



The Blue Chip Report January 2018

BCV Asset Management Inc.

2017 and Beyond

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Portfolio Manager

2017 G7 Market Returns

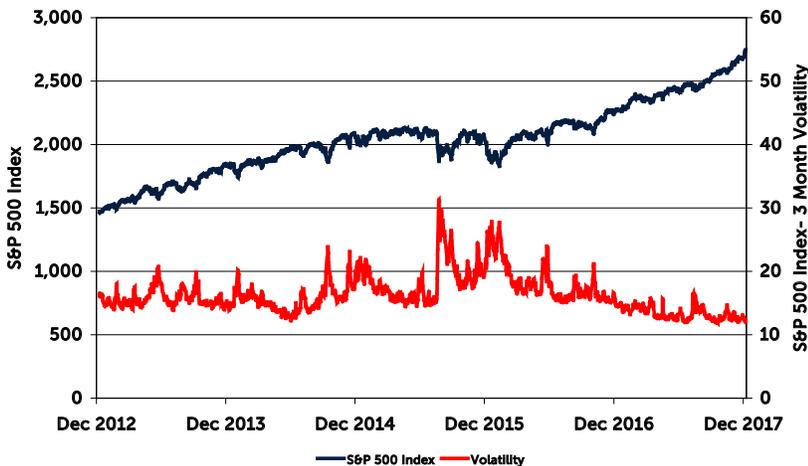
S&P 500 Index (United States): +19.42%
 Nikkei 225 Index (Japan): +19.10%
 FTSE MIB Index (Italy): +13.62%
 DAX Index (Germany): +12.51%
 CAC40 Index (France): +9.26%
 FTSE 100 Index (United Kingdom): +7.63%
 S&P/TSX Composite Index (Canada): +6.03%

Source: Bloomberg LP

The end of the calendar year tends to be a time for reflecting on the past and making predictions about the future. The past year was a relatively calm one in the capital markets, with the political turmoil that was so evident not carrying over to the financial markets. There was no shortage of anxiety with the United States more aggressively and unconventionally challenging the North Korean missile program.

Global markets mostly ignored the geopolitical challenges, producing strong returns with muted volatility. Markets in the United States, Japan, Germany, and the United Kingdom all reached multi-year highs during 2017. As seen in the chart below, the market highs experienced in the United States were accompanied by volatility that fell to historic lows. The Canadian market showed gains as well. With the coming legalization of recreational marijuana use in Canada, there was no shortage of investor interest in newer Canadian-listed companies hoping to capitalize in this industry.

**S&P 500 Index and Volatility
(December 2012 - December 2017)**



Source: Bloomberg LP

Global fixed income markets were relatively steady as interest rates moved mostly as expected, with inflation subdued. However, Canadian central bank policy shifted notably mid-year, as short-term interest rates started to move higher, leading the Canadian dollar to eventually rise to 0.80 CAD/USD in response.

Much like 2017, where the year started with some geopolitical concerns and elevated stock markets, 2018 has started in the same fashion but with more momentum. In the forty-five countries tracked by the Organization for Economic Cooperation and Development (OECD), which encompasses most of the developed world, all are on pace for economic expansion this year. It is an uncommon occurrence for all of these economies to be growing in sync. Expanding economies create more demand for products and services, which in turn support growing corporate earnings. Global purchasing manager indices are very strong and with the United States recently passing a large corporate tax reduction, conditions are quite stimulative for further equity market appreciation.

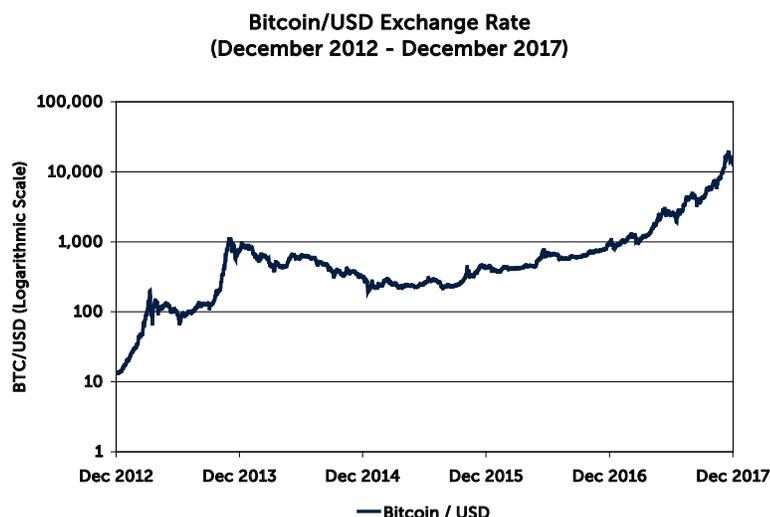
History has shown us that markets do not appreciate in a straight line and current valuations are stretched when compared to historical averages. There is ample market risk if a geopolitical problem develops or monetary policy becomes much more restrictive. At BCV Asset Management, we do not focus on short-term market forecasting when managing investor portfolios. Instead, our focus is on a three to five year outlook, with a view to how the companies in which we invest can continue to increase their earnings and dividends in their business environment. While the future is uncertain, we want to own businesses whose valuation is justified by the fundamentals. Valuation is particularly important following years like 2017, where there was a tailwind to total returns. Irrespective of how the markets perform in 2018, we remain confident that the companies in which we invest will be able to sustainably grow their dividends over the next three to five years. To us, finding conservative companies that can grow their dividends is the single most significant variable in delivering satisfactory long-term investment returns.

The Rise of Cryptocurrencies

James McInnis, B.Comm (Honours), CFA

Portfolio Manager

The headline-grabbing, fifteen-fold increase in the value of Bitcoin in 2017 has drawn the attention of most people to Bitcoin and other cryptocurrencies. At BCV Asset Management, these cryptocurrencies are not an asset class in which we invest. Instead, we invest in assets that generate cash flow. That cash flow is the mechanism that allows us to value the investment.



Source: Bloomberg LP

Regardless of the investment type, we first and foremost want to protect our clients' investment capital. If there is any outcome in which there is a meaningful probability that an investment will lose all of its value, we simply will not make that investment. We invest our clients' money (and our own money) into companies that are expected to generate a stable and growing stream of cash flow. Bitcoin is, without a doubt, a speculative investment. Even Stephen Poloz, Governor of the Bank of Canada, has stated the same publicly. The blockchain technology used by Bitcoin and other cryptocurrencies could benefit the world greatly. It makes it much quicker to verify parties to transactions, reducing what used to take multiple days to a few seconds. The investment thesis for cryptocurrencies as a long-term investment is far less certain. The value of these currencies depends on what someone will pay for them, which begs the description of the 'greater fools theory'. While there may be a market for a currency that allows users to hide their identity for fraud and other illegal activities, it is debatable whether such a currency could survive or be widely-adopted. There is already reports that those using Bitcoin for illegal activities have already moved on to other cryptocurrencies as regulators begin to monitor Bitcoin more closely.

Investment success at BCV Asset Management hinges on avoiding mistakes, finding opportunities that we believe will be good investments for the long term, and monitoring those investments daily. We avoid short-term speculation, including investments that are opaque or have a meaningful risk of losing value. Our investment philosophy centres on finding high-quality, dividend-paying companies that grow their dividends year over year, providing a relatively predictable and growing stream of cash flow for our clients. This investment philosophy has served us well for over ten years and we expect it to continue to do so in the future.

The Research Process

Cory Lang, CFA, CPA, CA

Financial Analyst & Securities Trader

At BCV Asset Management, we are always on the lookout for promising investment opportunities. You might be asking yourself where those ideas come from. Well, there is no one source of ideas, although if you happen to have breakfast with Warren Buffett occasionally, that might be all you need. Short of that, I would like to give you some insight into the research process at BCV and the various sources that we use.

Peter Lynch was famous for advising individuals to invest in what they know. At BCV, this is fundamental to our research process. If we cannot explain what a company does or how they make money, we do not want to invest in it.

The Investment Committee meeting is a key part of our research process. This is not the type of meeting that is formal and structured, although we do follow some guidelines. What is great about it is the free-flowing nature of the conversations that start. Because each member of the Investment Committee has a different background and experience, we get a variety of perspectives. The result of these discussions is sometimes no more than a bit of insight, while at other times it is the seed of an idea that will hopefully grow into a successful BCV investment.

We have close to two dozen regular sources of research that we utilize, including news publications, broker research, industry-specific trade publications, and financial data sources. We like to use these as supplementary sources to our own independent research. These sources provide supporting evidence for our ideas, but also provide us with alternative viewpoints to our own, ensuring that we are considering the other side of the trade. We also read financial statements, listen to conference calls, review investor day presentations, and meet with management and analysts to provide additional insights into potential investments.

Once all of the available information is compiled and analyzed, it makes its way back to the Investment Committee for review. After it has proceeded through the committee and each member has reviewed its merits, it is only then that an idea has a chance to become an actual investment within client portfolios. That is only the beginning of the process though, as at BCV we utilize our research both to generate new investment ideas and to continuously monitor the investments that we have made.

Research is a critical part of what we do at BCV Asset Management. By bringing together a wide variety of sources, quantitative information, and the opinions of our investment professionals, we aim to continue generating promising opportunities for clients now and in the future.

Recent Dividend Increases



Canada

Fourth Quarter 2017:

Bank of Nova Scotia: 79 cents (76 cents)
Canadian Imperial Bank of Commerce: 130 cents (127 cents)
Royal Bank of Canada: 91 cents (87 cents)
Sun Life Financial Inc.: 45.5 cents (43.5 cents)

First Quarter 2018 (Pending):

TELUS Corporation: 50.5 cents (49.25 cents)



United States

Fourth Quarter 2017:

Bank of America Corporation: 12 cents (7.5 cents)
Bank of New York Mellon Corporation: 24 cents (19 cents)
Medtronic plc: 46 cents (43 cents)
United Technologies Corporation: 70 cents (66 cents)
Wells Fargo & Company: 39 cents (38 cents)

First Quarter 2018 (Pending):

Honeywell International Inc.: 74.5 cents (66.5 cents)
Johnson Controls International plc: 26 cents (25 cents)
JPMorgan Chase & Company: 56 cents (50 cents)
Microsoft Corporation: 42 cents (39 cents)
Starbucks Corporation: 30 cents (25 cents)
U.S. Bancorp: 30 cents (28 cents)
VISA Inc.: 19.5 cents (16.5 cents)

Dividend Increases reported in domestic currency of common shares, except where noted.

* Dividend paid in USD.

Source: Bloomberg LP

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