RBC Wealth Management
Dominion Securities

George Stedman, CFA
Portfolio Manager

RBC Dominion Securities Inc.
1501 McGill College Avenue, Suite 2150
Montreal, QC H3A 3M8

george.stedman@rbc.com
Tel:(514) 840-7626
Fax:(514) 840-7639
Toll-free:1-866-652-4511

Wednesday, January 09, 2013

Year End 2012

Last year was a real cliffhanger. After selling off from September until November, stock markets climbed back up in December, before finally scaling the cliff on the first day of January 2013. For the first time in what seems a long time, last year stocks did better than bonds. Perhaps, after 5 years of a zero interest rate policy, bond yields cannot fall much more (and so bond prices cannot rise much more).

During the financial crisis back in 2008-2009, we bought corporate bonds for the first time in many years. But corporate bond spreads have now normalized to a large extent and we're somewhat inclined to sell corporate bonds. We did a little bit of that last year, especially in tax deferred accounts, and we anticipate doing more this year. We intend to use the proceeds to buy government bonds, buy GICs or buy stocks that pay dividends.

We've attached a table sampling the dividends your stocks pay and the increase in the dividend over the last two years. It is not the dividend yield that is key, but the rate of increase in the dividend. Also key for the long term investor is the yield on cost (YOC). Albert Einstein is said to have called compound interest the eighth wonder of the world. I feel that way about YOC. For instance, I first bought 3M shares 30 years ago when the shares were around $9.00, adjusted for splits. At the time they paid an adjusted dividend of $0.40 and yielded 4.4%. Today the shares trade for $95, pay a dividend of $2.36 per share and yield 2.47%. For those who've owned it continuously since 1982 the YOC is 26% per year. That is a dramatic example to make a point and, it took 30 years time.

(I began in this business in early 1981 and last month I celebrated 30 years of working for Dominion Securities (as it used to be called). In appreciation RBC gave me a catalogue of gifts to choose from. I decided on a new bicycle to keep up with my son, who will be 7 years old when the snow melts. In what I hope was only an unintended commentary on my advancing years, this shiny new mountain bike came with a GPS, so I suppose I could find my way home. Sure to be useful in Town of Mount Royal.)

Warren Buffett is known for saying that his favorite holding period for a stock is life. What he means is that is the attitude to have going in to an investment. I doubt that today he actually owns any of the stocks his partnership owned in the 1950's or 60's. Nor are we looking for dividends in all the same places that we were 5 years ago. Then, in the depth of the Great Recession, we were emphasizing, along with corporate bonds, stocks like utilities, pharmaceuticals, foods, pipelines – companies with relatively predictable businesses and obvious appeal as dividend payers. In some cases we got lucky. (And as we say in sailboat racing, in shifty winds you are better lucky than smart.) We chose railroads because their rights of way were unique assets. It didn't occur to me then that they would become major shippers of oil. We invested in pipelines because their rights of way presented barriers to the entry of competitors. Frankly I wasn't thinking that, for example, TransCanada might replace western Canadian gas with oil in its Canadian mainline pipe. Today our focus is more on what I call unconventional sources of dividend income. Smaller companies, cyclical companies or even, like the lumber companies we bought late last year, companies that I think could be the source of good dividends in the future.

There are many things I love about the Christmas / New Year holiday. Looking over a fiscal precipice was not one of them. It was a magical time for my kids. I love that my wardrobe tends to get refreshed (thanks to my wife, the other K. Middleton) and, that I usually get some good books, and some time to read them. This year my sister gave me a first novel by M. L. Stedman, *The Light Between Oceans*. The author is obviously of good character and has written a movingly sad story about motherhood. Also, my client Kathryn gave me *Tap Dancing to Work: Warren Buffett on Practically Everything, 1966-2012* (Thank you Kathryn.) It is Carol Loomis's collection of articles by and about Buffett that have appeared in *Fortune*. It is of course full of Buffett's aphorisms, know as Buffettisms, such as; "It is usually far more profitable to simply stick with the easy and obvious then it is to resolve the difficult…Overall, however, we've done better by avoiding dragons than by slaying them." I would give you a copy, but, you know me, I'm waiting for the paperback.

I will end however with yet one more quotation. When asked to explain his success, Buffett replied:

> I can certainly define happiness, because happy is what I am. I get to do what I like to do every single day of the year. I get to do it with people I like, and I don't have to associate with anybody who causes my stomach to churn. I tap dance to work, and when I get there I think I'm supposed to lie on my back and paint the ceiling. It's tremendous fun. (Buffett in Loomis, 2012, p. 135)

Thanks to all of you for making my job fun, Happy New Year.

Sincerely,

George Stedman, CFA
Portfolio Manager
Please visit us at www.georgestedman.com
Password: stedman