

MAY
2018

cardinal UPDATE

DIVIDEND INCREASES

Johnson & Johnson	7.1%
Whirlpool Corp.	4.5%

(During the period April 1 to April 30, 2018)

LOOKING THROUGH THE NOISE

The steady flow of negative news these days can make one feel unsettled by each new headline, breaking story or Tweet. There are many fears including potential trade wars, lingering uncertainty about NAFTA, rising interest rates, inflation concerns, market volatility, pipeline politics and geopolitical tensions. None of these issues is trivial and any one of these concerns could have one looking for a hiding place.

It is at times like these that we continue to adhere to our investment philosophy that has done well for more than 25 years and revert to the fundamentals. On the macro front, interest rates are still accommodative and fiscal policy is aiding economic growth particularly in the U.S. There are some caution signs like higher commodity prices and a flatter yield curve, but not to the point of signaling an imminent recession.

And how do company fundamentals look? Are we comfortable riding out volatility with these businesses? The answer is that the fundamentals are solid with the majority of companies growing earnings and dividends. Most holdings have beat or been in line with earnings expectations this quarter and some have raised 2018 guidance. Many U.S. holdings have had a boost from tax changes and strong demand, which also helps Canadian holdings with U.S. operations.

Dividend increases have also been strong this year with 18 holdings raising their dividends by 11% on average during the first quarter. Not only does this provide a hedge

against inflation, but it also demonstrates the confidence of company management in the sustainability of their business as they feel comfortable raising dividends. The Canadian portfolio is yielding about 3.5% while the U.S. portfolio yields about 2.5%. Even with market weakness, the dividends keep flowing.

While dividends have steadily grown, dividend stocks have been out of favour recently. The S&P/TSX Dividend Aristocrats Index had a total return with dividends of -4.3% for the year ended March 2018 compared to the S&P/TSX Composite Index total return of +1.7%. There are many reasons for this including rising interest rates. As rates rise, investors may switch out of dividend stocks into alternatives like bonds. This changes at some point when the market grows more concerned about a recession and returns to emphasizing conservative, dividend paying stocks trading at attractive valuations. Over the last 10 years, the Dividend Aristocrats Index has outpaced the Composite Index by 3.7% annually.

The markets may fluctuate with every headline, but reacting each time leads to overtrading and chasing performance. Headlines change and so will the political leaders that will usher in another wave of uncertainty. Economies will adapt over time to new trade agreements and cooler heads usually prevail on geopolitical issues as the alternative solution sees no winners. Perhaps the only certainty that we have is that there will always be uncertainty and that staying on a patient, steady course works in the long run.

COMPANY FOCUS: ALIMENTATION COUCHE-TARD

Alimentation Couche-Tard (ATD) is one of the largest operators of convenience stores and fuel stations in North America and has a growing presence in Europe. Best-known for their Mac's and Circle K brands, ATD has a network of over 12,000 stores plus licensing agreements with over 1,800 stores in 13 other countries including China, Mexico, and Hong Kong. ATD has a strong track record of making prudent acquisitions and successfully integrating the new stores into their existing network. Given its expertise and scale ATD is able to apply best practices and utilize buying power for both fuel and store merchandise when adding acquisitions to their store base.

ATD has a consistent record of growing earnings and, given a fragmented U.S. convenience store industry as well as ample international expansion opportunities, lots of runway remains to continue growing via acquisitions and through increasing existing store sales. ATD's dividend yield is below 1% however the dividend has grown at a rapid pace, increasing at a 29% compounded annual growth rate over the last 5 years.

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