The Opportunity Update – November 26th, 2014

Table of Contents

Track #1: Introduction – The Skinny on What I am Going to Speak To

Hi, this is Chris Raper, Senior Vice President & Portfolio Manager, Private Client Group of Raymond James Ltd. & co-founder of **The Dividend Value Discipline™**. Welcome to **The Opportunity Update**, which is being recorded for you in Victoria, B.C. on Wednesday, November 26, 2014. 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 speak to.

On **Track # 2: The Markets – Oil, is it time to play the contrarian card?** I am going to give you my take on what the collapse in oil prices means to us as investors and what we must do to adjust. As always, there are winners and losers and we obviously want to be on the winning side. I will then wrap up the track with comments on the world's best economic forecaster, the price of copper, and my expectation for the CDN$ in the weeks ahead.

On **Track # 3: The Dividend Value Discipline™ – Shopping America,** I am basically going to roll the clip since the last recording, as I outline the buys and sells within the program, which have been driven in large part by the strength of the U.S. dollar. We have shifted course because when the evidence changes, we change. Part of being successful in this business is recognizing when you are on a wayward path and getting it corrected quickly.

On **Track # 4: The Wrap Up – Here Comes Santa Claus**, I will give you the key takeaways and then spend a little time discussing the usual Santa Claus effect that we have into year-end and where this year's bargains are apt to be.

Track #5: Postscript I, is where I walk you through our core investment program, **The Dividend Value Discipline™**, its methodology, return objectives and all-in costs. This track is primarily for the benefit of potential clients who are being introduced to us by way of this recording. By the time you are done listening you will know what makes the process unique vis-à-vis our competition and whether or not you are interested in pursuing it any further. Not interested, not interested right now and let's talk further, are all perfectly acceptable answers.

Track #6 is Postscript II – again for the benefit of prospective clients. It will give you some insight on what to expect during our initial meeting, where we both want to answer the question, "Is there a fit between our services and your needs?"

In terms of legal requirements – the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.

I am also required to tell you that Raymond James Ltd. is a member of the Canadian Investor Protection Fund, which is a good thing. If you are interested in those details, please ask me the next time we speak.

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. If you catch me using industry jargon beyond that, I invite you to call me out – i.e. send an email to the office and believe me, my team will let me know.

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

Track #2: The Markets – Oil, is it time to play the contrarian card?

The answer to that question is of critical importance to Canadian investors, so I am going to spend most of this track wrestling with it. To give you some context, the TSX Composite, Canada's major stock index, is made up of roughly ~23% of oil and gas stocks and that number seems to be shrinking every day. It is important to understand that it doesn't stop there. Much of our industrial base supports the build out of oil and gas infrastructure. Obviously, consumer companies have been beneficiaries of all the high wages paid to energy workers; ditto for our financial services companies. There just isn't much in the Canadian landscape that isn't tied to fortunes of the oil market in one way or another. Furthermore, most Canadian investors are over exposed to our domestic markets and therefore overexposed to the energy complex. For the record, the DVD is now only 54% allocated to Canada, of which 18% is cash, and I still feel overexposed.

Given that context, let's tackle the question. Canada's energy index is down some 24% from its 52 week high water mark back in June - given all the current bearish talk on oil, is it time to play the contrarian card and buy the oil producers? Before we say yay or nay, let's explore the evidence. When I left you on this track back in September I told you, quote "My bias is steady-to-up on oil prices, but I have to confess, I don't have a lot of conviction on that call", unquote. Clearly the hackles were already standing on the back of my neck and the lack of conviction translated to just being plain wrong. The price of oil then was just north of $93.00 per barrel and this morning, Nov. 26, it is trading at ~$74.00 per barrel, down some 21% in U.S. dollar terms and considerably less in Canadian dollar terms. Any way you take it, it is still a big haircut.

Let's review the fundamental argument. On the demand side, the U.S. leading economic indicators are still very strong so that is a net positive. However, Japan has entered into a recession and much of Europe is teetering that way. China is obviously worried about its growth and finds it necessary to lower interest rates to fuel same. As my colleague Jeff Saut likes to say, "Markets don't care about the absolutes of good and bad, just whether or not things are getting better or worse". When it comes to the oil complex, the demand side is neutral at best. In my mind, the bigger issue is on the supply front. When I look at the oil producers today, it is a classic case of "the cure for high oil prices is high oil prices". Looking back over the last decade, as oil became increasingly scarce, technology was adapted to make previously uneconomic resources, economic. Today we have an almost unlimited supply of known horizontal drilling and fracturing prospects to be exploited. North American production is growing at double digit rates and we are going to need sustained prices below $75.00 per barrel to have any meaningful contraction in production. Why? Because most producers can still make money at the $75 level. By the time you are reading this, the **Organization of the Petroleum Exporting Countries (OPEC**) will have met in Vienna to discuss production cuts, i.e. reducing supplies. I have to wonder why they are even meeting as its largest producing members, Kuwait, UAE, Saudi Arabia and Qatar, have already signaled they have no intention of cutting production. Even if they did agree to cuts, it is important to watch what they do, not what they say – my read is that they will continue to pump. Meanwhile, all the marginal suppliers of OPEC are starving for foreign currency so they really have no choice – they pump.

Thus the fundamental argument tilts bearish for oil prices and barring any sudden expansion in the global economy, it is hard to see how supply will not outstrip demand. Of course, you restore the balance with lower prices. In fact, here is some recent history in action – the May 2015 oil futures are now trading at ~$74.00. They were $92.00 on our last recording. If that sounds like a big change - it is, and when the evidence changes, we change.

Now let's turn to the investor psychology part of this decision. Here are my observations:

- When oil broke the psychologically important $90 level, we were at record high levels of speculator demand and record low levels of commercial interest. In essence, the users of oil are not worried – they see ample supply and cheaper prices ahead. In the meantime the speculators got caught holding the bag & have a lot of positions to unwind. I take that as a negative.
- Next, U.S. dollar strength is a big headwind for oil – if you want the evidence, check out the November 2014 edition of The Strategist, you can find it on our website at chrisraper.com. There I present a 30 year historical context. In a nutshell, even though most of us think the U.S. dollar has been on an absolute tear this year, the USD$ Index, at its current level of 88, is a lot closer to its 30 year bottom of 73 than its 30 year top of 160.
- Another thing I pay attention to is the oilfield service industry, and fortunately we have many clients who are directly involved. Their insight is invaluable. Ryan and I were in Alberta just last week and our observation is the closer your business is tied to an oil

producer, the worse you feel. Major producers have embraced a "cut costs at all costs" mentality, so clearly they see these lower oil prices as more than a short term blip. Regionally the cost cutting seems to be more evident in the northeast part of the province, whereas the Montney play which is northwest Alberta and northeast B.C. – think liquids and natural gas – still seems fairly robust. That said, our sense is that the investing public is just not that concerned…so far. That translates to a lot more downside pressure to come as investors get further disappointed and one by one, throw in the towel.

So where does that leave us on the oil complex both short and long term? Short-term, say over the next 6 weeks, we are like an overstretched rubber band, so a bounce to the upside before year end is certainly plausible. We intend to use any such bounce to lighten our already diminished energy exposure.

Longer term, there are a lot of headwinds for the industry and our sense is that investors en-masse do not fully appreciate how long this could go on. Anybody with a historical perspective can tell you that oil is a cyclical business. Let's recall that in both the 1980's and 1990's oil went sub $10.00 per barrel, and it went sub $40.00 per barrel as recently as 2008.

In conclusion, we are way too early in the cycle to play the contrarian card on the oil complex. We expect to remain underweight in our oil and gas exposure for the foreseeable future. The small 6% allocation we do own is biased to those companies that own refining assets as lower oil prices actually help that side of their business.

Okay, let's wind this track down with my usual comments on the Canadian dollar and then the world's best economic forecaster, the price of copper.

Addressing the Canadian dollar, and flipping back to our sister publication ***The Strategist*** in early November, the lead article was titled **U.S. Dollar Strength - Is It Time To Be A Contrarian?** The basic conclusion was that we have entered into a secular bull market on the U.S. greenback. Not only do they have the cheapest energy on the planet, but their state by state "right to work" legislation has made it much more attractive for global companies to re-locate within its borders. This is especially true from a European manufacturer's perspective. Of course when those companies invest in America, they must buy American dollars to do so. As we like to say, “Follow the money”. As global investors see Japan debasing its currency and then look to Europe and see much the same thing, investors want to sell their domestic currency, causing it to go down and then buy U.S. dollars, which causes it go up. As people embrace that trade, the whole phenomenon becomes a reinforcing mechanism that will absolutely reverse one day, yet history tells us that day can be years away. In the meantime, the trend is your friend and betting against it has not proven to be a winning strategy. My take – much like the oil complex, rallies in the Canadian dollar should be used to lighten your horde of loonies. Level wise, I see anything above .89 USD as a starting point and would become increasingly aggressive with each one point bump thereafter.

Last, Dr. Copper has been whipsawing back and forth over the $3.00 level and today it is trading at $2.95 versus a close of $3.17 when I left you on the last recording. The long term futures are also decidedly weaker, reflecting sub $3.00 copper as far as the eye can see. If you are wondering where my head is, please know that I recently sold our entire stake of Southern Copper. Not because it is a bad company, rather we saw copper prices getting marginally weaker and bad things can happen to commodity producers at the margin. In terms of an economic forecast, the translation for me is that the U.S. economy continues to grow while the rest of the world struggles. It also begs the question, longer term will the U.S. pull the global economy out of its malaise or will it work the other way around? There is no way to know, so you simply have to be prepared for both and adjust accordingly. Lower oil prices are going to help but it takes time. The biggest beneficiaries to date are our southern cousins because oil got cheaper and unlike the rest of the world, their currency did not depreciate along with it, so they realize the full benefit. Americans will save more than $8 billion in November and December versus last year – I expect Black Friday’s sale numbers to be eye popping.

With that we are on to Track # 3.

Track #3: The Dividend Value Discipline™ – Shopping America

As we walk through the major transactions over the last 90 days, you are going to see that we have reduced our commodity producer space – those companies that are being hurt by a strong U.S. dollar, while upping the allocation towards those that are being helped by the stronger U.S. dollar - again, follow the money.

First, let's deal with the sells. As previously mentioned, we did exit **Southern Copper Corp**. due to our outlook for weaker copper prices. We pegged a nominal loss of 0.22% based on our initial buy back in March of this year. We have also reduced our already light oil and gas exposure by some 25% since our last recording, choosing to simply reduce positions as opposed to outright sells.

The most challenging decision we faced since the last recording was the sale of long-time holding **Nike** for a gain of 105% since first buying it in the thick of the Euro-crisis, i.e. August 2011. What made it difficult was the fact that Nike is a great culture company with a tough to beat strategy. However, at a price of ~$89 USD and an earnings yield of just over 3%, the value proposition just didn't look that attractive to us. Of course the rest of the world doesn't have to agree with us and it is apparent they don't. The stock has rallied to $98 since then. Yes, this is a humbling business.

Next up, we nixed **Kraft Foods Group**, locking in a gain just shy of 3.0% over a four month holding period. I will confess that we were pretty excited when we bought Kraft and I thought we would hold it for years. As it turned out, despite Kraft's impressive strategic plan, the execution was falling well short of our expectations. As the quarterly earnings numbers rolled in, it was really a case of strike one, strike two...and we saw the risk of waiting for strike three to be too great. It would leave us vulnerable to bigger disappointments, so we chose to exit and seek better opportunities elsewhere.

Finally, we exited our position in drug distributer, **AmerisourceBergen** with a gain just north of 48% after a holding period of 17 months. Our sell decision was based on the explosive upside move in the stock price which offered us just too much "instant gratification" to let it pass by. Yes, we can make a case that ABC is worth more, but that case is based on continued strong growth and maintenance of already very narrow profit margins. Suffice to say, the value proposition is not what it once was, so we exited and went looking for greener pastures.

The irony is that as we looked for greener pastures, we ended up buying a hazardous waste management company. How does that happen? North American wide, **US Ecology** (ECOL) provides treatment, disposal and recycling of hazardous and radioactive waste. Here is what made it green, at least in our minds. It provides an essential service and hazardous-waste disposal sites are almost impossible to build today as everyone is understandably infected with the NIMBY syndrome: Not In My Backyard! That leaves existing sites and treatment providers with oligopoly type pricing because there is little in the way of new competition. The firm is also benefiting from the expanding petrochemical manufacturing industry. They recently bought 1 hazardous waste landfill site and 18 treatment facilities through their acquisition of The Environmental Quality Company. That further expands ECOL's footprint in the Eastern U.S. where that industry is growing. Yes, we expect good things to come.

Next up was a revisit to a voice from the past with the purchase of global risk and insurance services firm, **Marsh and Mclennan Co**. or MMC for short. They operate in more than 130 countries, helping clients identify, plan for and respond to risk and critical business issues. MMC got high marks from us on the corporate culture front and we like the fact that they cater to "sticky" midsize/larger companies at a time when those companies are flush with cash and keen to mitigate risk. Their revenue base is well diversified with roughly one half coming from Risk and Insurance Services and the other half coming from Consulting Services. We noted that when their former COO, Daniel Glaser, took the reins as CEO in early 2013, dividend increases have taken on a renewed focus and the company has stated publicly that they are committed to double digit increases in the future - yes, we love that rent cheque and expect more of the same.

That wraps up our major transactions in The Dividend Value Discipline since our recording of September 6, 2014. Turning to our shopping list between now and early January, I am seeing value in some of the more price sensitive U.S. consumer discretionary companies. Lower gasoline prices are helping companies like Wal-Mart and Target, and we are currently zeroing in on Williams Sonoma. We also note that while the major indices like the S&P 500 have been very strong so far this year, the smaller company Russell 2000 Index is only up some 2.0% on a year-to-date basis. Historically, smaller capitalization companies tend to rally strongly into year-end and the first few weeks of January, thus we are receptive to those names for further study. With that, we are on to the wrap up.

Track #4: The Wrap Up – Here Comes Santa Claus

First the takeaways:

Track # 1 – a reminder, the opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.

Track # 2 – The Markets - Oil, is it time to play the contrarian card? Our view is no – with the 52 week high in the Canadian oil complex less than 6 months old, there just has not been enough blood letting yet. It is interesting to me that oil prices broke down just as speculators were at record high positions. That too is a big negative. In our minds we are better off looking to those who are benefitting from cheap oil. Turning to the world's best economic forecaster, Dr. Copper is marginally weaker vis-a-vis our last recording, signalling a tentative global economy. On the Canadian dollar I intend to use rallies to ramp up our U.S. holdings. Historically speaking, betting against a secular bull market in the American greenback has not proven to be a winning strategy.

Track # 3 – The Dividend Value Discipline™ - Shopping America – there is not much more that needs to be said. For every penny that gasoline prices go down it adds a billion dollars per year to the U.S. economy. That is a powerful push on the U.S. economy and they continue to be the attractor of global capital. When it comes to new additions to The Dividend Value Discipline™, we intend to go with the flow, until we get evidence that the flow is changing. I expect that to be years away.

Finally, here comes Santa Claus…in investment terms, that speaks to what is known as the Santa Claus rally, which typically starts the week after U.S. Thanksgiving. It is postulated that portfolio managers return from the holiday full of turkey, look at their returns, and realize they fall way short of their benchmarks and then decide to try and make up that shortfall before year end to preserve their bonus, or perhaps more importantly, their job. Having been in this business for over 20 years now, I have seen it happen more often than not so you need to be ready to take advantage of it.

That concludes our key takeaways. To our clients, thank you. I appreciate you taking the time to listen. It allows us to spend our meeting time focusing on the issues that are important to you and your family.

To potential clients listening – thank you for your interest. The Opportunity Update is one of three quarterly communications pieces that we produce. They are designed to keep you informed, but not involved on a day-to-day basis. If you are interested in past productions, they are all archived on our website, www.chrisraper.com. Prior to meeting us face to face, you will want to listen to Postscript I where I deal with the methodology of The Dividend Value Discipline™ and outline what makes the program unique versus our competition. By the time you are done listening you will know whether or not a meeting is in order.

Assuming the answer is yes, you will then want to move to Postscript II, where I outline what you can expect during that initial meeting where we both try to answer the question, "Is there a Fit?"

Finally, as we approach this Christmas Season, we trust you will find some quality time with the ones you love. On behalf of the entire team here at Chris Raper & Associates, we wish you and yours the very best of over the holidays and of course, a prosperous New Year. This is Chris Raper, bidding you good day and may God bless, from Victoria, BC, on Wednesday November 26, 2014.

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

The first thing to note is that **The Dividend Value Discipline™** is core to everything we do – meaning if we were approached by a prospective client and we determined that our trademarked investment process did not fit with their investment philosophy or their need, then we are not the right advisors for that particular client – there is no fit.

You should also be aware that nothing gets any more attention at our shop than this particular program. The lion's share of our client assets are allocated to the program and that includes our most senior people, my family, and me. The take away is that my team and I have huge vested interest in ensuring the success of the program.

The process is discretionary, meaning we make all of the buy and sell decisions and report to you after the fact. Post a new purchase, our normal course is to send an email outlining the background of the company and the rationale for the decision, five business days after it settles to your account. When we close out a position, we also send an email outlining the result and our rationale.

Our objectives for the program are:

1. Income every month – that can be paid out or reinvested
2. An acquisition process where we buy **only** those securities which become attractive on a "go forward" basis
3. Absolute returns of 8%+, each and every year.

On September 27, 2014, we marked our 12-year anniversary with account #1, pegging in a net to client return of +8.77% compounded annually. That said, I do not want to leave you with the impression that it has been a consistent +8% each and every year – that is the objective, it has not always been the result. Yes, we took a bath in 2008 – learned lots and more importantly put structures in place to prevent it from happening again. 2009 was an absolutely stellar year and by February 2011 we were on to new highs having fully recovered from the worst bear market in 70 years. Accounts that have been around since the start of the program have experienced one calendar year of negative returns. Looking towards Dec. 31, 2014, we are tracking at a meet or a beat, in nine of the past twelve calendar years. Those results have been achieved by focusing on three keys objectives, so let's walk through this with the illustration of a three legged stool.

The First Leg is Dividends

Every security that we buy you must provide some form of income – we do that because income makes portfolios inherently less volatile, i.e. less chance of loss. The analogy I like to use is that of an apartment block versus a piece of raw land – it is a lot easier to hold onto the apartment block in a tough real estate environment when you are getting a rent cheque every month. Income drives stability and absolute returns.

The Second Leg is Value

Our research function is in-house. We were one of the first private client teams in the industry to have a dedicated analyst on staff and that team has expanded since then. My objective was and still is, to get to the truth. I did not want to depend on any outside analysts that I had little or no contact with. One of the great things about having an in house investment team is that I can ask questions until I am satisfied that we have the right answers. We spend an inordinate amount of time studying the corporate culture. If you are interested in what that looks like, read **Good to Great** by Jim Collins – that is the yardstick we use to measure potential investments against. More recently, we have expanded our thinking on the importance of wide economic moats. You can hear more on that subject by archiving the September 2013 edition of this recording on our website. We believe that the focus on great corporate culture and wide economic moats gives us an edge. Anecdotally, we can provide you with lots of evidence to support that. I remain convinced that having your own people who are totally dedicated to the investment process, adds a lot of value not available at most other private client focused groups.

The Third Leg is Discipline

Here I refer to the buy/sell decisions. We often identify extremely attractive value propositions and then delay the buying decision, why? Because if you are the only guy in the world that sees it as undervalued, you can wait a very long time for the market to recognize that value – in other words, the stock price doesn't rise or worse still, it goes down! Those are not comfortable situations so we try to avoid them. We buy when it is apparent that the market is starting to recognize the stock as undervalued. One of the most helpful indicators is positive relative strength – i.e. is the security in question starting to outperform its peer group and the market – because if it hasn't, there's little incentive in owning it. Sell decisions can be triggered by a number of things – i.e. when the company fails to materialize as expected, when a company's stock price exceeds what we believe it to be worth, negative relative strength, or when we find a better opportunity elsewhere. In reality it tends to be a combination of those factors.

Perhaps the most important part of the buy/sell discipline is the way we operate the program – we call it “The Buys Only Mandate”. Unlike our competition, we only buy those securities which become attractively priced on a go forward basis, meaning if you start today and your brother starts three months from now, your portfolios are going to be different in the short-term, and more closely aligned the longer you are in the program together. As rational as that might seem, most people do the exact opposite. Every time you buy a mutual fund, you buy a pro-rata share of an existing portfolio – by definition, you got the buys, the holds and the near sells. To us, that is not rational – would Warren Buffett buy 100 companies in a single day? Were they all great value propositions? You should also be aware that most 3rd party money management programs work exactly the same way – they buy the basket. Our objective is the protection of your hard earned money and we believe that the buys only mandate is consistent with that objective.

Other key points to the program – a fully invested account would normally have 20 to 25 positions in it, so we are relatively concentrated. Our fees are 1.75% per annum plus the GST or HST – it is tax deductible for non-registered accounts. Our target returns: 8%+, net to you – roughly half of it coming in the form of income and half in the form of capital gain.

You should also know that when I buy for you, I buy for me – when I sell for you, I sell for me – same time same price – and that statement also applies to our most senior people as well. Furthermore, every person on our team participates in on our profit sharing plan, which means they have a vested interest in looking after you.

Generally speaking, we are looking to establish new relationships with new clients that have north of $1 million in investable assets – that said, I’m a lot more interested in where you are going, than where you are. If you have a credible plan to get to that number say within a three to five year period, we are very interested in meeting with you.

To conclude this track, if income and absolute returns are attractive to you, and you think that there may be a fit between your objectives and those of **The Dividend Value Discipline™**, then I would suggest a face to face meeting is in order. You can check out what to expect during that initial meeting by moving to Track # 6 – Is There a Fit and that is where we are going, right now.

Track #6: Postscript II – "Is There a Fit?"

Our objective – and presumably yours – during the first meeting is to figure out whether or not we have a basis for an ongoing relationship. In essence, can we work together? If so, will it be mutually beneficial? Job one is to get your tough questions off the table, so we encourage people to ask whatever is on their mind. Our responsibility is to be forthright with our answers, regardless of what it is that you might want to hear.

Before we enter into any new relationship one of the biggies we ask ourselves is, "can we add significant value"? To answer that question we need to learn some things about you, your family, your finances and what your ideal future looks like. If you are not really sure on the latter point, we have some thinking exercises that will take us through that process.

Next we will walk you through an a la carte menu of our services that are most applicable to you. We'll also 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 client's most challenging financial decisions consistent with their life goals. Our mission is ongoing progress towards those goals, and the result we seek is appreciative clients who are increasingly confident about their future.

So… if that process sounds engaging, I invite you to call and book some time. If you'd like further information, including access to our quarterly communication pieces, you can check us out on the web at www.chrisraper.com and send us an email from there.

This concludes "Is There a Fit".