# The Dividend Value Discipline™
# Quarterly Market Commentary
# 4$^{th}$ Quarter 2015 (Q4) – as of December 31$^{st}$

We wrapped up 2015 with returns pegging in at +4% to +5%, for fully-invested accounts. In other words, we fell short of our objectives:

- ☺ Income every month … pass
- ☺ Buy only those securities which become attractive on a go-forward basis … pass
- ☹ Returns of +8% net to you each and every year … fail

To give you some market perspective, the S&P/TSX Composite Total Return Index (including dividends) here in Canada came in with a loss of 9.02% for the year. Turning stateside, you may hear that the S&P 500 Index also put in a loss for 2015 (albeit much smaller, at -0.73%), but if you include the dividends, it was slightly positive, at +1.38%. Given the whopping 16% loss for our loonie versus the U.S. dollar, the S&P 500 Total Return Index (again, including dividends) in Canadian dollar terms came in at +20.77%! Please be careful when comparing your returns to the S&P 500 in Canadian dollars. Most of the major gain contributors (stocks) do not pay dividends, and thus would not be eligible investee candidates for our program. To wit, here is an interesting statistic. At the start of 2015, the S&P 500 Index included 74 stocks that did not pay dividends. Those 74 stocks were up an average of nearly 4% (U.S. Dollar terms) for 2015, while the remaining stocks (those that pay dividends) lost 5% on average.  In short, it was a tough year for dividend investors, yet we need to remember that dividends comprise close to ½ of the total long term market returns.

In terms of challenges, extreme market volatility is now commonplace – it is not unusual for **The Dividend Value Discipline™** to move +/- 1% in a single day. Economically, we are awaiting the latest monthly leading indicators report from our senior analyst, Alex Vozian, on January 11$^{th}$. What we can tell you now is that we are less bullish/more bearish than we were in December. Markets, generally speaking, are leading indicators and the markets have turned tentative at best. Supporting that position, the recent "flow" of economic data points to slower growth, although no outright recession…at least not yet. Of course, what we are constantly trying to figure out is how close to the bottom we are. If we are close, it is time to get aggressive. If we are just starting a leg down, it is time to get defensive. Obviously, the oil and gas complex continues to suffer from low prices and dismal prospects so we continue to prefer U.S. stocks over Canadian ones, but we remain mindful of the currency risks. Q4 2015 saw us move the equity weighting (stocks) from a low of sub 60% to north of 70%, and we are back to ~65% at the time of writing (January 6$^{th}$). We managed to add somewhere between +3% and +4% to total returns in the quarter, for fully-invested accounts.

What follows are the major buy/sell decisions for the past quarter, and our condensed thinking at the time of those decisions. We will wrap it up with some commentary on how we intend to tackle the challenges of 2016 and what we are working on to improve our thinking and decision making. Suffice to say, we are not happy with returns pegging in with a range of 4% to 5%.

Starting with the "sell all" decisions, we nixed **Colgate-Palmolive Co.** at the end of October, at just north of US$69 per share. In short, investors had bid up the stock price to a level where we no longer considered it to be a decent value proposition. The company continues to struggle with foreign exchange headwinds and we don't see that changing anytime soon. If you were with us in November 2011, you bagged a gain of almost 35%. On the risk aversion front, we sold **Nextera Energy Inc**. in early December for a paltry gain of roughly 3%. We are seeing subsidies for solar and wind fall in other parts of the world as governments start to recognize the unsustainable costs. As the pendulum swings, we are of the mind-set that Nextera could get "clocked", i.e. see a significant deterioration in profits, as solar and wind generates ~40% of their electricity.  **Accenture PLC** took the final "sell all" honours for the year, at just north of US$104 per share, bagging a gain just shy of 20%. The increase in Accenture's stock price was reflecting what we believed the company to be worth – thus, we opted for the cash and are now shopping for better value propositions.

Now on to the new acquisitions, starting with our purchase of the largest independent oil refining company in the U.S., **Valero Energy Corp.** Our take is that the "not in my backyard" syndrome and difficult environmental permitting will make it near impossible to build new oil refineries anytime soon. Cheap crude feeds increasing demand for things like gasoline and jet fuel. The refineries are the bottleneck – there is a huge barrier to entry, so existing facilities can milk excess margins for years to come. Culture-wise, Valero's focus on their "operating income per barrel" gives us some great insight as to how management thinks – stick to your knitting, and do it well. Dividend growth has been significant – it has compounded at 17% for the last 5 years.

In the consumer space, we are back to being an owner of **TJX Companies Inc.**, a company that operates stores you may know such as Winners, HomeSense and Marshalls. They operate across North America and have a growing presence in the UK and Europe. Culture-wise, there is a lot to like at TJX. Management bench strength is deep, with most of its officers rising through the ranks and sporting 25+ year tenures. Employees are given a great deal of autonomy, which leads to high morale and productivity. Traditional retailers are overburdened with inventory and this plays to TJX's advantage, with them essentially buying excess inventories for nickels on the dollar and selling it for dimes. Financially, TJX has a habit of returning capital to shareholders. Shares outstanding typically decrease by ~3.5% annually, while dividend increases have increased at ~20% annually for the last decade.

Still in the consumer space, we bought **Lowe's Companies Inc.**, the second largest home improvement retailer worldwide. Home Depot is currently holding the number one spot. This industry has a significant tailwind because many of the bankruptcies associated with the 2008 real estate collapse have now been forgiven. In the U.S., people are re-entering the home ownership market. Their moat, primarily due to scale, is evidenced by their track record of above average returns on invested capital. The culture is strong, with the executive board having an average tenure of 16 years. Their employees are a happy lot, often citing Lowe's ability to hire "great people" and provide them with "good pay" and "great benefits". The rent cheque (dividend) has compounded at 28% annually for the last 5 years.

We also bought **United Parcel Service Inc.** (UPS), the world's largest package delivery company, and a leading global provider of specialized transportation and logistics services. E-commerce is expected to grow four times faster than global GDP, so the package delivery business has a considerable tailwind. While both FedEx and UPS command market share in this space, UPS has a track record of better returns on invested capital. We attribute that result to their constant drive to handle shipping volumes more efficiently. Their global network translates to a significant barrier to entry. The company has grown its dividend at an annualized rate of 9.5% for the last 5 years. Bottom line – UPS is a wide moat company with a great culture, and is trading at an attractive risk/reward ratio.

Our last acquisition, this time in the technology space, was **Intuit Inc.**, a software company that develops financial and tax preparation software – namely, QuickBooks and TurboTax. Small to mid-size business is their forte, and that segment of the market is rapidly growing, as is the move to cloud-based subscription agreements – the holy grail of recurring revenue. The company scored well on our culture tests and the latest rent cheque increase was ~ 20%.

As we look ahead to 2016, we are mindful that most dividend paying stocks got cheaper in 2015 and many are even cheaper at the time of writing. Those that focus on the rent cheque (and, perhaps more importantly, the growth of that rent cheque) are well positioned to take advantage of these lower prices. As we start the year afresh, our investment team here at Chris Raper & Associates is hard at work analysing past decisions, both good and bad. We call this "sharpening the saw" and it is just one way in which we constantly try to improve both our thinking and the ultimate value to those we serve.

**Please accept our best wishes for a happy and prosperous New Year,**

**Chris Raper, CIM, CFP**
**Senior Vice President, Senior Portfolio Manager**
**Private Client Group, Raymond James Ltd.**

**Ryan Cramp, CIM**
**Portfolio Manager**
**Private Client Group, Raymond James Ltd.**

**www.chrisraper.com**