3rd Quarter 2019 (Q3) Market Commentary for The Dividend Value Discipline™

The Big Picture

The third quarter of 2019 was a challenging one for most investors as they digested a seemingly never ending “drip, drip, drip” of geo-political events, i.e. the recent machinations of Boris (Brexit), Xi (trade) and Trump (trade and now impeachment threat). Throw in the undeniable evidence that the global economy is slowing, and by the end of August the CNN Fear Greed Index hit the lowest level (Extreme Fear) we have seen since the Christmas Eve panic of 2018. As you would expect, investors responded en-masse by selling (withdrawing) almost $20 billion in equity based exchange traded funds for the month. That’s more than the month ended December 2018; the Christmas Eve rout. Why is that important? Because investor behaviour continues to be the number one factor in lifetime returns. You buy when the world gets fearful – you sell when the world is happy. While the worries of today are front page news, five years from now, our bet is that it will adieu about nothing.

In our view, the top three developments over the quarter were:

1. The $USD Index hitting a two year high as the late August Extreme Fear reading pushed investors in a so called flight to “safety”.

Chart courtesy of StockCharts.com

2. A new two year low in the 10 Year US Treasury (Bond) yield (1.4%) as investors sold stocks and bought bonds, which are now more expensive today than they have been in virtually every readers lifetime, safe for a brief period in July 2016.

Chart courtesy of StockCharts.com

3. Fresh evidence that investor interest in dividend paying stocks is returning as they reconsider their options in the light of today's paltry 1.5% 10 year US Treasury (bond) yields and the downward draft in internet stocks. The latter picked up momentum in early August, interestingly, right after the S&P 500 hit an all time high. The chart below points to the evidence.

Chart courtesy of StockCharts.com

VIG Top 10 Holdings [View All]

Microsoft Corporation	4.50%	Johnson & Johnson	3.43%
Visa Inc. Class A	4.46%	McDonald's Corporat...	3.02%
Procter & Gamble Co...	4.46%	Abbott Laboratories	2.72%
Walmart Inc.	4.22%	Medtronic Plc	2.63%
Comcast Corporation...	3.62%	Costco Wholesale C...	2.35%
		Total Top 10 Weighting	35.41%

FDN Top 10 Holdings [View All]

Amazon.com, Inc.	8.82%	PayPal Holdings Inc	4.63%
Facebook, Inc. Class A	7.19%	Alphabet Inc. Class A	4.60%
Cisco Systems, Inc.	5.72%	Netflix, Inc.	4.36%
salesforce.com, inc.	4.73%	Twitter, Inc.	3.06%
Alphabet Inc. Class C	4.64%	eBay Inc.	3.00%
		Total Top 10 Weighting	50.75%

Suffice to say, investors continue to seek out income generating investments and they are scarce. Especially, those investments with growing incomes. As central bankers continue to believe that the only tool in their arsenal is lower rates, we don't see that changing anytime soon. The bloom is off the rose in the interent sector – it seems every other day there is another policitician who is going to fix the world by taxing the likes of Google, Amazon and Facebook – investors are starting to believe it and selling begets selling – the money needs to find a home. Our conviction to the dividend space has only grown stronger.

The Dividend Value Discipline™

As you would expect, our objectives remain unchanged:

- Invest in companies that evidence superior corporate culture and are disrupting/re-inventing the way business is done and/or aggregating (purchasing smaller competitors) their way to sustainable double-digit earnings and dividend growth.
- To hold such companies through the inevitable market downturns by focusing on their competitive advantage and thereby, the long-term earnings/dividend growth, as opposed to the euphoria and dysphoria of the stock market.
- To generate a consistently growing income and absolute returns of 8%+ per annum over any investment cycle, i.e. peak to peak or trough to trough.

Most accounts in our "balanced" version pegged in at roughly +8.70% year to date (equities only at +10.60%) while the "what's ultimately important" rent cheque (dividend) growth continued at an impressive rate. In Q3, Northern Trust Corp came in with a 16.7% boost, US Bancorp notched a 13.5% increase, KLA Corporation pegged a 13% bump, while Expedia Trust Corp came in with a 6.3% raise and the Bank of Nova Scotia a somewhat disappointing 3.45%. On the latter note, it may provide some comfort to know that the current dividend yield is almost 5% and let's not forget the dividend tax credit!

The table below reflects the rent cheque increases of our current investee companies that have been enacted over the last 12 months, with some additional colour.

The Dividend Value Discipline™

Rent Cheque Increases Past 12 Months as at September 30, 2019

	Company	Aggregator/ Disruptor?	Annual Rent Cheque	Current Yield	Last Dividend Change*	3-Year Dividend CAGR	Years to Double Rent Cheque**	Years of Consecutive Increases	Comments
1	PROGRESSIVE CORP	Disruptor	$ 2.71	3.62%	123.5%	45.1%	2	2	Long history of disruption - their website allows you to shop competitors' insurance rates
2	CHARLES SCHWAB CORP	Disruptor	$ 0.68	1.86%	31.0%	36.1%	2	4	A technology-driven investor platform for next-generation investors
3	A. O. SMITH CORP	Aggregator	$ 0.88	1.95%	22.0%	32.3%	2	13	Providers of the high quality hot water systems and accessing China and India consumers
4	CANADIAN NATIONAL RAILWAY	Disruptor	$ 2.15	1.90%	18.1%	24.1%	3	19	Unmatched USMCA wide rail network and willing to innovate - watch for bitumen "pucks"
5	TJX COMPANIES INC	Both	$ 0.92	1.70%	17.9%	22.9%	3	22	An autonomous culture that "out-retails" their competitors
6	NORTHERN TRUST CORP	Neither	$ 2.80	3.21%	16.7%	22.6%	3	8	The go-to private bank for Fortune 500 families - leads in blockchain security
7	LOWES COMPANIES INC	Aggregator	$ 2.20	2.07%	14.6%	20.4%	4	56	New CEO joined in July 2018 who learned at HD - improvements in strategy/culture are clear
8	INTUIT INC	Disruptor	$ 2.12	0.81%	12.8%	19.6%	4	8	Creator of TurboTax/QuickBooks, dominant in small business & now cloud subscriptions
9	CCL INDUSTRIES INC	Both	$ 0.68	1.24%	30.8%	19.3%	4	17	Long-term aggregator of very stable businesses and a great track record of capital allocation
10	NVIDIA CORP	Disruptor	$ 0.64	0.37%	6.7%	17.5%	4	6	The king of graphics for gaming, professional visualization, data center, and automotive users.
11	NIKE INC	Disruptor	$ 0.88	0.96%	10.0%	14.9%	5	11	Design-savvy, brilliant marketer with growing online sales channel
12	MANULIFE FINANCIAL CORP	Neither	$ 1.00	4.35%	13.6%	14.6%	5	5	Digitizing a dinosaur industry and has great exposure to Asia where sales are growing +20%
13	US BANCORP	Neither	$ 1.68	3.18%	13.5%	14.5%	5	8	5th largest U.S. bank with improving efficiencies and lots of room to expand dividend
14	VALERO ENERGY CORP	Neither	$ 3.60	4.35%	12.5%	14.5%	5	8	Cost-focused management with a dividend that has grown from $0.65 to $3.60 in last 10 years
15	MTY FOOD GROUP INC	Aggregator	$ 0.66	1.05%	10.0%	12.8%	6	1	A top decile management group riddled with founder thinking and a disciplined aggregator
16	MICROSOFT CORP	Both	$ 2.04	1.52%	10.9%	11.5%	6	15	Culture transformer under Satya Nadella, exploiting cloud and MS Office subscriptions
17	EXPEDIA GROUP INC	Disruptor	$ 1.36	1.03%	6.3%	10.8%	7	7	Tech-savvy, online travel aggregator acquiring the best platforms & management that stays
18	SHERWIN WILLIAMS CO	Aggregator	$ 4.52	0.84%	31.4%	10.4%	7	40	Prolific aggregator, big generator of cash, long term payer of growing rent cheques
19	3M COMPANY	Aggregator	$ 5.76	3.70%	16.2%	9.1%	8	60	Globally diversified - incredibly innovative, loved by employees.
20	ANALOG DEVICES INC	Both	$ 2.16	1.98%	12.5%	8.7%	8	15	Transforming sound, pressure, light, and temperature to data, fueling our digital world
21	THE BANK OF NOVA SCOTIA	Disruptor	$ 3.60	4.87%	3.4%	7.2%	10	8	Slower dividend growth, yet we find the Asia/Latam business very attractive due to growth
22	JOHNSON AND JOHNSON	Aggregator	$ 3.80	2.88%	5.6%	6.5%	11	56	Fantastic culture, huge insider ownership base and well diversified products stream
23	LAMB WESTON HOLDINGS INC	Disruptor	$ 0.80	1.09%	4.6%	2.2%	32	2	Innovator & supplier of the world's most profitable restaurant item, french fries
24	CONSTELLATION SOFTWARE INC***	Aggregator	$ 4.00	0.31%	0.0%	0.0%	n/a	0	Special $20 dividend in 2019 - gets 20% return on retained capital - highest culture score
	Median			**1.88%**	**13.14%**	**14.52%**	**5.1**	**8**	

*Annualized. 0% if no change to annual dividend in the last 12 months.

**Based on 3-year Dividend CAGR (Compound Annual Growth Rate) - as of August 21, 2019

***Constellation Software declared a special dividend of $20 US per share on February 13, 2019. This is not taken into account in annual rent cheque or any CAGR calculations.

***Constellation Software's dividend rate is in USD ($1.00 per quarter), but the payments are made in CAD and therefore vary with currency fluctuations

The market volatility in Q3 presented us with more opportunities than usual. We were able to acquire positions in class leading railroader, Canadian National, food court consolidator MTY Food Group Inc., e-retailer in brick and mortar clothes Williams Sonoma Inc., physical to digital processor Analog Devices Inc., professional visualization processor creator Nvidia Inc., and finally the worlds' builder of next generation semi conductor manufacturing processes KLA Corp. In the "sell all" category, we nixed Amphenol Corp. over valuation concerns, Marsh and McLennan Co for like reasons and International Flavors and Fragrances over untoward developments and a reassessment of the management group. For program participants, you will receive a more detailed briefing on each company via separate email.

As we look towards the home stretch for 2019, our focus on dividend growth continues. October has started with its usual downside momentum - we take it in stride and hope that it presents us with some great opportunities. In the meantime, we continue to collect our rising rent cheques.

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