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Global Equity Strategy

Dear Investor,

For the month of February, Desautels Capital Management's Global Equity Fund returned 1.19% net of fees and expenses, bringing full year returns to 6.26%. Our benchmark, the MSCI World Index ($C), returned 3.21% in February, and 8.62% year-to-date.

2013 got off to a roaring start; January was one of the best Januarys for markets in nearly two decades. The Dow Jones Industrial Average climbed 5.8% on the month and is currently flirting with its all-time high. The UK's FTSE 100 was up 6.4% and Japan's Nikkei was up 7.2%.

Overall, the fund's recent underperformance can be attributed to our defensive holdings. Wells Fargo, widely considered to be one of the safe banks with little investment banking operations, missed the risk-on rally in the beginning of the year. Metro, our only holding in the consumer staples sector, was down slightly, and Teva, one of our core healthcare holdings, was flat.

On the positive side, the fund outperformed within the industrial, consumer discretionary, and energy sectors. Conrad Industries, our largest holding in the industrial sector, increased 22% while the sector increased by 7%. Conrad is notable as being the fund's first "two-bagger", a stock in which we doubled our initial investment. We hope to score more of these in the future. In the consumer discretionary space, both Bagel Restaurant Group and Bauer Performance did well relative to the sector, as our theses of a successful dividend recapitalization and penetration in to the Lacrosse market continue to play out. Finally, the resurgence of interest in nuclear energy from Japan lifted Cameco by 9.6%, and Pulse Seismic rallied 12% on strong earnings, relative to a 3% gain for the energy sector.

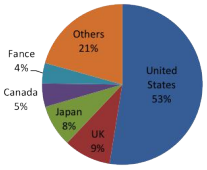
Benchmark Changes

Since inception, we have used the MSCI World Index as our benchmark. As of January 31, 2013 the index had the following characteristics:

DESAUTELS | Capital Management Gestion de capitaux

Global Equity Strategy

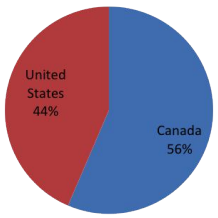
Figure 1: MSCI Benchmark



Index Characteristics	
Number of Constituents	1610
Index Market Cap ($ million)	26888940.92
Largest Market Cap ($ million)	426810.33
Small Market Cap ($ million)	615.4
Average Market Cap ($ million)	16701.21
Median Market Cap ($ million)	7409.93

Our Equities Fund however, had the following characteristics.

Figure 2: DCM Global Equity Fund Weight



The above charts clearly show that we are overweight Canada and underweight the rest of the world relative to our current benchmark. This is not a macroeconomic view we wish to express, but rather a natural result of our analysts following companies they are more familiar with, and to which they have greater access.

Thus, to better measure the fund's relative performance, we decided that beginning March 1, 2013, we will be using a blended benchmark composed of 60% TSX and 40% S&P 500.

Going forward, when reporting the historical performance of the benchmark, we will use the MSCI index up to February 28, 2013, and the performance of the new benchmark thereafter.

Portfolio Changes

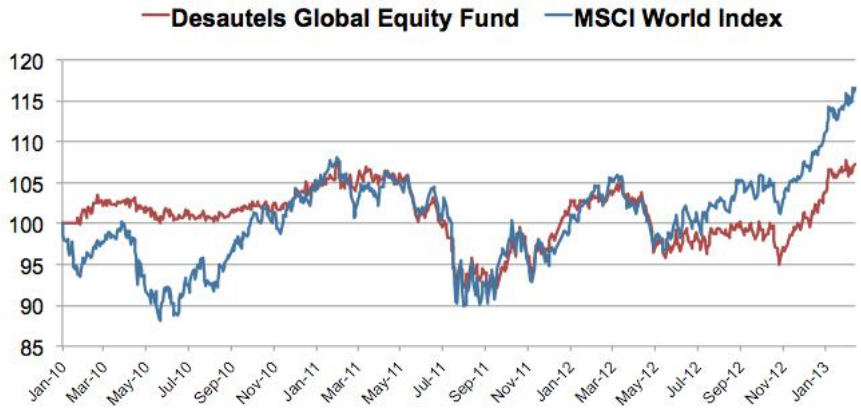
Einstein Noah Restaurant Group

In the month of February we exited our investment in Einstein Noah. Einstein Noah (BAGL) is a bagel specialty restaurant operator with 783 stores across 39 states in the US. Its banners include Einstein Bros. Bagels, Noah's New York Bagels, and Manhattan Bagel Brands. We initially invested in Einstein Noah in anticipation of their dividend recapitalization. We felt that the stock was mispriced at the time for several reasons:

1. Illiquidity discount. BAGL only has $94m in float currently, and this will be reduced to $56m. However, illiquidity affects different fund sizes differently. As a small fund with sticky capital, we are alright with buying a few hundred shares while being compensated for taking on this illiquidity premium.

2. Operationally, the company is transforming from a

Global Equity Fund Performance Overview: as of February 28, 2013



Desautels Global Equity Fund	Fund	Benchmark
1 month	1.19%	3.21%
3 month	8.38%	10.73%
6 month	8.33%	14.65%
1 year	4.20%	12.88%
YTD	6.26%	8.62%
Since Inception	6.94%	16.61%

Note: Please note that fund performance was slightly understated in prior newsletters due to an incorrect treatment of year-end unit trust distribution. We regret this error. Also, note that going forward benchmark performance will be based on the MSCI World Index up to February 28, 2013, and a blended 60% TSX - 40% S&P 500 index thereafter.

capital intensive company-owned model to a low capital based franchise-model. What management is doing operationally complements the financial engineering on the liability/equity side of the balance sheet, as both strategies require a focus on higher cash flows as a major success factor.

Since then, we received the $4 special dividend and felt the core of our investment thesis was realized. We exited the position at $12.71, giving us a holding period return of 5.62%.

Mercer International

Mercer International is a pure play producer of non-bleach softwood kraft (NBSK) pulp. NBSK is used in products such as tissue, specialty paper, and recycled paper. There are several reasons why we like Mercer as an investment:

1. It is no secret that the pulp and paper industry is in a structural decline phase as its largest customer, the newspapers, have seen their readers move to an online based platform. However, demand for softwood such as NBSK should continue to grow as demand for tissue and specialty paper grows, helped by the growing Chinese middle class.

2. Strong operations. Mercer has three modernized mills that are net exporters of energy rather than importers. Over the past five years, energy sales have grown at 10.9% CAGR, which we believe should make Mercer trade at a premium to its peers. Currently, however, it trades at a discount both to its North American and European peers.

3. Option value of a potential one-time $250MM gain as a result of an arbitration request with NAFTA. According to Mercer, its Celgar Pulp Mill in British Columbia is given an unfavorable and inconsistent ruling from BC Hydro in terms of pricing of its purchased electricity usage as well as its sale of electricity production, relative to other paper mills in the province. This is significant as the company's market cap is only $400MM.

4. M&A optionality. We see continued consolidation of the industry as big players buy out pure plays (Resolute acquisition of Fibrek). Given Mercer's pure play status, its modernized mills, as well as its relatively small market cap, Mercer is an attractive takeout candidate.

We see a target price for Mercer of $8.70 based on an implied EV/EBITDA of 8.8x, which is in line with industry averages. We purchased 5800 shares of Mercer at $7.19.

Patrick Industries

We made a critical error when it came to Patrick Industries. Patrick is a manufacturer and supplier of building products and materials to the manufactured housing and recreational vehicle industry, which represents 20% and 68% of revenue, respectively. All the industries served by Patrick were hit hard during the financial crisis and are currently in a phase of recovery. Our investment theses were as follows:

1. Exposure to the recovery of RV and MH. Patrick Industries is the nationwide market leader. During the crisis, the company underwent restructuring with the sale of non-core assets and an optimization of utilization rates in facilities. The cash raised was used to finance small strategic acquisitions that would expand the company's product line and content sold per unit.

2. Efficient Operations. As the company successfully restructured itself through the crisis, EBITDA and net income margins improved significantly. Now the company is profitable at a much lower revenue threshold. Inventory turnover has improved from 8.5x from pre-crisis levels to 12 times.

We purchased Patrick at around $15.37. However, we

Global Equity Strategy

were disappointed with the fourth quarter results published on February 21st. Taking out the effect of the last acquisition, Patrick achieved almost no growth in the RV space. Competitors such as Drew Industries did much better. In the MH space, Patrick managed to decrease revenue by 10% while Drew held steady. Our hypothesis is that the company lost a big customer or started receiving slower orders from a large customer. This was mentioned as one of our risks in our initial investment as the top 5 customers made up 60% of revenue. We sold Patrick Industries with a loss at $11.48.

Fund Update

February was election season at Desautels Capital Management, and after a very hard fought campaign, we would like to congratulate Nick Di Giorgio as the new Equity Strategist for next year. Nick was previously an analyst in the Financial sector of the fund and we have no doubt he will be an excellent leader for the year to come.

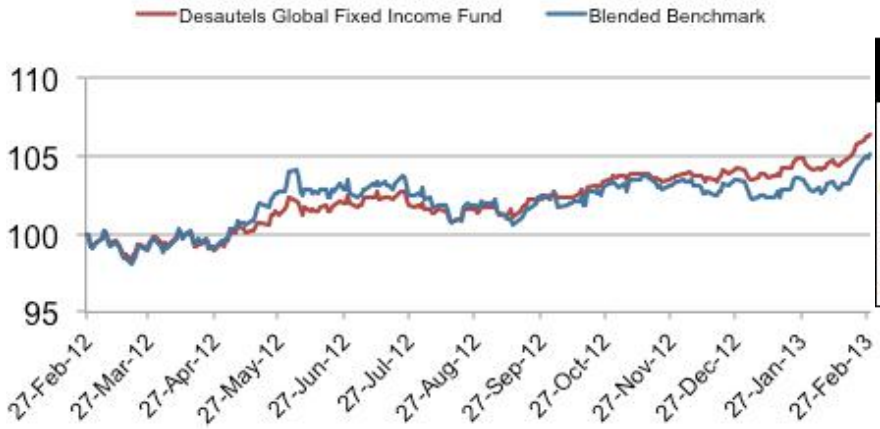
Thank you,
Ivan Di
Global Equity Strategist

Fixed Income Strategy

Dear Investor,

We are pleased to report that since our last newsletter in November, the fixed income fund has returned 2.73% and has outperformed the benchmark by 82 bps. These results were due to our long credit and short duration positions, which benefitted from the strong performance of the U.S. economy. Moreover, the sequester and debt ceiling scheduled for early January were pushed forward to early March, easing investor fears. Our financial sector bonds continued to experience spread tightening, and the fixed income fund is now outperforming our benchmark over 3 month, 6 month, YTD, and 1 year periods.

Fixed Income Fund Performance Overview: as of February 28, 2013



Desautels Fixed Income Fund	Fund	Benchmark
1 month	2.05%	2.22%
3 month	2.52%	1.72%
6 month	4.60%	3.14%
1 year	7.22%	5.84%
YTD	2.21%	1.70%
Since Inception	10.94%	13.27%

Please note that fund performance was slightly understated in prior newsletters due to an incorrect treatment of year-end unit trust distribution. We regret this error. The current performance chart above shows fund performance over the past year.

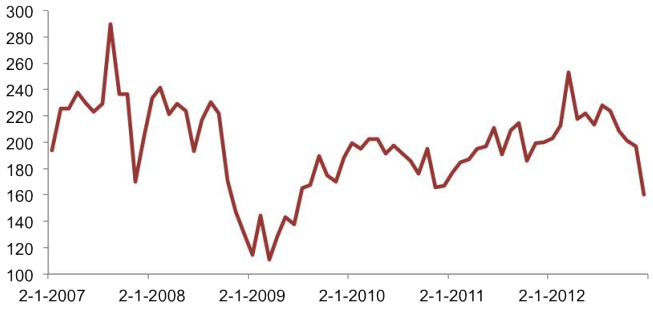
Fixed Income Strategy

Macro View

The global economy has seen a marked improvement in momentum after years of dismal growth. Significant downside risks, however, still loom. Sluggish growth in Japan and the United Kingdom, the deleveraging of the Canadian household, and the upcoming U.S. public sector spending pullback will reinforce a slow pace of economic growth.

According to the Bank of Canada, the largest threats to the Canadian economic outlook are household debt and the housing market. Canadian household debt levels have hit a record 164.6% in Q3 2012, up from 160.9% a year earlier, according to Statistics Canada. This increase, fuelled by persistent low interest rates and high home prices, has placed the Canadian family in a vulnerable financial position; economic shocks such as job losses, interest rate hikes, or a sudden decline in home prices would hit hard and jeopardize the stability of the Canadian economy.

Figure 3: Canada New Housing Starts



In terms of recent indicators, November GDP came in at +0.3%, a larger than expected increase consistent with a strong fourth quarter. The modest gain in October GDP, however, will limit fourth-quarter 2012 annualized GDP growth to only around 1% and thus offers little prospect of sustained downward pressure on the unemployment rate. To this point, we have seen some weak numbers in the employment space; Canadian employment fell by 21,900 in January, the first decline in seven months. Though the unemployment rate fell to 7.0% from 7.1%, this is mainly due to a contraction in the labour force.

We have also seen weakness in consumer spending and new home construction, all of which has contributed to a headline CPI at or below the low end of the Bank of Canada's 1% to 3% target. However, we expect Keystone XL to resolve the bottleneck currently causing a significant discount in Canadian Western Crude, which would increase inflation expectations.

As the Canadian consumer deleverages and the Bank of Canada tightens the availability of credit through unconventional methods, we believe that the economy may experience short-term pain on the path to a healthier and more sustainable future. On this note, interest rates are likely to remain range bound with a skew towards the upside once the soft-landing in housing and deleveraging process have run their courses.

Figure 4: Canadian Inflation Expectations

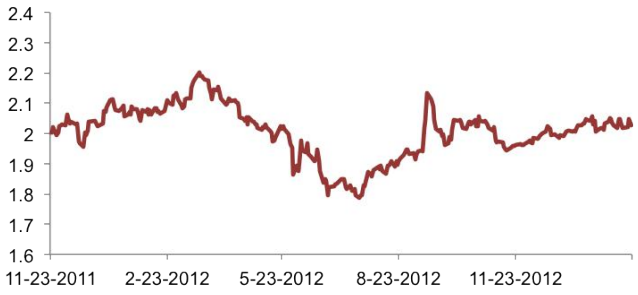
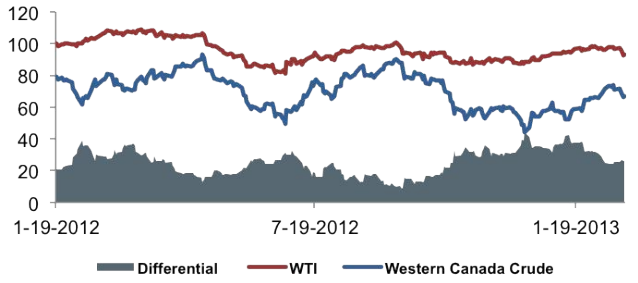


Figure 5: Oil Differential



In the United States, however, we have seen a slow improvement in economic conditions. New home sales in the US increased by 15.6% in January, a better than

expected rise and the largest improvement since July 2008. Though the inventory of unsold homes held steady at 150,000, we believe that the increasing pace of sales will serve to push inventory down over time. Rising demand and declining inventory are supportive of a strengthening housing sector, increased homebuilding, and a positive contribution to GDP in the next few years.

Accommodative monetary policy from the Fed continues to help bolster the economy. Rates remain low in the 0-0.25% range, and the Fed continues to purchase $85 billion in agency mortgage-backed securities and Treasury securities to ensure liquidity in the mortgage market and low rates to stimulate the American economy. As of late, members of the FOMC have expressed reservations about the asset purchase program, namely fears of inflation and difficult normalization of policy in later periods. Some members also warn that a balance sheet with a large amount of long-duration assets is exposed to "significant" losses when the holdings are unwound. Without the asset purchase program, 10 year treasury yields are expected to rise to 3% or more, which could be a risk to growth.

Ben Bernanke has made it clear, however, that he believes the benefits outweigh the costs; full employment and price stability are the main goals at this point in time. We see American banks and the housing market as two bright spots for the US economy; we have seen increased momentum in both lending and housing, albeit at a slow pace. One risk to growth is the upcoming debt ceiling and sequestration. We believe, however, that history is likely to repeat itself. Either a timely solution will be found and implemented, or the can will get kicked further down the road. As economic conditions improve, the private sector will re-leverage, boosting consumer spending and spurring higher growth.

The Eurozone continued to exhibit positive trends in the beginning of 2013 with consumer confidence rising and 2 year yields falling significantly. Monetary easing took effect as the banks showed significant improvement in capital ratios leading to dissipation in headline risk and a decrease in volatility. Gross lending from the ECB to Euro area credit institutions has been slowly declining indicating that banks are requiring less emergency funding and rather are able to access credit markets in order to fund operations. The Euribor-OIS spread continues to fall as liquidity in the banking sector improves. Recently, Italian elections shook markets with the resulting hung parliament. Bersani, the more conservative governor and abdicate of austerity controls the lower house while the ever infamous Berlusconi blocked a majority in the senate. This means the Italian government is in stalemate and political paralysis. Obviously this is not a good thing for the economy as new reforms and legislation concerning austerity will have a difficult time getting passed. Markets reacted extremely negatively during the election pushing Italian bond yields up and we expect volatility to increase in the coming weeks up to the next election. We see the results of the election as a backlash from the Italian public to the increasing austerity. It is difficult to predict who will end up winning, although we continue to monitor the situation and in our view the advantage goes to Bersani who has proven to be somewhat of a middle ground between the Berlusconi government and full on austerity presented by Monti. Since our investment time horizon is relatively long we do not believe the Italian elections threaten our short duration view but rather that the positive developments in the Euro area as a whole strengthen our outlook on the global economy supporting our thesis of rising rates.

Figure 6: Eurozone Business Confidence

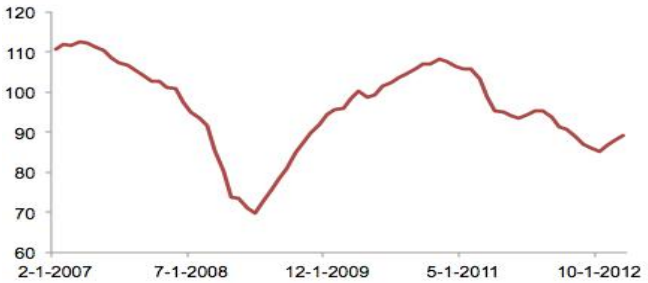
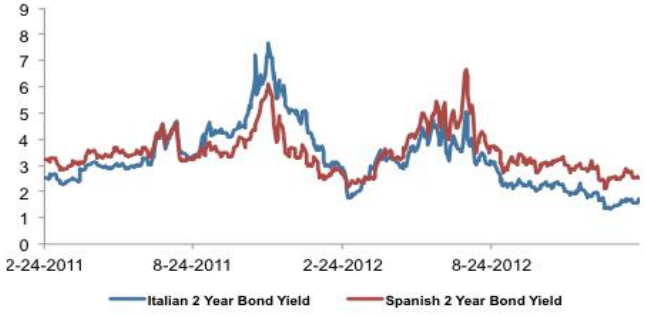


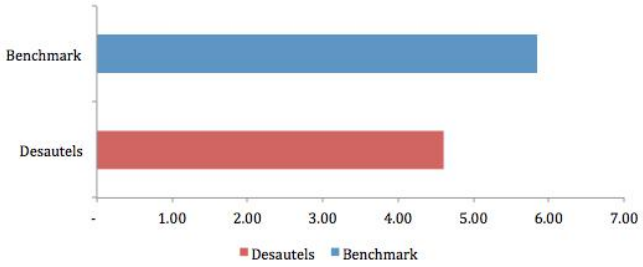
Figure 7: Spanish and Italian Bond Yields



Duration Views

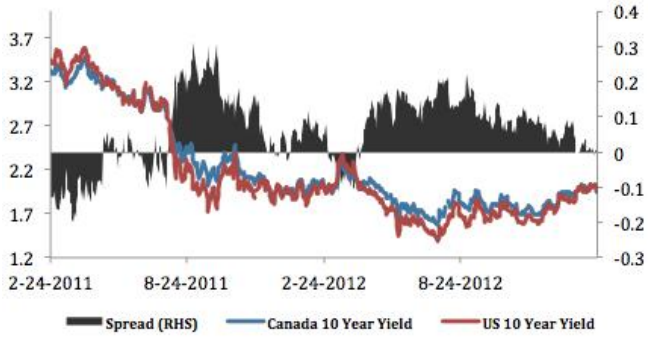
In the United States, we remain short duration versus our benchmark. We are optimistic about the trajectory of the US economy, especially the housing market. Our interest rate expectations are stable, with a slight skew to the upside given our optimism. We have progressively seen 10 year Canadian bonds outperform their US counterparts resulting in lower yields in Canada as compared to the US for the first time since early 2012. This divergence in Canadian and US yields has contributed to our outperformance given our longer duration exposure in Canada relative to the U.S. Going forward we are more bullish on the US economy than on the Canadian economy, and will therefore continue to remain shorter duration in the U.S than in Canada.

Figure 8: Duration



In Canada, we have numerous factors to consider. An overheated housing market and unsustainable household debt levels speak to a rate hike, but the Bank of Canada is hesitant to hike rates too soon for fear of making a soft landing a hard one. Thus, we remain short duration versus our benchmark but only by about 0.5 years with bearish headwinds mitigating a large spike up in rates.

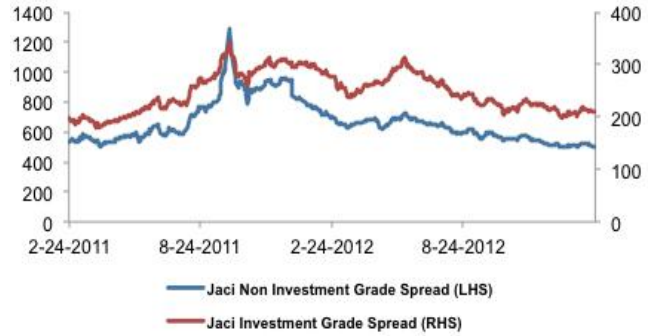
Figure 9: US vs. Canadian 10-Year Gov. Spread



Credit Views

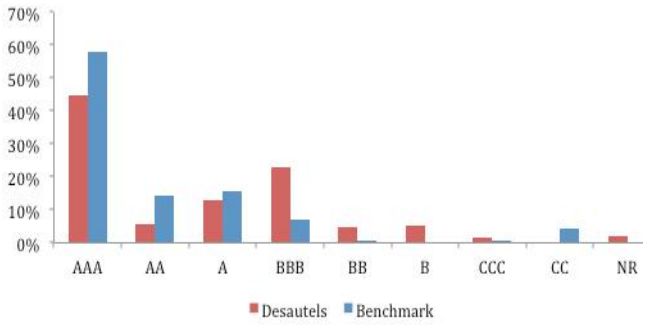
Overall, credit spreads have compressed to pre-crisis lows across the corporate universe and will most likely trade sideways for the coming months. We continue to actively seek bonds which are trading cheap in the high yield and lower quality investment grade space. Specifically, we are bullish on Canadian oil producers as resolution to bottleneck issues should push up Canadian Western Crude prices. We currently hold Morgan Stanley, Goldman Sachs, and Bank of America maple bonds, which have performed very well as the banking landscape in the US improves. We are looking to exit out of these positions should spreads tighten another 30-50 bps.

Figure 10: Corporate Bond Spreads



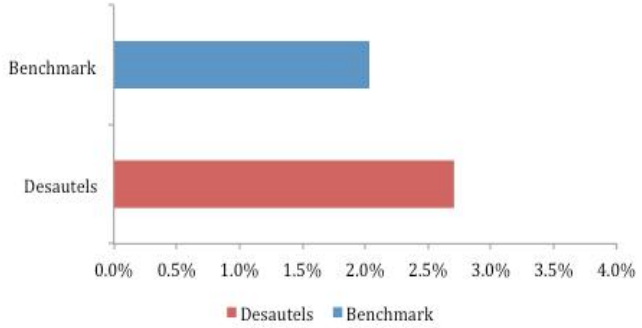
In the US, credit spreads are trading extremely tight and we have been encountering resistance at current levels. As investors search for yield in the current low

Figure 11: Credit Quality



interest rate environment, the demand for corporate bonds remains strong. We expect credit spreads to trade sideways, but we look for a widening in spreads come 2014 as investors continue to transition into riskier equity securities.

Figure 12: Net Yield



The fixed income fund recently purchased an Aimia 4 year maturity bond. Aimia provides loyalty points and loyalty services to a multitude of clients globally. The business has relatively high switching costs for both customers and partners, which should provide consistency in free cash flow generation. The company has been successful in integrating acquisition in the US-APAC market and will look to a more organic approach to growth in the EMEA region. We purchased the bond because we believe it is undervalued trading at a g-spread of about +270 bps, while comparable companies with similar debt metrics are trading at a much tighter spread. The bond is rated BBB by DBRS and is a secured first lien note meaning that we have priority over certain fixed assets. Aimia has strong free cash flow and has been increasing gross billings consistently. We will be looking for spread tightening of about 40-50 bps before looking to possibly exit the position.

Other Views

We hold a 3.3% position in the Brazilian Real, and we continue to monitor economic and monetary conditions in Brazil.

Figure 13: Brazil Inflation Expectations

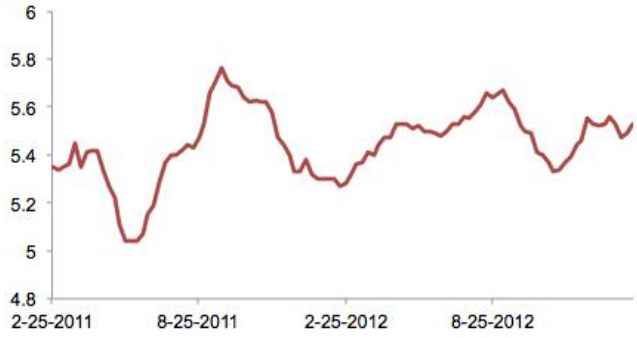
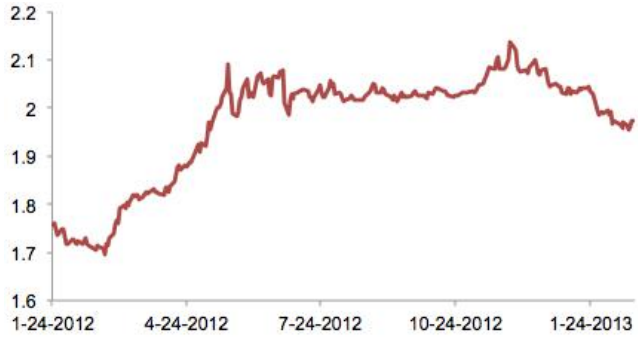


Figure 14: Brazil Real Spot



Currently, we expect increasing inflation, which could lead to a rate hike, which would continue to strengthen the BRL. The Banco Central do Brasil has set a new higher target range for the currency (1.95-2.00 BRL/USD), which also bolsters our position. The BCB has reversed its forward operations by going out into the foreign exchange market to purchase BRL rather than selling it, resulting in further appreciation. Lastly, the influx of high profile events, such as the Olympics and the World Cup have increased internal infrastructure spending and will bring an inflow of foreign funds over the next 3 years.

Fixed Income Strategy

Fund Specific

We are currently recruiting analysts for the next academic year. The application process is underway and extremely competitive with excellent candidates trying their best to get into the program.

At this point we would like to thank all of our graduating analysts for their hard work and dedication over the past two years, and we are excited to welcome new analysts to the program.

Michaela Hirsh, a junior fixed income analyst, will be assuming the role of fixed income strategist come next year. She is currently transitioning into her new role and learning the methods of the firm. She is looking forward to her new position, and hopes to build on the previous momentum and strength to lead the fixed income fund to continued outperformance.

Thank you,
Michael Commisso and Michaela Hirsh
Fixed Income Strategists (Current and Incoming)

Current Holdings

The fund information below is accurate as of February 28, 2013

Global Equity Fund Holdings	
METRO INC	7.37%
PULSE SEISMIC INC	6.95%
HOME CAPITAL GROUP INC	6.67%
WHITECAP RESOURCES INC	5.76%
BANK OF MONTREAL	5.02%
BCE INC	4.18%
CAE INC	3.11%
BAUER PERFORMANCE SPORTS LTD	2.55%
CANADIAN DOLLAR	2.38%
CAMECO CORP	2.36%
TSO3 INC	1.45%
ISHARES S+P GLOBAL CONSUMER DI	7.33%
ISHARES S+P GLOBAL HEALTHCARE	6.12%
CONRAD INDUSTRIES INC	6.01%
WELLS FARGO + CO	5.96%
MICROSOFT CORP	4.10%
TEVA PHARMACEUTICAL SP ADR	3.94%
NVIDIA CORP	3.79%
INTEL CORP	3.70%
MERCER INTERNATIONAL INC	3.44%
ISHARES S+P GLOBAL MATERIALS S	3.41%
US DOLLAR	2.56%
ISHARES S+P GLOBAL UTILITIES S	1.85%

Fixed Income Fund Holdings	
Barclays MBS Bond Fund	14.20%
DEX Hybrid	9.50%
Alberta 2022	9.30%
SPDR High Yield	9.80%
3-7 Year US Treasury	8.90%
BANK OF AMERICA 2017	8.50%
MORGAN STANLEY 2017	7.50%
BMO PROVINCIAL SHORT TERM	5.00%
BMO FEDERAL LONG TERM	4.50%
CI INVESTMENTS 2016	4.10%
USD	4.00%
GOLDMAN SACHS 2022	3.60%
CANADA HOUSING TRUST 2021	3.40%
WisdomTreeBRL	3.30%
CAD	0.40%

Investment Team

A Message from the Chief Investment Officer

This world-class program now attracts some of the brightest and most talented students from around the world. I would like to take this chance to thank the many contributors who help make all this possible. On behalf of the Desautels Capital Management, I would like to thank everyone for having confidence in us, and we look forward to another exciting new month!

Sincerely,

Kenneth Lester

Chief Investment Officer | Desautels Capital Management

Contact information for members of our investment team is available below:

First	Last	Email
Alan	Vergeldedios	alan.vergeldedios@mail.mcgill.ca
Alan	Ang	alan.ang@mail.mcgill.ca
Alejandro	Cardot	alejandro.cardot@mail.mcgill.ca
Alexis	Cardinal	alexis.lemieux-cardinal@mail.mcgill.ca
Ali	Abdullah	ali.abdullah@mail.mcgill.ca
Amir	Ghasemi	amir.ghasemi@mail.mcgill.ca
Andrew	Macdonald	andrew.macdonald3@mail.mcgill.ca
Anna	Wright	anna.wright@mail.mcgill.ca
Antonino	Piazza	antonino.piazza@mail.mcgill.ca
Cedric	Garnier-Landurie	cedric.garnier-landurie@mail.mcgill.ca
Emily	Ren	emily.ren@mail.mcgill.ca
Fei	Qi	fei.qi@mail.mcgill.ca
Ivan	Di	minghui.di@mail.mcgill.ca
Jimmy	Xie	jimmy.xie@mail.mcgill.ca
Kamran	Shojaei	kamran.shojaei@mail.mcgill.ca
Karolina	Kosciolek	karolina.kosciolek@mail.mcgill.ca
Mak	Doric	mak.doric@mail.mcgill.ca
Meghan	Chen	ying.q.chen@mail.mcgill.ca
Michael	Commisso	michael.commisso@mail.mcgill.ca
Michaela	Hirsh	michaela.hirsh@mail.mcgill.ca
Mohammad	Awada	mohammad.awada@mail.mcgill.ca
Nicholas	DiGiorgio	nicholas.digiorgio@mail.mcgill.ca
Nicholas	Bigelow	nicholas.bigelow@mail.mcgill.ca
Noah	Senecal-Junkeer	noah.senecal-junkeer@mail.mcgill.ca
Rafael	Barroso	rafael.barroso@mail.mcgill.ca
Rami	Karabibar	rami.karabibar@mail.mcgill.ca
Rene	Boissonnault	rene.boissonnault@mail.mcgill.ca
Samantha	Fu	samantha.fu@mail.mcgill.ca
Sanja	Vencentijevic	sanja.vicentijevic@mail.mcgill.ca
Shawn	Moses	shawn.moses@mail.mcgill.ca
Simon	Bouchard	simon.bouchard@mail.mcgill.ca
Simon	Bibeau	simon.bibeau@mail.mcgill.ca
Zeeshan	Maqsood	zeeshan.maqsood@mail.mcgill.ca

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