

The Opportunity Update – Monday, March 25, 2019

Table of Contents

Track #1: Introduction – The Skinny	1
Track #2: The Markets – U Turn – Here’s What’s Different!	4
Track #3: The Dividend Value Discipline™ – Band-Aids, Perfume and Fries	9
Track #4: The Wrap Up – 2019 Headwinds and Tailwinds.....	12
Track #5: Postscript I – The Dividend Value Discipline™ Methodology	14
Track #6: Postscript II – “Is There a Fit?”	17

Track #1: Introduction – The Skinny

Hi, this is Chris Raper, Senior Vice President & Portfolio Manager, Private Client Group of Raymond James Ltd. & co-founder of **The Dividend Value Discipline™**. Welcome to **The Opportunity Update**, which is being recorded for you in Victoria, BC on March 25, 2019. Here is what we are going to cover today.

You are now listening to **Track #1: The Introduction**, where I give you the skinny on what I am going to talk about.

On Track #2: The Markets – U Turn – Here’s What’s Different!

In short, the market came roaring back post the Christmas Eve capitulation panic sell, but there are different sectors leading the market north this time around, and there is a lot of conflicting data on the economic/earnings front. Earnings growth is slowing relative to expectations and yet stocks are up and so are bonds – that’s not supposed to happen. Who’s right? We’ll unpack that and outline how to deal with the wrong question by asking the right question.

On Track #3: The Dividend Value Discipline™ – Band-Aids, Perfume and Fries

We’ll cover off three of the companies that we have acquired since our December 6, 2018 recording, namely; Johnson & Johnson, International Flavours and Lamb Weston, and address their corporate culture, their competitive advantage, and a brief discussion of the secular headwinds/tailwinds. Those

are the three key drivers for earnings and dividend growth which we view as the ultimate source of long term investment returns.

On **Track #4: The Wrap Up – 2019 Headwinds and Tailwinds**, I will wrap it up giving you the key takeaways from each track, and then give you some lesser known insights on the macro headwinds and tailwinds for the aggregate capital markets. Why are they lesser known? Because they are not in the lead stories of major media outlets – if they were, it's too late – the market has already adjusted.

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

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

In terms of legal requirements, there are three things to note:

1. The opinions that are expressed on this recording are mine. They may differ from those of Raymond James Ltd.
2. Raymond James Ltd. is a member of the Canadian Investor Protection Fund. That is a good thing. If you are interested in those details, please ask me or any one of our relationship managers the next time we speak.
3. This recording/transcript provides links to other Internet sites for the convenience of users. Raymond James Ltd. is not responsible for the availability or content of these external sites, nor does Raymond James Ltd. endorse, warrant or guarantee the products, services or information described or offered at these other Internet sites. Users cannot assume that the external sites will abide by the same Privacy Policy which Raymond James Ltd. adheres to.

I also want you to recognize that some of the things I am going to say today are going to be proven wrong. It is an inevitable part of this business. It is also important to recognize that you don't have to be right all the time to do well. You just have to be more right than most or, conversely, less wrong than most.

Finally, regarding investment jargon, when I say I am bullish, it means I expect things to go up. When I say I am bearish, it means I expect things to go down. Likewise, north means up and south means down. When I speak about rent cheques, I am speaking about income, primarily dividends. You will also hear me using the term disruptor, which is our moniker for those companies that are disrupting or re-inventing the way business is done in their particular market and are thereby able to grow at rates far faster than those of the economy. Think of Wal-Mart twenty years ago and Amazon today. You will also hear me use the term aggregator, which is our moniker for those companies that have a systemized approach to acquiring smaller competitors as a means to fuel their growth. That growth is the path to increasing dividends or in our language, growing rent cheques. If you catch me using industry jargon beyond that, I invite you to call me out. Send an email to the office and the team will let me know, usually with considerable gusto!

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

Track #2: The Markets – U Turn - Here's What's Different!

As we drive towards the close of the first quarter of 2019, the change in animal spirits, ergo the markets, could not be more disparate. Since the Christmas Eve peak panic sell, the S&P 500 has been on a rip-roaring tear north, leaving little opportunity for those investors who sold into the FEAR (False Expectations Appearing Real) to get back in. Renowned investor, Peter Lynch, is right: “There is far more money lost preparing for the recession, than during the recession.”

In terms of what's driving the U turn, most of the things that investors were worried about last fall have abated:

Interest rates are significantly lower, not higher. The U.S. Fed indicated just last week, no further increases in the Fed funds rate this year – painting itself into the proverbial corner, once again.



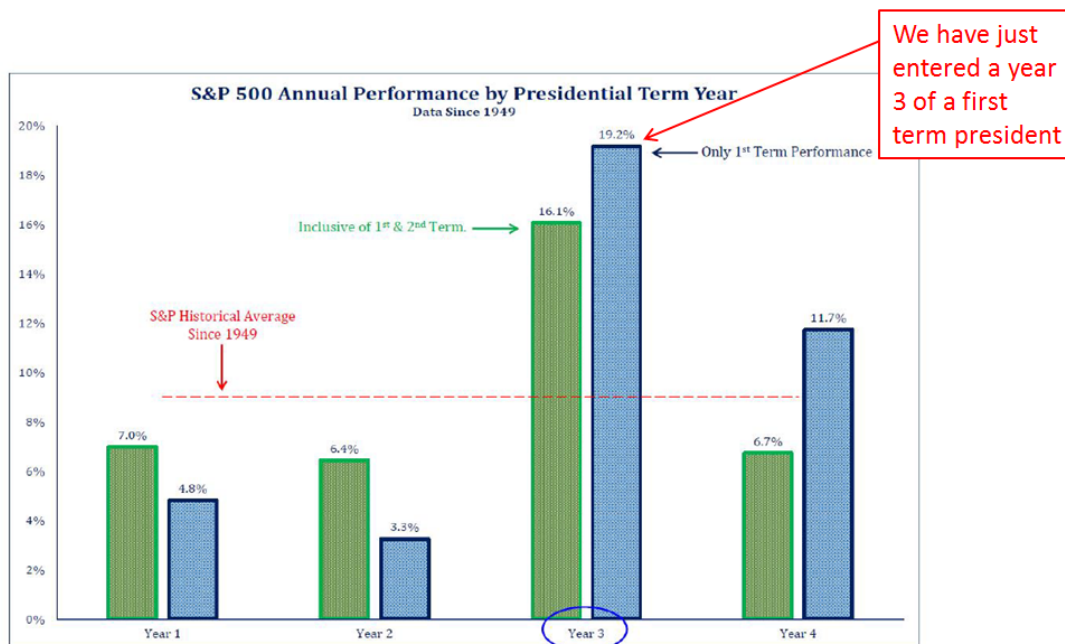
Not surprisingly, the U.S. dollar is sideways to down as rate increase expectations evaporated. That makes U.S. dollar-denominated debt (the kind that most emerging market countries must pay), easier to service and repay - a positive for global economic growth.



The China/U.S. trade difficulties are on their way to getting resolved, albeit with some hiccups, and we need to recognize the political reality of President Trump. He is a first term president and is clearly gunning for a second term. To get that second term he needs the U.S. economy to be firing on all cylinders when voters go the polls in November of 2020. Ergo, he is unlikely to risk an all-out trade war with China. He needs a deal and so does China.

Historically speaking, since 1949, the market's (S&P 500) performance in year three of first term presidents is a pretty impressive 19.20%, and year four is no slouch either at 11.70%. My read is that Trump is going to do what all of his predecessors have done - he is going to grease the wheels of commerce to increase his odds of gaining a second term.

Historical Presidential Cycle



Turning to our favourite leading economic indicators, as was the case on the December recording, the price of copper continues to tick north. On the September recording it was \$2.63 per pound, when I reported to you last December it was \$2.73, and as of this morning it was pegging in at \$2.84 and had hit a six month high in early March of \$2.98 per pound. Why is that important? Because copper goes into virtually every manufactured good you can think of and stronger prices point to improving demand, especially as it relates to the developing/manufacturing economies like China. Bottom line – Dr. Copper is leaning bullish. That's a good thing for resource economies, and Canada is certainly one of them.



Our best leading indicator for the developed economies is the Philadelphia Semiconductor Index (symbol \$SOX), and it has moved from clearly bearish on the last recording to pegging a new all-time high of 1,451 just last week – it reads bullish! Why follow semi-conductors? They tend to be a great “tell” for the developed economies because much of their economic growth is fueled by human ingenuity and processing power. As the demand for processing power (the price of semiconductors) increases, it points to better things to come economically and of course, the converse is true.



Opposing the positives that one might draw from copper and semiconductors are our ancillary indicators, the world’s Purchasing Managers Indices (PMI’s) which are continuing to slow. We need to be aware that PMI’s are slower to move than copper or semiconductors, so it is entirely possible that we have actually passed through an economic slowdown and are on our way to further expansion, but it doesn’t have to roll that way. “So which is it Chris, an impending recession or a reaccelerating economy?”

While I appreciate that the answer has obvious implications for stocks, it’s the wrong question. The right question is “Do I have enough money set aside in my ‘safe money’ and ‘income’ buckets so that I am never forced to sell in a down market?” Just imagine if you bailed on or close to the Christmas Eve

panic with the idea you would get back in when things look a little more positive. Just for arguments sake, let's say you were waiting for both copper and semiconductors to hit new six month highs to confirm better times are likely ahead. That happened on March 21st – now maybe it was because of the full moon coinciding on the first day of spring, but maybe things are getting better. The guy who sold on Christmas Eve (when investors redeemed \$90B in equity funds and exchange traded funds that week) is now faced with the prospect of buying back after strong double-digit gains on the S&P 500 and TSX!

Peter Lynch is right - investor behaviour is the largest determinant of your life time returns. If you can force yourself to buy (aka: send money) during the times when the world is in panic mode, you are going to do very well. If you do the opposite, you have no chance of doing well. We are here to help you with those challenging decisions and it is certainly the greatest value factor we can bring to the table.

Being Canadian and picking up on our usual course, let's move to oil and our loonie.

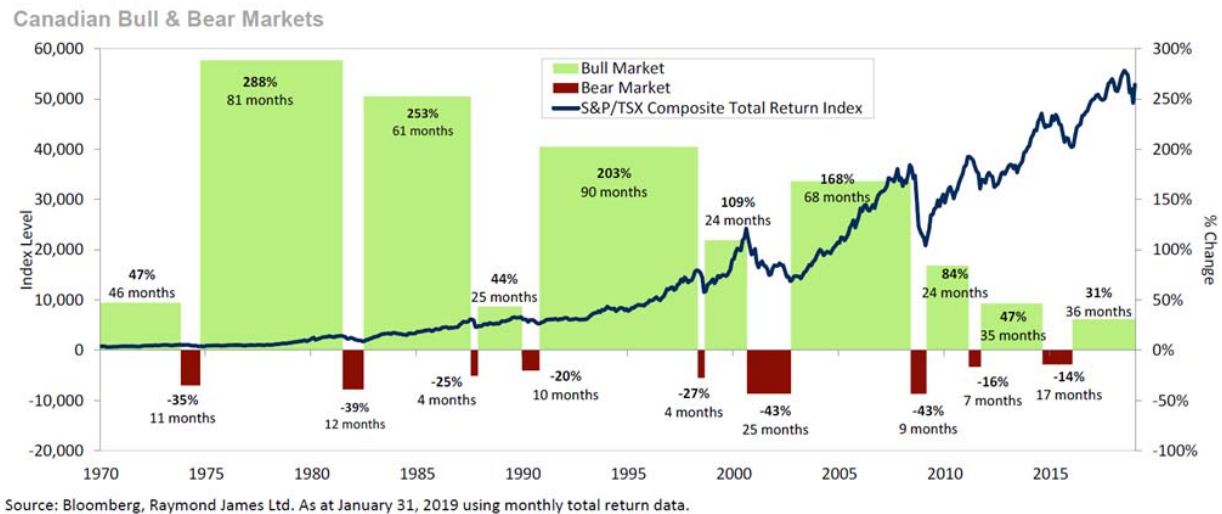
The price action in oil is certainly bullish and it too begs the question, if we are going to into a recession, why is the price of oil rallying? While higher oil prices can be indicative of a growing economy, we need to remember, it's about supply and demand - and supply is under threat. Saudi Arabia is the 2,000 lb gorilla swing producer and when the Saudi's brought down their federal budget earlier this year, it was based on \$80 Brent Crude oil and Brent is trading at \$67/bbl this morning. It follows that they have to cut a lot of supply to make it happen, and they are doing so. For me, the more interesting point is they also chose to massively increase taxes the on the expat community as a means to make the budget "work". As you would expect, the expats are leaving in droves and expats are largely the brains behind Saudi oil production. If they are not there, can the Saudi's ramp up production when their price targets are achieved? Any way you shake it, this a positive outcome for Western Canada and maybe, just maybe, our eastern brethren and federal political leaders will wake up to the fact that we really are better off with an Alberta to New Brunswick oil pipeline (the kyboshed Canada Line), as opposed to importing oil from the Saudis shipping it down the St. Lawrence Seaway.

That takes us to the Canadian dollar where the overwhelming consensus is weaker – you can read about it in the Globe and Mail just about every other day. With the sideways drift in the U.S. dollar and higher oil prices, I am wary of the consensus. Right now I see it range bound from \$0.74 to \$0.76 USD, but please be aware that we are entering a period of seasonal strength for our loonie that tends to peak in late April to early May. If the Saudis reach their objective of \$80 Brent this year, it's hard for me to see how we won't have a stronger Canadian dollar.

Longer-term (months to years), I am bullish on Canada and here's why: The Canadian economy is very dependent on commodities. Historically speaking, the long term commodities cycle (peak to peak or trough to trough) is roughly 14 years. If you are willing to take late 2007 and early 2008 when oil

peaked at \$150 per barrel as the last cycle peak, then the next cycle peak should be somewhere around 2022, and let's say it is delayed by a few years because the '08/'09 recession was so severe. That would take us to 2025 before we see the next peak, and importantly, we have to have a boom to get there.

If you are following along with the transcript of this recording you will see a chart of the TSX's performance in past cycles. You will also note it has been substandard for a decade, but look at the pre-2008 cycles - in a word, fantastic. Those hay days will come again and those who don't open their minds to that possibility will miss it.



Off we go to Track #3.

Track #3: The Dividend Value Discipline™ – Band-Aids, Perfume and Fries

What follows is some insight into our thinking behind three companies that we have added to the program over the last 90 days or so.

To start, “I am stuck on Band-Aids because Band-Aids are stuck on me” and the maker of Band-Aids is none other than Johnson & Johnson (“JNJ”, <http://www.jnj.com>), but they do a whole lot more than Band-Aids. In fact, consumer sales only make up about 17% of global revenues; whereas Pharma and Medical Devices make up the balance - in sum, almost \$82 Billion in sales last year.



Culture-wise, JNJ is one of the best we have ever studied. The median management tenure is over 19 years and we love the large insider ownership base. Furthermore, the management team is highly praised by the line employees and there is a massive focus on innovation throughout the company.

That innovation has generated a very wide moat in the healthcare industry - scale and intellectual property barriers are clearly significant.

Tailwinds-wise, with an aging population in developed countries and growing middle class in the developing economies, one should expect a healthcare spend rate well beyond normal economic growth. While JNJ's dividend growth rate is smaller than our average holding, we are okay with that given their great reinvestment track record and ample opportunities for aggregation.

Next up is a scent and taste provider to many of the things that you and I buy every day. **International Flavors & Fragrances, Inc.** ("IFF", <https://www.iff.com>) supplies ingredients for things like soap and detergents, food and beverages, and finally cosmetics/perfumes. They define themselves as 'the catalyst for discoveries that spark the senses and transform the everyday'.

Their culture is roughly in line with our other investee companies - long management tenures and hiring from within is clearly evident. We also like the fact that there is broad cultural diversification across the management ranks, something we deem to be important for a company that operates in over 175 countries around the world.

Their moat is wide and getting wider. Throughout the years, IFF has aggregated its way to higher growth and we see that trend continuing. We also see tailwinds from emerging markets, which is now 50% of sales, and their Frutarom acquisition, which specializes in natural product offerings and the private label markets, gives them a significant leg up in faster growing products. Rent cheque-wise, we see near double-digit annual growth rates in the future.

You say potato and I say potato, and at **Lamb Weston Holdings Inc.** ("LW", <http://www.lambweston.com>) it doesn't matter because they are all coming out as fries. This innovator of the frozen potato industry has operated out of Idaho for almost 60 years now and is a global supplier of frozen potato and sweet potato fries to restaurants and retailers around the globe. How do you innovate on the humble potato? Well their latest product is CrispyCoat Fries® which holds its crispiness for 30 minutes, and has obvious implications for restaurants and the growing delivery services like Grubhub and Deliveroo.

Lamb Weston (LW) ranked really well in our culture assessment – a culture that seems to be driven by an unflappable focus on their core product. Their motto is seeing possibilities in potatoes.

Scale-wise, they are the number one frozen potato supplier in U.S. and number two globally, and they measure their customer effectiveness by the average age of their customer relationship. That's what makes these "frozen fry" giants formidable competitors and it helps that their clients find their potato-based products as one of the highest margin items on their menu – think tailwinds.

The most recent rent cheque (dividend) increase was only 5%, and we are okay with that because they have ample opportunity to reinvest their excess cash flow at double-digit rates.

That's a wrap and we are off to Track #4.

Track #4: The Wrap Up – 2019 Headwinds and Tailwinds

First, the takeaways:

Track #1: Introduction – The Skinny

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.

Track #2: The Markets – U Turn – Here’s What’s Different!

Yes, we have had a rip-roaring rally after the Christmas Eve panic sell. Copper continues to lean bullish and the semiconductor space made a massive U turn from bearish to bullish since our December recording. That said, the ancillary data is voting in the other direction - bearish, but let’s not forget that President Trump is clearly going to do everything he can to grease the wheels of commerce. There is no question that things look better today than when I reported you last December, in part because we have had the capitulation and investors now recognize their mistake and want back in.

Where to from here? Again, wrong question – let’s not get too excited about the recent performance. Let’s ask the right question “Do I have enough money in my safe and income buckets to withstand the next downturn, whenever it comes?” If you can’t answer that with an “in all likelihood, yes”, then stop listening and call us now.

We closed out Track #2, with what seems like a permanent dent in Saudi oil supply, an issue that hasn’t got a lot of press, so I expect it has not been factored into oil stocks. Certainly, energy has been one of the lead sectors so far this year, and that is a full 180 from last year. Accordingly, I am wary of the weaker Canadian dollar consensus, especially in light of the historical seasonal strength. If we are headed for a recession, it just kicks the higher oil prices down the road.

Track #3: The Dividend Value Discipline™ – Band-Aids, Perfume and Fries

We covered off Johnson & Johnson, International Flavors and the potato kings, Lamb Weston. What do they have in common? Long management tenures, hire from within, and a culture of innovation that is focused on the end customer. That is what built their competitive edge – their moat. The earnings and rent cheque increases are what we are after but they are generated by people who are passionate about their business.

Track #4: The Wrap Up – 2019 Headwinds and Tailwinds

Headwinds-wise, I continue to believe that most of the FAANG behemoths (Facebook, Amazon, Apple, Netflix and Google (now Alphabet)) will continue to be challenged with ever-increasing regulatory issues, lawsuits and anti-monopoly fines; to wit, the \$1.7B fine that the EU regulators levied on Google last week for “abusing its dominant role in online advertising”. That’s almost \$10 billion thus far, and I will give you odds on there is a lot more to come. And why would the EU regulators quit? It’s like milking a cow and others are going to want to milk that cow too. Over time, this is going to slow earnings growth. It distracts management and means you spend a lot of time and money defending yourself. Because the FAANG group makes up the largest companies in the U.S., if they don’t do well, U.S. index investors (which we are not) will not do well either.

Tailwinds-wise, lower U.S. interest rates and a sideways-to-down U.S. dollar is terrific news for companies domiciled outside of the U.S., as it makes earnings growth that much easier to attain. It is also great for the commodities complex. Furthermore, valuations outside of the U.S. are also a lot more compelling. Accordingly, I expect to see continued money flows out of the U.S. in search of better values, which is something I have witnessed since late last summer.

The surprise for 2019? I suspect that it just might be that non-U.S. stocks actually outperform U.S. stocks, and that includes Canada. And if it doesn’t happen in 2019, the case for 2020 only gets stronger.

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

Thank you for taking the time to listen. This is Chris Raper bidding you a good day and may God bless from Victoria, BC on Monday, March 25, 2019.

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

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

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

Our objectives for the program are:

1. Income every month – that can be paid out or reinvested;
2. An acquisition process where we buy only those securities which become attractive on a “go forward” basis;
3. Absolute returns of 8%+ over any investment cycle, which we would describe as peak to peak or trough to trough. If you are looking for a time frame in terms of years, think 5+ years but please understand investment cycles have a wide range of timeframes.

The program operates with three key objectives and I will walk you through them using the illustration of a three legged stool.

The First Leg is Dividends

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

The Second Leg is Value

Our research function is in-house. We were one of the first private client teams in the industry to have a dedicated analyst on staff and we add additional resources every year. We spend an inordinate amount of time studying the corporate culture of potential investee companies. If you are interested in what great corporate culture looks like, read *Good to Great* by Jim Collins – that is the yardstick we use to measure potential investments against. Another yardstick is the importance of wide economic moats – the things that make the company tough to compete with. We want to own companies that the end client can't live without – great examples might be Microsoft or Intuit, both long term holdings of ours. We believe that the focus on great corporate culture and wide economic moats gives us an edge, and while I can't prove it you I can certainly give you lots of anecdotal evidence to support that thesis.

The more recent development in our strategy has been tackling the growth problem. History buffs will note that when we started the program in 2002, we had 5-year GICs yielding roughly 5%, much better economic growth, and stocks benefiting from decreasing interest rates, whereas today we have 5-year GICs yielding say ~3.0% and much slower economic growth. In short, the 8% is tougher to come by.

Accordingly, we spent late 2015 and 2016 tackling the “growth problem”. We needed to find companies that are growing far faster than the economy. As you would expect, we start within the normal confines of “has to pay a rent cheque, score well on the corporate culture front and have some sort of strategic advantage (the moat) that makes the company difficult to compete with”. We then focused on those companies that have demonstrated their ability to grow their earnings/dividends at double-digit rates as a primary indicator of growth and capital gain potential. As we searched, we found that most such companies fell into one of two themes. They tend to be disrupting the existing marketplace – think Wal-Mart 20 years ago or Amazon today - with a better way of doing things and/or they tend to be aggregating their way to growth by buying smaller tuck-in acquisitions, much like Expedia has done with their acquisition of HomeAway, Travelocity and Hotels.com.

The Third Leg is Discipline

Here I refer to the buy/sell decisions.

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

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

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

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

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

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

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

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

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

Next we will walk you through an a la carte menu of our services that are most applicable to you. We’ll outline how we will report to you and who the key relationship people will be. You will also have a very clear picture of the costs involved.

Before you leave we’ll outline how we see our program fitting with your situation, or not. We will not ask you for a go/no go decision at the meeting and quite frankly, we don’t want to be pressed for a decision that day either. We’ll schedule a meeting of the minds call, say a week out, and then mutually agree on the best course of action from there.

At the end of the day, we are in the business of keeping our clients’ most challenging financial decisions consistent with their life goals. Our mission is ongoing progress towards those goals, and the result we seek is appreciative clients who are increasingly confident about their future.

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

This concludes “Is There a Fit”.

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