RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

**The Opportunity Update – Tuesday, June 5th, 2018**

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## 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, June 5th, 2018. 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 – Pipes and Steel** – I will try to make some sense out of the nonsensical place we find ourselves in - a government-owned pipeline that Kinder Morgan is still going to build and steel tariffs which have once again upped the ante to getting the NAFTA deal done. Then, we will follow our usual course - updating you on our favourite leading economic indicators: the price of copper and semiconductor index, speak to the oil complex (where we continue to be more bullish than bearish) and finally speak to the Canadian dollar, which is very close to making a new year-to-date low this morning.

On **Track #3: The Dividend Value Discipline™ - Finance *x* Technology = Growth²**

We will explore the two new companies that have been added to the program since our last recording – both are in the financial services industry and both have a strong technology bent that is allowing them

to disrupt their respective competitors and thus grow at abnormally high rates. We will cover off the culture that built both firms, their moats, and why we believe those moats are expanding.

On **Track #4: The Wrap Up – Commodities, The Next Bull Market?**

I will wrap it up, giving you the key takeaways from each track and then speak to the growing evidence that is pointing to the next commodities boom.

**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 that 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.

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 are thereby able to grow at rates far faster than those 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. That 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 – Pipes and Steel**

Recording this track seems like déjà vu to me because I opened it last quarter with, "As you are no doubt aware, President Trump's threat of 25% import tariffs for steel and 10% on aluminum has been NAFTA exempted, for now…" …and here we are three months later with those tariffs actually being imposed. As you would expect, the U.S.'s trading partners, including Canada, are now engaged in a tit-for-tat battle that hurts everyone. What is curious to me is that there has been very little negative reaction by investors. In fact, post announcement, as of today the TSX is marginally higher and the US markets are more so. How does that make sense? To me, it suggests that investors do not believe the tariffs will last and they are simply an action to drive a better trade deal. Let's recall that the market is a forward looking animal – participants discount what they see happening into the future and right now, net-net, investors are betting that on balance, things are getting better notwithstanding Trump's agenda.

Moving to pipes, how does the government takeover of the Trans Mountain pipeline impact participants of **The Dividend Value Discipline™**? Frankly, it doesn't move the needle very much – since the beginning of the year we have opted for most of our oil exposure via Exchange-Traded Funds (ETFs) and the majority of the companies within those ETFs are U.S. domiciled. That move was intentional – it is simply easier/cheaper to produce oil in the U.S. and, naturally, that is where the money has flowed. Does the federal government's purchase of the project get it built faster? I don't know but I am skeptical of governments entering the private sector with taxpayer money. I could go on at length but it changes nothing – we deal with the hand we are dealt, at least until the next election. By then the evidence should be plain for all to see.

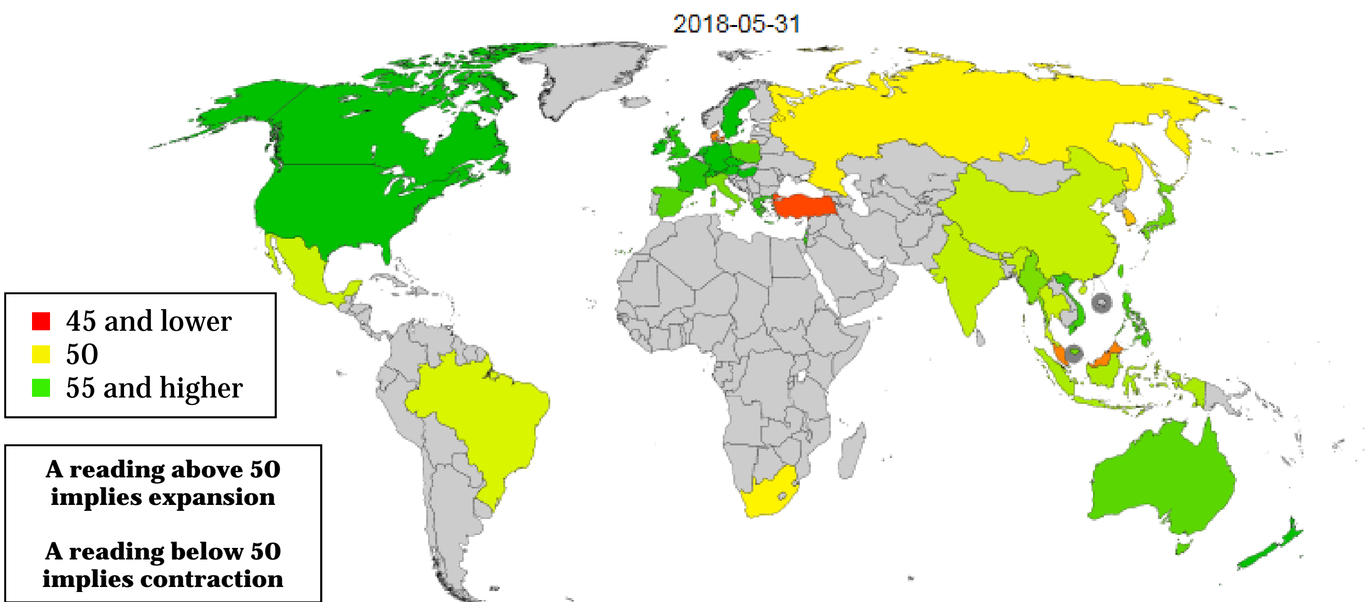
Moving on to our favourite leading economic indicators, copper consolidated since our last recording on March 13th when it was trading at $3.13 per pound. Since then we saw it peg a low $2.94 in late March and then rally its way back to some $3.20 per this morning. It is important to note that during that weakness, the U.S. dollar was rallying strongly and that is generally a negative for all commodity prices. As of today, it looks like the uptrend is reasserting itself but it is fair to say that my conviction on that comment is somewhat weaker than last quarter.

Why is the price of copper important? Because copper goes into virtually every manufactured good you can think of, so strong prices point to robust demand and a growing economy, especially as it relates to the developing economies. The raw material of the developed economies is the semiconductor and the measure of that is the Philadelphia Semiconductor Index (symbol $SOX). You may recall that it just hit an all-time high on our March recording and, after consolidating through the month of April, we are back to rally mode - as of this morning we are with spitting distance of another fresh all-time high, with

the index currently pegging in at 1423. With the technology-laden NASDAQ Composite also hitting an all-time high this morning, I am thinking it happens.

When we look at most of the ancillary evidence, the world's Purchasing Managers Indices (key leading indicators) did moderate somewhat through April but the latest data suggest a pause and push north as opposed to declining economic growth. For those of you receiving this recording via email, you can see the global manufacturing heat map courtesy of Ned Davis Research. Suffice to say, most of the world continues to be expansion mode.

- Global manufacturing momentum cooled to a nine-month low in May, but remains at historically strong levels.
- Although most economies saw slower growth, sustained strong readings in the U.S. and China, the world's two largest economies, support a continuation of the global expansion.




| Country | Reading |
|---|---|
| Turkey | 46.4 |
| Denmark | 47.5 |
| Malaysia | 47.6 |
| South Korea | 48.9 |
| Russia | 49.8 |
| South Africa | 49.8 |
| Brazil | 50.7 |
| Mexico | 51.0 |
| Thailand | 51.1 |
| China (Markit) | 51.1 |
| India | 51.2 |
| Indonesia | 51.7 |
| Burma (Myanmar) | 52.6 |
| Singapore | 52.7 |
| Italy | 52.7 |
| Japan | 52.8 |
| Australia | 53.2 |
| Poland | 53.3 |
| Taiwan | 53.4 |
| Spain | 53.4 |
| Philippines | 53.7 |
| Vietnam | 53.9 |
| Israel* | 54.0 |
| Greece | 54.2 |
| U.K. | 54.4 |
| France | 54.4 |
| Hungary | 55.4 |
| Ireland | 55.4 |
| Eurozone | 55.5 |
| Sweden | 55.8 |
| Canada | 56.2 |
| U.S. (Markit) | 56.4 |
| Czech Republic | 56.5 |
| Germany | 56.9 |
| Austria | 57.3 |
| New Zealand* | 58.9 |
| Netherlands | 60.3 |
| Switzerland | 62.4 |

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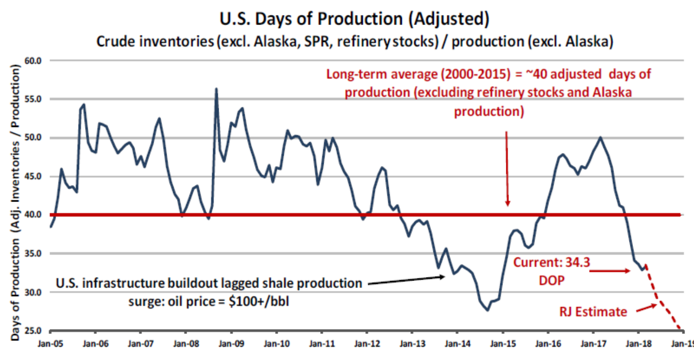
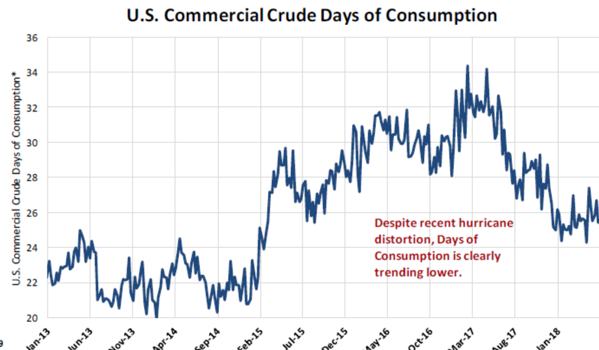
Moving to the oil complex, we continue to be biased to the upside on oil prices for the simple reason that the days of available supply continue to drop. Yes, U.S. oil production continues to grow – it's just that U.S. and export demand is growing even faster. The other insight that factors into our thinking is that production side of the business, basically how fast drillers and frackers can develop new supply, is now constrained by labour, equipment and production materials - i.e. fracking sand. That hampers supply growth in the same way that political disruption in Venezuela and Iran do.




That brings us to the Canadian dollar, which is certainly weaker today than it has been most of the year and as noted earlier we are very close to taking out the March 2018 low. It should be noted that we have just passed the historic seasonal high for the loonie, the month of May. Our lack of tidewater access for Canadian oil means that we will continue to sell our oil at huge discounts to world prices, a net negative for the Canuck Buck. Couple that with our Bank of Canada Governor's softer tone on interest rate vis-a-vis the U.S. Federal Reserve, and precious little progress on NAFTA, and it is hard to see how the loonie can strengthen until one or more of those issues changes for the better – my take is that the Canadian dollar gets marginally weaker before I am back to you in September. Today it is at $.7688 U.S. or, if you prefer it the other way round, the spot rate for a U.S. dollar is $1.3005 Canadian.

That's a wrap on track #2 and we are off to Track #3, right now.

**Track #3: The Dividend Value Discipline™ - Finance *x* Technology = Growth²**

Since our last recording, we have added two new names to the program. Both are in the financial services sector, both have built out their technology platforms to better serve their customers, and in doing so have upped the value proposition to those they serve. What we find encouraging is that they are aggressively disrupting their competitors resulting in outsized sales and profit growth. Let's recall that there are only three things a company can do with profits – they can pay tax, they can reinvest for further growth, or they can pay a dividend. While the first option, tax, is a non-negotiable, the other two are music to our ears.

So without further ado, let's get to the first acquisition - a financial/investment advice provider and perhaps the strongest competitor to our U.S. parent company, Raymond James Financial Inc., **Charles Schwab Corp. (SCHW)**. We start with culture. Like Raymond James, Schwab has a basic tenant of "put the client first" and, from my perspective, both firms live it out. Interestingly, both firms were founded by visionaries who could see a better way to serve private client investors. Charles Schwab and Tom James continue to exert their considerable influence over their respective firms today. I could go on ad nauseam about the parallels but I will drop that now and focus on Schwab. They endeavour to see the world through their clients' eyes and they are constantly innovating better ways of getting things done. That modus operandi has taken Schwab from an upstart discount brokerage in 1975 to the largest publicly traded client asset custodian in the U.S. Through the years they have collected numerous industry accolades and most recently have been selected as one of FORTUNE's Top 50 World's Most Admired Companies for 2018. Charles Schwab, now 80, continues to be the Chairman of the Board, and the current CEO, Walter Bettinger, has worked his way up the ranks since joining the firm in 1995. Furthermore, he was a founder of his own firm that Schwab bought - The Hampton Company. Suffice to say, we like long management tenures, talent development and promotion from within. We also like founder firms.

I have given you some insight into why we believe that Schwab has a superior and sustainable culture so let's move to answer the question, do they have a moat (a strategic advantage that makes the firm difficult to compete with) and, if so, is it expanding or contracting? Our take is a definite yes to both – their moat is part culture, part scale and then a big slice of innovative technology disruptor. The firm has created smarter, faster and cheaper ways to serve individual investors through their client friendly on line investor platform. You can open an account online, get financial advice via robo-advisors with as little as $25,000 to invest and, as your needs for more specific advice grow, you can seamlessly transition up the value chain. Due to their scale, they have the resources to constantly improve the offerings while lowering the incremental cost of additional features on a per-client basis. That improves profit margins and drives sales - ultimately, driving the rent cheque north. For the record, Schwab

started upping its dividend in 2016 and the growth has compounded at 18.60% per annum since then. Our take is that we will see more of the same for the foreseeable future.

On to Acquisition #2.

Last quarter I spoke about finding companies that are undergoing a major transformation in their business model as it can be a huge catalyst to the stock price. We believe that the acquisition of property and casualty insurance innovator, **Progressive Corp. (PGR)** is one such company.

Again let's start with the culture – like Schwab, you can see that talent development and long management tenures are part of its DNA. Tricia Griffith worked her way up from a claims representative to become the Chief Executive Officer in July 2016. Most of the key executives have been with the firm for over two decades. Importantly, the firm has a history of innovating/disrupting to better serve customer needs. Industry firsts include drive-in claims centres, premiums paid by instalments, 24/7 Immediate Response® claims service, and by 1994 you could buy your insurance over the phone. By 1997 you could compare competitor rates and buy your policy online. I still can't do that!

In 2015, they expanded to home insurance - again leveraging their technology platform, their disruptor advantage, across more business lines while improving the customer experience, ergo value proposition. In short, we believe that their moat is getting wider and the most recent sales and earnings growth tends to support that view. Over the last two years, sales have increased at double digit rates and with each passing quarter they get better yet. Profits have followed suit and that is ultimately what they are going to pay us rent cheques from. Bottom line – we believe we have found another high culture wide moat firm that is expanding its strategic advantage via its client-centric technology platform. That is a tremendous lever for growth. This is transformation in action and we expect to be well rewarded as shareholders.

As we think through both companies, their drive to create an ever increasing value proposition for their end clients, and adopting industry leading technology to do so, leads us to believe that the earnings surprises will be to the upside. We are excited about the long term prospects for both Schwab and Progressive – we see any short term weakness as opportunities to add to our existing positions.

We are off to Track #4.

**Track #4: The Wrap Up – Commodities, The Next Bull Market?**

First, the takeaways:

**Track #1: Introduction – The Skinny:** A reminder that 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 – Pipes and Steel** – the key takeaways for Trump's tariffs is that investors really don't believe it is going to be a long term thing as evidenced by the lack of market reaction. In terms of our new pipeline purchased with your tax dollars, although there is little direct impact for participants of **The Dividend Value Discipline™**, I am skeptical of nationalized takeovers in general. Be that as it may, we remain bullish on oil prices and flat to down on the loonie versus the U.S. dollar. Economy wise, we did have a pause in the March/April window but the latest evidence suggests we are back on track and pointing north.

**Track #3: The Dividend Value Discipline™ - Finance *x* Technology = Growth²**

Schwab and Progressive have both harnessed their desire to improve the value proposition to their end clients by adopting/building out their technology platforms, enabling them to disrupt their competitors and thus grow at abnormally high levels. It is important to note, though, we didn't find them by looking for advanced technology platforms. We found them by looking for firms that have superior culture and you will often find that in founder led firms. The search continues.

**Track #4: The Wrap Up – Commodities, The Next Bull Market?**

Before we close I thought it important to draw your attention to what I see as the mounting evidence for a bull market in commodities. To me, the cards are falling into place. Students of market history know that most commodity cycles last about 14 years, so we are now 10 years out from the last bust, the 08/09 recession. Let's recall that there was a boom before the bust, so from a timing perspective it makes the argument at least plausible. On the last edition of The Strategist, we wrote about how the commodity-centric TSX Composite Index has basically gone nowhere for the last 10 years and, counter-intuitively, we should see that as a good thing because historically after ten years of essentially no returns you tend to get a decade of double digit returns. If that turns out to be true, commodities will have the leading role. Similarly, earlier this year the capitalization of the energy industry in the U.S. fell to ~5% of the value of the S&P 500, a number that historically has marked the low point of the cycle – it

is interesting to me that we are now seeing labour, equipment and materials constraints in the energy complex. Let's factor in the now growing emerging market economies and China's massive global Silk Road infrastructure project ($124 billion) and, just for fun, think about electric cars that need 5x the amount of copper as a gasoline powered car. Think that through and you soon realize we need a lot more than just oil and gas. Iron ore, copper and zinc are all trending higher and there has been precious little investment in new supply for over a decade. Ultimately, this is a good news story for Canada and it just might Trump our lack of pipelines (pun intended).

With that, I will close. A reminder that if you are being introduced to us by way of this recording, tracks 5 & 6 are for you. Thank you for taking the time to listen.

On behalf of the entire team here at Chris Raper & Associates, please accept our best wishes for a great summer ahead. We trust you will get some R&R with the ones you love before I am back to you with our next recording in September. This is Chris Raper bidding you good day and may God bless from Victoria BC on Tuesday, June 5th, 2018.

**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.

While it is not our only offering, 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 Dividend Value Discipline™**.

The process is discretionary, meaning we make the entire 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%+ over any investment cycle, which we would describe as peak to peak or trough to trough. If you are looking for a time frame in terms of years, think 5+ years but please understand investment cycle have a wide range of timeframes.

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 15 calendar year history, we have had 14 years of positive returns and 9 years where we met or exceeded the +8% objective. The original accounts opened in 2002 have net to client compound annual growth rates ranging from a low of 6.8% to a high of 8.9%. Why the big discrepancy? Part of the differential is due to the timing of money and money out, but when you really drill down, the high number is a result of intelligent investor behaviour. The client with the absolute best performance sends us money when others are ready to fire us. There is valuable lesson therein – for your sake, please don't overlook it.

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".

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