The Dividend Value Discipline™
Market Commentary
3rd Quarter 2014 (Q3) – as of September 30th

As we close out the third quarter of 2014, we are happy to report another positive quarter for program participants, notwithstanding Canada's commodity-centric **TSX Composite Total Return Index** pegging in with a -0.6% return for the quarter and the U.S.-based **S&P 500 Total Return Index** at +1.0% (a whopping +6.0% in CDN$ terms). Fully invested accounts within **The Dividend Value Discipline™** were up ~2% on the quarter and ~7% year-to-date for 2014. We did give up ~1% during the past month after 14 consecutive up months for the program, as September lived up to its reputation as being the toughest month of the year. Due to differences in start dates and the timing of cash flows, no two account returns 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, the 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% each and every year. To accomplish those objectives, we continue to take a "shock absorber" approach to investing. This means taking money off the "stock table" and moving it to the "fixed income table" when people are greedy and/or valuations are expensive, and vice versa when people are fearful and/or valuations are compelling, and we always focus on the "rent cheque". We endeavour to smooth out returns. That's important, as it allows our clients (and our team) to stay "in the game" during the rough patches which is ultimately how we all make money. You should expect us to outperform stock indices in down markets and underperform in up markets. By way of example, here is an excerpt from our Q4 2011 Market Commentary: *"the S&P/TSX Composite Index pegged a -11.1% return for the year and the S&P 500 Index came in a bit stronger at 0% (+2.2% in CDN$ terms)…So how did we stack up? Fully invested registered accounts (RRSP, RESP & RRIF) met or exceeded the +8% bogey, whereas non-registered accounts pegged in at a respectable +5%, on average.".*

What follows are details of the major transactions in the program over the last 90 days and the rationale for each.

First amongst the "sell all" decisions was discount retailer **TJX Companies Inc.**, booking a 9% loss on the position after holding it for a little over a year. Our thinking? The discount retail sector was struggling, i.e. Wal-Mart, Target and Sears, and in TJX's case earnings and sales had come in at low single digit increases for the last two quarters. I concluded that things were likely to get worse before getting better. Post the sell decision and the company's second quarter earnings release on August 19, 2014, it became apparent that I was just plain wrong. By the end of the quarter, the stock had improved to what would have been a small profit position for us – yes, this is a humbling business.

The next exit was a difficult decision because the company is so great culture-wise, but that in itself does not necessarily make a great investment. We parted ways with **Deere & Co**, better known as John Deere, booking a 14% gain for a 2-year holding period. In a nutshell, the returns of Deere have historically been very closely tied to the price of corn which has dropped off a cliff during the past few months; i.e. north of $5.00 USD per bushel in May 2014 and trading recently below $3.50. Our belief at the time was that Deere remains a great company, yet we are going to be able to buy it considerably cheaper in the future. That has turned out to be the case, and we are currently of the mind-set that the value proposition gets better yet. A special thank you to our analyst, Alex Vozian, on the Deere decision – he had to press me pretty hard to make that call. I am glad he did.

The next sell came in mid-August and it was medical devices company **Medtronic Inc.,** which we exited after an 8-month holding period with a gain of 8%. Price-wise, Medtronic was nearing what we believed it to be worth and we saw additional risk with their announcement of the acquisition of Irish-based Covidien. The odds of indigestion in such a significant acquisition are high (and the potential benefits are already known), thus the value proposition was no longer attractive to us.

We also chose to exit asset manager **Blackrock Inc.**, with a gain of 21% for an 11-month holding period, over valuation concerns and its continued loss of market share in their Exchange Traded Funds platform.

Finally, on the last day of the month we exited our position in **Nike Inc.**, pegging a 105% gain for our holding period of 37 months – yes, we purchased it in the thick of the Euro-crisis in August of 2011. This was a tough decision as Nike is a great culture company with a tough to beat strategy. That said, at the current price of ~ $89 USD, the value proposition just didn't look attractive. We believe that there is too much good news priced in.

Moving to the buys, we added two names to the defensive staples group. First was **Kraft Foods Group Inc.** which needs little in the way of introduction. Their mission is *to be North America's best food and beverage company.* Their goals are succinct: profitable top line growth, consistent bottom line growth, and superior dividend payout. Best of all is their strategy – make our people our competitive edge. The company is backing it up by investing heavily in Kraft University and has recently implemented an impressive performance management system. Their scale translates to a much lower percentage of revenue spent on marketing versus their peer group, and their overhead costs have dropped from 12% of revenue in 2010 to 7.6% in 2013. Bottom line, we believe Kraft has developed a competitive edge through its focus on people development. We are also attracted to management's commitment to an ever increasing rent cheque, aka the dividend, which is currently about 3.5%.

Finally, we bought up a stake in **Costco Wholesale Corp.**, a great culture company if there ever was one. It is wholly dedicated to bringing members the best possible prices on quality brand-name merchandise. Costco's operating philosophy is pretty simple: keep costs low and pass the savings on to members. Against the wannabees i.e. Wal-Mart & Sam's Club, Costco steadily outperforms with higher sales per square foot and superior same store sales growth. Membership renewal rates have remained consistently high despite a 10% membership fee increase in 2012. We find the management team a humble lot and all of them have worked their way up from various positions in warehouses. Line employees rate Costco as one of the best employers to work for, with great benefits and above average pay. Financially, the company carries little debt and has consistently demonstrated a commitment to returning cash to shareholders.

The move to defensives is intentional. After a very strong July and August, markets have stuttered throughout September and the evidence is mounting for a "market in correction". We continue to be in a higher than usual cash position to take advantage of the better value propositions ahead. Please be reminded that rough spots are inevitable and the only way to profit in the long term is to manage through them. We will continue shopping for great culture/wide moat companies that offer us compelling value propositions.

Yours truly,

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