



Newsletter Q2 & Q3

Global Equity Fund

Dear Investors,

The Desautels Global Equity Fund returned 6.7% gross of fees in Q2 & Q3, underperforming the benchmark by 2.7%. The S&P 500 returned 6.3% over the period while the S&P/TSX composite index generated 11.2%, resulting in a blended benchmark return of 9.4%. Overall, due to our difficult Q1, DCM is down 1.5% YTD, compared to a 10.5% gain for the benchmark. Since inception, the Global Equity Fund has returned 8.5% on an annualized basis, compared to 9.1% for the benchmark.

Our YTD underperformance can partially be explained by our conservative position over the summer, where we maintained a 10% cash position and were underexposed to commodity driven sectors. In particular, we were caught off guard by the massive rally in metals and mining and largely missed out on the huge 76% subsector gain. We have since reduced our underexposure to the materials sector through an ETF purchase and are currently looking at individual names in the space to add to the portfolio. Overall, we remain conservative going into Q4, partially due to political risk surrounding the November 8 US election. In terms of our individual stock positions, we had some good performers (Westrock and CRH Medical), and some not so good performers (Dream Office REIT). Details are provided in the individual stock section further below.

Table 1: Global Equity Fund – Current Sector Allocation

Global Equity Fund - Current Sector Allocation			
Sector	Global Equity Fund	Benchmark	(+/-)
CAD	5.6%	0.0%	5.6%
Consumer Discretionary	12.0%	8.6%	3.4%
USD	3.1%	0.0%	3.1%
Telecommunication Services	6.3%	4.3%	2.0%
Utilities	4.1%	3.0%	1.1%
Industrials	8.9%	9.4%	(0.5%)
Consumer Staples	5.5%	6.7%	(1.2%)
Materials	7.1%	8.8%	(1.7%)
Information Technology	8.4%	10.1%	(1.7%)
Financials	25.2%	28.0%	(2.8%)
Health Care	3.1%	6.4%	(3.3%)
Energy	10.8%	14.8%	(4.0%)
Total	100.0%	100.0%	0.0%

Graph 1: Global Equity Fund Performance vs. Benchmark

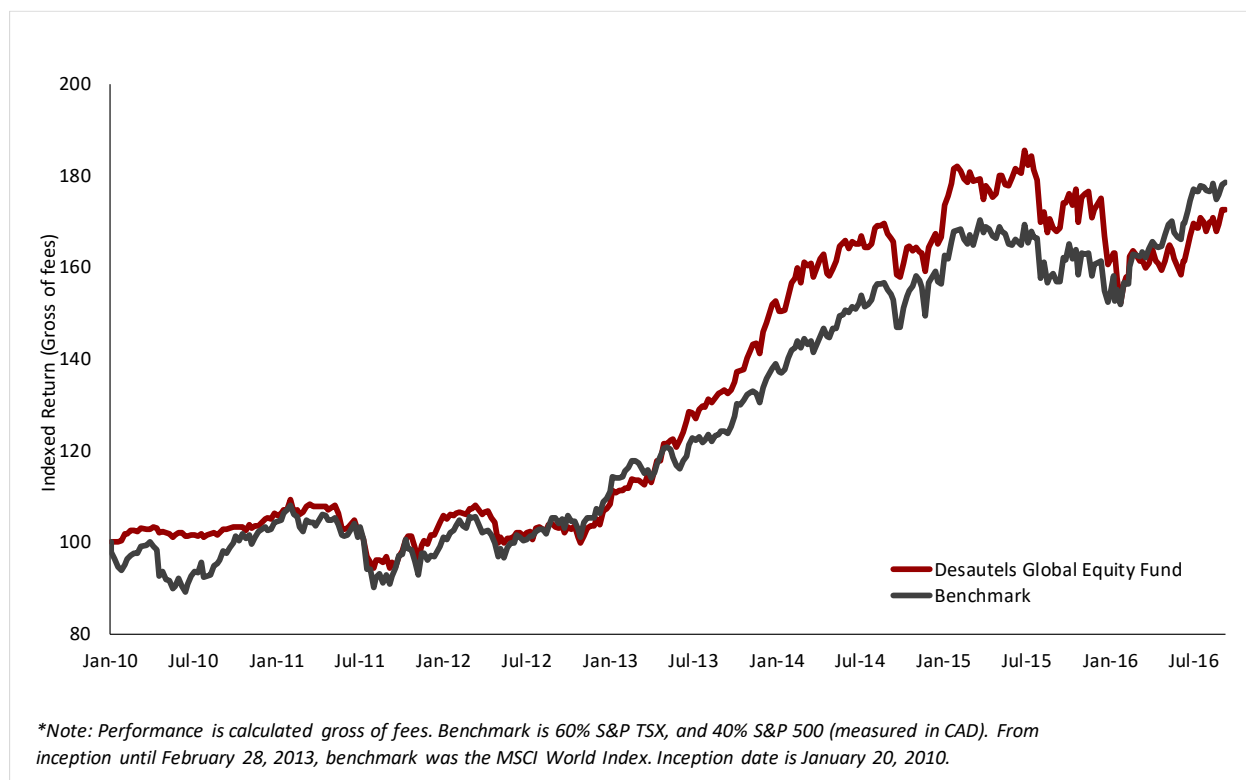


Table 2: Global Equity Fund Returns

GLOBAL EQUITY FUND RETURNS			As of Sep 30, 2016
Time Period	Gross Return	Net Return	Benchmark
2016 Return	(1.5%)	(2.6%)	10.5%
Q3 2016	6.9%	6.5%	5.3%
Q2 2016	(0.2%)	(0.6%)	4.1%
Q1 2016	(7.7%)	(8.0%)	0.8%
Since Inception*	8.5%	7.0%	9.1%

**Returns are annualized.*

PERFORMANCE METRICS		
	Equity Fund	Benchmark
Annualized Return	8.5%	9.1%
Annualized Std Dev	10.2%	11.6%
Annualized Sharpe Ratio	0.60	0.58
Beta	0.70	
Annualized Gross Alpha	1.5%	
Daily Tracking Error	0.99%	

Performance metrics are calculated gross of fees.

Market Commentary & Outlook

(I) Politics – A Big 33% Risk

2016 has seen at least three spectacular voting surprises: 1) Donald Trump securing the Republican nomination, 2) the UK voting in favour of Brexit, and 3) Colombia rejecting the FARC peace deal. November 8, 2016 is US election day, and a day that could drive the stock market for the rest of the year, and decade. Clinton appears to be well on top: Nate Silver's renowned FiveThirtyEight polls-plus forecast gives Trump a 34.8% of winning the election, the British betting website OddsChecker gives Trump a 33.3% chance, and the New York Times's campaign blog estimates Trump's chances at 24.0%. But recent events have taught us that low probability events can and do happen. More importantly our unscientific feeling is that a Clinton win would result in a mild market rally, but a Trump win could cause a much more serious selloff. In short, the US election gives us cause for concern, and as such we retain a conservative allocation going into Q4.

(II) Commodities – Guess Who's Back

After a four-year bear market, commodities are back in bullish territory. The Bloomberg Commodity Index, which tracks a basket of 22 commodities ranging from energy to livestock is up 17% since hitting its low on January 20, 2016. While each commodity has its own supply and demand drivers, broadly speaking a few factors can be credited for the rally: a weakening U.S. dollar at the start of the year, strong imports from China and other developing countries, supply constraints, the weather, and investor sentiment.

Due to our fund's main philosophy of bottom-up fundamental analysis we ended up recently moving away from non-energy commodity driven stocks as we recognized prices would be driven largely by macro trends in the commodity space, and did not have any particular conviction related to those commodities. As such, we focused our alpha-seeking attention elsewhere. In retrospect, this decision proved to be ill-advised. The lesson learned here is that for a fund like our own, risk is both an absolute and a relative concept as our performance is invariably compared to our benchmark. Given that we didn't have a particularly bearish outlook on commodities, the wiser decision would have been to more closely match our benchmark sector exposure, especially for a very cyclical sector like materials. As this newsletter is being written, the DCM materials team is working on a pitch to potentially buy a specific company exposed to non-energy commodities. In the meantime, we decided to buy the S&P/TSX Capped Materials ETF to bring us closer in line with our benchmark.

(III) Oil – A Special Commodity

Oil prices have doubled from their \$25 low at the beginning of the year and the very recent OPEC "breakthrough oil deal" seems to have charmed the markets. On September 30, OPEC countries surprised everyone by agreeing for the first time since oil prices halved in 2014

to cut their overall production of ~33.5 million barrels per day (bpd) by 0.5-1.0 million bpd. The market reacted very positively sending crude oil prices close to their year high above \$50. Despite the initial reaction, the DCM energy team remains skeptical and sees the deal as more rhetorical than effective. Oil output from OPEC members just recently reached a multi-year high, partly driven by increased production from Iran - following its nuclear deal, Iran significantly increased oil exports and recently reached its 2011 pre-sanctions peak of 2.8 million bpd. Libya and Nigeria, also OPEC members, are set to restart production of 800,000 bpd after years of dealing with internal conflict. This upcoming increase in production potential could make it very difficult for Saudi Arabia to hold the OPEC deal together.

As a result of our skepticism, we prefer to remain slightly under exposed to the energy sector and invest in solid companies that we think will perform well at the current price level (Pembina Pipeline being the most recent example of such an addition to our portfolio).

(IV) Market Valuations – Should We Be Afraid?

On certain measures, the market seems to be significantly overvalued. Looking at the Market Cap to GNP ratio, deemed by Warren Buffet as "probably the best single measure of where valuations stand at any given moment", it seems to be very expensive at 122%. The lowest historical point was about 35% during the 1982 recession and the highest point was 148% during the tech bubble in 2000.¹ The current level is higher than at the height of the 2007 bull market and second only in history to the tech bubble era. On other measures, such as the earnings yield minus Baa yield spread, equity markets seem to be on the cheap side. The current spread stands at 1.7%, which is attractive when compared to the 25-year average spread of (0.4%).

Looking at the more common forward 12 months P/E and EV/EBITDA multiples (see tables 3 & 4), it seems that most of the sectors in the U.S. and in Canada are pretty expensive. Although valuations are within one standard deviation of their 10-year averages, one must remember that the 10-year average includes approximately 2-years of very high valuation multiples at the peak of the pre-crisis bull market. To be sure, one cannot look at multiples in isolation. Time-varying interest rates, market volatility, and growth outlooks are among rational explanations for time-varying multiples. Indeed, we have argued in the past that equity multiples looked reasonable based on the current low interest rate environment. However, given the multiple expansion that occurred over the summer and of the upcoming risk of a binary event (i.e. the presidential vote), we are now more cautious. While we remain exposed to the market's systematic risk, we intend to manage our exposure carefully, notably by holding a higher than usual cash balance and by continuing to employ our usual bottom-up approach for attractive valuations at the company-specific level.

¹ Guru Focus

Table 3: S&P/TSX Composite Valuation

S&P/TSX Composite Valuation							
Sector	# of Stocks	YTD Tot. Ret.	F12 P/E	STD vs. 10Yr.	F12 EV/EBITDA	STD vs. 10Yr.	Sellside Exp. Ret.
Total	246	15.3%	22.9x	0.6	11.5x	0.9	10.0%
Communications	10	17.6%	17.0x	0.8	8.3x	1.5	3.8%
Cons. Discr.	21	5.7%	16.4x	(0.3)	9.7x	0.0	13.8%
Cons. Stap.	12	10.9%	19.4x	1.2	11.3x	1.4	12.4%
Energy	49	25.3%	44.1x	1.3	11.0x	1.1	10.6%
Financials	49	10.6%	13.1x	0.1	NA	NA	6.9%
Health Care	3	(72.5%)	5.1x	(2.0)	8.1x	(0.4)	43.6%
Industrials	17	15.6%	19.2x	0.9	11.1x	1.2	5.6%
Materials	56	49.0%	28.3x	0.6	10.6x	0.3	20.9%
Technology	15	5.6%	18.1x	1.2	12.7x	1.2	6.3%
Utilities	14	19.9%	30.9x	0.6	10.4x	0.1	8.4%

Table 4: S&P 500 Valuation

S&P 500 Valuation							
Sector	# of Stocks	YTD Tot. Ret.	F12 P/E	STD vs. 10Yr.	F12 EV/EBITDA	STD vs. 10Yr.	Sellside Exp. Ret.
Total	505	6.7%	20.2x	0.6	11.8x	0.9	10.6%
Communications	30	7.7%	21.9x	0.2	11.7x	0.3	14.3%
Cons. Discr.	76	1.4%	25.5x	0.3	12.3x	0.5	13.0%
Cons. Stap.	39	6.8%	20.3x	1.3	12.8x	1.3	9.9%
Energy	38	16.6%	34.2x	1.5	10.6x	1.9	8.5%
Financials	99	1.2%	19.2x	0.3	NA	NA	9.3%
Health Care	58	0.4%	16.7x	0.5	12.0x	0.9	14.8%
Industrials	53	11.0%	17.8x	1.0	11.3x	1.5	6.7%
Materials	27	12.4%	18.1x	0.8	10.5x	1.1	10.1%
Technology	57	13.4%	17.0x	0.4	9.7x	0.5	7.1%
Utilities	28	17.8%	17.6x	1.3	10.0x	1.6	8.9%

Selected Holdings Review

In this section, we highlight some of our key individual holdings.

Recent Transactions

Replacing Wells Fargo by Bank of America - Up 5.6% for Bank America vs. Down 12.9% for Wells Fargo

For those of you who were following U.S. bank valuations in February 2016, you probably noticed that 3 of the 4 integrated commercial U.S. banks, namely J.P. Morgan Chase, Bank of America and Citigroup had a tough start to the year. They dropped between 20% and 35% in less than 6 weeks as the market was very concerned with their profitability given the prolonged low interest-rate environment, the riskiness of their energy-loan portfolio, and the political tone during the U.S. presidential primary regarding tougher bank regulation. As a result, Bank of America and Citigroup traded well below their tangible book value. As always, Wells Fargo, the 4th wheel of the U.S. big 4 integrated commercial banks, seemed to resist the punishment exercised on its peers due to its focus on commercial banking and its higher profitability, as measured by return on equity. We always liked Wells Fargo as a company, but as an investment we were starting to think it was too expensive – especially on a comparative basis with its peers.

DCM also saw the market valuation for the 3 peers as fully pricing the worst case scenario. As Klarman nicely explains, “value investing is at its core the marriage of a contrarian streak and a calculator.” So, DCM took out its Excel calculator and did its own internal valuation of the different U.S. banks. The result increased our confidence in the attractiveness of the sector’s valuation. Our conviction was raised further when looking at the behavior of company insiders. Indeed, there were significant activities from insiders buying the stock of their banks in Q1 and the most telling instance was certainly from Jamie Dimon - one of the most prominent figures in the financial industry. It was only the second time since being named CEO of J.P. Morgan in 2004 that he bought shares in the open market and he bought for a substantial amount - \$26 million, the equivalent of his 2015 full-year salary. To explain his transaction, he used these simple words: “[the recent market decline] is either a financial catastrophe, or this is an epic buying opportunity”.

The entire exercise led us to pick Bank of America over its peers and replace our legacy position in Wells Fargo. We choose Bank of America over JPMorgan and Citigroup for a combination of a more attractive upside given by our valuation models, a lower international and energy loan exposure, and a better financial disclosure.

Even though we ended up waiting a bit too long to execute the trade (i.e. we lost some price appreciation on the Bank of American side), the timing could not have been better with respect to the Wells Fargo side. As you are certainly aware, Wells Fargo has been all over the news recently for the wrong reasons as it has been facing an internal scandal regarding fictitious customer accounts created by its own employees. Some rumors have been floating around that Wells Fargo’s practices are widespread throughout other U.S. banks.

Although we remain aware of those allegations, we are less concerned over a potential spillover on Bank of America for two reasons: 1) Wells Fargo had a very aggressive target for its cross-sale measure (Wells Fargo CEO, John Stumpf, had made it one its favorite measure and was actively advertising it to shareholders) and 2) Wells Fargo’s market correction is also a direct consequence of John Stumpf’s poor crisis reaction and his wretched testimony to congress.

In brief, while Wells Fargo was being punished by the market, Bank of America trended upward and we still see significant upside with its current valuation.

Web MD

Web MD is an internet health information service provider. Its main mandates are helping consumers manage their health, making it easier for physicians and healthcare professionals do their jobs, and providing personalized health and benefit information to health plan participants. The DCM TMT team initially pitched the company in March but decided to wait to buy the company due to its high valuation. The stock was put on our watch list with a potential entry price of \$50.

The bottom-up thesis was built on 4 main arguments. 1) Web MD is a virtually no-cost business model that has shown resilience in economic downturns and with very interesting growth prospects. 2) The technological platform provides a hedge against patent cliffs and gives an optionality on the digitization of the entire healthcare value chain. 3) The company is financially and operationally sound. It has high liquidity, low debt level and positive free cash flows which provide a lot of financial flexibility. On one side, the company has historically returned value to shareholders through share buybacks and has successfully achieved strategic acquisitions. 4) Finally, there is hidden value in “non-core” assets of the company, such as Medscape (the knowledge database and social network for physicians).

Waiting for a more attractive entry price paid off as the company breeched the \$50 barrier on an earnings miss, but with no change in long-term fundamentals in our view. We maintain high conviction in our thesis and given the now attractive valuation, initiated a position in mid-September at a price of \$50.68.

Biggest Movers

West End Indiana Bank – Up 11.9%

DCM initiated a position in this ~\$25M USD market cap regional bank in December 2015 – making it the smallest cap holding of our portfolio. Our investment thesis was centered on 4 core pillars that have partly materialized over the past 6 months: 1) significant improvement in operating metrics driven by a strong management team, 2) upside potential driven by oligopolistic position and “soft skills”, 3) ideal acquisition target given its location in a region with a strong precedent for M&A and its recent demutualization, and 4) valuation yields, as measured by P/TBV and our DDM internal model, pointed out to an asymmetric risk-return profile and a 48% upside. Our thesis on the operational side has so far played out very well with

a continued increase in ROE to 6.8% YTD, up from 5.3% YTD in 2015, and net charge-offs down to 0.58%, near its 2-year low.

DCM continues to see attractive upside in West End Indiana Bank's valuation and the potential catalyst of an acquisition bid that could provide us with the perfect exit opportunity. The ~12% return over the past 6 months is not only satisfying in absolute returns, but also in relative terms with a ~25% outperformance of the US Regional Bank Index.

CRH Medical - Up 46.0%

The fund added CRH Medical to its portfolio in December 2015. CRH Medical is a North American company focused on two segments in the gastrointestinal diseases market: 1) their historical business of selling medical devices to treat hemorrhoids and 2) their emerging model as a consolidator of anesthesia services. We were attracted to anesthesia services for endoscopic procedures partially due to the strong demographic tailwind for the industry. DCM particularly liked CRH's ability to consolidate the decentralized anesthesia market with tuck-in acquisition and partnership with gastrointestinal practices to provide their anesthesia business. CRH stood out given its changing product mix, driving towards the higher margin anesthesia business, and its cheap valuation on forward 12-month multiples despite its stronger growth prospects than its peer group.

During Q2 & Q3, CRH Medical has successfully delivered on its growth prospect while maintaining a strong cash flow generation from its legacy business. The company was able to further consolidate the anesthesia services space by acquiring 3 service providing companies using its cash balance and its newly created credit facility. The result was a significant stock price appreciation. Using our internal valuation model, DCM still foresees some upside with a price target of \$6.70.

Westrock - Up 38.0% / Ingevity - Up 101.0%

Westrock is the second-largest paper and packaging company in the world. It was a legacy holding in our portfolio created from the merger of MeadWestVaco and RockTenn. The initial thesis by DCM revolved around the three following ideas: 1) excessive corporate overhead and inferior operating margins leave significant room for cost-cutting measures and margin expansion, 2) hidden value in the high-growing chemical segments due to its inclusion in the complex conglomerate structure, and 3) over pessimistic market perception surrounding high capital expenditures and negative cash flows. The first year-and-a-half of our position did not lead to much value creation for DCM as the stock of the newly merged company continually trended downward.

Fortunately, the past two quarters proved to be key in a partial redemption for DCM and a successful realization of the initial investment thesis as the following developments took place: 1) Westrock improved its margins, notably due to cost synergies resulting from the merger, making it now in-line with its competitors, 2) Westrock successfully spun off its chemical business under the name Ingevity in May, 3) the free cash flow yield improved and is now above the industry average at 7%. The spin-off of Ingevity proved to be key for DCM as this new entity we inherited appreciated by 100%

this summer. The appreciation was mainly driven by a EV/EBIT multiple conversion towards the industry average as a result of Ingevity reporting on a standalone basis rather than a blended basis with Westrock.

As a result of the now premium valuation for Ingevity and the realization of Westrock thesis, DCM did not have enough convictions to hold on to the two positions. We therefore recently completed a successful exit of both stocks.

Dream Office REIT – Down 15.7%

Dream Office REIT was the worst-performing stock in our portfolio over Q2 & Q3, losing 15.7% since initiating a position back in April. Given the sluggish outlook in Alberta, where over a quarter of the company's NOI is generated, the company wrote down their western portfolio by nearly \$750 million over the summer, after downtown vacancy rates topped 21%. This resulted in a steep stock decline.

Although, we are disappointed with our entry price and our inability to correctly assess the trouble facing the Alberta portion of the portfolio, DCM remains confident in Dream's core assets located outside of the province. Valuing the company with conservative cap rates ranging from 6% (core assets in Ontario and British Columbia) to 15% (Alberta's assets), Dream currently trades at a ~30% discount to their NAV, which DCM believes is unwarranted. Even if we value Dream's Alberta portfolio at \$0 NAV, the REIT's current market valuation would still be just below the intrinsic valuation of the company. Dream trades at a F12 P/FFO of 6.5x, well below the current 16x average for its peer group. We therefore view the current valuation of the company as providing us with, as Benjamin Graham would see it, a significant margin of safety. On top of that, we collect an eye-popping 8.9% dividend yield and, given the current 77% payout ratio of the company, we are not concerned with an upcoming dividend cut.

The one element we are keeping a close look on is Dream's debt repayment schedule. Its debt average term to maturity is 3.7 years and it has ~\$1 billion of secured and unsecured debt maturing over the next 2 years and a half. We expect Dream to refinance this debt as it did over the summer with its maturing debt. If we use last summer as a precedent, Dream should even be able to generate some interest rate savings from the upcoming debt refinancing. If at some point in the future, Dream has trouble refinancing its debt, the company has \$650 million available in liquidity coming from its current cash balance and its revolving credit facility.

DCM Update

September is always the best time of the year at DCM as it is the onboarding process for the incoming class. New Junior Analysts worked very hard over the summer to publish earnings update for the entire team and to produce mini-pitches during our annual Boot Camp, which gives us great confidence in the future of the program. As per tradition, we concluded our first intense week of work with our retreat at Ken's cottage where Ken kept his throne as the best tennis player in HIM after an intense matchup with Lambert.

It is an honour to welcome our new analysts to the Equity Fund: Alex Bibic (TMT), Robert Chen (TMT), Mackenzie Chisholm (Financials), Antoine Francoeur (Financials), Sabrina Frias (Energy), Noah Gillard (Consumers), Alaa Hachem (Energy), David Meyers (Healthcare), Thomas Milne (Healthcare), Noah Petkau (Industrials), and Jaskrit Singh (Materials).

On the firm initiative side, we recently announced the launch of the Desautels Capital Management Mentorship Program, a yearlong program that connects DCM analysts with DCM alumni in the workforce. This announcement coincides with the launch of a new annual event: the DCM Alumni Cocktail. The first event is already planned for October 29, 2016 and you are all more than welcome to attend. We are also leveraging Michael Fishman in his duty of Chief of Operations, a newly created position, to increase DCM brand awareness and to assist with a fundraising campaign. DCM's main strength remains in every analyst deeply caring about the fund's future and taking a personal responsibility to build the next milestone of this amazing program.

To our investors, I would like to take this opportunity to once again thank you for your generous investment and your continuous commitment to the program. I speak on behalf of myself and the rest of the students here at DCM when I say that your contribution is having a profound impact on our university experience and our journey in the world of finance.

Sincerely,

Olivier Babin

Global Equity Strategist

INVESTOR NEWSLETTER – Q2 & Q3 2016

Global Equity Fund - Holdings List as of (30-09-2016)									
#	Security Name	Sector	Currency	Size	# of Units	Local Cost / Unit	Local Price / Unit	Base Market Value	Position Size %
1	ISHARES S&P/TSX CAPPED	Financials	CAD	ETF	6,745	\$30.28	\$31.97	\$215,638	8.1%
2	BANK OF AMERICA CORP	Financials	USD	Large	7,850	\$15.01	\$15.65	\$161,459	6.1%
3	CANADIAN DOLLAR	CAD	CAD	Cash	148,271	\$1.00	\$1.00	\$148,271	5.6%
4	TIME WARNER INC	Information Technology	USD	Large	1,350	\$81.07	\$79.61	\$141,247	5.3%
5	INDUSTRIAL ALLIANCE INS & FINL	Financials	CAD	Mid	2,912	\$40.01	\$47.23	\$137,534	5.2%
6	UNION PACIFIC CORP	Industrials	USD	Large	885	\$79.86	\$97.53	\$113,438	4.3%
7	ISHARES S&P/TSX CAPPED MAT	Materials	CAD	ETF	8,000	\$14.05	\$13.65	\$109,200	4.1%
8	PEMBINA PIPELINE CORP	Energy	CAD	Large	2,700	\$37.85	\$39.98	\$107,946	4.1%
9	BMO EQUAL WEIGHT UTIL INDEX	Utilities	CAD	ETF	6,400	\$16.01	\$16.80	\$107,520	4.1%
10	CRESCENT POINT ENERGY CORP	Energy	CAD	Large	5,650	\$17.44	\$17.30	\$97,745	3.7%
11	ISHARES GLOBAL CONSUMER STAP	Consumer Staples	USD	ETF	710	\$90.77	\$99.30	\$92,659	3.5%
12	MACY'S INC	Consumer Discretionary	USD	Mid	1,900	\$42.64	\$37.05	\$92,517	3.5%
13	DREAM OFFICE REIT	Financials	CAD	Large	5,400	\$20.98	\$16.92	\$91,368	3.4%
14	COGENT COMMUNICATIONS HOLDINGS	Telecommunication Services	USD	Mid	1,830	\$33.61	\$36.81	\$88,531	3.3%
15	ISHARES S&P GLOBAL CONSUMER	Consumer Discretionary	CAD	ETF	2,960	\$29.52	\$28.15	\$83,324	3.1%
16	TEN PEAKS COFFEE COMPANY INC	Consumer Discretionary	CAD	Small	10,856	\$10.07	\$7.67	\$83,266	3.1%
17	CRH MEDICAL CORP	Health Care	CAD	Small	16,200	\$3.87	\$5.09	\$82,458	3.1%
18	U.S. DOLLAR	USD	USD	Cash	62,221	\$1.00	\$1.00	\$81,774	3.1%
19	APPLE INC	Information Technology	USD	Large	550	\$109.92	\$113.05	\$81,717	3.1%
20	WEBMD HEALTH CORP	Telecommunication Services	USD	Mid	1,200	\$50.68	\$49.70	\$78,382	3.0%
21	WESTERN FOREST PRODUCTS INC	Materials	CAD	Small	36,191	\$1.98	\$2.16	\$78,173	2.9%
22	GENERAL MOTORS CO	Industrials	USD	Large	1,640	\$32.01	\$31.77	\$68,476	2.6%
23	WEST END INDIANA BANCSHARES IN	Financials	USD	Small	1,900	\$22.22	\$25.20	\$62,926	2.4%
24	PERFORMANCE SPORTS GROUP LTD	Consumer Discretionary	CAD	Small	10,985	\$7.16	\$5.33	\$58,550	2.2%
25	PANGAEA LOGISTICS SOLUTIONS LT	Industrials	USD	Small	16,449	\$4.43	\$2.50	\$54,045	2.0%
26	ISHARES S&P/TSX CAPPED CONS	Consumer Staples	CAD	ETF	1,000	\$53.66	\$53.69	\$53,690	2.0%
27	MARATHON PETROLEUM CORP	Energy	USD	Large	940	\$44.14	\$40.59	\$50,145	1.9%
28	MEG ENERGY CORP	Energy	CAD	Mid	5,195	\$33.15	\$5.93	\$30,806	1.2%
Total								\$2,652,804	100.0%

Dear Investor,

For Q2 and Q3, the Desautels Fixed Income Fund returned 3.5% gross of fees, representing a 20 bp outperformance of our blended benchmark's 3.3% return. Our gross annualized return since inception now stands at 5.0%, outperforming the benchmark's 4.3% annualized return over the period. Q2 and Q3 brought considerably less volatility to fixed income markets than Q1, as consistent corporate spread compression was interrupted by bouts of risk-off behaviour that were of comparatively shorter severity and duration. The continued rally in risk assets, particularly oil, for most of Q2 was aided by investor conviction in the continued support of central banks globally and docility of the Fed, despite positive momentum in U.S. economic data. This, in tandem with favourable liquidity conditions carried a similar rally in high yield, benefitting DCM's relative performance given our 12% HY allocation versus the benchmark's sole IG composition. However, this market conviction in Fed docility, as evidenced by a flattening yield curve leading up to the June meeting despite prior hawkish comments from FOMC officials, also caused long-duration bonds to lead in returns for Q2. This slightly disadvantaged our performance given duration gaps maintained against both our U.S. and Canadian benchmarks of -1.35 and -1.38 years, or 26% and 18% respectively.

The close of Q2, however, brought a slight reversal of those trends with the British vote to leave the EU clearly catching investors off-guard. Market sell-offs extended beyond equities, with the U.S. HY index falling 1.25% in the two days following the vote, in contrast to a modest 1.1% gain in U.S. IG and rally in sovereigns. The move was unsurprising given the higher correlation between various classes of risk assets in times of market stress, and somewhat justifiable in terms fundamentals given the initial uncertainty of Brexit's long-term impact on global economic growth was pertinent to corporate credit quality. Importantly, however, the event did not have a lasting adverse impact on our fund's performance despite our comparatively higher HY exposure and lower sovereign exposure, at 31% versus 43% for the benchmark. As N.A. investors, armed with more information and time, developed greater assurance over Brexit's likely limited long-term impact on their economies, both Canadian and U.S. HY indices retraced their steps to pre-Brexit spread levels only slightly over 2 weeks after the vote. Recoveries for the spreads of our HY single-names, all from Canadian issuers, were also seen by July-end.

Calmness followed in fixed income markets for most of Q3. Amidst a better-than-expected corporate earnings season in the U.S., continued signs of improvement in economic data, and no sign of the end of central bank easing in sight, equity markets climbed to eventually reach record-highs in August. Volatility not only remained at its usual summer lows, but the VIX touched the lowest point on record for over the past two years by August. The very high (0.87) historical correlation between HY and the VIX also continued to bear out over this period, with investors piling on this risk class. U.S. and Canadian HY spreads compressed 16% and 15% respectively between the close of Q2 and end of August. This again benefitted our comparatively higher HY exposure against the benchmark. That unusual deep lull was however interrupted by a sudden market

tantrum on September 9th, to which most attributions have centered on an ignition of investor concern that central banks globally were reconsidering their stimulus that had driven yields to new lows. An initial sell-off of long-dated sovereigns significantly steepened the U.S. and other yield curves. However, as expectations for Fed action gradually become more dovish, largely confirmed by the September meeting, the curve flattened to end the quarter only marginally higher on the long end. Nonetheless, it meant our short duration exposure posed an additional, albeit minor benefit to our performance that quarter.

Though to a lesser extent than Q1, our geographic weighting has continued to detract from our most recent performance, with our Canadian exposure relative to our blended benchmark overweight at 60% versus 45%. Continued recovery and stabilization of oil prices alleviated, with limited justification in our view, investor concern over the significant corporate credit risk posed by the commodities slump on the resources sector. Given the Canadian HY market's O&G composition is far higher than that of the U.S., this helped contribute to a general rally in Canadian HY spreads equal to that in the U.S. (index spreads both down 30% since Q1) despite a far less optimistic outlook for the Canadian macroeconomy over the period – a factor that normally weighs on the HY sector. As that rally eclipsed U.S. IG spread compression over the same period, our 10% Canadian HY exposure (83% of our total HY holdings) thus ceased to be a significant drag on fund performance.

Meanwhile however, the Canadian IG space arguably missed out on a significant tailwind helping the U.S. market since the start of the summer – the ECB. The ECB's commencement of corporate bond purchases on June 8th has resulted in a sharp fall in Eurozone high-grade corporate yields (in excess of 60%), displacing many investors in need of higher returns. While QE theory dictates that this results in an intended 'portfolio rebalancing effect' where investors thus shift up along the risk spectrum within the same market, we believe rebalancing has also taken the shape of a geographic reallocation to the U.S. The fact that net inflows to U.S. corporate bond funds have outpaced those for European funds by \$2bn since the start of June potentially serves as a crude metric for the profundity of this trend. This shift ultimately helped contribute to a considerably higher 17% tightening of U.S. IG spreads since Q1 than the 10% seen in Canada, and thus a 200 bp higher period return for our U.S. versus CAD benchmark. Nonetheless, as elaborated in the Credit section below, we currently stand wearier than the market on valuation levels in U.S. credit given corporate fundamentals, and are thus skeptical that such significant U.S. outperformance can be sustained.

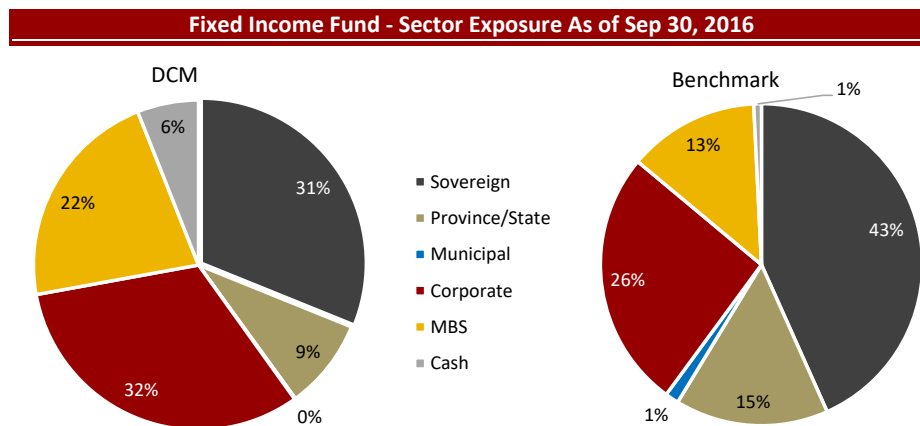
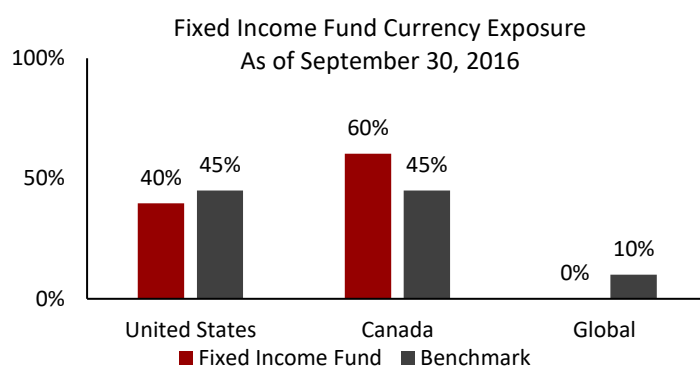
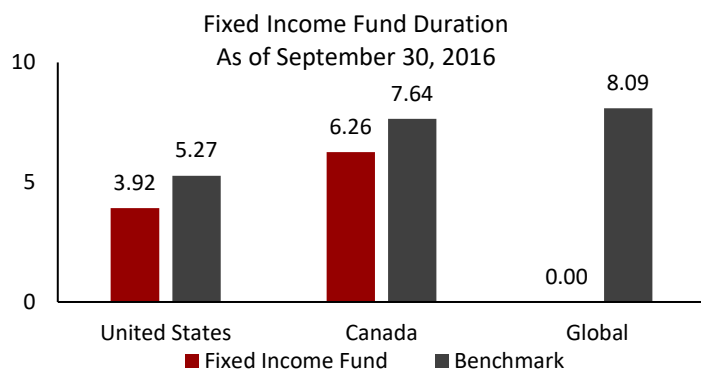
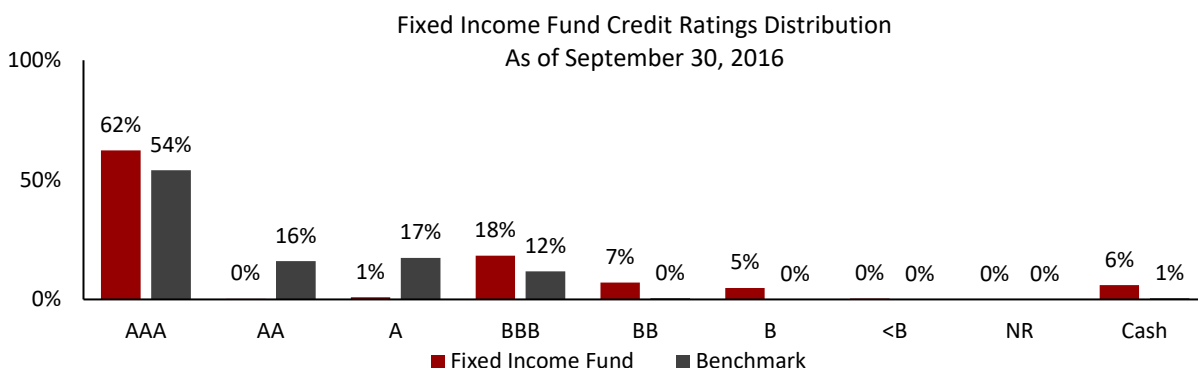
Fixed Income Fund

Fixed Income Fund Returns As of Sep 30, 2016			
Time Period	Gross Return	Net Return	Benchmark
2016 Return	1.9%	1.5%	2.2%
Q3 2016	1.5%	1.4%	1.1%
Q2 2016	2.0%	1.9%	2.2%
Q1 2016	(1.5%)	(1.7%)	(1.0%)
Since Inception*	5.0%	4.5%	4.3%

*Returns are annualized.

Fixed Income Metrics Since Inception As of Sep 30, 2016		
	Fixed Income Fund	Benchmark
Annualized Return	5.0%	4.3%
Annualized Std Dev	4.8%	7.3%
Annualized Sharpe Ratio	0.55	0.27
Beta	0.51	
Annualized Alpha	1.6%	
Tracking Error	0.64%	

Performance metrics are calculated gross of fees.



Canada Macro and Duration

The Canadian yield curve has flattened considerably since Q1, with the 2Y-10Y spread narrowing by 23 bp and 5Y-30Y spread narrowing 28 bp (Figure 1). As it was driven exclusively by the long-end of the curve, this flattening typically points to lowered investor expectations for long-term growth and inflation – poor signs of confidence for the Canadian economy. Indicators were initially mixed. While Q1's 2.4% annualized real GDP growth, reported May 31st, was a 1.9% increase from the prior quarter's figure, it masked a downwards trend as the economy faced an accelerated contraction since January. On the surface, capital formation contracted at the lowest rate in 5 quarters, boding well for business investment. However, it in fact contracted 9.2% ex-residential construction, dragged down by the commodities sector. To us, this was little surprise. The nature of oil-sands projects – high upfront capex, long lead times and high break-evens – means many Canadian oil producers are slower to respond to price improvements. Thus, given they had set their capital-investment plans during the nadir of commodity prices in the second half of 2015, we should reasonably expect acute weakness in Canadian energy sector investments for most of 2016 before any potential recovery.

The overall results appeared to catch most off-guard. Not only did economist consensus call for 2.9% growth, but many were at a loss to explain the contraction in business investment excluding energy, in addition to the moderate drawdown of inventories, which traditionally indicates a deterioration in business outlook. The negative surprise in turn led to a considerable 10 to 14 bp fall in sovereign yields across the curve and clear flattening in the days immediately following the May 31st release. That conclusion does overlook an arguable bright spot in exports, which increased 16.9% and contributed on a net basis to 71% of the quarter's overall growth. Poloz himself, in refusing to concur with market pessimism, pointed to non-energy exports, operating in many segments "near their capacity limits" in his words, to insist a gradual recovery is still underway. We believe these results broadly support DCM's consistent view that a rotation to the non-resource sector, particularly centered on exports and manufacturing, is a viable but drawn-out structural shift for the Canadian economy to sustain modest growth longer-term.

Against Q1's backdrop, the downside-shock posed by Alberta wildfires in April and May, which took almost 50% of production from the oil sands off-line, made the bond market particularly bullish on Bank of Canada policy. Expectations were also better matched to Q2's 1.6% annualized GDP contraction, leading to minimal 2-3 bp downward movement in yields across the curve following the data's release. Business investment ex-residential again edged down, though at a slower 1.9% pace of contraction versus Q1, with continued weakness in the energy sector. Unlike Q1 however, exports demonstrated considerable weakness, contracting 16.7% in the largest decline since Q1 2009 and shaving 5.9 percentage points from overall annualized growth. The decline could not solely be blamed on the Alberta shut downs either, as it was seen in milder form through most export categories. We believe this can be largely explained by weakness in U.S. business investment and manufacturing inventories, down 2.5% and 1.2% in Q2, to which Canadian exports are closely tied

to. The only seeming positive for Q2 was consumer demand, with the 2.2% increase in household expenditure roughly in line with the previous quarter, despite a slight uptick in the household saving rate to 4.2% following 4 consecutive quarters of declines.

DCM maintains that certain factors mean economic growth going forward will not be the doom-and-gloom painted by Q2, though we remain more cautious than before. U.S. orders of capital goods have modestly risen for a 3rd straight month in August, while the lower upfront capital investment and fixed costs of U.S. shale production have enabled American producers to respond more quickly than Canadian counterparts to the stabilization of oil prices, now expected by economists to add to U.S. rig count in Q3. These trends thus point to a cyclicity, rather than structural weakness to Canada's Q2 export demand, making it an unlikely indicator of longer-term performance. A period of Canadian export stabilization will induce strengthening of Canadian business investment in turn. Meanwhile, the vast majority of the fiscal stimulus pledged by the Liberal government through \$126bn in infrastructure spending has yet to be deployed, with the first outlay of funds having only been earmarked for April-June period of Q1 Fiscal 2016-2017. This undertaking will not only add to GDP through the government expenditure component, but enact a multiplier effect to stimulate additional private-sector investment. Its meaningful addition to productivity will help to raise export competitiveness as well. As we however recognize that the structural shift we anticipate to a non-resource, exports-oriented economy still remains quite reliant on the health of export markets, predominantly the U.S., we exhibit prudent caution in the confidence of our outlook.

We believe that view is shared by the Bank of Canada, with Poloz having consistently thrown his weight behind the same bet on the non-resource sector that we have in previous BoC announcements. He recently conceded that as the U.S.'s trajectory for business investment is fundamental to export growth expectations, weakness in that market has somewhat tilted risks to growth and thus inflation to the downside. However, we believe two elements are clear in Poloz', and thus the BoC's, approach. The first is a considerably greater degree of patience and tempered expectations than the market. Even in his most recent address, Poloz stressed that it is necessary to wait out the fiscal stimulus, particularly in infrastructure, to witness its long-term benefits in higher export competitiveness and potential output. The second is a degree of skepticism toward the relative utility of monetary policy to provide any further stimulus that may be necessary to close Canada's output gap. In his most recent address in which he characterized rates as "lower for longer", Poloz still reaffirmed monetary policy is presently constrained, and structural reforms such as trade liberalization, in combination with fiscal stimulus, is our current option to further spur growth. DCM is thus confident that the BoC's overall approach will continue to be one of insistently waiting on the side-line, with little risk of a rate cut both in the immediate future and 2017. As this view is moderately less dovish than the market's current pricing of a 43% probability of a rate cut by the end of 2017, we see it justified to maintain our 1.38 year duration gap to the Canadian benchmark.

U.S. Macro and Duration

Q2 and Q3 saw similar volatility in Treasuries, now accompanied in the broader context by a 'bull' flattening of the curve, with the 2Y-10Y spread narrowing 22 bp since March 31st (Figure 2). Regarding volatility, many instances in recent months have been caused by the usual fluctuations in risk-on/risk-off behaviour of investors as they quickly overreact to incremental news, around which there is actually considerable uncertainty in terms of materiality and long-term impact. During these times, Treasuries pause in their role to reflect U.S. economic fundamentals, serving instead as a barometer of general risk sentiment. A salient example of this was Brexit, where a sell-off of Treasuries, particularly at the long-end of the curve, was seen in the days leading up to the vote as markets acted on polls narrowly in favour of "remain" as though they knew the outcome with 100% confidence. The vote to leave in turn plunged investors into a sharp panic, with the 10Y and 30Y falling 36 bp and 33 bp respectively to all-time record lows. Yet again however, it proved to be a hasty jump to conclusions in areas of uncertainty – near-term financial market stability and long-term global growth impacts. Treasury yields staged their biggest 1 week gain in over a year only 2 weeks out from the vote as investors revised their overreaction and risk assets including oil and equities rallied.

These movements, we ultimately believe, are not within DCM's purview or investment strategy due to their transience. Instead, what should be focused on is the aforementioned connection between rates and U.S. economic fundamentals – which has shaped the broader trend of the 'bull' flattening mentioned above. This shift, which indicates lowered expectations for long-term inflation, arguably goes against DCM's retained view that the U.S., through moderate further expansion, is steadily nearing potential output, making inflationary pressures a concern and justifying monetary tightening.

While recent data does not overwhelmingly support our position on the surface, closer analysis reveals a more confident backing. The headline figures from the recent revision of Q2 GDP data indicated tepid 1.4% annualized growth, much in-line with tempered expectations following a weak Q1. However, disaggregating categories of weakness reveals a number of drags we label as temporary. Weak business investment, for example, will benefit from cyclical drivers going forward. The net export drag of H1 2016 likely reflects the materialization of the delayed pass-through of prior USD appreciation to higher export prices in foreign currency terms, and thus a fall in external demand. Stabilizing export demand in future quarters from a stabilization in local pricing should not only mitigate net exports' current drag on growth, but also justify incurrence of previously delayed capital expenditures in the manufacturing sector. Furthermore, the significant recent scale-back in commodities sector capex will reverse if Q3 sees the market-anticipated first increase in U.S. rig count since the second half of 2014. Drag from inventories, which had subtracted a significant 0.33 and 1.26 points from GDP growth in Q1 and Q2, is also unlikely to persist in coming quarters as inventories' overhang relative to sales has been eliminated, and both domestic consumer confidence and exports (and thus logically business confidence) have modestly strengthened since May.

With the growth box checked, the Fed will next turn to its other two formal mandates for confirmation to proceed with a hike – unemployment and inflation. Yet again, on the surface, headline data does not appear highly confirmatory to DCM's view. With a stabilizing participation rate, unemployment has stubbornly refused to fall below 4.9% in recent months, supporting Fed doves who complain that number remains above NAIRU. Coupled with soft inflation data, softening inflation expectations and modest 2% wage growth, they have been making the case for holding rates in an attempt to eliminate slack in the labour market, as it would pose minimal risk of inflationary pressure. However, that stance ignores the more intricate relationship between labour costs and business pricing pressures. For that, it is most relevant to focus on 'unit labour costs', which is the differential between wage growth and productivity growth. Productivity growth has contracted for 3 consecutive quarters, down to a 0.6% annualized decline in Q2, the longest slide since the end of the 1970s. The end result is that, though wage growth has indeed been modest, unit labour costs have been increasing sharply, rising at an annualized 4.3% in Q2. Given the close but delayed relation between the core PCE price index and unit labour costs, the rational conclusion is to expect recent labour trends will place upward pressure on consumer prices – and thus the doves' risk assessment for inflationary pressures from the labour market is inaccurate.

This factor, compounded with others, causes DCM to view upside risk to U.S. inflation. For example, similar to the story for exports, an examination of the data (Figure 3) appears to indicate that the delayed pass-through effect of past USD appreciation to lower import prices has also materialized. General month-over-month changes in import prices, both including and excluding fuel, have turned to the positive after a year of decline. Meanwhile, further expected strengthening in consumer spending, up 4.4% in Q2, is set to put upward pressure on domestic prices as well. While we do not go as far as claim these factors together put us at immediate risk of a rapid inflation take-off, we believe that Yellen will take heed to these subtle but mounting pressures. In the press conference following the September FOMC meeting, she again rejected a "whites of their eyes" approach to inflation in terms of setting policy, reinforcing the idea that the FOMC has to be forward-looking in analyzing data.

Putting growth, employment and inflation considerations together we believe firmly sets the stage for a December hike. Even the Fed's 'tacit' mandate of financial market stability has remained supportive in recent months, with volatility only appearing in intermittent and quite mild doses since Brexit. Indeed, the repeated mention of "financial market developments" by FOMC officials in Q1 was largely absent from September's post-meeting statement or Yellen's press conference. Given the market is currently pricing in a 59.25% probability of a December hike, we stand to be more hawkish on duration. Furthermore, with a pick-up of growth and identified inflationary pressures we identified being longer-term in nature, it is reasonable to expect that incoming data in the coming months will continue keeping the Fed's formal dual-mandate targets for employment and prices on track. This should provide the impetus for the FOMC to keep to its current dot plot in 2017 – again a much more hawkish view than the 10.86% currently priced by the market for a

further 2 hikes in 2017. We therefore remain comfortable maintaining our -1.35 year, or 26% U.S. duration gap to our benchmark.

Credit

Canada

Canadian credit spreads have continued a steady tightening since the end of Q1, though the extent of the “risk on” trade observed in tandem with the rapid climb in commodity prices has notably subsided. The trend has been far more pronounced in the HY space. Thus, while the IG index has compressed 10% (18 bp) since March 31st, the HY index has posted a 30% (290 bp) tightening over the same period, leading the IG-HY spread to decline from 797 bp to 525 bp (Figure 4). Though the U.S. has observed a similar discrepancy in performance between the two grades, it has not been as pronounced.

A likely explanation behind the divergence of the two markets is the diversity of their respective HY classes. While energy comprises 16% of the U.S. HY universe, it unsurprisingly forms a much higher 40% of the Canadian HY market. The outlook for oil and gas segment has changed substantially from the cycle-low of oil prices hit in mid-February, which caused sector spreads to widen to panic levels at a time when credit rating agencies were assigning multi-notch downgrades to Canadian producers. O&G bonds across the board have rallied in tandem with the sustained recovery in oil prices, which has caused concerns over default risk and sector liquidity to at least partially subside – a shift the Canadian HY market has certainly stood to benefit more from overall. However, in focusing on the credit fundamentals, DCM is hesitant to share the market’s recent enthusiasm. On the one hand, elevated bankruptcies have helped to weed out many of the weak players in the space (with 12 Canadian O&G bankruptcies since Q4 2014, or about 11% of the global O&G total). In addition, various “credit improvement strategies” have been deployed by issuers with stronger balance sheets, including solely utilizing equity issuances to fund operations and acquisitions. However, the prospect of operational recovery and profitability for high upfront-investment, high-fixed cost oil sands projects representing 46% of all Canadian oil production still remains heavily contingent on a sustained recovery in prices. We thus believe that at current valuation levels, that obligatory risk to assume is not being sufficiently rewarded with corresponding spread.

Outside of that realm, we remain skeptical of the broad direction of corporate credit fundamentals. Q1’s positive trend in corporate leverage, with TSX Net Debt/EBITDA declining 0.10x Q/Q to 2.56x, was attributable both to a boost in earnings and a 17.2% slowdown in issuance across sectors. However, that positive momentum was not sustained in Q2. In-line with challenging GDP data, not only did corporate earnings decline in absolute terms (quarterly EBITDA was down 9.4% Y/Y), but the trailing 12M EBITDA margin slid 39 bp sequentially as well, in turn impacting ROC, which fell to 2.4%. Add to that a pick-up in issuance (at \$25.5bn, up \$1.8bn from Q1 and in-line Y/Y), and the end result was a 0.43x jump in TSX Net Debt/EBITDA to 2.99x – the highest level since 2008.

Though the “energy card” can be played in this more heavily-IG realm as well to justify the leverage spike, with energy comprising the second highest weight of the TSX at 20%, other sectors have clearly been continuing their ‘re-levering’ for corporate purposes generally averse to credit holders. Chief amongst these is M&A. While U.S. M&A started 2016 off with a slow start, Canadian M&A witnessed record dealmaking in H1 2016 with transactions, at \$122.8bn, increasing 20% Y/Y to reach the highest point on record since 2007. Companies are heavily attempting to offset the current dearth of organic corporate growth, a trend that was observed across a broad range of industries including industrials, consumers and infrastructure. As acquisitions are often funded through debt, thus increasing leverage, and introduce greater operational uncertainty, the combined effect is a typical elevation in credit risk that should result in a risk premium in the form of a higher spread. It is arguable that the larger source of recent re-leveraging we are currently seeing in Canada however remains ‘unintentional’ in nature, caused by a deterioration in cash balances (continued operational struggles in the commodities sector potentially being a large factor), rather than increase in absolute level of debt (a conscious corporate decision). While TSX Q2 Net Debt climbed by 15.8%, Debt itself only increased by 2.5%; that in tandem with the comparatively smaller 3.2% fall in LTM EBITDA means the declining cash balance is thus attributable for most of increase in the leverage ratio seen that quarter.

Our challenge in either case is to discern, both on an aggregate and specific security basis, whether risk premia are being adequately awarded to identify investment opportunities, in light of the consistent spread compression we’ve seen this year despite higher corporate leverage. On the surface, it appears the tables have turned since our outlook at the end of Q1, when we noted that HY had generally reached an attractive relative valuation point offering generous carry for higher credit risk. Since then however, the 277 bp rally in the HY index has brought the spread from below average to its narrowest levels since the index’s inception in January 2014. Conversely, it’s IG that now appears to present the comparative value opportunity, as the current spread of 150 bp remains near the high-end of the post-crisis range, and well off the floor of 77 bp seen in March 2010. This in turn is helping the 5Y IG spread drive 68% of the all-in yield, also near the peak of the post-crisis era.

Thus, through careful analysis, we believe we may find a relatively more attractive risk-return profile in the Canadian IG space at current valuations. This is particularly given DCM’s relative confidence in Canada’s ability to revive growth over the long term through the slow, structural shift the economy is currently undergoing towards non-resource sectors, which would in turn provide relief to the aforementioned deterioration of certain operational fundamentals. However, corporate risk-taking, chiefly leverage, must be closely watched to ensure it does not rise in tandem and overshoot improvements in fundamentals in order to have confidence that credit profiles will indeed improve, justifying further spread compression. DCM is accordingly adjusting our focus, recently on HY, to the Canadian IG space, unless we uncover what we believe to be a truly compelling risk/return mispricing in a HY bond.

U.S.

Similar to Canada, the intervening months since Q1 have brought a soft decline in U.S. corporate spreads, though with the aforementioned more narrow discrepancy between IG and HY performance. Thus, the 30% fall in the U.S. HY spread to 505 bp from April 1st to date has been more closely matched by the 17% decline in the IG spread to 144 bp, though the end result is still a narrower IG-HY differential, down from 548 bp to 361 bp (Figure 5). Aberrations in the tightening trend did indeed appear during bouts of risk-off behaviour, which had investors pursuing a flight to quality in the form of high grade corporate debt or 'risk-free' Treasuries. Chief among these this summer was Brexit. It held true to the strong historical correlation (0.87 over the past 15 years) between HY spreads and the VIX, intuitive given: a) factors underlying the VIX, such as investor confidence in economic growth and capital market stability, are pertinent to debt servicing ability, particularly for lower credit quality firms; and b) the HY market is much less liquid than that of IG, leading to larger price fluctuations in times of market stress. Thus, volatility in equity markets was mirrored by a 27 bp widening of the U.S. HY index on the day following the vote, only to contract back below pre-vote levels about 2 weeks later. IG bonds, which are more closely correlated with Treasuries than equities, saw a small 5 bp rally on the day following the vote, with spreads normalizing quickly thereafter.

However, the relevant question is whether these transient movements are actually of concern to us as investors. Examining U.S. corporate fundamentals reveals little to be excited about. S&P earnings growth, as measured by EBITDA, was flat Y/Y in Q2, in line with GDP and mirroring Q1 performance. ROC fell 54 bp Y/Y in the same period. Meanwhile, the re-levering of corporate America continued in its prolonged easy credit environment, with S&P Ex-Financials Debt to EBITDA, at 2.3x, now standing at its highest point in the past 15 year period. What is even more disconcerting, however, is that similar to Canada, proceeds are going to credit-unfriendly uses. For example, Q2 LTM share buybacks have increased 6.8% Y/Y to reach the fourth highest level in history. That this use of funds alone is outstripping FCF for a vast array of companies (130 firms and counting in the S&P 500, the highest since the depth of the recession), leading to the near-inevitability that debt is necessarily being used to finance these shareholder 'returns'. As this has been occurring in an environment where U.S. business investment has been modestly contracting for 4 consecutive quarters, we thus express concern over the prudence of capital allocation on the aggregate, which currently appears averse to creditors.

Against that backdrop, it is challenging to justify current valuation levels in a wide spectrum of U.S. corporate credit. The current HY market spread, at 509 bp, is 16% or 96 bp below the 15-year historical average. Likewise the current IG spread, at 143 bp, is 18% or 32 bp below the 15-year historical average. Given U.S. corporate leverage has now exceeded its previous peak during the dot-com bubble, those figures already appear illogical, failing to accurately price the true level of credit risk in the broad market. The ability to service such a high debt level is obviously contingent on two key factors – profitability and borrowing costs – and the picture for either does not seem promising. S&P 500 EBITDA margins and ROC both declined 101

bp and 98 bp respectively to 18.5% and 6.4% in 2015, and have continued the downwards trend on a Q2 2016 LTM basis as well, which we believe are logical symptoms of a maturing business cycle. That postulation is supported by the recent slowdown of U.S. GDP growth and capital investment, which suggests an increasing challenge to find attractive investment opportunities to expand organically.

With a weakened profitability outlook, the other end of the equation - borrowing costs - would need to remain very accommodating to sustain current leverage levels, particularly as interest coverage ratios already began to decline in 2015. However, given DCM's aforementioned confidence that based on the current economic data, the Fed will indeed move to raise rates, that bet can no longer be made. With this outlook DCM will exhibit caution around the U.S. corporate space. As rising borrowing costs logically hit HY firms first in the credit cycle, both in terms of actual credit quality fundamentals and a sharp fall in valuations, we are currently moving to reduce our already very limited U.S. HY exposure (at 2% of our fund). We will also choose to focus our efforts on the Canadian corporate space to select new single-name positions to replace the upcoming maturities of Rona and Aimia, two Canadian IG bonds, in October and January respectively.

Selected Holdings Updates

Home Capital Group 3.4% 2018

On December 3rd 2014, we initiated a 5% position in Home Capital Group (HCG) 2018 at a G-spread of 158 and Yield to Worst of 2.77%. It is a senior unsecured bond rated BBB by S&P, guaranteed by HCG's parent company Home Trust. HCG is a federally regulated deposit-taking institution that provides mortgage and retail lending. It focuses on providing fixed rate residential mortgages in the Alt-A market, targeting individuals whose credit scores are not reflective of their true credit worthiness, and engaging in securitization sales of its CMHC-insured portfolio.

Our investment thesis postulates that HCG is shifting to higher and more stable revenue streams through its off-balance sheet securitization activities. In the origination, securitization and subsequent sale of CHMC-insured loans, HCG does not bear default risk for its newly originated loans. It however retains servicing rights and thus continues to generate a stable revenue stream of fees from these loans. As HCG is no longer in possession of 'substantially most' the risks and rewards of ownership of these assets post-sale in the eyes of IFRS (rewards are regarded predominantly as interest income), it is allowed to de-recognize these loans from its balance sheet. This then expands HCG's lending capacity, which is driven by the ratio between HCG's capital and risk-weighted on-B/S assets. Thus, we recognized that through this ongoing strategy, HCG will be able to continually grow total loans under administration, for which it derives stable servicing fees, without growing its risk exposure – an attractive dynamic for creditors.

This thesis has partially materialized. H1 2016 saw significant growth in sales off-balance sheet of HCG's securitized CHMC-insured loans, up 18.8% Y/Y. As these de-recognitions have largely kept pace with growing insured loan originations, when combined with natural loan

amortization and maturities these sales continued to successfully shrink the on-B/S insured loan portfolio, which has declined 12.0% YTD. Thus, off-B/S loans, and total loans under administration from which HCG derives servicing fees, are steadily growing from this activity, up 12.8% and 2.7% YTD respectively.

Our postulation regarding the end-growth of servicing fees has proven less accurate this year. Despite the robust growth in HCG's loans under administration, total servicing fees fell 14.4% Y/Y in H1. This was attributed to 'adjustments' that essentially amount to a recent cut in fee rates to lure greater retention among existing eligible borrowers upon renewal of their mortgages. While this cut certainly reduces the outlook of this stable revenue stream (equal to 14% of HCG's net interest income) going forward, there is one interesting advantage of this decision for credit holders. Its intentions are to improve the growth rate of HCG's on-B/S portfolio from which it derives interest income, as originations each quarter being partially offset by run-offs of non-renewed loans. The alternative, of course, is to try and ramp up the pace of originations. However, chasing after existing borrowers, we argue, poses lower credit risk than pursuing new ones, as it mitigates the information asymmetry in selecting new borrowers. To explain, HCG, like any originator, can only rely on various signals such as income when screening new borrowers, whereas it has access to a much more informative complete, detailed record of actual payment history to use in the assessment of a borrower coming up for renewal. Thus, this recent shift of focus to borrower retention, though coming at the expense of servicing fees, should help improve the general credit quality of borrowers going forward – to the advantage of bond holders.

Our investment thesis also pertains to HCG's favourable valuation against other Alt-A Canadian mortgage lenders and chartered banks, despite superior credit loss performance, net interest margin, and capitalization. We initially postulated that, after demonstrating a consistent track record of credit loss outperformance and thus stronger risk management, HCG would trade at a premium to other Alt-A lenders, with the discount to Prime lenders narrowing. Compression against Alt-A lenders has materialized, with HCG now trading at a premium over other Alt-A lenders. However, that premium has narrowed since the end of Q1, from 55 bp to 31 bp.

We believe this is largely attributable to adverse market reaction to an article circulated posted on an investing blog at the end of August claiming to have evidence that HCG is transferring bad loans off-balance sheet to hide credit losses. HCG directly responded to the article, and after careful analysis, we concluded it is ultimately a non-issue. Firstly, the volume of loans historically sold to third parties for the purpose of work-outs or restructurings has proven immaterial and steadily declining, falling from \$113mm in 2014, to \$12mm in 2015, to zero in 2016 against a total on-B/S portfolio of \$18.1bn. Over the same period, credit loss statistics have been steadily improving, suggesting the sales have little bearing on loss performance, and thus making the stated rationale for HCG engaging in these transactions appear unlikely. Secondly, HCG stated clearly that all losses during HCG's holding period were fully booked and accounted for, which is the regulatory-compliant practice (and given how closely scrutinized

the industry in Canada is by regulators like OFSI, we believe it's unlikely that management would falsify such a claim). We thus conclude overall that the current spread, which remains elevated following the incident, is unjustified, and stands to compress as concern subsides and management continues to demonstrate its above-average prudence in originations and risk management in coming quarters. However, to be sure, we will closely monitor all updates related to this matter going forward for anything that could impact our conclusion.

Cogeco Inc. 4.925% 2022

On November 17th 2015, we initiated a 5% position in Cogeco 2022 at a G-spread of 176 bp and Yield to Worst of 3.02%. It is a first lien bond rated BBB- by S&P, ranking pari passu with Cogeco's first-lien loans at the top of the company's capital structure. Cogeco is a Quebec-headquartered Cable company with 3 business units; 2 cable divisions operating in Ontario/Quebec and eastern U.S. respectively, and an enterprise data unit offering cloud, server and IT services throughout its datacenter network in North America and the U.K.

Our first investment thesis postulates that pessimistic investor sentiment towards Canadian cablecos, resulting from the formidable competitive threat perceived to be posed by new FTTH network technology, overlooked Cogeco's competitive advantage through its geographic positioning. Though news of Bell extending its FTTH network coverage were sending Cogeco's spread higher, we postulated that a then-recent CRTC ruling mandating FTTH wholesaling would significantly alter Bell's deployment economics in light of its inability to act as a monopolist on new networks it could construct. In particular, the ruling would push Bell to focus on markets with the lowest deployment costs and highest expected penetration rates, dense urban centers, and avoid Cogeco's core network geography – underserved rural area and small towns. Thus, we expected FTTH overlap would remain much lower with Cogeco's network versus other Canadian cablecos, stemming subscriber loss and making similar market pessimism unwarranted.

Performance YTD has been in-line with our thesis. FTTH overlap has indeed remained low at 43%. In May 2016 the federal government also rejected Bell's appeal to overturn the original CRTC ruling, which was grounded on the premise that the ruling would render certain deployment projects uneconomical. It thus provided us confidence that Cogeco's 'natural hedge' offered by its network geography would prove effective and be maintained into the foreseeable future. Thanks to the limited competition, Cogeco has been able to post robust internet PSU additions, up 15% YTD, as more rural households transitioning to high-speed internet face Cogeco as amongst the fastest, lowest-cost options available. Our anticipation that the shift in PSU mix towards internet would also benefit overall cable segment margins as it is a higher-margin service than TV has also materialized; Canadian cable operating margins are up 80 bp YTD to 51.8%. TV PSU losses are also being held steady at roughly 2.4% YTD despite a rate increase in early 2016, mitigating the offering's drag on revenue growth.

Our second investment thesis related to the recent restructuring of the Enterprise unit, which was consolidating its prior-separate two

operating units and undergoing heavy capex. While many research analysts had dismissed the segment as chronically unprofitable, we postulated that, as construction of two new 'mega' datacenters in Canada neared completion, and consolidation yielded economies of scale inherent in the datacenter industry, the unit would be poised for FCF growth. This thesis has remained challenged, though we still anticipate FCF improvements to materialize. As a result of greater than anticipated competition from large cloud companies (likely including AWS) in the hosted services segment, long-term growth and profitability expectations for the Enterprise unit were lowered, leading to a \$450mm non-cash write-down in goodwill in FQ3.

Management has however wisely recognized that direct competition with these giants in certain segments is unrealistic, and has thus moved decisively to transition out of unprofitable services, streamline product offerings and rationalize operating costs. Cogeco has refocused on niche enterprise computing segments outside the competitive realm of big players like AWS, including colocation services, in which it has achieved slow but steady growth including major contract wins this year. Supporting our thesis, completion of datacenter construction mid-way this year has already benefitted segment capex, down 8.0% YTD, with management projecting further segment capex declines in F2017. We thus expect modest, but steadily improving FCF growth from the segment going forward, which will still benefit management's stated aim of delevering.

Our third investment thesis pertained to the nearing completion of the TiVo digital TV rollout in both the Canadian and U.S. segments. We hypothesized the introduction would yield both revenue and FCF improvements through multiple levers. Firstly, as one of the very few IPTV alternatives many of its customers situated in more rural markets have, we expected its pricing structure would reduce churn amongst existing internet/cable bundle customers on the cord-cutting fence. Thus, not only would it help to reduce TV PSU losses, but it would sustain the proportion of 'multi-play' subscribers, who possess the highest ARPU and retention rates. This aspect of the thesis has begun to materialize. In the U.S. segment, TV PSU losses have not only decelerated, but decreased on an absolute basis, 12.7% lower Y/Y in FQ3. While in the U.S., the proportion of 'double-play' customers has remained stable at 36%, in Canada double-play proportions have been increasing, up from 35% to 37% Y/Y in FQ3. This in turn has driven a modest increase in ARPU, and thus operating margin. The second portion of this thesis anticipated stronger segment FCF generation due to the capex dynamics of the (then-in-progress) TiVo rollout. The most significant deployment costs are incurred upfront when the technology is launched on the local network, rather than on an ongoing basis with customer additions – yielding a logical expectation of diminished segment capex going forward. This thesis element has now successfully materialized, with the Canada/U.S. capex down a sharp 17.6% Y/Y in FQ3 and anticipated by management to continue decreasing in F2017.

On a valuation basis, Cogeco 2022 performed well in the first few months of the year. Its G-spread not only bottomed below 200 bp in mid-May, but achieved substantial compression against the Canadian IG index as well, the spread narrowing to as tight as 38 bp. The spread

has gradually drifted wider, and since the release of Q3 results, which contained the goodwill impairment of the Enterprise segment and was received somewhat pessimistically by street analysts, it has remained 10 to 15 bp higher against the IG index, now standing at 60 bp. However, DCM not only believes there are multiple, reliable levers for modest FCF growth in coming quarters for Cogeco, but that delevering can also be subsequently expected, as management has maintained reference to its intention to use FCF to reduce indebtedness. We thus expect coming quarterly releases to provide reassurance to creditors, meriting compression against the index to levels closer to pre-Q3 spreads.

Iron Mountain 6.125% 2021

On December 21st 2015, we initiated a 3% position in Iron Mountain (IRM) 2021 at a G-spread of 396 bp and Yield to Worst of 4.56%. It is a senior unsecured bond rated B+ by S&P, ranking after only a first lien loan (due 2019) in IRM's capital structure. Iron Mountain is a U.S.-headquartered REIT specializing in enterprise information management, with operations in 36 countries. Revenues are primarily derived through physical and electronic records management, storage and destruction services. In April 2015, IRM announced the acquisition of Recall, another data management company, for \$2.6 bn, completed in May 2016. The combined company controls 65% of the global records management market.

Our first investment thesis hypothesized that the acquisition of Recall was being incorrectly priced as a credit-negative event by investors, with spreads spiking to a record high 438 bp upon its announcement, for two main reasons. Firstly, DCM recognized that acquiring Recall would achieve meaningful revenue diversification, thus reducing operating risk. Recall not only enables geographic diversification into four large regional markets, but possesses greater developing market exposure as well. This geography is attractive in the records and data management space as it poses organic, market size growth opportunities from companies in those markets who are still outsourcing physical records storage and management for the first time. Firms in these markets, whose archiving practices are behind those of developed markets in formality and breadth, are strengthening their processes, driven by both increased scale and local regulation (gradually converging to the standard of developed markets). Given Recall is a market share leader in the majority of these distinct markets it operates in, the acquisition would thus offer the opportunity to gain a strong foothold in expanding markets, in an industry also characterized by high customer retention and thus revenue stability.

We believe financial performance thus far has supported this element of our investment thesis. As the Recall acquisition was only completed May 2nd, 2016, Recall's P&L items are only consolidated for 2 of the 3 months of Q2 in IRM's income statement. Even missing 1 month of revenues, however, Recall still accounted for 35% of IRM's Q2 ex-N.A. and Western Europe markets revenue; calculating and adding a pro-rata 1 month of revenue raises that figure to 53%. Importantly however, is that ex-acquisitions IRM achieved Q2 organic developing market storage and services growth of 8.7% and 5.3%, in contrast to 3.5% organic contraction in the N.A. and Western Europe unit. The

performance difference between the two units confirms diverging trends in the two respective market types, given that in developed markets, records management is a mature business transitioning to be more archival in nature. Thus, the diversification of IRM's revenue streams with Recall's developing markets-focused business should continue to be a critical growth driver going forward.

The second element of the investment thesis relates to how the Recall acquisition, as a result of the deal's solely equity financing and Recall's lower leverage, would help IRM achieve deleveraging, to the benefit of existing bondholders. Financial performance thus far subtly confirms this. Though IRM's net lease-adjusted leverage ratio post-acquisition at Q2 2016 was in-line at 5.7x versus 5.7x pre-acquisition, this masks the deal's true delevering potential on two fronts. Firstly, the ratio is a metric of 'stock' (debt) over 'flow' (EBITDAR). As IRM only completed the Recall acquisition on May 2nd, though Recall's debt is fully consolidated on IRM's balance sheet, only 2 months of Recall's earnings are factored into IRM's LTM EBITDAR. Thus, the metric is temporarily 'skewed' upwards and, all else equal, should fall in coming months as more months of Recall's earnings get included in IRM's consolidated LTM EBITDAR calculation to in fact reflect lower leverage. This is supported by looking at a 'flow' over 'flow' credit metric – fixed charge coverage – for which pro-rata consolidation applies to both the numerator and denominator. Coverage increased for IRM from 2.5x to 2.6x Q2, indicating superior debt servicing ability with the acquisition in place. Secondly, current leverage does not reflect the meaningful cost synergies to be achieved through the Recall acquisition, which we assessed to be attainable given scale economies present in the REIT space from joint management of combined real estate holdings. We believe this assessment has proven accurate this far, as management stated in the Q2 earnings release that IRM will realize an even greater portion of Recall synergies in 2016 than originally anticipated (\$18mm vs. \$15mm previously), with overall synergy targets being maintained.

Our second investment thesis pertains to IRM's extensive tangible asset base from real estate holdings. Management has pursued a stated goal of increasing ownership of operating facilities from 36% in 2015 to 50% in 2020, adding high-quality assets to IRM's balance sheet. Specifically, storage facilities typically have lower maintenance expenses, turnover costs and greater tenant retention than other types of properties held by REIT peers. Additionally, IRM poses superior portfolio diversification against peers as a result not only of operating in 41 countries, but possessing 94% of the Fortune 1000 as customers. As IRM does not employ significant leverage in mortgaging its real estate portfolio versus other REITs, acquisitions offer more substantial collateral to existing credit holders. We believe those factors combined thus create comparatively more attractive

credit fundamentals versus peers for IRM's owned and growing property portfolio. Since initiation, IRM's net book value of PP&E to net debt has remained a constant 0.53x despite adding \$703mm in real estate holdings through the Recall acquisition, arguably confirming management's strategy of minimizing leverage on its real estate portfolio.

Much like the Canadian HY Index, YTD IRM 2016's g-spread has compressed steadily and significantly, down 308 bp. This represents 48 bp outperformance against the index. We anticipate further improvements in certain aspects of IRM's performance going forward that will strengthen its cash flow, and thus credit profile. These include margin improvements from two sources. The first pertains to the aforementioned synergies to be realized through integration and SG&A cost redundancy elimination of the merger with Recall. The second pertains to IRM's 'Transformation Initiative' initiated in Q3 2015 to consolidate overhead functions and reduce costs in developed markets, with estimated overall savings of \$125mm by 2017. As we have less visibility on the viability or progress of this initiative, we will closely analyze coming quarterly releases for indications of the expected magnitude of this margin improvement.

Fund Update

As the new school year kicks off, it is with great pleasure that I introduce the three latest additions to the Fixed Income Fund, our new junior analysts: Ariane Laurin, Jun Ng and Charles Feng. These students have already made significant contributions to the fund over the summer by monitoring and publishing earnings updates for our holdings, and adding new investment ideas to the pipeline through the mini-pitches they created and presented at DCM's annual Boot Camp.

To you, our investors, I want to thank you for the amazing opportunity you continue to provide to every student in DCM. With each day that passes, my involvement in DCM makes me more and more convinced that, if one puts in the effort and dedication, this program offers back the single-handedly greatest source of knowledge and learning available anywhere to people our age who are passionate in investing. I thus have little doubt that any of us here at DCM, like all years of students, will work hard to strengthen this program for its next beneficiaries. Now, we can also hope to keep even more closely connected to the program once we leave through new initiatives like the DCM Mentorship program, which we are proud to launch this year.

Kind Regards,

Jonathan Kamel
Fixed Income Strategist

Fixed Income Fund Exhibits

Figure 1: Canada Government Curve – Q2/Q3 2016

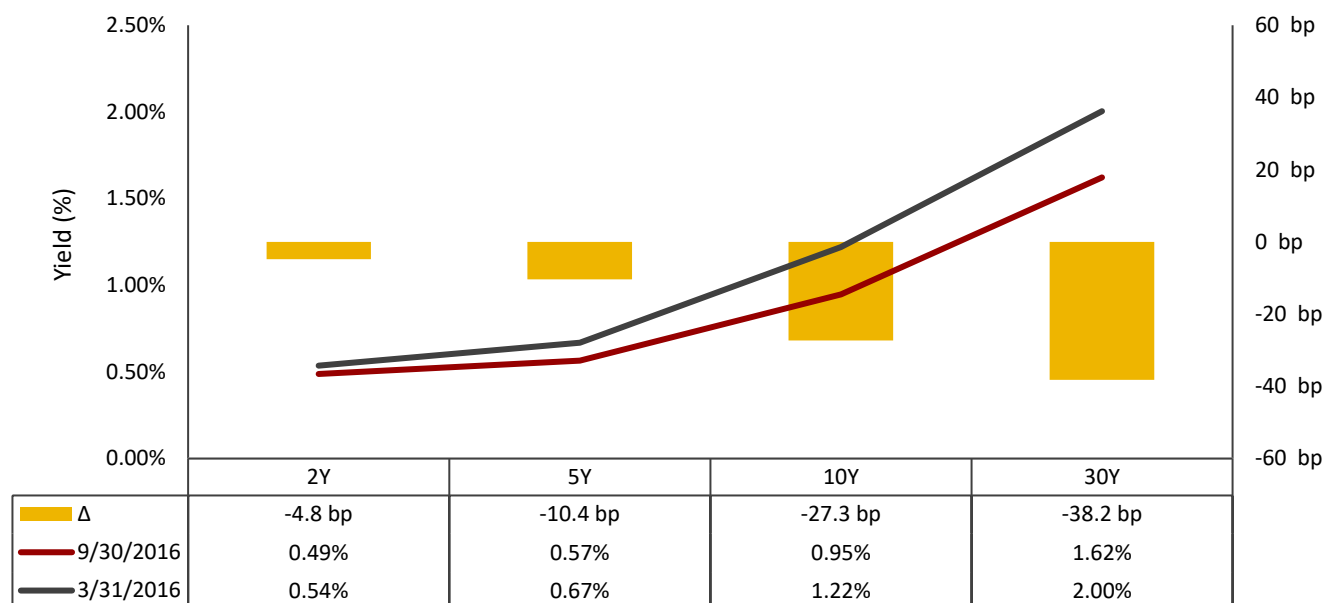


Figure 2: U.S. Treasury Curve – Q2/Q3 2016

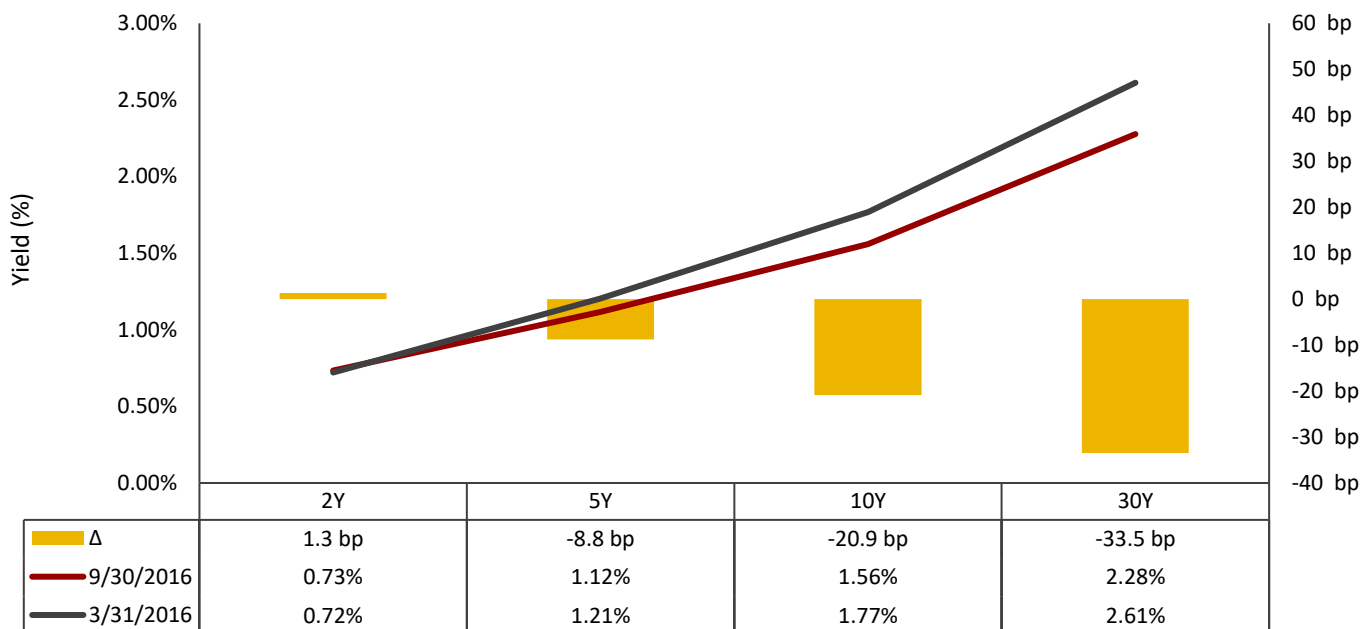


Figure 3: U.S. Export and Import Prices, Month-over-Month Change

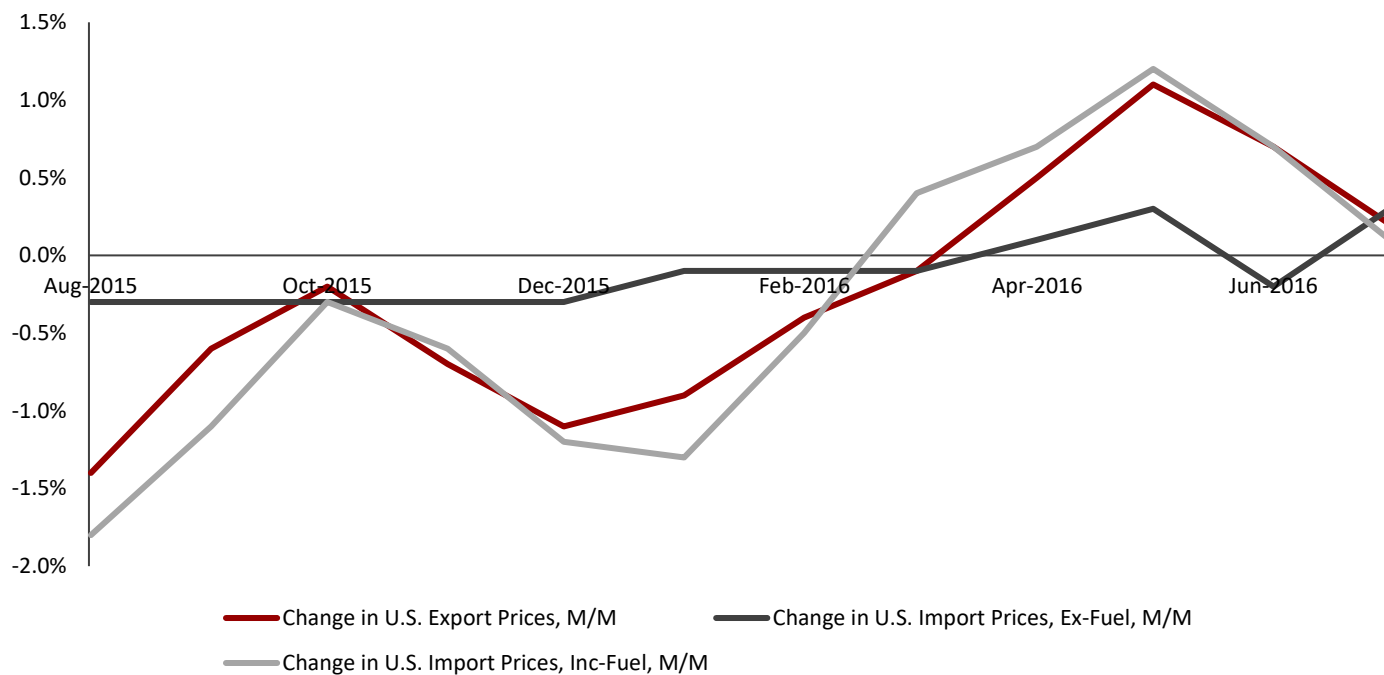


Figure 4: Canadian Investment Grade and High Yield Spreads – 2016 YTD

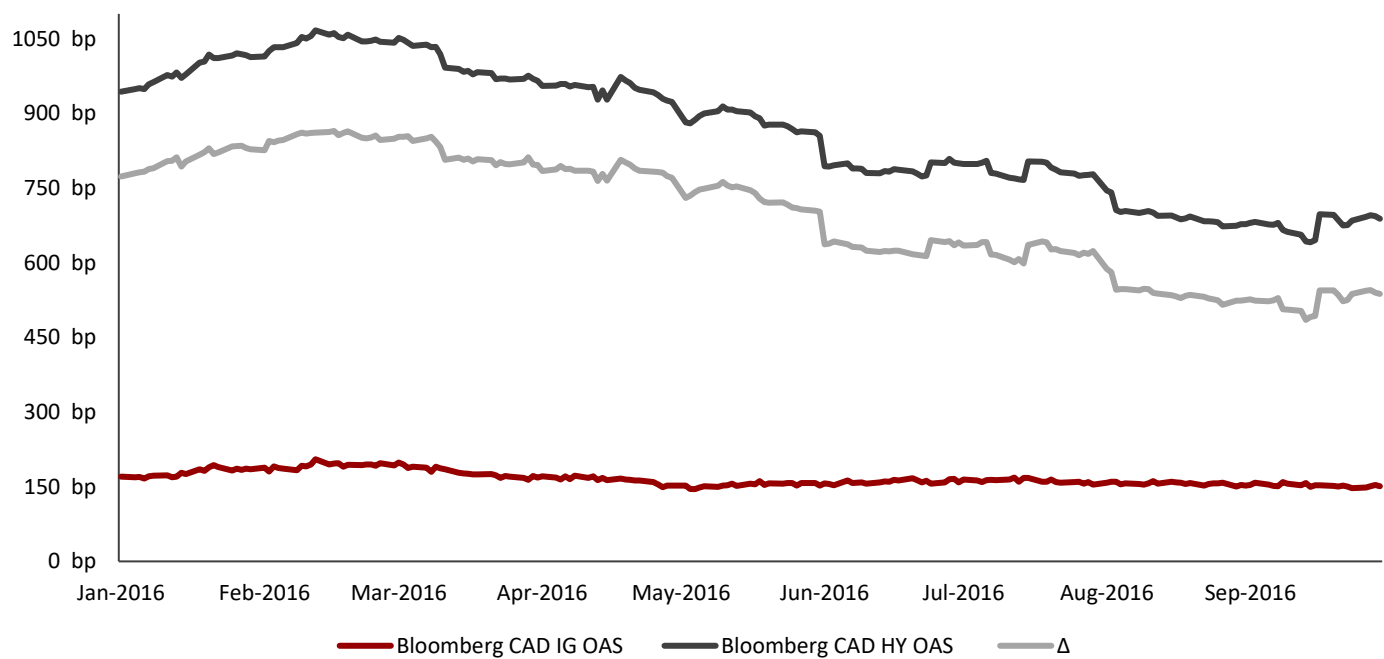


Figure 5: American Investment Grade and High Yield Spreads – 2016 YTD

