DESAUTELS | Capital Management
Gestion de capitaux

Newsletter Q1 2016

McGill

Global Equity Fund

Dear Investors,

Volatile equity markets proved themselves to be a challenging environment in Q1 2016. The DCM Equity fund was not spared with a gross return of -7.70% resulting in a significant underperformance of 8.50% relative to our blended benchmark. The S&P/TSX and S&P 500 indices had been down over 10% by mid-February before recovering to end the quarter up 4.54% and down 5.63%, respectively, measured in CAD.

Our underperformance in Q1 was due to a combination of macro factors and bad idiosyncratic news for some of our stock holdings. Upon much reflection and analysis, we increased positions in those underperformers where we remained confident in the investment thesis and valuation (PSG, Ten Peaks) and exited where we thought the initial investment thesis no longer held (Lannett, TJX). Some of the macro factors that drove our overperformance in 2015 reversed course in Q1 2016: our overexposure to the weakening USD, our overexposure to the financial sector - the second worst performing sector in Q1 -, our underexposure in the energy sector and our decision to move away from commodity-driven stocks in the material sector. We continue to monitor our allocation closely, but we remain comfortable with these long-term views moving forward.

Global Equity Fund - Current Sector Allocation

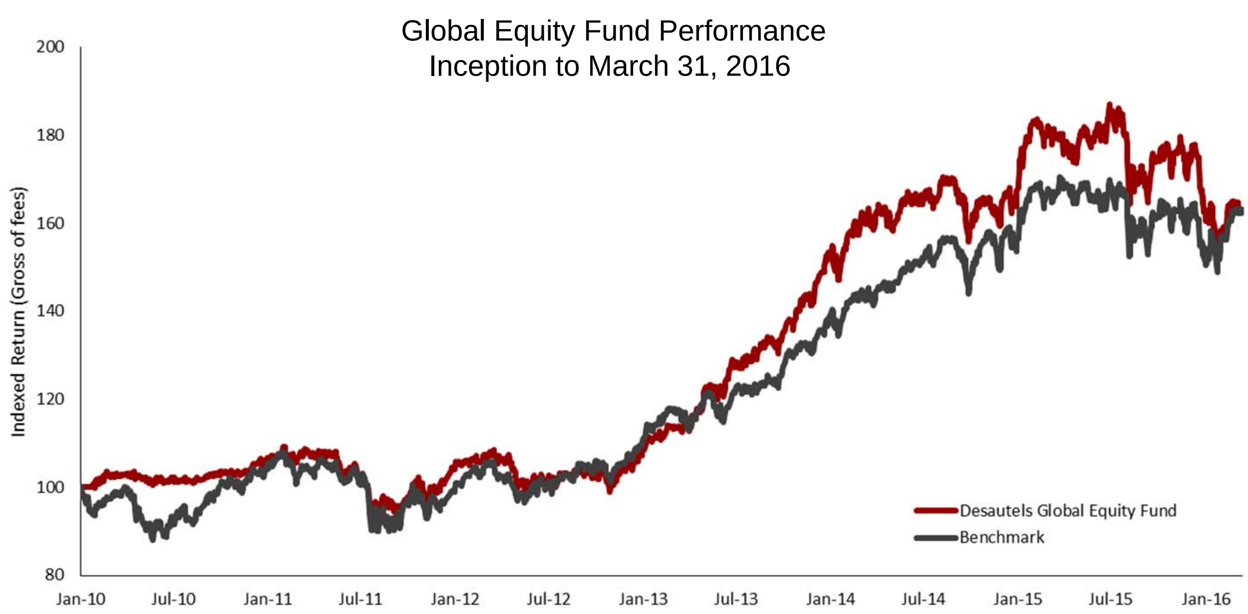
Sector	Global Equity Fund	Benchmark	(+/-)
CAD	7.2%	0.0%	7.2%
USD	6.3%	0.0%	6.3%
Financials	31.6%	29.0%	2.6%
Materials	7.8%	7.7%	0.1%
Utilities	2.7%	2.9%	(0.2%)
Telecommunication Services	4.1%	4.5%	(0.4%)
Health Care	5.1%	6.3%	(1.1%)
Consumer Staples	5.3%	7.0%	(1.7%)
Information Technology	8.4%	10.2%	(1.8%)
Industrials	7.1%	9.0%	(1.9%)
Consumer Discretionary	5.9%	9.2%	(3.3%)
Energy	8.4%	14.3%	(5.9%)
Total	**100.0%**	**100.0%**	**0.0%**

Global Equity Fund Returns			As of Mar 31, 2016
Time Period	Gross Return	Net Return	Benchmark
Q1 2016	(7.7%)	(8.0%)	0.8%
Q4 2015	4.4%	4.1%	3.3%
1 year	(9.7%)	(10.9%)	(2.2%)
2 year*	0.2%	(1.2%)	6.4%
Since Inception*	8.5%	6.8%	8.5%

**Returns are annualized.*

Performance Metrics Since Inception		As of March 31, 2016
	Equity Fund	Benchmark
Annualized Return	8.5%	8.5%
Annualized Std Dev	11.4%	12.2%
Annualized Sharpe Ratio	0.53	0.50
Beta	0.73	
Annualized Gross Alpha	1.6%	
Daily Tracking Error	0.47%	

Performance metrics are calculated gross of fees.



*Note: Performance is calculated gross of fees. Benchmark is 60% S&P TSX, and 40% S&P 500 (measured in CAD). From inception until February 28, 2013, the benchmark was the MSCI World Index. Inception date is January 20, 2010.

Market Commentary and Outlook

(I) Correlated Markets – A New Reality

Something on everyone's mind since the start of 2016 is the strong correlation between equity markets and oil prices. The correlation between the S&P 500 and the front-month West Texas Intermediate crude oil future in the first month of 2016 was 0.97 – the highest level in 26 years. While surprising, this is not entirely unusual. The 30-day correlation reached 0.80 for the 2-year period from mid-2008 to 2010.

Everyone has their view on the phenomenon with Ben Bernanke recently arguing that both stocks and oil are reacting to slowing global growth, while Howard Marks claimed that the correlation simply proves that investors do not understand the relationship between the two asset classes - the usual presumption being that a decline in oil prices is good news for net oil importer countries like the United States and China as well as for the earnings of all non-oil producing corporations.

In our view, the relation is more complex. Fundamentally, we explain the trend rationally with low and volatile oil prices having a three-fold impact: 1) the economic impact on oil-producing countries with major ramifications on currency volatility and worldwide growth uncertainty, 2) a spike in corporate credit spreads in North America due to lower investor confidence, and 3) risk in financial companies' earnings, which exposes the overall market to a potential financial crisis.

So what happens from here? We see two possible outcomes: 1) crude oil will rapidly rebound to higher prices, or 2) the financial system will absorb all the negative repercussions – this is not a rosy outcome with a path full of bankruptcies, bond defaults and decline in corporate earnings. In our view, observing market reactions to oil price changes, we think stock markets are adequately pricing in this risk factor and we are not particularly bullish or bearish on the overall market.

The new correlation pattern between Oil and the North American stock market is far from isolated with an upward trend being observed across all risky asset classes (Exhibit 1). Naturally, with increased correlation comes decreasing benefits of diversification, which is a theme we think will be a recurrent topic in 2016, especially considering the high volatility we have seen so far in Q1. The VIX reached a high of 28 on February 11, a level only reached twice since the European Debt crisis of 2011 – the other time being during the Chinese sell-off in August 2015.

Exhibit 1: Correlation Evolution Between 1997 and Today

1997 Correlations (10-Year Trailing)					
Asset Class	S&P 500	EAFE	EM	REIT	GSCI
Index	1.00				
MSCI EAFE Index	0.45	1.00			
MSCI Emerging Markets Index	0.41	0.43	1.00		
Dow Jones U.S. Select REIT Index	0.44	0.23	0.25	1.00	
S&P GSCI Total Return Index	-0.20	-0.08	-0.12	-0.18	1.00

Today's Correlations (10-Year Trailing)					
Asset Class	S&P 500	EAFE	EM	REIT	GSCI
Index	1.00				
MSCI EAFE Index	0.90	1.00			
MSCI Emerging Markets Index	0.79	0.89	1.00		
Dow Jones U.S. Select REIT Index	0.74	0.67	0.58	1.00	
S&P GSCI Total Return Index	0.50	0.58	0.62	0.25	1.00

(II) Bears on the Street: Danger or Opportunity?

As evidence of broad institutional investor pessimism, we note that short interest as a percentage of float for the S&P 500 rose to 4.6% as of February 12, its highest level in over 5 years. On the retail side, the American Association of Individual Investors weekly survey showed bearishness at a nearly three-year high of 49% in the middle of February, well above its historical average of 30%.

Another interesting insight comes from the implied volatility of 1-year 20% out-of-the money call and put options on the S&P 500. The implied volatility of the call stands at 12%, while that of the put is 25%. The difference in implied volatility, if you exclude skewing effects such as the dividend yield, means that your 20% OTM put is astonishingly 5x costlier than its call equivalent, a reflection of investors' eagerness to buy downside protection.

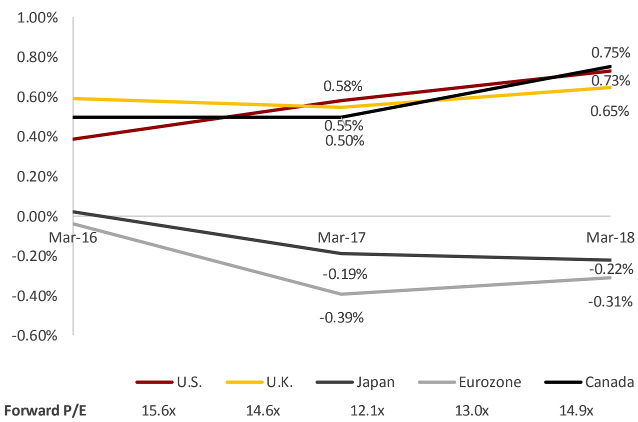
Some investors view market pessimism as a contrarian indicator based on the logic that prices already incorporate significant bearishness and are more likely to rally as investors cover short positions and mediocre news represents a positive surprise relative to doomsday expectations. On the other hand, some investors analyze things like the relative prices of puts and calls to see whether options market participants know something about the stock market that stock traders don't. So bearish sentiment can be viewed as a sign of danger, but can also be viewed as an opportunity. Without being overly bullish, we lean towards the opportunity interpretation as we balance the uncertain macroeconomic environment with attractive valuations.

Not only is the market cheap based on all equity multiples (Exhibit 2), it is even more so when compared to the fixed income market as measured by the spread in S&P 500 earnings yield vs corporate bond yields. Going forward, given the persistent low interest environment (Exhibit 3), we predict a decrease in the earnings yield spread, which could result in an index-wide multiple expansion.

Exhibit 2: S&P 500 Q1 2016 vs. Historical Valuations

Current S&P 500 Valuations			Historical Perspective		
Valuation Measure	Description	Current	1-Year ago	25-Year Avg.	Std. Diff.
P/E	Forward P/E	16.6x	16.9x	15.8x	0.2
CAPE	Shiller's P/E	25.6x	27.8x	25.7x	0.0
Div. Yield	Dividend Yield	2.3%	1.9%	2.0%	-0.5
P/B	Price to book	2.6x	2.8x	2.9x	-0.8
P/CF	Price to cash flow	11.6x	11.8x	11.4x	0.1
EY Spread	EY minus Baa yield	0.7%	1.4%	-0.5%	-0.6

Exhibit 3: Market Expectation for Policy Rate

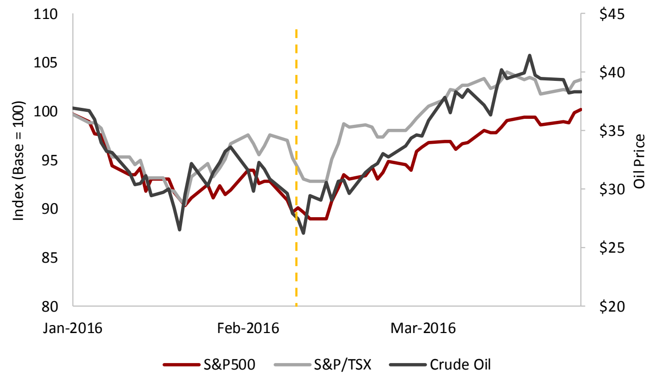


(III) February 12 - A Paradigm Shift

February 12 proved to be the most important date of Q1 2016. Up until then equity markets in Canada and in the US were down 10% while crude oil was down 30%. Volatility was high and investor sentiment low. It looked like 2016 was going to be a long and painful year for equity investors.

Then suddenly, driven by no apparent change in fundamentals, the equity markets and crude oil started a rally that would allow them to unexpectedly close the first quarter around where they started the year (Exhibit 4). The key trigger happened to be Jamie Dimon. The well-known CEO of JPMorgan disclosed on February 12, the day the rally started, that he had just bought $26 million worth of JPMorgan shares - the equivalent of his full 2015 salary. To understand the significance of the transaction, one must know that prior to this transaction, Jamie had only bought JPMorgan stock twice in the open market - in January 2009 in the wake of the post-financial crisis era and in July 2011 during the European debt crisis sell-off. His transaction signalled what everyone was hoping, that emotional and fear-based selling in the equity market was overdone.

Exhibit 4: Q1 2016 Returns



(IV) Country for Sale!

The S&P/TSX 60 index is down over 20% since its August 2014 peak. Since then the Canadian dollar has depreciated from parity with the US dollar to $1.30 on March 31. This is obviously closely linked to oil price declines and the major dependency of the Canadian economy on natural resources. However, one of the unintended consequences of these market corrections falls on non-oil-related Canadian companies. In our view, many of these companies now stand as very interesting buying opportunities, not only for local investors, but also for foreign acquirers looking to take advantage of the depressed Canadian dollar.

A recent event that best exemplifies this view is Loews' acquisition of Rona. Four years ago Loews was willing to pay $1.8 billion CAD for Rona, whereas this time they offered $3.2 billion CAD. While this represents a huge 75% increase in CAD terms, when viewed in USD, it is only a modest 25% increase. We suspect this acquisition may be the first in a stream of foreign acquisitions that could propel the Canadian stock market.

Summary

Overall, we remain optimistic based on valuation and cautious based on macro factors, particularly oil price risk. We also foresee correlated markets to be a persistent challenge for investors. Nevertheless, to the extent that the market may be focusing too much on the macro picture, and ignoring differences in company-specific fundamentals, opportunities will arise for long-term bottom-up investors like ourselves. We remain committed to seeking out those opportunities based on in-depth rigorous fundamental analysis.

Selected Holdings Review

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

Intesa San Paolo – Down 16.7% in Q1

Intesa is a major Italian bank and our only holding outside of North America. The investment was trimmed by half back in July 2015 after the majority of our thesis played out with the positive outcome of the Asset Quality Review Test and the onset of the Quantitative Easing in the Euro-Zone.

While Intesa was our best performing stock in 2015, results in 2016 have been disappointing as the European banking sector took a big hit due to falling oil prices and increased regulation on capital requirements. The major European Bank Index (i.e. Stoxx Europe 600 Banks) is down 20% in Q1 and the average European bank, including Intesa, is now trading well below book value as the market is pricing a long-term return on equity that is below the banks' cost of equity. The other widespread is related to the incredible amount of non-performing loans (NPL) on European banks' balance sheets – the amount is estimated to be €1 trillion, almost 6% of the total loan books. The banks have been trying to ease the concerns by slowly selling those loans - €104 billion were sold in 2015.

In Italy, the situation is even worse with NPL reaching 20% of total loans or, put in a different way, 12% of Italy's GDP. The market is becoming increasingly concerned with a possible collapse of the Italian banking system. The situation has deteriorated to the point where the European Central Bank is now monitoring liquidity levels at Monte dei Paschi –the oldest bank in the World - on a daily basis.

We have for a long time held the view that Intesa could emerge as the clear winner of this Italian meltdown given its strong competitive position. Our bullish conviction was supported by our long-term view that 1) the Italian macro landscape would slowly return to normal or 2) the Italian government would intervene by buying back non-performing loans and by injecting liquidity in the market with a new commitment for stimulus. However, we have recently come to the conclusion that the Italian banking system recovery is not imminent and the outcome is too binary for our taste.

We therefore decided to exit our position. Our conviction to sell was supported by four main pillars: 1) Intesa is not cheap as it trades at a premium to Southern European banks, 2) the risk is too large compared to the potential upside, 3) non-performing loans stand at 17.5% and we have not seen significant improvement since 2008 and 4) the long-awaited rescue of the Italian banks' loan portfolio will come from a fund financed by the banks themselves - the Atlante bank fund - rather than a government injection.

Performance Sports Group – Down 68.9% in Q1

The news in Q1 2016 that had the biggest impact on our portfolio comes from Performance Sports Group and it was not good. Performance Sports Group was fortunately one of our smallest holdings – it only accounted for 1.6% of the portfolio before the drop. The dive came on March 8 after the sports equipment and apparel company slashed its profit outlook for the 2016 fiscal year. Earnings per share guidance was changed from a range of $0.66-$69 to a range of $0.12-$0.14. There were three main factors driving this complete turnaround.

Firstly, the company wrote down the receivable balance from Sports Authority, a national retailer that filed for Chapter 11 Bankruptcy protection on March 2. In addition to the write-off, the loss of sales related to this retailer will have a negative impact on the bottom line of $0.09 per share. Secondly, due to the weakness in the baseball/softball market, there is another anticipated reduction in sales that should cause a reduction of $0.31 earnings per share. Finally, the company had to put additional allowance for certain US hockey customers and the related loss of sales amounted to $0.19 earnings per share.

After reviewing our position, we have decided to increase our exposure to Performance Sports Group to 2.0% of the portfolio. At the current price we feel that the company presents a good buying opportunity for several reasons. 1) Performance Sports Group remains the market leader in its market due to its established brands (Bauer, Maverick, Cascade Helmets, Easton). 2) The change of CEO was a necessity and good news if we are hoping for a restructuring of the business (i.e. selling off the Lacrosse division). 3) The accounting and guidance in Q1 may be an accounting big bath for PSG's new management who may want to put most of the bad news behind them so that it falls on the previous CEO's track record. 4) Spinning off one division of PSG would solve its leverage problem and act as a big catalyst for the stock. To explore this avenue, some DCM analysts took the initiative of preparing an activist presentation and are reaching out to some of PSG's active institutional investors to discuss it. 5) From an intrinsic valuation perspective, we see significant upside potential based on our sum-of-the-parts analysis.

Union Pacific – Up 1.7% in Q1

We initiated a position in this leading US railroad company back in December. The initial thesis supporting the acquisition related to two main elements: 1) the rail industry is currently priced at a discount due to higher than expected volume decline in 2015 and 2) Union Pacific remains the best operator in the railroad industry with a profit margin that matches the ones of technological, healthcare and financial giants.

Regarding the first argument, lower freight volumes were felt industry-wide in 2015, with traffic on major US railroads falling 2.5%. As a consequence, Union Pacific's stock price fell 34% throughout the year after reaching its highest point in February 2015. We see this as an over punishment given the contained impact that the lower volumes had on Union Pacific's income statement – while revenue was down 9.2%, net income only decreased 2.7% due to the quick implementation of an effective cost cutting program. In addition, although there is still short-term headwinds in volumes, mainly due to the coal segment, we do not expect this to be a major long-term risk as Union Pacific is more than well diversified across all freight categories with 1) industrial products, 2) intermodal, 3) agricultural products, 4) coal, 5) chemicals and 6) autos all individually accounting for 10% to 20% of its revenue mix.

As for the second argument, we feel very confident in Union Pacific management's ability to make the best of the macroeconomic condition in the railroad industry. Union Pacific has repeatedly demonstrated its ability to quickly cut costs in the face of external headwinds and has an impressive track record as being the most profitable company in its industry – even attracting Warren Buffet's praise in Berkshire Hathaway's 2014 annual report. We are very happy to have added Union Pacific to our holdings at what we consider to be a very attractive entry price.

Ten Peaks – Down 26.5% in Q1

It would not be surprising if you had never heard of Ten Peaks. It is a $72.5 M market cap company located in Burnaby, British Columbia. The company positions itself as a premium green-coffee decaffeinator through its use of the Swiss Water Process, the only 100% chemical-free water process for third-party decaffeination and the world's only decaffeination branded process.

DCM was attracted to the company for four main reasons: 1) a premium position in the decaffeination market, 2) industry tailwinds with the "third wave of coffee" taking place, 3) attractive valuation given growth prospects and monopolistic features and 4) near-term catalysts with the development of the caffeine capture optionality.

Leading to the company's earnings in mid-March, DCM had increased its position in Ten Peaks to around 3.5% of the fund's NAV. Unfortunately, the timing did not prove to be right. The stock fell 25% the day following the earnings. We did not feel the drop was warranted. While we were disappointed by growth and margins (Q4 YoY volumes declined by 1% and there was a 4% compression in gross margins), we are not worried by the earnings per share that were lower than forecasted. The difference between the forecasted and reported earnings was caused mainly by $4.2m of unrealized losses on derivative financial instruments. The $4.2m of unrealized losses can be split between a $2.9m loss from FX derivatives - caused by the appreciation of the USD in the last quarter of 2015 - and a $1.3m loss from coffee derivatives - caused by the rally in coffee prices. We think the market missed that those marked-to-market derivative losses (implemented as a hedge) will be offset by the future revenues coming from the USD (all costs are in CAD while 61% of revenue is in USD) and by higher future gross margins (the unrealized derivative losses cannot be offset by any mark ups in coffee inventory value under IFRS, which means that the inventory value currently stands below market prices).

Our thesis, which hinges on Ten Peak's position as a premium decaffeinator with a strong growth story remains intact. We felt confident after the earnings release and we took advantage of the lower price by adding another 1% to our position.

TJX Companies (NYSE: TJX) – Up 9.9% in Q1

TJX has been the best performer in our consumer discretionary portfolio recently with the off-price clothing and homeware chain up 23% in 2015 and continuing its momentum into 2016. The chain has persistently been a thorn in the side of traditional retail chains with its strategy of buying second hand and off-season clothing from high quality designers and selling them at discount prices. TJX capitalizes on the trend of an expanding middle-class in the US and Europe by delivering high quality products at low prices. One way in which TJX is able to achieve this success is through its buying power gained through a network of 17,000 vendors in over 100 countries.

Since we bought TJX we have seen the market come around to our belief that margins and sales would grow, warranting higher trading multiples. Multiples have now grown to levels more in keeping with our expectations thanks to continued comparable stores' sales growth, EV/NTM EBITDA has risen from 8.8x when we bought in Q4 2014 to 10.5x now with Forward P/E rising from 13x to 19.5x over the period. The multiple expansion, however, may now come under pressure as the entry of British low-price fashion giant Primark into the US market will increase competition. While not being a direct off-price competitor, Primark provides low-cost clothing and is looking to replicate its success in the UK where Primark was able to carve out enormous market share. We expect that Primark's entry will put pressure on TJX's margins and headline sales numbers which, combined with the strong recent performance, causes us to believe that the upside for the company is limited. Having seen our investment thesis play out, we decided to exit our position.

DCM Company Update

While Q1 2016 was not a successful quarter on the equity investment side, it proved to be very rewarding in other aspects of the DCM program. Recently, two undergraduate teams from McGill, composed mostly of DCM analysts, won first and second prize at the prestigious National Investment Banking Competition out of a pool of more than 350 international teams. Moreover, earlier this year, two of our Senior analysts won the Harvard Stock Pitch Competition and a team from DCM won the local competition of the CFA challenge in Montreal and went on to represent McGill at the international final in Chicago. Those results give us confidence that the learning opportunity we get at DCM has no equal and makes us feel proud to be part of this amazing program.

The end of the academic year is a transition period at DCM. As we sadly say goodbye to our senior class of analysts who are moving on to their respective careers in finance, we would like to thank them for their mentorship, their friendship and their dedication to the program. We, as incoming Seniors, have big shoes to fill, but we are confident in our ability to do so.

I am honored to have been elected as the new Equity Strategist and I look forward to putting all my efforts in serving our investors and improving DCM. I would like to personally thank our former Equity Strategist, Drew Allen, whose dedication and leadership has helped DCM reach new heights this year. His mentorship has proven to be invaluable to both myself and my 14 junior colleagues.

To our investors, I would like to take this opportunity to once again say thank you for your generous investment in the fund and your continuous support of our great program. I speak on behalf of myself and my colleagues when I say that your generosity is having a profound impact on our university experience on a daily basis. We look forward to another exciting year.

Sincerely,

Olivier Babin
Global Equity Strategist

Dear Investors,

In the first quarter of 2016, the Desautels Fixed Income Fund returned -1.5% gross of fees, 0.1% below our blended benchmark's -1.4% return. Our rolling 1 year gross return now stands at 1.6%, representing a slight underperformance to the 1.8% return of our benchmark. Q1 demonstrated significant volatility in the fixed income asset class, as the market sharply fluctuated between risk-off and risk-on behaviour. General stabilization following the Fed's December rate increase was soon shattered by the emergence of considerable investor uncertainty in the health of fundamentals in key commodity markets and major economies. The market for risk assets sold off through most of January before bottoming out mid-February. These events led to significant initial outperformance of Treasuries and very liquid, top-quality corporate debt over higher yield counterparts. As our benchmark is weighted heavily to high quality issuers, with a 100% IG allocation versus 87% for our fund (ex-cash), we were comparatively disadvantaged by this initial trend.

However, the clear transition mid-February on the part of many major central banks to a much more supportive stance catalyzed a reversal of this risk-off behaviour. Thus, the US IG-HY spread partially reversed its initial expansion by quarter-end, ending around 10bps higher than year-end 2015. Though the risk-on rally benefitted our greater HY exposure, it was also accompanied by revised expectations of a much more dovish pace to future US normalization. This in turn led to the outperformance of long-duration bonds in Q1, causing our maintained duration gaps against both our U.S. and Canadian benchmarks of -1.75 and -0.98 respectively to contribute to our slight underperformance. However, as elaborated in the Macro section below, we believe the long-end outperformance will remain a temporary phenomenon.

Our geographic weighting also contributed to our slight underperformance this quarter, given our overweight Canadian exposure relative to our international benchmark at 58% versus 45%. Investors were wearier of the heightened systematic corporate credit risk posed by the far-reaching impact of the commodities slump in the less diversified Canadian economy versus the US. Thus, Canadian spreads largely missed out on the recent risk-on rally observed south of the border, particularly in the HY space, where the Canadian index's 23 bps expansion compared to 39 bps compression for its American counterpart. Given nearly all our individual corporate holdings and 88% of our HY investments are from Canadian issuers, we were disadvantaged by this divergence. Nonetheless, as elaborated below, we consistently stood more optimistic than the market with regards to the health of the overall Canadian economy and non-O&G issuers against oil's impact, which leads us to believe risk was in many ways mispriced in the Canadian credit market in Q1.

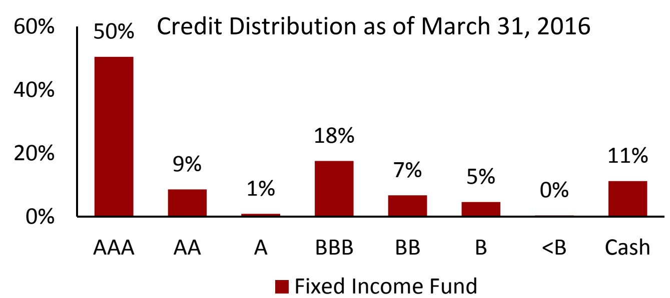
Fixed Income Fund

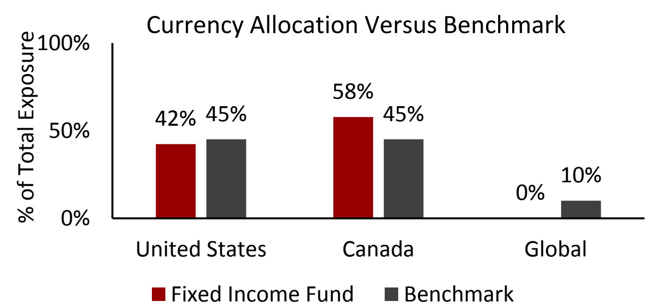
Fixed Income Fund Returns			As of March 31, 2016
Time Period	**Gross Return**	**Net Return**	**Benchmark**
Q1 2016	(1.5%)	(1.7%)	(1.4%)
Q4 2015	1.4%	1.3%	1.4%
1 year	1.6%	1.1%	1.8%
2 year*	6.3%	5.8%	7.2%
Since Inception*	5.0%	4.5%	4.6%

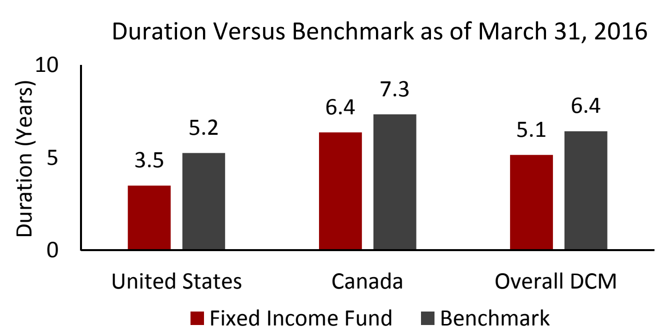
**Returns are annualized.*

Fixed Income Metrics Since Inception		As of March 31, 2016
	Fixed Income Fund	**Benchmark**
Annualized Return	5.0%	4.6%
Annualized Std Dev	4.4%	6.6%
Annualized Sharpe Ratio	0.58	0.32
Beta	0.55	
Annualized Alpha	1.6%	
Tracking Error	0.60%	

Performance metrics are calculated gross of fees.







Canada Macro and Duration

The Canadian yield curve notably flattened in Q1, with the 2Y-10Y spread decreasing by 23bp YTD (Figure 1). Prior to the Bank of Canada's January statement, the market was pricing in a 54.5% probability of a rate cut, as investors saw the combined effects of WTI's continued fall below the $30 threshold and projections that US GDP growth had in fact slowed in 4Q15 as significant headwinds translating to a negative outlook for the Canadian economy. While the decision to hold the overnight rate steady at 50bp represented the BoC's confidence that the Liberals' planned expansion of fiscal policy, and an anticipated export boost caused by CAD depreciation facilitating the transition to a non-resource driven economy, were sufficient stimulus for Canadian growth, such optimism failed to be adopted by the market. The long-end of the yield curve actually fell in the context of overall curve flattening following the statement – pointing to lowered expectations for future inflation, and thus near-term growth.

Through most of the quarter, incoming data appeared to reaffirm the outlook that the Canadian economy is unable to offset continued headwinds from low commodity prices that have arguably led to its stagnation. While the recently released 4Q15 growth figure positively surprised at 0.8% (annualized) versus BoC and analyst expectations of a largely flat quarter, it is important to decompose this growth into its core components. From this angle, we see that investment continued to weaken, declining 12.4% Q/Q, and household consumption growth slumped in comparison to Q3, with increased government expenditure largely responsible for lifting the final growth figure. When one considers the multifaceted economic impact of our energy industry downturn, this result is predictable – not only is the investment component of GDP adversely affected by continued Oil and Gas capex cuts (down 30% Q/Q in 4Q15), but the sizeable negative income effect generated by the resource sector slump also hampers consumption and residential investment; these two components alone comprise 64% of GDP.

However, given the 4Q15 growth figure does not reflect the significant fiscal stimulus, particularly in infrastructure, planned by the new Liberal government, based off of Q4 results it seems easy to conclude that government expenditure can once again be relied on to produce an uptick in GDP growth for 2016 and beyond. Indeed, when the government presented the new deficit-fuelled budget on March 22, it projected 0.5% and 1% net additions from the plan to GDP growth in 2016 and 2017 respectively. Given these benefit estimates come from the same source as the budget itself, we believe a degree of skepticism towards their magnitude is necessary; nonetheless DCM agrees with most projections that 2016's GDP growth now stands to be higher than the Bank of Canada's most recent 1.4% January pre-budget forecast. Lower net taxes from higher transfer payments should stimulate consumption in the short-term, while heightened government purchases in infrastructure are unlikely to crowd out what clearly remains a dearth in private-sector investment, in addition to benefits from their general multiplier effect. Looking at the Treasury market's response to the budget, yields on short maturities rose notably higher than Treasuries further out on the yield curve. We believe this marginal bear flattening points to further diminishing of investor expectations in additional BoC monetary stimulus, confirming higher growth expectations in response to the budget.

DCM has consistently believed that, as a result of greater export competitiveness from loonie depreciation and continued strength of the US economy, Canada can successfully shift to the non-resource sector as its growth driver. Patience is simply needed as economic dynamics make this transition much longer-term in nature. Research has empirically demonstrated that export demand is fairly inelastic in response to currency depreciation in the short term, due to a number of lags – chiefly pre-existing fixed trade contracts, and foreign consumers only gradually adjusting consumption habits. This explains why, despite continued deprecation of the CAD since July 2014, on a volume basis (to ignore foreign exchange distortions), month-over-month, seasonally adjusted export growth had failed to show a meaningful pickup going into 2016 (see Figure 2).

Encouragingly however, it appears our relative optimism is being vindicated. Looking at most recent trade figures from January, despite all commodities sectors posting declines and energy exports contracting 7.7% in volume terms, exports overall were able to deliver robust 3.6% volume growth, the highest since May 2014. This is attributable to surge in several key manufacturing sectors propping up overall export growth, such as consumer goods and industrial machinery, up 14% and 7% on a volume basis respectively. This manufacturing momentum is supported by January's 2.4% growth in seasonally adjusted factory sales volume, significantly higher than economists' 0.5% consensus and the highest rate since the financial crisis. While it may be premature to conclude that the trade lag effects from CAD depreciation have finally worn off, we believe the decomposed data nonetheless demonstrate that the shift to the non-resource economy as Canada's growth driver is indeed underway.

With Poloz finally having partial evidence to support his January hold, we believe that another BoC rate cut in the near term and significant further downside for Canadian yields is unlikely. On the flip side, a near-term rise in yields seems more challenging to predict. The aforementioned growth in exports, coupled with a likely incomplete substitution process amongst Canadian consumers of domestic goods for imports, should result in significant growth in real net exports in the coming quarters. Whether its resultant positive contribution to overall GDP growth, coupled with added consumption and government purchases from the sharply increased fiscal stimulus, will be enough to substantially offset energy sector weakness to yield an appreciable improvement to Canada's tepid pace of growth remains less clear. We thus see it prudent to continue roughly matching our Canadian duration to that of our benchmark, though we may look to go short on duration in the coming months if incoming data further supports our thesis on the Canadian economy and market pessimism continues.

U.S. Macro and Duration

Q1 2016 has demonstrated marked volatility in Treasuries within the broader context of a downwards shift across the curve (Figure 3), with the 10Y VIX peaking to 7.65 on February 11 – higher than any point of August's 'China crisis' and indeed any date stretching back till January 2013. Yields appear to be in a tug-of-war game between reflecting still-improving US economic fundamentals (which should in theory be driving Fed rate decisions) and reflecting Treasuries' role as an investor safe haven. Thus, significant recent uncertainties in other asset markets, causing investors to arguably overreact to incremental news, have resulted in sharp swings in yields as Treasuries oppositely mirror the resultant fluctuations in risk-on/risk-off behaviour of investors in those markets. To illustrate – February 11 to 12 saw WTI go from a plunge to a 12-year low to a record one-day rally, as investors sharply reversed views based on a single piece of news (but arguably unchanged fundamentals). The impact on Treasuries was an unprecedented 20 bp round trip in the 10Y, approaching within 15 bp of its all-time low on the 11th only to spike the following day as bears became bulls overnight.

DCM retains its view that the U.S. is poised for moderate further expansion in the near future as the economy is nearing potential output, stance ultimately supporting near-term Fed tightening. According to the Fed, the U3 unemployment rate has reached its estimated 4.9% NAIRU this year. Supporting this assertion is a significant pick up in wage growth in recent few months (2.5% OYA increase in January), confirming that the slack has finally been cut from the labour market – hence the upwards pressure on wages. The combination of higher labour costs and disposable income growth resulting from this wage growth is predictably in turn placing upwards pressure on prices; February's core PCE of 1.84% largely sustained January's jump to the highest level since May 2012, confirmation that the Fed's preferred measure of inflation is indeed edging towards the 2% target. Solely viewing policy decision from the perspective of the Fed's longstanding statutory objectives of full employment and price stability, it thus supposedly appears clear which direction rates need to be moving in the near future.

But Q1's volatility in other markets has a more important impact on Treasuries beyond the aforementioned short-term swings – it appears to be elevating Fed concern towards the complex relationship between global market movements and domestic 'real economy' health. While at the start of January Yellen acknowledged the potential negative economic ramifications of recent volatility, she largely downplayed any Fed role in stabilizing markets to avoid this impact by asserting "I don't think it's mainly our policy" (referring to December's rate hike) to be held responsible for recent market tumult.

However, by the end of February Fed Vice Chairman Fischer, amongst other FOMC members, had stated that "financial market developments" are now making the necessary path for Fed policy much less clear. The Fed's March policy statement further affirmed that the FOMC now sees an increasing risk of "global financial developments" undoing aforementioned progress towards its economic targets, and with that in mind chose not only to leave policy unchanged, but lower the number of planned hikes for this year.

While Yellen's stance makes it clear that Fed policy will not be used to stabilize markets, it is likely that the Fed is in less of a hurry to resume its normalization cycle until it is clear that markets have settled by themselves. Such stability is arguably necessary for a confident outlook and inflationary expectations amongst consumers and firms to finally solidify. These firmed expectations in turn are regarded by many FOMC members to be the key ingredient to ensure progress in restoring full output and inflation are resilient to further rate hikes and financial tightening.

While some may point to subsided market volatility in recent weeks as impetus for near term tightening, we believe that argument is a case of reverse causation. Markets are stabilizing precisely *because* investors are now expecting the Fed to tighten much more slowly in the near future as a result of its recent clear shift to a more dovish stance, not because of improving sentiment in other market factors. The burden for now lies on the Fed to ratify those expectations via a continued hold for stabilization to stick, much to the contrary of using it as a near-term justification to proceed with normalization. Thus, despite promising recent signs in 'traditional' indicators relevant to the Fed's statutory objectives, we believe a rate hike as early as April to be unlikely. However, DCM's confidence in US economic fundamentals supports an expectation of continued inflow of positive economic data that should firm consumer and business expectations over the coming months; if market calmness concurrently demonstrates itself to be persistent we believe a rate hike for the September meeting is likely. As this stance is far more bullish than the 38.1% probability of a September hike currently priced by the market, we therefore feel comfortable maintaining our US duration gap to our benchmark.

International Macro

Everywhere you look the buzzword is NIRP, and with good reason. Though the ECB admittedly entered negative deposit rate territory over one and a half years ago, the concept has only broken through European borders this quarter – and not just with Japan imposing a -0.1% rate on excess reserves. Though we believe their actual adoption is extremely unlikely, the Fed itself has given an acknowledging nod to NIRP in Q1, not only through Yellen stating in January's semi-annual testimony that "we wouldn't take it off the table," but through the Fed recently revising its next round of bank stress tests to include the scenario of negatively yielding Treasury rates. In our new, negative-rate accepting world, a total of 25% of all Developed Market sovereign debt outstanding is currently trading with a negative yield. We thus see it fitting to focus in on the market that started it all to analyze the present interplay between macroeconomic health and central bank policy – the EU.

Eurozone

We believe the start of the year showed signs of promise for the Eurozone regarding consistent growth in the coming quarters: fairly neutral fiscal policy, strengthening consumer sentiment and elevated household saving, a greater willingness amongst banks to lend to corporations, low commodity prices and a weak currency. And initial signs were promising – Eurozone PMI reached a 20 month high of 53.2 in December, leading to every EU country posting output growth and job creation. However, in January it quickly became apparent that market volatility was posing a larger downside macroeconomic risk than previously expected, leading to Draghi's promise of "we will not hesitate to act" for its future March policy meeting. This concern was reaffirmed by the Eurozone's alarming slide back into -0.2% CPI deflation in February.

A key question to ask is why something as seemingly external as market volatility is having such a profound and near-immediate impact on Eurozone economic growth. We argue that there are ultimately two key channels that transmit this market stress to Europe's real economy. The first is bank behaviour. Heightened market volatility has pushed investors to question European banks' balance sheet positions, and they now perceive a mounting number of critical shocks to European financial system health. These include net interest margin (and thus profitability) pressures from deeper negative rates, and higher-than-expected non-performing loan exposure. Heightened risk perception in turn may lead to a significant tightening of lending standards as banks seek to restore confidence, increasing financing costs for borrowers and thus hampering growth. The second channel is sentiment: historically, European business and consumer confidence have moved in sync with equity returns. Indeed, the Eurozone's consumer sentiment measure slid from -6.3 to -8.8 in February, a month of broad Euro stock market declines, representing an even sharper drop than the -6.6 consensus. We can therefore expect both corporations and consumers to react to recent market turmoil by becoming more cautious in spending decisions. Thus, regardless of whether the credit channel continues to open up and financing remains accessible, borrowing, investment and spending will slow. The reluctance to invest and spend is simply aggravated by any potential re-start of deflationary expectations that is now more likely thanks to February's price trends.

We therefore believe that the Eurozone risks remain skewed to the downside, irrespective of March's ECB policy decision. Even if the ECB decides to not only cut the deposit rate further into negative territory, but also appreciably increase the size of its monthly asset purchase program, the fact remains that a) credit channels can still stand to tighten and b) weakened consumer/business confidence, and thus risk-taking behaviour, can remain unaffected. Thus, we believe it prudent to remain out of the European credit space for now, with poorer economic prospects and extremely low (to real negative) yields for corporates making them far less attractive than North American counterparts.

Credit

Canada

Like the US, Canadian credit spreads widened noticeably in Q1 to a seeming 'inflexion point' mid-February. However, their subsequent contraction in the HY space has been less pronounced than in their American counterparts. Thus, while the Canadian IG index now only stands 1 bps higher than the start of January, the HY index remains 23 bps higher (Figure 4). This begs the question of whether general risk-off investor behaviour across markets is simply causing a flight to quality in the Canadian corporate credit world, or credit quality is actually deteriorating. There is reason for caution on corporate fundamentals. The double-effect of weaker earnings (aggregate Canadian EBITDA declined 16% sequentially in Q3) and accumulation of net debt on balance sheets (up +8% Q1, +2% Q2 and +1% Q3) has resulted in leverage steadily increasing, with Canadian corporate Net Debt to EBITDA rising from 2.6x at the end of 2014 to 3.9x Q3 2015. While it may be tempting to lay the blame for deterioration on the energy sector, it is clear that other sectors have recently been 'actively' re-leveraging to fund capital spending, dividend increases/share repurchases and M&A – indeed, 2015 brought 34% growth in Canadian M&A, and share buybacks on a TTM basis were 44% higher in 3Q15. Thus, even ex-energy, corporate Net Debt to EBITDA has increased from 3.0x year-end 2014 to 3.4x Q3 2015.

Also unlike the U.S., Canadian risk premiums have more consistently steepened over Q1, with the spread between IG and HY up 22 bp, and defensive sectors such as infrastructure and regulated utilities significantly outperforming others thus far. We believe this divergence between Canadian and American HY to be motivated by two main reasons. Firstly, as commodity prices continue to remain low, investor perception of much higher exposure amongst Canadian issuers to a weakening energy sector is fueling growing concern over liquidity and default risk amongst all but the highest grade issuers. Secondly, while some economic data has subtly turned to the positive in recent days, we believe investor sentiment towards the Canadian economic outlook, unlike that of the US, has remained more pessimistic. This is affirmed by the futures implied probability of virtually 0% assigned to a BoC rate hike this year. As HY issuers across sectors are the first to struggle in a downturn, this translates into lowered investor appetite for the Canadian HY space in general.

However, we believe bright spots remain in Canadian credit. Firstly, despite indications of slightly deteriorated credit metrics, we do not believe we are at the peak of the current credit cycle. Canada's economic recovery has been much more "L" than "V" shaped in nature, and is thus forecasted to occur over a longer period of time than the historical norm. This should in turn provide a longer-than-usual runway for the corporate risk-taking phase of the credit cycle before entering a contractionary downturn. Secondly, we remain more patient than the market regarding Canada's ability to revive appreciable economic growth through its gradual diversification to a non-resource dependent economy. Thus, irrespective of whether oil sustains its price downturn, we believe the macro deterioration necessary to produce widespread credit distress, particularly in the HY space, is unlikely. Much to the contrary, the near-term improvement in GDP growth should help stabilize and potentially reverse the recent deterioration in Canadian credit metrics, and mitigate the risk of a spike in HY defaults. We thus believe that, through careful analysis, we can find attractive names in the Canadian HY space in particular given aforementioned investor pessimism has translated to attractive relative valuations for lower-grade issuers, and generous carry to compensate for higher credit risk.

U.S.

The start of Q1 continued last quarter's trend of widening credit spreads, as bouts of risk-off behaviour amidst volatile financial markets brought 'flights to quality' in the form of higher grade corporate debt or 'riskless' Treasuries. Both the American IG and HY OAS indices (Figure 5) widened a substantial 48 and 192 bp respectively to February 11.

More recent bullish market rallies, particularly in commodities have however renewed investor appetite for credit risk, with the same spreads essentially reversing the earlier trend by contracting 51 and 182 bp respectively. Q1 also brought substantial movements in US risk premiums, with the spread between IG and HY initially widening by 144bp to 666bp on February 11, only to contract to 535bp at quarter end. This is likely due to diminished fears of the risk of near-term US recession in the now more bullish market mindset; as recessions are typically led by rising HY defaults this therefore spells more positive news for the HY space.

We believe opportunities remain within the US corporate space. Firstly, credit metrics are currently heavily skewed by recent energy sector performance, exaggerating the true picture of US credit trends across sectors. Ex-energy and metals/mining, 4Q15 EBITDA swings from a 7.2% Y/Y decline to 1.4% Y/Y growth. In combination with a slowing pace of total debt growth in 4Q15, this resulted in Net Leverage ex-commodities declining to 2.19x 4Q15 from 2.21x 3Q15, pointing to a degree of overall stabilization in corporate credit risk. Admittedly, concerning corporate trends for credit holders remain across sectors – for example, the ex-commodities LTM earnings payout ratio has continued to increase to 42% in February, up 1.4% Y/Y. However, considering our relative confidence in the strength of the US economy going forward, we believe generally stabilizing credit profiles in combination with limited downside risk to GDP growth fail to suggest an imminent credit shock/bubble burst that leads us into the cycle's contraction. We thus feel comfortable engaging in careful fundamental analysis of specific US names to yield attractive investment ideas to add to our currently CAD-only corporate portfolio.

Selected Holdings Updates

Cogeco Inc. 4.925% 2022

On November 17 2015, we initiated a 5% position in Cogeco 2022 at a G-spread of 176bp 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 the eastern US, and an enterprise data unit offering cloud, server and IT services throughout its datacenter network in North America and the UK.

Our first investment thesis postulates that pessimistic investor sentiment towards Canadian cablecos overlooks Cogeco's competitive advantage – its geographic positioning. The market has regarded new, FTTH network technology as a formidable threat to cable, sending Cogeco's spread higher on news of Bell extending its FTTH network coverage. However, a July 2015

CRTC ruling mandating FTTH wholesaling under a 'variable cost + markup' pricing model negatively impacted Bell's FTTH deployment economics in light of the massive upfront capital expenditure required on a per-home basis. This decision thus pushes Bell to focus on markets with the lowest FTTH deployment costs – dense urban centers. Cogeco's network geography, on the other hand, has exclusively focused on rural areas and small towns underserved by larger players. This crucially implies that not only is current FTTH overlap with Cogeco's network more limited than other cablecos, but, as a result of the ruling, we believe this coverage is unlikely to increase rapidly in the foreseeable future. Thus, Cogeco's unique geographic focus amongst its peers poses as a natural protective hedge against the emerging fibre threat, which we anticipate will stem subscriber losses and protect EBITDA.

Our second investment thesis concerns the recent restructuring period of the Enterprise unit. As the unit was undergoing heavy sustained capex to complete two new 'mega' datacenters in Canada, and costs related to the consolidation of 2, formerly separate operating units, many analysts dismissed the consistently negative FCF segment as unprofitable. However, we recognized that as data centers become operational in the near future (significantly expanding capacity) and the consolidation yields major operating efficiencies achievable through scale economies present in the datacenter industry, the unit is in fact poised for significant FCF growth. Our third investment thesis relates to future deleveraging capacity. Analyzing Cogeco's past leverage profile around acquisitions and management commentary on debt strategy, we concluded that Cogeco has an implicit target leverage ratio they consistently delever back to following debt-funded acquisitions. As a recent acquisition has pushed Net Debt to EBITDA (3.4x) beyond the implicit target range, we thus expect Cogeco to proceed with delevering in the coming quarters.

Since initiation, financial performance thus far has supported most of our theses. Regarding the first thesis, thanks to continued limited FTTH overlap and thus IPTV competition, 1Q16 subscriber loss amounted to only 0.9% Y/Y versus 3-4% Y/Y losses for cableco peers Shaw and Rogers. In combination with higher ARPU due to the ongoing demand shift away from TV to higher-margin internet services, Canadian cable EBITDA has thus been able to sustain modest 1.6% Y/Y growth in an overall declining industry. Regarding our second thesis, 1Q16's enterprise data segment PP&E acquisitions declined 35.9% Y/Y as a result of the final completion of all pods in one of the two mega datacenters. This has helped to finally achieve positive segment FCF. However, as enterprise revenue has yet sustain the consistent growth we anticipate to result from expanded datacenter capacity, we believe there is room for further FCF growth going forward. Regarding the final thesis, Cogeco has yet to appreciably delever subsequent to its acquisition, with Net Debt/EBITDA unchanged Q/Q at 3.3x. We however believe that as FCF generation continues to improve, the liquidity needed for significant debt repayment will materialize in future quarters. Overall, these signs of progress have helped Cogeco outperform the Canadian IG benchmark by 4 bp YTD.

Iron Mountain 6.125% 2021

On December 21 2015, we initiated a 3% position in Iron Mountain (IRM) 2021 at a G-spread of 396bp and Yield to Worst of 4.56%. It is a senior unsecured bond rated B+ by S&P, ranking only after a first lien loan (due 2019) in IRM's capital structure. It matures following the first lien loan and 2020 senior unsecured bonds, with available capacity on IRM's revolver currently exceeding the combined principal value of the two aforementioned obligations.

Iron Mountain is a US-headquartered REIT specializing in enterprise information management, with operations in 36 countries (primarily NA and UK) and clients including 92% of the Fortune 1000. 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, to be completed in early 2016. The combined company will control 65% of the global records management market.

Our first investment thesis postulates the acquisition of Recall will extend the durability of IRM's business, improving both operating performance and credit quality. Recall offers increased geographic diversification into four large regional markets. This not only represents significant revenue growth potential for IRM through market share gains in a space characterized by high customer retention, but greater revenue stability as well – higher customer industry and geographic diversification translates to a mitigated impact of customer industry- or country-specific headwinds. Additionally, the deal's equity financing and Recall's lower leverage will help reduce IRM's consolidated leverage ratio, from 2.8x to a projected 2.4x. In combination with strengthening cash flow through anticipated cost synergies, particularly through scale economies resulting from joint management of their combined global real estate holdings, these operational and balance sheet improvements from the merger will appreciably strengthen Iron Mountain's credit profile.

Our second investment thesis pertains to Iron Mountain's extensive tangible asset base, providing substantial collateral and thus solid credit fundamentals. IRM is actively increasing the portion of its operations' real estate that it owns rather than leases, with a stated goal of increasing ownership from 36% to 50% by 2020. The shift to majority-owned model not only reduces lease expenses, but adds high-quality assets to IRM's balance sheet. Importantly, however, is that IRM employs minimal leverage in its real estate portfolio, thus its total gross book value of $3.7 Bn compares to only $300 mm in outstanding mortgages. Given IRM's $2.6 Bn total debt outstanding, the net asset value of its real estate puts the company in the financial position to fully cover liabilities in any worst-case scenario.

Our third investment thesis relates to Iron Mountain's favourable valuation against investment-grade comparables. IRM has operationally out-performed IG peers, with higher rental revenues per square foot, comparable operating margins, a higher retention ratio and lower maintenance capex. Its credit metrics are also on par, with comparable Net Debt/EBITDA and interest coverage. We believe the market is likely concerned of a potential shift away from paper record keeping towards digital data, potentially adversely affecting IRM's spread more than IG peers. However, the continued necessity of record management services has been significantly reinforced by a number of recent regulations and legislation worldwide (including all IRM's core markets) mandating extensive record retention across multiple industries. This ensures the record management industry's sustained relevance.

Since initiation, IRM has demonstrated solid operational performance and subsequently free cash flow generation while the Recall acquisition moves along its timeline. Cost reductions through an ongoing corporate reorganization have yielded significant EBITDA margin expansion, with 4Q15 coming in at 31.6% versus 28.3% in 4Q14. This therefore provides reassurance than IRM's management has the capability to realize the anticipated cost synergies of the Recall merger. In combination with stable organic constant-currency revenue growth of 2.1% Y/Y 4Q15 (to be expected of this business model), we thus believe management's targeted deleveraging path for the coming years to be highly viable. The market appeared to agree, with the spread compressing 7 bp following Q4's earnings release.

Aimia 6.95% 2017

On February 28 2013, we initiated a 3% position in Aimia 2017 at a G-spread of 252 and Yield to Worst of 3.65%. The bond is a first-lien obligation, the highest tranche of Aimia's capital structure, with an S&P rating of BBB-. Aimia is a loyalty marketing and analytics company. Its loyalty services division builds, operates and owns loyalty programs effectively outsourced by clients, who span across North America, EMEA and Asia-Pacific. Revenues are primarily derived from selling 'loyalty units' to clients (eg. TD) to be earned by their partner's credit card customers. Aimia then purchases rewards (eg. Airline seats) from partners to deliver to the end-customer upon redemption of loyalty points. As a market leader in the field, its clients include some of the largest rewards providers such as Aeroplan and AMEX. Its analytics division collects and analyzes extensive customer data to deliver insights for clients in creating marketing strategies.

Our first investment thesis initially postulated that its Canadian market share dominance will facilitate stable revenue growth. Card acquisition and customer retention rates, and average spend per card amongst Aimia's clients – key underlying drivers behind the number of loyalty units accumulated by a card's customers, and thus Aimia's gross billings growth – have all increased in 2015. However, under pressure from the federal government to limit fee inflation, Canada's largest credit card issuing-banks had agreed to freeze their interchange rate charged to merchants at 1.5%, starting April 2015. As banks partially use interchange fees to pay for loyalty programs, this has translated into more limited rewards spending amongst banks, adversely impacting the value of loyalty units earned and thus Aimia's gross billings growth. In response, AIMIA has taken a number of cost reduction initiatives (such as scale economies in procurement through segment consolidation, and IT outsourcing) under a broader corporate restructuring to protect EBITDA and FCF, which proved effective in 4Q15. Cost efficiencies have not only resulted in a significant improvement in Canada segment's EBITDA margin (16.6% 4Q15 vs. 13.3% 4Q14), but has helped Aimia's overall 2015 FCF to come in ahead of analyst consensus and management guidance.

Our second investment thesis relates to Aimia's consolidation of acquisitions abroad, which should foster new sources of revenue. Management has recently focused on international diversification on two fronts. Firstly, in terms of business mix, Aimia is actively increasing the proportion of revenues derived from proprietary loyalty services to reduce reliance on potentially more volatile gross billings from loyalty units accumulation. Secondly, in terms of client base, it has aggressively pursued new international client contracts to reduce reliance on large national program anchor partners. This strategy proved critical in 2015, as Aimia's Nectar Italia anchor partner, in scaling back Italian operations ultimately did not renew its contract. While this did have an appreciable impact on Nectar Italia 2015 gross billings (a $47.9 mm decrease Y/Y), as a result of the aforementioned diversification initiatives, total EMEA revenues ultimately managed to still grow 4.4% Y/Y in 2015, bolstered by proprietary services growth. Thus, we believe that cash flows from Aimia's international segments are poised to be more stable going forward and benefit from greater visibility – representing an improved credit profile.

In addition to these aforementioned developments, 4Q15's very recent earnings release saw management focusing on its balance sheet, likely motivated by the nearing maturity of its 2017 bonds (the first debt obligation to mature). With no new debt issuance in 2015, Net Debt to EBITDA has fallen to 2.6x 4Q15, down 0.2x Q/Q. Crucially however, management also stated on its 4Q15 earnings call that, given the current state of capital markets, Aimia prudently seeks to leave the door open to outright repayment in addition to refinancing in 2017. Thus, management is actively working to further strengthen its liquidity through the divestiture of non-core assets and curtailment of share buyback activity in 2016. Given Aimia's business model already possesses a strong FCF generation profile, we see management's conservative repositioning on debt repayment as an unexpected, but welcomed shift. However, the market reacted less conclusively to the news, with 2017's G-spread sharply widening and compressing over a significant 49bp range before ending slightly higher in the week following Q4 earnings' release (ending March 4th). As we however remain convinced that Aimia's credit fundamentals demonstrate gradual improvement, we therefore feel comfortable holding the bond and expect the G-spread to settle in the near future.

Fund Update

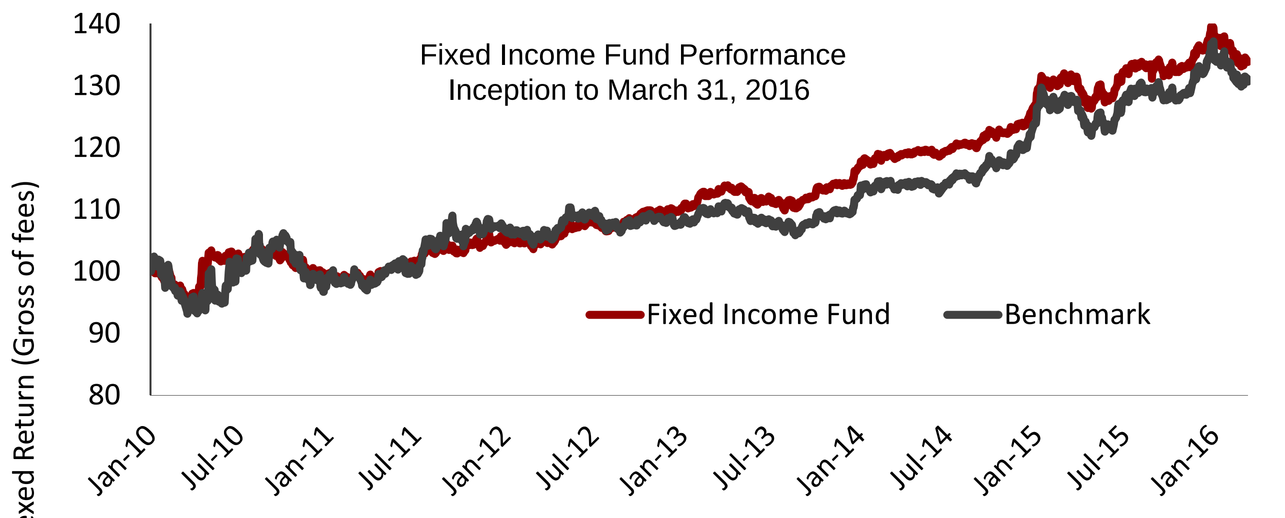
With the end of the academic year, we must bid adieu to our senior and Fund Strategist Peter Huo. His dedication to the fund and passion for the asset class translated to an intellectually challenging and fruitful environment in which I undoubtedly transformed my knowledge of fixed income from the precious little I knew at this time last year. I am highly honoured to have been elected as the new Fixed Income Strategist, and hope to excel in every capacity I can to serve our mandate to investors and enrich the program.

As the new academic year begins, the Fixed Income Fund has welcomed three juniors to the team: Ariane Laurin, Charles Yu Feng and Jun Ng. Their eager enthusiasm to dive into this asset class (which DCM uniquely offers amongst the general underrepresentation of fixed income at university-level investment funds) makes me confident that this coming year will be one of significant growth and learning for the fund.

Thank you for your continued support of our truly unique program. You have provided many students with an unparalleled opportunity to pursue their financial passions, build immense knowledge and skill, and prepare for successful careers in this dynamic and challenging field. I personally look forward to yet another strong year ahead for DCM.

Kind Regards,

Jonathan Kamel
Fixed Income Strategist



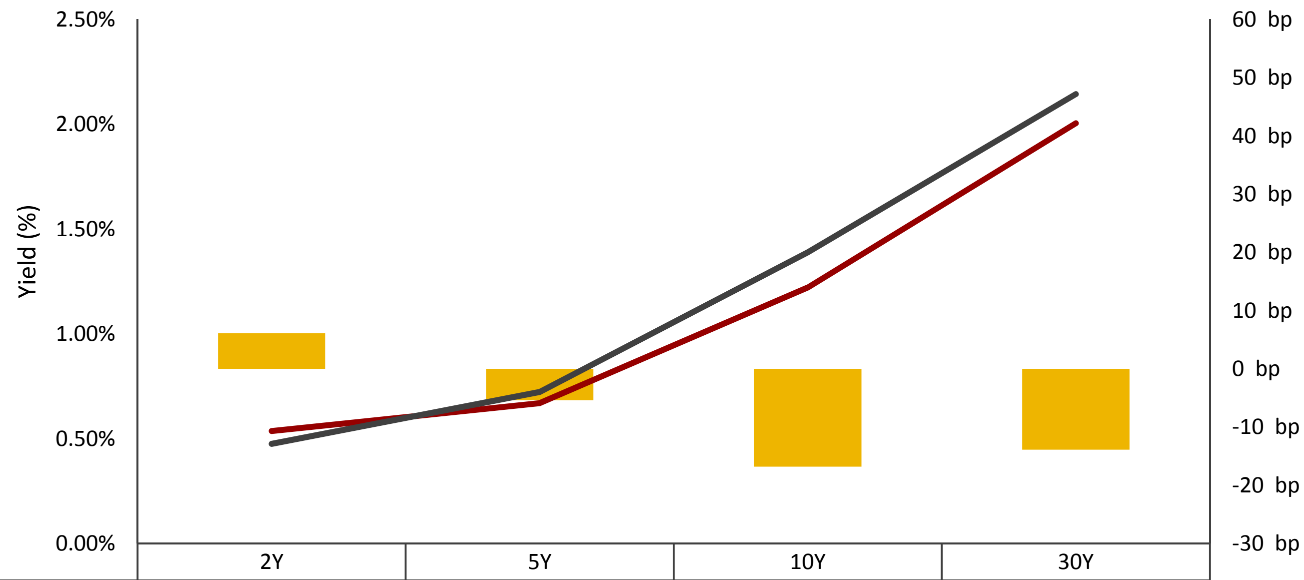
Note: Benchmark is a blended Barclays US Aggregate Total Return Value Index (45%), Dex Universe Bond Index (45%) and S&P/Citigroup International Treasury Bond Ex-U.S. Index (10%). All indices are measured in CAD. Inception date is January 20, 2010.

Fixed Income Fund Holding List

Fixed Income Fund Holdings						**As of March 31, 2016**
#	**Security Name**	**Units**	**Purchase Price**	**Market Price**	**Market Value**	**% of total**
1	BMO LONG FEDERAL BOND INDEX	4,300	18.61	19.14	82,283	16.3%
2	ISHARES MBS ETF	550	106.74	142.29	78,260	15.5%
3	ISHARES 3 7 YEAR TREASURY BOND	300	125.39	170.32	51,095	10.1%
4	PROVINCE OF ALBERTA	400	99.54	104.05	41,619	8.3%
5	ISHARES CORE U.S. AGGREGATE	270	143.28	150.04	40,510	8.0%
6	COGECO CABLE INC	220	109.41	110.09	24,220	4.8%
7	HOME TRUST CO	240	102.31	100.57	24,137	4.8%
8	DIRECTCASH PAYMENTS INC	190	102.75	100.50	19,095	3.8%
9	BANK OF AMERICA CORP	170	95.70	104.47	17,760	3.5%
10	AIMIA INC	160	111.14	104.20	16,673	3.3%
11	IRON MOUNTAIN CANADA	150	102.99	101.79	15,269	3.0%
12	CANADA HOUSING TRUST	130	111.43	112.74	14,656	2.9%
13	RONA INC	140	103.75	101.94	14,271	2.8%
14	SPDR BARCLAYS HIGH YIELD BOND	200	39.40	47.10	9,421	1.9%
15	US DOLLAR	25,965		1.29	33,585	6.7%
16	CANADIAN DOLLAR	20,721		1.00	20,721	4.1%
Value of Cash & Securities					**$503,574.55**	**100.0%**
Top 5 holdings					$293,767	58.3%
Top 10 holdings					$395,652	78.6%

Fixed Income Fund Exhibits

Figure 1: Canada Treasury Curve – Q1 2016



	2Y	5Y	10Y	30Y
Δ YTD	6.1 bp	-5.4 bp	-16.8 bp	-13.9 bp
3/31/2016	0.54%	0.67%	1.22%	2.01%
12/31/2015	0.48%	0.72%	1.39%	2.14%

Figure 2: Canadian Export Growth on Volume Basis (Seasonally Adjusted): February 2013-December 2015

Line colour change denotes beginning of USD/CAD decline

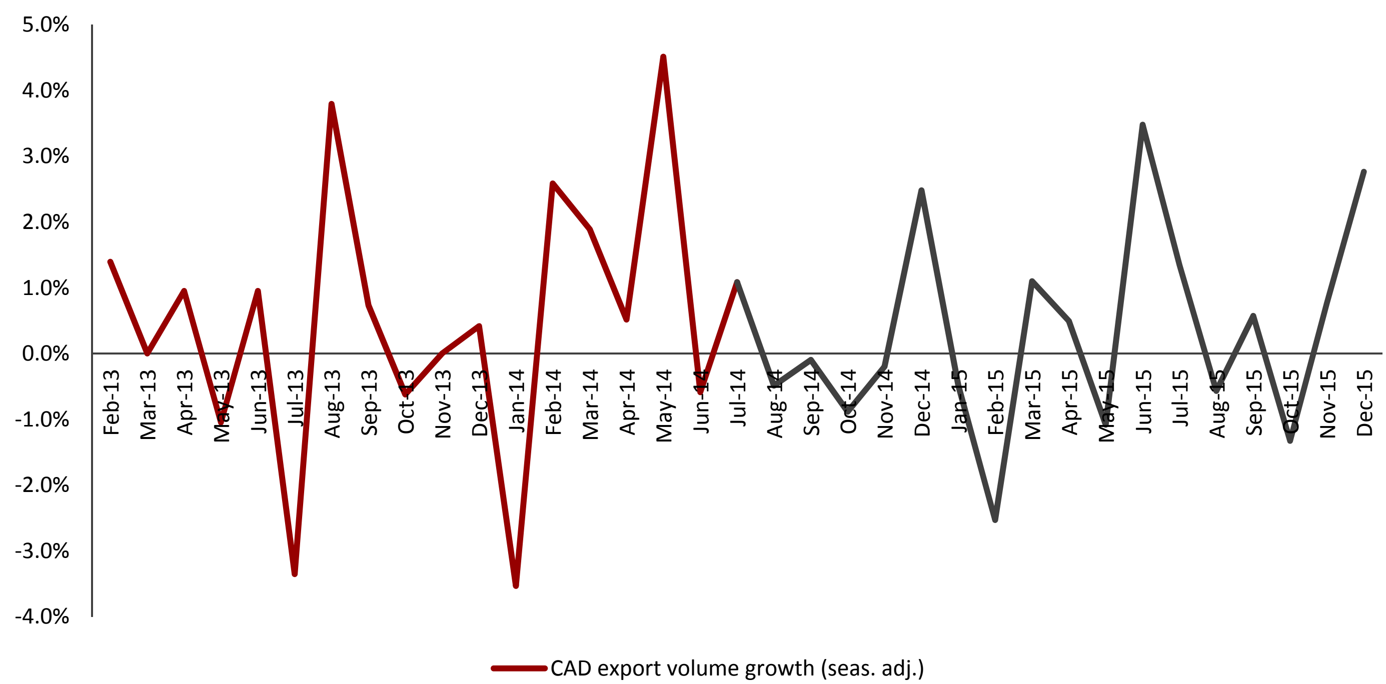
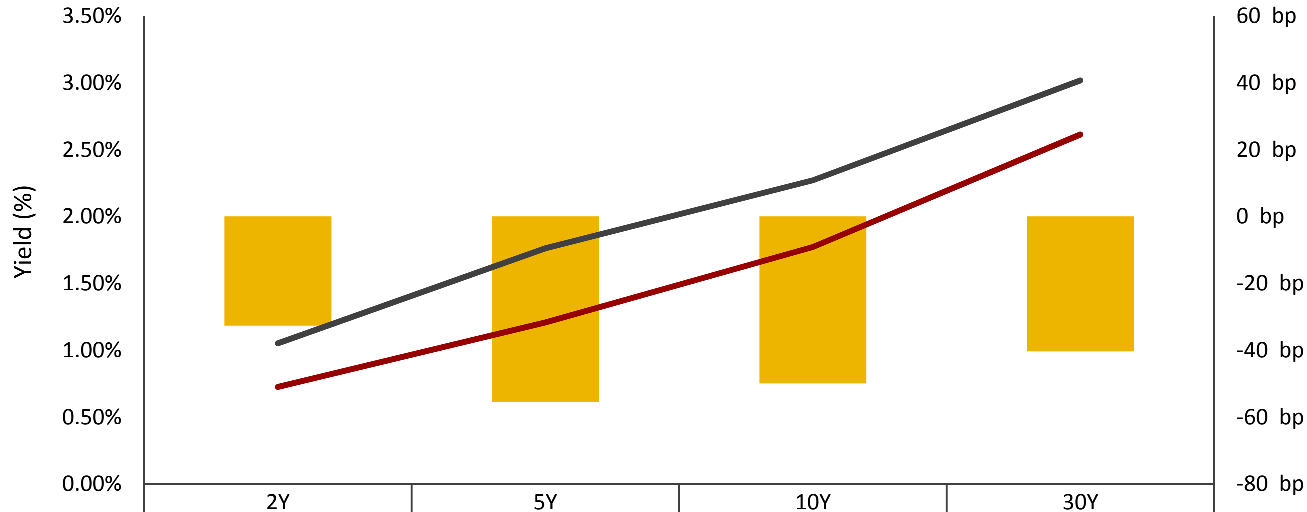


Figure 3: U.S. Treasury Curve – Q1 2016



	2Y	5Y	10Y	30Y
Δ YTD	-32.7 bp	-55.5 bp	-50.0 bp	-40.4 bp
3/31/2016	0.72%	1.21%	1.77%	2.61%
12/31/2015	1.05%	1.76%	2.27%	3.02%

Figure 4: Canadian Investment Grade and High Yield Spreads – Q1 2016

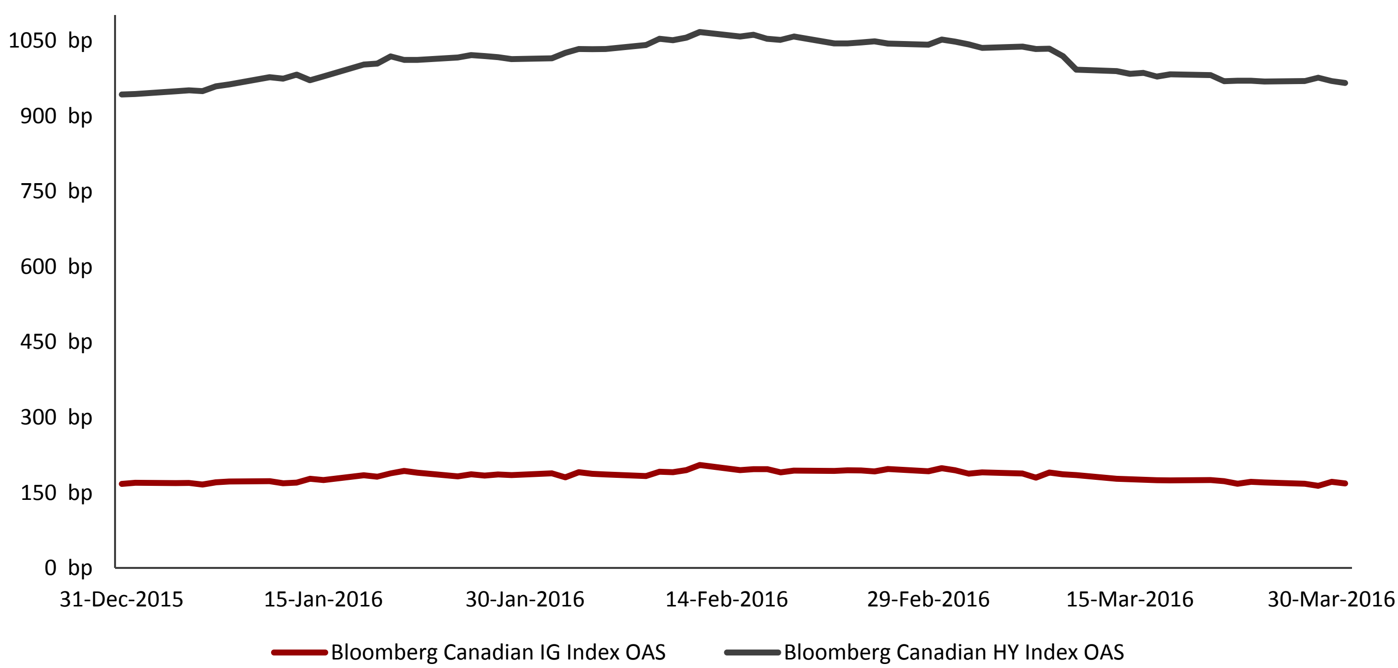
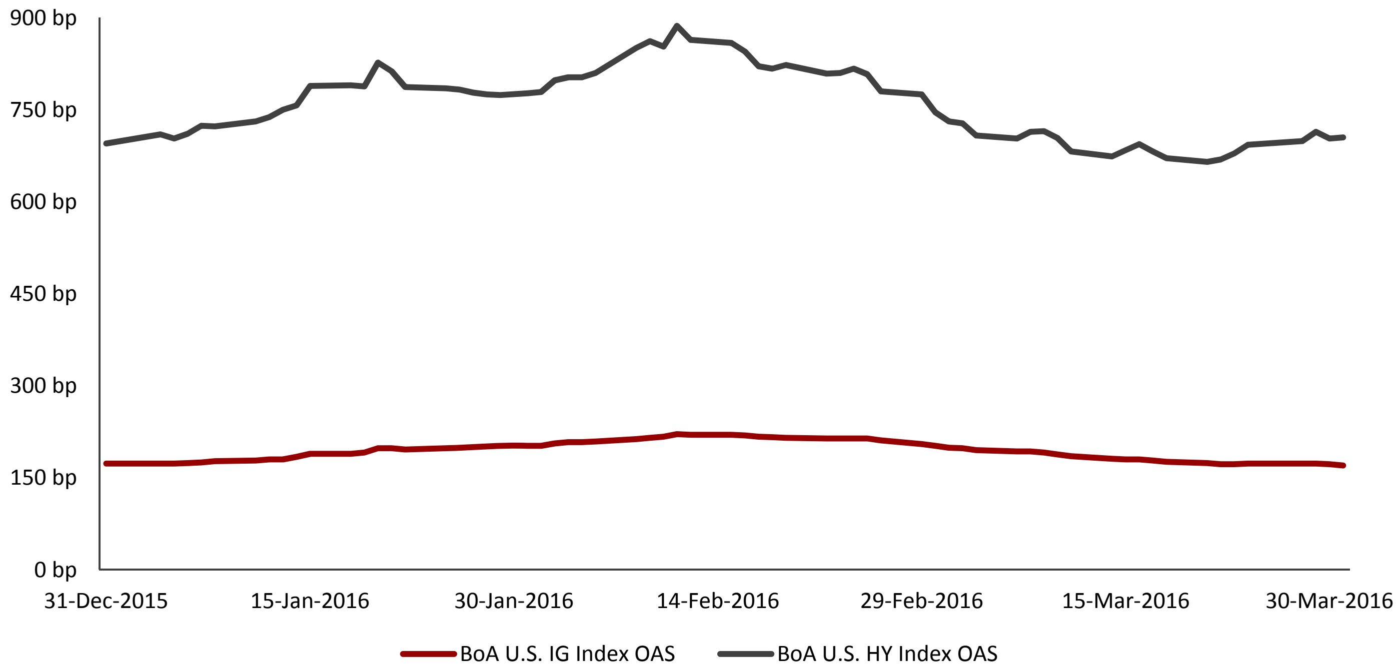


Figure 5: American Investment Grade and High Yield Spreads – Q1 2016



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