BCV Asset Management Inc.

The Blue Chip Report
April 2019

Growing Dividends

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Given the stock market's disappointing finish to 2018, it was hard to be optimistic about the state of the global equity markets in January 2019. Investors were reluctant to hear that the downturn provided an opportunity to buy well run, successful businesses at cheaper prices. Through all this negativity, there was a bright side to 2018, and it came in the form of growing dividend payments to client investment portfolios. This silver lining was more like gold.

BCV Asset Management Inc. actively manages forty-three equity positions for client investment portfolios. Most clients own between twenty-five to forty of these companies, and in some cases, all of them. Across these forty-three actively managed positions, ALL pay a dividend. In 2018, forty-two of the forty-three companies raised their dividend. The one United States stock that did not was involved in a major acquisition, so their cash was being used for that purpose. We expect ALL of our selected positions to raise their dividend annually. Over the past five years ended December 31st, 2018 the Canadian stocks held in our Canadian Equity Model Portfolio raised their dividend annually by a compounded average of 10.2%. The United States stocks held in our United Stares Equity Model Portfolio raised their dividend annually by a compounded average of 11.5%. These increases also came while investors were doing other important things in their lives like working or pursuing leisure activities - no extra effort was required. With inflation running at approximately two percent per annum, these dividend increases are meaningful to client portfolios from a cashflow perspective. We also strongly believe that "as goes the dividend, so goes the share price". This means that shares prices, over time, will ultimately rise in tandem with dividend increases, just not in a perfect linear pattern.

We are only three months into 2019, and so far, fourteen of the forty-three companies have increased their dividend again, with six more pending into Q2. In our professional opinion, when a company raises its dividend, it is giving a clear signal to shareholders that it has confidence in its business and its ability to increase profits. Higher profits generally lead to higher dividends, which generally lead to higher stock prices. Therefore, investing in companies that raise their dividend regularly is a successful way to grow portfolio wealth over time. The additional benefit to this strategy comes into play when an investor needs income from their portfolio for consumption purposes. The stocks in the portfolio not only pay cash to the investors on a quarterly basis, but the rising dividend allows for investor purchasing power to keep up with the rising cost of living, beating the coupons of their fixed income security counterparts.

Over one's lifetime of investing, market participants will not cease to worry about the state of the capital markets. Each year brings with it a new set of concerns and new reasons to think twice about saving or putting capital to work in the market. In our opinion, the best course of action is to ignore the daily noise and to continue to be a patient, long-term investor. Our clients can be comforted by the fact that they own a diversified portfolio of high-quality dividend paying and dividend growing companies. We continue to show optimism towards these companies, and we continue to devote time and resources to our investment research on new investment ideas that could potentially be added to client portfolios in 2019.

Investing In 5G

Michelle Smith, CFA
Portfolio Manager

The first industrial revolution radically changed the world. The way people lived and how businesses operated shifted from manual labour to mechanical production. The revolution of steam power and mechanized processes gave way to improved efficiency and productivity; forever altering social, cultural and economic conditions. Greater innovation and inventions progressed through the decades, yielding two more industrial revolutions – the age of science and mass production, and the digital revolution. Today, we are at the forefront of the fourth industrial revolution with 5G technology. 5G is anticipated to bring an evolution and revolution of mobile technology that will have a profound impact on life and business as we currently know it.

What is 5G? 5G means “fifth generation”; a new and improved level of wireless technology. It signifies the next major upgrade to wireless network standards. It is designed to deliver unimaginable speed (100 times faster than 4G, the current generation), dramatically increased reliability, and a significant reduction in latency (responsiveness). These upgrades will allow a mass number of devices to connect on the same network simultaneously without a degradation in service. Previous generations of wireless technology have focused on connecting people – voice, text, video, and social media. This generation will take technology to the next level by connecting *things*; opening a whole new realm of possibilities. Smart cities and homes, industrial automation, self-driving cars, remote surgeries, drone deliveries, advancements in artificial intelligence and so on are real life examples that are no longer fiction from decades ago. The advancement of 5G will create a ripple of developments that will alter society and business.

From an investment perspective, 5G and its emerging technology will disrupt every area of business as it currently stands today. It will eventually affect every company, regardless of industry. At BCV, we do not invest in fads. We invest in sustainable trends that transition business operations from status quo to competitive strategy. We are capitalizing on the disruption of 5G technology through exposure to various end markets by way of, but not limited to, the following companies (in alphabetical order):

Analog Devices, Inc. – ADI’s technologies are used to convert real-phenomena, such as light, sound, temperature, motion, and pressure into electrical signals. Such technology is critical as the world becomes increasingly connected, with the addition of sensors and connected devices that require signal processing, conversion of signals, and power management. Quite simply, the internet of things cannot converse without the technology of ADI.

Apple Inc. – New phones will be critical for 5G compatibility and usage. With a growing base of over 900 million users and an expected upgrade cycle in 2020, iPhone sales stand to benefit. Additionally, Apple is at the leading edge in augmented reality, which will require the fast and reliable connection that only 5G can provide. Augmented reality will deliver new applications, games, and experiences that will aid in growing Apple’s Services business. Through its Wearables, Apple has improved the ability to track and manage wellness. The company is expected to continue to build out health-monitoring features through the advent of 5G. Apple’s CEO, Tim Cook describes the company’s healthcare advances as “its greatest contribution to human kind”.

AT&T Inc. – This April, AT&T will launch its United States 5G service in Chicago and Minneapolis. By 2020, it’s 5G network is expected to cover nearly 200 million people, or 60% of the population in the United States. Its coverage will allow AT&T to grow beyond its current base of 150 million subscribers. However, the true opportunity lies within its business customers. Businesses are leading the 5G revolution – automated factories, healthcare, etc. – that will rely on the low latency and high quality of 5G to drive innovation. AT&T anticipates business usage will be the first source of revenue growth from 5G.

Microsoft Corporation – Applications that are everywhere and always on will be the fabric of 5G. "5G will become the air we breathe", says Rick Lievano, Microsoft Worldwide Director of Industry Technology Strategy. The pervasiveness of 5G and its devices that will transmit a vast amount of data will require more data storage in the devices themselves and data centres. Azure, Microsoft's cloud computing service, stands to benefit from the enormous expansion of connected devices. Some industry analysts estimate there will be nearly 21 billion internet connected devices by 2020 (more than three times that of 2016).

We are excited to see what the 5G world will have to offer. While the technology companies discussed above will be direct beneficiaries of 5G, there are numerous applications in other sectors such as healthcare that will also see value. We feel our investment models and client portfolios are poised to benefit from the fourth industrial revolution and the significant changes that it will bring.

Negative Yielding Bonds

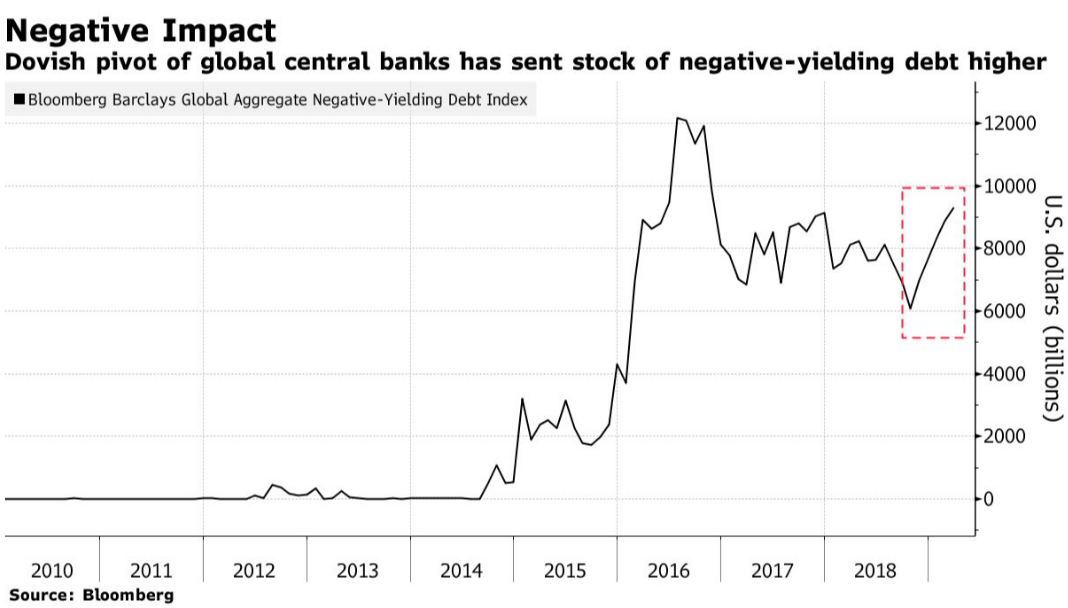
Chris Richard, CFA

Portfolio Manager

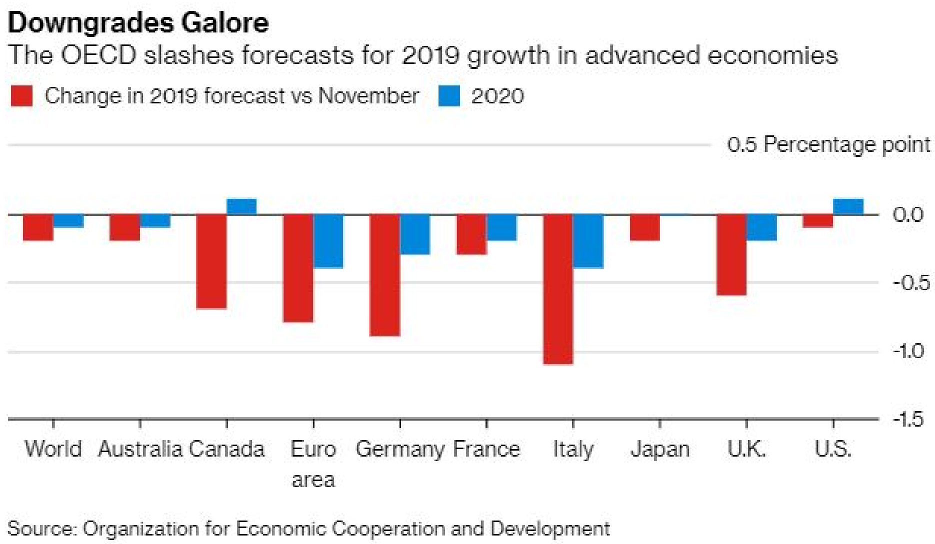
What is a negative yielding bond? It is a bond that if purchased and held to maturity, will result in having less money than your original investment. The question is, why would anyone invest in this type of security? That's a good question.

These bonds are issued by countries that have growth profiles leading fixed income investors to believe that economic growth will be very low in the future. Those investing in these bonds are typically institutions who have investment restrictions of buying government bonds regardless of the returns. Central banks, pension funds and insurance companies are some examples of institutions who purchase these risk-free assets.

Having said that, you might think that the market for securities with a negative yield is relatively small. That is where you may be surprised. Since the financial crisis, there has been a steady increase in the total value of bonds issued with negative returns. As of March 2019, the market value of bonds that have a yield to maturity less than zero was over $9 trillion, as shown in the chart below.



Reduced growth expectations in several large economies is putting downward pressure on interest rates. This comes at a time when uncertainty over Brexit (Britain's separation from the European Union) has taken centre stage and an ongoing trade dispute between the United States and China threatens economic growth. These two issues are presenting conditions that may not favor the global growth that financial markets have been expecting.



Modern economies function best when inflation is low and stable. When these conditions exist, banks can pay interest rates on deposits at a lower rate and lend money out at a higher rate. This process becomes distorted with negative interest rates. National Bank CEO, Louis Vachon was once asked how the economy would work in Canada if we were to ever have negative interest rates. He responded saying that asking a banker how he would like negative interest rates is like asking a turkey how it likes Thanksgiving.

At BCV, we don't invest in government bonds because the income received is not enough of a return to warrant an investment. We focus on investment grade or near investment grade bond issues that have a return above the government rate. We perform the same research and analysis on bonds as we do for equity securities, and in doing so, ask two fundamental questions: Will we receive a suitable return ON our investment and will we receive a return OF our investment? We focus on items such as collateral, quality of the corporate management team, balance sheet strength and cash flows of the company before we make an investment. By using a disciplined approach to fixed income security (bond) selection and avoiding negative yields, we are confident that we can continue generating reasonable returns for our clients with an acceptable level of risk.

Recent Dividend Increases

Canada

First Quarter 2019:
Bank of Montreal: 100 cents (96 cents)
Brookfield Asset Management Inc.: 16 cents (15 cents)*
Brookfield Property Partners LP: 33 cents (31.5 cents)*
Canadian National Railway Company: 53.75 cents (45.5 cents)
Canadian Western Bank: 27 cents (26 cents)
Enbridge Inc.: 73.8 cents (67.1 cents)
Intact Financial Corporation: 76 cents (70 cents)
National Bank of Canada: 65 cents (62 cents)
Suncor Energy Inc.: 42 cents (36 cents)
TELUS Corporation: 54.5 cents (52.5 cents)

Second Quarter 2019 (Pending):
Bank of Nova Scotia: 87 cents (85 cents)
Canadian Imperial Bank of Commerce: 140 cents (136 cents)
Canadian Natural Resources Ltd.: 37.5 cents (33.5 cents)
Power Financial Corporation: 45.55 cents (43.3 cents)
Stantec Inc.: 14.5 cents (13.75 cents)
TransCanada Corporation: 75 cents (69 cents)

United States

First Quarter 2019:
Analog Devices Inc.: 54 cents (48 cents)
AT&T Inc.: 51 cents (50 cents)
Home Depot Inc.: 136 cents (103 cents)
Wells Fargo & Company: 45 cents (43 cents)

Second Quarter 2019 (Pending):
None

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