RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

The Opportunity Update – Wednesday, June 10, 2020

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Track #1: Introduction – The Skinny

Hi, this is Chris Raper, Senior Wealth Advisor & Senior 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 Wednesday, June 10, 2020. 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 – Be Wary of FOMO,** I am going to speak to both the anecdotal evidence and the empirical evidence that suggest to me that once again, investment decisions are being driven by FOMO, the fear of missing out, on what can only be described as a spectacular market rally since the bottom of March 23, 2020. We will then hit our favourite leading indicators for the global economy – the price of copper and the semi-conductor index – and address the tremendous fiscal stimulus that makes the 2008/09 effort look like a pittance. At the end of the track I will outline why I am cautious, why I might be wrong, and what I think the appropriate response is given that conundrum.

On **Track #3: The Dividend Value Discipline™ – New Names for a New Reality,** for those of you that follow your portfolios closely, you are aware that there have been a number of new names in the program as we adjust to a world where the initial COVID wave has passed. In Gretzky terms, "skate to where the puck is going to be, not where it has been". On this recording I am going to highlight french fry producer Lamb Weston, thrift retailer Dollarama, and rural lifestyle retailer Tractor Supply, and share our thinking behind those decisions.

On **Track #4, The Wrap Up – Avoid Taking Extreme Positions,** I will highlight the key takeaways from each track and then spend some time on why I believe it is wise to avoid taking extreme positions, i.e. all cash or all in.

Track #5: Postscript I is where I walk you through the methodology and return objectives of **The Dividend Value Discipline™**. 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. The transcript of this recording 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 – Be Wary of FOMO

On the March 2 edition of this recording, I closed out this track with the following:

"Yes, there is a lot of uncertainty out there, but here is what we are reasonably certain of:

- *The rent cheques of our investee companies will continue to grow.*
- *A lot of investors will lose sight of why they bought the "dividend growers" as they embrace their FEAR - False Expectations Appearing Real. Those investors are going to sell some truly exceptional companies at deeply discounted prices – you are not going to be one of them, right?*
- *They will feel better for a while, and you may feel worse, but then the long term regret will seep in as they watch those same companies continue to up their rent cheques at double-digit rates every year, and see the stocks price adjusting accordingly."*

Well as of today, it looks like things are panning out pretty much as expected. The fear of the COVID induced bear market is rapidly being replaced with FOMO – the fear of missing out on what can only be described as a spectacular market rally. My counsel is to be wary of both fears – they are hazardous to your wealth. Recall that investor behaviour is the #1 determinant of lifetime returns.

Anecdotally, we had one family send us money during the market collapse – that is behaviour you want to emulate. Last week, with the market up some 40% of its bottom, the money started trickling in and I was getting calls/texts from prospective clients who had previously been reticent to invest anything in the selloff, with comments like, "my FOMO is hitting its limit". Who do you think is going to do better?

Please understand, I do not share such stories to rub salt in anybody's wounds. If we are honest, we have all made dumb investment decisions at one time or another. I share them to make us all better and that includes me.

To give you some empirical evidence on the current state of investor psychology the [CNN Fear Greed Index] hit the first percentile, extreme fear, during the March bottoming process. Yesterday it pegged the 67^{th} percentile, greed – not extreme greed yet, but greed nonetheless. As per Buffett, "be fearful when others are greedy".

With our Investor Psychology 101 out of the way, let's move to our favourite leading economic indicators to see what clues they might offer us about the future. Starting with Dr. Copper, "the metal that goes into everything" and consequently, a great proxy for what is happening in the world's manufacturing economies. When I left you on the March 2 recording, copper was at $2.60 per pound. Before March was over it had bottomed at $1.97 and as of this morning (June 10, 2020) it was trading at $2.68. For perspective sake, the low in 2008 was $1.25, so mid March, things were looking pretty dire but I probably didn't have to tell you that. There is an adage in our industry that says the market does not give a hoot about whether things are good or bad, it only cares if things are getting worse or better. For today at least, copper is saying things are getting better.

Chart courtesy of https://stockcharts.com/

Our best leading indicator for the service-based economies, the Philadelphia Semiconductor Index (symbol $SOX) is also singing from the same song sheet, having hit an all time high on Friday, June 5, up a whopping 65% from its March 18 intra-day low. The semiconductor complex tends to be a great "tell" for the service-based 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, it is suggesting the service-based economies are back in expansion mode.

Chart courtesy of https://stockcharts.com/

That view squares with a host of other ancillary indicators that while things are a long ways from being good, i.e. record unemployment, things are getting better, i.e. in the US, nonfarm payrolls increased by 2.5 million people in May.

So yes, things are getting better. Whether or not that justifies the massive rally we have seen in equity markets worldwide is the gazillion $ question. We must recognize the fiscal and monetary stimulus has had a big part in inflating this market and it is massive relative to what we saw during the 08/09 Global Financial Crisis. By some estimates as much as 15% of global GDP in the span of what 12 weeks? That "new money" has to go somewhere and it has obviously flowed at least in part, into stocks.

Fiscal response to COVID-19 vs. Global Financial Crisis

Fiscal policy response

Economy	COVID-19	% of GDP (2019)	Global Financial Crisis	% of GDP (2009)
U.S.	Congress has passed $2.8 trillion in stimulus, including CARES act and PPP.	13.1	$939 billion in direct stimulus via tax rebates and investment for businesses	6.5
China	Discretionary spending of 3.6 trillion yuan, which includes increased health spending and unemployment insurance.	3.5	4 trillion yuan plan focused on infrastructure and direct support	11.5
Japan	Emergency Economic Package Against COVID-19 worth 117.1 trillion yen, followed by a supplementary package of the same amount.	42.0	15.4 trillion yen in consumer and business support	3.1
Germany	913 billion euros in direct aid to businesses and consumers and loan guarantees.	28.9	82 billion euros in tax cuts, consumer support, and infrastructure	3.4
France	110 billion euros in direct support for businesses and consumers and 315 billion euros in loan guarantees.	19.0	26 billion euros in infrastructure and investment	1.3
Italy	80 billion euros in direct support and 400 billion euros in loan guarantees.	29.7	9 billion in consumer support and tax rebates	0.6
Canada	205 billion Canadian dollars in healthcare spending and direct support to businesses and consumers.	9.8	45 billion in consumer support and infrastructure	2.9
South Korea	29 trillion won in direct support for businesses and consumers, with additional measures waiting for approval.	1.5	69 trillion yuan in infrastructure and tax breaks	5.7
Australia	162 billion Australian dollars in direct support for businesses and consumers.	8.3	52 billion Australian dollars for consumer and business support	4.1

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Ultimately, stock prices are determined by their earnings yield relative to what you can get on a government guaranteed bond. The industry standard proxy is the US 10 year treasury yield. We entered our pre-COVID world with that rate at ~1.8% whereas today it is at ~0.80%. It is not hard to extrapolate why the current 3.5% dividend yield on 3M, a rent cheque that has increased for the last 61 years, might be worth more in 0.80% environment, than a 1.80%.

Chart courtesy of https://stockcharts.com/

The potential fly in the ointment is that the dividend is based on earnings and it is the earnings aspect that I remain concerned with. Will the earnings come back in short order or do we get into a prolonged earnings slump due to higher costs of COVID protocols, personal stimulus cheques that run out and thus falling demand and of course we cannot know how bad the second COVID wave might be. While the answers are unknowable, my take is that we best recognize the risk. Yes, I remain cautious about "putting cash to work" in this environment, not only because others are getting greedy but I find the assumption that earnings will soon return to pre-COVID levels as suspect. Accordingly, we proceed with caution and keep our cash levels significantly higher than normal.

We are off to Track #3.

Track #3: The Dividend Value Discipline™ – New Names for a New Reality

For those new to this recording, when we look for companies to invest in, the first thing we do is assess its corporate culture – management tenure, insider ownership, talent development and a track record of innovation are all part of the equation. The next thing we look at is its moat – how difficult is it to compete with the company – really difficult is good, getting more difficult each year is even better. Next up is an assessment of the growth path, because earnings growth is ultimately what fuels growing rent cheques (dividends). Growth usually comes from being a disruptor in your market or by way of aggregating smaller companies. The icing on the cake is a strong secular tailwind and suffice to say, given the pandemic, the winds have changed and therein lies the opportunity.

To demonstrate, we are back to owning, **Lamb Weston Holdings Inc**. (LW) after selling it last December over valuation concerns. Culture wise, Lamb Weston (LW) scored exceedingly high in part due to its strong track record of innovation. By way of example, their patented 'Crispy on Delivery' fries are designed to remain crispy up to 30 minutes after cooking and that is no doubt gaining some traction in our post COVID world as restaurants move to take away service offerings. What really speaks to us is that LW measures their customer success with a metric of the average age of the client relationship – undeniably simple and at the same time, crystal clear. Their moat is impressive – they are the #1 frozen potato supplier in US and #2 globally. Tailwind wise, here's our thinking – the restaurant business obviously collapsed during the lockdown as did LW's stock price. Rather than take a bet on a single restaurant chain, why not allocate our money to LW that supplies most of them with the most profitable item on their menu, french fries! Put another way, we believe the bad news on restaurant closures is already priced in to the LW stock, so does the news get better from here, or worse. Out take is that the odds favour better.

Next up is **Dollarama** ("DOL"), which needs little in the way of introduction because you see them in every strip mall in the country. We have owned this company in the past and I previously sold it over concerns about a deteriorating culture as the management passed from one generation to the next, and increasing competition from Miniso of Japan and the US's Dollar Tree making a beachhead in Canada. I was wrong on both counts. The pandemic's economic damage and tight household budgets is likely to give DOL a significant increase in store traffic. The other push that should not be overlooked is the attractive expansion opportunities due to cheaper real estate. Landlords will be lining up with attractive leases to fill up their now vacant space as other retailers fold. All of this bodes well for Dollarama – they were out with quarterly earnings today and they beat their own expectations and the stock has responded favourably thus far, up some 3% on the day and heavier than normal volume. Our take is that the tailwinds will continue and will likely increase as the government assistance programs start to wind down.

Last, I want to highlight **Tractor Supply Company** ("TSCO") which is a company that we first looked at all the way back in 2015 and I would describe it as a souped up version of say Peavey Mart, here in Canada. They are an American retail chain of superstores that describe themselves as "the largest rural lifestyle retailer in the United States". They operate ~ 1900 stores in every U.S. state except for Alaska and have been in business for over 80 years.

Some listeners would know that in my downtime, I am a farmer wannabe. In the early days of the pandemic, I started noticing that our local farm supply store, Buckerfield's, was inordinately busy. You lined up to get in the store and when you did get in there was very little stock left, especially when it came to garden seeds. That got me thinking about a new generation of gardeners that the pandemic might spawn and whether that would become a trend. I have also observed the millennials are very interested in where their food comes from and that they have a big interest in local. Throw in employers who are now more receptive to remote work arrangements and it is not hard to connect the dots for a move from the dense city to a more rural demographic. Those seem like good tailwinds to us.

Moat wise, its rural niche makes TSCO less vulnerable to the competition and the strong returns on invested capital, averaging some 18% over the last five years, certainly points to continued double digit rent cheque growth.

Culture wise, CEO, Hal Lawton took the reins in January 2020 and he was hired from the outside. We would normally see that as a potential negative but after studying his background and highlighting his extensive e-commerce experience at eBay and Home Depot, we came away with a positive bias. We are especially impressed with the Board, which is primarily made up of former CEO's. Our take is that they made a great choice.

That wraps up our three highlights for this recording and I trust it demonstrates some of our thinking. We are off track # 4.

Track #4: The Wrap Up – Avoid Taking Extreme Positions

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.

On Track #2, I highlighted what I see as the biggest danger to your wealth in the current environment – acting on FOMO, fear of missing out. We also touched on the improvements we are seeing in copper and semiconductors, both positive leading indicators, which tells us the economy has likely found a bottom. What it does not tell us is whether or not the current rally in stocks is justified by their future earnings or if it is merely a result of the mammoth global government spending/money creation schemes that we have seen over the last 12 weeks. The answer is likely somewhere in the middle and it can only be known with the passage of time. As hard as it is, try to avoid making significant decisions when your fear levels are high. If you have a $1.0 million in cash to invest right now, I would encourage a staged approach over the next several weeks/months as opposed all in on any given day. If we get into an extreme fear environment again, we can get more aggressive.

On track # 3, we highlighted three new additions to **The Dividend Value Discipline™**, french fry producer, Lamb Weston, thrift retailer, Dollarama and rural lifestyle retailer, Tractor Supply and share our thinking behind those decisions. We see the tailwinds gaining steam and are looking forward to what we believe will be double digit rent cheque growth for years to come.

That takes us to my counsel for all listeners, **Avoid Taking Extreme Positions.** Here's why – when you take an extreme position, for example, sell all your stocks and move to cash, you have opened yourself up to the possibility that you could be precisely wrong. I.e. the market continues to crawl the wall of worry and you are left holding cash. The more it moves against you, the harder it is to get back in. The converse is also true, you think the market has found a bottom and you are all in, or worse FOMO pushes you to go all in on stocks. Again, you have opened yourself up to the possibility of being precisely wrong.

To close I want to leave you with some 500 year old advice that still strikes me as prudent today:

> "Divide your fortune into four equal parts: stocks, real estate, bonds, and gold coins. Be prepared to lose on one of them most of the time. During inflation, you will lose on bonds and win on gold and real estate; during deflation, you lose on real estate and win on bonds while your stocks will see you through both periods, though in a mixed fashion. Whenever

performance differences cause a major imbalance, rebalance your fortunes back to the four equal parts."

Jacob Fugger the Rich
1459-1525
https://en.wikipedia.org/wiki/Jakob_Fugger

The beauty of his approach is that it was virtually impossible for him to be totally wrong – **Avoid Taking Extreme Positions**.

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. On behalf of the entire team here at Chris Raper & Associates, this is Chris Raper bidding you good day and may God bless from Victoria BC on Wednesday, June 10, 2020.

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 a large slice of our client assets under management and in my case, it is by far the largest.

The process is discretionary, meaning we make all of the buy and sell decisions and report to you after the fact.

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 elements and I will walk you through them using the illustration of a three legged stool.

The First Leg is Dividends

With one exception, gold, 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, I encourage you to 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% and much better economic growth, whereas today we have 5-year GICs yielding say ~2.0% 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 started 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 income 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 Analog Devices Inc.

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. More recently, I would put Lamb Weston in that category.

Sell decisions are getting increasingly tougher because the quality of our companies just keeps going up and with their 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 you and I buy at the same time, same price. The converse is also true.

Generally speaking, we are looking to establish new relationships with new clients that have north of a $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 – the things you want to do, the things you want to have and the legacy you want to leave. In short, we walk you through our How We Help process and the planning starts immediately. We document what and who is important to you, we identify the structural risks and we paint a go forward picture with a worst case picture of the cost involved. We both decide if there is potential for a long term relationship and 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 the 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".