# The Dividend Value Discipline™
# Market Commentary
# 4th Quarter 2012 (Q4) – as of December 31st

The close of 2012 marks ten full calendar years that **The Dividend Value Discipline™** has been in existence. Our objectives are exactly the same as they were back in 2002:

(1) income every month
(2) buy only those securities which become attractive on a go-forward basis
(3) absolute returns of +8% each and every year

Due to differences in start dates and the timing of cash flows, no two account returns are the same. Your individual results can be found on **The Progress Monitor**, which is included in your quarterly reporting package.

Fully-invested accounts closed out 2012 with returns in the +2.5% range, a sub-par performance on my part and one I am clearly not happy with. I am sure you share that sentiment. While not an unmitigated disaster, the year-end numbers pale in light of the TSX Composite Index's +4.0% return, the S&P 500 Index's +10.3% return (in CDN$ terms), and most importantly, our stated objective of +8%.

At the end of Q3 2012, returns for fully-invested accounts were around +5% on a year-to-date basis. So what happened? By far, our biggest detractor was oilfield fluid systems provider Poseidon Concepts (PSN), which knocked some 3.5% off the overall return in the aftermath of its disappointing earnings report on November 14. Earnings and revenues were about half of what investors were expecting, a huge reversal from the blow away numbers that were becoming routine. We spoke with PSN's CEO that evening, and in the spirit of transparency, we e-mailed a summary of our thinking shortly thereafter.

We then added (albeit marginally) to the PSN position on November 28 and December 24. My thinking at both intervals was that we were on the cusp of a significant rebound and there was considerable upside/limited downside from the current price. I was wrong on both counts, at least in the short-term. On December 27, PSN announced some difficult decisions. First and foremost was getting on top of their bad receivables and some much needed management changes. They also put all future dividend payments under review, which seems like a negative, but if I was running the company I would have done the same thing. From my perspective, the best thing they could do is buy back their own stock with any excess cash. I find it interesting that Scott Dawson, former CEO of Open Range (PSN's previous parent company), is the newly appointed CEO. In my opinion, they are preparing the company for a takeout. That being said, I want you to know that I currently have no intention of making any further purchases. With that explanation out of the way, we move on to the major transactions over the past quarter.

The only "sell all" decision was that of **Nu Skin Enterprises** (NUS), where we locked in a gain of almost 45% over a 23-month holding period. This decision was driven by some unflattering news that came to our attention, concerning the lifestyles of some of their past and present senior executives. The news caused us to reassess the company's management, and our conclusion was that leadership was lacking.

Moving on to new acquisitions, in late-September we started building a position in flow systems provider **Enerflex Ltd.** (EFX). Their main business is getting oil and gas from the wellhead to market. As shale oil and tight gas deposits in North America develop, EFX will provide many of the systems to move these products to market. Given North America's abundant supply of natural gas and the economic incentive to use that cheap energy, the company's prospects are bright indeed.

In October, we added **Apple Inc.** (AAPL). A major attraction is how people adopt the ecosystem. Younger people start with an iPod and before you know it, the whole family is on the Apple platform, where everything is integrated – the iPhone, iPad, iPod, iMac, iTunes, etc. Financially, AAPL is stunning – it started paying a dividend in July 2012, so after our analysis, we made an initial purchase when the stock retrenched some 14% off its high water mark. Post that purchase, the short-term price action has not been particularly encouraging. We continue to see the shares as significantly undervalued and assuming we find evidence of renewed relative strength, I am open to adding to the position.

Our next acquisition was **U.S. Bancorp** (USB). The company is very well managed and we have to give it "great culture" status. We like its rigorous, performance-driven compensation policy based on surpassing internal targets **and** surpassing the average performance results of its peer group. Now that is leadership! USB also has a policy of delivering rent cheques, by returning up to 80% of earnings to shareholders in the form of dividends and common share repurchases. Insider ownership is broad and growing.

Our last addition is one of Canada's great success stories, **Ritchie Bros. Auctioneers Inc.** (RBA). RBA has been committed to the unreserved auction process for over the past six decades. Revenue and earnings per share have grown at average growth rates of 13% and 14%, respectively. RBA is now the largest industrial auctioneer in the world, and given its strong balance sheet it can guarantee consignors a minimum price and/or outright buy inventory to ensure a stable supply of industrial equipment for its bidding customers.

I should also note that, during the post-election market swoon, we increased our holdings in smartphone chip provider Qualcomm, farm-equipment manufacturer Deere & Co., technology real estate specialist Digital Realty, and finally, the "just do it" people, Nike. Thus far, the results have been encouraging.

In closing, while I acknowledge the disappointing performance over the short-term, it is worth drawing attention to the program's long-term results. Even after the past quarter, accounts that have been fully-invested since the end of 2009 have enjoyed 3-year annualized returns of close to 9% (versus the TSX Composite Index at +1.9% and the S&P 500 Index at +6.4%, in CDN$). On an even longer-term, accounts that have been fully-invested since the end of 2002 have enjoyed 10-year annualized returns of close to 8% (versus the TSX Composite Index at 6.5% and the S&P 500 Index at 0.2%, in CDN$).

As we look forward to 2013, we can't help but be optimistic. If we continue to hone our skills, focus on the "rent cheque", and concentrate on great culture companies like Colgate, Deere, and Nike, we will get this thing righted. Investing is a marathon, not a sprint.

**Yours truly,**

**Chris Raper**
**Vice President, Portfolio Manager**
**Private Client Group**
**Raymond James Ltd.**
www.chrisraper.com

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