The Blue Chip Report
July 2017

The Worry List
Todd Johnson, B.Comm (Honours), CFA, CIM

The Worry List- United States Since The 2008 Credit Crisis:

GM/Chrysler Near Bankruptcy

US Bank Bankruptcies

Government Shutdowns

Massive Budget Deficits

Multiple Terrorist Events

Tax Hikes & Healthcare Reform

Ukraine-Russia Conflict

Ebola Virus

Possible Greek Exit from Euro

P.I.I.G.S Debt Problems

US Credit Rating Downgrade

Brexit

Federal Reserve Ultra-Low Interest Rates

Syrian War

ISIS and Iraq Destabilization

China GDP Slowdown

Flash Crash

Arab Spring

President Donald Trump

Canada is celebrating its 150th birthday this year, marked by a year-long celebration of attaining this milestone. It is also a time for reflection on our collective history and, in looking at the financial markets, much has changed over the last one hundred and fifty years. For the markets in Canada, this year seems less like a year for celebration and reflection and more like a year of worry.

The concerns and worries that overhang the markets are both economic and political, coming from both inside and outside of Canada.

- Ultra-low interest rates seem to be coming to an end, with Canadian consumers seemingly unprepared for the higher interest rates that will follow. It has been a long eight years of unorthodox monetary policy in Canada and around the world, with a narrow focus of stimulating economic growth overriding all other concerns. The unwinding is sure to present some uncomfortable moments.
- Commodity prices remain weak, including crude oil which remains at approximately one-half of its August 2014 price. This continuing price weakness is detrimental to Canada and other countries whose economies are heavily dependent on those resources.
- Housing prices in Canada are seemingly at extremely overvalued levels when viewed against historical average price to income ratios. In addition, certain metropolitan markets in Canada have major housing affordability problems.
- Exports represent a significant portion of the Canadian economy, but significant pressure is being applied by the United States. The North American Free Trade Agreement is being renegotiated and protective tariffs on softwood lumber have been imposed as the United States becomes increasingly suspicious of trade and trade agreements.
- The Kinder Morgan pipeline expansion in British Columbia, which is intended to bring more of our resources to Asian markets, has found opposition in the new British Columbia government and with environmental groups, irrespective of the economic benefits that it would bring.
- Geopolitical tensions are rising in the Middle East and on the Korean peninsula and the United States is led by an unpredictable and unconventional leader with a penchant for controversial Twitter messages.

There is certainly a fair number of issues to worry about, irrespective of how one is invested. If you are concerned about Canadian financial markets, some combination of these issues could develop into a significant problem and lead to lower stock and bond markets for Canada and the world in general.

However, the problem with focusing too much on today's problems is that while some may have significant long-lasting effects, most resolve themselves over time with little financial impact. If one constantly reacts to potential problems, the portfolio adjustments in aggregate will likely not be positive. Only a small handful of potential problems ultimately turn into real problems that impact financial markets significantly. The so-called Worry List that investors faced in the United States since the financial crisis some eight years ago shows just that. The uncomfortable choice to remain invested even in periods of uncertainty is generally the most profitable over the long term.

So, as you celebrate Canada's 150th anniversary, do not worry too much about financial markets and your portfolio. Canada has faced much worse financial and geopolitical challenges before and prospered. A portfolio of quality bonds and dividend-growing companies will prove to be very resilient in these challenging times for Canada.

Portfolio Update- Healthcare Sector

James McInnis, B.Comm (Honours), CFA

We recently travelled to New York City to participate in the Jefferies Health Care Conference, which allowed us to meet with some of the companies in which we have invested and other healthcare companies, as well as key industry participants, including doctors and politicians. This sector remains a core element of our client portfolios, which we achieve through investing in companies that are listed in the United States. Historically, this sector has offered favourable risk-adjusted returns as revenues have been less correlated with the economy in general because demand for healthcare less sensitive to changes in price or income and because healthcare is generally a non-discretionary expenditure. During four of the past five times that the S&P 500 Index has corrected by 10 percent or more, the healthcare sector declined by less than the index.

Performance of Healthcare Sector During Market Corrections:

Bear Market	S&P 500	IXJ	Difference
November 2015 to February 2016	-13.3%	-14.2%	-0.9%
May 2015 to August 2015	-12.4%	-10.0%	+2.4%
April 2011 to October 2011	-19.4%	-13.6%	+5.8%
April 2010 to July 2010	-16.0%	-10.9%	+5.1%
October 2007 to March 2009	-56.8%	-41.8%	+15.0%

IXJ: The iShares Global Healthcare ETF is used as a proxy for the Healthcare Sector.

Source: Bloomberg LP

The fundamentals of the healthcare sector remain attractive, driven by the twin forces of technology and demographics, which more than offset the risks of pricing pressure and political actions. The aging population in the United States provide a favourable demographic trend, as ten thousand baby boomers are expected to turn 65 each day until 2030. This trend is complimented by the surge of the middle class in India, China and other emerging markets accessing healthcare. Beyond demographics, improvements in technology such as advances in genomics, minimally-invasive technology and robotics are leading to new medicines, earlier detection and improved health outcomes. These advances are often rewarded with higher prices for these products and services.

Obamacare has been a tailwind to the healthcare sector, as millions of uninsured Americans gained access to healthcare benefits, boosting hospital visits and increasing consumption of the goods and services offered by healthcare providers. Any changes to Obamacare that cause less people to be insured or to lower the level of coverage for those who are insured will have the opposite effect. As bottom-up, fundamental analysts, we still have to be mindful of the political situation in Washington because of the potential to adversely impact the pricing of and demand for healthcare products and services.

In our opinion, if there is a cutback in healthcare coverage, it should raise the possibility that tax reform is passed in part by redirecting the savings from healthcare towards tax reductions. In turn, those tax reductions should lead to higher levels of disposable income. The market already appears to be moving higher on this expectation, but it could be premature in our view because the odds of replacing the Patient Protection and Affordable Care Act ('Obamacare') appear low.

Bryan Hanson
Executive Vice President, Medtronic Inc.
President, Minimally Invasive Therapies Group

During the conference, we had the opportunity to speak with Bryan Hanson. The Minimally Invasive Therapies Group comprises about one-third of Medtronic's revenue. He explained how innovation in therapies is helping to grow their revenues, citing the upcoming launch of some thirty new robotics products. These products will help to cultivate a shift from open surgeries, which make up 60 percent of surgeries currently, towards minimally invasive surgeries, resulting in better outcomes for patients. These new products are expected to generate material revenue for Medtronic in the 2019 fiscal year.

Alex Gorsky
Chairman and CEO, Johnson & Johnson

After conversing with Alex Gorsky, we were left feeling confident in their business plan. At JNJ, technology and big data are being harnessed to improve the medical outcomes for patients. As an example of this approach, they seek to identify conditions earlier with the help of biomarkers, to improve outcomes in areas such as oncology. In their pharmaceuticals division, they have eleven drugs in the pipeline that could be $1 billion revenue generators by 2021.

We remain optimistic that few changes will be made to Obamacare. The Republican aim is to repeal and replace it with their own American Health Care Act, but we view this as having a low probability of happening. Not all Republicans support this aim and there is no support for it from the Democrats. This is important because even though the Republicans could force such a legislative change by using the budget reconciliation process, they recognize that the absence of bipartisan support will likely mean that the Democrats will litigate those changes as soon as they return to power. The Republicans will be using the reconciliation process to make changes to the tax code later this year, so the fate of the American Health Care Act will soon become apparent.

The Conference was attended by over four hundred companies, but few attracted our attention as we stay true to our disciplined investment philosophy of focusing on firms that have a proven track record of earnings and dividend growth and are leaders in their industry. These leaders are protected by economic moats- patents, brand recognition, distribution networks, economies of scale and high switching costs- that allow them to generate attractive returns on capital. Dividend growth remains a remains a core focus of our healthcare holdings, even following a flurry of industry consolidation in which some of the companies in which we have invested have made large acquisitions. We remain true to our investment philosophy that has served our clients well for over ten years, owning high-quality, blue chip companies that pay a dividend and increase those dividends annually.

The Chartered Financial Analyst Designation

Cory Lang, B.Comm (Honours), CPA, CA

The first Saturday in June was probably an unremarkable day for the average investor. With the summer months just around the corner, many people were likely doing every day activities such as working in the yard or planning summer vacations. This was not the case for approximately 182,000 global candidates in the Chartered Financial Analyst® (CFA) Program. The first Saturday in June was the day they sat and wrote an intensive 6-hour exam, and vacations were not on their minds.

So, what is the CFA program and what would induce someone to go through the process of writing three separate six hour exams and study close to 1000 hours to earn the CFA Charter? The CFA Program is widely recognized as the highest distinction in the investment management industry and is globally renowned. Candidates who successfully complete the three exams and have the required work experience to earn the charter have in-depth knowledge of financial and capital markets. In addition, CFA charter holders have strong ethical guidelines and must demonstrate fiduciary responsibilities to clients.

The CFA curriculum includes a broad variety of topics related to investment management. Not only do topics such as economics or equity and fixed income investments get tested on all levels of the CFA exams, there is a strong emphasis on practical application. The subject areas are demanding and can be quite complex. The program provides charter holders with excellent foundational knowledge of financial markets and ensures that it can be effectively applied in real-world scenarios when managing portfolios.

BCV Asset Management believes strongly in the CFA charter. Five members of the investment management team hold the CFA designation and one is a candidate in the program. This provides assurance to clients that their investments are being managed in a professional manner. It also gives clients peace of mind knowing that there is a fiduciary responsibility to always put the client's interest first and foremost when making investment decisions.

According to the CFA Institute, 263 candidates sat for the first CFA exam in June 1963. Thousands of individuals have written the exams since then, typically on the first Saturday of June. So, next June, when you are outside cutting the grass and enjoying the sun, think about the challenging work that 180,000 CFA program candidates are going through. And then realize your investment portfolio is being managed by individuals who have gone through the same process and are diligently striving to achieve positive returns on your portfolio. And then go ahead and plan that next vacation.

Recent Dividend Increases

Canada

Second Quarter 2017
BCE Inc.: 71.75 cents (68.25 cents)
Bank of Nova Scotia: 76 cents (74 cents)
Brookfield Property Partners LP: 30 cents (29.5 cents)*
Canadian Imperial Bank of Commerce: 127 cents (124 cents)
Canadian Natural Resources Ltd.: 27.5 cents (25 cents)
Power Financial Corporation: 41.25 cents (39.25 cents)
Royal Bank of Canada: 87 cents (83 cents)
Sun Life Financial Inc.: 43.5 cents (42 cents)
Toronto-Dominion Bank: 60 cents (55 cents)
TransCanada Corporation: 62.5 cents (56.5 cents)

Third Quarter 2017 (Pending)
National Bank of Canada: 58 cents (56 cents)
TELUS Corporation: 49.25 cents (48 cents)

Dividend Increases reported in domestic currency of common shares, except where noted.
* Dividend paid in USD.
Source: Bloomberg LP

United States

Second Quarter 2017
Apple Inc.: 63 cents (57 cents)
International Business Machines Corporation: 150 cents (140 cents)
Johnson & Johnson: 84 cents (80 cents)
JPMorgan Chase & Company: 50 cents (48 cents)
PepsiCo Inc.: 80.5 cents (75.25 cents)
Qualcomm Inc.: 57 cents (53 cents)
UnitedHealth Group Inc.: 75 cents (62.5 cents)

Third Quarter 2017 (Pending)
FedEx Corporation: 50 cents (40 cents)