The Opportunity Update – Monday, March 2nd, 2020

Table of Contents

Track #1: Introduction – The Skinny 1
Track #2: The Markets – Coronavirus, What's Knowable and What's Not and Where We Can Have Reasonable Certainty 4
Track #3: The Dividend Value Discipline™ – Mission Critical Software Providers 8
Track #4: The Wrap Up – Market Routs + Extreme Fear = Opportunity 10
Track #5: Postscript I – The Dividend Value Discipline™ Methodology 12
Track #6: Postscript II – "Is There a Fit?" 15

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 Monday, March 2, 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 – Coronavirus, What's Knowable and What's Not** – I will give you some insights on why the recent market selloff has been so severe, vis-à-vis other virus-related market corrections, before moving to our favourite leading indicators, the price of copper and the semi-conductor index. Then we will look at some other lesser known, but highly pertinent indicators as we attempt to gauge the severity of the economic impact, and confess that the magnitude of the impact is unknowable. Then as per our usual diddy, I give you some perspective on the energy complex and the Canadian dollar, and then finish with three major points where we have reasonable certainty.

On **Track #3: The Dividend Value Discipline™ - Mission Critical Niche Markets** – I will highlight two recent additions to the program - both of whom provide mission critical software platforms to specialized markets. As an FYI, I am always encouraging our analyst team to look for companies that the end client cannot live without. Think about trying to run a business without Microsoft's

Windows/Office products - pretty tough. In that vein, I will introduce you to two more, namely Enghouse Systems Ltd. and MarketAxess Holdings Inc.

On **Track #4, Market Routs + Extreme Fear = Opportunity, Always?** – I will wrap it up giving you the key takeaways from each track, and then give you a short history on previous bouts of intense market selloffs that are coupled with investor sentiment that registers extreme fear, as we take on “it’s different this time” - which in our business, are known as the most expensive words in the English language.

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. This 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 – Coronavirus, What's Knowable and What's Not and Where We Can Have Reasonable Certainty

Here is what we know:

- As per our January 31st, 2020 Timely Market Dispatch, we entered the corona news with the market at/near all time highs, and Investor Sentiment registering extreme greed on the CNN Fear Greed Index. To quote Buffett, "be fearful when others are greedy". Of course that begs the question, where was it last Friday when we finished the week down more than 10% on the S&P 500? The answer won't surprise you: bottom decile – extreme fear.
- When the news of the coronavirus broke, our first question was what's different this time, versus other virus outbreaks we have witnessed? One thing that was super apparent to us early on, was that China was shuttering whole swaths of its economy and given the nature of global supply chains, it seemed obvious that the world's economy was going to take a significant hit.
- Thus far, there are an estimated 2,900 deaths attributable to the virus. For context, there are ~ 80,000 death per year from the common flu. The virus is far less lethal than SARS or MERS.
- China is getting back to work. While we are skeptical on the creditability of the news flow from China, the fact that air pollution is back to increasing tells us that factories are re-opening and people are moving about.
- Central bankers are back to the only game they know – pushing interest rates lower, which should make growing rent cheques ever more valuable. The go-to alternative to dividend-paying stocks, the 10-year U.S. Treasury (government bond) yield dropped to an all time record low of 1.10% at today's close. As the world starts to stabilize, that makes say, 3M's current dividend yield of 3.80% a lot more attractive, and keep in mind they have upped that dividend every year for the last 61 years. Betting against that just doesn't seem smart to me.

Chart courtesy of StockCharts.com

Here is what is unknowable:

- How long and how far the virus spreads. While unknowable, my best guess is far and wide because I believe it will be a lot easier for a country like China to lock down whole cities than it will be for western democracies.
- How much the economy will shrink as a result of the virus spreading.
- When the market will find its bottom.

Chart courtesy of StockCharts.com

While the unknowables may seem obvious, we can we can look to our leading economic indicator for clues as to what the future holds. Starting with Dr. Copper, "the metal that goes into everything" and consequently, a great proxy for what is happening in the manufacturing economies, i.e. China. Pre-corona, things were looking up. Copper pegged a fresh six month high of $2.89 per pound, a significant improvement over the $2.73 of our December recording. Post-corona, was one of those "down comes you doghouse" moments where the washout thus far was a low of $2.49 - interestingly enough, just where it bottomed during the extreme fear of last August. At the Monday, March 2nd close, we pegged in at $2.60 per pound. While that doesn't get us out of the woods, we can take some small comforts in the previously mentioned pollution levels and the fact that all last week the Baltic Dry Index did tick up, indicating bulk shipping companies are seeing increased demand for their services. That's a modest positive.

As regular listeners would know, our best leading indicator for the service-based economies, is the Philadelphia Semiconductor Index (symbol $SOX). It hit an all time high after the coronavirus news broke and yes, it has been clipped since then, but I would refer to it as bent as opposed to broken. 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 points to continued growth ahead. For now, it is still suggesting the service-based economies will continue to expand.

Chart courtesy of [StockCharts.com](https://stockcharts.com)

There are a host of other ancillary indicators that have moved from north pre-corona to now south. Time will not permit me to list them all. Suffice to say, the flashing yellow light applies - proceed with caution. Yes, we started nibbling at the edges early last week and then on Friday exhausted our cash that we raised on January 31st. By the close of the week, we had upped our stake in Starbucks, United Healthcare, NVidia and Microsoft. The latter two were bought on Friday when the [CNN Fear Greed Index](https://money.cnn.com/data/fear-and-greed/) was bottom decile, extreme fear, a perfect 10. We remain mindful of the Buffett axiom, be greedy when others are fearful.

The energy complex is another case of "down comes you doghouse". As always, it is about supply and demand, and the latter part of that equation just took a major hit when China went into lock down. $WTIC (West Texas Intermediate Crude) closed today at ~$47 USD versus ~$60 on the December 5th recording. While we exited our energy-related ETF positions on January 31st, we are also fully aware that the demand destruction won't last forever and the recovery is likely to be robust. Does Canada get to participate? With major infrastructure blockades, work stoppages, and the resulting layoffs, that seems to be getting more doubtful by the day.

Chart courtesy of [StockCharts.com](https://stockcharts.com)

Turning to the Canuck buck, as per normal, whenever there is a flight to safety, the U.S. Dollar Index is shown a lot of love – ergo, the greenback rallied to fresh two year highs on Friday, February 21st last, and our loonie has been pretty much done the opposite. It cracked six month lows last week and the prognosis is decidedly negative. Capital has no loyalty – it moves to where it is treated best, and capital is leaving Canada. That said, the old adage applies - if it is in the news, it is in the stock (or in this case, the currency). The U.S. dollar has fallen like a rock from a week ago and of course, that helps all things X-USA, including Canada. I expect we get a bounce in the short term, but I remain bearish over the next several months.

Chart courtesy of StockCharts.com

Closing out this track, 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.

On that upbeat note, we are off to Track #3.

Track #3: The Dividend Value Discipline™ – Mission Critical Software Providers

My mantra to our analyst team of buy companies that the end client can't live/operate without seems to be bearing some fruit. **Enghouse Systems** ("ENGH") is a mission critical software provider/developer serving three niche markets:

- Cloud and premise based software that integrates call/chat/email based client service centres
- Software for telecom/utility providers to deal with things like online billing
- Systems for the private transportation industry to deal with things like dispatch and timekeeping

The great thing about such a business is that you tend to have sticky clients, as the cost of switching from one provider to another is enormous. And that in turn discourages competition in their "turf" markets and thus, the moat just gets stronger.

The management group at ENGH is top drawer - they are a lot more interested in doing than saying. We like that they eat their own cooking, with insiders owning ~25% of the company. Their track record of using free cash flow to "aggregate" complimentary businesses is an enviable one.

Those sticky niche clients have helped ENGH become a free-cash-flow-generating machine. That has translated into rent cheque (dividend) growth just shy of 16% per annum over the last three years, and assuming they keep it up, the math works out to a doubling of our rent cheque every five years.

MarketAxess Holdings Inc. ("MKTX") is a similar story, but one that has a massive runway in front of it. Believe it or not, an awful lot of the global bond market is still traded over the phone. I know that sounds archaic and it is, but it is true. MarketAxess is changing that with electronic trading platforms for institutional credit markets, worldwide. Their platforms make it easier, cheaper, and more transparent to trade bonds. There is also an interesting feedback loop – the more institutions that sign on, the more pressure there is for firms on the "outside" to sign on as well, i.e. the moat gets stronger with every new customer. This is a classic disruptor, and it is something we look for in our investee companies.

Their culture is one of a founder mind-set and no wonder, because the current CEO, Rick McVey, is the founder.

MKTX is another cash flow powerhouse enabling a rent cheque growth rate of +25% per annum over the last three years. Using our rule of 72, it implies a double every three years and that would be great.

I know many of listeners are probably interested what our go-forward plan is given all the recent market volatility. Our modus operandi for last week was to leg in cash when the panic seems way overdone. That's not to say that our stocks can't go down further in the short term - they can. The real question for us is, are things going to get so bad that our investee companies – companies like 3M and Johnson & Johnson, are going to cut their rent cheques? Some of our companies have been increasing their rent cheques (dividends) every year for decades - they have obviously been through lots of panics. We see across the board dividend cuts as highly unlikely.

The plan for this week? Get up really early every day, keep our heads screwed on and watch for panics (both up and down) – when and if they happen, do our best to take advantage of the opportunities presented.

And off we got to track # 4, **The Wrap Up**.

Track #4: The Wrap Up – Market Routs + Extreme Fear = Opportunity

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, we spoke about the knowables, the unknowables and the things we are reasonably certain of. The three knowables I would ask you to keep in mind, are that by last Friday, the close of February, we were registering bottom decile, extreme fear on the CNN Fear Greed Index. Historically speaking, you are much better off buying at such extreme levels than selling. We also know that pollution levels are back to increasing in China and we can attribute that to factories ramping up. The investing world doesn't give a rat about whether things are good or bad – the real question is, are things getting better or worse? Finally, we know that central bankers are once again pushing interest rates lower. The go-to comparison for dividend paying stocks, the 10-year U.S. government bond yield traded below 1.10% this morning – it was 3.20% in the fall of 2018. As the panic subsides, our bet is that companies like 3M, with a rent cheque yield of 3.80% and track record of growing that rent cheque for the last 60+years, becomes increasingly attractive.

The unknowables in our mind are how long and how far the coronavirus spreads. How much the economy shrinks as a result of the virus, and when or if the market has already found its bottom. No, not every extreme fear event is followed up by a huge rally like we saw today with the DJIA (Dow Jones Industrial Average) up just shy of 1,300 points or some 5%. During the '08/'09 crisis, we saw several periods where extreme fear was followed by more extreme fear, but note that historically, the '08/'09 crisis was a once-a-generation event.

To recap the reasonable certainty department, here's my list:

- 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. They will feel better for a while, and 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. And last - you are not going to be one of investors, are you?

Track # 3, I shared with you my mantra to our analyst team of buy companies that the end client can't live/operate, and it has been bearing some fruit. We acquired a position in mission critical software

provider/developer **Enghouse Systems** (“ENGH”), a great aggregator of complementary businesses and it has turned itself into a free cash flow machine. Then we highlighted **MarketAxess Holdings Inc.** (“MKTX”), a company with a massive runway and a true disruptor of the global bond markets.

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 Ryan, me, and the entire team here at Chris Raper & Associates, this is Chris Raper bidding you good day and may God bless from Victoria BC on Monday, March 2nd, 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

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% 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 MTY Food Group does with its numerous restaurant franchises.

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 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 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 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".

This presentation has been prepared by Chris Raper and expresses the opinions of the authors and not necessarily those of Raymond James Ltd. (RJL). Statistics and factual data and other information in this presentation are from sources RJL believes to be reliable but their accuracy cannot be guaranteed. It is for information purposes only. Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Commodities may be subject to greater volatility than investments in traditional securities. Investments in commodities may be affected by overall market movements, changes in interest rates, and other factors such as weather, disease, embargoes and international economic and political developments. Raymond James advisors are not tax advisors and we recommend that clients seek independent advice from a professional advisor on tax-related matters. Securities-related products and services are offered through Raymond James Ltd., member-Canadian Investor Protection Fund. Insurance products and services are offered through Raymond James Financial Planning Ltd., which is not a member-Canadian Investor Protection Fund. Raymond James (USA) Ltd. is a wholly owned subsidiary of Raymond James Ltd. Raymond James (USA) Ltd. member FINRA/SIPC. This may provide 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.