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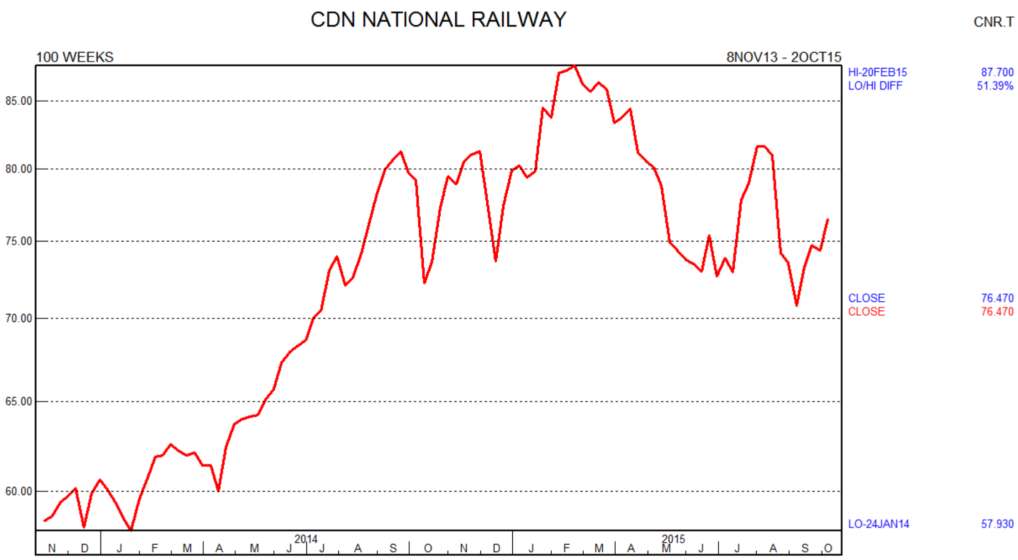
Third Quarter 2015

The third quarter was the worst since 2011. The Toronto stock market index returned -7.9% and the S&P 500 -6.4% measured in U.S. dollars and near even when counted in Canadian dollars. In Toronto, Energy, Materials, Financials and Health Care were by far the worst performing sectors. An economic slowdown in China was all the talk. Resource stocks now represent half the weight in the S&P/TSX Index than they did in 2008. Now they are just 27.5% of that index.

It is not unusual for stocks to be weak at this time of year. September is on average the worse month and the only month to have had on average negative returns in Canada and in the U.S. This stock market correction only feels unusual because we haven't had one since 2011. The stock markets are now down about 10% from their April highs. Up until this millennium there used to be ten percent corrections every 18 months or so. Incidentally, speaking of millennia, since December 31, 1999, which nearly coincided with the peak of the great stock market bubble of the late 1990s, the world stock market index has had an average annual price return of 0.2%, not including dividends. Dividends have been important.

Several of our investee companies announced increases to their dividends in the quarter. For example, electric and gas utility company Fortis, which I singled out in last quarter's letter as a stock that was unnecessarily down, last week raised its dividend by 10.3% to 37.5 Canadian cents a share per quarter. At the recent price of $38, Fortis now has a dividend yield of 3.95%.

This quarter I want to give a shout out to Canadian National Railway. I've loved railroads since I was a little boy although I will admit to feeling a little unease in the last couple of years when I've seen long lines of oil tanker cars. Personally I would prefer that oil was shipped in pipelines, but that is another matter and CN is about much more than oil.
CNR shares have fallen from February's high at least in part because of falling oil prices, which make the higher cost of shipping oil by train more of an issue, and because of concerns of falling demand in China for other Canadian commodities that are shipped in bulk, like coal and grain.



Graphic obtained from Trend & Cycle (October 5th, 2015)

CN has other strengths though. CN transports approximately $250 billion worth of goods per year over a network of 20,000 route miles of track connecting three coasts; the Atlantic, the Pacific and the Gulf of Mexico. As Walter Spracklin, CFA, has recently written for RBC Capital Markets, "Our favorable view on CN is centered on the company's core competitive advantage that is its track network." (June 22, 2015) CN's network of track would be very hard for a competitor to copy today. CN benefits from improved demand for housing in the U.S., for automobiles and for consumer products. Intermodal (containers) is one of the railroad sector's fastest growing segments. CNR has raised its dividend at a compound annual growth rate of 17% since becoming a publicly traded company in 1995. At $77 CN yields 1.62%.

Kristin, the kids and I are really looking forward to getting away to the country for the Thanksgiving long weekend. Let me take this opportunity to thank you for your patronage and for your patience. It is easy to get a bit gloomy when the days get short, a long weekend can help. Happy Thanksgiving.

Sincerely,

George Stedman, CFA
Portfolio Manager, Vice-President