



BCV Asset Management Inc.

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No Capital Markets Gain Without Some Downside Pain

Tony Demarin, CFA, CIM, FCSI

President & Chief Investment Officer

In cognitive psychology and decision theory, loss aversion refers to people's tendency to prefer avoiding losses to that of acquiring the equivalent gains - it feels better to avoid the loss of a hundred dollars than to gain the same hundred dollars. In other words, the negative feelings coming from losses are much stronger than the positive ones coming from gains. More simply, we hate losing, and that creates loss aversion.

This principle is very prominent in the domain of capital markets and economics. Nobody likes pain and we go out of our way to avoid it. In managing investment portfolios for the long term, there is rarely an investment gain without some short-term, downside pain. We must learn to live with it or simply exit the capital markets altogether. In that case, a guaranteed investment certificate or term deposit at a qualified financial institution could be an option or an alternative to a capital market instrument. Other than a potential loss of purchasing power, there will be little downside to this approach, but there would be little growth in income or capital appreciation either.

Selling a security is a more difficult undertaking than buying one and we must remain disciplined in our selling decision. At BCV Asset Management, we sell stocks once they become clearly overvalued, if we determine our initial investment thesis to purchase the security has played out (or not come to fruition), or if we have found a more attractive investment opportunity on the risk to reward spectrum. We can make two mistakes in investing: selling a stock at a significant loss or selling a stock much too early thereby forgoing potential future gains.

Investors have been known to throw in the towel on a losing stock, only to see it recover shortly thereafter. Investors are not always patient with a security that they have purchased, and they will let their emotions overrule rational decision making. It is difficult to stay the course when Mr. Market is telling you to give up and sell.

No investment will be perfect and climb higher every single day. In fact, most stocks will drop significantly at some point. We must remember to continue to hold a stock if the original thesis with which we bought the stock holds. To be a successful investor, you need capacity to suffer. If one looks back at select long-term winners such as Apple Inc. or any of the large Canadian financial institutions, they have all dropped in stock price by close to 50 percent at one point, yet today they are all trading close to their all-time highs.

As investors, we must trust the research that we undertake when making an investment decision. We must be patient and trust the investment process, while waiting for value to rise to the surface. If we do so, we will avoid being ruled by our emotions and selling at or near the bottom. We cannot

succumb to short-term thinking and sell a security just because other securities are rising or because it feels bad to see it on an investment statement.

It all comes back to our thinking bias and how it influences our behavior. Our strongest cognitive bias is loss aversion. Attempting to avoid this pain will lead to bad portfolio decision making and timing and, consequently, lower long-term returns.

*"We ordinarily make no attempt to buy equities for anticipated favorable stock price behavior in the short term. In fact, if their business experience continues to satisfy us, we welcome lower market prices of stocks we own as an opportunity to acquire even more of a good thing at a better price."
(Warren Buffett, 1977 Berkshire Hathaway Letter to Shareholders)*

The World is Becoming a More Interconnected Place

Chris Richard, CFA

Portfolio Manager

The world is becoming a more interconnected place. With the increase in connective technologies and enhanced logistical capabilities, we can work anywhere, with anyone, and do all of this with relative ease. This interconnectedness allows the opportunity for companies to sell their goods and services around the globe, while being domiciled domestically in Canada or the United States. Like global companies, clients are keen on having global exposure in their portfolios; however, you do not always need to look around the globe to foreign markets to get your global exposure.

The companies that we invest in are large, very large. The average market value (or market capitalization) of the companies in the BCV United States Equity Model Portfolio is over 200 billion dollars. To attain this size, many conduct business around the world. If we look at where revenues are generated, we see that these are companies in the international market who happen to be headquartered in the United States.

Companies in the BCV Canadian Equity Model Portfolio generate 55 percent of their revenue from Canada, 27 percent from the United States and 18 percent internationally. Brookfield Asset Management Inc. and Magna International Inc., for example, derive over 50 percent of their revenue from countries other than Canada and the United States. For companies in the BCV United States Equity Model Portfolio, almost 35 percent of the revenue comes from outside of Canada and the United States. International revenue accounts for over 50 percent of the total for companies such as Apple Inc. and VISA Inc. These are truly global companies.

As the world becomes more connected, stock markets in developed countries become more highly correlated with the United States. This higher correlation simply means that these markets will tend to move in the same direction at the same time. Looking over the past 10 years, we see that the United States has been very closely tied to other equity markets around the globe. The markets in the United Kingdom, Germany and Japan each exhibit high correlations with the United States markets. One explanation is that enhanced global trade flows benefit both the United States and its trading partners. The United States is the largest economic region of the world. With a world-wide Gross Domestic Product of some 75 trillion dollars in 2016, the United States comprises one-quarter of that amount. When the United States does well, so does the rest of the world and vice versa.

What about emerging markets? They are less correlated to the United States market, so there could be diversification benefits, but it comes at a cost. Investing in emerging markets generally involves investing in companies of a smaller size and corresponding higher risk. The constant movement in foreign exchange can be difficult to hedge and in some less developed markets there are liquidity and political risks that do not fit with BCV's investment philosophy.

China is no longer an emerging market but is not far from it. It has a low correlation with the United States market; however, the average risk is quite high relative to the traditional developed markets. A proxy that we use to evaluate risk is the Chicago Board Options Exchange Volatility Index, or the VIX as its commonly known. Over the past 10 years, the VIX in the United States has averaged 14.6. In China, it's 25. The relative volatility of China versus the United States is a risk that we don't feel is necessary to take in order to generate returns for clients. Sometimes looking out your own backdoor, you can find the foreign exposure you are looking for without the exposure to the global risk factors.

Dividend Investing in Down Markets

Michelle Smith, CFA

Portfolio Manager

On March 9th 2009, global equity markets stopped their decline following the worst recession on record since the Great Depression. Since then, the S&P/TSX Composite Index has gained over 185 percent and the S&P 500 Index has gained more than 300 percent, producing the second-longest bull market in history. However, this period has not been without volatility, driven by events such as oil prices declining in 2014 and 2015 and the NASDAQ Composite Index hitting record highs in 2018. At BCV Asset Management, our focus is not on market fluctuations but rather on the fundamentals of the companies in which we invest. If these companies are fundamentally solid, even if the market is not, they can create long-term value for shareholders.

In the long-run, the share price reflects the value of a company. However, in the short term, the stock market can be volatile and irrational. The direction of the market is driven by share prices, currency fluctuations, changing interest rates, and a myriad of other factors which in turn often drive macro events and investor sentiment. In today's age of instant information and high frequency trading, these factors are exacerbated and can distort the market. Therefore, current share price may not reflect the value of a company. Current share price tells us nothing about the underlying growth of a business, it only tells us what active buyers and sellers are willing to trade at. We believe a company's business model, competitive advantages, management team, financial standing, and its ability to pay and grow a dividend tells investors a lot more about the health of a company than share price alone.

At BCV, our focus on dividend paying and growing companies has delivered a positive track record since our inception through changing market cycles. Dividend-focused investing performs in both up and down markets, but it can significantly outperform in declining markets. Companies that pay and look to grow their dividend are generally characterized as mature, well-established entities that are leaders in their industry and have a solid financial position. The companies with these characteristics are generally more stable during times of market turmoil than younger, growth-focused or cyclical-type companies that do not pay a dividend. For investors, dividend-focused investing tends to create a stable and rising income stream, regardless of the market direction. In a rising market, dividends

can accelerate wealth accumulation through reinvestment while in a declining market, the dividend income acts to protect capital by providing a cushion.

At BCV, we look at short-term volatile and irrational markets as opportunities for the long-term investment process. When the market falls, not only can an investor ride out a declining market better with solid, dividend-paying companies, but that same investor can use dividend income to buy even more of these companies at discounted prices.

Recent Dividend Increases



Canada

First Quarter 2018:

Brookfield Asset Management Inc.: 15 cents (14 cents)*
Bank of Montreal: 93 cents (90 cents)
Brookfield Property Partners LP: 31.5 cents (29.5 cents)*
Canadian National Railway Company: 45.5 cents (41.25 cents)
Canadian Western Bank: 25 cents (24 cents)
Enbridge Inc.: 67.1 cents (61 cents)
Intact Financial Corporation: 70 cents (64 cents)
Magna International Inc.: 33 cents (27.5 cents)*
Manulife Financial Corporation: 22 cents (20.5 cents)
National Bank of Canada: 60 cents (58 cents)
Suncor Energy Inc.: 36 cents (32 cents)
TELUS Corporation: 50.5 cents (49.25 cents)

Second Quarter 2018 (Pending):

BCE Inc.: 75.5 cents (71.75 cents)
Bank of Nova Scotia: 82 cents (79 cents)
Canadian Imperial Bank of Commerce: 133 cents (130 cents)
Canadian Natural Resources Ltd.: 33.5 cents (27.5 cents)
Power Financial Corporation: 43.3 cents (41.25 cents)
Stantec Inc.: 13.75 cents (12.5 cents)
TransCanada Corporation: 69 cents (62.5 cents)

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

* Dividend paid in USD.

Source: Bloomberg LP



United States

First Quarter 2018:

AT&T Inc.: 50 cents (49 cents)
Analog Devices Inc.: 48 cents (45 cents)
Home Depot Inc.: 103 cents (89 cents)
Johnson Controls International plc: 26 cents (25 cents)
VISA Inc.: 21 cents (19.5 cents)

Second Quarter 2018 (Pending):

None

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