RICHARDSON GMP

First Quarter 2013 Equity Trading Accountability Report

General Comments

The first quarter of 2013 was a good quarter for investors in global developed market equities. Investors in Canadian equities had minor gains (unfortunately wiped out in the first week of April) while fixed income provided a small positive return.

The intention of this report is to provide more explanation of the equity securities trades that I am doing proactively for clients that I manage money for discretionarily. I am very focused on being successful in making money for clients with the equity trading discipline I have developed. I hope to provide insight into the value I have added as well as the mistakes I have made.

Peter Lynch said, "water your flowers and pull your weeds." Selling equities that haven't worked out, buying more of winning positions, and a willingness to exit the market entirely when conditions and sentiment are moving against investors, are common strategies used by the most successful stock traders in history. These are simplified ideals. Actual implementation of these ideas takes hard work, time, and dedication.

Market Overview

Political news has gradually become more influential than corporate news. The collapse of Lehman Brothers in 2008 caused a global transfer of private debt in the financial system to governments and central banks. Now governments have massive levels of debt with no one to pass that debt to. Investors, corporations, and business owners have become less concerned with actual earnings of companies. They are now more concerned that the political environment may significantly destabilize the ability to properly carry on business at all. If investing is like a game, the players seem more concerned about the rules being changed than what is happening in the game itself.

A change in the social contract between government and its citizens is also taking place all throughout the world. For developed countries, governments have such a large debt burden, that citizens are bracing for significant taxation and austerity. This is causing a great deal of uncertainty about retirement for some, and competition for jobs or unemployment for others. In less developed worlds, there is a desire and awareness for education, equality, access to consumer goods and freedoms, that helps demand in the global economy, but is also very uncertain.

Investors have the two massive drops in the stock market during the 2000's very fresh in their minds. The first came at the tail end of nearly two decades of fantastic growth and innovation, capped off with wild optimism for the internet and technology companies. Internet companies offering to do everything free simply spent all the money investors gave them, and destroyed the ability of legitimate businesses to compete fairly and profitably. This led to over a 50% decline in stock market averages. The drop from 2000-2003 was painfully slow, rife with accounting scandals and large, previously successful companies, going bankrupt. The second drop starting in 2008 took only seven months for stock prices to again be cut in half. It highlighted how large, complex, and intertwined the global economy is. **Investors have been nervous ever since.**

Challenges for Canadians Investing in 2013

- **Commodity prices quadrupled to quintupled for virtually every commodity since 2000.** This has caused the Canadian dollar to rise from 60 cents U.S. to par and the Canadian stock market to outperform most world markets until 2008. It is unlikely that the next decade will bring a further quadrupling of commodity prices, which would suggest that the heavily resource-concentrated Canadian index may continue to significantly underperform other global indexes.
- **The Canadian economy represents less than 3% of the world's economy.** The Canadian stock market is represented by over three-quarters of its value in only three of ten sectors – banks, energy and metals. Resources were buoyed for many years in the 2000's by a significant upward revaluation, while banks survived the financial crisis better than global competitors. This unique situation caused Canadian investors to beat the other 97% of world economy for most of the 2000's. Today, global demand is being established in sectors not present in Canada's undiversified economy.
- **Interest rates are extremely low.** For over a decade, it has been easy to get reasonable rates in the form of risk-free bonds and GICs, guaranteed federally or provincially by government. But what can investors do for income if government-guaranteed products pay less than inflation?

The Current Bull Market

Few investors may have realized that April 2009 was one of the best opportunities they might see to double their money by buying U.S. stock. And now, four years later, many investors feel markets may be peaking and they have only captured part of the recovery. This recovery has been slow and filled with constant pessimistic news. When bad news hits, of any kind, investors sell hard and fast. The Canadian market recovered from its 2009 lows by only two-thirds while the U.S. markets are hitting new highs.

The influence of political news has made trading more difficult and humbling. Months of growth in a security or in whole markets can be wiped out in a few days or less. It is like being in a crowded building, trying to do day-to-day business, but with a vague expectation that some kind of critical alarm might go off any time and you will have to run for your life. Yet staying out of equity markets is also painful with interest rates so low. Very few families can hope to continue their standard of living for their lifetime without getting a reasonable return from their investments, unless they expect to continue to work and are lucky enough to do so. Not planning for and actively engaging the challenges of the financial markets, however, might ensure becoming a victim of them.

Money flows have showed a recent change, particularly in the later stages of the first quarter of 2013. In the United States there is a slow rotation back into defensive stocks, particularly in the utility, basic foods, telecom, and health care sectors. Also, pessimism for bonds has peaked and optimism is now rising.

The end of the business cycle is usually characterized by an optimistic, highly expansionary period where industrial and resource companies outperform. Why doesn't this seem to be happening this time? Maybe:

1. **Cycles going forward have less growth in them.** With government debt at critically high levels, and deleveraging and austerity becoming popular, growth may be simply slower than before.
2. **Perhaps economically sensitive sectors** such as industrials, materials and energy, may trade in more seasonal cycles and post very little long-term growth.

Or alternatively, the end of the business cycle has not yet come. Maybe expansion is still ahead.

Summary of First Quarter 2013 Equity Trading Activity

		12/31/2012	Buys		Sells		3/31/2013	1st Quarter	Total
Security	**Curr**	**Value**	**Date**	**Price**	**Date**	**Price**	**Value**	**Dividends**	**Return**
Best Core Holdings									
Celgene	U	78.47					115.91		48%
Valeant Pharmaceuticals		59.34					76.26		29%
Green Mountain Coffee Roaster	U		1/24/2013	43.73			56.76		28%
			1/31/2013	45.17					
Tim Hortons		48.83					55.21	0.260	14%
BCE		42.63					47.46	0.568	13%
Shaw Communications		22.84					25.16	0.247	11%
Waddell & Reed Financial	U		2/1/2013	40.15			43.78		9%
Open Text		55.63					60.04		8%
Black Diamond Group		20.05					21.05	0.180	6%
TJX Company	U		1/23/2013	44.40			46.75	0.101	6%
Mylan	U	27.45					28.96		5%
North West Co		22.39					23.19	0.260	5%
Buckle	U	44.64					46.65		5%
Best Trades									
Platinum Group Metals		0.81			3/18/2013	1.40			73%
United Therapeutics	U		1/23/2013	53.15	3/22/2013	60.85			14%
NCR	U	25.48			1/23/2013	28.31			11%
Horizons S&P 500 Bull ETF			3/5/2013	17.34			17.97		4%
Constellation Software		119.99			2/15/2013	119.20		0.984	0%
Assigned Covered Calls									
Rogers Communications		45.16			3/13/2013	42.00		0.395	2%
Rogers $42 Call Option		(3.55)							
Tupperware Brands	U	64.10	1/21/2013	65.00					3%
Tupperware $65 Call Option	U	(0.75)							
Average Core Holdings									
Ross Stores	U		1/23/2013	58.85			60.62	0.147	3%
			3/5/2013	59.14					
Ishares MSCI Belgium Invest	U	13.85					14.18		2%
Federated Investors	U		1/23/2013	23.35			23.67	0.205	2%
Saputo			1/23/2013	50.50			51.58	0.210	2%
			2/7/2013	50.75					
Priceline.Com	U		1/25/2013	680.20			688.16		1%
			1/31/2013	686.50					
Walton Westphalia		5.00					5.00		0%
Labrador Iron Ore Royalty		34.40					33.93	0.375	0%
Ishares MSCI Germany Idx Fd	U	24.72					24.47		-1%
Positions Held in Warning State									
Ishares Dow US Home Cnstr Idx	U		3/20/2013	24.80			23.89	0.004	-4%
Chorus Aviation			1/31/2013	4.38			3.93		-5%
			3/4/2013	3.90					
Novo Nordisk As S/ADR	U		3/5/2013	182.50			161.50		-7%
			3/26/2013	163.86					
Parkland Fuel			2/4/2013	19.95			17.10	0.085	-14%
Alamos Gold		17.45					13.95		-20%
Sold on Discipline Violation									
Potash Corp Of Sask		40.48			2/20/2013	41.40		0.207	2%
Intel	U	20.62			1/23/2013	21.08			2%
Teva Pharmaceuticals ADR	U	37.34			1/23/2013	37.90			1%
AGF Emerging Markets		12.15			3/28/2013	12.21			0%
Ishares MSCI Austria Capped	U	18.19			3/26/2013	17.30			-5%
Oracle	U	33.32			3/25/2013	31.33			-6%
Mens Wearhouse	U	31.16			2/1/2013	29.11			-7%
Coach	U	55.51			1/23/2013	51.55		0.253	-7%
Ishares MSCI South Korea Index	U	63.36			3/20/2013	58.21			-8%
Barrick Gold		34.82			1/31/2013	31.90			-8%
CH Robinson Worldwide	U	63.22			3/5/2013	57.25		0.302	-9%
Lululemon Athletica		75.51	2/20/2013	70.50	3/19/2013	65.97			-10%
Apple	U	532.17			1/24/2013	451.90			-15%

Managed Account Equity Analysis

Best Moves

The best move in the first quarter of 2013 was to increase the amount of exposure to U.S. stocks in my clients' accounts. Depending on the indexes used, the U.S. stock market has made triple to quadruple what the Canadian one has. Wish I'd done even more of it.

A reduction in the level of fixed income has also been a positive strategic move. It is important to note that many families are focused on getting a consistent return and in particular getting away from the uncertainties of the stock market. Many accounts still do have core holdings of corporate fixed income products that are focused on providing income and reducing volatility.

The best investments were Celgene (48% gain), Valeant Pharmaceuticals (29% gain), and Green Mountain Coffee Roaster (28% gain). This partly demonstrates added value by diversifying into successful businesses investors might not typically chose if they select securities for themselves.

Of the 27 equity securities currently held, 21 of them are in a gaining position over the quarter. Investors should consider a longer period than just a quarter when evaluating an equity portfolio, but in general my discipline favours holding winning positions over losing ones.

Mistakes to Learn From

Apple represented a significant mistake. To be fair, many clients doubled their money on Apple stock from original purchase three years ago. However, it was a mistake not to have reduced or eliminated this position in the fourth quarter of 2012. I was too lenient in letting the stock weaken because of such great prior success with it, combined with fantastic quantitative screening, a strong earnings position, and generally cheap valuation. Hoping that selling pressure would go away because it was a "good" company didn't work. Have to be loyal to results, not to any stock.

Nine trades resulted in losses in the quarter. Keep in mind there may have been prior gains on these positions, and I don't consider a loss a mistake. **Not** taking a loss is a mistake. Too many of the positions didn't work out though, suggesting more patience on entry may be required.

Two-thirds of the securities sold at a loss had just experienced a significant gap down overnight. These quick drops are likely the result of investors being nervous as previously discussed. A gap down doesn't always mean the same thing – sometimes buying more is right, and sometimes selling out quickly is. It keeps me humble and believing that nothing replaces hard work. Owning companies with less surprise variability may make this task easier.

Rogers and Tupperware show as modest gains when coupled with the covered call sold on the underlying shares. However, these stocks grew substantially higher than the target price. I have been disappointed with the low premiums offered for setting target prices for stocks, and these examples show that in the current market the flexibility to trade may be more important than income from writing covered calls.

Three of the losses were in the retail clothing sector – Coach, Lululemon, and Men's Warehouse. All of these stocks had minor gains within the last six months that was not captured. The first two continued to fall in price after I sold, but Men's Warehouse recovered by 15% after selling out. Other retail stocks like Buckle and the Gap worked very well. Retail stocks continue to have money flowing into them and many are currently still recommended on my quantitative models.

Two of the securities were in the gold sector, carried over from 2012. With elections and significant political uncertainty last year, I expected gold and gold stocks to outperform. I was wrong. Holding gold stocks into 2013 hasn't worked. They have been dropping for a year-and-a-half now, despite all the talk that they shouldn't. With gold it has been important not to listen to all the stories about what might happen and focus instead on what investors **actually** are doing. Alamos Gold ☹.

Market Results

Including dividends, **Canadian investors** had a reasonable return in the first quarter, although if they owned more speculative securities on the Venture Exchange, they have been punished for almost two years.

The **U.S. indexes** continued their dominance from the prior year, more than tripling Canadian returns.

Emerging Markets struggled to provide any return, and strength in the fourth quarter last year in **Europe** flattened out.

Index	Country	First 3 Months 2013	2012
S&P/TSX Composite Total Return Index	Canada	3.3%	7.2%
S&P/TSX Venture Composite Index	Canada	-10.0%	-17.7%
S&P 500 Total Return Index	U.S.	13.1%	13.0%
Nasdaq Composite Index	U.S.	10.7%	12.9%
Euro Stoxx 50 Index	Europe	-0.8%	12.6%
Nikkei 225 Index	Japan	13.5%	6.9%
MSCI Emerging Markets Index	E.M.	0.6%	12.2%
MSCI World Index	World	9.7%	10.2%
DEX Bond Universe	Bonds	0.7%	3.6%
Canadian 3-Month T-Bill	Cash	0.2%	0.5%

Source: Richardson GMP. All returns are in Canadian dollars as of March 31, 2013.

Japan was marginally the best place to invest, although many consider it speculation that the current government may actually finally turn around the 24-year-old Japanese bear market.

Investors in **cash and bonds** aren't losing money but struggle to keep up with inflation. To put it in perspective, the gain in the U.S. over the last three months might take about seven years or so invested in GICs to catch up to.

The accounts I manage are not put into any kind of pool. Clients own each security in their account and I apply six different equity models in different proportions to each client. There may be unique positions as well as some differences in portfolios due to the timing of their transition to the securities I manage. Technology helps me manage everyone at once, but I still apply a significant amount of judgment in each client's accounts. I currently do not have any clients that own exclusively equities with me. There is therefore variation of client results based on the application of their own situation and needs, even though there is a commonality of the overall trading decisions.

Find Out if My Approach Is Right for You

I would be honoured for the opportunity to assess your situation, find your dream, and help you improve your investment results. **Please contact my team to set up a complimentary meeting.**

Brad A. Hunter, CA, CFP, CIM
Portfolio Manager, Director, Wealth Management | **Richardson GMP Limited**
Suite 4700 • 525 8th Avenue SW • Calgary, AB • T2P 1G1

Direct 403.355.6033
Toll Free 1.866.867.7735
Email Brad.Hunter@RichardsonGMP.com
Web **www.bhunter.ca**