BMO Dividend Fund

Quarterly Commentary

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Macro Narratives Driving the Bus – Time Favors Quality Dividend Investing

Doom and gloom media headlines and recession predictions are hard to avoid these days and they are having a dramatic impact on investor sentiment and the direction of the stock market. Macro issues remain front and center but if the last few years have taught us anything it is that short-term forecasts are impossible to consistently get right. So, while investors are searching for definitive answers to the direction of central bank policy, oil prices, economies, and stock markets over the next 6-12 months we continue to focus our attention and time on things such as the number of stores Dollarama will open over the next five years, the quantum of synergies associated with S&P Global Inc.'s company making IHS acquisition, and the accelerating shift of enterprise business to the cloud as it relates to Microsoft. These are the things that impact the value creation process for companies over the long-term and allow us to think about how a business will be much better in 5 years than today.

We would expect gyrations in the market to continue, with central banks at this point not looking to take half measures in dealing with today's inflation threat. History has shown that taming inflation can be problematic for financial markets. That said, markets are forward thinking and have reflected some pretty poor scenarios thus far. Time will tell just how much downside is left. It is important to remember that drawdowns, pullbacks, and bear episodes are not as unusual as one would think. Historically, investors on average have been treated to a 10% dip every year and a bear market pullback every 3 years or so. The key is to invest in businesses that will be able to push forward during tough times and grow dividends through the ups and downs of the business cycle. While uncomfortable, it is this volatility that creates investing opportunities. We are constantly revisiting our shopping list for great businesses to buy into when the market gives us the chance. More recently, we have used the correction to initiate two new positions—Costco Inc. (COST) and Fastenal Inc. (FAST). Both businesses generate high levels of free cash flow, benefit from wide economic moats, and are led by very capable stewards of capital who are guided by long-term decision making. These businesses will add to the overall dividend growth rate of the portfolio while offering diversification benefits (i.e., geography, end-user markets, business models).

Source: Bloomberg, June 21, 2022

Fastenal Inc. (FAST-US)

Fastenal is a recent addition to the fund. We have long admired this company whose culture of frugality and unique business model has generated significant returns to shareholders for many decades. While the company may seem highly cyclical at first glance, the company is much more than just a large distributor of industrial tools and supplies in the US. The company's motto of "Growth through Customer Service" encapsulates Fastenal's unique business model of using scale to integrate deeper and deeper into their customer's supply chain - providing value well beyond the supply of goods. This feedback loop of growing scale and growing value to customers is what drives Fastenal's long history of attractive organic growth. Additionally, many items on today's wall of worries – such as inflation, global and domestic supply chain disruptions, and geopolitical tension – are tailwinds to Fastenal's business. Whether our economy falls into a recession or not, we believe Fastenal's strong customer value proposition will provide many years of market share gains in an otherwise large, highly fragmented industry. In turn, we see attractive long-term returns to shareholders that are bolstered by Fastenal's strong commitment of capital returns via dividends and buybacks.

Costco Wholesale (COST-US):

Shoppers have been flocking to Costco's chain of 830 membership-only big box retail stores across 12 countries to save on surging gasoline, food, and goods pricing. While Costco originally began as a B2B wholesaler of goods, it quickly expanded to the retail channel and has grown to become the 3rd largest retailer in the U.S and has established a reputation for its excellent value both in terms of price and quality. Costco operates under a unique retail business model driven by the effort to create the strongest value proposition for its members. The company is maniacally focused on its customers and cost efficiencies. This model allows absolute rock-bottom prices for customers, driving incredible demand and sales volume to their stores. However, to access these incredible deals, customers require a membership costing $60-$120, leading to an incredibly high margin business line which produces the bulk of the profits for the firm. The result of this business model is a positive flywheel where low prices attract a growing membership base increasing scale and bargaining power with suppliers which in turn further reduces prices. We also have a high degree of confidence in the best-in-class management team behind the operation that has displayed a relentless focus on increasing value to customers and maintaining a strong culture around the organization leading to industry low employee turnover (12x less than the average retailer).

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