RAYMOND JAMES | CHRIS RAPER & ASSOCIATES

The Opportunity Update – Friday, September 18, 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 Friday, September 18th, 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 – Green, Yellow, Red,** I am going to speak to the southbound U.S. dollar, aka the greenback, then the north bound yellow metal, gold, and finally the also north bound red metal, copper. Each of those phenomena is an important tell of things to come. Then I will wrap it up with some closing comments on the other indicators we follow and why the oil complex should be on your radar.

On **Track #3: The Dividend Value Discipline™ – Unpacking Cintas,** I am going to highlight our investment process by walking you through why we think so highly of Cintas, which is a recent addition to the program and a lesser known name.

On **Track #4: The Wrap Up – Mega Cap Concentration & The U.S. Election,** I will highlight the key takeaways from each track and then spend some time on why I believe it is wise to avoid piling into the mega-cap space, notwithstanding its meteoric performance in our post-COVID environment. I will close it out with my answer the on the most common question I get these days: “Chris, what is going to happen to the market as we approach the U.S. election?”.

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 differentiates us from 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 – Green, Yellow, Red

Kicking it off with the greenback, aka the U.S. dollar, we have seen its index – which is the U.S. dollar measured against a global basket of currencies – head south after making a parabolic move, pegging a five year high of $1.04 on Monday, March 23rd last. The fact that it went hyperbolic at the start of the week and closed down on that week meets the classic definition of what we call a blow off top in the industry. It is a "tell" that the buying panic is in and lower prices are likely to prevail. Today, the U.S. greenback is down some 10%+ since then, trading at roughly $0.93. By now I hope you are asking, why is that important?

Chart courtesy of StockCharts.com

A falling U.S. dollar environment (defined as a drop of more than 10% from its previous high water mark) has historically been extremely positive for X-USA stocks, especially the emerging markets complex and commodities – i.e. oil, gold and copper. If you think this through, it makes sense. Most emerging market countries have to issue bonds denominated in U.S. dollars – if the dollar goes down against their currency, it is easier for them to pay those loans back. That means more money to invest, which ripples through their economies translating into growing demand for oil, copper and the like. Furthermore, the U.S. dollar is often seen as a flight to safety currency, but once the downtrend sets itself in place, investors get wary and all of a sudden gold looks more attractive. Pour in the facts that real interest rates are actually negative today and global central banks continue to create paper money out of thin air, and gold looks like an even better option. How long does this typically go on for? Over the last 35 years, the average up down cycle for the U.S. Dollar Index has been 522 days. In other words, it could easily be the case that the downtrend is just getting started.

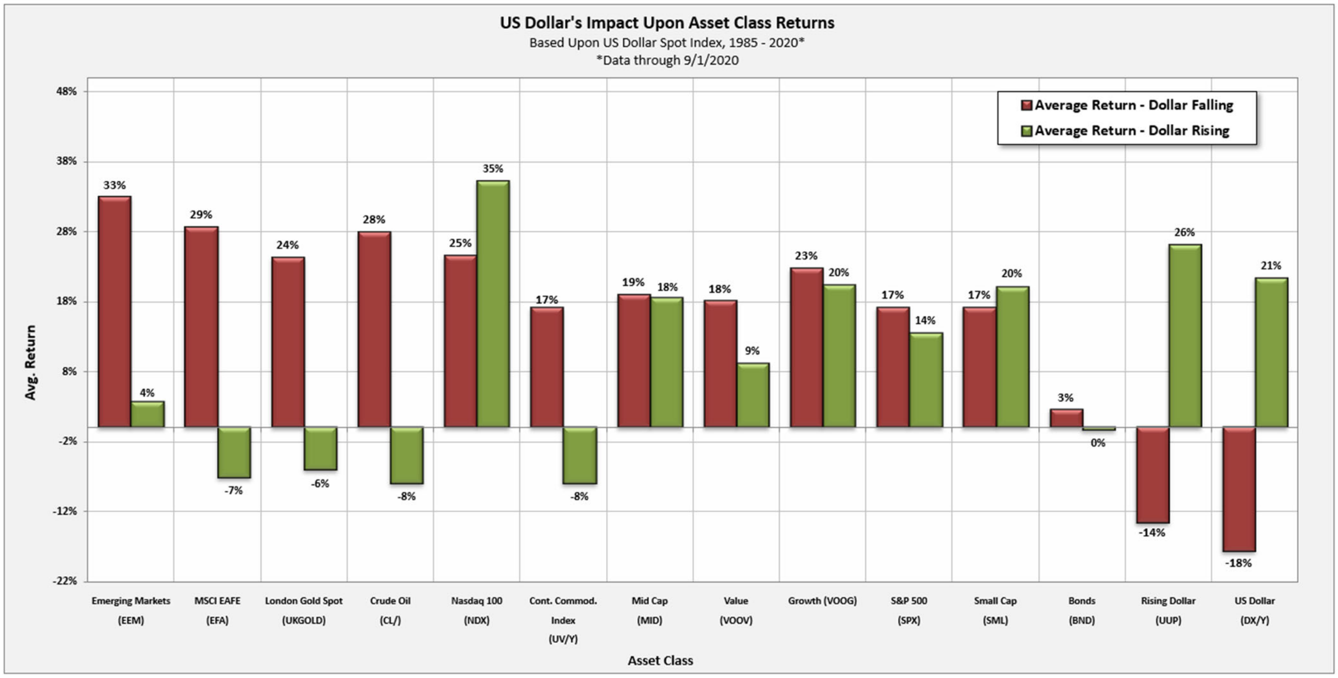


Chart courtesy of DorseyWright.com

Study Parameters:

- **<u>Rising Dollar Market:</u>** Any move of at least 10% from a low constitutes a new "rising dollar market". The beginning of this trend is established at the low watermark and the trend remains in force until a correction of at least 10% occurs, at which point the peak of that rally then marks the end of the rising trend in the dollar. This represents a "trough to peak" move in the dollar, and that time period is what we use to qualify a rising dollar market.
- **<u>Falling Dollar Market:</u>** Any decline of at least 10% in the dollar index from a peak begins a "falling dollar market". The beginning of this trend is established at the high watermark and the trend remains in force until a rally of at least 10% occurs off a low, at which point the trough of that decline marks the end of the falling trend in the dollar. This represents a "peak to trough" move in the dollar, and the time period within is what we used to qualify a falling dollar market.

Getting specific on the yellow metal complex, gold, most investors are probably unaware the U.S. dollar denominated gold bullion ETF (IAU) is up some 28% year-to-date, and that the VanEck Vectors Gold Miners ETF (GDX) is up a whopping 43%. The best part of that observation is that there are few people even giving such vehicles consideration, let alone investing in it. Would you like to test that theory? Here is my suggestion: when you get together for Thanksgiving dinner, ask those sitting around the table what percentage of their liquid investments is allocated to the gold complex. My bet is that amongst your friends and associates, you would find less than 5% have any exposure to gold and less than 1% have more than say a 5% allocation. My take: it is early days.

Still not convinced? Please recognize as per the chart below, in gold terms, global equities peaked in 2018.

Charts courtesy of StockCharts.com

Jumping to the red metal that goes into virtually every manufactured good you can think of, copper too has had a spectacular rally. Believe it or not, it is pegging in at 2 year highs and is trading at ~$3.08 per pound this morning (vs. $2.68 on our June 10th recording). As you have heard me say ad nauseam, Dr. Copper is perhaps the world's best economic forecaster – stronger prices point to stronger demand and the fact that this is happening on the backs of the COVID-induced recession tells us once again that we are in the early innings.

Chart courtesy of StockCharts.com

While copper gives us insight into what is happening in the manufacturing-based economies, our best leading indicator for the service-based economies is the Philadelphia Semiconductor Index (symbol $SOX), and it too is pointing to economic expansion having hit an all time high on September 2nd last. 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.

Chart courtesy of StockCharts.com

The next obvious question is what about oil? Yes, it is still in the dumpster and so are the oil producers. It is easy to see the reason why – commercial aviation is currently running at about 50% of pre-COVID levels, and of course all of those planes burn oil derivatives. That is a lot of oil that is no longer needed.

When we look out over the next 6 to 12 months, my take is that we should have some combination of herd immunity and effective COVID treatments and/or vaccines, so it is not hard to paint a picture of considerable pent up travel demand from both the consumer and business sectors. Recall how many people were never going to fly again in the post-9/11 era. It didn't last long, and I don't expect this cycle to be much different. Being married to a wonderful woman who is planning our next trip before the wheels touch down on our way home, I know of what I speak. Just be aware that over the last six months, we have lost our total oil producing capacity at breakneck speed. Supply is rapidly declining. That sets us up for the next bull market in oil. At this point we have no exposure to oil producers, but we have spent a lot of time building the program that is going to allow us to take advantage of it when the time comes. Our intention is to launch a new mandate, The Next Cycle Resource Fund (NCRF), on October 1st, 2020. The program has been under beta testing with a modest amount of money since January 2020 and the progress has been very encouraging. If you are interested in those details, please reach out – I am happy to share the story with you.

With that, we are off to Track #3.

Track #3: The Dividend Value Discipline™ – Unpacking Cintas

I wanted to highlight Cintas this quarter for a couple of reasons – unlike say Mastercard or Microsoft, it is not a well known name amongst our clients, and most importantly it has almost every attribute that we look for in an investee company and thus demonstrates a lot about our investment philosophy and processes.

In terms of what Cintas does, it is a pretty simple business – they help over one million businesses get ready to open their doors, every work day. Their products and services include uniforms, floor cleaning solutions, restroom hygiene, first aid, and fire extinguishers coupled with safety & compliance training. In a COVID environment, it is not hard to see the secular tailwinds. But tailwinds are not enough, so let's unpack our study process and give you the Cole's Notes version of what we learned.

There are five perspectives we look at for any potential investee company – edge, corporate culture, moat, tailwinds, and finally rent cheque growth. If you have ever met our senior research analyst, Alex Vozian, the guy I describe as the most rational person I know, then it will be no surprise to you that each of those categories get scored on our proprietary rating systems. In other words, we take a lot of qualitative observations and make them into quantitative data so that we can weigh the various investee companies against one another. We are heavy on processes because we believe that is the path to better results.

We start with edge, which is really a question of do we understand the business well enough to make a call on what it is worth. As I said at the outset, Cintas is a pretty simple business and their financial statements are presented in a straightforward manner. Unlike the companies that are trying to develop the COVID-19 vaccine, we do not need a PHD in virology to make a reasonable assessment. As Warren Buffet says, the matter is not how big your circle of competence is, it is knowing its limit. The other thing that we look at within the edge perspective is the company's debt level – it is much easier to make a significant mistake valuing a highly leveraged company, so Cintas got high marks for its conservative use of debt.

As for culture, which is perhaps the card that trumps all others, we like the fact that Cintas has what we call the founder advantage – the current CEO came up through the ranks and is the son of the person that really put Cintas on the map. We are also impressed with the lack of flash and hype on their investor website, which again is rare, but speaks to who they are. The CEO owns 15% of the outstanding shares and the rest of the executive team have most of their wealth concentrated in Cintas stock. That puts them on the same side of the table as us. They treat their employees well and they look out for their communities. To wit Forbes Magazine has awarded them with three bests: Best Employer for Diversity, Best Employer for New Graduates, and Best Large Employers, whereas Barron's has given them the nod for their Most Sustainable Company Award.

Moat-wise, we are really talking about their strategic advantage or conversely, how hard it is to compete with them. Cintas has a tremendous advantage in scale and it dwarfs it nearest competitors. They are the largest company in their industry, with 20,000 vehicles serving 11,400 local delivery routes and operating 500 facilities across North America. There are a lot of logistics to build should you decide you want to take them on.

For tailwinds, as alluded to earlier, cleanliness and compliance to cleanliness standards are some great tailwinds to have in a COVID environment, yet there is more to the story. Cintas serves one million businesses in North America each day and that leaves roughly 15 million businesses they don't serve. Most of those are served by Mom and Pop operators. As standards, protocols and training demands increase, those who have the systems to deliver, will naturally get the business. The good news is that Cintas has been winning market share for years. Almost two thirds of their revenue growth comes from new customers. The trend of a greater focus on health and safety is only going to drive corporate outsourcing faster.

Turning to rent cheque growth, Cintas's free cash flow growth and consistent earnings power has allowed it to increase its annual dividend for the last 36 years. Over the last five years that rent cheque has increased at 25% per annum, and even this year in the post-COVID environment they boosted it by 24%. As evidence of their wherewithal to keep doing so, we note that they have grown their sales and earnings per share for 49 of past 51 years. Suffice it to say that we expect more of the same.

That wraps up our story on Cintas and I want to leave you with one major caveat – notwithstanding everything that I have outlined above, it is still plausible that an investment in Cintas can go wrong. Accordingly, I counsel against taking an independent and/or outsized position in the stock. Risk mitigation is the ultimate driver of returns.

We are off Track #4.

Track #4: The Wrap Up – Mega Cap Concentration & The U.S. Election

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.

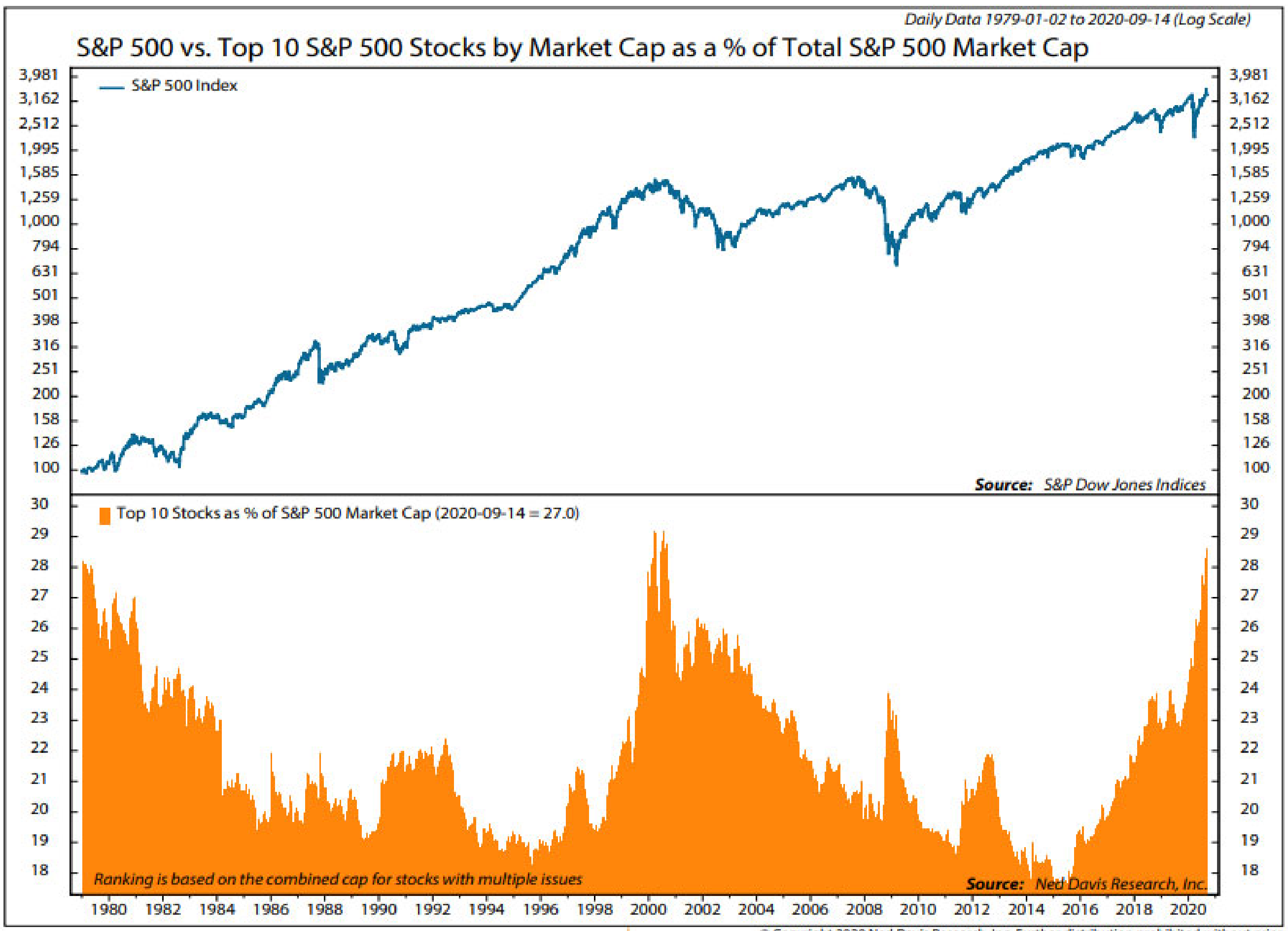
On **Track #2: Green, Yellow, Red**, I highlighted that the U.S. Dollar Index has headed south and is currently in a downtrend. Over the last 35 years, those downtrends tend to average about 500+ days – i.e. it's early in the game. Why does it matter? Because historically, a weaker U.S. dollar has been a positive for X-USA markets and especially beneficial for the emerging markets sector and commodities. I highlighted gold being up some 28% on a year-to-date basis and nobody is talking about it, let alone investing in it. Our leading indicators are saying things are getting better (not worse) and it is the direction that matters, not the absolutes of good and bad. Copper is at a two year high and the Semiconductor Index just hit an all time high on September 2nd, 2020. Oil continues to be in the doghouse and COVID's demand destruction coupled with the industry's necessary supply curtailments are sowing the seeds for the next oil boom. We are not there yet but we have spent a lot of time thinking about how we are going to take advantage of it when it does come. To that end, standby for our launch of the new mandate, The Next Cycle Resource Fund on October 1st next. If you are interested in the details, please reach out – I will be happy to walk you through the process.

On **Track #3**, we highlighted the new addition to **The Dividend Value Discipline™,** Cintas, and the five perspectives that we look for in every potential investee company. I trust it gave you a better understanding of Cintas and perhaps more importantly, our investment process.

That takes us to what I see as too much concentration in too few stocks. The chart below highlights the 10 largest companies of the S&P 500 (Companies) Index. For those listening, it is reflecting the fact that the top 10 stocks make up almost 29% of the index's weight. Why is that important? The last time it was this high was in the year 2000 – a relatively short time before the tech bubble burst – and if you were all in on the dot.com era, down came your doghouse. On average those 10 stocks – namely: Apple Inc., Microsoft Corp., Amazon.com Inc., Alphabet Inc., Facebook Inc., Berkshire Hathaway Inc., Visa Inc., Walmart Inc., Johnson & Johnson, and Mastercard Inc. – are up some 21% year-to-date. Those things that cannot go on forever, don't. They are not the only game in town and they are definitely what we would call over-owned in the industry.

No.	Ticker	Company	Market Cap, $B	Perf YTD
1	AAPL	Apple Inc.	1,912	50.3%
2	MSFT	Microsoft Corporation	1,546	28.7%
3	AMZN	Amazon.com, Inc.	1,536	62.8%
4	GOOG	Alphabet Inc.	1,027	11.9%
5	FB	Facebook, Inc.	730	24.2%
6	BRK-B	Berkshire Hathaway Inc.	530	-3.7%
7	V	Visa Inc.	439	9.2%
8	WMT	Walmart Inc.	388	15.0%
9	JNJ	Johnson & Johnson	385	0.9%
10	MA	Mastercard Incorporated	343	13.7%
			AVERAGE	**21.3%**

Near record concentration in top 10 stocks in S&P 500



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That takes us to U.S. election, which is by far the most common question I get these days. My short answer is that I don't know who will win but I do believe that either candidate is plausible, but that is not what they are really asking me. What is implied is what is the election going to do to the value of our stocks, and should we be selling? In and of itself, the election is not a good reason to sell U.S. stocks – most of the U.S. stocks we own are truly global companies (e.g. Nike), and market performance has tended to be good with both Democrats and Republicans at the helm. My counsel is to think in terms of years as opposed to months.

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 Friday, September 18th, 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 needs, 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 less than 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 were 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 (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 tended 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 tended 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 that 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 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 relationships with new clients that have north of $1 million in investable assets, but please understand that 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".