DIXON MITCHELL
INVESTMENT COUNSEL

DM MONTHLY REPORT
Summer 2020

PORTFOLIO ACTIVITY

During May, the bulk of our activity took place on the fixed income side of portfolios, with trades executed to both extend duration and increase corporate exposure. Equity changes were limited to rebalancing transactions.

FEATURE STOCK

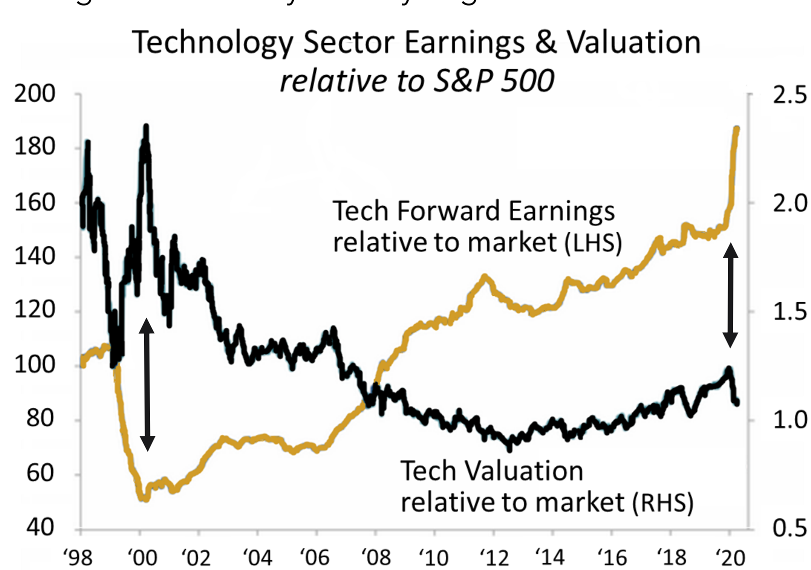
Roper Technologies Inc. (ROP)

ROP designs and develops software and engineered products within four internal segments: Application Software; Network Software & Systems; Measurement & Analytical Solutions; and Process Technologies. Its products are used in diverse industries, from healthcare and biotech, to transportation and construction. The company's portfolio of niche businesses is characterized by low cyclical exposure, high rates of recurring revenue, and low asset intensity and fixed costs, all of which translate into healthy levels of operating cash flow. ROP is known for its progressive management approach and decentralized structure, which allow divisions to operate nimbly in response to market opportunities and business threats. During the COVID crisis, guidance to business units was built on three key pillars: 1. find ways to maintain margins and cash flow; 2. target temporary counter cost measures; and 3. continue to make 'no-regrets' investments in talent and innovation with an eye toward economic recovery. ROP reported record earnings for Q1-20 and its stock reached an all-time high in early June.

A CLOSER LOOK INTO MARKET CONCENTRATION

Last month we showed how the market's sharp rise from its mid-March low had been skewed by a handful of large capitalization tech-related names but that, when S&P 500 members were weighted equally rather than by size, the rebound was much less spectacular. Though the rally has gained breadth since then, with industrials, financials, and other economically sensitive stocks playing catch-up, Apple, Microsoft, Amazon, Alphabet, and Facebook still collectively account for more than 20% of the S&P. This significant concentration at the top of the market has caused some concern that investors might be overlooking fundamentals and putting an unhealthy emphasis on an overly narrow list of names.

Even though not all of the 'big 5' stocks are officially in the S&P Information Technology group, the sector nonetheless provides a reasonable proxy for how today's market leaders are valued relative to the rest of the index and how their earnings stack up against the field. As the gold line in the chart below indicates, expected earnings for the tech sector have been steadily climbing vs. the S&P and, helped by the economic transition triggered by the COVID crisis, they are forecast to significantly outpace income for the broad market in the year ahead. At the same time, the tech sector carries only a slight valuation premium to other stocks (black line), despite the group's significantly more attractive profit profile. When tech stocks dominated market performance in 2000, on the other hand, the story was reversed with the group priced at a massive valuation *premium* to the market, even though it was producing much less income. Because both the DM Canadian and DM Foreign Equity portfolios carry overweight allocations to technology, we naturally watch valuations in this area closely. While these stocks have generated outsized price performance for our mandates in recent quarters, we're comfortable that their prices are reasonable relative to current earnings output and against what they're likely to generate in the future.



Source: *Factset*

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