The Dividend Value Discipline™
Quarterly Market Commentary
1st Quarter 2016 (Q1) – as of March 31st

It will come as no surprise to most that the first quarter of 2016 was akin to a roller coaster ride. After a rough January and February, we spent most of March inching back towards where we started the year, with most fully invested accounts within **The Dividend Value Discipline™** pegging in with losses of -1.00% to -1.50% for the quarter. To give you some market context, Canada's S&P/TSX Composite Total Return Index was up 4.34% for the quarter (after last year's loss of 9.02%), while the U.S.'s S&P 500 Total Return Index came in at +1.34%. All figures include dividends, and are net of any fees.

Differences in start dates and the timing of cash flows translate to "no two accounts 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, our objectives for the program remain unchanged:

- Income every month
- Buy only those securities which become attractive on a go-forward basis
- Absolute returns of +8% net to you each and every year

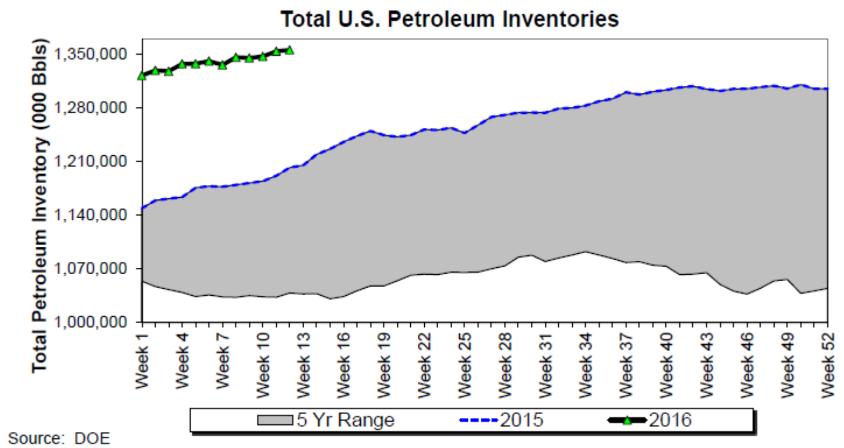
Your first question may be, "why was the Q1 2016 return for **The Dividend Value Discipline™** negative, while North American stocks indices were positive?" By far, the biggest negative contributor to our Q1 performance was the ~6% increase in the Canadian dollar ($CAD), given our ~60% exposure in U.S. dollar ($USD) denominated securities. Last year's tailwind became Q1's headwind.

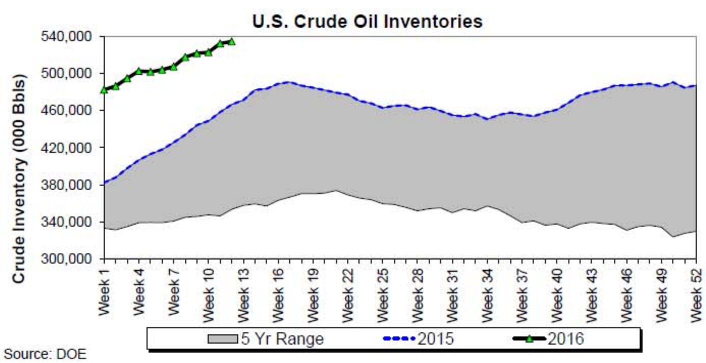
Was it $CAD strength or $USD weakness? Our take is that most of the move had to do with lowered expectations for interest rate increases by the U.S. Fed. At the beginning of the year, economists were forecasting four increases in 2016, and this has since decreased to only two and even that is suspect. In Canada, most economists are forecasting zero interest rate increases for 2016, and some believe we will have another rate cut.

As we see it, the only way that the $CAD will continue to outperform the $USD is if we get higher oil prices, and we don't believe that is in the cards anytime soon. Here is why.

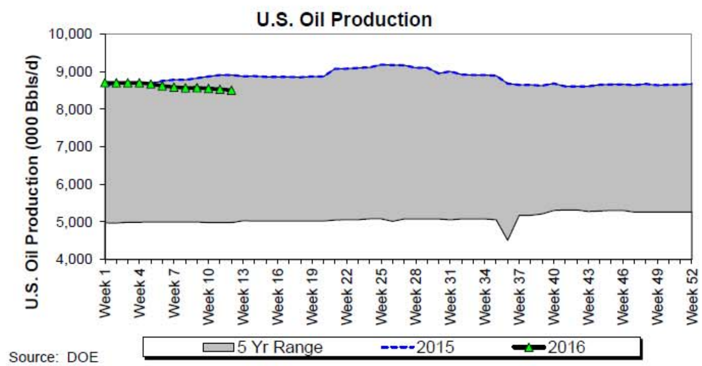
When oil went below $30 per barrel, we observed record "short" oil positions – i.e. speculators selling oil they didn't own at $30, hoping to buy it back at say $25. Of course, when the price goes in the other direction, it is a two-sided sword. The speculative crowd got caught on the "wrong side of the trade" and scrambled for the exit as they tried to buy back their positions while having their heads handed to them. In our mind, that phenomena has recently peaked with oil hitting the ~$40 ceiling and the market has now shaken out most of the speculators and will slowly return to the more mundane commercial interests and the supply/demand equation.

On the supply side, we see little to get excited about. The images below are self-explanatory, and are as of the March 30th Department of Energy report. As I wrote to one client last week: *"John, these cycles take a long time and they tend to wear investors out as opposed to scare them out. The sheer time duration of waiting for prices to improve is what eventually starves producers of investment capital, and only then does supply get sufficiently tight to see prices get to a new sustainable plateau. When I consider the fact that we went into this downturn with a hugely expanded resource base - shale oil combined with horizontal drilling/fracking - it makes me even more convinced of the "lower for longer" mantra. As far as OPEC cutting supply, I think they should change the name to the Liar's Club – there is no way those guys are going to cut unless it is price alone that forces them to cut."* All of that to say, we are cautious on Canada. Anecdotally, our #1 performing stock on a year-to-date basis was Dollarama, which was, in part, a bet on more hard times for Canada.





Total U.S. crude oil inventories rose by 2.3 MMBbls (consensus estimate: + 3.1 MMBbls) to end the week at 534.8 MMBbls, or 68.2 MMBbls above this time last year.



U.S. crude production decreased by 27 MBbls per day from last week to 8504 MBbls per day, or 407 MBbls per day below this time last year. Since the start of the year, U.S. crude production is down 202 MBbls per day.

Now (at last ☺), turning to the major buy/sell decisions for the quarter:

In early January, **Kaiser Aluminum Corp**. got the axe, bagging a 20% gain. Our concern was deteriorating business conditions – Kaiser is a big supplier of high spec aluminum to companies like Boeing. As fuel gets cheaper, the incentive to buy new planes starts to wane and we thought it best to take the money off the table. It is interesting to us that Boeing just announced a round of layoffs.

We then exited **St. Jude Medical Inc**., accepting a ~8% loss. St. Jude has failed to deliver on the market's expectations and the entire sector has fallen into disfavour with investors. In conditions like that, the best thing you can do is get out of the way.

We struggled as we sold truck and intermodal transportation company **JB Hunt Transport Services Inc**. in early February, for a measly 1% gain. It continues to be a fine company; we just found something else in the transportation sector that we liked better, namely UPS, which I will address later.

As the U.S. Fed developed its "nervous Nellie" syndrome over increasing interest rates, it was evident that the expected boost to financials was not going to happen anytime soon. The risks to the downside prompted us to nix our two U.S. banks – **PNC Financial Services Group Inc**. was sold for a loss just over 1% and **US Bancorp** for a gain just shy of 1%. You may be aware that Janet Yellen and her crew chose not to raise rates at their March meeting and she has become considerably more dovish with respect to future raises, citing "global risks".

The most painful exit of the quarter was the sale of department store **Macy's Inc.,** where we accepted a loss of ~21%. Bottom line is that I was just plain wrong on this name. I bought, and worse, drank the Kool-Aid on their omni-center retailing scheme. What was once a plausible strategy has now developed into the spaghetti strategy, where Macy's is trying every format you can think of with uninspiring results. The only comfort I can give you is that I bought and sold it in lock-step with you.

Turning to the new acquisitions, after all of our talk about our expectations for a long-term bear market in oil, we did reacquire oil and gas producer **ARC Resources Ltd**. in early January (but sold half since then, at a 19% gain), when investors were hitting the panic sell button. At ~$15 per share, we just couldn't help ourselves! It is a name we know well – great management, an exceptional resource base in the Montney play, and an efficient operator. When they posted last quarter's results, we were stunned at how much progress they had made on their finding and development costs, which are now below $9 per barrel of oil equivalent, compared to a three year average of $17. When you couple that with the long term hedges they have in place, we can see across the valley of low oil prices. This is one company where we have no fears of their credit line being pulled.

Next up was another familiar name, **Microsoft Corp.**, where they finally seem to be firing on all cylinders under the direction of their newish CEO, Satya Nadella. Their cloud business is the envy of its peers, they are gaining a lot of traction with their subscription-based Office 365 product, and their Surface and Xbox numbers are pretty impressive as well. We see management as "improving", their moat is undeniable, and they continue to boost our rent cheque with a dividend that has grown at north of 15% annualized for the last three years. Our take is we are going to see more of the same.

In March, we humbly returned to the gold complex, buying the exchange traded fund, **Market Vectors Gold Miners ETF**, which is designed to shadow the NYSE Arca Hold Miners Index. In a nutshell, the index is used to track the overall performance of companies involved in the gold mining industry. We say humbly because it was just last August when we sold gold miner Newmont, shortly after China started devaluing their currency. Our read at the time was if China devaluing couldn't shove the price of gold north, what could? As we see it, the game changer was when Janet Yellen, the U.S. Fed Chair, spoke publically about the possibility of negative rates in the U.S. Up until that point, if you had one country devaluing, you always have the option of selling currency X and moving your cash to a country Y that is not devaluing. But what happens if there is no such country left? You might buy gold to try to preserve your purchasing power. We are not there yet, but the market is typically ahead of the curve and gold was up some 17% in Q1. Why the ETF as opposed to a company like Newmont? We are basically buying insurance and we believe whatever happens to gold will be reflected the price of the gold miners. The ETF allows us to mitigate the individual corporate risk and devote more time to sustainable companies with big moats and great corporate culture.

Our last acquisition of the quarter was the industrial supply company **W.W. Grainger, Inc**., one of North America's leading broad line suppliers of maintenance, repair and operating products – think recurring revenue, the Holy Grail for long term business prosperity. Our take is that Grainger is a great company in a still fragmented industry, and therein lies the opportunity. It has demonstrated its ability to make tuck in acquisitions over and over again, while driving efficiencies that are the envy of its peers. With almost 40% of its sales via e-commerce, it is now the 15th biggest e-retailer in the U.S. Our senior analyst, Alex Vozian, describes them as the "rent cheque champion" with 44 years of consistent dividend increases. Obviously, management is getting a few things right. Our intention is to buy more.

As we look to the start of Q2, we are mindful that April is the last month of the seasonally strong period (November through April) for the markets. We currently have ~55% of the portfolio invested in dividend paying equities, which is historically underweight for us, so we are looking forward to the "sell in May and go away" season which often offers up some bargains. Our roster of potential investments has never been larger, nor has it been as thoroughly studied. As alluded to in the past few communications, we are increasingly mindful of the need for growth in a no growth world, with Grainger being one such example. Stand by for more on that front in the months to come.

Yours truly,

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

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