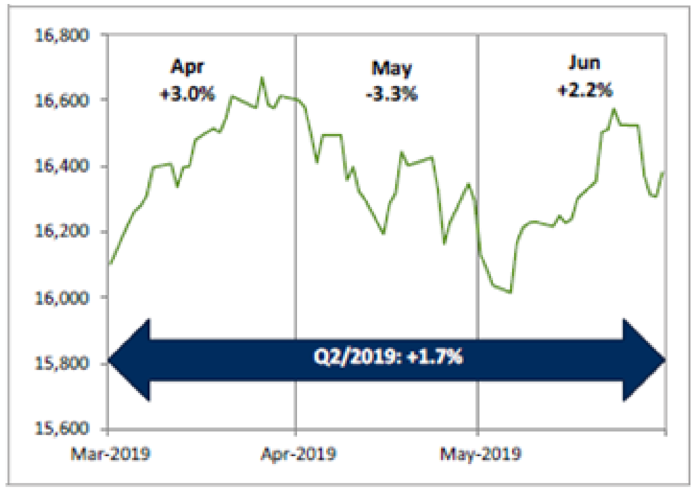
The Dividend Value Discipline™
2nd Quarter 2019 Review

Quarterly Commentary

The second quarter saw a modest upswing for the equity markets compared to the blazing start seen through the first quarter. Expectations that the US Federal Reserve will start lowering interest rates to help support the economy has been a significant contributor to the market performance. The Canadian S&P/TSX added 1.7% for Q2, while the US S&P500 was up 1.66% in Canadian dollars.

S&P/TSX Q2 Monthly Price Returns



Source: Bloomberg, Raymond James Ltd. As at June 30, 2019.

The lower interest rate outlook has also revived the bond market with the Canadian Universe Total Bond index rallying +2.5% in Q2. The combination of good bond returns and exceptional stock returns since the beginning of the year has been a positive for balanced portfolios after the carnage in 2018.

Global PMIs Bottoming Process in the Works?

Global PMIs	Current	1 Month Ago	3 Months Ago	6 Months Ago	1 Year Ago
Global	49.4	49.8	50.5	51.4	52.9
U.S.	51.7	52.1	55.3	54.3	60.0
Canada	49.2	49.1	50.5	53.6	57.1
Japan	49.3	49.8	49.2	52.6	53.0
U.K.	48.0	49.4	55.1	54.3	54.0
Euro zone	47.6	47.7	47.5	51.4	54.9
Germany	45.0	44.3	44.1	51.5	55.9
France	51.9	50.6	49.7	49.7	52.5
Italy	48.4	49.7	47.4	49.2	53.3
Brazil	51.0	50.2	52.8	52.6	49.8
China	49.4	50.2	50.8	49.7	51.0

Source: Bloomberg, Raymond James Ltd.

The global economy has been the opposite of equity and bond markets. Throughout Q2 we've seen continued evidence of a broad-based global slow down.

Most countries have fallen from expansion into contraction territory (a number below 50). This is the result of tightening monetary policies, the slowing trade due to tariffs, and less business investment due to the trade fight between the US and China. The table to the left shows far more countries contracting than expanding compared to one year ago.

The big question for strategist and money managers is; how much weaker will our economies get over the next 12 months and how will central banks respond to this?

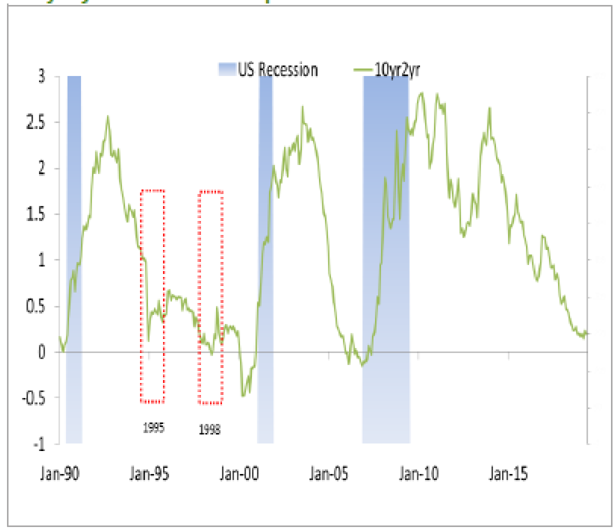
One could argue, the best case scenario would be one where growth reaccelerates in the second half of the year. However, markets have now fully built in interest rate cuts and so have begun cheering for bad news in order to get them.

The Insurance Cut

As of the end of June, it was expected that the US Federal reserve would cut interest rates by 0.25% in July, and cut twice more by the end of the year. With the economy not yet in recession and unemployment low, this would be seen as insurance to avert further economic slowdown. Historically when the Fed starts an easing cycle, interest rates decline by an average of 5.25% over a 24 month period. This will be difficult today as the Fed rate is only 2.50% to begin with.

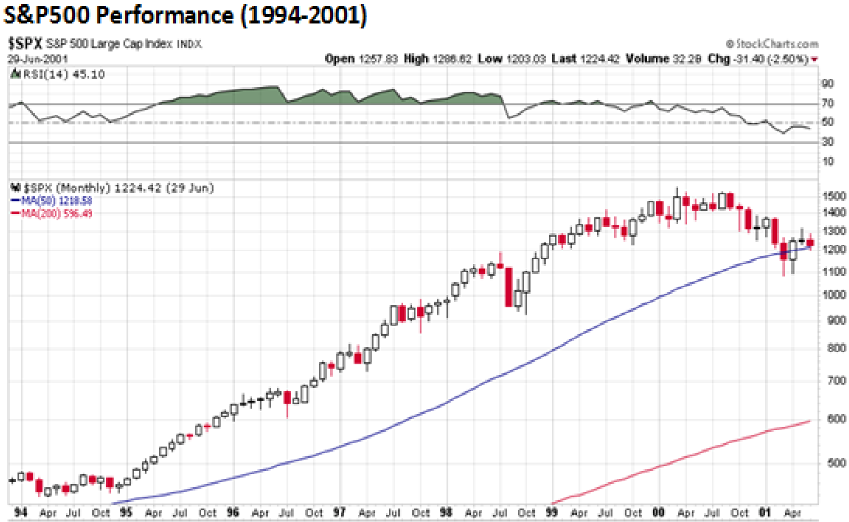
The optimistic scenario is that of the "mini-easing" cycle seen in 1995 and 1998. In 1995, rates were cut to forestall weakening economic data. In 1998, the rate cut was a pre-emptive measure taken when global trade declined due to the Asian financial crisis.

10yr2yr Curve Re-steepens after Insurance Cut



Source: Bloomberg, Raymond James Ltd.

S&P500 Performance (1994-2001)



Source: StockCharts

When interest rates are cut in a non-recessionary period it has a less meaningful impact on the real economy, but a greater impact on sentiment. As sentiment improves, markets usually improve in tandem. After the rate cuts in 1995 and 1998, the S&P500 responded positively.

If we are on the slippery slope to recession, then lower rates will only cushion the decline. Given the current environment of supportive monetary policies and low inflation, a recession in the next 12 months is still a low probability.

The Recession Checklist

Raymond James has a recession checklist that we monitor. In the past 12 months, six of the seven indicators have declined from positive to neutral. ISM Manufacturing levels were the most recent indicator to turn down into neutral territory reflecting the slowdown we have witnessed since last fall. Worries of a recession have grown in the media as a result, even as the data suggests this is just a pause, rather than anything worse.

US Recession Checklist

	Indicators						
Start of Recession	Manufacturing	Employment	HY Spread	Yield Curve	Housing Starts	Cons. Confidence	Inflation
January 1980	☒	☒	☒	☒	☒	☒	☒
July 1981	☒	☒	☒	☒	☒	☒	☒
July 1990	☒	☒	☒	☒	☒	⊟	☒
March 2001	☒	☒	☒	☒	⊟	☒	☒
December 2007	☒	☒	☒	☒	☒	☒	☒
Current	⊟	☑	⊟	⊟	⊟	⊟	⊟

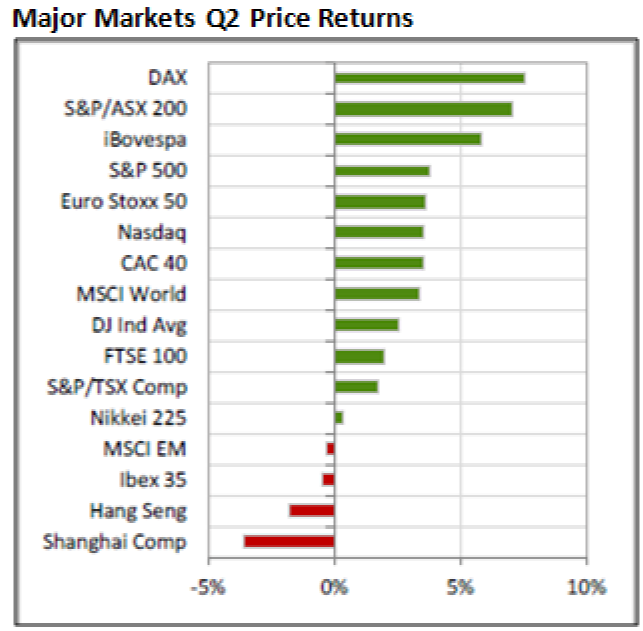
☒Recessionary territory; ☑ Expansionary territory; ⊟Neutral

Source: Bloomberg, Raymond James Ltd.

A recent update from Pimco, a large US Bond manager with former Fed Chair Ben Bernanke as a senior advisor, suggested a recession has been pushed out further and the severity would be less than previously thought. Time will tell if a change in Fed policy can breathe new life into the economic cycle.

The Dividend Value Portfolio

The Dividend Value model portfolio returned +1.4% for the second quarter, and +9.1% for the year-to-date (net of all fees). This compares to our benchmark returns of +1.8% for the quarter, and +10.6% for the first half of the year. We are slightly behind the benchmarks as we are more defensively positioned.



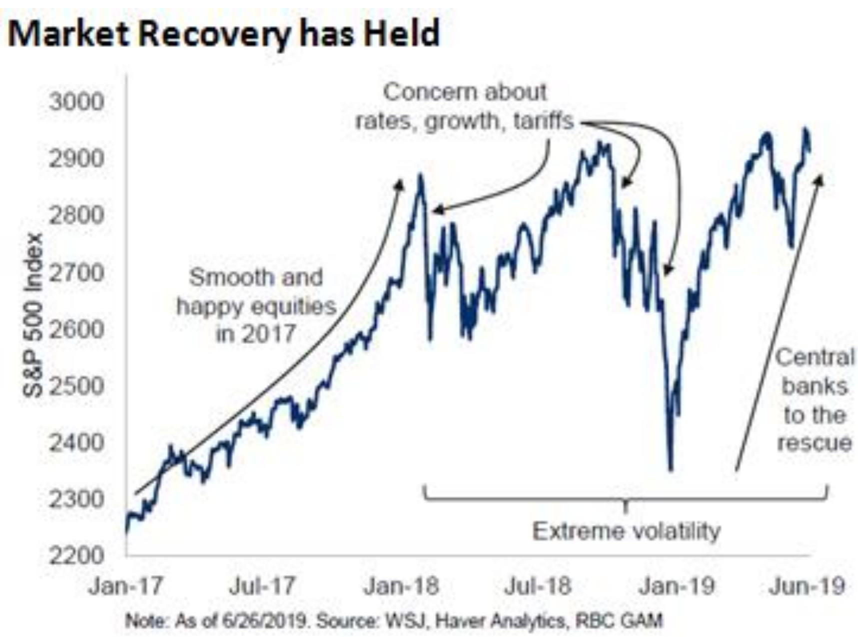
Source: Bloomberg, Raymond James Ltd. As of June 30th, 2019

Despite an improving Canadian economy, stocks haven't broadly improved over Q1. The Energy sector was quite weak at -3.9%, and we further reduced our exposure by selling all of our Cenovus Energy. The utility sector remained a bright spot in Canada, and we took some profits from TC Energy (formerly TransCanada Corp).

On the surface**,** the US equity market was better than Canada, but once you factor in currency Canada slightly outperformed. The strength of the Canadian Dollar over the US dollar continues to be a headwind, reducing performance of the US equites by 1.9% in Q2. So far this year, the currency has trimmed approximately 4.0% from the US portfolio performance. This quarter we trimmed profits from United Health Group and added a new position in Expedia, the global travel technology company. We also trimmed Prudential Financial after a sharp 14% rally.

With the talk of falling interest rates, the bond portfolio continued to add value this year. Six of the seven managers we hold were positive for the quarter. The only exception was the National Bank Preferred Equity Income fund. This is a Canadian preferred share mandate which is adversely affected by lower interest rates. We took the weakness in this mandate as an opportunity to increase our weighting. We believe preferred shares are undervalued at this stage and offer attractive yields.

Last quarter**,** we suggested the second quarter may not be as kind to investors. Global growth was fading, corporate earnings were slowing, and risks were rising. We have been on target with that call as the gains in Q2 were minor compared to the beginning of the year. Thankfully we have held onto the big gains from the start of the year.



The outlook has not changed, but the question is whether central banks have enough influence to extend the economic cycle. There are indications the current slowdown maybe modest and temporary. Markets are anticipating better growth in the second half of the year. If the second half can deliver positive returns it will be an exceptional year overall.

The Dividend Tracker

Fundamentally, we believe that owning strong, stable companies with a track record of consistently growing their dividends is the best way to grow your money. For this reason, we track the number of dividend increases received in our portfolio every quarter and for the year-to-date. In the second quarter, four of our Dividend Value stocks increased their dividends. The total number of dividend increases so far this year is twelve.

Q2 Dividend Changes (Quarterly)			
Apple Inc.	Increased to 0.77 from 0.73	**Telus Corp.**	Increased to 0.5625 from 0.545
UnitedHealth Group	Increased to 1.08 from 0.90	**Bank of Montreal**	Increased to 1.03 from 1.00

Quarterly Performance

Mandate	3-mos	1-yr	3-yr	5-yr	10-yr
Dividend Value Portfolio	1.4%	4.1%	7.3%	5.4%	7.3%
Dividend Value Benchmark	1.8%	3.3%	5.8%	4.2%	6.6%
S&P/TSX Composite Total Return	2.6%	3.9%	8.4%	4.7%	7.8%
S&P/TSX Preferred Share Total Return	-2.0%	-9.4%	4.5%	-0.9%	2.6%
MSCI EAFE (Cdn$) Total Return	1.5%	0.5%	9.3%	6.5%	8.2%
FTSE-TMX Universe Bond Total Return	2.5%	7.4%	2.7%	3.9%	4.5%

The above performance data is current as of June 30, 2019. Not all portfolios will be alike, given different starting dates, slightly different securities owned, or the timing of funds added or removed. Please see the individual client statements that are being included separately for specific account performance. The Dividend Value Benchmark is the Morningstar "Canadian Equity Balanced" index, a composite of all funds that meet that criterion in Morningstar.

DVD Quarterly Transactions

The following securities were bought this quarter:
Expedia (EXPE)

The following securities were sold this quarter:
Cenovus Energy (CVE)

The following securities were topped-up this quarter:
National Bank Preferred Equity Income fund

The following securities were trimmed this quarter:
United Health Group (UNH)
Prudential Financial (PRU)
TC Energy (TRP.TO)

Sincerely,

Paul Siluch
Senior VP, Portfolio Manager
Raymond James Ltd.

Lisa Hill
Senior VP, Portfolio Manager
Raymond James Ltd.

Peter Mazzoni
Financial Advisor
Raymond James Ltd.

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