BCV Asset Management Inc.

The Blue Chip Report
January 2020

A 'BIG YEAR'
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It has been a big year in financial markets. I have recently learned that the term 'BIG YEAR' refers to an informal annual competition among serious birdwatchers (also known as 'birders'). According to the American Birding Association® the goal for these birders attempting a 'BIG YEAR' is to observe by sight or sound as many different species of birds in a calendar year. There is also a movie titled "The Big Year" about the same, which is quite humorous. How big of a year has it been for financial markets? Well, 2019 was quite a 'BIG YEAR'. The S&P/TSX Composite Index (Total Return), which is comprised of a broad collection of Canadian public companies, rose 22.88%. The S&P 500 Index (Total Return), which contains the largest five hundred public companies in the United States rose 31.49%. The Wilshire World Index (Total Return) was up 31.02%. So, it was a very positive year for equity markets in general. The more conservative fixed income asset class also saw solid returns. The Universe Bond Index, which is comprised of a broad collection of Canadian bonds, returned 6.88%, and the United States bond market had similar positive returns.

These returns are opposite to what many investors and pundits expected twelve months ago as 2018 came to a close. At that time the United States economy was perceived to be running a little too hot and the Federal Reserve, the central bank in the United States whose actions influence global capital flows, was raising short-term interest rates. The 'yield curve' shows the interest rates of short-dated to longer dated United States Treasury Bonds. For a brief period of time in 2019, the short-dated interest rates were higher than the long-dated interest rates causing the yield curve to invert. Historical examples of yield curve inversion and its correlation with the economic recessions that followed shortly thereafter in 1990, 2001, and 2007 were cited with negative investment consequences. In addition, the extraordinary trade friction between the United States and China was chilling capital investment and world trade flows, and combined, it all seemed to doom global equity market expectations. But instead, we experienced just the opposite.

With the big year that was 2019, what returns should investors anticipate as we enter 2020? First, we should err on the side of caution in making predictions. While the common and natural feeling that last years' returns seem 'too good to last', we are unlikely to be on the precipice of a dramatic decline in equity or bond markets. Although anything can happen in any given year, and equity markets could drop substantially in 2020, last years' strong returns do not meaningfully increase the probability of a challenging and difficult 2020 for equity or bond returns in the North American capital markets.

We can be more confident in predicting over a longer time horizon as we enter the next decade. In looking forward over that time span, the news is much more problematic for future returns. It is extremely likely that both equity and bond returns will be challenged to approximate the returns experienced in the previous decade. The main reason would be starting equity valuations, which are much higher than the ten years prior. We have also just experienced a decade of major Central Banks experimenting with ultra-loose monetary policy, post the financial crisis of 2008. These initial 'short-term' policies were specifically designed to suppress interest rates and raise asset prices to create the 'wealth effect' and support GDP growth. They have accomplished both. We now have low starting bond yields (and after inflation, negative real yields) and full equity market valuations also benefiting from an extended business cycle. The broad investment landscape will have many pitfalls, as we expect the environment to be challenging. As always, we remain fixed to our philosophy of identifying investments with a low probability of permanent loss of capital, companies with limited downside and with solid dividend income (or interest income for bonds). We will not sacrifice capturing dividend income and growth in these businesses even though the next decade will have bouts of volatility and likely modest equity returns.

Among birders, John Weigel of Australia just set the record in 2019 for a 'BIG YEAR'. He mostly photographed 841 different bird species in Canada and the United States. That is a 'BIG YEAR'. So, while 2019 has been a big year for some 'birders' and financial markets alike, when compounding positive long-term returns, investing equally needs the consideration of how to avoid the worst of the 'bad years'. Those times will require patience and discipline as investors manage through both big and bad years to come.

Securities Selection - Capital Markets versus Business Fundamentals

Cory Lang, CFA, CPA, CA

Portfolio Manager

With the turn of the calendar year and the end of a decade, it's very natural for investors to look back and see how the stock market performed. Whether it's the Dow Jones Industrial Average, the S&P 500 Index or the S&P/TSX Composite Index, these benchmarks make it easy to see how "stocks" performed over a period of time. While it's convenient, from a business owner's perspective it may be very irrelevant.

When we talk about the stock market, we're simply talking about how a group of stocks has performed. While this can serve as a rough guide to the performance of the economy, it tells us very little about how individual businesses are doing. Moreover, stock prices can be subjected to emotional and cognitive errors that don't align with underlying business results. This is particularly true when you consider that speculators are trading stocks alongside investors, such as BCV.

Certain events can have an impact on the broader stock market averages but not necessarily to individual businesses. Recent geopolitical events involving the United States and Iran put a damper on the record highs that the stock market has been hitting. But if we look at our portfolios from a business perspective, the picture doesn't look as bad. The banks will continue accepting deposits, making loans, and providing mortgages; regardless of global affairs. Medical device makers such as Becton Dickinson and Medtronic will continue providing their cutting-edge technology to doctors and hospitals to help treat patients. With our focus on large, mature businesses, we can rest assured that some of the noise around headlines isn't impacting the companies we invest in as much as we may think.

At BCV we often speak about the fundamentals of a business. Those fundamentals matter far more than what is happening with the overall stock market. For instance, sales, or the top line of the statement of profit and loss, is very important to a business' continued success. When sales are flat or declining, we must question what management can and may do to change the situation. If sales are growing, is it due to increases in volumes or prices or is the company responding to more aggressive practices by their competition? These are just some of the many questions around a single line on a company's reported financials.

Aside from financial concerns, businesses are also concerned with human resources, technology, supply chains, regulations, marketing and a host of other factors. It's the company's ability to manage these day-to-day and over time that determine how successful a business will be and whether that will translate into a higher net worth. Stock prices are simply a way to keep score, and when they deviate from that underlying worth, that creates opportunities for long-term investors like BCV. It's our job to seek out great businesses that we can include in your portfolio and take advantage of those opportunities.

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)

Second Quarter 2019:
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)
Open Text Corporation: 17.46 cents (15.18 cents)*
Power Financial Corporation: 45.55 cents (43.3 cents)
Royal Bank of Canada: 102 cents (98 cents)
Sun Life Financial Inc.: 52.5 cents (50 cents)
Stantec Inc.: 14.5 cents (13.75 cents)
Toronto-Dominion Bank: 74 cents (67 cents)
TransCanada Corporation: 75 cents (69 cents)

Third Quarter 2019:
Algonquin Power & Utilities Corporation: 14.10 cents (12.82 cents)*
Bank of Montreal: 103 cents (100 cents)
Canadian Western Bank: 28 cents (27 cents)
National Bank of Canada: 68 cents (65 cents)

Fourth Quarter 2019:
Canadian Imperial Bank of Commerce: 144 cents (140 cents)
Royal Bank of Canada: 105 cents (102 cents)
Sun Life Financial Inc.: 55 cents (52.5 cents)

First Quarter 2020 (Pending):
National Bank of Canada: 71 cents (68 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:
Apple Inc.: 77 cents (73 cents)
International Business Machines Corporation: 162 cents (157 cents)
Johnson & Johnson: 95 cents (90 cents)
UnitedHealth Group Inc.: 108 cents (90 cents)

Third Quarter 2019:
Bank of America Corporation: 15 cents (12 cents)
U.S. Bancorp: 37 cents (30 cents)
Wells Fargo & Company: 43 cents (39 cents)

Fourth Quarter 2019:
Becton Dickenson & Company: 79 cents (77 cents)
Honeywell International Inc.: 90 cents (82 cents)
JPMorgan Chase & Company: 90 cents (80 cents)
Microsoft Corporation: 51 cents (46 cents)
U.S. Bancorp: 42 cents (37 cents)

First Quarter 2020 (Pending):
None announced

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

* Dividend paid in USD.
Source: Bloomberg LP