

# DM Monthly Report

March 2016

## PORTFOLIO ACTIVITY

In an effort to reduce cyclical exposure in DM Foreign, we sold both Devon Energy and CSX Corp. in February. In DM Canadian, we liquidated Pason Systems and used the resulting cash to acquire Constellation Software.

## FEATURE STOCK *Transforce Inc. (TFI)*

TFI is a leading provider of transportation and logistics services in Canada and the US. The company has grown significantly in recent years through a series of well executed acquisitions, including Vitran Corp. in 2013 and Transport America and Contrans in 2014. Unlike many of its competitors in the space, TFI has built a strong track record of cash flow generation, which has allowed management to both incrementally strengthen the company's balance sheet and increase its dividend by 70% since mid-2011. In its fourth quarter earnings report released in February, TFI also announced that it would repurchase up to 10 million shares through a "modified Dutch auction". This buyback could see more than 10% of the company's outstanding shares retired and signals management confidence in both TFI's current capital position and its ability to produce and grow cash flow in the quarters to come.

## DISPLAYS OF CONFIDENCE

When stocks fall sharply, as they did at the beginning of this year, it's useful to gauge whether the decline reflects an actual deterioration in business conditions, or just a bout of elevated investor pessimism. If it's the first scenario, a more defensive position in equity portfolios might be warranted; if it's the second, reconfiguring one's stock allocation is likely to do more harm than good.

In looking for clues to this question, last month we compared the dividend yield of Bank of Nova Scotia shares with the current interest return offered on the 10 year Government of Canada bond and found that the spread between the two (and the implied risk premium for owning BNS shares) was higher than it was during the worst of the financial crisis. Put another way, for a return-oriented investor to be indifferent between owning these two securities over the next decade, BNS shares would need to fall by roughly 40% over that timeframe. On this metric, we suggested that the market may have been overestimating the difficulties currently faced by Canadian banks, the most important industry group in the TSX.

In February, we received another hint that business conditions may be better than the market perceives when several of the holdings in our core portfolios—including Express Scripts, Cisco Systems, Apple, HCA Group, Transforce, Agrium, CP Rail, CN Rail, Magna, Gildan Activewear, Saputo, Jean Coutu, and Home Capital Group—announced new or expanded share buyback programs. Put another way, these firms believe that current share prices underestimate the current and imminent fundamentals of their businesses. Home Capital's buyback was particularly powerful as its shares were recently the second most shorted on the TSX. When management asserted its conviction last month by declaring a substantial share repurchase, many of these bets against the company were reversed, unleashing a buying surge that contributed to a quick gain of more than 30%.

