



DECEMBER 2018 NEWSLETTER

Market Review

2018 was a very challenging year for equity investors, with most of the major world markets declining. While our clients have outperformed the TSX index, even the highest quality companies lost ground this year and we are certainly not bragging or beating our chests. While there are many culprits to blame, including world trade protectionism, Brexit worries, and the diminishing amount of pragmatic investor friendly world leaders, the important issue is how we react to the cards we have been dealt. Good investment decisions always win out in the end.

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	<u>Dec</u> <u>29/17</u> <u>Close</u>	<u>Sept</u> <u>28/18</u> <u>Close</u>	<u>Dec</u> <u>31/18</u> <u>Close</u>	<u>90-Day</u> <u>%</u> <u>Change</u>	<u>1-Year</u> <u>%</u> <u>Change</u>
S&P 500	2,674	2,914	2,507	-14.0%	-6.25%
S&P/TSX Composite	16,209	16,073	14,323	-10.8%	-11.6%

Source: Thomson One

<u>World Markets</u>	<u>YTD</u>
S&P/TSX Composite	-11.6%
S&P 500	-6.25%
NASDAQ	-4.00%
Dow Jones	-5.63%
Russel 2000	-12.1%
iShares S&P/TSX Preferred Index ETF	-12.9%
DJ Stoxx 50	-14.4%
FTSE 100	-12.5%
HANG SENG	-13.6%

As of December 31, 2018

Source: Thomson One

Canadian T-Bills and Bonds Yields

	<u>Jun. 29, 2018</u>	<u>Sept. 28, 2018</u>	<u>Dec. 31, 2018</u>
90-day	1.31%	1.60%	1.70%
180-day	1.49%	1.76%	1.81%
1-year	1.73%	2.04%	1.91%
2-year	1.915%	2.214%	1.862%
5-year	2.068%	2.340%	1.887%
10-year	2.169%	2.428%	1.967%
30-year	2.204%	2.422%	2.184%

Source: Thomson One

International 10-Year Bond Yields

	<u>Jun. 29, 2018</u>	<u>Sept. 28, 2018</u>	<u>Dec. 31, 2018</u>
Japan	0.02%	0.12%	-0.01%
U.S.	2.86%	3.06%	2.68%
Germany	0.30%	0.47%	0.24%
Canada	2.17%	2.43%	1.97%
U.K.	1.28%	1.57%	1.27%
France	0.66%	0.80%	0.70%
Spain	1.31%	1.49%	1.41%
Italy	2.67%	3.14%	2.74%
Portugal	1.76%	1.87%	1.71%
India	7.90%	8.02%	7.36%

Source: Bloomberg.com

Most of the world's 10-year bond rates fell this quarter as investors made a "flight to safety", and the market discounted slower growth in the future. While long term rates continue to be higher than short term rates, the flatness of the yield curve indicates that bond investors are not expecting strong economic activity. We continue to use high interest savings accounts for the bulk of our fixed income investing as the long term rates barely exceed inflation.

Our Top 30 Positions

Position	Investment	Dec	Dec	Income	Performance
		29/17	31/18		
		Close	Close		
30	RioCan REIT	\$ 24.36	\$ 23.80	\$ 1.44	3.61%
4	Johnson & Johnson*	\$ 175.57	\$ 176.18	\$ 4.91	3.14%
9	H&R REIT	\$ 21.36	\$ 20.65	\$ 1.38	3.14%
5	Fortis Inc.	\$ 46.11	\$ 45.51	\$ 1.80	2.60%
26	Russel Metals 6% 19APR22	\$ 103.25	\$ 99.75	6.00%	2.42%
25	TD Capital 7.243% 31DEC18	\$ 105.02	\$ 100.00	7.24%	2.11%
8	Manulife Premium Savings Account	\$ 10.00	\$ 10.00	1.70%	1.70%
1	BNS Investment Savings Account	\$ 1.00	\$ 1.00	1.60%	1.60%
10	ADSB Investment Savings Account	\$ 1.00	\$ 1.00	1.60%	1.60%
7	WSP Global Inc.	\$ 59.91	\$ 58.67	\$ 1.50	0.43%
29	Cash	\$ 1.00	\$ 1.00	0.00%	0.00%
12	Telus Corporation	\$ 47.62	\$ 45.25	\$ 2.18	-0.40%
13	Canadian National Railway Co.	\$ 103.65	\$ 101.11	\$ 1.82	-0.69%
6	Brookfield Asset Management Inc.	\$ 54.72	\$ 52.32	\$ 0.80	-2.92%
3	Toronto Dominion Bank	\$ 73.65	\$ 67.86	\$ 2.68	-4.22%
2	Royal Bank of Canada	\$ 102.65	\$ 93.44	\$ 3.92	-5.15%
24	BCE Inc. (BELL)	\$ 60.38	\$ 53.93	\$ 3.02	-5.68%
15	JPMorgan Chase & Co.*	\$ 145.99	\$ 133.27	\$ 4.37	-5.72%
27	Bank of America Corp.*	\$ 37.09	\$ 33.64	\$ 0.82	-7.09%
20	Bank of Montreal	\$ 100.59	\$ 89.19	\$ 4.00	-7.36%
19	Raymond James Financial Inc.*	\$ 112.60	\$ 101.58	\$ 1.86	-8.13%
	Vanguard FTSE Canada All Cap Index ETF	\$ 32.77	\$ 29.02	\$ 0.83	-8.92%
28	Brookfield Infrastructure	\$ 56.38	\$ 47.15	\$ 2.52	-11.91%
11	Bank of Nova Scotia	\$ 81.12	\$ 68.05	\$ 3.40	-11.92%
16	Brookfield Renewable Energy LP	\$ 43.81	\$ 35.35	\$ 2.62	-13.33%
18	Suncor Energy Inc.	\$ 46.15	\$ 38.13	\$ 1.44	-14.26%
22	Wells Fargo & Company*	\$ 76.24	\$ 62.91	\$ 2.32	-14.44%
23	TransCanada Corporation	\$ 61.18	\$ 48.75	\$ 2.76	-15.81%
17	Power Financial Corporation	\$ 34.54	\$ 25.83	\$ 1.73	-20.20%
14	Manulife Financial Corporation	\$ 26.22	\$ 19.37	\$ 1.00	-22.31%
21	Freehold Royalties Ltd.	\$ 14.05	\$ 8.27	\$ 0.63	-36.65%

*Performance in Canadian dollars Dec. 29/17 \$0.7958, Dec. 31/18 \$0.7325

Source: Thomson One

The chart above indicates the performance of our top 30 positions in 2018, compared with the Vanguard Canada fund (which we don't own) as a benchmark for the TSX. While the majority of our positions beat the index, there were very few places to earn a positive return this year.

Our major goal during 2018 was to reduce any positions that could potentially be vulnerable due to debt issues, significant litigation, or an economic pullback, and add positions that we feel are more resilient to economic stress. We eliminated Altgas common shares, which are not a top 30 position, and this paid off as the stock declined further. Trinidad Drilling (not a top 30 position either) has had a takeover offer, and has been sold or tendered. We

also reduced Wells Fargo due to legal issues in the US, adding JP Morgan and Bank of America in its place for more diversification.

On the positive side our net purchases this year include CN Rail which has moved from our 29th position to our 13th position, Fortis, which has moved from our 11th position to our 5th position, and TransCanada Pipeline, which has become our 22nd position. We believe that all of these companies will have good results even if the economy goes into recession.

In Canada insurance companies were poor performers but continue to pay very attractive dividends. The Canadian oil industry had a brutal year, our largest oil company positions Suncor and Freehold Royalties have very good balance sheets but still under-performed the general Canadian market.

Johnson & Johnson (JNJ-US)

5 Year Chart



Source: Thomson One

In our search for companies with diversified recession resistant businesses, great balance sheets and rising dividend income, Johnson & Johnson has been a good candidate and is our 4th largest position. As recently as December 13, Johnson & Johnson was close to an all-time high and was a bright spot in everyone's portfolio.

Unfortunately a recent article in Reuters brought to light recent litigation against Johnson & Johnson for potentially causing cancer through the use of baby powder. If you read Johnson & Johnson's response, these are frivolous claims that ignore scientific studies in order to enrich lawyers. If you read the plaintiff's claims, Johnson & Johnson was aware that the talc in baby powder contained asbestos and they recklessly allowed the product to be sold. My own view from reading the different arguments is that numerous studies have indicated that baby powder is safe. That being said no one can predict court outcomes, and any potential liability is hard to measure.

Many of our clients have doubled their money on Johnson & Johnson over the last few years, so if your position is much greater than 5% you may consider reducing the position slightly to diversify into other US stocks many which are down just as much or more than Johnson & Johnson. Costco and Visa might be good alternatives.

Dividend Changes

<u>Position</u>	<u>Investment</u>	<u>Q4 2017 Dividend</u>	<u>Q4 2018 Dividend</u>	<u>Increase</u>
1	BNS Daily Interest Account	0.95%	1.60%	68.42%
10	ABSB Daily Interest Account	0.95%	1.60%	68.42%
19	Raymond James Financial Inc.*	0.22	0.34	54.55%
15	JPMorgan Chase & Co.*	0.56	0.8	42.86%
8	Manulife Bank Premium ISA	1.25%	1.70%	36.00%
27	Bank of America Corp.*	0.12	0.15	25.00%
14	Manulife Financial Corporation	0.205	0.25	21.95%
18	Suncor Energy Inc.	0.32	0.36	12.50%
3	Toronto Dominion Bank	0.6	0.67	11.67%
23	TransCanada Corp.	0.625	0.69	10.40%
13	Canadian National Railway	0.4125	0.455	10.30%
22	Wells Fargo & Co.*	0.39	0.43	10.26%
28	Brookfield Infrastructure*	0.435	0.47	8.05%
12	Telus Corporation	0.505	0.545	7.92%
2	Royal Bank of Canada	0.91	0.98	7.69%
11	Bank of Nova Scotia	0.79	0.85	7.59%
4	Johnson & Johnson*	0.84	0.90	7.14%
6	Brookfield Asset Management Inc.*	0.14	0.15	7.14%
20	Bank of Montreal	0.90	0.96	6.67%
5	Fortis Inc.	0.425	0.45	5.88%
24	BCE Inc. (BELL)	0.7175	0.755	5.23%
21	Freehold Royalties Ltd.	0.05	0.0525	5.00%
17	Power Financial Corporation	0.4125	0.433	4.97%
16	Brookfield Renewable Energy LP*	0.4675	0.49	4.81%
30	RioCan REIT	0.1175	0.12	2.13%
7	WSP Global Inc.	0.375	0.375	0.00%
9	H&R REIT	0.115	0.115	0.00%
25	TD Cap III 7.243% 31DEC18 Bond	7.24%	7.24%	0.00%
26	Russell Metals 6% 19APR22 Bond	6.00%	6.00%	0.00%
29	Cash	0.00	0.00	0.00%

*Performance in Canadian dollars Dec. 31/18 \$0.7325

Source: Thomson One

While world markets corrected very sharply in 2018, we enjoyed good dividend increases this year from the majority of our largest holdings. If we can identify companies that increase their dividends over time, our investment income will grow regardless of the periodic market corrections and bear markets. This strategy makes it easier to ride out tough markets so that we continue to be invested when the new bull market starts.

Dividend Yields

<u>Position</u>	<u>Investment</u>	<u>Dec 31/18 Close</u>	<u>Income</u>	<u>Yield</u>
21	Freehold Royalties Ltd.	\$ 8.27	\$0.63	7.62%
16	Brookfield Renewable Energy LP	\$ 35.35	\$2.66	7.52%
25	TD Capital 7.243% 31DEC18	\$ 100.00	7.24%	7.24%
17	Power Financial Corporation	\$ 25.83	\$1.73	6.71%
9	H&R REIT	\$ 20.65	\$1.38	6.68%
30	RioCan REIT	\$ 23.80	\$1.44	6.05%
26	Russel Metals 6% 19APR22	\$ 99.50	6.00%	6.03%
23	TransCanada Corporation	\$ 48.75	\$2.76	5.66%
24	BCE Inc. (BELL)	\$ 53.93	\$3.02	5.60%
28	Brookfield Infrastructure	\$ 47.15	\$2.55	5.41%
14	Manulife Financial Corporation	\$ 19.37	\$1.00	5.16%
11	Bank of Nova Scotia	\$ 68.05	\$3.40	5.00%
12	Telus Corporation	\$ 45.25	\$2.18	4.82%
20	Bank of Montreal	\$ 89.19	\$4.00	4.48%
2	Royal Bank of Canada	\$ 93.44	\$3.92	4.20%
5	Fortis Inc.	\$ 45.51	\$1.80	3.96%
3	Toronto Dominion Bank	\$ 67.86	\$2.68	3.95%
18	Suncor Energy Inc.	\$ 38.13	\$1.44	3.78%
22	Wells Fargo & Company*	\$ 62.91	\$2.32	3.69%
15	JPMorgan Chase & Co.	\$ 133.27	\$4.37	3.28%
	Vanguard FTSE Canada All Cap ETF	\$ 29.02	\$0.83	2.86%
4	Johnson & Johnson*	\$ 176.18	\$4.91	2.79%
7	WSP Global Inc.	\$ 58.67	\$1.50	2.56%
27	Bank of America Corp.*	\$ 33.64	\$0.82	2.44%
	5 Year Government of Canada Bond	\$ 100.00	\$1.89	1.89%
19	Raymond James Financial Inc.*	\$ 101.58	\$1.86	1.83%
13	Canadian National Railway Co.	\$ 101.11	\$1.82	1.80%
8	Manulife Premium Savings Account	\$ 10.00	1.70%	1.70%
1	BNS Investment Savings Account	\$ 1.00	1.60%	1.60%
10	ADSB Investment Savings Account	\$ 1.00	1.60%	1.60%
6	Brookfield Asset Management Inc.	\$ 52.32	\$0.81	1.56%
29	Cash	\$ 1.00	0.00%	0.00%

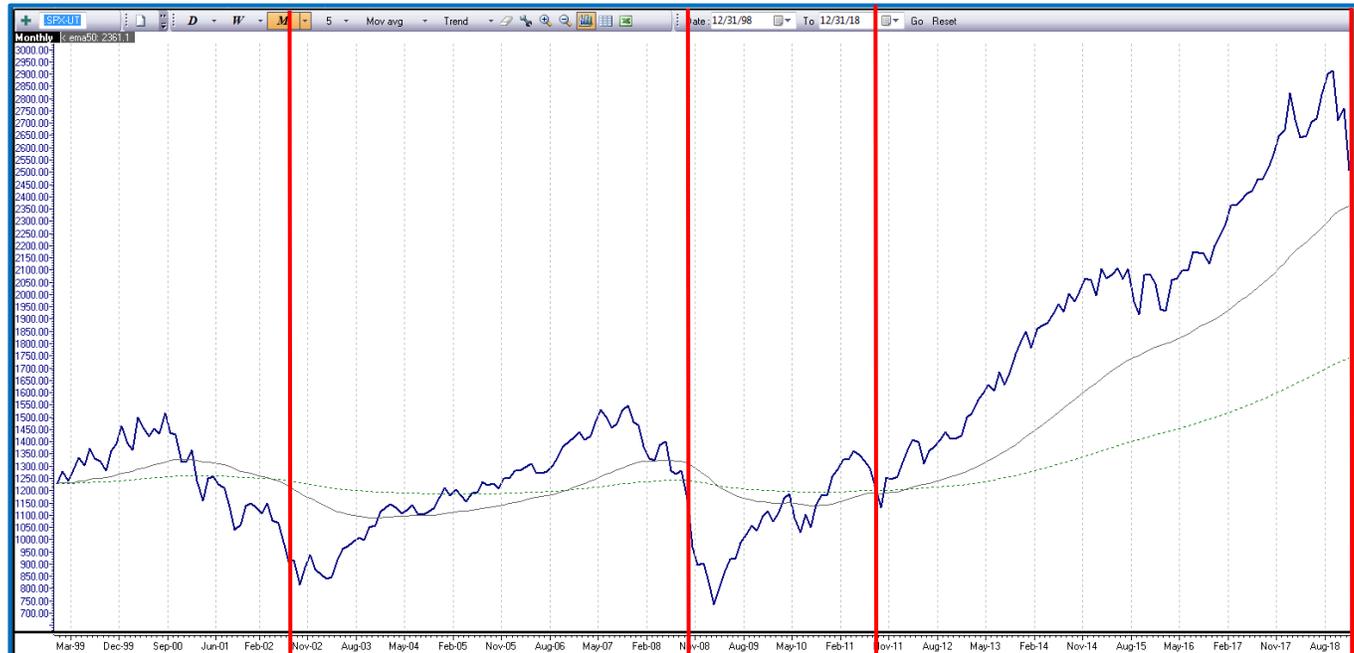
*Performance in Canadian dollars Dec. 31/18 \$0.7325

Source: Thomson One

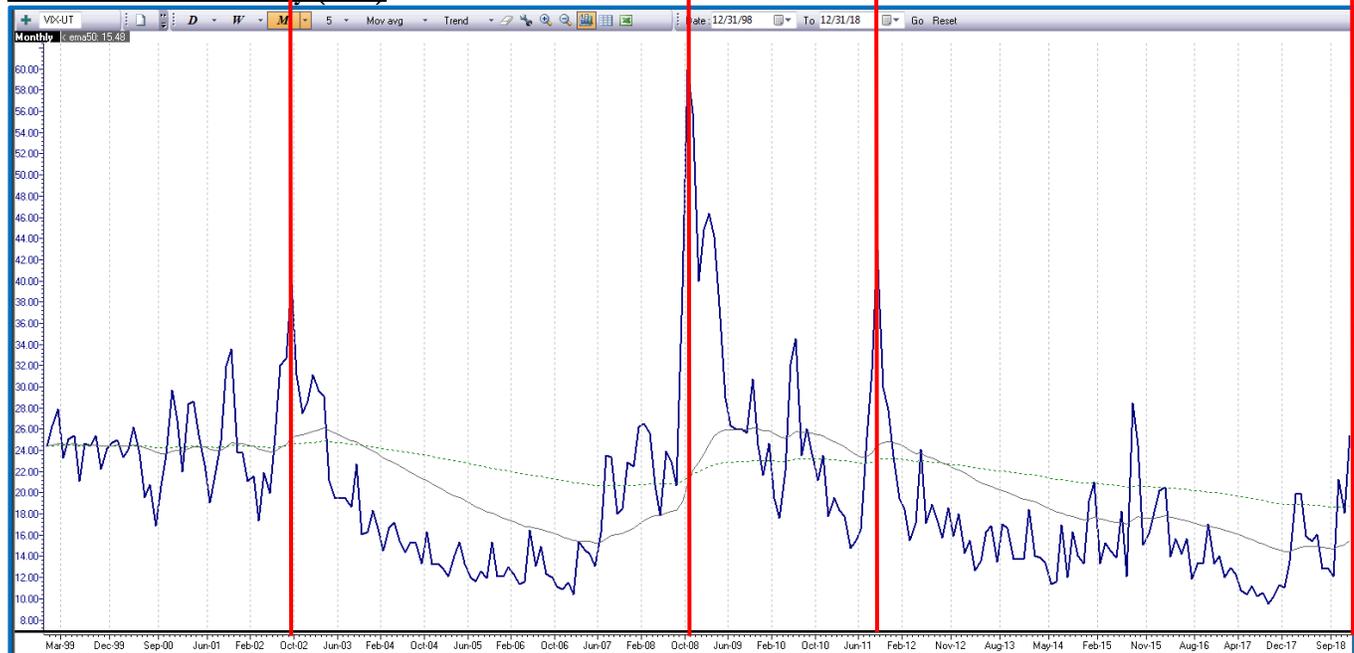
While the markets have dropped sharply, the majority of our positions earn dividend yields far in excess of 5-year Canada bonds or the TSX, measured by the Vanguard FTSA Canada All Cap Index ETF. Our 26th position, the TD Capital 7.243% 31 Dec 2018 Capital Trust, was purchased during the 08/09 financial crisis and we have been enjoying the 7.243% yield for close to 10 years. These matured on December 31, and while there are certainly no TD Bank fixed income investments with that kind of yield, there are a multitude of high-yielding common stocks and preferred shares trading at distressed prices.

The Fear Index

S&P 500 Index



CBOE Market Volatility (VIX)



Source: Thomson One

The CBOE Market Volatility Index, commonly called the VIX, is a measure of the stock market's expectation of volatility implied by S&P 500 index options.

By comparing the S&P 500 index to the VIX index, it is clear that when expected volatility or fear is high, this usually coincides with an attractive market entry point. The exception to this was in 2008 when the VIX index was very high and the market got worse for another six months. The charts above indicate that fear has only been higher than the December 24 level on three or four occasions in the last 20 years. Our conclusion is that while no one can time market bottoms exactly, the odds are that investors are likely better off buying than selling at this point.

Activities of First Quarter 2019

The first thing we will be doing in 2019 is calling everyone for review and to discuss your TFSA and/or RRSP contributions. The TFSA contribution limit for 2019 was increased to \$6,000.00. The deadline for RRSP contributions for the 2018 year is Friday, March 1, 2019.

T4RSP, T4RIF, T4A (RESP), T5008, T5 and *summary of investment income* tax receipts should be mailed to you on February 28, 2019. T3 and T5013 tax receipts should be mailed by March 29, 2019. Please note, all T5 and T3 tax receipts for mutual fund investment income are issued directly by the fund companies, not by Raymond James Ltd.

If you would like a capital gain/loss report for the year please call. Unless you request otherwise we will report U.S. capital gains or losses in Canadian dollar terms to simplify your tax returns.

Summary

We have experienced a correction in most of the world markets, and very few securities have been left unscathed. Defensive stocks, including utilities and real estate have had the best relative returns, while energy, emerging markets, growth oriented technology companies, and other economically sensitive companies have fared the worst. Our strategy is to play it safe and focus on companies that should continue to maintain or grow their revenues even if the world experiences an economic slowdown. We wish you all the best for the 2019 year.

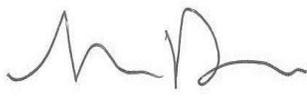
With the addition of Mark and Meaghan as Associate Advisors, we now have the ability to take care of more relationships. If you have friends who have expressed an interest in finding a new advisor, we would be delighted to hear from you. Just call our office at 250-729-2830 and we'll take it from there. Thanks!



Ian Douglas

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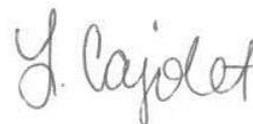
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