The Dividend Value Discipline™
Quarterly Market Commentary
2nd Quarter 2016 (Q2) – as of June 30th

The recent market environment has been a challenging one. We have experienced more volatility in the first half of 2016 than we have seen in the previous five years. To wit, crude oil (West Texas Intermediate) marked a low of $27.24 and a high of $51.67, our loonie traded as low as US$0.6805 and as high as US$0.8024, and gold hit a low of $1,060.24 and a high of $1,358.20, all within a 6-month period! Obviously, the Fickle Fed ("we are likely to raise interest rates, no wait, I wonder if we have the legal right to go to negative interest rates") and Brexit (which surely won't be the last European Union referendum amongst member countries) added to the complexity.

Most fully invested accounts within **The Dividend Value Discipline™** pegged in at June 30th with 2016 year-to-date returns between +0.50% and +1.00%. This was an improvement of 1.5% to 2% over the March 31st results, but we clearly have some work to do in the second half of the year to reach our 8% return goal. As you may recall, differences in start dates and the timing of cash flows means that no two accounts are exactly alike – your individual results can be found on **The Progress Monitor**. All return figures are net of fees.

The good news is that the year is not over, and most of our stocks are doing well – the subdued performance is mainly due to our loonie's strength (up 7% year-to-date vs. the USD), a considerable headwind when more than 60% of **The Dividend Value Discipline™** is in USD-denominated securities.

In terms of reference points, Canada's TSX Total Return Index has made up much of 2015's 9.02% loss, ending the first half with an impressive 9.84% gain, with over half of that gain attributed to the gold sector. In the U.S., the S&P 500 Total Return Index gained 3.84% for the first half of 2016 (in local currency), but is a **negative** 3.04% in Canadian dollar terms. All of these figures include dividends.

What follows are last quarter's major decisions within the program and our thinking at the time.

Getting the "sell all" decisions out of the way, we made the decision to part ways with fracking company **Canyon Services Group Inc.** in late April, exiting at $4.67 per share. For those of you participating in the program in May 2015, we pegged a loss of ~20%. Notwithstanding the high regard we have for Canyon's management, at the time of sale we did not see the oil rally as sustainable, and in addition, the company no longer pays a dividend and thus is disqualified from any further purchases.

A side note on our oil call – it has become apparent that we have been too bearish and that there are a lot of things happening outside of North America that are supportive of higher prices. We balance that with the observation of just how easy it was for oil producers to raise money over the last quarter. We normally find an oil bottom when bankers and investors are no longer willing to fund the producers. For now, we accept what is "is" and the current evidence is suggesting that we need to relax our bearish view…but do so very carefully. Market history is rife with oil rallies that turn out to be false starts. Oil cycles are long, often extending fifteen years or more.

We also eliminated the **Vanguard FTSE Europe ETF** position in late April just shy of US$50 per share, pegging a loss just north of 10%, most of which was currency-related. Our European aspirations had not materialized and we saw the upcoming Brexit vote as adding additional risk. The sale decision has been the right one thus far.

Next was **United Parcel Service Inc.** in early June**,** where we notched a marginal loss of ~1%. Our positive view of UPS notwithstanding, we have to acknowledge that the "last mile" side of their business seems to be under threat from technology-driven platforms like Uber. This could substantially change UPS's scale advantages and, over time, erode profitability.

Finally, we exited **Apple Inc.** in mid-June, just shy of $96 USD, notching a 17% gain. The technology behemoth has come under pressure as the smartphone market reaches the saturation point and each new iPhone upgrade has fewer bells and whistles vis-à-vis both their competitors and existing handsets. Their last quarterly results were disappointing, a trend that usually gets worse before it gets better. From an investor psychology perspective, we see Apple as "over-owned", and more people are inclined to sell with each new disappointment. Anecdotally, we note that many of our younger employees have moved from Apple to Samsung, LG, or Motorola handsets, with little loss of functionality. This suggests the Apple "moat" is not as strong as it once was. Accordingly, we chose to move to greener pastures.

Please understand that we try to sell our laggards and let the winners run. If the above is leaving you feeling like you need some good news, below is a list of our top ten performing stocks within **The Dividend Value Discipline™**. All figures are as of July 5, 2016, and include dividends.

Company	**Holding Period Return (in CAD)**	**Holding Period Return (in local currency)**
Marsh & McLennan Companies Inc. (USD)	+37.7%	+21.2%
Vaneck Vectors Gold Miners ETF (USD)	+32.2%	+32.6%
CVS Health Corp. (USD)	+31.6%	+25.1%
ARC Resources Ltd. (CAD)	+29.1%	+29.1%
Casey's General Stores Inc. (USD)	+13.7%	+13.2%
Dollarama Inc. (CAD)	+9.7%	+9.7%
Intuit Inc. (USD)	+7.8%	+11.3%
TJX Companies Inc. (USD)	+7.7%	+4.6%
Rockwell Automation Inc. (USD)	+6.7%	+9.9%
Sherwin Williams Co. (USD)	+6.7%	+7.4%

Turning to last quarter's buys, as you may expect, they are concentrated in the "disruptor and aggregator" categories, our solution for growth in a no-growth world. You can read more about this concept in the May edition of ***The Strategist*****.**

In the "aggregator" space, we accumulated shares of speciality packaging company **CCL Industries** throughout April and May. They are a growth by acquisition story with some 119 manufacturing facilities across North America, Latin America, Europe, Asia, Australia and Africa. They mitigate the risk by sticking to things they know, keeping the balance sheet strong and successfully integrating newly acquired divisions into their corporate culture. CCL's economic moat is driven by its scale. They have one of the highest corporate culture scores (our internal scoring system) that we have ever seen. "Rent cheque"-wise, they recently announced a 33% increase in their dividend and their 3-year dividend growth rate is almost 27% per annum. Bring it on!

In April and June, we purchased another aggregator, U.S-based self-storage operator **CubeSmart**, the fourth largest company of its kind, with some 30 million square feet of rentable space. We like the fact that the self-storage business is a fragmented industry. As Mom and Pop owners retire, CubeSmart can make small “tuck in” acquisitions and can gain efficiencies on the human resource and technology fronts, which enables them to grow profits, and more importantly to us, dividends. Their dividend has grown at ~25% per annum over the last three years.

Still yet another aggregator, in May and June we purchased an initial stake in apparel distributor **VF Corp**. You will recognize their brands: Lee, Vans, Nautica, Timberland and North Face, to name a few. A serial acquirer of “cash cows” when brands stop giving milk, they send them to the packing plant. The corporate culture runs deep – hiring from within is the norm and the median tenure of the current executive team is 18 years. Their moat is wide due to their scale and brand advantages, and another rent cheque champion with 43 consecutive years of dividend increases.

The last aggregator purchase was **Casey’s General Stores Inc**. They own and operate over 1,900 convenience stores in 14 Midwestern states, selling self-service gasoline, grocery items, and prepared foods such as made-from-scratch pizza. Again, as Mom and Pop operators retire, the company can make numerous “tuck in” acquisitions and improve the businesses with better systems and expanded product offerings. Their management group is an impressive lot – transparency, tenure and a clear focus on their economic engine (operating income per store) are behaviours we look for. The rent cheque has grown at a respectable clip and represents a modest ~20% payout – the rest finances growth!

Last, we bought an initial stake in the **Bank of Nova Scotia**, an outlier amongst its Canadian-based peers. It displays both disruptor characteristics, i.e., their recent acquisition of fast growing digital bank Tangerine; and aggregator characteristics, with its long history of buying related businesses domestically and is now a major player in Mexico & Latin America. Their culture is driven by a willingness to think outside the box. Management hires from within, their median tenure being 26 years. The growth in the rent cheque has been modest of late (about 7% per annum for the last three years), but the decline in the stock price has translated to an attractive dividend yield of ~4.5% on our purchase.

In closing, what are the likely impacts of Brexit and the upcoming U.S. election, and how do we intend to get to 8% by year-end?

The good news about Brexit is that it surprised the world and it scared a lot of “Nervous Nellies” into panic sell mode, only to see stocks rally strongly immediately thereafter. From a historical perspective, we expect more volatility over the summer and as investors figure out that “leaving” is going to take years, not months, it will become a far lesser issue. In short, more positives than negatives, at least for this side of the pond. The U.S. election is normally a positive for markets, yet Trump’s protectionist rhetoric scares us – we tried that in the 1930’s and it didn’t work very well. Who wins? As per Brexit, this is unknowable, even with the polls showing Hillary’s lead. We try not to spend much time on unknowable outcomes – we are far better off studying/acquiring disruptors and aggregators and we are making significant progress on that front. In our view, that is the path to 8% returns by year-end.

Yours truly,

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