RBC Wealth Management
Dominion Securities

George Stedman, CFA

RBC Dominion Securities Inc.
1501 McGill College, Suite 2150
Montreal, QC H3A 3M8
Tel: 514-840-7626
Fax: 514-840-7639
george.stedman@rbc.com
www.georgestedman.com

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Second Quarter 2014

Not much happened in financial markets in the second quarter. Bond yields fell a little, the Canadian bond market returned 2%, almost 5% in the first half. The Canadian dollar was up 3.5% in the second quarter and almost even in the first half. The Canadian stock market, when measured in Canadian dollars, way out performed, up 6.4% in the second quarter versus 1.6% for the S&P 500. The TSX has powered back in 2014 after lagging badly in 2013.

According to a colleague that has been keeping score, it has now been 1,004 days since the last 10% correction for the S&P 500. That is remarkable as 10% corrections used to be normal, almost annual events.

Last quarter I discussed index investing and two of the tenets of behavioral finance, fear of regret and recency bias, which together help to explain why investors tend to get worried after stock market declines and complacent or even greedy after rises. While celebrating Independence Day last week I read an article by Patrick O'Shaughnessy, *Investor Behavior: The Final Frontier*, that put a number on that impact. O'Shaughnessy writes:

> "… in the past 15 years (as will likely be the case in the next 15) the 'investor return' (dollar weighted, what the actual investors earn) in the [Vanguard 500
>
> Index Fund] has significantly lagged the 'total return' (time weighted, what the fund itself earns). The 15 year return for the fund itself is **4.25%** per year, which for 15 years compounds to **86.7%**. But the 'investor return', as calculated by Morningstar, was just **2.29%** per year for a total return of **40.4%**.

> That means that because investors have entered and exited the fund at the wrong times collectively, *they've missed out on more than half of the total return earned by the fund.*
>
> Now that investing is almost free, this is the final frontier; how to effectively protect investors from themselves. The best financial advisors earn their keep by doing just this: keeping clients oriented towards the long-term during times of greed/euphoria and during times of fear/panic."

I have found that one way of keeping the focus on long-term objectives is by investing in companies that can come to mean something more than just a quarterly return: companies that can earn something approaching loyalty. Last quarter I described my long term attachment to Walt Disney. I am a thematic investor. I identify long term societal changes and try to position clients ahead of them. Virtually all of our stocks have been, in my mind at least, slotted into one long term theme or another. Disney is a premier creator of entertainment content that can be distributed on many kinds of devices.

Some of our long term investing themes are obvious. An aging population led me to health care companies generally and specifically to Johnson and Johnson. I also like its AAA credit rating, which is better that the USA's, and its enviable dividend record of 52 years of consecutive dividend increases. Today J&J yields 2.6%. Dividends are one of our favorite investment themes.

The Globe and Mail on July 3rd had a story headlined *Power Surge: A World of Gadgets Sends Electricity Usage Soaring*. Electricity is another of our long-term themes. The proliferation of connected devices means "electricity use from such electronics is climbing at a rate of 6% per year, twice the increase in overall global power consumption". We are invested in large and small hydro-electric companies. Fortis is the largest investor owned utility in Canada. It has the best record of consecutive dividend increases in Canada, 41 years. Today Fortis yields 3.9%. Algonquin Power & Utilities Corp. owns and operates a portfolio of renewable electric generators and sustainable utility distribution businesses in North America. Over the last three years Algonquin, a former income trust, has raised its dividend 11.5% per year. Algonquin's current yield is 4.2%.

The surge in North American hydrocarbon production has reinforced our enthusiasm for both mainline pipelines and for midstream energy companies as well as railroads. Enbridge Inc. and Transcanada Corp. are two of the biggest pipeline companies in North

America. Enbridge has paid dividends for 61 years and the dividend has been increased every year since 1996. Enbridge yields 2.8%. Transcanada's dividend has a compound annual growth rate of 7.2% over the last 14 years. Today Transcanada yields 3.7%.

Altagas is an energy infrastructure company with natural gas processing, power generation and utility operations. It benefits from cheap and abundant natural gas. In the last three years Altagas has raised its dividend an average of 7.1% per year. Altagas yields 3.6%. Inter Pipeline transports crude oil and processes natural gas, mostly in Alberta. It converted to a corporate structure in 2013. Over the last 5 years the compound annual growth rate of the dividend has been 8.8% and it now yields 4%.

Pipelines offer energy producers efficiency and low cost, railroads offer flexibility. Canadian National Railway has increased its dividend every year since it went public in 1995, increasing at an annualized rate of 16% over that period. CN yields 1.4%.

Often times finding long-term promising themes to invest in is not the challenge – finding sensible low risk ways of doing so is. I hope to illustrate some more of our themes in the next few quarters.

Sincerely,

George Stedman, CFA
Portfolio Manager, Vice-President
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