RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

The Opportunity Update – Tuesday, June 5, 2019

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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 June 5, 2019. 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 – Mega Caps Under Pressure**: As opposed to the U.S./China/Mexico/Canada and whoever else Trump decides he doesn't like tomorrow, I chose to lead with continued selling pressure in the mega capitalization stocks, namely Microsoft, Amazon, Forrest Gump's fruit company, Apple, Facebook and Alphabet (formerly Google), as it has huge implications for our markets going forward. I will demonstrate why that is the case and why it is a good thing for dividend growth investors.

Before we get there, I will follow our usual course and give you an update on our favourite leading economic indicators: the price of copper and the semiconductor index, and then the always important to Canadian investors, energy complex, and finally - our Canadian dollar.

On **Track #3: The Dividend Value Discipline™ – Lower Rates in Our Favour,** we'll start off the track by giving you an update on global interest rates and why the southerly direction is a good thing for dividend-growth investors. Then we will highlight a recent addition to the program, namely our initial stake in the world's largest independent oil refiner (not producer), Valero Energy. We'll give you our take on the corporate culture, their moat and the tailwinds that we see pushing them north in the months and years to follow.

On **Track #4: The Wrap Up – Canada, Reasons for Optimism**, I will wrap it up giving you the key takeaways from each track, and then outline some overlooked good news stories within our Canadian economy and once again reiterate why we believe it is dangerous for Canadian investors to abandon Canadian equities.

Track #5: Postscript I is where I walk you through our core investment program, **The Dividend Value Discipline™**, its methodology and return objectives. 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, there are three things to note:

1. The opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.

2. Raymond James Ltd. is a member of the Canadian Investor Protection Fund. That is a good thing. If you are interested in those details, please ask me or any one of our relationship managers the next time we speak.

3. This recording/transcript provides links to other Internet sites for the convenience of users. Raymond James Ltd. is not responsible for the availability or content of these external sites, nor does Raymond James Ltd. endorse, warrant or guarantee the products, services or information described or offered at these other Internet sites. Users cannot assume that the external sites will abide by the same Privacy Policy which Raymond James Ltd. adheres to.

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!

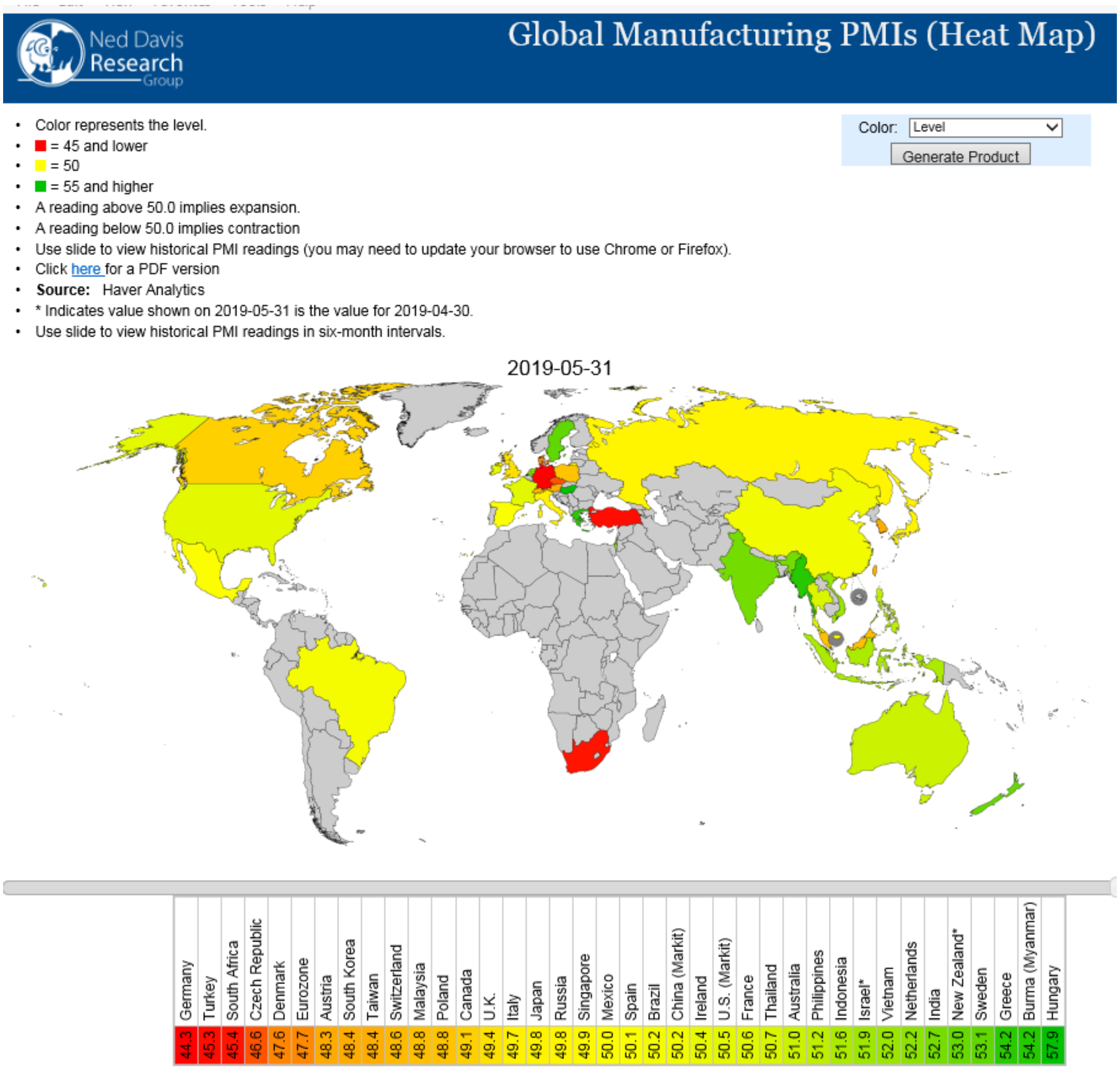
That's a wrap on the skinny, and off we go to Track #2.

Track #2: The Markets – Mega Caps Under Pressure

Starting with our usual course, the price of copper has moved from a bullish $2.84 per pound on our March 25, 2019 recording to a now bearish $2.64 per pound, which is not far off its 52 week low pegged on Jan. 3, 2019 of $2.54. In terms of why, China is the largest user of copper and with the U.S. China Trade War seemingly escalating every other day, this should not surprise us. Any way you shake it, this is a net negative for the global economy as weaker demand for copper points to weaker manufacturing economies and China is the largest amongst them. Let's also recall that Trump's bluster has often turned out to be far worse than the actual result, so no I don't believe it is prudent to "sell all" on the belief you will be able to buy back cheaper. That said, as we moved towards the highs of April, we did take on a more defensive posture, so we are in the fortunate position of being a little cash heavy - which I expect we will employ in the weeks and months ahead.

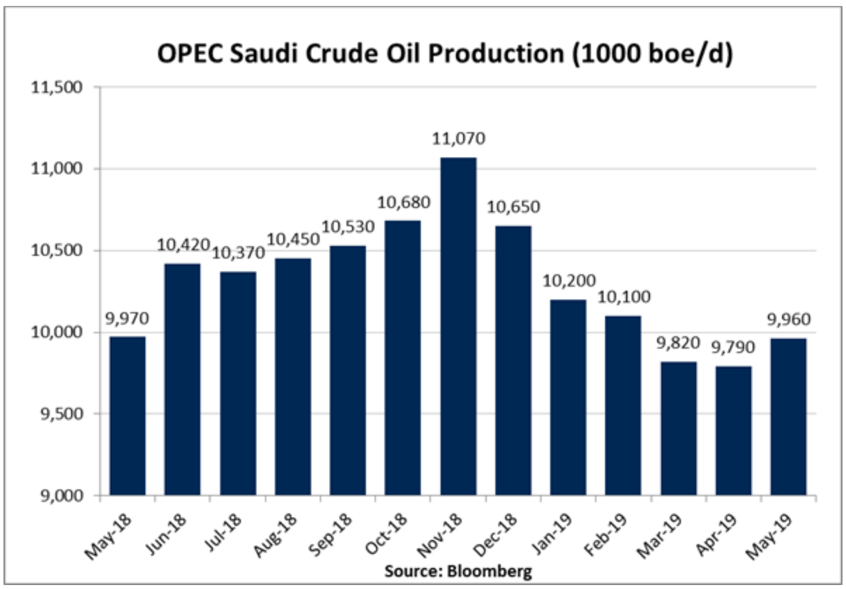
The action in our best leading indicator for the developed economies, the Philadelphia Semiconductor Index (symbol $SOX) has followed Dr. Copper's pattern. After pegging an all-time high in late April at 1,605 versus 1,450 on our March recording, it too has turned turtle and is now plumbing the 1,330 level, in the span of 5 weeks! Clearly the animal spirits have moved from really bullish to really bearish. Once again, the semi-conductors tend to be a great "tell" for the developed economies because much of our economic growth is fueled by human ingenuity and processing power. As the demand for processing power (the price of semiconductors) increases, or in this case decreases, it points to a slowing economy.

Both copper and semiconductors recent price actions are consistent with what we are seeing in our ancillary indicators, i.e. the Global Manufacturing Purchase Managers Indices (PMIs) had turned up for the month of April but then turtled as has other obscure measures like the containerboard production, but I digress.



As far as prognosticating the end of the trade war, given President Trump's increasingly neurotic behaviour, it is unknowable. What I do know is that if we only sell when most investors are fearful (and they certainly are - Tuesday's June 4 reading on the CNN Fear Greed Index registered a 22 - Extreme Fear rating https://money.cnn.com/data/fear-and-greed/), and we only buy when most investors are optimistic, we are destined to become paupers and I am pretty confident that is an outcome that all of would like to avoid. As I have quoted ad nausea, Peter Lynch was right when he quipped, “far more money is lost preparing for the recession than during the recession”.

Turning to the energy complex, the price of oil took it on the chin for the month of May. Today West Texas Intermediate Crude is trading at~$52, versus $58 on our March recording. Back then we highlighted what we believe to be the underappreciated bullish developments within the 2,000 lb gorilla swing producer, Saudi Arabia. In a nutshell, the Saudi Kingdom needs $80 U.S. Brent Crude to make its federal budget work, versus the ~$61 it is trading at today. How do they get there? They continue to cut production until the reduced supply drives prices north. Those production cuts are happening and thus it is difficult for me to get too bearish on oil.



Furthermore, the rate of growth in U.S. oil production is actually slowing – the production engineers attribute this to over-fracking where one well actually “steals” from another. The above said, if we get into a prolonged recession, demand will fall and price is always established where supply becomes balanced with demand.

That takes us to the loonie, where we have plumbed a recent low of $0.7375 U.S., after me telling you I saw it as range bound in the $0.74 to $0.76 level on the March recording, so that is pretty much what has happened. On that same recording, I told you I was more bullish than bearish in the months and years ahead and accordingly, we continue to migrate money north, albeit at a snail’s pace. As to why, I will address that on track #4.

That takes us our lead story, **Mega Caps Under Pressure**. Let’s first understand why this phenomenon is important:

1. These are some of the largest companies in the world by market capitalization and thus, have an outsized influence on the global capital markets and perhaps more importantly, investors perspective on the future. Translation: no investor can escape their impact.

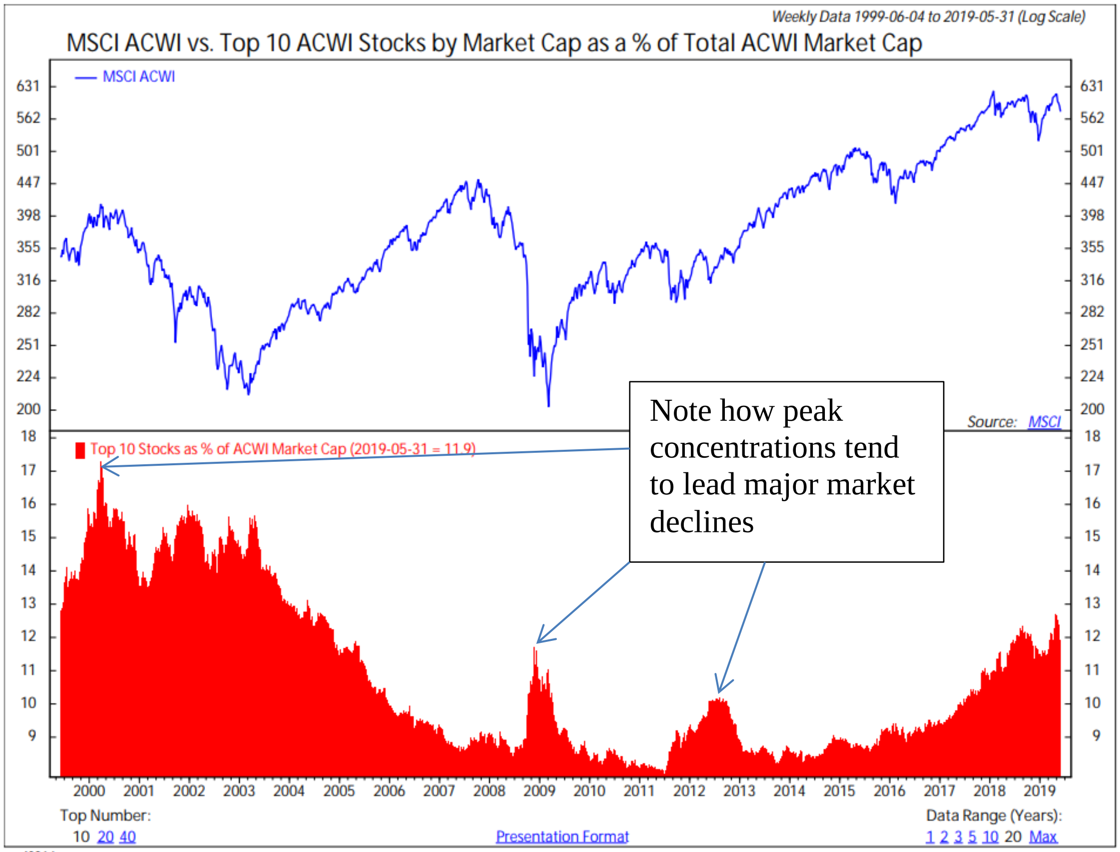
Top 10 MSCI All Cap World Index as of June 4, 2019 Close

Company	Sector	Weight in MSCI ACWI	Date of 52-Week High	Loss from 52-Week High (%)
Microsoft Corp	Technology	2.05	25-Apr-19	-6.76
Apple Inc	Technology	1.88	03-Oct-18	-23.24
Amazon.Com Inc	Consumer Discretionary	1.68	04-Sep-18	-15.93
Facebook Inc (A)	Communication Services	0.96	25-Jul-18	-23.34
Johnson & Johnson	Health Care	0.79	04-Dec-18	-10.19
JP Morgan Chase & Co.	Financials	0.79	20-Sep-18	-8.31
Alphabet Inc. (A)	Communication Services	0.79	29-Apr-19	-18.82
Alphabet Inc. (C)	Communication Services	0.75	29-Apr-19	-18.47
Nestlé S.A.	Consumer Staples	0.69	03-Jun-19	-2.11
Exxon Mobil Corp	Energy	0.68	25-Sep-18	-16.07

Notes: MSCI ACWI Weights as of 05/31/2019. % Loss from 52-Week High data as of 06/04/2019.
Sources: MSCI, Thomson Reuters.

It is worth noting that the mega caps that are off the most from their 52-week highs are heavily biased to the technology sector, an area where investors have been on a multi-year run of bidding up their stocks prices. As we have highlighted in past missives, all tailwinds eventually turn to into headwinds. The growing antitrust cases and the “I want to milk that cow too” attitudes are a major headwind for the world’s largest technology companies. The more powerful, the more vulnerable they are to government sanctions. Recall, the break-up of Standard Oil in 1911 and bust-up of the AT&T monopoly in 1982 – these things can happen again. Even if the breakup doesn’t happen, the proceedings can take a decade, i.e. Microsoft starting in 1998.

2. We are seeing increasing selling pressure in the mega cap stocks at a time when the concentration on the world’s largest companies is higher than it has been for the last 15 years. To illustrate what can happen when investors get overly focused on a particular sector, recall when Nortel made up almost 20% of the value of the TSX only to shrink into oblivion. Now that I have your attention, please understand that I am not drawing a parallel, merely illustrating the point in the extreme.



As dividend growth investors, the important thing for us to understand is that money is coming out of these mega cap stocks and it will find a home. As we will see on track #3, interest rates are once again flirting with all-time lows, meaning bonds just aren't that attractive. The current yield on a 10-year U.S. Government bond is a paltry 2.10%. If you lock in at that rate, you are guaranteed that for the next 10 years, your income will never shrink. Conversely, you are guaranteed it will never grow! How many people can meet their life objectives with a 2% return for the next 10 years? Not many, I suspect. Turning to the dividend-growers, there are lots of companies already paying dividend yields north of 2%. Certainly that 2% can shrink, but with a diligent selection effort, it is far more likely to grow. We need to understand that if you start with a 2% dividend yield and it grows at 15% CAGR (Compound Annual Growth Rate), your 2% becomes 4% within five years, and your 4% becomes 8% in the next five years.

Off we go to Track #3.

Track #3: The Dividend Value Discipline™ – Lower Rates in Our Favour

When I left you on the last recording, the yield on a 10-year U.S. Treasury Note was roughly 2.45%, versus a new low of this week of 2.10% and a country mile from last fall's peak of almost 3.25%. Do the math and you will see that is a 35% reduction from last fall's available income stream. The available income stream from a 10-year government guaranteed bond is the classic comparison to any dividend-paying stock. In other words the "go-to" alternative has fallen like a rock, and all other things being equal, it makes dividend-paying stocks increasingly attractive and dividend-growers even more attractive than that.

Furthermore, if you plot the dividend-paying stocks versus the overall market, what you will see is that every time the market sells off in a notable way, the dividend-payers outperform. Our take is that the recent selling pressure in the mega caps stocks and lower interest rates are tailwinds in our favour, whereas they have been signficant headwinds for the past few years. We are in a good spot.

Switching gears, the company that I am going to highlight for you today has a stellar record of dividend growth, and obviously we believe that is going to continue or else we would not have bought the stock. **Valero Energy Corp.** ("VLO") is the largest independent refiner in the United States. Please note that this is not an exploration and production company. Essentially, they buy oil and turn it into useable products like gasoline and jet fuel. As such, they are largely indifferent should oil prices be high or low.

Culture-wise, VLO scored a 4 out of a possible 5 points on our proprietary rating system, receiving top marks for "founder" type thinking, long management tenures (some 29 years) and their focused metric of "Cash Operating Expenses per Barrel of Throughput". Throughout their history they have demonstrated themselves to be skilled aggregators, often purchasing assets at a fraction of their cost.

Their economic moat is derived from their scale, the difficulty of establishing new refinery sites, and in recent years, their predominately U.S. locations that have allowed them to access cheaper feedstock (oil) from the growing U.S. production. VLO's flexible refineries also allow it to process lower-quality (i.e. cheaper) heavy crude – the kind we produce in north east Alberta.

VLO is dedicated to returning cash to shareholders, having raised its dividend at a compound annual growth rate of 14.50% for the last 3 years. Taking a longer look, in the last ten years the dividend per share has grown from $0.65 to $3.60 with no appreciable increase in long-term debt. That's more than a fivefold increase over ten years. If we only get a triple in the next 10 years, I will be ecstatic because we bought our initial position with a 4% yield.

That concludes Track #3 and we are off to the **The Wrap Up**.

Track #4: The Wrap Up – Canada, Reasons for Optimism

First, the takeaways:

A reminder that the opinions expressed on this recording are mine. They may differ from those of Raymond James Ltd. Please recognize that some of what I told you is going to turn out to be wrong.

Since our March recording, we had what looked like the beginning of an acceleration in the global economy, that quickly turned south when president Trump upped the ante on multiple trade fronts. Our key leading indicators, copper and the semiconductors, have turtled and most of the ancillary evidence is pointing in that direction. We are also mindful of the Extreme Fear sentiment which is a contrarian indicator. Sum it up and the outlook tilts negative, so we take on a slightly more defensive posture and look forward to any panic sells to deploy cash.

Money continues to leak out of mega cap stocks and that leakage is gaining momentum, which tends to be a self-fulfilling prophecy. The mega technology stocks are the most vulnerable as they are easy fodder for politicians – life is getting more difficult for the likes of Facebook and Google. As those stocks get sold, the money from them needs to be reallocated and lower interest rates make dividend-paying stocks increasingly attractive.

Where to from here? I can't tell you how long the trade war will last or how much the economy might shrink as a result of it. I can tell you that Central Bankers are already taking steps to mitigate the negative impact with the only tool they know - lower interest rates. Australia cut this week, and they won't be the last. Again, lower interest rates make dividend-paying stocks increasingly attractive.

Our usual counsel stands - let's not get too excited about the recent performance. I know you were pretty happy with your April statements and I know you will be lot less happy with your May statement. With the S&P 500 down some 6.58% (local currency) it is unrealistic to think we will come away unscathed. Yes, it seems like a scary time to be holding equities, but it was like that during the Asian Flu Crisis, the Tech Wreck, the '08/'09 Financial Crisis, the Euro Debt Crisis, and the sub $30 Oil of early 2016. Take note that during every one of those events you would have been far better off buying than selling. As long as you have enough in your safe money and income buckets, with the right intestinal fortitude (we are here to help), you can withstand virtually every downturn, and when it comes to lifetime returns, investor behaviour is what really counts.

Now to **Canada, Reasons for Optimism** - and when you hear me say that, you may think I have rocks in my head. The bad news is the Canadian economy is well-known. It is on the front page of the newspaper every day, but the back page is where you get insights into what might become front page news (and thus profitable to us) in the months and years ahead.

Consider the following:

- LNG Canada's Kitimat LNG plant will be exporting to Asia by early 2025.
- Keyera Corp.'s Key Access Pipeline will be complete by 2022, providing new markets for landlocked gas in Northwest Alberta/Northeast BC.
- Alta Gas opened a new propane export facility this week in Prince Rupert, BC. Their focus is Asia, not the U.S. Pembina Pipelines, and building a propane export facility near Prince Rupert with similar aspirations which will be operational by 2020.

The net effect of these projects is that we are going to get our previously landlocked resources to international markets and every bit of propane or LNG we ship means less coal being burned in Asia, a net positive for the environment. The Trans Mountain Pipeline is not the only game in town. Furthermore, my sense is that attitudes are changing with people like Vivian Krause https://fairquestions.typepad.com/rethink_campaigns/about-the-author-vivian-krause.html making people aware where the money is coming from for anti-pipe protesters. And if that is not enough, a $1.80/litre gasoline tends to change perspectives.

That brings us to a close for this edition of The Opportunity Update. A reminder, if you are being introduced to us by way of this recording then Tracks #5 and #6 are for you.

Thank you for taking the time to listen. This is Chris Raper bidding you a good day and may God bless from Victoria, BC on Wednesday, June 5, 2019.

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

The first thing I want to share with you is that **The Dividend Value Discipline™** is not the only investment offering that we have. In fact most of our clients have three buckets of money with us – a safe money bucket, an income bucket and a growth bucket. **The Dividend Value Discipline**™ straddles the latter two and depending on your need, we augment it with other strategies. That said, the program continues to be the largest slice of our client assets under management and that includes my business partner, Ryan Cramp, my family and me. The takeaway is that my team and I have huge vested interest in ensuring its success.

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:

1. Income every month – that can be paid out or reinvested;

2. An acquisition process where we buy only those securities which become attractive on a “go forward” basis;

3. 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 cycles have a wide range of timeframes.

The program operates with three key objectives and I will walk you through them using 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 on to an 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. We spend an inordinate amount of time studying the corporate culture of potential investee companies. If you are interested in what great corporate culture 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 – the things that make the company tough to compete with. We want to own companies that the end client can't live without – great examples might be Microsoft or Intuit, both long term holdings of ours. We believe that the focus on great corporate culture and wide economic moats gives us an edge, and while I can't prove it you I can certainly give you lots of anecdotal evidence to support that thesis.

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 roughly 5%, much better economic growth, and stocks benefiting from decreasing interest rates, whereas today we have 5-year GICs yielding say ~3.0% and much slower economic growth. In short, the 8% is tougher to come by.

Accordingly, we spent late 2015 and 2016 tackling the "growth problem". We needed 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 focused on those companies that have demonstrated their ability to grow their earnings/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 – think Wal-Mart 20 years ago or Amazon today - with a better way of doing things and/or they tend to be aggregating their way to growth by buying smaller tuck-in acquisitions, much like Expedia has done with their acquisition of HomeAway, Travelocity and Hotels.com.

The Third Leg is Discipline

Here I refer to the buy/sell decisions.

On the buy side, I would sum it up as do your homework, be ready and be patient. Over the years our absolute best buys have been when we have done our homework on the company, perhaps months before, and then some untoward event happens that gives you opportunity to buy in size. The Euro debt crisis in 2011 is a great example that enabled us to buy Nike at a terrific price because we were ready and we had conviction.

Sell decisions are tougher and they have become increasingly so, because the quality of our companies has just keeps going up and with rent cheques (dividends) growing at double-digit rates, our history tells us more often than not, we are better off holding than chasing new shiny baubles. That said, new competitors with disruptive technologies can wreak havoc on a company's growth prospects – back to the Amazon/Wal-Mart example. Transition periods of the senior management teams can be risky especially when there is no hire from within bias. Then there are times when the price of a stock just gets so far in front of its growth prospects that the only reasonable thing to do is sell. As Buffett likes to say, "you pay a high price for a rosy consensus". When things are universally rosy we try to be sellers, not buyers.

Perhaps the most important part of the buy/sell discipline is the way we operate the program for new entrants – we call it "The Buys Only Mandate". Unlike most of 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. Who buys 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. The buys only mandate was designed to protect your hard earned money.

Other key points to the program: a fully invested account would normally have 20 to 25 positions in it, so we are relatively concentrated. You should also know that when we buy for you, we buy for us, meaning Ryan and I personally. When we sell for you, we sell for us – same time, same price.

Generally speaking, we are looking to establish new relationships with new clients that have north of $1 million in investable assets but please understand, we are 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™,** with at least a portion of your investable assets, then I 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".