DM Monthly Report

February 2016

PORTFOLIO ACTIVITY

In January, we sold our remaining shares in American Express in DM Foreign Equity and used the resulting proceeds to add home improvement retailer, Lowe's.

FEATURE STOCK

Johnson & Johnson (JNJ)

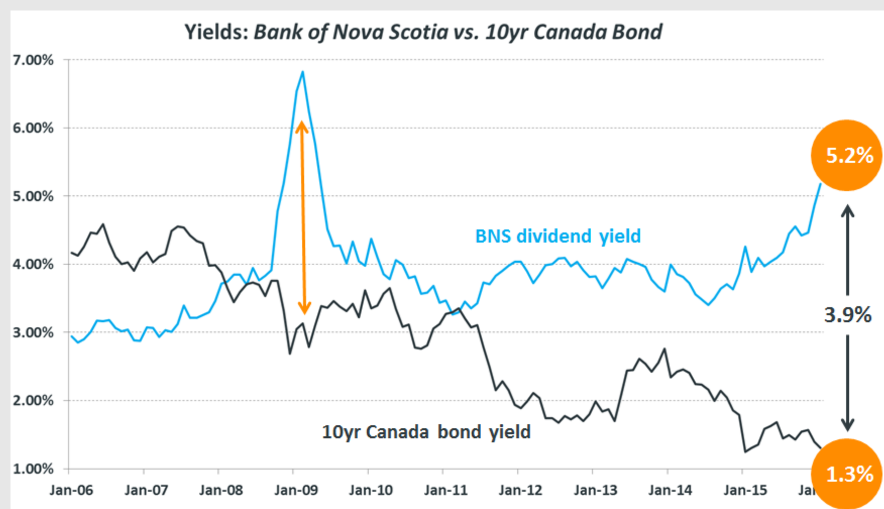
As it often does during difficult market periods, JNJ reminded us again in January of the value of stability within an equity portfolio. While the S&P 500 shed more than 5%, JNJ shares *gained* nearly 2% for the month, bolstered by fourth quarter earnings that beat analyst expectations. Recent income growth has been driven by effective cost cutting, as well as strong sales in its drug unit, which have increased at a 10% annual clip since 2010. Results such as these have produced a strong balance sheet, with $35bn in gross cash, and allowed the company to increase its dividend in each of the past 53 years. At the same time, JNJ is not without its challenges, with its key rheumatoid arthritis drug, Remicade, due to come off patent in 2018 and potentially facing competition from similar products sooner than that. With this in mind, we took advantage of the stock's recent strong relative performance to reduce its position weight slightly and redeploy resulting funds elsewhere in the portfolio.

PROTRACTED SOFT PATCH OR FULL BLOWN FINANCIAL CRISIS?

As most are well aware, stocks have set a horrid pace for 2016, with the S&P 500 posting its worst first week *ever* and the TSX battered by unrelenting energy weakness and a shared sense that our economy will be under pressure for some time. Though it's true that Alberta, Saskatchewan, and Newfoundland have been hit hard in recent quarters, the larger BC and Ontario economies have actually been adding jobs and are expected to post reasonable growth in the year ahead. Regardless, many Canadian stocks are trading like it's 2008 all over again, with investors folding their positions in high quality businesses as if they were bad poker hands.

One of the most visible examples of this heightened pessimism can be found in the TSX's most important industry sub-group, the Canadian banks. These stocks have sagged significantly since the fall, collectively shedding about $32bn in market value in the first two weeks of January alone. To put this figure in perspective, it is:

- equal to the group's total after-tax earnings in 2015;
- slightly greater than its book value growth last year and;
- roughly the same as the after-tax provisioning for a 100% loss on loans made to the energy industry.



Singling out the Bank of Nova Scotia, the chart above shows that in mid-January, its dividend yield exceeded that of the 10 year Govt. of Canada bond by nearly 4%; notably, the yield premium for BNS is now greater than it was during the worst of 2008/09. While our banks may face growth pressure in some of their markets in the year ahead, it's difficult to believe that conditions are as dire as they were in the teeth of the financial crisis. By this measure, it appears that a very attractive value cushion has been built into Canadian bank share prices.

Suite 1680, 1055 West Hastings St., Vancouver, BC V6E 2E9
Tel 604 669-3136 **Toll Free** 888 340-3136 www.**dixonmitchell**.com

DIXON MITCHELL
INVESTMENT COUNSEL