

## AWAITING THE TURN

“Patience is not simply the ability to wait  
-- it’s how we behave while we’re waiting.”

- Joyce Meyer

Over the past 15 months we have proactively repositioned our five ABC Funds’ portfolios toward the new investment world of ecommerce, mobile technology, healthcare and globalization. It was our sense that profound economic, financial and technological changes would continue to impact the world economies and that investors would have to take notice.

We concluded that in spite of many investors trying to bottom-fish for overly price-depressed resource stocks, we strongly believed that we were in the midst of a transformation into an asset-light, digital and service-based economy. The risk, however, was that it would not happen overnight and that we would have to maintain our composure.

In all candour, the current investment environment has been quite difficult given the extreme market volatility caused by incessant economic, financial and political news which bombard us daily. It is our belief that one should not be swayed from credible investment positions due to the non-stop flow of noise and the pressure to conform to short-term market trends. This commitment discipline is extraordinarily demanding in an extremely competitive and fickle financial environment. An investor’s endurance will be constantly tested if one’s end is to be attained.

Although there has been a price bounce in resource securities, particularly, in the oil & gas, mining, and gold sectors, we have stuck to our “new world investment thesis” whereby liquid technology, healthcare and American financial common shares would be the mainstay of our portfolios.

Companies such as Apple, Avago/Broadcom, Nvidia, Amgen, Boston Scientific, Wells Fargo, First Republic Bank and MasterCard were added to our portfolios and while their quarterly business results have generally been up to or better than expectations, the price performance of a number of these holdings appears to be lagging the general market. We are not dismayed.

In Canada, our favoured stocks such as Exco Technologies, CCL Industries, Stingray Digital, and Uni-Select have also produced good corporate results, however, they remain relatively undervalued versus the market benchmarks. Despite this lag we remain very patient as we await the market’s eventual recognition of these securities.

Overall, it is our view that the North American economies will continue to grow at a slow, but steady pace with both monetary and fiscal stimulus elongating the current slow growth economic cycle. Moreover, we believe that solid, dividend-paying liquid stocks are comparatively attractive alternatives relative to low yielding short-term money market securities and government bonds. Although we expect to be incessantly tested within the present inconsistent investment environment we intend to bide our time until our stock selection price targets are realized.





Economic

Perspectives

## SURPRISINGLY POSITIVE ECONOMIC ACTIVITY

Considering the generally negative economic and financial expectations overhanging the securities markets many investors have been pleasantly surprised by recently reported U.S. economic growth. For instance, the U.S. Commerce Department had initially estimated that Q4/2015 American GDP at +0.7% compared to upgraded economists' expectations of +1.0%. However, when finally released in late March the Department, in fact, announced that Q4/2015 GDP grew at an unanticipated rate of 1.4%. Furthermore, it is now estimated U.S. economic activity grew at +2.4% for all of 2015.

The point is that due to the fact that the securities markets have been extraordinarily volatile and frustrating, investors economic growth expectations have been general pessimistic and understated. It is our view that although the U.S. economy is still on a slow growth path we believe that a continuation of surprisingly positive economic activity should eventually benefit corporate profits and raise common stock prices. In short, we believe the glass is half full rather than half empty.

Investment

Perspectives

## UNEXPECTED EARNINGS BEATS

Although equity markets have recovered from the February lows investor psychology remains quite subdued and corporate earnings expectations are very cautious. With low earnings predictions a number of recently released company results produced unexpected earnings beats. These positive results included a number of favoured ABC Funds' equities such as: The Home Depot, Salesforce.com, AutoZone Inc., The Kraft Heinz Co., Exco Technologies, Six Flags Entertainment Corp.,

Gilead Sciences, Nvidia Corp., O'Reilly Automotive and CCL Industries. With this unanticipated performance most of these companies climbed to new 12-month price highs but have since retreated with the market variability. It is our view that poor investment psychology combined with improving fundamentals and rebounding investor perceptions should become meaningful positive catalysts toward higher common stock prices.

Portfolio

Perspectives

## LARGE CAPITALIZATION FOCUS

Since the start of 2016 North American equity markets have been fraught with extreme market price volatility and broad-based investor indecision. Over the past year we have continued to upgrade our ABC portfolios toward relatively undervalued large capitalization common stocks. These particular selections provide not only excellent liquidity but also offer: significant free cash flow, solid dividends with the prospect of annual increases, steady earnings growth and very strong balance sheets with high cash pools. Given the current

uncertain economic environment we feel very comfortable with these common shares which include: Alphabet Inc., Apple Inc., Facebook Inc., Johnson & Johnson, Microsoft, Nike Inc., PepsiCo Inc., The Home Depot, The Kraft Heinz Co. and The Kroger Co.



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# THE NEW VALUE

“Every time we’ve moved ahead in IBM  
it was because someone was willing to take a chance,  
put his head on the block and try something new.”

- Thomas J. Watson

Over the past decade there have been many changes with respect to traditional value investing. For instance, over the years we were able to purchase deeply undervalued stocks trading at half of book value, net asset value and/or at several times cash flow multiples. Successful purchase examples during that time included Com Dev International, Flint Energy Services, High Liner Foods and Vector Aerospace. However, the likely occurrence of similar investment opportunities, today, has fallen off significantly due to increased investor competition, aggressive corporate takeovers of deeply undervalued securities and fewer initial public offerings.

Looking back, many changes occurred with regard to the securities markets and it is our view that the stock market has become increasingly efficient. This result is largely due to expanding media attention and the remarkable growth in the transfer of financial information, greater investor education and a declining appetite for investment risk. Consequently these factors are making it extremely difficult to uncover overlooked, deeply undervalued equities. The point is not to imply that an investor won't be able to pick off an attractive deep value stock from time to time. It is our opinion, however, that generally the purchase quantities will likely be insufficient for most institutional investors, the stock might be an illiquid value trap and/or the stock may lie in the precarious resource sector vulnerable to volatile commodity prices. This situation is the reality of today's value marketplace. The fact is that pickings are very slim and value investors such as ourselves have had to face a more complicated world of “new value” whereby past parameters of low price/earnings multiples, discount to book value, replacement cost and/or out-of-favour contrarian investments are no longer enough to achieve investment success.

In approaching the new value stock selection process and factoring in the current fickle investment environment we find that many investors are shifting away from traditional “buy and hold” investing. We are encountering more of a traders’

market mentality with common share liquidity becoming increasingly important. While we are not forsaking our old value investing principles we do expect that liquid large capitalization common stocks will lead the market recovery over the next 12 months and that a liquidity-driven environment will likely continue to the end of 2016.

In fact, our new value selections emphasize not only liquidity, free cash flow and excessively strong balance sheets but also corporate globalization, e-commerce, cloud computing, high technology, mobility, healthcare, fintech and strong product branding. These themes are most prominent in our security selection process today. Interestingly, many of our new selections have been in very large capitalization American equities which offer the numerous new value elements we are seeking. A few examples of these new value ABC Funds’ holdings include Apple Inc., Boston Scientific Corporation, Microsoft, Johnson & Johnson, Visa, Amgen Inc., Kraft Heinz Co. and PepsiCo Inc. We believe that these common stocks offer not only good long term value and liquidity but also investment stability, dividends and growth in an extremely volatile financial environment.

Summing up, we have moved ahead to expand our common stock value selection universe given that many market changes have taken place. Going forward we intend to constantly review our value principles and will opportunistically make modifications wherever necessary.

**Irwin A. Michael, CFA**



## BOSTON SCIENTIFIC CORP.

Boston Scientific Corporation develops, manufactures, and markets medical technology and devices. The company has a diverse portfolio of medical products that are used in a wide array of fields including cardiology, endoscopy, urology, and gynecology.

We believe that Boston Scientific is an attractive healthcare investment for several reasons. Firstly, the company represents a free cash flow growth story, which is increasing its market share and improving its efficiencies. Boston Scientific has demonstrated impressive achievements over the past several years, including double-digit EPS growth (excluding foreign exchange). Moreover, the company significantly improved its operating margin from 17.8% in 2012 to 22.5% in 2015 and produced excellent sales growth accretion. Beyond exhibiting an impressive growth profile, Boston Scientific has a very promising product pipeline and trades at an attractive 2016E price earnings multiple of 18.0x. We believe that the company's revenues and earnings should continue to expand through the development of its product pipeline, increasing operating efficiencies and widening global demand for healthcare products.

Secondly, Boston Scientific's current product line has helped the company achieve strong results over the past several quarters and we believe this trend will continue since the company has historically demonstrated above market sales growth and margin improvement. For instance, during Q4/2015, Boston Scientific produced sales of \$1.978 billion which represented a 10% operational revenue growth (constant currency basis, excluding divested businesses) and adjusted EPS of \$0.26 versus \$0.22 in the prior year. Over the fiscal year 2015, the company achieved an 8% operational revenue growth and adjusted EPS of \$0.93 compared to \$0.84 in 2014.

Thirdly, Boston Scientific has an exceptionally strong product pipeline that should materially grow company revenues and earnings in the future. Some of Boston's

recently launched products include Synergy, its promising treatment for coronary heart disease and Watchman, the company's new structural heart product. Both new medical technologies have a very positive outlook and should expand Boston's earnings potential. We believe that enhanced earnings growth can be achieved since the company is targeting an operating margin of 25% by 2017. Furthermore, the company grew operational revenue by 16% in emerging markets and it is our opinion that this geographic segment can expand materially.

Fourthly, Boston Scientific has strong business fundamentals. The company is using its free cash flow to repay its \$5.7 billion debt and to enter into M&A in high growth markets. Considering that Boston Scientific is expected to earn \$2.4 billion in EBITDA in 2016, the company will have sufficient capital to grow its product pipeline, maintain a strong balance sheet and make additional opportunistic acquisitions.

In summation, it is our belief that Boston Scientific has transitioned into a first-class, medical technology leader with a growing market presence. The company has the ability to expand its product pipeline through M&A and organic growth with the support of its strong balance sheet. We believe that Boston Scientific presents impressive fundamentals and a remarkable business model at a very attractive valuation.



## THE HOME DEPOT INC.

Home Depot, the world's largest home improvement specialty retailer, is an attractive investment for both its high quality business operations and strong growth from the American housing market recovery.

The company operates close to 2300 retail stores in the United States, Canada and Mexico, with roughly 2000 of them located in the U.S. Unlike other large American multinational companies, Home Depot is primarily exposed to the American economy and is relatively unaffected by global economic weakness and currency fluctuations. The company serves three types of customers, the first being do-it-yourself (DIY) individuals. DIY customers are home owners who prefer to buy their own products and upgrade their homes on their own. The second type is the do-it-for-me consumer, who will buy products at Home Depot and hire a professional to install them. The final group are professional customers, who do all the work for their clients and purchase the necessary materials from Home Depot.

The primary factor for Home Depot's continuous success is the recovery of the American housing market from the 2008 recession. Pent-up demand for homes has resulted in a gradually recovering U.S. housing market. Additionally, low interest rates, employment growth and higher wages are encouraging homeowners to spend more money on renovating their homes, while rising home prices are encouraging homeowners to spend more on larger renovations. It is our belief that there is considerably more room for the American housing market to improve. For instance, private residential fixed investment as a percentage of GDP is still well below the historical average, the average house in the U.S. is almost three decades old, and American house prices are still below the 2006 peak.

We believe Home Depot is one of the strongest and most diversified ways to invest in the American housing recovery. The company holds an estimated market share of over 25%, larger than any other rival and with stores in every U.S. state.

Despite the company's size, Home Depot has an industry leading sales growth rate, which can be attributed to the company's superior strategy. This success is driven by several factors, the first being excellent customer service. The company has an integrated business model that analyses the customer and adapts to their needs. The company is not opening new stores in America, but instead, management is focused on driving store traffic, productivity and efficiency within existing outlets. By growing sales at existing locations, efficiency gains have resulted in a steadily increasing gross margin percentage each year. Also, the company has a wide array of private brands that are very popular with customers, such as Behr Marquee paints.

Home Depot has been among the most resilient retail businesses facing the threat of e-commerce and Amazon.com. This can be explained by the type of products that Home Depot sells, which are less suited to online shopping and shipping. This advantage gives Home Depot a natural moat against internet competitors. Nonetheless, the company is still focused on selling products online and has a rapidly expanding ecommerce business.

Home Depot operates an extremely profitable business, with low fixed capital investment requirements. In the past year, the company generated over \$7 billion in free cash flow. Home Depot has a disciplined capital allocation policy, targeting a 50% dividend payout, with annual dividend increases each year. Any excess liquidity is used for share buybacks or accretive acquisitions.

Home Depot trades at a forward price-earnings multiple of 22 times, which we believe is very fair given the company's strong growth, high quality business operations, sector dominance and capital returns. We are in the midst of a recovery in the American housing market and there is still significant room to reach normalized levels. We believe that Home Depot is among the best positioned beneficiaries.



# FULLY MANAGED FUND

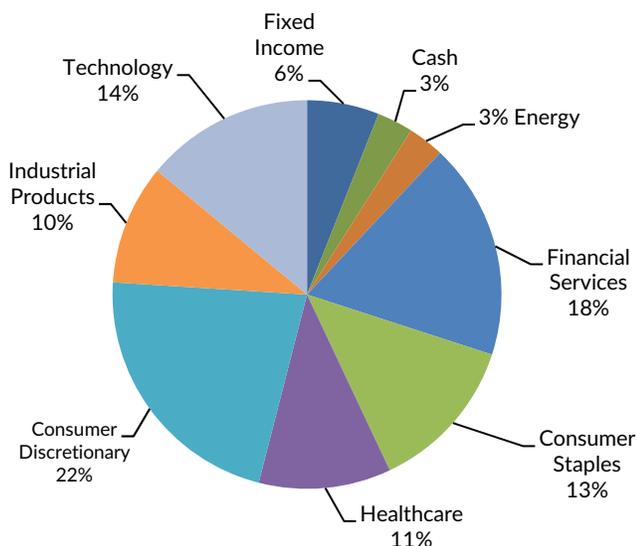
INVEST YOUR MONEY  
WHERE WE INVEST OURS

ABC Fully-Managed Fund is a diversified Canadian balanced fund. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity and fixed income securities. While our long-term asset mix target is 50% fixed income and 50% North American equities, in practice, our portfolio mix of stocks versus bonds is quite flexible to take advantage of periodic investment opportunities.

## TOP TEN HOLDINGS

- Loblaw Companies Ltd.
- Exco Technologies Ltd.
- Uni-Select Inc.
- Broadcom Ltd.
- Fortress Paper Inc., 6.5%, Dec. 31/2016
- Microsoft Corp.
- The Kraft Heinz Co.
- Stingray Digital Group Inc.
- The Home Depot Inc.
- NVIDIA Corp.

## Sector Allocation



## Geographic Allocation





# FUNDAMENTAL VALUE FUND

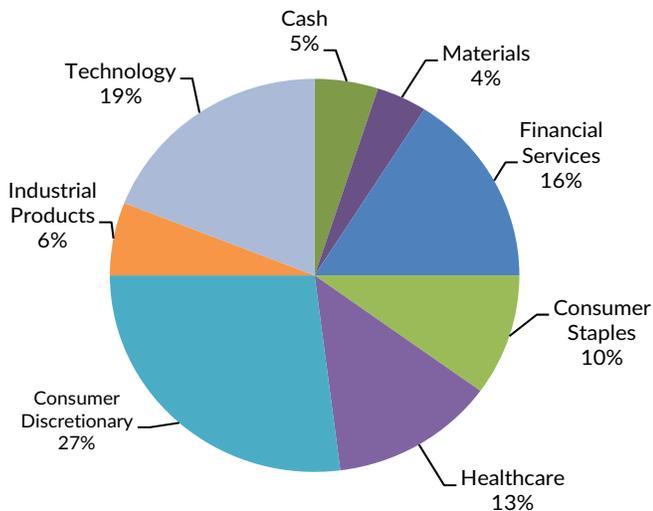
INVEST YOUR MONEY  
WHERE WE INVEST OURS

ABC Fundamental-Value Fund seeks out fundamentally attractive North American equities. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity securities. Our extensive “value research” style attempts to ferret out North American equities with appealing valuations. With these discerning selections we cobble a diversified portfolio of all-capitalization North American value stocks. When fully invested and having discovered new, fundamentally attractive securities, our sell discipline forces us to cull our portfolios to liquidate the most expensive holdings.

## TOP TEN HOLDINGS

- Exco Technologies Ltd.
- Alphabet Inc. Class A
- Activision Blizzard Inc.
- Loblaw Companies Ltd.
- Microsoft Corp.
- The Home Depot Inc.
- Nike Inc.
- Becton, Dickinson and Co.
- Uni-Select
- Stingray Digital Group Inc.

## Sector Allocation



## Geographic Allocation





# AMERICAN VALUE FUND

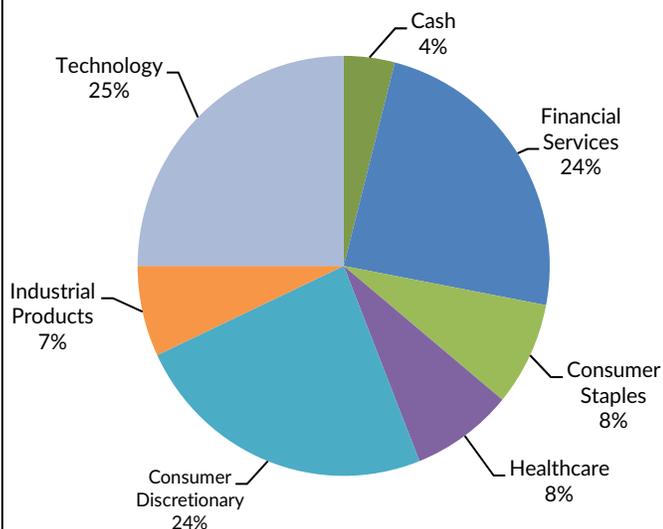
INVEST YOUR MONEY  
WHERE WE INVEST OURS

ABC American-Value Fund searches out fundamentally attractive American common shares. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of American equity securities. While using the same investment techniques as our two Canadian ABC Funds, the American market due to its sheer size provides us with extensive value opportunities.

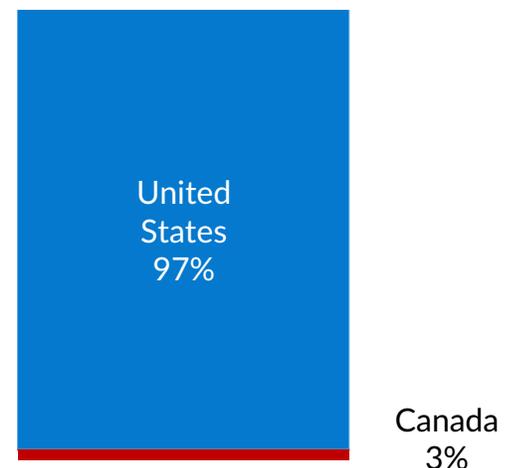
## TOP TEN HOLDINGS

- Alphabet Inc. Class A
- Nike Inc.
- Broadcom Ltd.
- Microsoft Corp.
- First Republic Bank
- Activision Blizzard Inc.
- The Home Depot Inc.
- O'Reilly Automotive Inc.
- NVIDIA Corp.
- Visa Inc. Class A

## Sector Allocation



## Geographic Allocation





# NORTH AMERICAN EQUITY FUND

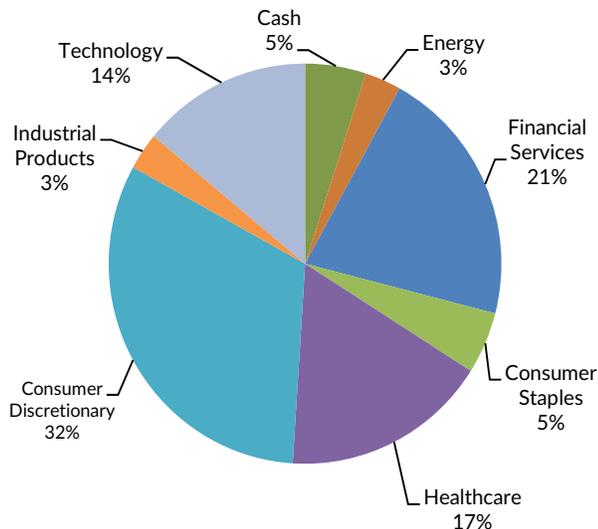
INVEST YOUR MONEY  
WHERE WE INVEST OURS

ABC North American Equity Fund searches out fundamentally attractive Canadian and American stock exchange-listed common shares. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canadian and American equity securities. This closed-end fund has maximum flexibility to invest in a diversified mix of value securities. The country and asset mix, as well as currency exposure, can vary and has no set limits. The portfolio, ordinarily, will have a mix of 40 to 50 holdings.

## TOP TEN HOLDINGS

- Echelon Financial Holdings Inc.
- Boston Scientific Corp.
- Stingray Digital Group Inc.
- Becton, Dickinson and Co.
- Electronic Arts Inc.
- Facebook Inc.
- Uni-Select Inc.
- Skyworks Solutions Inc.
- Brunswick Corp.
- Visa Inc. Class A

## Sector Allocation



## Geographic Allocation





# GLOBAL EQUITY FUND

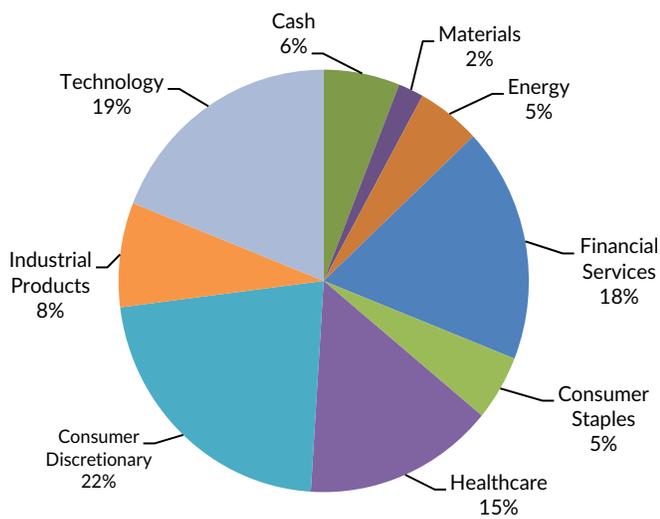
INVEST YOUR MONEY  
WHERE WE INVEST OURS

ABC Global Equity Fund is a “go-anywhere in the world” equity fund with unlimited investment flexibility. The investment objective of the Fund is to seek long-term capital appreciation by investing primarily in a diversified portfolio of Canada and American equity securities with a bias to international exposure.

## TOP TEN HOLDINGS

- Exco Technologies Ltd.
- Broadcom Ltd.
- Activision Blizzard Inc.
- Echelon Financial Holdings Inc.
- First Republic Bank
- Six Flags Entertainment Corp.
- Boston Scientific Corp.
- Petrowest Corp.
- Adobe Systems Inc.
- Aetna Inc.

## Sector Allocation



## Geographic Allocation





**ABC Funds**™

INVEST YOUR MONEY  
WHERE WE INVEST OURS

## FIVE FAVOURED ABC COMMON STOCK HOLDINGS

As the first quarter of 2016 has come to an end we remain very selective in our common stock holdings. Here is a group of our favourite companies we have chosen to highlight. We believe these businesses are well-positioned in their respective industries and have bright outlooks for the remainder of 2016 and beyond.

**CCL Industries Inc.**, is a Toronto-based global leader in label and packaging solutions for large corporations and small businesses. The company has a vast distribution network operating 119 facilities in 31 countries. We see continuing growth for CCL, driven by strong end markets, margin expansion and acquisitions as well as organic growth. CCL shares are held in two of our ABC Funds, the Fully-Managed and North American Equity Fund.

**Loblaw Companies Limited**, is a leading and well-managed Canadian grocer selling under its Loblaw, PC, Shoppers Drug Mart and Joe Fresh brands. The company, after the purchase of Shoppers Drug Mart, became the foremost pharmacy retailer in Canada. More importantly, with its huge distribution network of over 2400 grocery and pharmacy stores, Loblaw provides a wide selection of consumer staples and should be a major margin beneficiary of corporate cost cutting, increased company synergies and a firming Canadian dollar. We hold Loblaw in every fund except the American Value Fund.

**The Kraft Heinz Company**, one of the world's largest consumer food brand companies, is well-known all over the world for its many products including Kraft peanut butter, macaroni, cheeses, Heinz ketchup and many others. The company's positive performance has been driven by investments in its brands and cost cutting strategies. Additionally, the company has a 3% dividend and is free cash flowing. We are confident in Kraft's prospects and expect it to perform well as management continues to aggressively focus on costs and efficiencies, while its timeless brands stay a top choice among consumers. We hold Kraft Heinz in the Fully Managed, Fundamental Value, and American Value Fund.

**Skyworks Solutions Inc. and Broadcom Limited**, are two favourites in the chip technology sector. Skyworks and Broadcom both reported excellent Q4 2015 results as revenue and earnings beat analyst expectations. We believe that the radio frequency (RF) chip companies are very inexpensive, particularly Skyworks and Broadcom. Both companies have promising outlooks, impressive free cash flow, and strong balance sheets. Moreover, Skyworks and Broadcom have positive catalysts including the impending release of Apple's iPhone 7 and the growing theme of the "Internet of Things". In the interim, Skyworks and Broadcom are growing their operations and revenue, offering excellent value in the current marketplace. We hold Skyworks Solutions in the Fundamental Value and North American Equity Fund and Broadcom in the Fully Managed, American Value and Global Equity Fund.

### Administrative Information

- All cheques are to be made payable to RBC Investor Services.
- All client requests are to be directed to ABC Funds.
- We continue to request that clients assist in updating their "Know Your Client" forms. This information is a regulatory requirement to assess the suitability of our various ABC Funds to individual client's needs.
- FATCA forms were sent to clients over the past year. Please ensure to complete, date and sign your forms and send them by email or fax to our office before May 20, 2016. If you need assistance in completing the form, please contact our office.
- There are units of the ABC North American Equity Fund & ABC Global Equity Fund available for purchase. Contact our office for more information.
- Purchase requests must reach our office by the last business day of the month and redemption requests (for our open funds) must reach our office no later than ten business days before the last business day of the month.
- Clients that are invested in our closed-end funds are able to redeem their reinvested distribution units on a monthly basis. Also, you can participate in the annual 10% redemption right if you provide the completed form by November 30 for a December 30 transaction date. If you need assistance with either of these options, please do not hesitate to contact our office for assistance.

This newsletter is published by I.A. Michael Investment Counsel Ltd. and the ABC Funds

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