceptable at ~1%, but most importantly the dividend is growing – the last increase this past March was a 22% bump year-over-year. We also purchased **Rockwell Automation Inc.** at the end of the quarter, a company that we alluded to many months back. While not a household name, it is the world's largest company dedicated to industrial automation and information – a growth industry, as we see it. Rockwell has an impressive culture that is dedicated to innovation and excellence. The executive team's interests are aligned with shareholders - they own a median of 26.4 times their base salary in company stock and over half of their annual compensation comes from incentive plans. Their economic moat was developed by building a "sticky" customer base, i.e. when a company purchases an automation system from them, the useful life can reach up to 20 years, so you can imagine the level at which Rockwell is ingrained within its customers' business. Their dividend has more than tripled in the last 10 years, and the 5-year compound annual growth rate is some 15%. Shortly after this purchase, we bought a stake in **J.B. Hunt Transport Services, Inc.**, one of the largest transportation logistics companies in North America. One of the first things we noticed about J.B. Hunt was their strong return on invested capital – some 17 to 23% over the 2010 to 2014 timeframe. Company-wise, management is heavily invested – their average tenure is 26 years and their median stock ownership is ~14x their base salaries. The outlook on the industry itself is also favourable – fuel is obviously cheaper, the industry is consolidating due to driver shortages, and J.B. Hunt is an employer of choice due to its culture and modern fleet.

As we look ahead to the fourth quarter of 2015 and reflect on our meagre return for the first nine months of the year, it should be noted that we have been here many times before (sometimes negative) and still delivered on our annual objective of +8% by year end. Obviously, I can't guarantee you that, yet we are encouraged by the fact that we still have our heads above water when the markets remain significantly in the red. I am expecting a rough October and that normally gives way for a stronger year-end close. Between now and then, it is entirely possible (if not plausible) that today's bargains will become even better bargains. The good news? We have cash ready to be deployed.

Yours Truly,

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