The Dividend Value Discipline™
Market Commentary
3rd Quarter 2011 (Q3)

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The third quarter of 2011 was one of the "wilder rides" of my investment career and needless to say, many investors lost their appetite for stocks, selling en masse. As one strategist noted, "it's like an elevator with just two buttons, **SURGE** and **PLUNGE**". At the end of the quarter, the S&P/TSX Composite Index had pegged a year-to-date return figure of -13.53%, while the S&P 500 Index came in at -10.04% (-5.91% in CDN$ terms).

While the world worried about the European debt fiasco, we used the record volatility to our advantage and were able to report positive months for July and August. Unfortunately, September became the month of "nowhere to hide" (the TSX Composite was down 8.97% for the month) and we certainly got knocked off our pedestal, with most accounts down some 3% on the month.

On a year-to-date basis, most fully invested accounts within **The Dividend Value Discipline™** have returns in the -2% to +1% range, whereas the year-over-year numbers are in the +4% to +7% range.

As you know, our objectives for the program are 8% net to you each and every year, income every month and an acquisition process where new entrants buy only those securities which become attractive on a go forward basis. Due to our **"buys only"** approach and different start dates, no two accounts are exactly alike. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly report.

The program's major buy/sell decisions over the past quarter, along with our rationale for same are as follows:

In July we bought an initial position in real estate investment trust **Digital Realty Trust**. Digital caters to recognizable companies like Amazon, Pfizer, and even Facebook, specializing in providing them with mission critical data centres that are purpose built for secure operations. They are located in 29 markets throughout Europe, North America, Singapore and Australia, and have a strong corporate culture where senior management see themselves as investors, rather than empire builders. That kind of attitude attracts us. Digital has grown its dividend by 29% over the last three years, with it currently yielding over 5%.

Next was the purchase of **Nike**, the "just do it" people. We executed our initial buy on August 4th, with the S&P 500 Index down almost 5% on the day. In hindsight, we should have waited. On August 18th, with fear so thick you could cut it with a knife, we mustered the courage to buy more shares, this time at considerably cheaper prices. Culturally, Nike fits our criteria for a great company – it hires from within and has long management tenures. Insiders own a lot of stock. It sees itself as the world's leading designer, marketer and distributor of athletic gear, and its focus on emerging markets allowed it to sail through the 2008/09 recession with increased earnings. In May 2010, it announced its audacious goal of generating annual revenues of some $27 billion by 2015, then on track and apparently optimistic, it raised again in June of this year to the $28 billion to $30 billion range.

Post the Nike purchase, we exited the last of our position in food wholesaler and distributor **Colabor Group Inc.** averaging $9.89 per share on the way out the door. The sell decision was driven by the company's increased use of debt. When we first purchased Colabor, its financial leverage was low and in decline. Cash flow was stable and amply covered its dividend. In the subsequent quarters, it began making debt-financed acquisitions at a time when business conditions were getting tougher. Then in response to its lower share price, Colabor began buying back its common shares rather than paying down debt. We believe that decision was misguided and upon challenging senior management on their conference call, they avoided most of our questions. That's when we started selling. It took us two months to get clear of it at acceptable prices and we booked a 2% loss over the 9-month hold period.

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We also eliminated **West Fraser Timber** from the program, notwithstanding its near great company status. There isn't much question in my mind that we could have made money on West Fraser in the long term – the question was "what is the opportunity cost of waiting," and ultimately, that is what pushed us over the edge. Housing starts remain weak and it is hard to see how they will get turned around any time soon. We booked a 7.5% loss on the position, which was a nominal 1% weighting in the program, thus the affect on overall results will be less than 1/10 of 1%. We may get the opportunity to buy West Fraser with a better value proposition at some point in the future.

In mid-September we purchased an initial position in global energy services company **ShawCor**, one of the world's largest providers of advanced pipeline coatings. ShawCor has manufacturing and service facilities in over twenty countries and prides itself for coming up with technologically advanced products and cutting edge management systems. Management has openly stated that its long term earnings growth rate is expected at around 15%, which is consistent with its 14% result over the past decade. It currently has worldwide bids at an unprecedented $1.5 billion, which is consistent with our view that the pipeline business is a secular growth story. As those bids get awarded, we expect investors to sit up and take note. In the interim, the company has been aggressively buying back shares, which speaks well to management's confidence.

Looking ahead, there have been some significant changes on the economic front since the last recording of **The Opportunity Update** on September 8th. The most notable is the downdraft in copper prices, i.e. $4.00 per pound on the day of the recording, versus $3.20 on September 30th. Most clients will know that we see the price of copper as a core leading economic indicator. A downdraft of this magnitude makes us take note, but to gain some perspective, please note that copper bottomed at $1.25 in December 2008.

When we weigh all of the evidence at our disposal, my best guess is that we are now in recession. Historically, the second recession of a "double dip" is far more benign and shorter in duration than the preceding one. Stock markets tend to forecast the end of recessions 6 to 12 months in advance. We are encouraged by the fact that 10-year U.S. government bonds are now yielding less than the dividend yield for the S&P 500 Index. Since 1953 that has only happened 20 times, and the average return 12 months later has been 20%. ***"But Chris, it's different this time!"*** Aside from being the four most expensive words in the English language, you're right! The issues are always different. What doesn't change is how we as humans respond to it. These are the types of markets where people are permanently separated from their money. My job is to make sure we don't join the permanent crowd even if we have to endure some temporary losses.

At this point in time, our goal of an 8% return for 2011 is still within our sights and we are doing our level best to make that happen.

Yours truly,

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