3rd Quarter 2020 (Q3) Market Commentary for The Dividend Value Discipline™

The Big Picture

AAII Survey	Bulls	Bears	Spread
Oct 1	26%	43%	-17%
Sept 24	25%	46%	-21%
Sept 17	32%	40%	-8%
Sept 10	24%	49%	-25%
Sept 3	31%	42%	-11%
Aug 27	32%	40%	-8%
Aug 20	30%	42%	-12%
Aug 13	30%	42%	-12%
LT Average	**39%**	**30%**	**9%**

Source: Chris Raper & Associates and https://www.aaii.com/sentimentsurvey?

As we closed out Q3 2020, markets continued to crawl the wall of worry. To wit, on September 30th, 2020, CNN's Fear Greed Index pegged in at 44 FEAR whereas the American Association of Individual Investors weekly survey notched a mere 26% bullish versus the long term average of 39%. Both of the aforementioned indicators are contrarian, i.e. when investors are most fearful, markets tend to go up over time. The selling has already happened.

Furthermore, the evidence suggests that investors are embracing their fear with action – equity (stock) fund flows remain widely absent, with cash on the sidelines near historic highs. Bottom line, these are not the types of observations that occur at market tops.

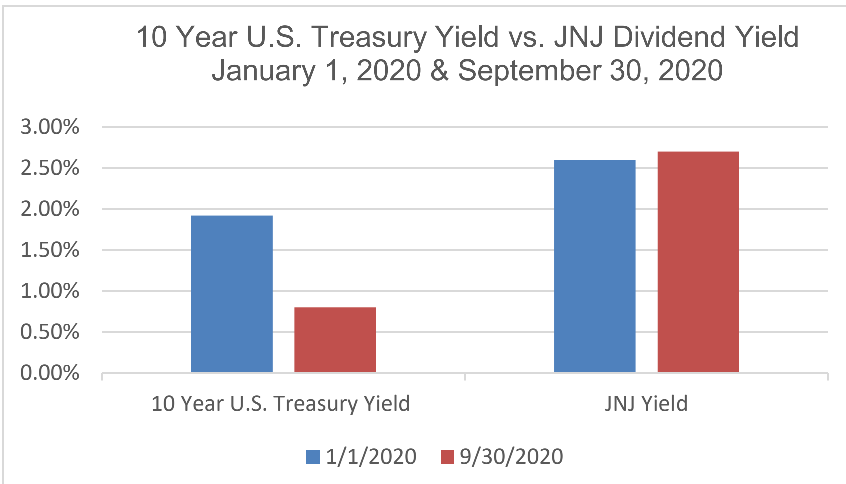
Yes, we have the U.S. election on November 3rd and there may be some unpleasant aftermath, yes, President Trump and a large swath of White House staff have contracted COVID-19, and yes, COVID-19 cases are increasing at a seemingly alarming rate. However, we should not lose sight of the following:

- Markets have gone up and down under both Republican and Democrat administrations, **and much more up than down**.
- Most of the White House staff will not die from the disease.
- The number of daily COVID-19 cases in the U.S. is currently 34% below the all-time record high set in July 2020, and the number of daily deaths is currently 64% below the all-time high set in April 2020 (source: https://www.worldometers.info/coronavirus/country/us/). The U.S. is the epicentre of the disease, as you can clearly see from this link: https://coronavirus.jhu.edu/map.html.

Our take? We will get through this. In fact, we *are* getting through this, and if we look at the data objectively, things are getting better. As we covered off on the September 18th, 2020 edition of The Opportunity Update, economically speaking, things are pointing north. Our best leading indicators for the global economy, the price of copper ($COPPER) and the Semiconductor Index ($SOX), are above pre-COVID-19 highs.

Charts courtesy of StockCharts.com

Additionally, valuations relative to the alternatives are just not that bad. The 10-year yield on U.S. government bonds is currently at ~0.80% (Canada is even lower at ~0.60%), versus ~1.90% at the start of the year. By way of example, should Johnson & Johnson's (JNJ) current 2.7% dividend yield, with a track record of raising that dividend each year for the last 57 years, be worth more in a 0.80% environment as opposed to a 1.90% environment? Our thinking says absolutely it should. The best part of the JNJ story is that because of the excessive fear in investors' minds, the stock price (and thus resulting dividend yield) has changed very little since the start of the year. Furthermore, there are a lot of "JNJ's" available. To wit, in early September, the S&P 500 dividend yield versus the 10-year Treasury yield was the highest it has been since 1935, and it is not far off that as I write (source: https://361capital.com/financial-advisor/weekly-briefing/the-end-of-summer/).



Notwithstanding the ~60% reduction in the 10-year U.S. interest rate yield, Johnson & Johnson's dividend yield is roughly the same as it was at the start of the year!

Source: Chris Raper & Associates and https://stockcharts.com/h-hd/?%24UST10Y and https://finance.yahoo.com/quote/JNJ/history?p=JNJ

The Dividend Value Discipline™

Our core strategy has continued to track higher – most accounts in the "balanced" version of the program saw net year-to-date returns to September 30th, 2020 in the -1% range (recall the 2019 numbers were in the +14% to +15% range). For the third quarter in a row, the all equity version did even better, pegging in at the +3% to +4% range (2019 numbers were in the +17% to 18% range). The lack of fixed income exposure and thus heavier weighting in stocks was the key driver. As you know, cash inflows/outflows and different start dates mean that no two accounts are exactly alike. You will find your individual results in your personal reporting package.

As you would expect, our objectives remain unchanged:

- Invest in companies that evidence superior corporate culture and are disrupting/reinventing 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.

In terms of position changes, things have slowed considerably since Q2 when we exited a number of our investee companies because their business models were clearly broken in the post-COVID-19 environment. The only totally new position for Q3 was American Tower Corporation (AMT), a disciplined aggregator of communications towers that rents space on said towers and adjacent lands to the world's wireless service companies, i.e. your cell phone provider. Our culture study found that management is driven by return on invested capital and free cash flow – something that has been clearly demonstrated in terms of track record. With the coming of 5G and the fact that less than 25% of their sites are in the U.S. whereas 50%+ of their sites are in high growth areas like India and Brazil, it is not difficult to make the case for strong secular tailwinds. Barriers to entry are high – switching costs dissuade clients from shopping and the capital/regulatory hurdles for new sites are significant – we see their moat as intact and growing. Rent cheque-wise, the dividend has grown at 22% per annum over the last five years, and given their low payout ratio we remain cautiously optimistic about similar numbers going forward (but would be content with anything in the double digit range).

We also took up a fresh position in Costco, a previously owned name and frankly, one I wish I had never sold. The lesson? When it comes to our great culture companies, valuation concerns more often than not resolve themselves by earnings and dividend increases coming in higher than you expect. This business still humbles me, daily!

Turning to rent cheque increases, as you would expect they have been modest versus years gone by. That said, the table below reflects that 15 of our non-resource/materials companies have increased their dividends in excess of 10% over the last year, and only two have temporarily suspended their dividends. All in, the weighted average increase in dividends over the last year (for holdings at September 30th, 2020) has been 5.4% which, relative to a ~60% cut in the 10-year U.S. Treasury rate, seems pretty respectable indeed.

The Dividend Value Discipline™ - Rent Cheque Growth - September 30, 2020

Company	Symbol	Aggregator/ Disruptor?	Annual Rent Cheque	Current Yield	Year over year growth, %	Years to Double Rent Cheque	Years of Consecutive Increases	Last increase	Comments
CINTAS CORP	CTAS-US	Aggregator	$ 2.55	0.76%	24.4%	3	27	2019-11	A uniform rental and cleaning services company - primed to benefit from COVID
ENGHOUSE SYSTEMS LTD	ENGH-T	Aggregator	$ 0.54	0.72%	22.7%	3	11	2020-05	A mission-critical software provider and lifetime aggregator
MASTERCARD INCORPORATED	MA-US	Aggregator	$ 1.60	0.47%	21.2%	4	13	2020-01	A major player in the global payments industry that needs no introduction
AMERICAN TOWER REIT	AMT-US	Aggregator	$ 4.56	1.88%	20.0%	4	6	2020-09	Largest global telecom tower REIT
MARKETAXESS HLDGS INC	MKTX-US	Disruptor	$ 2.40	0.47%	17.6%	4	9	2020-02	Quickly becoming the global standard platform for bond traders - a market that dwarfs stocks.
THERMO FISHER SCIENTIFIC INC	TMO-US	Aggregator	$ 0.88	0.19%	15.8%	5	2	2020-03	A science enabler through lab systems, software and services
UNITEDHEALTH GROUP INC (DEL)	UNH-US	Aggregator	$ 5.00	1.54%	15.7%	5	10	2020-06	One of the largest healthcare companies from the world - solid growth and cash flow generation.
LAMB WESTON HOLDINGS INC	LW-US	Aggregator	$ 0.92	1.28%	15.0%	5	2	2020-01	North America's largest producer of frozen french fries and potato products
ANALOG DEVICES INC	ADI-US	Both	$ 2.48	2.10%	14.8%	5	16	2020-02	Transforming sound, pressure, light, and temperature to data, fueling our digital world
TRACTOR SUPPLY CO	TSCO-US	Aggregator	$ 1.60	1.09%	14.3%	5	10	2020-08	This rural lifestyle retailer is the industry leader in selling products designed "for life out here"
STARBUCKS CORP	SBUX-US	Both	$ 1.80	2.03%	13.9%	5	9	2019-11	A new store in China every 15 hours where coffee consumption is growing at 16% per year
INTUIT INC	INTU-US	Disruptor	$ 2.36	0.70%	12.8%	6	9	2019-10	Creator of TurboTax/QuickBooks, dominant in small business & now cloud subscriptions
NIKE INC	NKE-US	Disruptor	$ 0.98	0.76%	11.4%	6	30	2019-11	A marquee designer/innovator in sports apparel
MICROSOFT CORP	MSFT-US	Both	$ 2.24	1.07%	10.9%	7	16	2019-11	Culture transformer under Satya Nadella, exploiting cloud and MS Office subscriptions
ACCENTURE PLC (IRELAND)	ACN-US	Both	$ 3.52	1.58%	9.6%	8	10	2019-10	Helping the world's largest companies adopt technologies that drive down costs
STERIS PLC (IRELAND)	STE-US	Aggregator	$ 1.60	0.87%	8.1%	9	14	2020-08	A sterilization systems provider to the global healthcare industry
COSTCO WHOLESALE CORP	COST-US	Aggregator	$ 2.80	0.77%	7.7%	9	16	2020-04	Chain of membership-only warehouse clubs. Great culture and ecommerce growth.
CANADIAN NATIONAL RAILWAY	CNR-T	Disruptor	$ 2.30	1.58%	6.9%	10	20	2020-03	Unmatched USMCA wide rail network and willing to innovate - watch for bitumen "pucks"
JOHNSON AND JOHNSON	JNJ-US	Aggregator	$ 4.04	2.73%	6.3%	11	57	2020-05	Fantastic culture, huge insider ownership base and well diversified products stream
DANAHER CORP	DHR-US	Aggregator	$ 0.72	0.32%	5.9%	12	26	2020-03	Science enabler for the medical research, environment and diagnostics industries
ROCKWELL AUTOMATION INC	ROK-US	Disruptor	$ 4.08	1.73%	5.2%	14	23	2019-11	Helping the world become more productive - faster, cheaper, better - great free cash flow
GIBSON ENERGY INC.	GEI-T	Neither	$ 1.36	6.26%	3.0%	23	8	2020-03	Toll booth to North American energy producers with a driven executive suite
DOLLARAMA INC	DOL-T	Aggregator	$ 0.18	0.33%	0.0%	na	8	2019-04	A recession-resilient business with improving real-estate opportunities
NVIDIA CORP	NVDA-US	Disruptor	$ 0.64	0.12%	0.0%	na	7	2018-11	The world's leader in computer graphics/virtual reality
CONSTELLATION SOFTWARE INC	CSU-T	Aggregator	$ 5.31	0.35%	-0.2%	na	na	2019-03	Gets 20% return on retained capital - highest culture score
PROGRESSIVE CORP OH	PGR-US	Disruptor	$ 0.40	0.41%	-5.8%	na	3	2019-02	Long history of disruption - their website allows you to shop competitors' insurance rates
CAE INC **	CAE-T	Aggregator	$ 0.44	2.11%	-100.0%	na	na	2019-09	A leader in flight simulators and training with strong long-term tailwinds
TJX COMPANIES INC **	TJX-US	Both	$ -	0.00%	-100.0%	na	na	2019-05	An autonomous culture that "out-retails" their competitors
Dividend growth, weighted average - all holdings					**5.4%**				
Dividend growth, weighted average - all holdings, excluding temporarily suspended dividends (CAE and TJX)					**10.7%**				

** Excluding ETFs and individual companies in Materials and Energy.*

*** Temporary suspension of dividend.*

In Summary

We continue to see the go forward investment landscape from a glass half full perspective. While the headlines of the day will give us lots to worry about in Q4, the underlying trends are largely positive – if that changes, we will adjust. Our intention is to use any election volatility to employ the balance of our modest cash reserves.

To close, most readers will be aware that we said adieu to Ryan Cramp after a 21 year run with Chris Raper & Associates, officially on September 30th, 2020. For my part, I want you to know that it has been a pleasure to work with Ryan and I know I speak for the entire team when I say all of us appreciated his “client first / the details matter” modus operandi. We admire Ryan’s courage to launch his new venture and we wish him, and the clients that made the decision to follow him, well. We also want you to know that we remain on excellent terms and we expect that to be the case for years to come. His departure has given us license to imagine an even bigger future, one that each of you have chosen to be a part of. Thank you for the confidence – our intent is to affirm the confidence you have placed in us for decades to come.

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Postscript - If you believe these missives can help your family or friends please feel free to forward. Alternatively, they can subscribe (first name and email) at http://www.chrisraper.com/contact-us.aspx.