The Dividend Value Discipline™
Quarterly Market Commentary
3rd Quarter 2016 (Q3) – as of September 30th

The dog days of summer wrapped up with some noteworthy developments. After 15 months of sideways motion, the SandP 500 Index finally made a new high back in July, as did the more growth-oriented NASDAQ Composite Index. We also notched a record month-end high at the end of July with **The Dividend Value Discipline™**.

Closing out the quarter, most fully invested accounts pegged in at September 30 with 2016 year-to-date returns between +2.00% and +2.50%. Yes, another improvement over the June 30 figures, but leaving us with a considerable gap to make our 8% target by year-end, in large part due to the Canadian dollar headwind - up +5.32% on a year-to-date basis at the end of Q3. As you know, differences in start dates and the timing of cash flows means that no two accounts are exactly alike – your results can be found on **The Progress Monitor.**

The good news is that we are now through September (the historically toughest month of the year for stocks) and only one month away from the seasonally strongest time frame of the year, November through April – thus the investment adage "buy them when it snows and sell them when it goes".

In terms of reference points, at the end of Q3, the U.S.'s S&P 500 Total Return Index had gained +7.80% on a year-to-date basis in local currency (+2.40% in Canadian dollars), whereas Canada's S&P/TSX Composite Total Return Index continues to make up lost ground, pegging in at +15.16% over the same time frame. It should also be noted that at the end of Q3, the S&P/TSX Composite Total Return Index is still ~1.5% shy of its all-time high set in March 2015.

Throughout the quarter we continued to layer on our ***"aggregator and disruptor"*** themes, over top of our ***great culture, wide moat*** and ***rent cheque*** prerequisites. Our sense is that we are making solid progress... finding growth in a no-growth world, as per the **Top 10 Rent Cheques That Grow** table on the following page. From our perspective, the 8% bogey is going to be increasingly difficult to achieve at the macro level and we just have to find companies that can grow in virtually any economic environment. You can read more about the rationale in the May edition of **The Strategist**, located here.

Top 10 Rent Cheques That Grow

	3-Year Dividend CAGR	Company	Current Yield	1-Year Dividend Growth	5-Year Dividend CAGR	Type
1	32.5%	CCL INDS INC	0.8%	33.3%	23.4%	Aggregator
2	27.2%	LOWES COMPANIES INC	1.9%	37.3%	22.9%	Aggregator
3	24.8%	INTUIT INC	1.2%	29.5%	55.4%	Disruptor
4	23.7%	TJX COMPANIES INC	1.4%	29.2%	23.6%	Disruptor
5	23.6%	CVS HEALTH CORP	2.0%	21.4%	27.7%	Disruptor
6	22.5%	AMPHENOL CORP	0.9%	5.7%	79.6%	Aggregator
7	22.2%	CUBESMART	3.1%	21.7%	24.6%	Aggregator
8	19.5%	HORMEL FOODS CORP	1.5%	16.0%	17.8%	Aggregator
9	18.9%	SHERWIN WILLIAMS CO	1.2%	25.4%	18.1%	Aggregator
10	17.6%	BANK OF NOVA SCOTIA	4.3%	7.2%	7.3%	Disruptor

CAGR = Compound Annual Growth Rate – as at September 30, 2016

What follows is the strategy in action, albeit executed imperfectly, as we walk you through the major buy and sell decisions for the quarter.

Turning first to the eliminations, we sold our nominal position (1% weighting) in **Kaiser Aluminium Corp.** in mid-September after a hold period of three short months, notching a loss of 3.6%. Our rationale for selling was driven by the need for cash to fund an increased position in Casey's General Stores – a company where we see better upside and more consistent growth.

The only other "sell all" decision was that of **Rockwell Automation Inc.** on September 19, at a gain of 9.36%. Rockwell was approaching a price point very close to what we believe it to be worth, and we have better value propositions within our sights that are less dependent on global growth. Accordingly, we took the cash and will be redeploying it promptly.

New acquisitions for the quarter were as follows:

First up was electronics provider to the "internet of things", **Amphenol Corp.**, in mid-August. Amphenol designs, manufactures and markets electronic connectors, sensors and fibre optics components for original equipment manufacturers. The world's insatiable demand for "connectedness", be it cellphones or washing machines, means Amphenol has strong secular tailwinds at its back. Despite being one of the largest players in its space, it only commands a 4% market share, leaving lots of room for growth via aggregation. Our view is that management is up to the task – in short, it has one of the best culture scores we have ever witnessed. Overhead is lean and 80% of its manufacturing is in low-cost countries. Free cash flow continues to grow with each cycle, notwithstanding their numerous "tuck in" acquisitions. The rent cheque has grown at an eye popping 38% over the last three years and the dividend pay-out ratio is a modest 25% – so again, lots of room for growth.

Next was our purchase of **AmerisourceBergen Corp.**, a name we have owned in the past and sold over valuation concerns. Thanks to Hillary Clinton's EpiPen tweet, the stock dropped like a stone on August 25, and we were able to pick it up on the cheap. History has shown that by the time the president gets elected, they will have bigger fish to fry – i.e. healthcare stocks tend do well as the election season winds down and during the months following the election. So... this time around, we are much happier with the value proposition. AmerisourceBergen is one of the world's largest pharmaceutical service companies, acting as the solutions provider between drug manufacturers and health care providers.

In late August, we acquired an initial stake in food brand aggregator **Hormel Foods Corp.** Hormel has a stable business in their 125 year old food processing segment and they are using the free cash flow from that business to aggregate (buy) brands like Skippy (#1 share in peanut butter), Muscle Milk (#1 share in protein drink), and Applegate (#1 in organic/natural value added proteins). That's a lot of #1's. This trend speaks well of management, where you will find a 27 year veteran of the company as CEO, all the executives have been hired from within, and refreshingly – they own lots of stock. Their discipline is evident by their high and stable return on capital employed, and lastly, we have another rent cheque champion with over 50 years of consecutive dividend increases – go Skippy!

Canadian National Railway Co. was added to the portfolio in mid-September. They have the largest rail network in Canada and the only transcontinental network in North America, offering integrated transportation services including rail, intermodal, trucking, freight forwarding, warehousing and distribution. As per usual, we start with management, and the CN group scored a 5 for 5 on our proprietary rating system. We found they walk the talk of "continuous pursuit of operational and service excellence, an unwavering commitment to safety and sustainability, and development of a solid team of motivated and competent railroaders". Moat-wise, they are the only transcontinental railway in North America, with service from coast to coast and into Mexico, where manufacturing is growing and thus, shipping is growing. Rent cheques have grown for the last 20 years compounding at 17% per annum and we expect the future to look much the same.

Last quarter's final new addition was **Constellation Software Inc.**, a provider of enterprise software solutions for industry specific applications – *read: sticky clients*. They have ~125,000 customers in ~100 countries and their exposure to both the public and private sectors offers a hedge against economic cyclicality. Culture-wise, we find the management humble yet highly effective – the best we have studied since 2013. The CEO, Mark Leonard, is sometimes dubbed the "Warren Buffett of software" for his candid talk and incessant ability to compound capital. Moat-wise, their strategy of aggregating "industry specific" software companies (and doing it with excellence) has allowed them to acquire over 250 companies in the last 10 years while compounding shareholder returns at eye popping rates. The rent cheque growth is a modest ~9%, but we are okay with that – they take their free cash flow and invest it at rates that far exceed what we could get elsewhere.

"Chris and Ryan, with all of this work, why aren't the results better?"

This is a fair question. Most of this year's subdued performance is due to currency. Although **The Dividend Value Discipline™** has a mix of Canadian and U.S. securities, we always report performance on a Canadian dollar basis. The Canadian dollar began the year at $0.7224 U.S., and at the end of Q3 it was at $0.7616, so we have had a 5.1% headwind on roughly 60% of the portfolio, for an impact of roughly -3% to the portfolio. Our bias at present is to slowly ramp up the U.S. dollar exposure, as we see few investment opportunities in Canada, and believe that the Canadian dollar will continue to move south towards year-end.

"What about the U.S. election?"

The result of the vote is unknowable, as is the impact of whoever gets to be President. Whatever the result, the U.S. political system makes it incredibly hard to get much done (and the divisiveness of the current players is not helping), so our take is not much changes.

Conclusion

Rather than fretting about unknowable outcomes, we believe we will all be better served if we continue to devote our resources to finding growth in this no-growth world, and that is our intended course. It is by finding and acquiring the ***aggregators and disruptors*** within the confines of our ***great culture, wide moat*** and ***rent cheque*** prerequisites that we intend to make our target return by year end.

Yours truly,

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