cardinal UPDATE

MAY 2016

DIVIDEND INCREASES

Johnson & Johnson	6.7%
United Technologies Corp.	3.1%
Wells Fargo & Co.	1.3%

(During the period: April 1 – 30, 2016)

POLITICS AND PORTFOLIOS

It is an election year in the U.S. and politics is getting more coverage than ever this year. The headlines south of the border, and globally it appears, are about Mr. Trump's run for the US presidency. We've also seen the Sanders phenomena down there, and up here we've seen an Alberta NDP and a free-spending Federal Liberal administration. A little more removed we have the Brexit debate in the UK, and under the radar, Cuba, Greece and Turkey. The media engages in a maelstrom of interviews and debate about how the political trends will impact the economy, the equity markets and even individual industries.

That's all very helpful if your mission is to increase audience in order to sell advertising, but less relevant to the prudent management of wealth. Political headlines have very little long term bearing on the economy, and even less on individual industries, even though they can impact day-to-day trading (another sign of the irrationality of markets!). Yes, one can point to Fidel/Raul Castro and Hugo Chavez, but it is very, very rarely that an individual has the power and the support to completely de-rail an economy. Even Bernie Sanders winning the US election would be unlikely to result in him achieving any small part of his agenda on the economy.

These days we are constantly queried about how we are investing in light of Trump's success, and the answer is generally that we're investing the same as before. Yes, he may change the odds on KXL, and may improve US tax policy, but on the other hand he may aggravate international trade issues. Because of myriad details, any influence from him will take months if not years to be implemented, and years to be felt in the economy and on corporate income statements. As engineers say, life is full of trade-offs: a bad policy here has good results there. Rarely is a policy 100% negative to all parties. And even then, in the investment universe in which Cardinal operates – large blue-chips – a clear winner from a specific economic policy is one who may see a boost of a few percentage points in revenue or margin. Disconcertingly, the equity market almost always over- or under-estimates the impact of public policy on individual firms, and usually jumps the gun. This reaction reinforces the view that politics matters, but it moves the issue from economics to psychology. To benefit, one has to predict how markets will react, rather than how profits and cash flow will change. We are comfortable with the second problem, and believe no one can be consistently successful at the first.

Don't let politics drive your portfolio – its bark is worse than its bite!

COMPANY FOCUS

CANADIAN NATURAL RESOURCES (CNQ)

Make no bones about it, the current oil price environment hurts companies like CNQ. With oil averaging its lowest level since 2004, Q1 2016 cash flows fell 50% year over year. In response, the company has reduced cash operating costs by 36%, administration costs by 23%, and has cut capex by 55%, in two years! Despite these deep cuts, long-term growth has not been sacrificed at the altar.

Sufficient capital continues to be put towards the 125,000bbl/d expansion of the Horizon oil sands mine, which upon completion in 2017 will deliver a large swing in free cash flow that will last for decades. Even at just $50/bbl oil long-term, we estimate that CNQ will generate $3-$4B in free cash flow per year, which is triple the current dividend.

CNQ is set-up to survive and thrive, even if oil prices do not recover to levels we expect.

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