RICHARDSON GMP

FIRST QUARTER ACCOUNTABILITY
2014

Sector Leadership Change

Stock markets are experiencing their fifth year of growth. Investors holding equity at the bottom of the Lehman Crisis in 2008 have more than doubled their money. But many investors, constantly bombarded by fears, uncertainty, and global political crisis, have missed sizeable chunks of these gains. Meaningful gains are achieved by holding securities for a long enough period to experience the underlying growth of the companies owned. Being focused on not losing money undermines the ability to earn it.

A rotation of ownership between the industry sectors seems to be underway. Leadership in early- and mid-economic cycle sectors has been established for several years now, and may finally be giving way to late cycle sectors. It is too early to be certain that the recent changes in relative strength will continue, but some portfolio adjustments should be made. Active changes I have recently made in managed portfolios include:

- **Reduction of winners from the prior cycle** (health and consumer stocks). These sectors have been winners for a long time and it makes sense for their run to slow. Partial reduction makes sense.
- **Moving some capital into the potential leadership sectors of energy and materials.**
- **Reduction of the overall weighting of equity**.
- **Keeping some equity money in cash.** Holding a 10-15% defensive cash position allows more time to determine new leadership and to possibly take advantage of new trends. Caution is also warranted because of the partial flow of market participant's capital to defensive sectors.
- **Fixed income is still under owned.** The term to maturity favours shorter corporate issues that offer some protection against yields rising and low government interest rates themselves.

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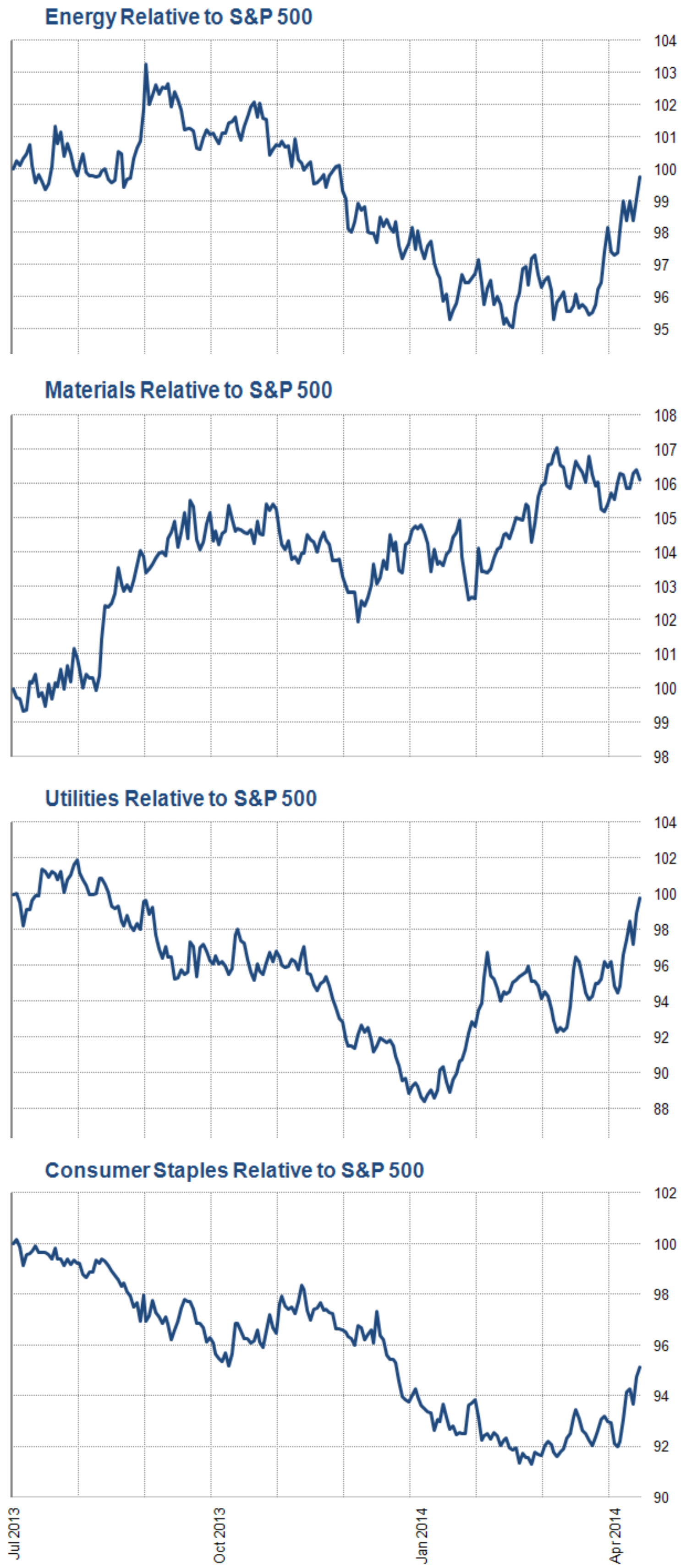


Source: Thomson One

Investors are experiencing a potential change in leadership so far in early 2014.

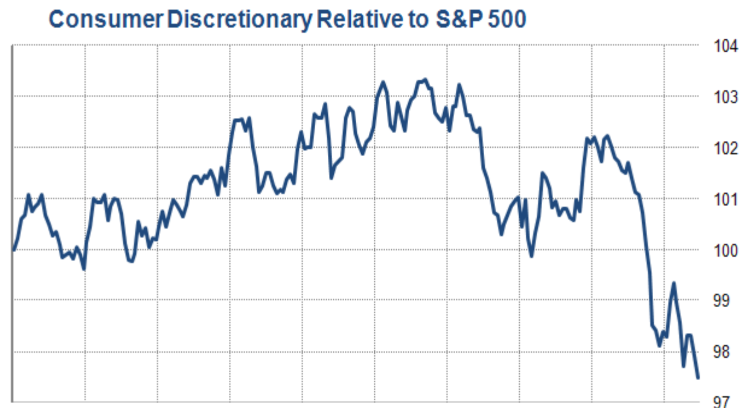
Energy stocks have been underperforming markets since oil hit a high of $147/bbl in the spring of 2008. This sector has had particularly poor performance during the subsequent recovery, especially since the spring of 2011. The two month basing pattern of energy relative to the market combined with only three weeks of recent outperformance is really not enough on its own to indicate a longer term trend. Short spurts like this have happened many times over the past five years and each failed. But the possibility of a trend change starts small.

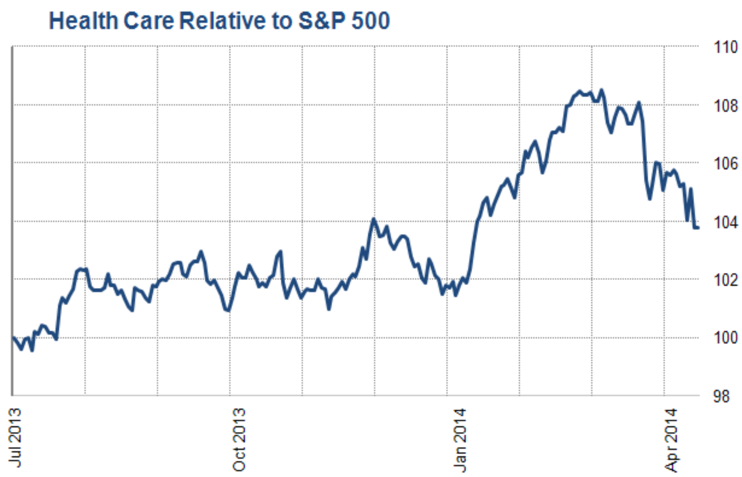
Materials stocks are typically producers of raw materials, construction materials, and precious metals. This index significantly underperformed the market since 2009. However, for the past nine months money seems to be periodically flowing into materials stocks.

A shift to materials and energy would be consistent with moving into the final stages of growth in the economic cycle. This is the expected progression from the mid-cycle industries that have out-performed for some time and are showing some signs of waning.

At the same time investors appear to be willing to buy the most economically sensitive sectors, they appear to be also buying the most defensive sectors as well - utilities and consumer staples. Usually investors buy defensive companies that are stable with dividends and little growth potential in the early stages of recession.

Seeing trend changes in nearly half the sectors of the market at the same time gives more confidence to the possibility of these trends lasting a longer time. Investors should rotate into these sectors in small amounts, with less conviction than they typically would. **Holding some cash also makes sense.**





Source: Thomson One

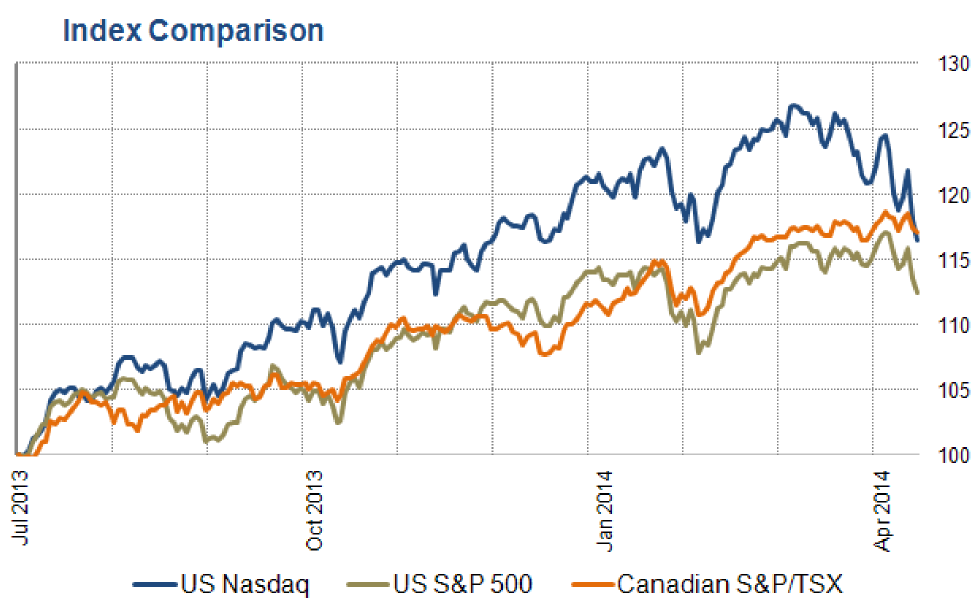
Consumer and Health stocks outperformed the market significantly for several years. The consumer sector often shows leadership during the early- to mid- phases of the economic cycle. **Investors have been waiting a long time for this sector to finally pass leadership to the next.** A three month counter-trend move is not enough to be certain the leadership trend is over but a flow to energy stocks next makes sense.

Health care has conservative aspects such as pharmacy and patient care stocks but also aggressive companies involved in medical research. Biotechnology stocks have contributed to the health sector being a dramatic outperformer most prominently since 2011. The last four weeks of decline in health stocks isn't enough to be sure that this sector has lost leadership; especially with relative strength not even reaching a lower low. But the dramatic fashion money left the sector recently with very little reason beyond profit taking means that more caution and less ownership of health stocks is appropriate.

The Nasdaq has been a strong outpeformer compared to the broad markets for the last several months, and in fact for many years.

In March the Nasdaq peaked and has dropped all the way to equivalent levels of the general markets.

At the same time, the overall markets didn't peak in March but instead hit new highs in April.



Source: Thomson One

The challenge now is to determine if the Nasdaq's drop is a sign of weakness to come or if the broad market's strength means continued growth.

Security	Curr	12/31/2013 Value	Buys Date	Buys Price	Sells Date	Sells Price	3/31/2014 Value	1st Quarter Dividends	Total Return
Top Performers									
Bankers Petroleum		4.37	1/17/2014	4.50			5.38		18%
Constellation Software Inc		224.99	2/27/2014	243.00			268.00	1.000	18%
Valeant Pharmaceuticals		124.62					145.44		17%
Saputo Inc		48.39					55.69	0.230	16%
Black Diamond Grp Ltd		30.00					34.25	0.225	15%
Waddell & Reed Fncl Inc Cl A	U	65.12					73.62	0.340	14%
Mylan Inc	U	43.40					48.83		13%
Core Holdings									
Biogen Idec Inc	U	279.57					305.87		9%
Open Text Corp (2 for 1 split)		48.86					52.82	0.300	9%
Baxter International	U		1/29/2014	68.71			73.58	0.490	8%
St. Jude Medical	U	61.95					65.39	0.270	6%
Ishares MSCI Belgium ETF	U	16.39					17.36		6%
BCE Inc		46.00					47.62	0.618	5%
Shaw Communications B		25.85					26.40	0.262	3%
Royal Bank		71.41					72.89	0.670	3%
Priceline.Com Inc		1,162.40					1,191.89		3%
National Bank of Canada (2 for 1 split)		44.20					44.30	0.460	1%
Colgate Palmolive Co	U	65.21	1/29/2014	61.80			64.87	0.360	1%
Walton Westphalia		5.00					5.00		0%
Corrections Corp of America	U	32.07					31.32	0.510	-1%
Tim Hortons		61.99					61.14	0.320	-1%
Ishares MSCI Germany ETF	U	31.79					31.35		-1%
Ishares MSCI UK ETF	U		1/24/2014	21.05			20.59		-3%
			2/21/2014	21.21					
North West Co Inc		25.74					24.52	0.290	-4%
Apple Inc	U	561.02					536.74	3.050	-4%
Gentex Corp	U	32.98					31.53	0.140	-4%
TJX Co		63.73					60.65	0.145	-5%
Sandvine Corp			2/21/2014	3.29			3.12		-5%
Warning Positions									
Rogers Communications B		48.07					45.81	0.458	-4%
Great West Lifeco Inc		32.75					30.47	0.308	-6%
Ross Stores Inc	U	74.93			1/29/2014	67.70	71.57	0.200	-7%
Labrador Iron Ore Royalty		34.36					30.06	0.400	-11%
Buckle Inc	U	52.56			1/29/2014	43.67	45.80	1.420	-12%
Celgene Corp	U	168.97					139.60		-17%
Eliminated Positions									
Bombardier Inc Cl B		4.61			1/9/2014	4.44			-4%
Ishares MSCI Japan ETF	U	12.13			2/24/2014	11.54			-6%
					3/18/2014	11.15			

Source: Richardson GMP as at March 31, 2014

Analysis of First Quarter Trading Activity

1. **The average actual gain of all equity consolidated for all managed accounts was 5.6% and was 3.9% including other asset classes like fixed income and cash.** The positions in the portfolio had very strong outperformance relative to the market until the second week in March. The drop in biotechnology and other Nasdaq holdings made a fantastic quarter into an okay quarter. The surge in energy stocks while the Nasdaq dropped the last two weeks of the months put the Canadian market as one of the best places to invest year-to-date.
2. **Seven of thirty or almost a quarter of investments held grew by 13-18%.** However, only half of the securities owned made money while the other half lost money. More stocks than I would have liked didn't contribute to results this quarter, but again, most of the weakness was in the last two weeks. Securities that gained on average made much more than securities that lost. During periods where there are more securities with losses, diversification is more important. Seeing such a mixed result with the securities held is another indicator supporting the possibility that a rotation in leadership of securities may be underway.
3. **There was little buying this quarter**. Prior successful positions were added to including Constellation Software, Bankers Petroleum and Colgate Palmolive. Only two new positions were added which fit into the heath and technology leadership at the time – Baxter International (a medical device company) and Sandvine (a software security company). Money was taken out of Japan and invested in the U.K.
4. **There were two positions eliminated for non-performance:** Japan and Bombardier. Both of these sells turned out to be very good as the securities continued to fall afterward and are now lower. The stop loss levels were fairly tight for these securities.
5. **There were six securities with losses that ended the quarter in a warning position.** Estimate revisions and consensus target revisions were beginning to move negative for these six stocks. They had fallen in price but not below stop loss levels yet. Note that securities like Celgene which shows a 17% loss in the quarter are up 80% from initial purchase price. Although not part of the first quarter, five of these six warning positions have already been sold or reduced near the beginning of the second quarter.
6. **In prior quarters and years, above average performance can be partly attributed to:**
   a. Not taking profits on winners.
   b. Buying more in winning positions when they correct in price by a typical amount.
   c. Eliminating losing positions.

   Identifying when a winning company is losing leadership is essential to this discipline working. Money flows during this last quarter seems to hint at the possibility of moving further along the economic cycle, and potentially investors rotating out of prior winning securities to new leaders. Leadership may be moving away from the best performers clients have owned over the last couple years. It is challenging to be willing to sell stocks that have been very successful; but a portfolio manager must chose loyalty to either the client return or the companies owned.
7. **This accountability shows purely the trading of stocks and not asset allocation decisions and larger strategic portfolio decisions.** The current environment suggests having a slightly lower equity weighting, holding a 10-15% reserve in cash, increasing the number of securities held, reducing overweight position in leaders that are slowing, and buying additional positions in sectors where money seems to be flowing.

Market Summary

Index	Country	First 3 Months 2014	2013	2012
S&P/TSX Composite Total Return Index	Canada	6.1%	13.0%	7.2%
Canadian DEX Bond Universe	Canada	2.8%	-1.2%	3.6%
Canadian 3-Month T-Bill	Canada	0.9%	0.0%	0.5%
MSCI World Index	World	4.8%	32.9%	10.2%
S&P 500 Total Return Index	U.S.	5.9%	41.8%	13.0%
Nasdaq Composite Index	U.S.	4.6%	48.1%	12.9%
Euro Stoxx 50 Index	Europe	6.0%	31.5%	12.6%
Nikkei 225 Index	Japan	-3.5%	38.2%	6.9%
MSCI Emerging Markets Index	E.M.	3.2%	1.7%	12.2%

Source: Richardson GMP. All returns are in local currency as of March 31, 2014

Seminar

Join me over a lunch seminar where I discuss the current financial market trends and the resulting securities that best take advantage of today's economic environment.

Topics of discussion will include:

- Global investing environment
- Examination of current market and securities trends
- Problems and opportunities with fixed income

RSVP: Rita Penno by telephone 403.355.6034 or
Rita.Penno@RichardsonGMP.com

Wednesday, May 7th, 2014

Time: 11:45am – 1:00pm

Location: Richardson GMP,
Eighth Avenue Place
Main Boardroom
Suite 4700, 525 8th Avenue SW

Lunch and refreshments will be provided.

I hope you will be able to join us. Please pass this newsletter to anyone who may benefit from attending.

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