RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

The Opportunity Update – Tuesday, September 5th, 2017

Table of Contents

Track #1: Introduction - The Skinny

Hi, this is Chris Raper, Senior Vice President & Portfolio Manager, Private Client Group of Raymond James Ltd. & co-founder of **The Dividend Value Discipline™**. Welcome to **The Opportunity Update**, which is being recorded for you in Victoria, BC on Tuesday, September 5th, 2017. Here is what we are going to cover today:

You are now listening to **Track #1: The Introduction**, where I give you the skinny on what I am going to talk about.

On **Track #2: The Markets and an Insider's Take on Washington –** I am excited to share with you what I gleaned when I met with Stuart J. Sweet last week, a 40 year veteran of the Hill in Washington DC, who now spends his time sharing the "what is" of US politics in an effort to help investment professionals make better decisions. You are going to hear about his take on the major drivers of the US political agenda that are getting lost in the media milieu. Post that analysis, we will close out the track following our usual course, updating you on our favourite leading economic indicators: the price of copper and semiconductor index, speak to the oil and gas complex (where we are more bullish than bearish) and close out with the seemingly unstoppable Canadian dollar.

On **Track #3: The Dividend Value Discipline™ - Under The Hood**

Most of our clients will be aware that the traditional summer lull has held true to form, i.e. markets have been soft for the month of August and we have now pegged four consecutive months of negative returns...in $CDN terms. I will obviously speak to the FX headwinds and more importantly point to the overwhelmingly positive things that are happening under the hood of our investee companies. Finally, we will highlight the latest additions to our stable of disruptor and aggregating dividend growers, Northern Trust, Suncor and Gilead.

On **Track #4: The Wrap Up – Far More Positives Than Negatives** is **<u>the</u>** most important track of this recording. Yes, I will recap the highlights, give you the take-aways and, most importantly, outline why we are so encouraged about the future as we face September and then enter the seasonally strong period of Q4.

Track #5: Postscript I is where I walk you through our core investment program, **The Dividend Value Discipline™**, its methodology, return objectives and all-in costs. This track is primarily for the benefit of potential clients who are being introduced to us by way of this recording. By the time you are done listening you will know what makes the process unique vis-à-vis our competition and whether or not you are interested in pursuing it any further. Not interested, not interested right now, and let's talk further are all perfectly acceptable answers.

Track #6: Postscript II is again for the benefit of prospective clients. It will give you some insight on what to expect during our initial meeting, where we both want to answer the question, "Is there a fit between our services and your needs?"

In terms of legal requirements – the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.

I am also required to tell you that Raymond James Ltd. is a member of the Canadian Investor Protection Fund. That is a good thing, and if you are interested in those details, please ask me or any one of our relationship managers the next time we speak.

I also want you to recognize that some of the things I am going to say today are going to be proven wrong. It is an inevitable part of this business. It is also important to recognize you don't have to be right all the time, to do well. You just have to be more right than most or conversely, less wrong than most. When we are wrong, our intent is to acknowledge it quickly and adjust accordingly - we try to keep our losses small.

Finally, regarding investment jargon, when I say I am bullish, it means I expect things to go up; when I say I am bearish, it means I expect things to go down. Likewise, north means up and south means down. When I speak about rent cheques, I am speaking about income, primarily dividends. You will also hear me using the term disruptor, which is our moniker for those companies that are disrupting or re-inventing the way business is done in their particular market, and thereby able to grow at rates far beyond the rate of the economy. Think of Wal-Mart twenty years ago and Amazon today. You will also hear me use the term aggregator, which is our moniker for those companies that have a systemized approach to acquiring smaller competitors as a means to fuel their growth. Said growth is the path to increasing dividends or in our language, growing rent cheques. If you catch me using industry jargon beyond that, I invite you to call me out. Send an email to the office and the team will let me know, usually with considerable gusto!

That's a wrap on the skinny, and off we go to Track #2.

Track #2: The Markets and an Insider's Take on Washington

My time with Stuart Sweet, founder of Capitol Analysts Network was tremendously insightful and what I am about to share with you is not an attempt to sway you right or left politically, rather to help us understand the key drivers of the US political agenda and the most likely impact on our investments. To lay the groundwork, here are a few things we need to be reminded of:

1. Trump is highly polarizing (as if you needed to be reminded of that), he is cunning and it is a mistake to write him off as stupid …after all, he is the president of the most powerful nation in the world and he got there when everybody else had written him off.

2. He gained the presidency by getting rust belt Democrats to vote for him – much of his volatile rhetoric is designed to appeal and hold on to that base – every politician thinks constantly about getting re-elected. In other words, his bark is far worse than his bite and we have already seen that with the lumber tariff issue and I believe that will be the case with NAFTA.

3. The Republicans control the Senate and the House and they do so by thin margins. As we near the 2018 mid-term elections, the Republican infighting will wind down and the odds are extremely high that they pass some sort of tax reform and a partial repeal/replacement of Obamacare. Why does that have to happen? Because if they don't, the Senators and the House Representatives won't be heading back to Washington. In short, it is a matter of survival and if they don't hang together, voters will hang them separately. It is in their collective interest to get something done. Survival is the name of the game on the Hill.

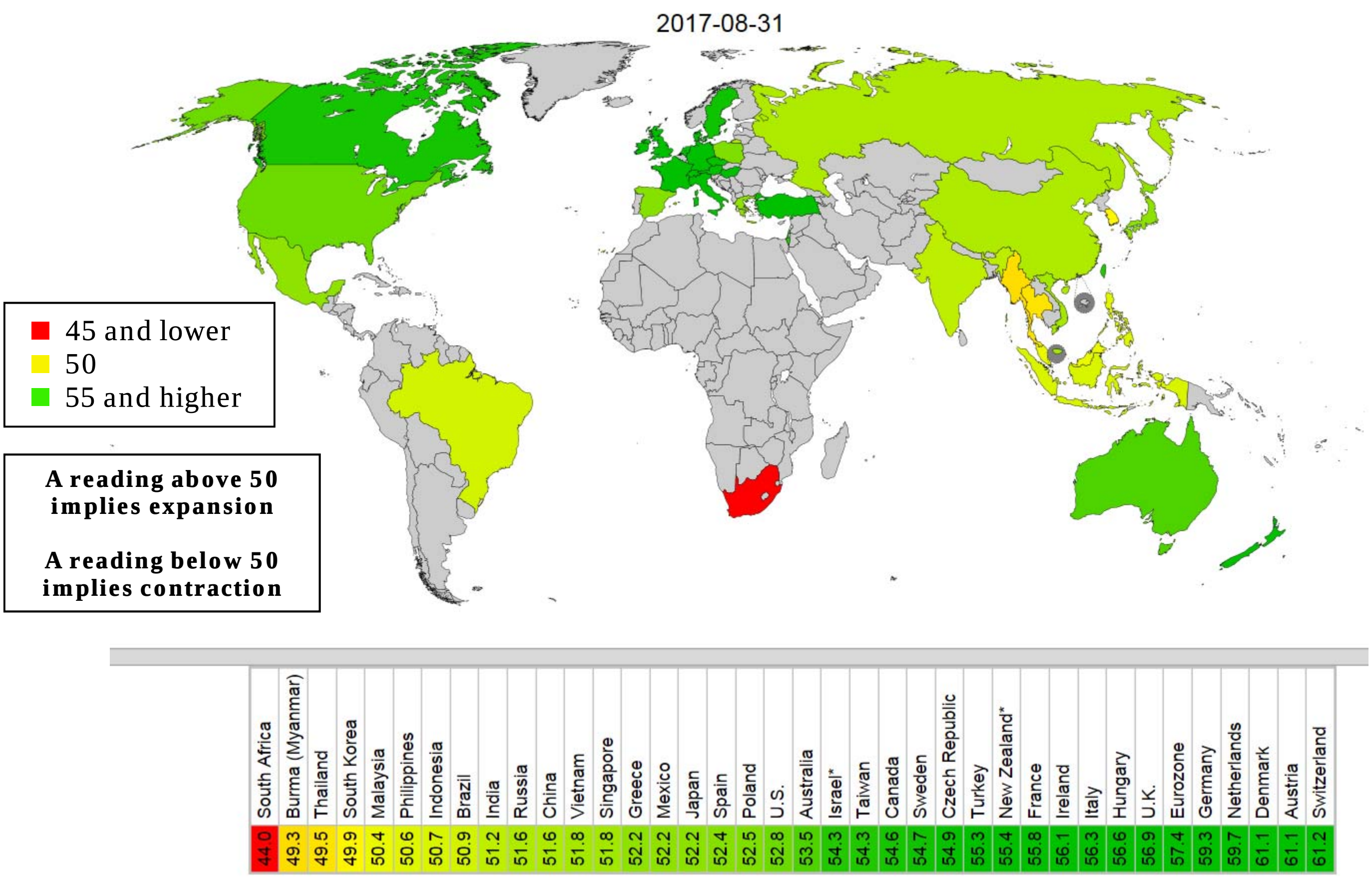
With that foundation laid, we need to think through Trump's incentive and what levers he has without the House and or Senate support. He knows he is highly unpopular and he knows that is not likely to change. Therefore, if he has any chance of getting re-elected, he needs an economy that is firing on all cylinders, so what's available to him to achieve that end? The U.S. President has broad powers over regulation and de-regulation acts like a de-facto tax cut. Translation, de-regulation means more money for re-investment, hiring and or returning cash to shareholders. That drives the economy and stock prices north. Accordingly, look for more news on the de-regulation front and especially as it relates to banking. Trump's incentive is "lend baby lend". We should also be aware that Trump has the ability to appoint 5 of the 7 US Federal Reserve Board Governors next year and the Board controls monetary policy and interest rates. When you look at a chart of five and ten year US interest rate yields, they are trending down, not up, so it appears the market is already anticipating a shift from an increasing interest rate environment to a decreasing rate environment. Think back to Trump's life as a developer – the guy practically invented leverage, so "lend baby lend" is very much a part of his psyche.

The other thing to note is that the only time Trump's approval goes up is when he takes a tough stand on the likes of Syria, North Korea and Venezuela. Ergo, defense spending is going up because even the Democrats are not going to vote against it with global tensions rising.

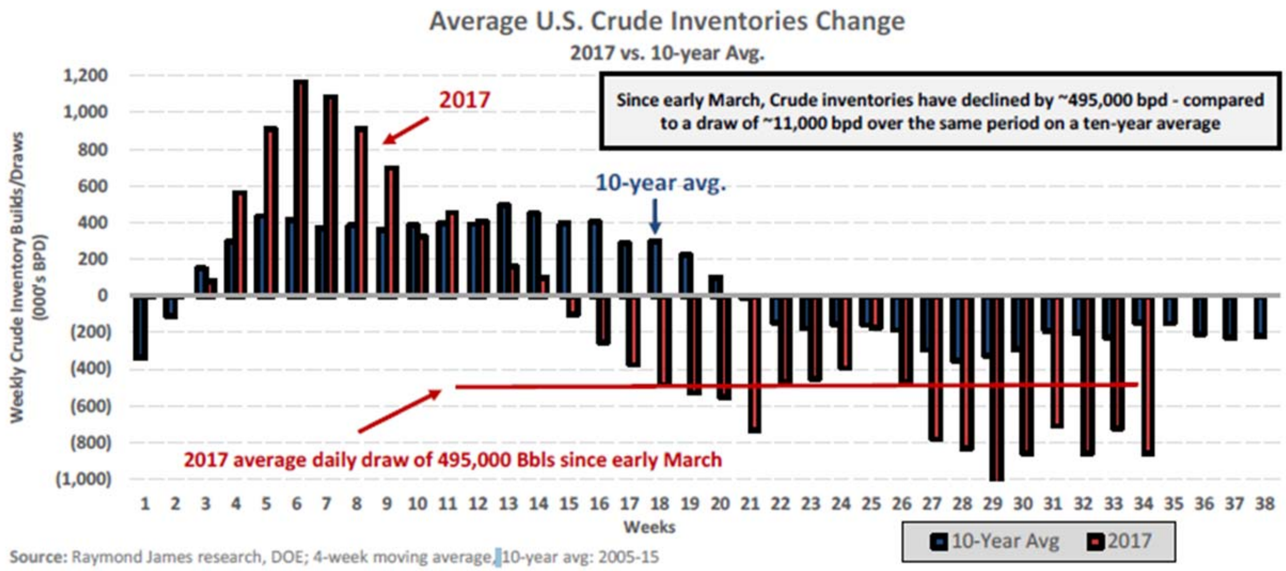
Thus, the likely winners are companies that are positively impacted from tax reform, U.S. banks, (especially the smaller regional banks because their cost of compliance is so much higher) and finally the defense industry. Once again, the objective here is to understand the most likely outcome of the legislative process and the impact on our investments – it is not a good versus bad or a pro versus con Trump argument. My job is to keep the politics aside and focus on making money.

Stepping away from the Trump agenda and looking at the world from the 50,000 foot level, the economic backdrop just keeps getting better and broader. After a decade of subpar growth, as per the heat map courtesy of Ned Davis Research most of the 45 countries in the OECD are in expansion mode and our leading indicators continue to point north. To wit, the price of copper is now at a three year high, notching $3.17 per pound today versus $2.59 on our last recording. Copper goes into just about every manufactured good so an increasing price speaks to robust demand and a growing economy. It is particularly relevant to the developing economies. Likewise, the raw material of developed economies is the semiconductor and when we check in on the Philadelphia Semiconductor Index (symbol $SOX) it is within 5% of its all-time high set back in June and up +20% on a YTD basis.

<u>Global Manufacturing PMIs (Heat Map)</u>



Turning to the oil and gas complex - there too, things are getting better, not worse. U.S. gasoline demand just hit a record high in August and that was well before Hurricane Harvey came to be. As per the August edition of The Strategist, the demand side is outweighing the supply argument and global growth only adds to that. U.S. Crude Inventories continue to draw down far faster than expected and that obviously points to higher oil prices in the months ahead. As many of you know, we added to our oil and gas exposure in July and August taking advantage of the extreme pessimism and cheaper stock prices.



That takes us to our bane of summer, the strength of the $CDN where we have experienced a top-to-bottom run of 9.4% over the last four months and the correlation of the loonie to oil has seemingly completely decoupled. History teaches us that it is only a matter of time until the relationship is restored, so either oil goes up and we would benefit from that or the $CDN retreats, which would also help returns. Our take is that the weakness in the $USD has as much to do with investors shifting attitude towards the Trump economic agenda as anything else. Recall that, when Trump got elected, U.S. markets and the USD$ took off like a rocket on the assumption that there would be rapid approval of tax reform, a more business friendly version of Obamacare, and a big spend on infrastructure. The pendulum has swung from extreme optimism to the point where few investors believe anything will get done - i.e. extreme pessimism. Our take? Both extremes are wrong and if you have not already done so, buy your snowbird money.

We are now off to Track # 3.

Track #3: The Dividend Value Discipline™ - Under The Hood

I want to start this track by acknowledging the concerns of our clients over the recent performance. Most of you won't need reminding that at the end of April, **The Dividend Value Discipline™** pegged in at ~+4% on a year-to-date basis and, over the next four months, we saw that whittle away to approximately -1% at the end of August. By far, the lion's share of that decline has been the 8.5% decline in the U.S. dollar as more than half of our investee companies are USD$ denominated...and all of that happened while the July headlines screamed "U.S. Markets hit record highs"...but keep in mind that is in USD$ terms. Yes, I acknowledge that four down months is not pleasant and yet, please remember, historically speaking, it certainly isn't unusual.

At times like this, our emotions and more truthfully clients tell us to "do something" and yet when we go back to basics, i.e. earnings growth and rent cheque growth of our investee companies, doing nothing or doing very little (no wholesale changes) strikes us as intelligent behaviour. The companies we owned in April are pretty much the same as the companies we own today and the reasons we bought them have not changed. As we wade through this weak spot in short term performance they continue to grow their earnings at impressive rates and we firmly believe that in time, the stock prices will reflect that. Here's the evidence – the Bank of Nova Scotia was the last of our investee companies to report its 2017 Q2 earnings. The median earnings growth of all 27 investee companies was 12.2% on a Q2 17/16 basis and for those companies that did announce dividend increases, which is normally a once-a-year event, the median rent cheque growth was an annualized 14%. Now if you owned an apartment block where the rent cheque was increasing at 14% per year, would you be in a hurry to sell?

As Kingpin (aka Ryan) said to me the other day, "Chris, fully invested accounts have not had a negative year since 2008 – our clients are getting used to only seeing the accounts go up – markets don't always do that". He's right, and our job is to find great companies that are delivering the rent cheque growth. Again, our belief is that the stock prices will reflect that growth over time and in the interim we get paid to wait with each successive dividend cheque.

On to the new companies that we have acquired. We took up an initial stake in a company I have long admired, to many the global standard of private banking, **Northern Trust Corporation** ("NTRS"). Founded in 1889, they cater to the ultra-rich in their private banking division which is ~50% of revenues and they have built a moat around that business with entrenched relationships that span generations. The other half of their revenue comes from their asset custody business where they have the advantages of scale and international capability. Culture wise, the firm evidences long management tenures (median 32 years) and a policy of hiring from within. Median insider ownership is ~5 times total compensation. Rent cheque wise, the firm was one of the few U.S. banks that maintained their dividend throughout the 2008/09 financial crisis. Dividend increases throughout the U.S. financial system have been constrained due to regulatory requirements and as per Track # 2, we see that changing for the better, providing NTRS with one more secular tailwind and good things to come for shareholders.

Next up was **Gilead Sciences Inc**. ("GILD"), an American biopharmaceutical company with operations in over 30 countries, discovers, develops and commercializes drugs, especially where unmet needs exist. The Company's portfolio and pipeline of investigational drugs include treatments for HIV/AIDS, liver diseases, cancer, inflammatory and respiratory diseases and cardiovascular conditions. Starting with the culture, we see so much to like. Five out of five executives have been hired from within and the team has a median tenure of 26 years. Furthermore, being a highly advanced science based organization, it has intellectual capital that few companies can match and the workforce seems to agree with top comments like "fast paced environment", "learn a lot" and "great benefits" being the norm. The biggest complaint? Not enough work-life balance which may not be a bad thing for shareholders. It won't surprise you to learn that we find GILD to be a wide moat business given the aforementioned intellectual capital, patents and research capability. They currently lead in the Hep-C and HIV/AIDS markets and have just made a deal that the market seems to love, an agreement to purchase Kite Pharma, which has a particularly promising therapy that enhances your body's immune system to battle cancer. Rent cheque wise, GILD started paying a dividend in June 2015 and they have raised it each year since. We expect more of the same.

Our last addition of the quarter was the purchase of **Suncor Energy Inc.** ("SU") where we have been biding our time waiting for the energy news to get so bad that it's good. That patience allowed us to acquire Suncor with a dividend yield in excess of 3% and assuming you are at the top tax bracket, that puts the interest equivalent yield of almost 5%. Even through the tough sledding of the oil and gas market over the last three years, Suncor has managed to raise its dividend at an annualized rate of 32%. More importantly, management has demonstrated considerable street smarts, acquiring assets on the cheap when the industry was in a tailspin – the most recent examples being Canadian Oil Sands in February 2016 and Petro-Canada in March 2009. Dare we call that opportunistic aggregation? Moat-wise, the multi-decade resource base of its oilsand assets translates to very little exploration risk, allowing the company to concentrate on reducing cost per barrel of oil produced. Their latest estimate of oil sands cash operating costs is below $23 CDN per barrel. The refinery business also buffers some of the cyclicality. Management-wise, we note seasoned tenure for most executives and a bias to hiring from within. The proof is in what they do, and when you stack Suncor up against its peers, you will find it rests in the top quartile across most measures that matter to shareholders. Catalyst wise, we see expansion capital decreasing in the future which leaves more free cash flow for dividend increases. Bring it on!

That completes the new additions to the program and we are off to Track #4.

Track #4: The Wrap Up – Far More Positives Than Negatives

First the takeaways:

Track #1: Introduction – The Skinny: A reminder, the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd. Please recognize some of what I told you is going to turn out to be wrong and when it becomes evident we are wrong, our intent is to acknowledge it quickly and adjust accordingly. The strategy is to keep the inevitable losses small and let the winners run.

Track #2: The Markets and an Insider's Take on Washington – in a nutshell, the investor attitude pendulum on the Trump agenda has swung from last falls "this is going to be fantastic" to this summer's "this is beyond terrible" and after spending some time with a Hill insider, our conclusion is both extremes are wrong. The odds of tax reform, banking de-regulation and lower not higher interest rates are high. Even if that doesn't happen, global growth is stronger than it has been for years and it is extremely broad based.

Our leading indicators continue to point north. We expect oil prices to rise primarily due to increasing demand and inventory drawdowns. Finally, we do expect the $CDN to moderate and the USD$ to strengthen when it becomes apparent that some of the Trump economic agenda gets pushed through.

Track #3: The Dividend Value Discipline™ - Under The Hood
Notwithstanding our negative year-to-date performance, we are tremendously encouraged with the underlying earnings results and dividend increases of our investee companies. Accordingly, we are resisting the call "to do something" as we firmly believe that those increasing rent cheques will be reflected in higher stock prices over time. Doing nothing or doing very little strikes us as intelligent behaviour. Our stronger loonie enabled us to acquire the likes of Northern Trust and Gilead far cheaper than we could have last May, and the dismal sentiment in the oil patch allowed us to pick up Suncor at a very attractive price as well.

Track #4: The Wrap Up – Far More Positives Than Negatives – just why am I so confident about the future. There is quite a list so I am going to go at this staccato style, as follows:

As I already alluded to, the Trump administration is not as bad as it seems. Yes, it is still bad, but that's not the point. The Republicans will either hang together and make some progress on tax reform or they will hang separately at the ballot box next year. Human nature being what it is, the most likely outcome is to make some progress whereas most investors believe it only gets worse.

If you are thinking “why do I own U.S. stocks”, consider that 97% of S&P 500 companies have reported their Q2 earnings and the year/year EPS growth is tracking at 18.8%, the fastest rate in nearly six years.

Again, global growth has finally returned with all OECD economies in expansion mode, copper hitting new highs, the $SOX is up some 22.9% on a YTD basis.

CNN’s Fear & Greed index pegged the Extreme Fear level during the third week of August – markets top on optimism, not pessimism.

Source: http://money.cnn.com/data/fear-and-greed/

Anecdotally, we have had more “I’m concerned” calls this past month than we have had in the past year, and clients are reluctant to add money even though U.S. stocks are almost 10% cheaper for Canadian investors than they were last May. Furthermore, the S&P TSX Composite Index pegged in on August 31, 2017 at 15,212 That’s 413 points below or down ~2%, to the 15,625 that it closed at on August 31, 2014. That’s right, three years ago - market history teaches me that that can’t last. My expectation is that surprises will come to the upside. Adding money to the program at times like this strikes me as intelligent investor behaviour.

That closes out the wrap up - if you are a potential client being introduced to us by way of this recording, please take the time to listen to Tracks #5 & #6.

To our clients, thank you for taking the time to listen. On behalf of the entire team here at Chris Raper & Associates, this is Chris Raper, wishing you good day and may God bless from Victoria, BC on Tuesday, September 5th, 2017.

Track #5: Postscript I – The Dividend Value Discipline™ Methodology

The first thing to note is that **The Dividend Value Discipline™** is core to everything we do – meaning if we were approached by a prospective client and we determined that our core investment process did not fit with their investment philosophy or their need, then we are not the right advisors for that particular client – there is no fit.

You should also be aware that nothing gets any more attention at our shop than this program. The lion's share of our client assets are allocated to the program, and that includes our most senior people, my family, and me. The takeaway is that my team and I have huge vested interest in ensuring the success of the program.

The process is discretionary, meaning we make all of the buy and sell decisions and report to you after the fact. Post a new purchase, our normal course is to send an email outlining the background of the company and the rationale for the decision, five business days after it settles to your account. When we close out a position, we also send an email outlining the result and our rationale.

Our objectives for the program are:

- Income every month - that can be paid out or reinvested;
- An acquisition process where we buy **only** those securities which become attractive on a "go forward" basis;
- Absolute returns of 8%+, each and every year.

Long term performance-wise, we started **The Dividend Value Discipline™** in the fall of 2002, and the average annualized return for all of the accounts that were opened that year (that are still in operation) is +7.94%, net of fees, as at the end of 2016. Throughout the course of our 14 calendar year history, we have had 13 years of positive returns and 9 years where we met or exceeded the +8% objective.

Those results have been achieved by focusing on three keys objectives, so let's walk through this with the illustration of a three legged stool.

The First Leg is Dividends

Every security that we buy must provide some form of income. We do that because income makes portfolios inherently less volatile, i.e. less chance of loss. The analogy I like to use is that of an apartment block versus a piece of raw land – it is a lot easier to hold onto the apartment block in a tough real estate environment when you are getting a rent cheque every month. Income drives stability and absolute returns.

The Second Leg is Value

Our research function is in-house. We were one of the first private client teams in the industry to have a dedicated analyst on staff and we add additional resources every year. Our objective was (and still is) to get to the truth. We do not want to depend on any outside analysts that we have little or no contact with. One of the great things about having an in-house investment team is that I can ask questions until I am satisfied that we have the right answers. We spend an inordinate amount of time studying the corporate culture. If you are interested in what that looks like, read ***Good to Great*** by Jim Collins – that is the yardstick we use to measure potential investments against. Another yardstick is the importance of wide economic moats. You can hear more on that subject by archiving the September 2013 edition of this recording on our website. We believe that the focus on great corporate culture and wide economic moats gives us an edge. Anecdotally, we can provide you with lots of evidence to support that. I remain convinced that having your own people who are totally dedicated to the investment process adds a lot of value not available at most other private client focused groups.

The more recent development in our strategy has been tackling the growth problem. History buffs will note that when we started the program in 2002, we had 5-year GICs yielding 5%, much better economic growth, and stocks benefiting from decreasing interest rates, whereas today we have 5-year GICs yielding only 2%, subpar economic growth, and the headwinds of rising interest rates. In short, the 8% is tougher to come by.

Accordingly, we spent late 2015 and 2016 tackling the "growth problem". We need to find companies that are growing far faster than the economy. As you would expect, we start within the normal confines of "has to pay a rent cheque, score well on the corporate culture front and have some sort of strategic advantage (the moat) that makes the company difficult to compete with". We then focus on those companies that have demonstrated their ability to grow their dividends at double-digit rates as a primary indicator of growth and capital gain potential. As we searched, we found that most such companies fell into one of two themes. They tend to be disrupting the existing marketplace with a better way of doing things or they tend to be aggregating their way to growth by buying smaller tuck-in acquisitions. More detail on our "disruptors and aggregators" themes can be found on the May 2016 edition of The Strategist which is archived on our website. I am happy to report we are currently bearing the fruit of those efforts.

The Third Leg is Discipline

Here I refer to the buy/sell decisions. We often identify extremely attractive value propositions and then delay the buying decision, why? Because, if you are the only guy in the world that sees it as undervalued, you can wait a very long time for the market to recognize that value – in other words, the stock price doesn't rise or worse, it goes down! Those are not comfortable situations so we try to avoid them. We buy when it is apparent that the market is starting to recognize the stock as undervalued. One of the most helpful indicators is positive relative strength – i.e. is the security in question starting to outperform its peer group and the market? Because if it isn't, there is little incentive in owning it. Sell decisions can be triggered by a number of things – when the company fails to materialize as expected, when a company's stock price exceeds what we believe it to be worth, negative relative strength, or when we find a better opportunity elsewhere. In reality it tends to be a combination of those factors.

Perhaps the most important part of the buy/sell discipline is the way we operate the program – we call it "The Buys Only Mandate". Unlike our competition, we only buy those securities which become attractively priced on a go-forward basis, meaning if you start today and your brother starts three months from now, your portfolios are going to be different in the short-term, and more closely aligned the longer you are in the program together. As rational as that might seem, most people do the exact opposite. Every time you buy a mutual fund, you buy a pro-rata share of an existing portfolio – by definition, you got the buys, the holds and the near sells. To us, that is not rational. Would Warren Buffett buy 100 companies in a single day? Were they all great value propositions? You should also be aware that most third party money management programs work exactly the same way – they buy the basket. Our objective is the protection of your hard earned money and we believe that the buys only mandate is consistent with that objective.

Other key points to the program: a fully invested account would normally have 20 to 25 positions in it, so we are relatively concentrated. Our fees are 1.75% per annum plus the GST or HST – it is tax deductible for non-registered accounts. Our target return is 8%+, net to you.

You should also know that when I buy for you, I buy for me. When I sell for you, I sell for me – same time, same price – and that statement also applies to our most senior people as well. Furthermore, every person on our team participates in our profit sharing plan, which means they have a vested interest in looking after you.

Generally speaking, we are looking to establish new relationships with new clients that have north of $1 million in investable assets. That said, I'm a lot more interested in where you are going, than where you are. If you have a credible plan to get to that number say within a three to five year period, we are very interested in meeting with you.

To conclude this track, if income and absolute returns are attractive to you, and you think that there may be a fit between your objectives and those of **The Dividend Value Discipline™**, then I would suggest a face to face meeting is in order. You can check out what to expect during that initial meeting by moving to Track #6 – “Is There a Fit”, and that is where we are going right now.

Track #6: Postscript II – "Is There a Fit?"

Our objective – and presumably yours – during the first meeting is to figure out whether or not we have a basis for an ongoing relationship. In essence, can we work together? If so, will it be mutually beneficial? Job one is to get your tough questions off the table, so we encourage people to ask whatever is on their mind. Our responsibility is to be forthright with our answers, regardless of what it is that you might want to hear.

Before we enter into any new relationship, one of the biggies we ask ourselves is, "can we add significant value?" To answer that question we need to learn some things about you, your family, your finances and what your ideal future looks like. If you are not really sure on the latter point, we have some thinking exercises that will take us through that process.

Next we will walk you through an a la carte menu of our services that are most applicable to you. We'll outline how we will report to you and who the key relationship people will be. You will also have a very clear picture of the costs involved.

Before you leave we'll outline how we see our program fitting with your situation, or not. We will not ask you for a go/no go decision at the meeting and quite frankly, we don't want to be pressed for a decision that day either. We'll schedule a meeting of the minds call, say a week out, and then mutually agree on the best course of action from there.

At the end of the day, we are in the business of keeping our clients' most challenging financial decisions consistent with their life goals. Our mission is ongoing progress towards those goals, and the result we seek is appreciative clients who are increasingly confident about their future.

So…if that process sounds engaging, I invite you to call and book some time. If you'd like further information, including access to our quarterly communication pieces, you can check us out on the web at www.chrisraper.com and send us an email from there.

This concludes "Is There a Fit".