RICHARDSON GMP

SECOND QUARTER ACCOUNTABILITY
2014

Smooth Sailing

Observations in financial markets:

- **Fixed income has provided a good return, even though rates are low.** Investors feared that the reduction of bond purchases announced a year ago would start a trend of rising rates. Instead, rates jumped immediately by 1% a year ago, and have slowly declined by half of that subsequently.

- **The Canadian stock market had one of the highest returns over the last six months.** But every sector underperformed the market with the exception of one: energy. And if you missed owning energy the handful of weeks it outperformed, you missed Canadian outperformance.

- **The U.S. Dollar started the year very strong, but weakened over the last few months relative to the Canadian dollar.** This coincided with the period of strength in the energy market, which helped boost the loonie. I expect the U.S. dollar to appreciate further over the next 2-3 years, although periods of energy outperformance will slow this rise.

- **Every correction over the past few years has been a buying opportunity.** Many investors have missed participating in growth of the stock markets because of fresh memories of the 2008 and the turn of the century market crashes. It is prudent to have a stop loss discipline and a means of protecting portfolios; but investors must also have a method of participating in and committing to market growth.

- **Markets seem to be moving from early and mid-cycle stages to the later stages of the business cycle.** Gains are often greater at this phase, but risks higher. Both participation and protection are important.

- **I expect to incorporate a greater amount of hedging strategies in portfolios over the next quarter**, in order to continue participating in market growth but also have a greater emphasis on protecting from declines. Expect a seminar to be held in September to discuss these strategies further.

OUR PARTNERS

Brad A. Hunter

Richardson GMP
Suite 4700, 525 8th Avenue SW
Calgary, Alberta
T2P 1G1

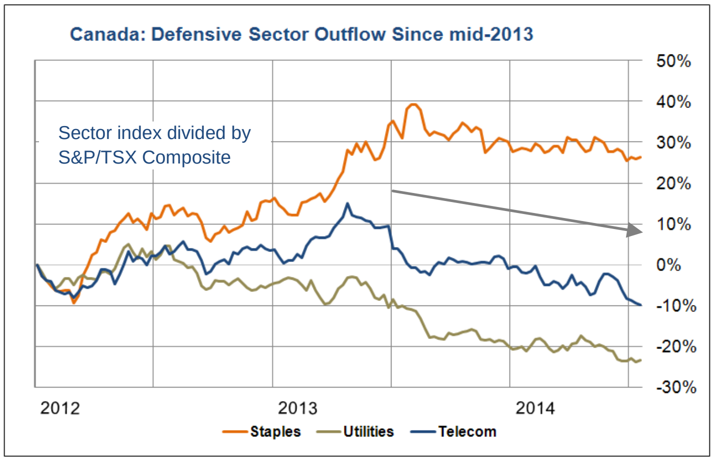
Tel. 1.866.867.7735
Fax 403.355.6109

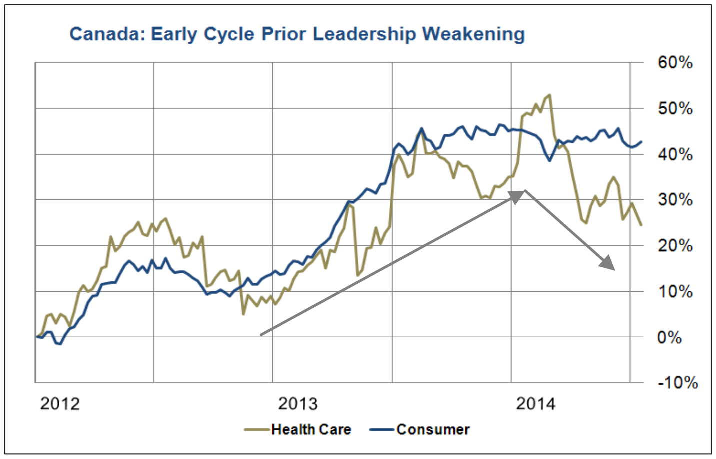
Brad Hunter, CA, CFP, CIM
Director, Wealth Management
Portfolio Manager
Tel. 403.355.6033
www.bhunter.ca

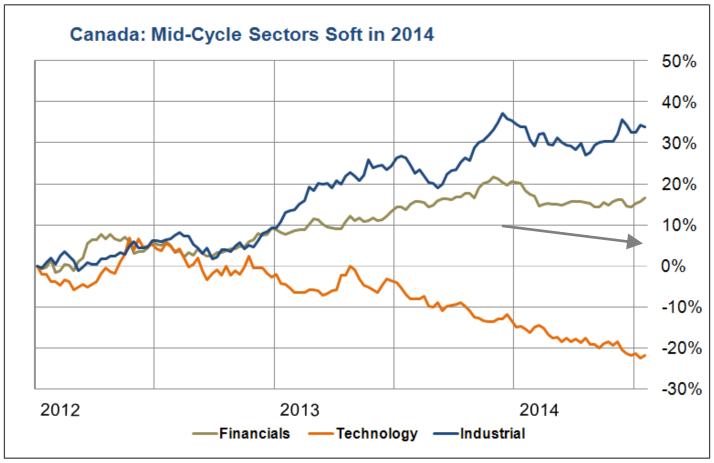
Connect with me on LinkedIn

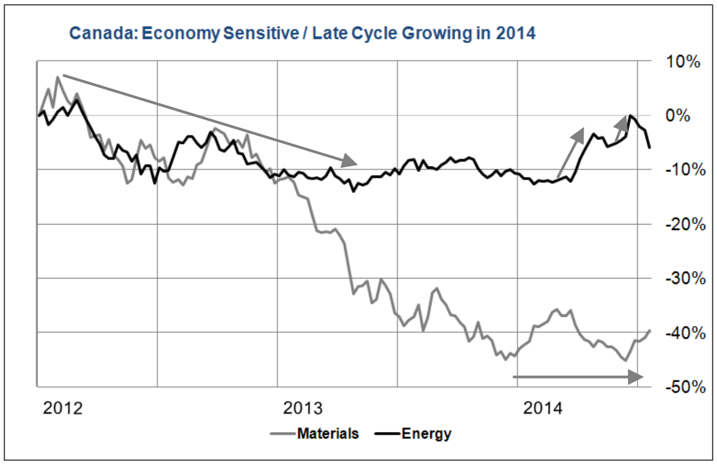
Rita Penno
Associate
Tel. 403.355.6034

Chris Mitchell
Associate
Tel. 403.355.6066









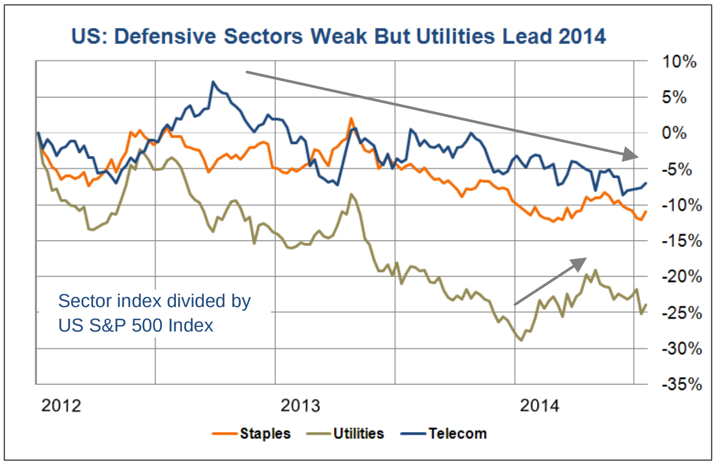
Source: Thomson One

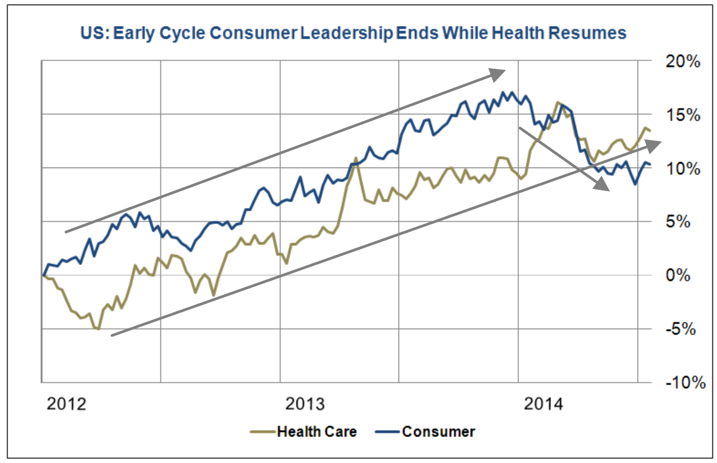
Going into 2014, leadership in Canada had been established in sectors that perform well in the early to middle stages of the business cycle – consumer, health, financial, and industrial companies. Nearly every sector that showed leadership for the past two years began to underperform the broad market by 2014. Defensive stocks were first to have money flow out of them in early 2013, around the time U.S. central bank policy changed to reduce bond purchases. Long-term leadership in consumer and health stocks faltered between the fall of 2013 and winter of 2014. Financial, industrial and technology stocks all experienced relative underperformance in Canada, although there has been some recovery in industrials possibly meaning leadership still may be intact for that industry.

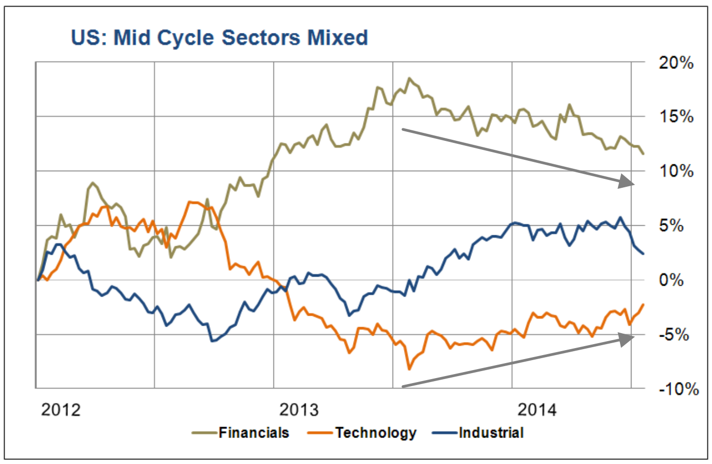
The biggest change is that after losing money consistently on a relative basis for years, energy and materials stocks, which compose a large part of the Canadian market, seem to have finally bottomed. Energy in particular, fueled by high natural gas prices during the cold winter, had two very strong spurts of growth.

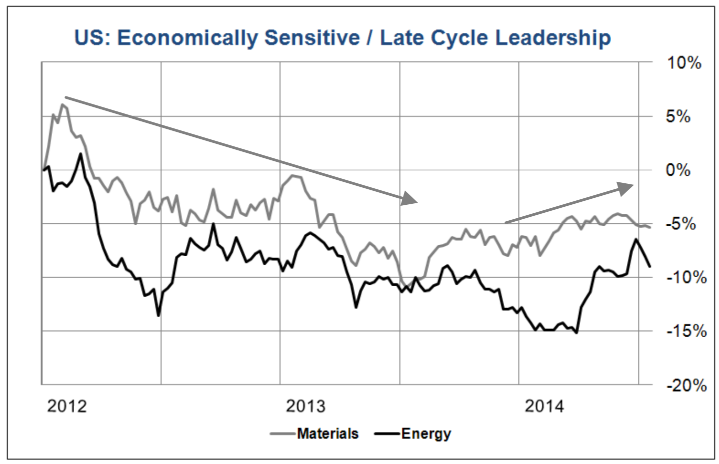
It seems the business cycle in Canada has moved into the later and final stages of growth as money moves out of defensive and early cycle industries to speculate on growth in commodity demand after several years of under-investment in supply. The bias for interest rates to rise going forward appears to be keeping investors away from the more conservative and defensive dividend yielding stocks. Investors may be more interested in yield from stocks in the energy and commodity industries where companies that pay a high dividend offer income, while the underlying commodity may offer some protection from inflation. Valuations have also been considered lower among commodity stocks because they have underperformed for so long.

The late stages of the business cycle tends to offer investors the greatest returns, but an elevated risk level. Participation in periods of greater growth is important, as is the ability to close out of positions when it appears that the rising trend is over.









Source: Thomson One

Relative strength in the U.S. is similar to what is seen in Canada, except in most cases the trends appear a little earlier. Defensive stocks started underperforming around nine months before Canadian defensive stocks under-performed in Canada. Financial stocks in the U.S. began behaving the same negative way roughly when central bank policy changed and interest rates seem to have bottomed in June 2013. There is a similar break in the leadership of both consumer and industrial stocks, and a similar early outperformance in energy and materials companies.

Overall there is a similarity between the U.S. and Canada in that defensive and early cycle sectors have money flowing out of them compared to late cycle sectors showing leadership. The U.S. economy is considered to be ahead of the Canadian one and perhaps the recent move to utilities in the U.S. can be seen as the first cautionary signal.

A major difference between the markets is a broader sector participation in outperformance in the U.S.. In Canada, if you missed the two quick jumps in energy stocks, there were not many other places you could find outperformance. In the U.S., not only are commodities showing strength, but technology stocks have been seeing increased money flow for nearly a year. Health care companies are still attracting investors, albeit with greater volatility. Industrials and Staples performed close to market levels. The move to utilities occurred for the first four months of 2014, and is possibly fading, leaving me with the overall view that investors are still buying growth in the U.S. over safety.

I believe an active approach can lead to better returns in the financial markets. At the end of 2013, close to 40% of client managed portfolios were invested in consumer and health stocks. In March/April of 2014, it seemed as though both of these sectors were being hit hard, and selling was occurring. It has taken some time to redeploy to the energy sector, to restore a portion of the sold health positions, and to find opportunity in the technology sector. At the same time, the greater risk in the later stages of the business cycle means that some funds are being moved out of equity.

Security	Curr	3/31/2014 Value	Buys Date	Buys Price	Sells Date	Sells Price	6/30/2014 Value	2nd Quarter Dividends	Total Return
Top Performers									
Bankers Petroleum		5.38					6.82		27%
Apple Inc (7 for 1 split)	U	76.68					92.93	0.470	22%
Whitecap Resources			4/21/2014	14.23			16.47	0.182	17%
Sandvine Corp		3.12					3.60		15%
Saputo Inc		55.69					63.93		15%
Deethree Exploration	U		4/8/2014	10.00			11.40		14%
Core Positions									
Tamarack Valley Energy			4/9/2014	6.15			6.44		9%
			5/12/2014	5.67					
			5/30/2014	5.64					
Ishares MSCI UK ETF	U	20.59					20.88	1.019	6%
St. Jude Medical	U	65.39					69.25	0.270	6%
Mylan Inc	U	48.83					51.56	0.060	6%
Colgate Palmolive Co	U	64.87					68.18	0.360	6%
Royal Bank		72.89	5/2/2014	73.05			76.28	0.710	6%
Shaw Communications B		26.40					27.36	0.262	5%
National Bank of Canada		44.30					45.26	0.480	3%
BCE Inc		47.62					48.40	0.618	3%
Labrador Iron Ore Royalty		30.06					30.68	0.250	3%
Constellation Software Inc		268.00					271.96	1.000	2%
Ishares MSCI Germany ETF	U	31.35	5/27/2014	32.12			31.28	0.631	1%
Pason Systems			4/17/2014	29.77			30.00	0.150	1%
Black Diamond Grp Ltd		34.25					34.32	0.225	1%
Ishares MSCI Belgium ETF	U	17.36					17.20	0.226	0%
Crew Energy			6/4/2014	11.03			11.05		0%
Raging River Exploration			6/16/2014	10.84			10.85		0%
Walton Westphalia		5.00					5.00		0%
Baxter International	U	73.58					72.30	0.520	-1%
Open Text Corp		52.82	4/9/2014	51.10			51.20	0.173	-2%
North West Co Inc		24.52					23.65	0.290	-2%
Tim Hortons		61.14					58.37	0.320	-4%
Ross Stores Inc	U	71.57					66.13	0.200	-7%
Waddell & Reed Fncl Inc Cl A	U	73.62	4/17/2014	68.70	5/20/2014	59.52	62.59	0.340	-14%
Reduced on Nasdaq Correction									
Priceline.Com Inc	U	1,191.89			4/4/2014	1,180.12	1,203.00		1%
Great West Lifeco Inc		30.47			4/2/2014	30.41	30.18	0.308	0%
Biogen Idec Inc	U	305.87	5/27/2014	307.78	4/4/2014	287.50	315.31		0%
Valeant Pharmaceuticals		145.44			4/4/2014	135.96	134.94		-7%
Eliminated on Nasdaq Correction									
Buckle Inc	U	45.80			4/3/2014	47.33			3%
Celgene Corp	U	139.60			4/4/2014	137.00			1%
					4/3/2014	144.00			
Rogers Communications B		45.81			4/2/2014	45.47			-1%
Proshares Ultrashort QQQ	U		4/7/2014	61.61	4/9/2014	58.85			-4%
Gentex Corp	U	31.53			4/7/2014	28.72		0.160	-8%
Eliminated from Discipline Failure									
Corrections Corp of America	U	31.32			5/20/2014	31.59			1%
TJX Co	U	60.65			5/27/2014	54.61		0.175	-10%
					5/20/2014	54.27			

Source: Richardson GMP as at June 30, 2014

Analysis of Second Quarter Trading Activity

1. **The second quarter performance of equities alone on a consolidated basis across all discretionarily managed clients was a gain of 1.0%, and 6.6% year-to-date.** This quarter's performance was below the benchmark S&P/TSX Composite Index which earned 5.7%. Managed account results were closer to the performance of global equity indexes like the S&P 500 in Canadian dollar terms which did 1.6%, and the MSCI World Index which in Canadian dollar terms which grew 1.3%.

2. **My actions at the end of 2012 to increase U.S. exposure and to focus on consumer and health care stocks was lucrative and resulted in very good returns for the last few quarters, particularly compared to a Canadian only strategy.** The strategy worked further by sticking with it for a longer period and buying more of winners while continually trimming losers.

   However, the second quarter of 2014, marked a significant change in trends. Prior leadership rotated into new areas. During this transition, protective measures were taken. My discipline moves out of established trends, in increments, after they are proven to be over. Movement into new trends occurs as they are established, again in increments. This quarter was about recognizing and reacting to some major trend changes.

3. **Crisis seemed to be brewing at the end of March into early April.** The Nasdaq dropped 9% from March 11th to April 15th. This came after several years of Nasdaq outperformance against other major markets and in particular, the prior eight months had been very strong for both the Nasdaq and U.S. markets in general. Since the Nasdaq had been a leader, I feared it's weakness would be a leading indicator of potential difficulties in other markets. During this time, nine reductions of individual stocks were completed in managed accounts, and a hedge was placed in accounts that would rise if markets continued to fall (Proshares Ultrashort QQQ). **I was preparing for a potentially larger correction after an exceptional eight-month gain.**

   The Nasdaq correction never did expand into broader markets. Rather, at the same time as the Nasdaq fell, energy stocks began to be repriced upwards based on the higher average energy prices over the winter. Money from the sold positions, and the closed out Nasdaq hedge started to be redeployed into energy stocks as it looked like the market drop was bottoming and the outperformance of energy became apparent. Managed accounts bought energy stocks eight times between early April and mid-June. Prior to that, accounts had very little invested in energy stocks, which is the primary reason for underperformance during the second quarter.

   At the end of the quarter, accounts typically held about 17% energy stocks, which is still well under the 27% in energy in the Canadian S&P/TSX Composite index, but there is now greater participation in this sector.

4. **The second quarter was about deciding:**
   a. If the bull market trend is continuing, (looked like it might stop, but it is continuing) and
   b. What sectors are going to show leadership during the two largest economic quarters – the first and fourth quarters, or October to March coming up. (so far it looks like technology, energy, health, and possibly some materials.)

5. **The transition to the later stages of the business cycles marks a period which may have higher returns, but also higher risks.** As a result, investment in total equity will be lower than the outset of 2014. Leadership in energy paused in July – two months late compared to historical seasonality! U.S. technology seems to be a good area to expand investment. The consumer trend appears broken, while investment in U.S. health still seems to be occurring. Over the longer term I expect further increases in the U.S. dollar, with the caveat that when energy is strong, the Canadian dollar will be strong. Finally, I have done significant work on alternative investments in products that have

significantly less volatility than the stock market, almost no correlation to it, and provide reasonable and consistent returns. I hope to have a seminar on these strategies by September.

6. **In summary, this quarter shows:**
   a. I remain committed to selling when I suspect a larger correction may be looming.
   b. I am willing to sell my best winning positions that I historically have bought more of as they grow when it appears their leadership has ended.
   c. I continue to search for new trends, and tend to invest in them as they become established.
   d. Managed accounts owned very little of the best sector this quarter, energy, because it had generally underperformed for the past several years. Half the best performing stocks in managed accounts that made over 10% last quarter were in the energy sector.

Market Summary

Index	Country	First 6 Months 2014	2013	2012
S&P/TSX Composite Total Return Index	Canada	12.9%	13.0%	7.2%
Canadian DEX Bond Universe	Canada	4.8%	-1.2%	3.6%
Canadian 3-Month T-Bill	Canada	0.9%	0.0%	0.5%
MSCI World Index	World	5.4%	32.9%	10.2%
S&P 500 Total Return Index	U.S.	7.6%	41.8%	13.0%
Nasdaq Composite Index	U.S.	6.0%	48.1%	12.9%
Euro Stoxx 50 Index	Europe	3.9%	31.5%	12.6%
Nikkei 225 Index	Japan	-2.9%	38.2%	6.9%
MSCI Emerging Markets Index	E.M.	5.3%	1.7%	12.2%

Source: Richardson GMP. All returns, including foreign indices, are in Canadian dollars as of June 30, 2014

Enjoy the summer!

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
Email Brad.Hunter@RichardsonGMP.com
Web www.bhunter.ca

Connect with me on LinkedIn

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