4th Quarter 2019 (Q4) Market Commentary for The Dividend Value Discipline™

The Big Picture

Q4 2019 saw a steady increase in investor confidence as we edged closer to a resolving the China/U.S. trade dispute, got some clarity on Brexit, and then finally the U.S.-Mexico-Canada Trade Agreement was inked. As we open up the year, we are presented with another uncertainty, in the form of the U.S./Iran conflict. Nobody promised us this was going to be easy ☺.

The top three developments, as we see it, for the start of 2020 are:

1. White-hot investor confidence – the [CNN Fear Greed Index] started the first day of trading for 2020 at the 96th percentile (extreme greed), compared to the opening day of trading for 2019 when it was registering extreme fear at the 12th percentile. As I alluded to in the last edition of The Opportunity Update, extreme fear readings are a lot more helpful than an extreme greed readings. Most market selloffs tend to be quite short in duration, so extreme fear readings are most often a call to buy. Conversely, extreme greed readings can last a long time, as do bull markets and thus we adopt a "buy on pullback" posture.

Source: CNN Fear and Greed Index

2. The U.S. Dollar Index finished 2019 in a weakened state after hitting a two year high in late August (on extreme fear reading) that pushed investors to a "flight to safety". Why is this significant? Because the world still sees the U.S. dollar as the global currency of choice and when it weakens, it gives the world (X-US) an adrenaline shot to their economies. U.S. dollar debts become easier to pay back, technology and capital equipment become cheaper because much of it is sourced from the U.S., and all things commodities tend to do well – the latter being a big boost for Canada.

Chart courtesv of StockCharts.com

3. A re-accelerating global economy – recall that the stock market is a forward looking animal and one of the best leading indicators of economic growth. Q4's strong market performance is clearly saying, things are getting better. Our best leading indicators for the manufacturing and service-based economies (copper and semiconductors) agree. Accordingly, geographic and sector rotations are already underway and likely to continue. As we write, we are witnessing money inflows to virtually all global equity markets and outflows in most things defensive, i.e. bonds, utilties, and real estate

investment trusts. Sectors like technology, industrials and financials are gaining. Even energy did well in Q4. As per Wayne Gretzky, skate to where the puck is going, not where it has been.

Three Month Sector S&P Sector Performance to Jan. 3, 2020

SYMBOL	NAME	SCTR	U	CLOSE	CHG	% CHG	
XLK	Technology Sector Fund	97.8	etf	93.39	13.36	16.91	
XLV	Health Care Sector Fund	82.3	etf	102.13	13.44	15.30	
XLF	Financial Sector Fund	84.1	etf	31.08	3.93	14.64	
XLI	Industrial Sector Fund	75.7	etf	83.01	8.39	11.27	
XLC	Communication Services Sector Fund	72.1	etf	54.26	5.27	10.83	
XLE	Energy Sector Fund	26.7	etf	60.58	5.57	10.16	
XLB	Materials Sector Fund	13.0	etf	60.70	4.02	7.21	
XLY	Consumer Discretionary Sector Fund	46.2	etf	126.91	8.11	6.89	
XLP	Consumer Staples Sector Fund	34.0	etf	62.48	2.42	4.04	
XLU	Utilities Sector Fund	40.3	etf	63.81	0.56	0.88	
XLRE	Real Estate Sector Fund	21.6	etf	38.22	-0.30	-0.77	

Chart courtesy of StockCharts.com

What about the U.S./Iran flare up?

We are writing this commentary on Friday, January 3, 2020, and find it interesting that as the news broke, the U.S. dollar "flight to safety" trade actually went down, not up. Let's recognize that Iran's economy is roughly 1/4 the size of Canada's (which is just over 2% of the global economy), and unless Iran can somehow block shipping in the Strait of Hormuz where ~25% of the world's oil gets transported, their retaliation options are limited. Their response and its impact are unknowable.

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 saw net returns in the +14% to +15% range for the year, whereas the equities only version was in the +17% to +18% range. Yes, it was a better year, but what we should be focusing on is the cash flow – how fast are our rent (dividend) cheques growing? On that front, announced dividend increases in Q4 included **Progressive Corp.** with a 5.4% bump and **Accenture plc** up 10%. Our suggestion is that the "Rent Cheque Increases Past 12 Months as at December 31, 2019" table at the end of this summary is a far more important measure of the progress we are making than the year-end performance numbers are.

Stock-wise, we added two new positions over the quarter, namely **United Health Group Inc**. and **MarketAxess Holdings Inc**.

United Health is committed to helping people live healthier lives, while making the healthcare system work better for everyone. Culture-wise, you can still see the founder-led mentality in practice as the company continues to aggregate the fragmented healthcare industry. They have a long history of implementing new technologies, data analytics, and bringing clinical insights to the healthcare market, resulting in 16% average annual earnings per share growth over the last decade. Rent cheque-wise, if they can sustain the current 3-year growth rate, it will mean a doubled rent cheque every 3.5 years – we will be happy with anything above double-digit percentage increases.

MarketAxess is disrupting/transforming the global bond trading market, which is still largely done by the telephone. Their technology-driven platform creates better liquidity, increased transparency and as users adopt it, you get a classic feedback loop – if you want to trade bonds, you are forced to sign on. MarketAxess is a founder-led company bent on improving transparency, efficiency, and competition in the global credit markets. As new users sign on, their moat gets stronger with each passing quarter. We expect continued exponential rent cheque growth.

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The Dividend Value Discipline^{TM}

Rent Cheque Increases Past 12 Months as at December 31, 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	3.65%	123.5%	45.1%	2	3	Long history of disruption - their website allows you to shop competitors' insurance rates
2	CHARLES SCHWAB CORP	Disruptor	$ 0.68	1.45%	31.0%	36.1%	2	5	A technology-driven investor platform for next-generation investors
3	STARBUCKS CORP	Both	$ 1.64	1.85%	13.9%	27.0%	3	9	A new store in China every 15 hours where coffee consumption is growing at 16% per year
4	MARKETAXESS HOLDINGS INC	Disruptor	$ 2.04	0.54%	21.4%	25.2%	3	9	Quickly becoming the global standard platform for bond traders - a market that dwarfs stocks.
5	CANADIAN NATIONAL RAILWAY	Disruptor	$ 2.15	1.82%	18.1%	24.1%	3	20	Unmatched USMCA wide rail network and willing to innovate - watch for bitumen "pucks"
6	TJX COMPANIES INC	Both	$ 0.92	1.50%	17.9%	22.9%	3	23	An autonomous culture that "out-retails" their competitors
7	NORTHERN TRUST CORP	Disruptor	$ 2.80	2.65%	16.7%	22.6%	3	9	The go-to private bank for Fortune 500 families - leads in blockchain security
8	UNITEDHEALTH GROUP INC	Aggregator	$ 4.32	1.49%	20.0%	22.1%	3	10	Innovative health care provider that helps people live healthier while driving down costs.
9	LOWES COMPANIES INC	Aggregator	$ 2.20	1.85%	14.6%	20.4%	4	57	New CEO joined in July 2018 who learned at HD - improvements in strategy/culture are clear
10	INTUIT INC	Disruptor	$ 2.12	0.80%	12.8%	19.6%	4	9	Creator of TurboTax/QuickBooks, dominant in small business & now cloud subscriptions
11	CCL INDUSTRIES INC	Both	$ 0.68	1.23%	30.8%	19.3%	4	18	Long-term aggregator of very stable businesses and a great track record of capital allocation
12	KLA CORPORATION	Disruptor	$ 3.40	1.89%	13.3%	17.4%	4	14	Preferred supplier for next generation semi conductor equipment and processes
13	MTY FOOD GROUP INC	Aggregator	$ 0.66	1.17%	10.0%	12.8%	6	2	A top decile management group riddled with founder thinking and a disciplined aggregator
14	ROCKWELL AUTOMATION INC	Disruptor	$ 4.08	2.02%	5.2%	11.6%	6	23	Helping the world become more productive - faster, cheaper, better - great free cash flow
15	MICROSOFT CORP	Both	$ 2.04	1.28%	10.9%	11.5%	6	16	Culture transformer under Satya Nadella, exploiting cloud and MS Office subscriptions
16	3M COMPANY	Aggregator	$ 5.76	3.24%	16.2%	9.1%	8	61	Globally diversified - incredibly innovative, loved by employees.
17	ANALOG DEVICES INC	Both	$ 2.16	1.82%	12.5%	8.7%	8	16	Transforming sound, pressure, light, and temperature to data, fueling our digital world
18	THE BANK OF NOVA SCOTIA	Disruptor	$ 3.60	4.90%	3.4%	7.2%	10	9	Slower dividend growth, yet we find the Asia/Latam business very attractive due to growth
19	JOHNSON AND JOHNSON	Aggregator	$ 3.80	2.63%	5.6%	6.5%	11	57	Fantastic culture, huge insider ownership base and well diversified products stream
20	CONSTELLATION SOFTWARE INC***	Aggregator	$ 4.00	0.32%	0.0%	0.0%	n/a	0	Special $20 dividend in 2019 - gets 20% return on retained capital - highest culture score
	Median			**1.82%**	**14.24%**	**19.46%**	**3.9**	**12**	

*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