DESAUTELS | Capital Management
Gestion de capitaux

2016 ANNUAL REPORT

McGill

DESAUTELS | Capital Management
Gestion de capitaux

“An investment in knowledge pays the best interest.”
- Benjamin Franklin

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Message from the DCM Executive Team

Dear Investors,

2016 was another great year for the DCM program. Job placements were better than ever, with most students heading to top-tier financial institutions in New York, London, Toronto, and Montreal (see pages 7 to 12 for full placement details). DCM students also continued to place well at academic competitions: at the PRMIA International Risk Management Challenge Meagan Prins was part of the team that took home the $10,000 prize for first place; at the Jeux du Commerce Olivier Babin and Sabrina Frias took first place in Debate while Charles Feng took third place in the Stock Simulation Challenge; at the Jeux de Commerce Central Michael Fishman and Noah Petkau took second place in the Finance section and Jonathan Kamel finished third in Debate; at the Financial Open Ariane Laurin and Lambert Lefebvre took second place in Corporate Finance, Charles Feng took third place in Stock Simulation, and Jun Ng took third place in the Financial Quiz.

2016 also marked the launch of DCM's third fund, the Alpha Squared Equity Fund, which uses a combination of quantitative and fundamental analysis, and is managed by students in Desautels' new Masters of Management in Finance program. The Alpha Squared Fund currently has $500,000 of AUM from three investors, bringing DCM total AUM to $4M. Full details of the MMF program and Alpha Squared Fund will follow in a separate Annual Report to be released later this year.

DCM continues to attract top students from around the world at both the undergraduate and graduate levels. We recently accepted a diverse cohort of 16 ambitious Junior HIM Analysts, who had to compete among 50 applicants with an average GPA of 3.8! At the Masters level we received nearly 500 applications and will be welcoming 40 outstanding students in July.

In terms of investment performance, the Global Equity Fund faced some challenges in 2016. While absolute performance was solid at 8.0%, this represented a 8.4% underperformance to our benchmark. The underperformance erased our past outperformances, and the fund is now back to par with our benchmark since inception. Important lessons were learned in 2016, including dealing with our first bankruptcy (Performance Sports Group). Despite the underperformance, the quality of analysis has never been better as you will see in the pages that follow. The Fixed Income Fund continued its quiet and modest outperformance in 2016, with a 0.26% gain vs. -0.75% for the benchmark. Since inception, the Fixed Income Fund has returned 4.5% on an annualized basis, compared to 3.69% for the benchmark. We strongly encourage our equity minded readers to also read through the Fixed Income section of this report as it contains some very insightful analysis.

We also take this opportunity to thank our investors for supporting DCM and without whom none of this would be possible, with a special thanks to our new investors who helped launch the Alpha Squared Fund. Your commitment to our program is allowing students to reach their full potential and no doubt become future leaders of the financial sector.

Finally, we thank all our student-analysts whose tireless work and dedication has made DCM the program it is today. Special thanks to our graduating Strategists Olivier Babin and Jonathan Kamel whose leadership and hard work further elevated the quality of our investment analysis. Finally, a congratulations to our newly elected Strategists, Alaa Hachem and Ariane Laurin, who are already working non-stop onboarding our new Junior Analysts. The program and investor funds are in great hands!

Sincerely,

Morty Yalovsky, Ken Lester, Vadim di Pietro, Jan Ericsson

DCM Executive Team

MORTY YALOVSKY, PRESIDENT

Professor Morty Yalovsky is the President of Desautels Capital Management. He joined the faculty in 1974, and in addition to his academic responsibilities, he has assumed several senior administrative roles, including Vice-Principal (Administration and Finance) at the University level. Professor Yalovsky's research interests include Statistical Methodology, Forecasting Methods, and Modeling. He has also consulted in the areas of Applied Statistics and Information Technology for several leading Canadian corporations.

KEN LESTER, CO-CHIEF INVESTMENT OFFICER

Ken Lester is the Co-Chief Investment Officer and registered Advising Representative for Desautels Capital Management. Ken has been teaching Applied Investments to BComs and MBAs at McGill since 1992 and currently also teaches Behavioural Finance. Ken has over 20 years of experience in the investment management industry and is President and CEO of Lester Asset Management.

VADIM DI PIETRO, CO-CHIEF INVESTMENT OFFICER

Vadim di Pietro is Co-Chief Investment Officer, Chief Compliance Officer, and registered Advising Representative for Desautels Capital Management. He joined the Faculty of Management as a Faculty Lecturer in Finance in 2009. Prior to Desautels, Vadim was an investment strategist at J.P. Morgan in London from 2007 to 2009. He holds a B.Eng. from McGill University, a Master's in Mathematical Finance from the University of Toronto, and a PhD in Finance from the Kellogg School of Management. Vadim is also a CFA charterholder.

JAN ERICSSON, HIM PROGRAM DIRECTOR

Professor Ericsson joined the Desautels Faculty of Management in 1999 with a PhD from the Stockholm School of Economics. Professor Ericsson's current research focuses on risk premia in corporate bond and credit derivative markets, and has been published in, among others, the Journal of Business and the Journal of Finance. He is a frequent guest speaker at industry conferences and has carried out consulting projects for a Nordic real estate investment firm, the Swedish National Debt Office, as well as for a hedge fund startup in Scandinavia.

DCM Board of Directors

YVES CARON, DIRECTOR

Director, Investments, Caisse de dépôt et placement du Québec

Prior to his current role, Mr. Caron was Vice President at iNFiNi-t Wealth Management Advisers Inc, and prior to that he spent 10 years managing alternative investment portfolios for institutional investors globally at HR Strategies Inc.

PETER BETHLENFALVY, DIRECTOR

Chief Investment Officer, C.S.T. Consultants Inc

Mr. Peter Bethlenfalvy is Chief Investment Officer at Canadian Scholarship Trust (CST) where he is responsible for the investment strategy and management of the $4 Billion CST investment portfolio, including aspects of risk, regulations and oversight. Prior to joining CST, Mr. Bethlenfalvy was Senior Vice President, Financial Regulations at Manulife Financial Corporation

EAMONN MCCONNELL, DIRECTOR

Portfolio Manager, Kensington Capital

Mr. McConnell is a member of the Kensington Investment Committee and is the Kensington advising representative. Mr. McConnell is also an equity partner of Gryphus Capital, a Private Equity firm he co-founded in 2002 based in Singapore and was the Deputy Chairman of the Alternative Investment Management Association (AIMA) Canada from 2008 to 2013.

NICOLAS MORIN, DIRECTOR

Partner, Davies Ward Phillips &Vineberg

Mr. Morin is a partner at Davies Ward Phillips & Vineberg LLP in the Capital Markets, Mergers & Acquisitions, and Corporate/Commercial practices.

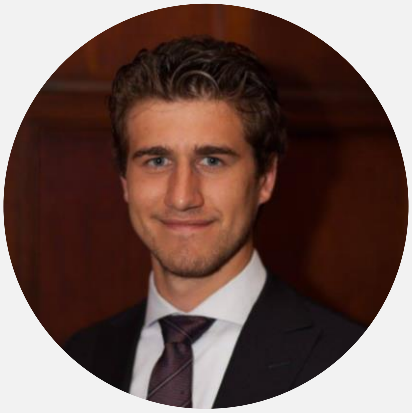
RICHARD PAN, DIRECTOR

VP and Head of Corporate Finance, Power Corporation

Mr. Pan is currently Vice-President and Head of Corporate Finance and is responsible for strategic and corporate planning at Power Corporation and at Power Financial. Before joining Power Corporation in 2008, Mr. Pan was an Executive Director in Investment Banking with Goldman Sachs International based in London, England.

OUR TEAM

FUND MANAGERS



OLIVIER BABIN

Global Equity Strategist

2017 Full Time

Analyst, Investment Banking

Goldman Sachs,
New York

JONATHAN KAMEL

Fixed Income Strategist

2017 Full Time

Analyst, Restructuring Advisory

Evercore Partners,
New York

JAYDEN VAN

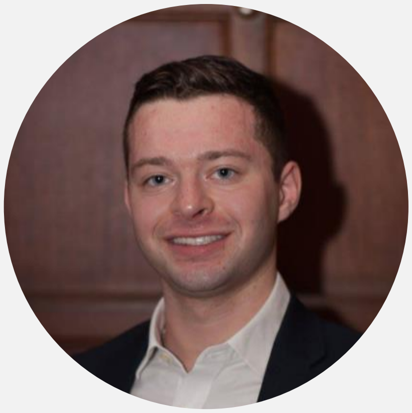
Risk Manager

2017 Full Time

Associate, Investment Banking

TD Securities,
Toronto

SENIOR ANALYSTS



NEIL CORBER

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Analyst, Investments

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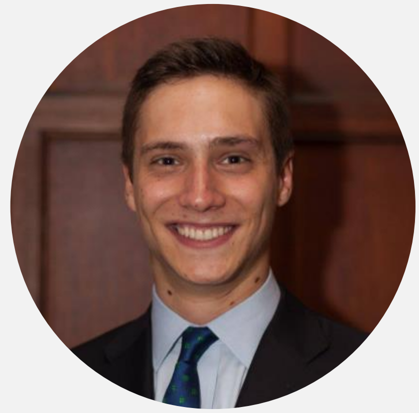

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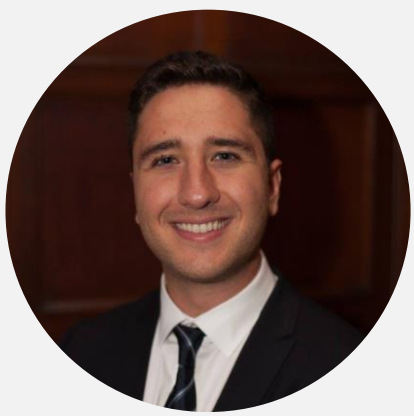

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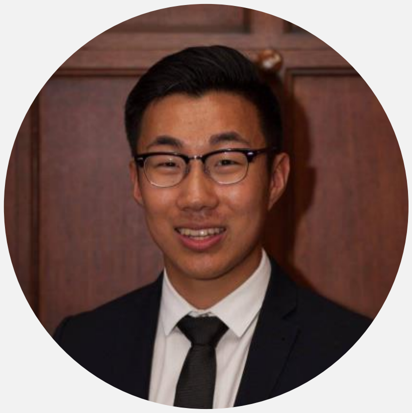

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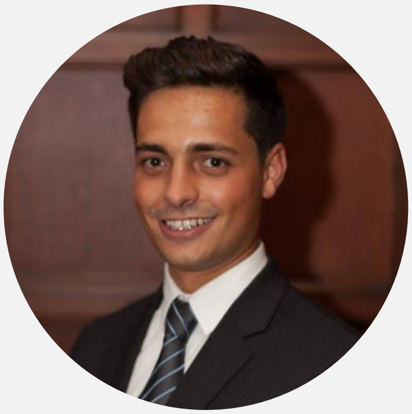

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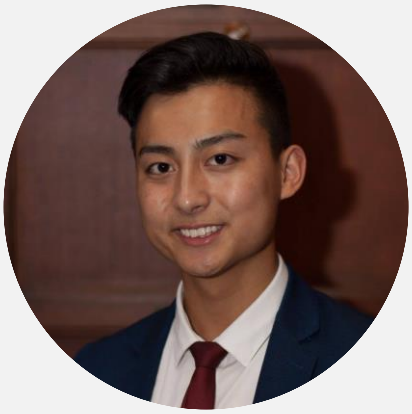

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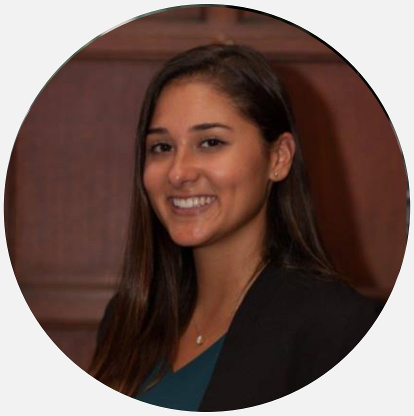

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Summer Analyst, Consulting

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JUN NG

Analyst, Fixed Income

2017 Summer Internship

Analyst, Investment Banking

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Analyst, Asset Management

Fidelity Investments,
Toronto

JASKRIT SINGH

Analyst, Materials

2017 Summer Internship

Analyst, Asset Management

PSP Investments,
Montreal

ECONOMICS

QUENTIN BATISTA

Economic Analyst

2017 Full Time

Masters in Economics

University of Tokyo,
Tokyo

Desautels Global Equity Fund

2016 Performance Summary & Attribution

By Olivier Babin, Global Equity Strategist

Global Equity Fund: 2016 Performance Summary & Attribution

Dear Investors,

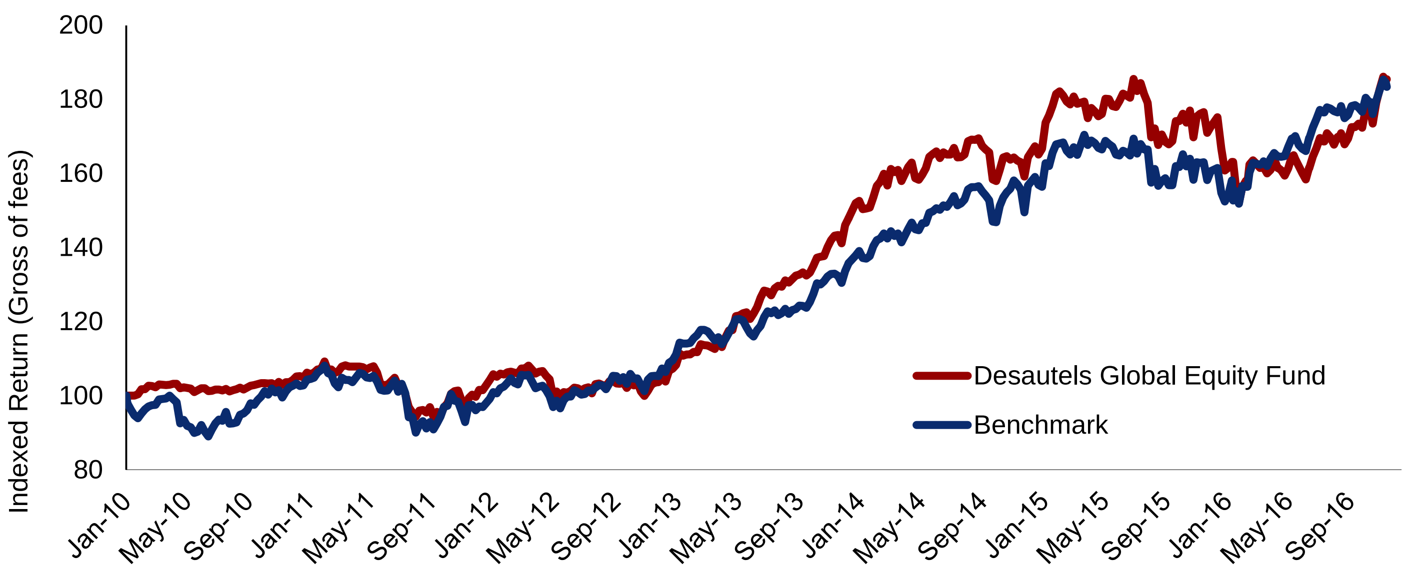
The Global Equity Fund returned 8.0% gross of fees in 2016, compared to 16.4% for our blended benchmark (60% S&P TSX, 40% S&P 500 in CAD). Despite this past year's underperformance, the Global Equity Fund is still outpacing the benchmark by 0.1% since inception on an annualized basis, with lower risk, for 2.2% of annualized alpha.

Underperformance in 2016 was largely due to poor performance in our Consumers holdings (PSG, Ten Peaks, Macy's) and our underexposure to the Metals and Mining subsector, which skyrocketed in H1. Highlights for the Fund in 2016 included strong performances by CRH Medical and Time Warner, which helped our Healthcare and Technology & Media sectors outperform their sector benchmarks by 53.8% and 17.2%, respectively (Figure 1). Our Financials holdings also outperformed, led by Bank of America and Industrial Alliance, where we realized gains of 33.4% and 24.5%. We are pleased to have ended 2016 on a positive note, outperforming the benchmark for 6 consecutive months and with a 9.6% return in Q4 versus 5.3% for the benchmark, as many of our investment theses began to materialize (Figure 2). Full details on individual holdings are provided in the sector sections that follow.

GLOBAL EQUITY FUND RETURNS			As of Dec 31, 2016
Time Period	**Gross Return**	**Net Return**	**Benchmark**
2016 Annual Return	8.0%	6.5%	16.4%
Q4 2016	9.6%	9.4%	5.3%
Q3 2016	6.9%	6.5%	5.3%
Q2 2016	(0.2%)	(0.6%)	4.1%
Q1 2016	(7.7%)	(8.0%)	0.8%
Since Inception (annualized)	9.5%	8.0%	9.4%

PERFORMANCE METRICS SINCE INCEPTION		
	Equity Fund	**Benchmark**
Annualized Return	9.5%	9.4%
Annualized Std Dev	10.2%	11.5%
Annualized Sharpe Ratio	0.70	0.62
Beta	0.71	
Annualized Gross Alpha	2.2%	
Weekly Tracking Error	0.99%	

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 (in CAD). From inception until February 28, 2013, benchmark was the MSCI World Index. Inception date is January 20, 2010.

Global Equity Fund: 2016 Performance Summary & Attribution

Figure 1: Global Equity Fund 2015 Sector Returns vs. Sector Benchmarks

Sector Returns			
Sectors	**Sector Return**	**Benchmark Return**	**+/-**
Healthcare	47.3%	-6.5%	53.8%
Technology & Media	26.4%	9.3%	17.2%
Financials	32.3%	16.5%	15.8%
Industrials	26.2%	14.0%	12.3%
Telecom	24.1%	14.1%	10.0%
Utilities	20.0%	13.2%	6.8%
Real Estate	-8.0%	-0.3%	-7.7%
Energy	21.0%	31.1%	-10.1%
Consumer Staples	-22.5%	3.5%	-26.0%
Consumer Discretionary	-28.4%	-1.5%	-26.9%
Materials	7.0%	62.0%	-55.0%

Note: Details for sector benchmarks can be found in the individual sector reports.

Figure 2: Global Equity Fund Monthly Returns vs. Benchmark

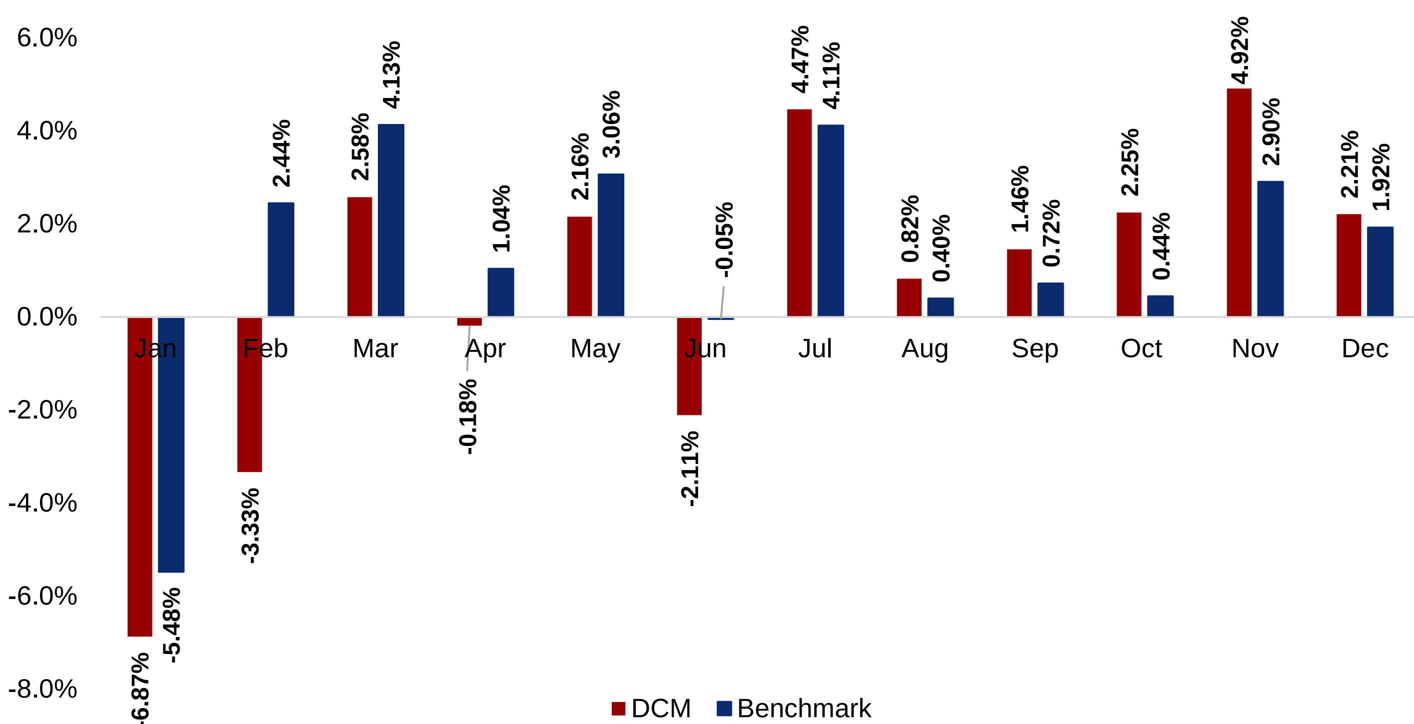
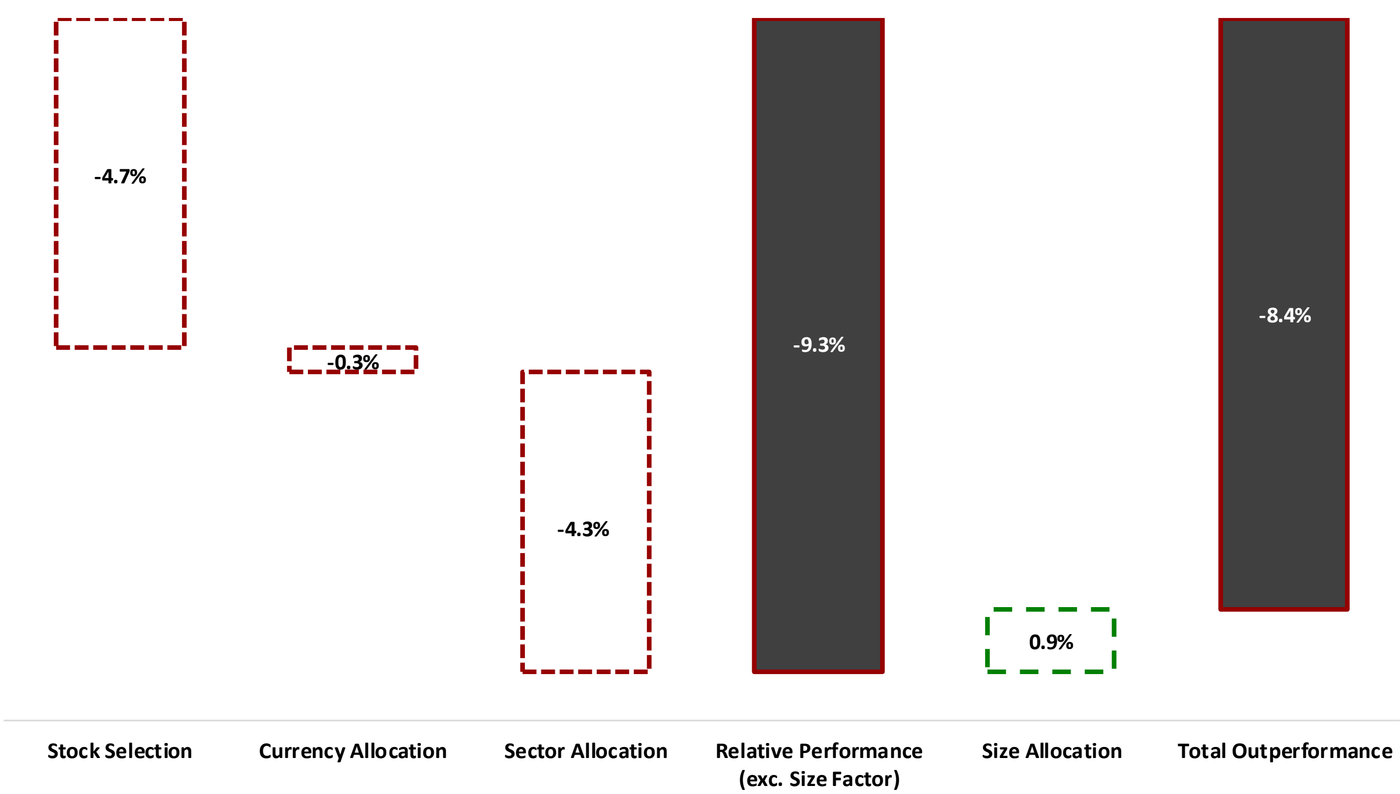


Figure 3 further illustrates that our underperformance was mainly due to sector allocation and stock selection. In terms of sector allocation, we were positioned defensively throughout 2016 given are view of overextended market valuations and political instability. Specifically, we underweighted cyclical sectors, including Materials, Energy, Industrials, and Financials. The first started the year strongly due to the rally in commodities while the last three finished the year strongly following the OPEC agreement and the Trump election. Our bearish outlook also led us to maintain a 10% cash balance for much of 2016, which further contributed 1.5% to our underperformance.

In terms of country/currency, we were slightly overweight USD for most of the year. This was driven by our ability to find more interesting investment opportunities south of the border rather than an active top down view on the U.S. economy. We moved closer to our benchmark mid-way through the year to minimize the effect of currency fluctuations on our relative performance. Finally, our exposure to small caps gave us a small boost versus the benchmark as small caps outperformed mid and large caps in 2016 (Figure 10).

Figure 3: DCM 2016 Relative Performance Attribution



Global Equity Fund: Portfolio Positioning

Global Equity Fund - Current Sector Allocation			
Sector	**Global Equity Fund**	**Benchmark**	**(+/-)**
Telecommunication Services	9.6%	3.9%	5.7%
USD	2.2%	0.0%	2.2%
Consumer Staples	8.1%	6.1%	2.1%
CAD	2.0%	0.0%	2.0%
Health Care	6.8%	5.8%	1.0%
Utilities	3.8%	2.9%	0.9%
Information Technology	9.1%	10.0%	(0.9%)
Materials	6.5%	8.4%	(1.8%)
Industrials	7.8%	9.7%	(1.9%)
Consumer Discretionary	6.1%	8.0%	(1.9%)
Financials	26.5%	29.5%	(3.0%)
Energy	11.4%	15.8%	(4.4%)
Total	**100.0%**	**100.0%**	**0.0%**

Figure 4: Size Exposure

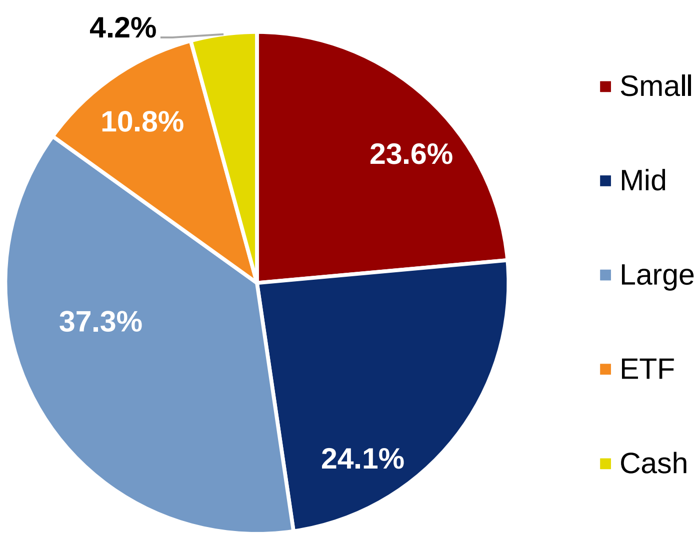


Figure 5: Currency Exposure

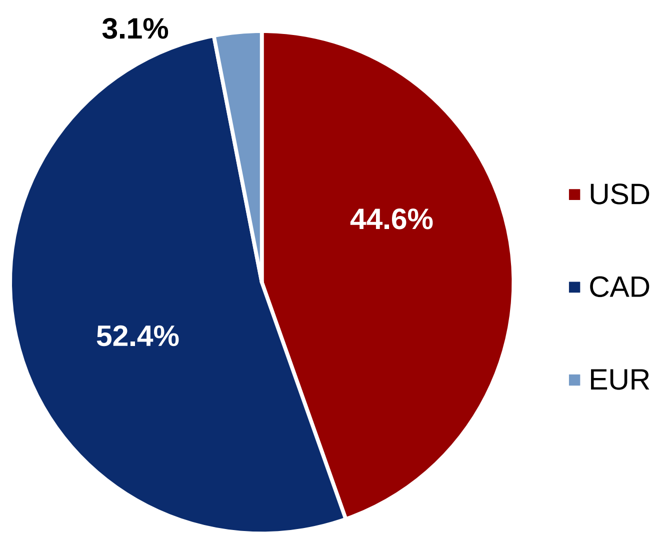


Figure 6: Global Equity Fund Holdings List

Global Equity Fund - Holdings List as of (31-12-2016)

#	Security Name	Sector	Currency	Size	# of Units	Local Cost / Unit	Local Price / Unit	Base Market Value	Position Size %
1	Time Warner	Telecommunication Services	USD	Large	1,350	$81.07	$96.53	$174,760	6.1%
2	Bank of America	Financials	USD	Large	5,850	$15.01	$22.10	$173,378	6.0%
3	Industrial Alliance	Financials	CAD	Mid	2,912	$40.01	$53.39	$155,472	5.4%
4	CIBC	Financials	CAD	Large	1,350	$104.02	$109.56	$147,906	5.2%
5	Union Pacific	Industrials	USD	Large	885	$79.86	$103.68	$123,050	4.3%
6	Pembina Pipeline	Energy	CAD	Large	2,700	$37.85	$41.96	$113,292	3.9%
7	Emera	Utilities	CAD	Mid	2,400	$45.23	$45.39	$108,936	3.8%
8	iShares Global Healthcare	Health Care	CAD	ETF	2,800	$38.91	$38.41	$107,548	3.7%
9	Dream Office	Financials	CAD	Mid	5,400	$20.98	$19.55	$105,570	3.7%
10	Crescent	Energy	CAD	Mid	5,650	$17.44	$18.25	$103,113	3.6%
11	Cogent Communication	Telecommunication Services	USD	Small	1,830	$33.61	$41.35	$101,478	3.5%
12	Cummins	Industrials	USD	Large	550	$137.83	$136.67	$100,805	3.5%
13	Corby Spirit and Wine	Consumer Staples	CAD	Small	4,400	$23.07	$22.31	$98,164	3.4%
14	Solium Capital	Information Technology	CAD	Small	11,400	$8.73	$8.44	$96,216	3.4%
15	iShares S&P/TSX Capped Fin.	Financials	CAD	ETF	2,600	$30.28	$35.34	$91,884	3.2%
16	Macy's Inc	Consumer Discretionary	USD	Mid	1,900	$42.64	$35.81	$91,244	3.2%
17	Fresenius Medical Care	Health Care	EUR	Large	1,550	$38.63	$42.21	$87,739	3.1%
18	West End Indiana Bancshares	Financials	USD	Small	1,900	$22.22	$34.00	$86,632	3.0%
19	Apple	Information Technology	USD	Large	550	$109.92	$115.82	$85,426	3.0%
20	Madison Square Garden	Consumer Discretionary	USD	Mid	350	$168.57	$171.51	$80,501	2.8%
21	WebMD Health	Information Technology	USD	Small	1,200	$50.68	$49.57	$79,771	2.8%
22	Ten Peaks Coffee	Consumer Staples	CAD	Small	10,856	$10.07	$7.30	$79,249	2.8%
23	Western Forest Product	Materials	CAD	Small	36,191	$1.98	$1.89	$68,401	2.4%
24	U.S. Dollar	USD	USD	Cash	47,956	–	$1.00	$64,311	2.2%
25	Marathon Petroleum	Energy	USD	Large	940	$44.14	$50.35	$63,471	2.2%
26	Alacer Gold	Materials	CAD	Small	28,300	$2.38	$2.24	$63,392	2.2%
27	Canadian Dollar	CAD	CAD	Cash	57,362	–	$1.00	$57,362	2.0%
28	iShares S&P/TSX Capped Mat.	Materials	CAD	ETF	4,400	$14.05	$12.73	$56,012	2.0%
29	iShares Global Consumer	Consumer Staples	USD	ETF	450	$90.77	$92.08	$55,568	1.9%
30	Meg Energy	Energy	CAD	Mid	5,195	$33.15	$9.23	$47,950	1.7%
31	Performance Sports Group	Consumer Discretionary	CAD	Small	10,985	$7.16	$0.28	$3,076	0.1%
						Total		**$2,871,674**	**100.0%**

Note: All values are as of Dec. 31, 2016.

Desautels Global Equity Fund

Equity Market Review and Outlook

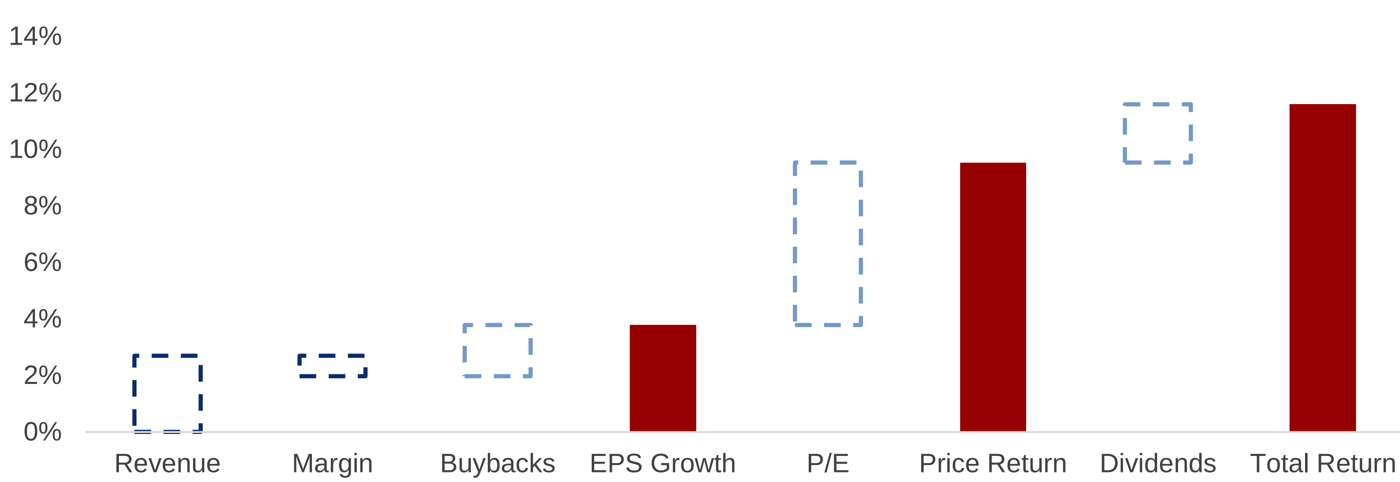
By Olivier Babin, Global Equity Strategist

"The stock market is the story of cycles and of the human behavior that is responsible for overreactions in both directions." — Seth Klarman, Founder and Fund Manager at Baupost Group

2016 once again showed that even (especially) when the street has everything figured out, it can be dead wrong. In late January, following Wall Street's worst ever start to a year, few were those not calling the end of the bull market. In June, Brexit caught the market off guard, and in October, the market consensus was that Clinton would win and that if (a big if) Trump won, it would lead to a severe market correction. Trump won and a correction happened overnight, but by daylight the trend had reversed and the market never looked back. The S&P 500 finished the year posting a total return of 11.6%, while north of the border the S&P TSX Composite returned 20.6%. The Canadian market's outperformance can be attributed to heavy sector weightings in the best performing sectors (Materials, Energy, and Financials).

Heading into 2016 we expected limited upside in the U.S. stock market as we saw limited potential for multiple expansion in the face of a mature economic cycle and three anticipated hikes by the Federal Reserve. Instead, the Fed hold off until December and North American equity markets rallied strongly Figures 7 and 8 decompose the 2016 S&P 500 and S&P TSX Composite returns into EPS growth, multiple expansion, and dividends. On the U.S. side, the main driver behind the S&P 500's total return was a multiple expansion. This expansion, surprising to see at this stage of the cycle, was mostly driven by the rally following the Presidential elections, and clearly indicates a shift of growth expectations and market sentiment. As discussed further down, we are not convinced. Share repurchases, despite slowing down in the second quarter, had a noticeable contribution to EPS growth by reducing the total amount of shares outstanding by 1.7%. Fundamentals had an overall small impact on the S&P 500 performance this year - the top line improved but there was a slight deterioration of margins.

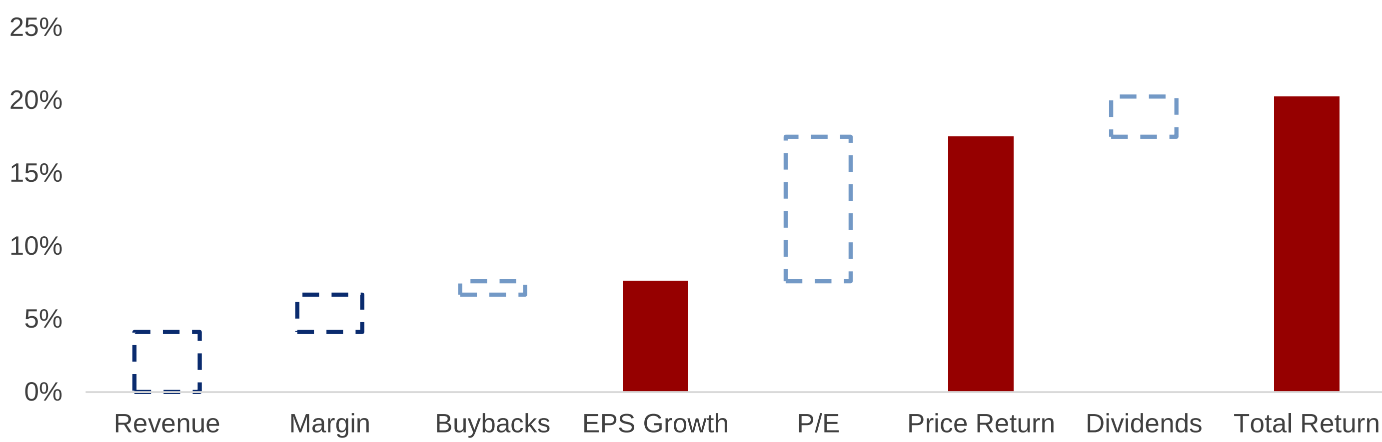
Figure 7: S&P 500 2016 Return Decomposition



As of Dec. 31, 2016. Note: EPS growth and its components are change in next twelve months expectations.
Source: Bloomberg

On the Canadian side, fundamentals improved significantly, mainly driven by the materials and energy sector. Index revenues were up more than 4%, margins expanded and share repurchases also had a net positive impact on EPS. The EPS growth was magnified by a 10% PE multiple expansion. Overall, the index was up 20.3%, ending the year only 4% shy of its all-time high (reached in September 2014).

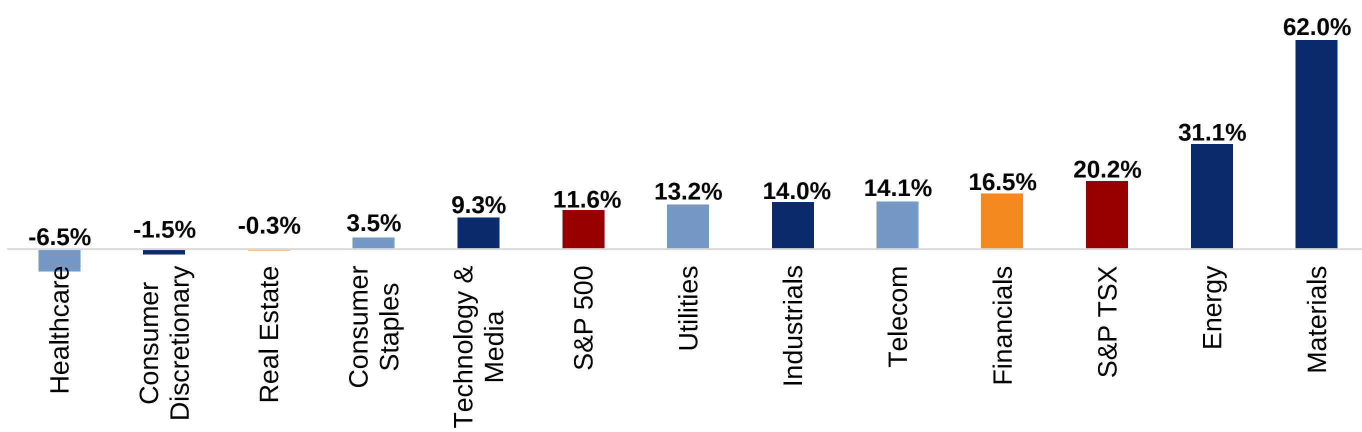
Figure 8: S&P/TSX 2016 Return Decomposition



Risk-On Despite the Risk

Brexit? Trump? Not a problem for equity investors in 2016 as the market turned into serious risk-on mode, particularly after the Trump election. The risk-on mode was further reflected by the general outperformance of cyclical sectors versus their countercyclical peers (Figure 9). There were a few exceptions. Telecom and Utilities, traditionally defensive sectors, benefited from the Bank of Canada maintaining its overnight rate at 0.5% and the Federal Reserve increasing rates only once in 2016. Consumer Discretionary, normally quite cyclical, was down 1.5%. Headwinds for the sector included: 1) a shift in consumer spending from traditional department stores to online sellers, leading to increased price competition, and 2) limited willingness from consumers to use debt to increase spending.

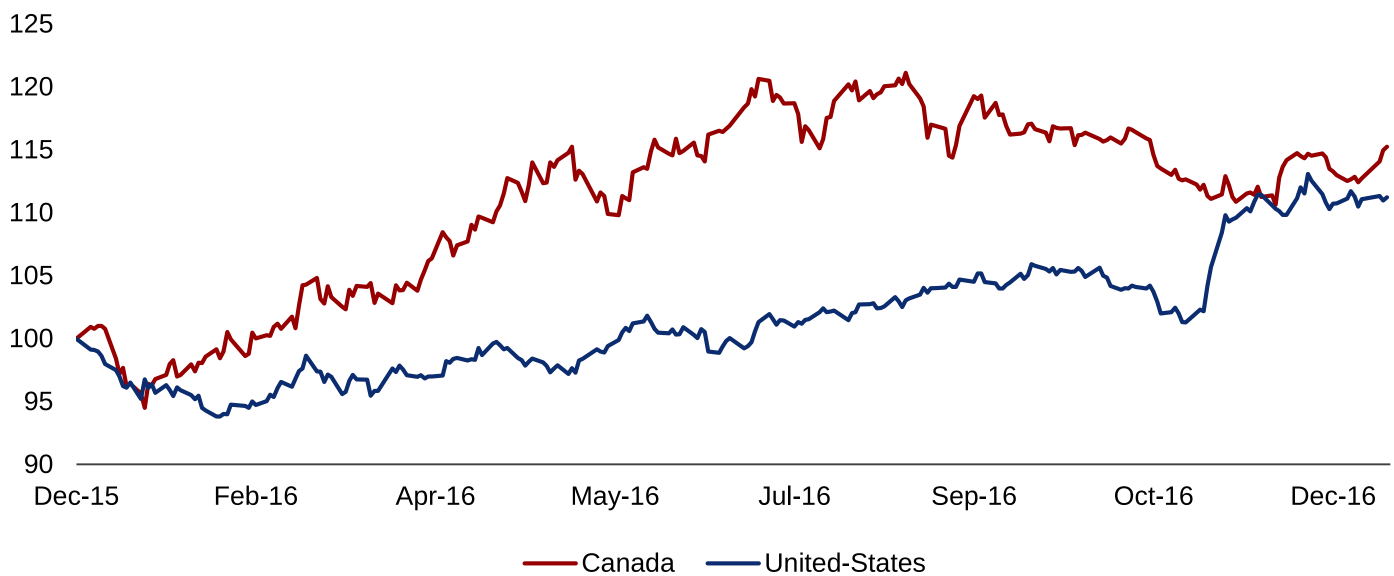
Figure 9: 2016 Sector Total Returns



Source: Bloomberg, FactSet

The outperformance of small cap companies versus their mid cap and large cap counterparts was a reversal from 2014 and 2015. In Canada, it started early in the year, driven by a resurrection in the commodity market which reinforced confidence in the overall economy. In the United States, the story was a bit different with large caps and small caps generating similar performances until Election Day on November 9th (Figure 10). Trump's call for more protectionism and less international trade benefits smaller companies, which tend to generate less sales overseas. Furthermore, Trump's desire to diminish the corporate tax rate from 35% to 15% would benefit smaller companies more as they do not rely as heavily on tax inversion deals and lower tax rate jurisdictions as their large cap peers.

Figure 10: Small Cap Returns Over Large Cap Returns in the United-States and Canada



Are Valuations Alarming?

This bull market will soon be celebrating its 8th anniversary, making it the second longest in U.S. stock market history after the 1990s rally (a bull market ends when the S&P 500 experiences a correction of at least 20%). Since the low point reached on March 9th, 2009, the S&P 500 has rallied 231%, which has outpaced all bull markets except that from the 1990s (Figure 11). Obviously analyzing market returns in isolation of improving fundamentals would be misleading. Therefore, we turn to market valuations to assess the likelihood of this bull market continuing its upward progression.

Figure 11: History of Bull Markets

Bull Markets		
Bull begin date	**Bull return**	**Duration (months)**
Jul-26	152%	38
Mar-35	129%	24
Apr-42	158%	50
Oct-60	39%	14
Oct-62	103%	74
May-70	74%	32
Mar-78	62%	33
Aug-82	229%	61
Oct-90	417%	115
Oct-02	101%	61
Mar-09	231%	95

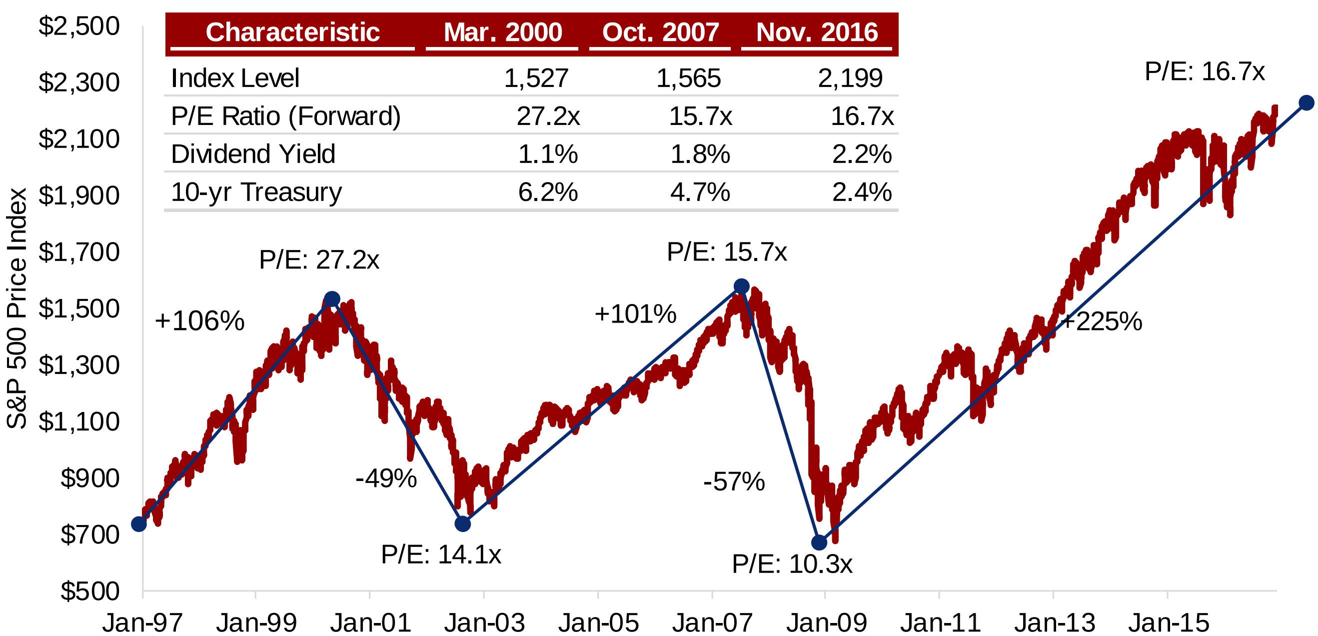
Source: Bloomberg, Fortune

Valuations have moved up in 2016. As shown previously, 2016 market returns in Canada and in the United-States were primarily driven by expanding multiples. Forward P/E and the cyclically adjusted P/E ratio (Shiller's P/E) are above their historical average and have risen compared to the end of 2015 (Figure 12). Although the ratios are not alarmingly far from their long-term averages (as measured by standard deviations from the mean), we believe this measure of deviation to be a bit misleading given the non-normality of the ratios' distributions. For example, looking at the CAPE ratio, we note that it ranks in the 96% percentile of its historical distribution. In other words, investors have only paid higher CAPE multiples 4% of the time in the past 25 years. This is worrisome in our view.

As we have noted previously, different market conditions warrant different multiples. In particular, low interest rates should imply higher multiples. As of December 31st, the spread between the Baa yield and the S&P 500 earnings yield stood at 1.2%, compared to a historical average of -0.4%. However, with the likely implementation of expansionary fiscal policies in the United-States and inflation breaching the 2.0% threshold, rates could start moving quickly. A resurrection of higher yields for good credits could affect the flows between assets classes and drastically alter equity valuations.

Figure 12: S&P 500 Valuation Metrics

Current S&P 500 Valuations			Historical Perspective	
Valuation Measure	**Description**	**Current**	**25-Year Avg.**	**Std. Diff.**
P/E	Forward P/E	16.9x	15.9x	0.3
CAPE	Shiller's P/E	28.3x	26.0x	0.4
Div. Yield	Dividend Yield	2.2%	2.0%	-0.3
P/B	Price to book	2.7x	2.9x	-0.3
P/CF	Price to cash flow	11.5x	11.4x	0.0
EY Spread	EY minus Baa yield	1.2%	-0.4%	-0.8



Source: J.P. Morgan

(I) The Year of Politics

Brexit

The vote on June 24, 2016 was designed to strengthen Prime Minister Cameron's power over his Tory government but ended up being one of the biggest political surprises of the decade. Unfortunately for free-trade proponents, it did not even constitute the biggest political disappointment of 2016.

Brexit took almost all by surprise, including the politicians that were advocating for it. The stock markets were deadly wrong and even the betting markets called it incorrectly. When the results were released, the reaction of the financial markets was immediate. Two days after the vote, the pound had dropped to its lowest value versus the dollar in more than 30 years. The increased uncertainty in the United Kingdom's economic growth also caused a 5% correction of the FTSE 100 within the span of three days. The S&P 500 had a 5% correction in the immediate aftermath of the vote, but this reversed within a week. There are multiple reasons that could explain the sudden change of investor sentiment but we explore two explanations. First, the U.S. economy is a relatively isolated one with approximately 15% of its GDP related to international trade. Moreover, the United Kingdom only constitutes the 7th trading partner of the U.S. in importance, far behind the European Union, Canada, China and Mexico. In Canada, the situation is a bit different since two-third of the Canadian economy depends on trade. However, the United-States is by far the largest trading partner – the United Kingdom only comes in at a distant 5th trading partner. Secondly, North American investors may have been anticipating an interest rate increase by the Federal Reserve. As a result of Brexit and the higher global uncertainty, that rate increase was delayed which injected more liquidity in U.S. markets.

Against the Gods: The Ascent of Donald Trump

Hours before the election, the polls were almost unanimous in predicting a Clinton victory. Much like everyone else, we relied on FiveThirtyEight to form our view on the election. It gave Clinton a 71% probability of winning. We warned against a potential surprise in the Q3 newsletter, but we still expected Clinton to win. Clinton seemed to be the market's favorite since the S&P 500 went up as Clinton's odds were improving and vice-versa.

Then, against all expectations, Trump won and the U.S. stock market (after a sharp 5% correction overnight) had its best week since 2014 with the major indices rising as much as 5%. Some have explained the reversal as a result of Trump's moderate acceptance speech and also high profile shows of confidence from Wall Street veterans ("Icahn Left Trump Victory Party to Bet $1 Billion on Stocks"). Alternatively, it could be a good old case of market irrationality. Regardless, of what might have happened, we focus our attention on how Trump's presidency is likely to affect our investment portfolio going forward. This is not an easy task as Trump has not been a consistent candidate. Most of his election promises lacked clear plans or were simply unrealistic. This leads us to believe that most of what he said during the primaries and the presidential campaign is still up in the air. Despite the clear uncertainty, three core ideas stand out.

1) Trump will undoubtedly be a pro-business president. This includes tax cuts for corporations and reduction of business regulations. Tax holidays could be especially profitable for corporations with significant cash balances abroad.

2) Trump will lead expansionary fiscal policies. This includes tax cuts and massive infrastructure spending. An expected consequence is the rise in inflation which could potentially lead to the end of the low interest rate environment. This is also likely to lead to an increase in U.S. national debt.

3) The Unite-States will enter a more isolationist era. This does not seem to be unique to the United States with the Euro Zone dealing with its share of problems. Donald Trump has been a strong advocate against free trade agreements. He has already confirmed that he will not be signing the TPP or TTIP and revisiting NAFTA stands out as a priority as he takes office.

The market rally is certainly a result of investors' belief that Trump can effectively implement his two flagship policies. Growth projections were increased by the World Bank (Figure 13), as were equity analysts' forecasts. Despite a fully controlled republican congress, we remain skeptical of the new President's ability to go through with policies that would lead to skyrocketing U.S. debt. We think, for instance, that a revenue neutral tax reform is more likely to be implemented than Trump's advertised 20% cut in corporate tax rate.

Figure 13: United-States Growth Forecast

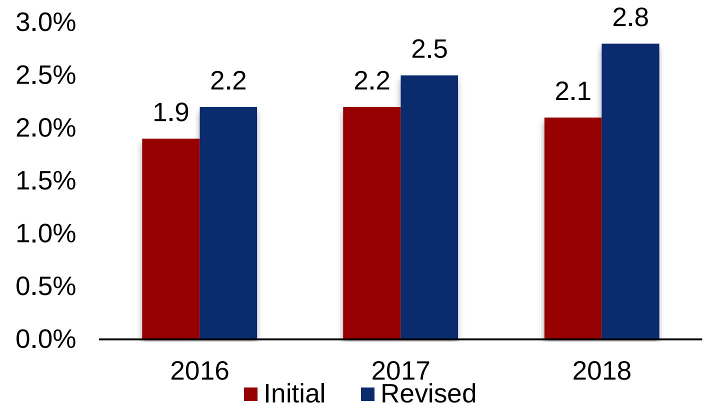


Figure 14: Historical Presidential Returns

Dow Jones Returns Under U.S. Presidents		
President	**First-Year in Office Return**	**Annualized Return**
T. Roosevelt	-1.4%	2.7%
Taft	13.5%	-0.3%
Wilson	1.8%	-0.9%
Harding	14.4%	6.9%
Coolidge	16.7%	25.5%
Hoover	-12.9%	-35.6%
F.D. Roosevelt	96.1%	9.3%
Truman	30.6%	8.0%
Eisenhower	0.4%	10.4%
Kennedy	10.5%	4.1%
Johnson	25.2%	5.3%
Nixon	-16.5%	-3.2%
Ford	5.2%	8.9%
Carter	-19.0%	-0.2%
Reagan	-11.0%	11.3%
H.W. Bush	19.8%	9.7%
Clinton	20.0%	15.9%
W. Bush	-7.7%	-3.5%
Obama	33.1%	14.5%
Average		
Republicans	1.9%	3.0%
Democrats	24.8%	7.0%

On a concluding note for this political section, the "Trump market rally" is in line with most investors' common belief that markets prefer a Republican president to a Democrat president. It is indeed true that, on average, markets were up 4% the day following a Republican win versus a 1% increase following a Democrat win. However, interestingly, the markets have historically performed better under Democrat presidents, as measured by the Dow Jones Industrial Average return during the first year in office and the total annualized return. A detail summary of the Dow Jones Industrial Average performance can be found in the table below.

Source: J.P. Morgan, Fortune

(II) The End of Buybacks?

Q3 2016 was the second consecutive quarter of year-over-year declines in share buybacks. After reaching a post 2008 crisis high in Q1 2016 with S&P 500 companies spending more than $150 billion on share repurchases, the notional amount fell drastically with two consecutive quarters below the $120 billion mark. This represents the lowest level since Q1 2013 and the participation level, as measured by the number of companies engaged in buybacks, fell below its 3-year average. The reduction was widespread with all sectors recording a year-over-year decline in buybacks, with the most significant decreases in the Energy, and Materials sectors.

The importance of a reduction in share repurchases activities must not be overlooked. Since the Great Recession, repurchases have been the preferred method for companies to return capital to shareholders. Along with dividends, repurchases have contributed to a skyrocketing percentage of capital return to shareholders, but they differ from dividends in several important ways: 1) They create an artificial growth in EPS that may not accurately reflect the fundamentals of the business or growth of the bottom line. 2) In the open market, buybacks also create artificial demand for stocks - earlier this year, a team of Goldman Sachs analysts reported that “corporate repurchases are the main source of net demand for U.S. stocks”. 3) Buybacks might indicate that the company believes their stock price is being undervalued by the market. 4) To the extent that buybacks are financed by debt issuance, the resulting change in capital structure would theoretically imply a higher cost of equity, and a lower P/E multiple as investors should be willing to pay less per dollar of now more leveraged and riskier earnings. On this last point, one concern is that the theoretical contraction in the P/E ratio may only show up with a lag, once a negative shock hits, thus further exacerbating the downside risk potential.

Moving forward, there are four elements that will drive share repurchases. 1) On the bright side, U.S. policymakers could potentially drive a resurgence of buybacks. Indeed, if a tax holiday is implemented by the Republican controlled Senate, this could potentially lead to some hefty one-time buybacks from corporations bringing back significant cash balances from abroad. 2) Still on the positive side, S&P 500 companies (ex-financials) are sitting on their largest cash balance in over 10 years with a staggering $1.54 trillion in cash and short-term investments. 3) Many corporations have been relying on debt issuance to finance their buybacks. With the FED shifting towards a more hawkish tone, this is likely to be a headwind for share buybacks. 4) Finally, expensive valuations and share repurchases are heavily interlinked. The observed reduction in share repurchases seen in the second half of 2016 is, in our view, an indication that corporations themselves might view their stocks as becoming too expensive.

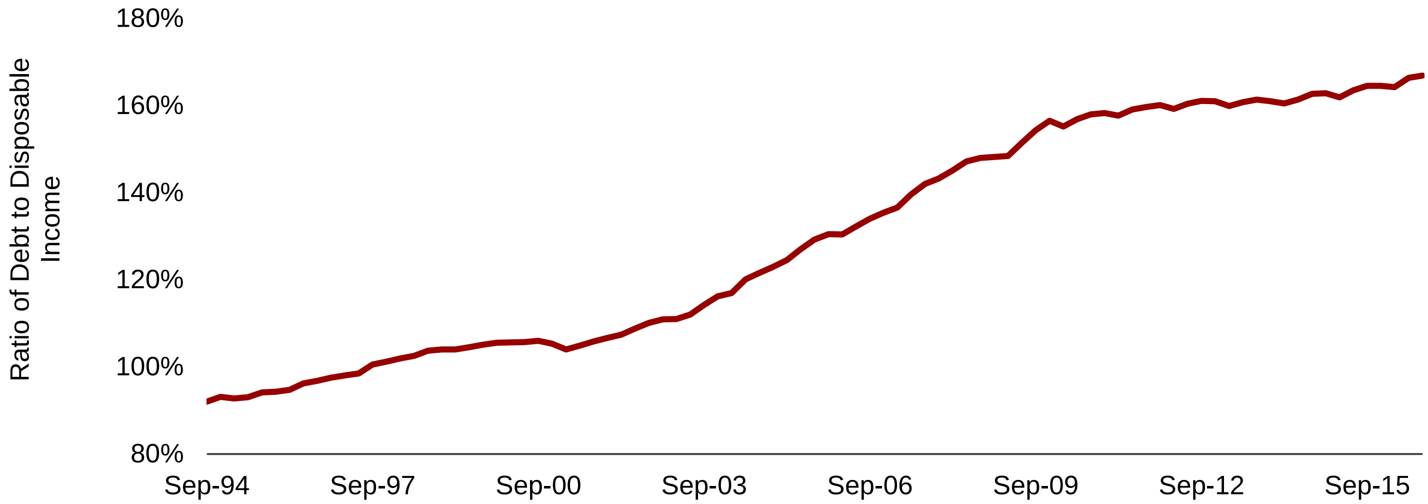
Although it might be premature to label it a trend, the reduction in share repurchases is something that we will monitor closely. A potential reduction in repurchases would translate into one less tailwind for the 7-year bull market.

Source: FactSet Research Systems, Reuters

(III) Canada, an Indebted Nation

Canadians are spending beyond their means. The savings rate is near an all-time low of ~4%. Moreover, a report recently published by Statistics Canada shows that the ratio of household credit markets debt to adjusted disposable income is now at 166.9% (Figure 15). The household debt service ratio – which measures payment obligations as proportion of disposable income – is at 14.0%.

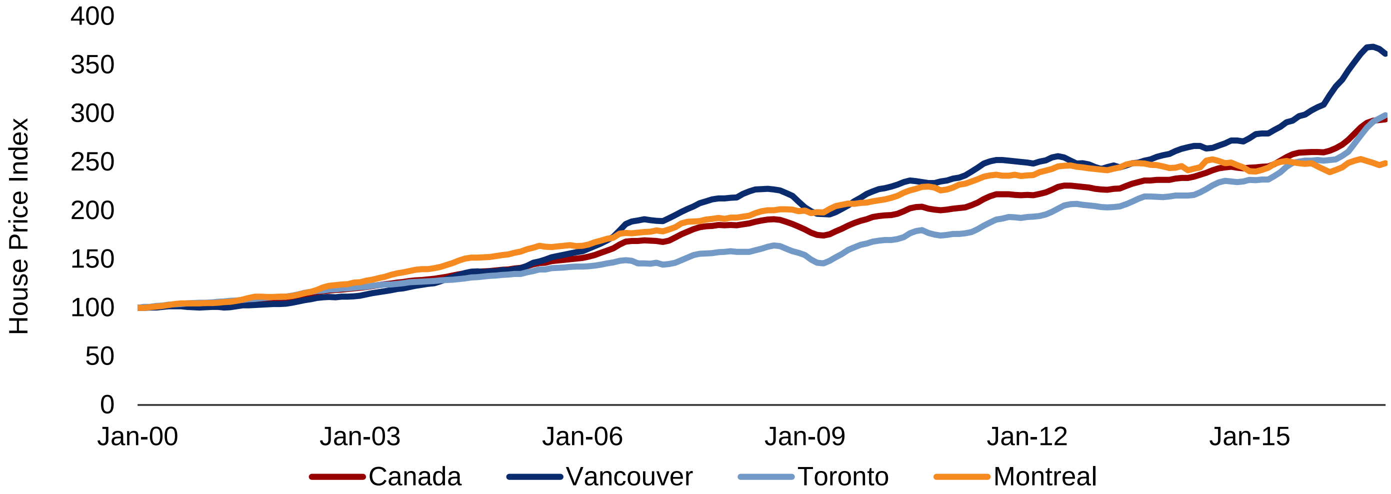
Figure 15: Evolution of the Ratio of Debt to Disposable Income in Canada



On a standalone basis, this graph is worrisome, but couple that with the sharp rise in housing prices in cities like Toronto and Vancouver and you end up with a Molotov cocktail. The average house price in Canada has been increasing at a very fast pace since 2000 and even more since 2008. The trend has even been accelerating recently with home prices up 12.9% YoY in Canada, up 19.3% YoY in Toronto and up 18.5% in Vancouver. Homebuyers that are stretching themselves too much on credit might end up in a very precarious position should mortgage rates rise as interest rates move upwards or should home prices move downward.

Source: FactSet Research Systems, Reuters

Figure 16: Evolution of Housing Prices in Canada and the Major Canadian Metropolis



The Government of Canada has moved to address this concern in the past year by implementing new mortgage rules. Most importantly, all insured mortgages will have to undergo a stress test. The government has also launched consultations on lender risk sharing and has imposed new restrictions on the conditions to provide insurance for low-ratio mortgages. It is not the first time the Federal Government tries to protect the long-term security of borrowers and address the concerns of Canada's housing market. It has implemented five federal housing rules since 2008. We hope for a soft landing of housing prices in Canada as we were in the front seat to observe the consequences of a hard landing in the United States in 2008 on the financial system and the stock market.

Source: FactSet Research Systems, Reuters

(IV) The Federal Reserve and the Threat of Rate Hikes

Back in December 2015, the Fed indicated, through its "dot plot", that committee members expected to raise rates 4 times by the end of 2016. Then, in March, the central bank's forecast was down to 2 hikes for 2016. The Fed finally waited until December for its only rate hike of the year.

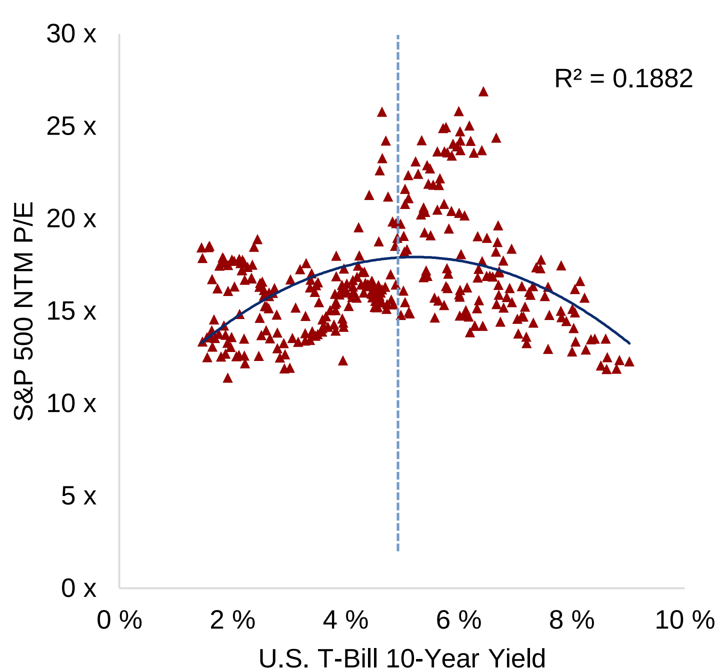
This was done despite clear signs of "strengthening of the labor market" and "inflation (picking) up in recent months". The concern was over "global economy and financial developments (that) continue to pose risks". Much like we argued in 2015, market sentiments outweighed fundamentals in the Fed's decision.

Moving forward, given the increased inflation expectations and the likely implementation of expansionary fiscal policies in the United-States, the Fed's officials have signaled their desire to hike between 3-4 times in 2017. The dot plot released after the December meeting shows that FOMC members see rates rising to 1.25-1.50% by the end of 2017. The main concern for Equity investors is the impact that rising interest rates will have on market multiples. Firstly, an historical analysis of past tightening cycles shows that the tightening cycle by itself should not lead to a market correction. It could however lead to a period of low real return over the next couple of years. Secondly, although there is limited correlation between market multiples and the interest rate level, higher interest rates seem to be associated with higher market multiples up to a yield of approximately 5.5%.

Figure 17: Tightening Cycles

Real Return (Ann.) After Initial Tightening			
Tightening Start Date	**12 Months Forward**	**24 Months Forward**	**36 Months Forward**
16-Jul-71	5.3%	-1.0%	-15.2%
16-Aug-77	-2.0%	-4.2%	-2.7%
21-Oct-80	-17.3%	-4.6%	1.9%
22-Mar-84	10.2%	18.5%	20.3%
4-Dec-86	-15.3%	-0.8%	6.8%
30-Mar-88	7.9%	9.2%	7.9%
4-Feb-94	-0.9%	13.2%	15.6%
30-Jun-99	2.2%	-8.7%	-12.7%
30-Jun-04	1.8%	2.0%	6.3%
Average	**-0.9%**	**2.6%**	**3.1%**
Median	**1.8%**	**-0.8%**	**6.3%**

Figure 18: S&P500 NTM P/E vs US 10Y Yield



Source: DCM Internal Analysis (First Publication in the 2014 Annual Report)

(I) Politics Drive Uncertainty

As much as 2016 was the year of political surprises, 2017 promises to be the year of political uncertainty. Key elections are happening in the Euro Zone, with the Netherlands, France, and Germany going to the ballots. The main risk for the markets is a populist and Eurosceptic wave that could jeopardize the free markets and endanger the future of the union. In Italy, Matteo Renzi just lost a referendum on Constitutional reforms, which means that there will be a new transition government until the General Election in 2018. Overall, this means that four of the five biggest continental European economies (the other one being Spain) will face high uncertainty over their future in 2017 and early 2018.

In the United Kingdom, Theresa May is expected to trigger Article 50 by March to formally start the Brexit process. The uncertainty and lengthiness of the negotiation process will cast some shadow over economic growth in the region, the currency markets and obviously, the stock market.

In the United-States, the Trump administration has been sworn into office. Backed by a full republican congress, the administration is likely to hit full speed with its “repeal and change” process. Trump’s core policies and how they are likely to affect the market have been addressed above. The real problem is nicely summarized by Nobel Prize winner Joseph Stiglitz: “no one can predict how Donald Trump will govern, or how the world will respond”. All those events and their complex ramifications will in our view lead to increase volatility in 2017 and could, in many possible ways, end the bull market. Indeed, the VIX index is currently near record lows, something we find inconsistent with all the uncertainties facing the market. Low recent volatility may be giving investors a false sense of security and should volatility spike, the party could be over in a very serious way.

(II) Return Dispersion

The monetary easing since the Great Recession, through an injection of liquidity in the stock markets, led to a rising tide for all stocks. Stock return dispersion remained near the low end of its historical range. As we move from expansionary monetary policy to expansionary fiscal policies, it is likely that the consequences on stocks will be more diverse and therefore, the returns more dispersed. Trump’s infrastructure spending policies will favor some sectors and industries at the expense of others. As a rule of thumb, higher dispersion is good news for active managers. Historical studies show that active managers tend to outperform passive index trackers in periods with higher return dispersion and underperform in periods of low return dispersion.

Source: Blackrock 2017 Outlook, Goldman Sachs

(III) 2017 Return Forecasts: A Multi-Scenario Approach

We forecast 2017 equity market total return in the United-States using 5 different drivers: revenue growth, margin changes, buybacks, multiple expansion, and dividends.

- **Base Case:** In our base case, we use the domestic growth forecasts of 2.2% for real GDP 2.2% and 2.2% for the inflation rate to project a growth in domestic revenue of 4.4%. However, this is partly offset by lower international revenue growth because of a stronger U.S. dollar and Trump's protectionist policies. Since international sales account for almost half of S&P 500 companies' sales, we forecast a blended revenue growth of 2.0%. With U.S. corporations currently generating their highest operating margin in more than 20 years, we see no incremental changes in margins as a result of cost improvements. We do however account for a 5% increase in EPS resulting from a reduction in the federal tax rate. We forecast a 1.5% impact from buybacks, which accounts for a reduction from the 2016 level. We do not believe that Trump's promise to cut the corporate tax rate by more than half from 35% to 15% is feasible in the context of his other fiscal promises and the U.S. budget deficit so we only forecast a more reasonable reduction. We factor a small multiple contraction in the face of 3 expected rate hikes and higher economic uncertainty both domestically and internationally. We forecast a dividend yield of 2.1%, in line with the current one.
- **Bull Case**: In our bull case we forecast a better than anticipated revenue growth on the domestic front and we acknowledge improving economic condition worldwide but this is partly offset by a stronger U.S. dollar, resulting in a forecasted revenue growth of 3.5%. We still see no significant cost cutting improvement but we forecast a reduction of the effective tax rate from 27% to 20% as a result of Trump's corporate tax rate reduction. This translates into a 9.5% impact on EPS. We also account for a 2.0% impact on EPS from the continued high stock buybacks we have seen in the past 2 years. We only forecast a minor increase in the P/E multiple given its current high level and our view that the FED will increase short-term rates at a faster pace in 2017. We forecast a dividend yield of 2.3%, slightly above the current one.
- **Bear Case**: In our bear case, we factor in weaker domestic economic conditions due to an ineffective implementation of expansionary fiscal policies by the Trump administration and a tighter monetary policy by the Fed. We also account for a stronger U.S. dollar that eats away overseas revenue for U.S. companies. After multiple years of cost cutting initiatives and strong buyback programs, we see a slight deterioration in margins and no benefit from buybacks. Finally, we forecast a contraction of the forward P/E from 16.9x to 14.9 due to a worsening economic outlook in the U.S. and worldwide uncertainty caused by a volatile commodity market and disastrous election outcomes in Europe. This results in a 12% negative impact on the share price.

Putting it All Together: Where Do We Go from Here?

Figure 19-a): S&P 500 2017 Return Scenarios – Base Case

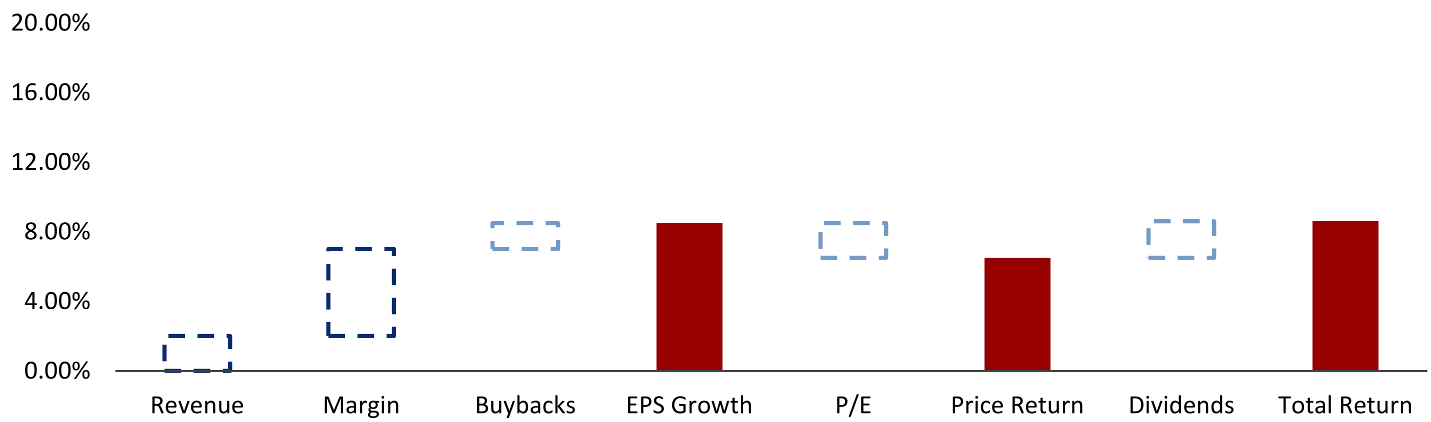


Figure 19-b): S&P 500 2017 Return Scenarios – Bull Case

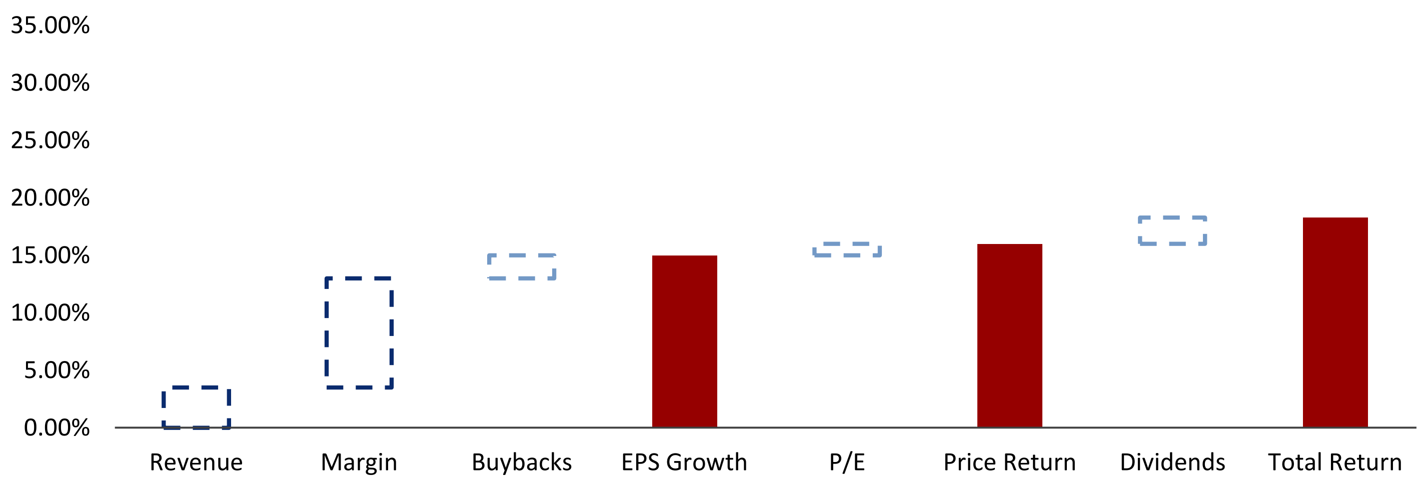
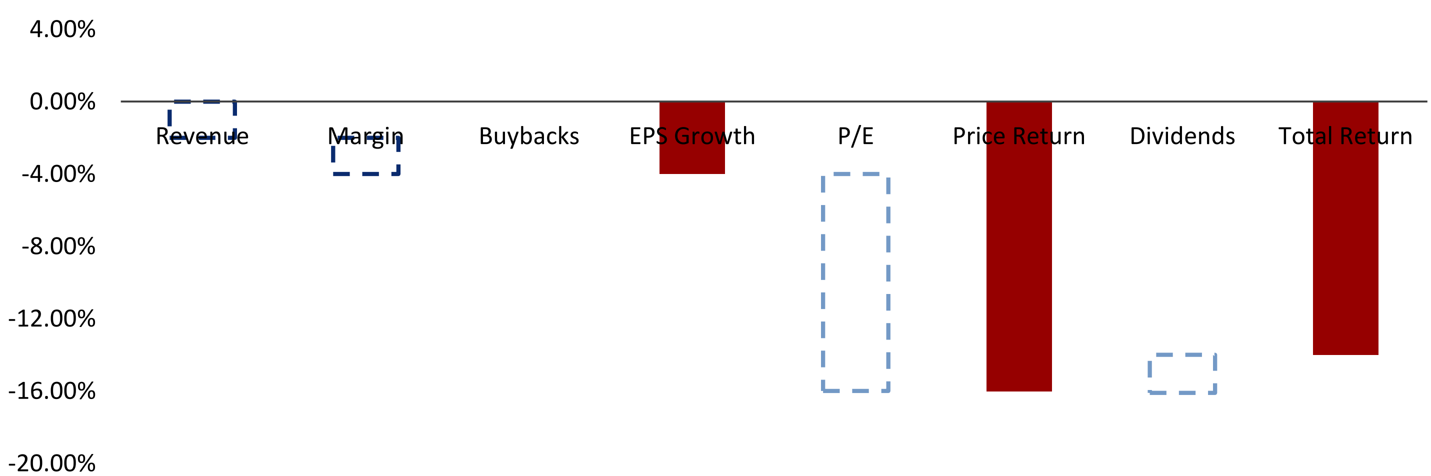


Figure 19-c): S&P 500 2017 Return Scenarios – Bear Case



Source: DCM Forecasts

Risk Management

2016 Portfolio Risk Analysis

By Jayden Van, Global Risk Manager

Introduction

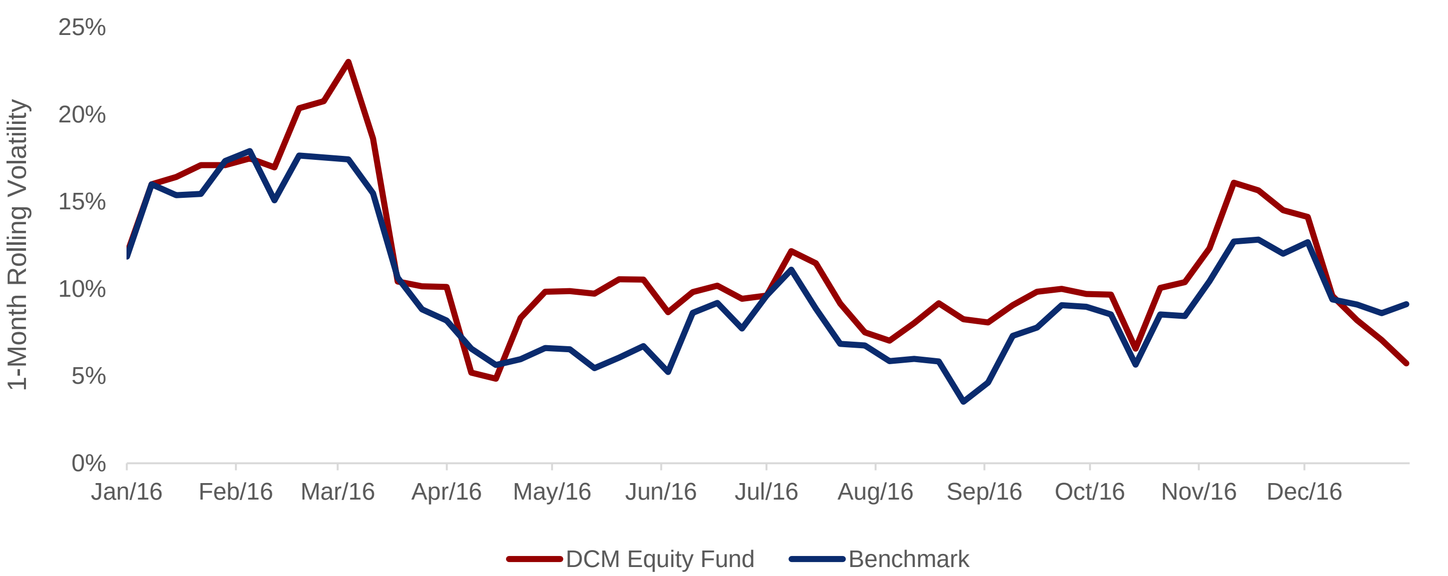
Risk is at the core of every investment decision we make at DCM. Rolling volatility, rolling beta, tracking error,, Value-at-Risk (VaR), and portfolio variance contribution are some of the metrics we look at The goal is to monitor and manage risk so that we are never overexposed to any particular risk factor and that risk levels are consistent with what a prudent investor would be comfortable with.

EQUITY PERFORMANCE METRICS 2016	Equity Fund	Benchmark
Annualized Return	8.0%	16.4%
Annualized Std Dev	11.4%	9.7%
Annualized Sharpe Ratio	0.50	1.45
Beta	0.90	
Annualized Alpha	(7.0%)	
Weekly Tracking Error	1.09%	

Performance metrics are calculated gross of fees.

In 2016, the Global Equity fund realized an annualized standard deviation of 11.4% versus 9.7% for the benchmark in what was a surprisingly low volatility year. Volatility fluctuated throughout the year, however, with 1-month annualized volatility ranging between 5% and 23% (Figure 1).

Figure 1: DCM Global Equity Fund 2016 Annualized 1-Month Rolling Volatility



Portfolio Asset Allocation and Beta Risk Exposure

The equity fund’s 2016 beta to our benchmark was 0.90. DCM also monitors rolling beta exposures to various risk factors including WTI spot price, the USDCAD exchange rate, and various market indices, based on monthly ending portfolio weights, allowing us to visualize risk exposure as we change our portfolio allocation.

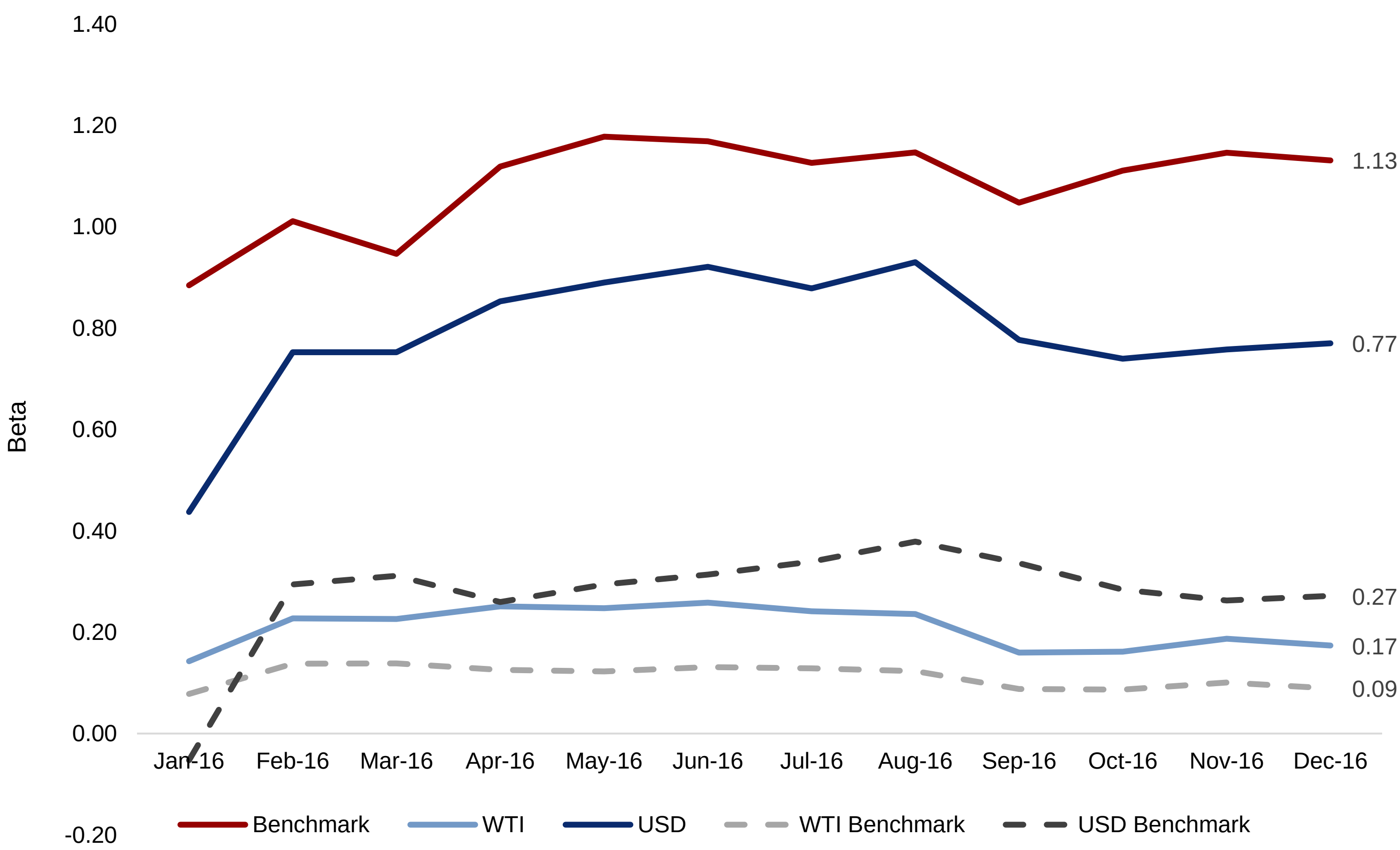
In order to calculate our beta risk exposures at a given month-end, we take our portfolio weightings at the end of that month and calculate theoretical portfolio monthly returns for the twelve months prior based on those fixed weights.

Those historically simulated monthly returns are then regressed against key risk factors in order to calculate the beta to those risk factors, using 1 year of data (Figure 2). The calculated rolling betas highlight how portfolio allocation changes affect our exposures to various risk factors. For example, our portfolio's exposure to the benchmark increased from a 1-year beta of 0.94 in January 2016 to 1.13 in December 2016.

In 2016 we also decreased our exposure to benchmark ETFs by (i) selling a ~12% position in the iShares TSX 60 ETF in the first and second quarters as well as (ii) decreasing allocations to sector ETFs throughout the year, thus increasing our tracking error. The ETF positions were replaced by individual stocks as our Analysts brought forward value-driven investment theses for companies that we believe are set to outperform.

Aside from market index exposures, the fund's beta to WTI increased slightly, from 0.04 at the start of the year to 0.17 at year-end. In the same period, our beta exposure to USD/CAD increased substantially from 0.41 to 0.77, which can be attributed to an overexposure to USD currency in 2016. Relative to the benchmark, the equity fund has a greater exposure to the USD, reaching as high as a 14.3% excess in August before readjusting in Q4.

Figure 2: 1-Year Rolling Beta Based on Month-End Holdings



Portfolio Value-at-Risk

Value-at-Risk (VaR) is another way to understand the downside risk of a portfolio. DCM monitors its 1-Day 1% VaR using historical simulation. Using a historical non-parametric method means that not only is there no restriction resulting from the need for the assumption of normality, but also the estimation of some parameters on the basis of historical data are avoided. Results are shown in Table 1.

Table 1: Global Equity Fund Value-at-Risk as at Dec 31, 2016

Method	1-Day 1% VaR		Commentary
	DCM	Benchmark	
Nonparametric Model	2.17%	1.93%	The simulation computes portfolio returns based on historical daily stock returns and current portfolio weights. The 1% VaR is then simply the 1 percentile return of that distribution

Figure 3: Global Equity Fund Historical Simulation as at Dec 31, 2016

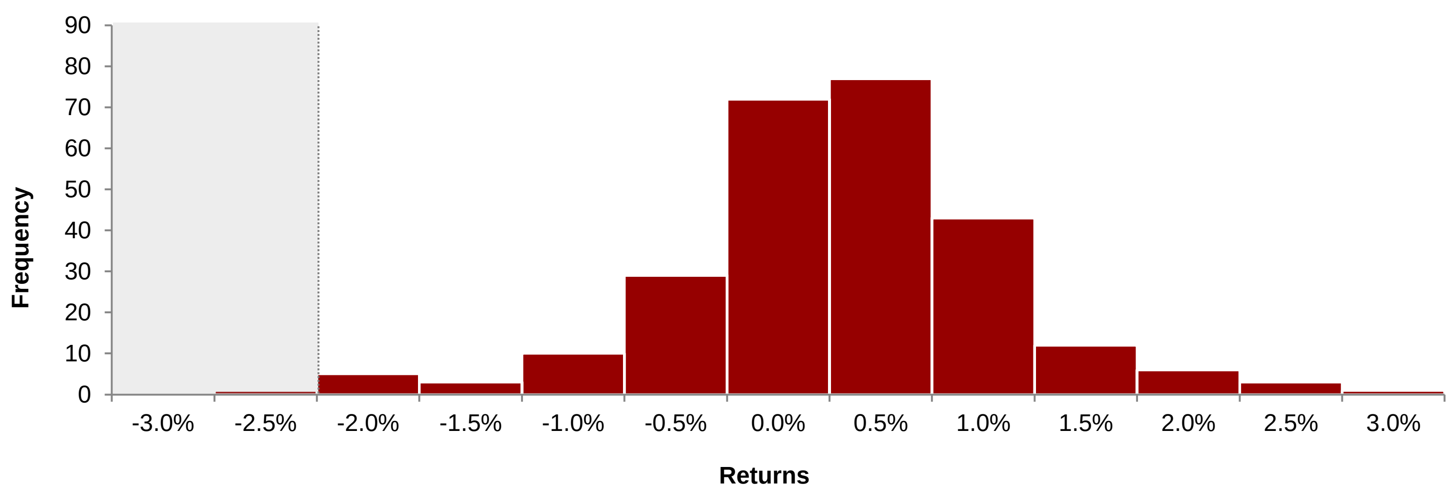
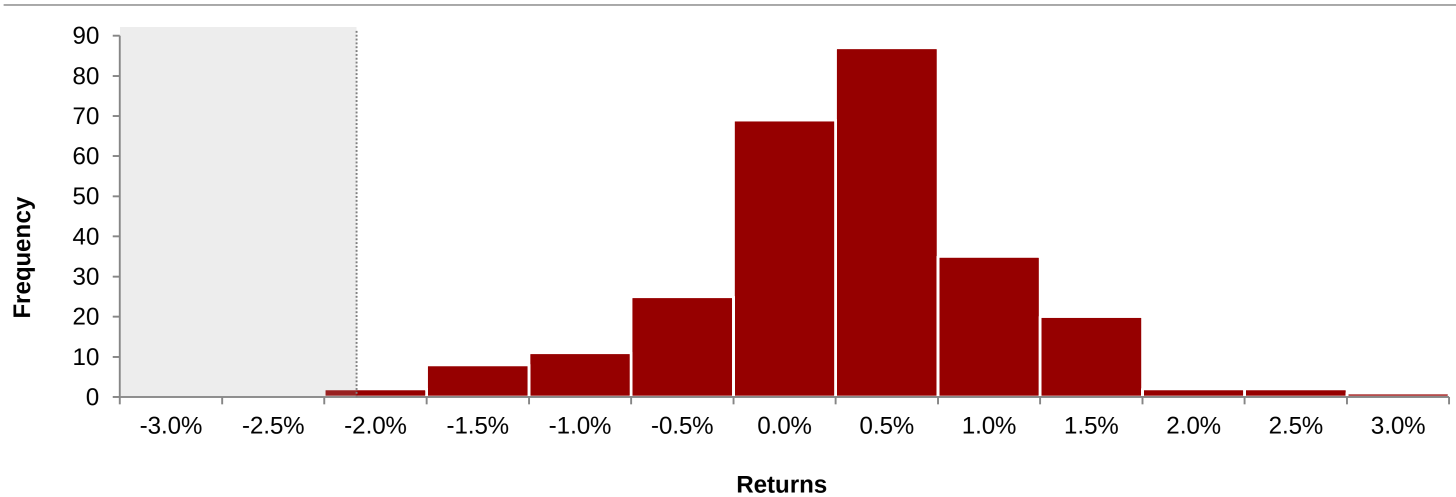


Figure 4: Benchmark Historical Simulation as at Dec 31, 2016



Financials Sector

2016 Review & 2017 Outlook

By Mackenzie Chisholm, Neil Corber, Antoine Francoeur, Adam Marcovitz, and Meagan Prins

2016 Sector Performance

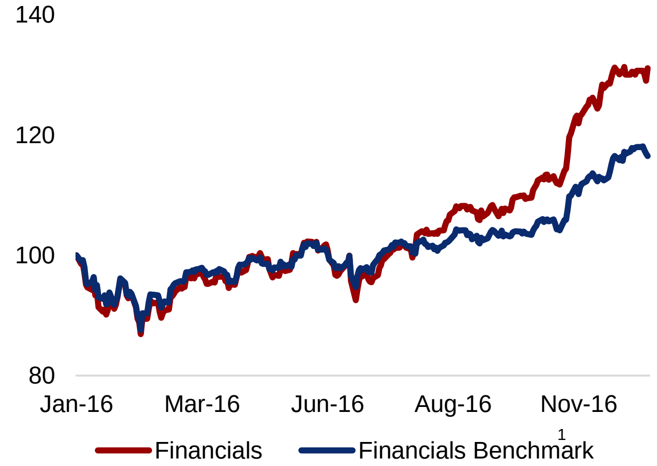
2016 Performance Review

The DCM Financials group had another successful year in 2016, returning 31.1% vs. 16.5% for our sector benchmark (Figure 1). In addition, all of our holdings outperformed their respective subsector indices (Figure 2). Individual holding details are discussed in the Holdings Review section.

Financials Total Shareholder Return

In general, Financials' strong performance in 2016 was driven by multiple expansion as investors began pricing in future growth. (Figure 3). Within the sector, banks were the best performing subsector, followed by Lifecos and P&C insurers. In addition, improvement in the strength of Financials' balance sheets allowed an increase in share buybacks and dividend distributions.

Figure 1: DCM Financials Performance

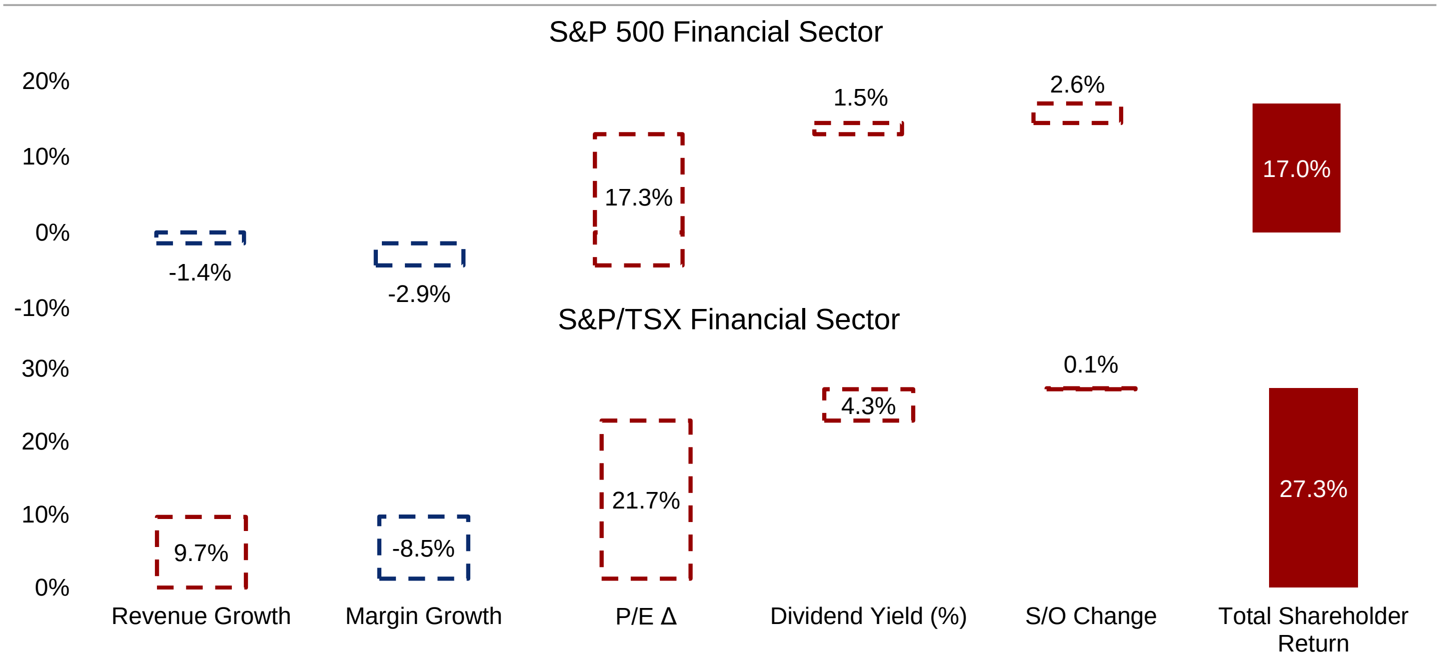


[1] 60% iShares S&P/TSX Capped Financials Index ETF (TSX:XFN), 40% iShares US Financials ETF (NYSE:IYF)

Figure 2: DCM Financials Weighted HPR Versus Their Sub-Sector Benchmark

	BAC	IAG	CM	WEIN
Weighted HPR	46%	23%	5%	46%
Sub-Sector Benchmark Return	31%	16%	3%	33%
Benchmark Selected	U.S. Banks ETF	Canadian Lifecos	Canadian Banks ETF	U.S. Regional Bank ETF
Outperformance / (Underperformance)	**15%**	**7%**	**2%**	**13%**

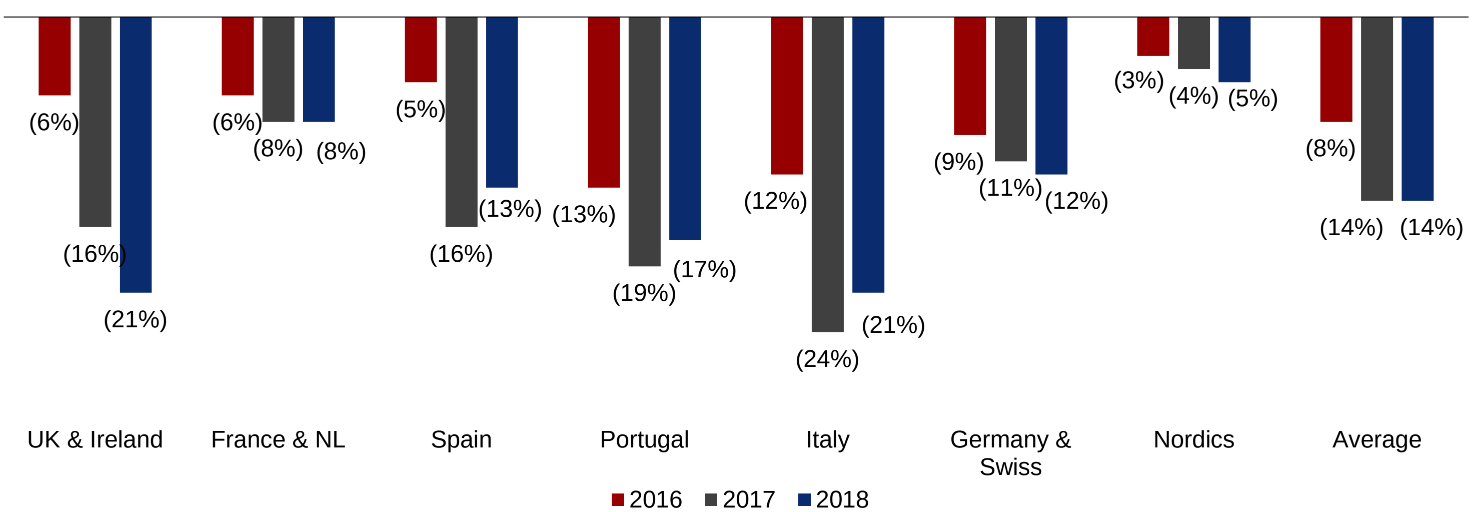
Figure 3: 2015 Total Shareholder Return Breakdown



Banks Review

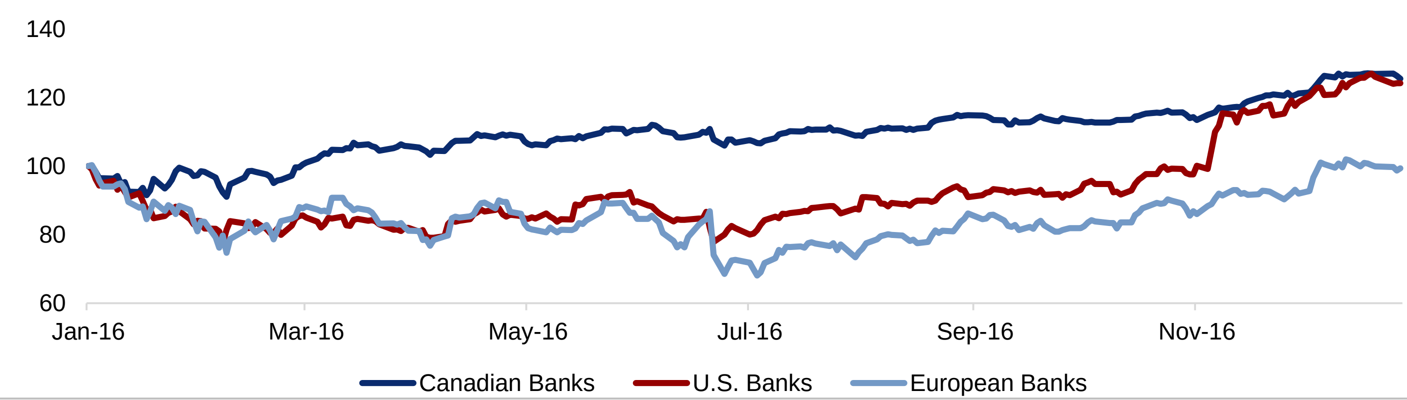
The vast difference in economic and political uncertainty between regions dichotomized the performance of banks in 2016. Canadian banks led the way in 2016 with a 25.5% gain, followed by U.S. banks, which returned 24.2%. European banks did not have the same success, realizing a small loss of 0.7%. Following Britain's vote to leave the European Union, European banks plummeted 15% over concerns about their long-term profitability and overall financial strength. Analysts revised their EPS forecasts downward by an average of 8% for 2016, and by 14% for both 2017 and 2018 (Figure 4). In early August, European banks took another hit following the release of the European Banking Association's (EBA) stress test results, which came in worse than expected. Italy's largest bank, UniCredit, saw their share price fall by nearly 10% after coming in as one of the weakest of the 51 banks tested. Moreover, the world's most important net contributor to systemic risks in the global banking system, Deutsche Bank, hit record lows after failing the U.S. Federal Reserve's stress test.

Figure 4: Change in EPS Forecasts Post Brexit



At the other end of the spectrum, Canadian and U.S. banks performed very well as investors became increasingly bullish on their outlook, especially after Trump vowed to deregulate the financial industry and decrease taxation. As a result, North American banks saw significant multiple expansion, in addition to posting strong revenue growth.

Figure 5: 2016 Banks Performance by Region

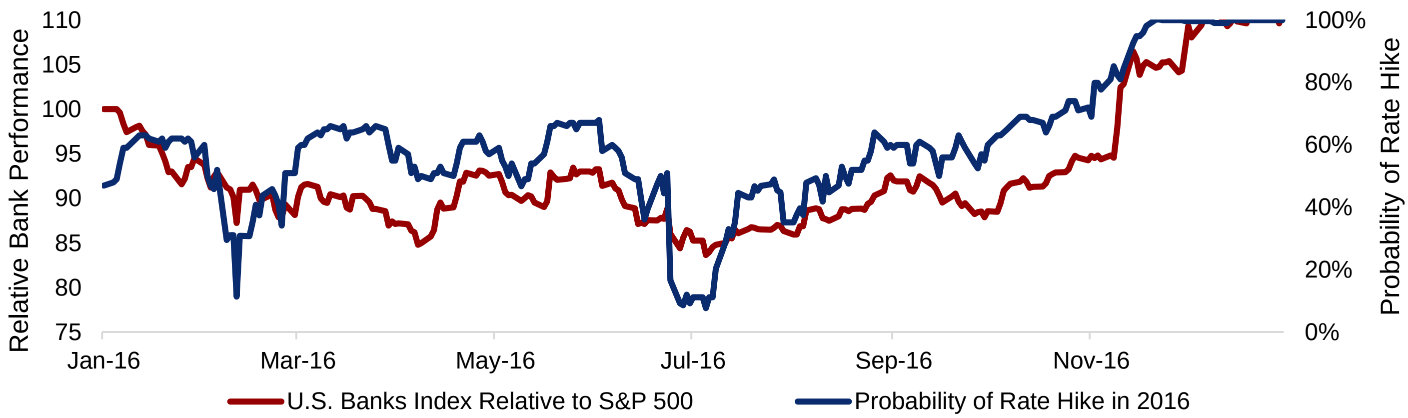


U.S. Banking

Bank stock performance was bifurcated in 2016: the bank index underperformed the S&P 500 by 15% in the first half of 2016 and outperformed the index by 29% in the second half.

Indeed, as seen in Figure 6, banks' relative performance to the broader market was mainly tied to the probability of a rate hike occurring in 2016; the correlation between U.S. banks' relative performance and rate hike probability stood at 85% for 2016. A rate increase leads to an increase in net interest margins for banks going forward, but more importantly signals a stronger economy, and in turn, increased lending activity.

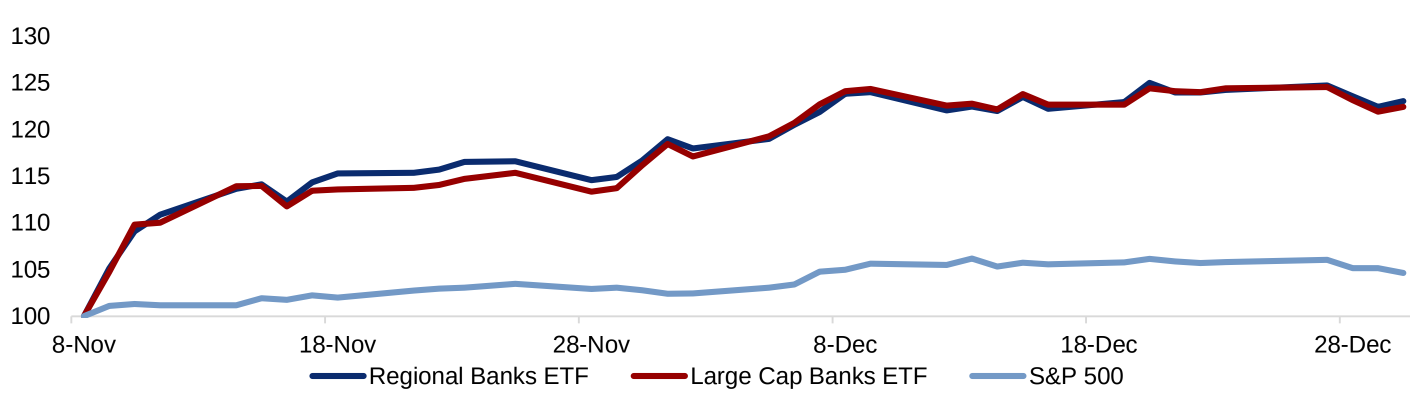
Figure 6: Relative Performance of U.S. Banks to S&P 500 Versus Probability of Rate Hike



With sluggish oil prices and Britain's vote to leave the European Union, bank stocks tumbled over concerns of a global economic slowdown in the first half of 2016. However, U.S. banks were a hot topic following the U.S. election. Optimistic beliefs boosted share prices after President Trump's victory. An increase in confidence surrounding the Fed's likelihood of increasing interest rates going forward, in combination with more financials-friendly regulatory environment, lead to exceptional performance towards the end of the year (Figure 7).

Moreover, many of the large banks, including Bank of America and J.P. Morgan, were able to improve their 2015 resolution plans that was required of them in the Dodd-Frank Wall Street Reform and Consumer Protection Act. That is, many of the banks are now better positioned in the event of material financial distress.

Figure 7: Bank Performance Since U.S. Election



Canadian Banking

After a difficult year in 2015, Canadian banks bounced bank with a strong showing in 2016, returning 25.5% and outpacing the TSX, which returned just under 20%. Banks were strong on all fronts: the average ROE, revenue growth, and book value growth of the big five Canadian banks stood at 15.1%, 9.0% and 9.1%, respectively. Most importantly, banks realized significant multiple expansion as investors had increased optimism surrounding the Canadian macroeconomic environment and profitability going forward; multiple expansion was the largest contributor to banks' share price appreciation in 2016 (Figure 8). Of particular concern to Canadian banks was the possibility of increased provisions for credit losses, specifically in the energy sector as WTI dipped below $30 early in the year. However, those fears were allayed following WTI's post Q1 recovery . Investors also found banks increasingly enticing as they provided an attractive dividend yield in a low interest rate environment, all the while providing a strong return on equity. In addition, many Canadian banks have large U.S. operations, and saw significant share price appreciation following president Trump's victory in November (Figure 9). This is primarily due to the market's expectation that lower tax rates will further increase Canadian Banks' profitability and ease their expansions into the U.S. going forward.

Figure 8: Contributors to Stock Performance

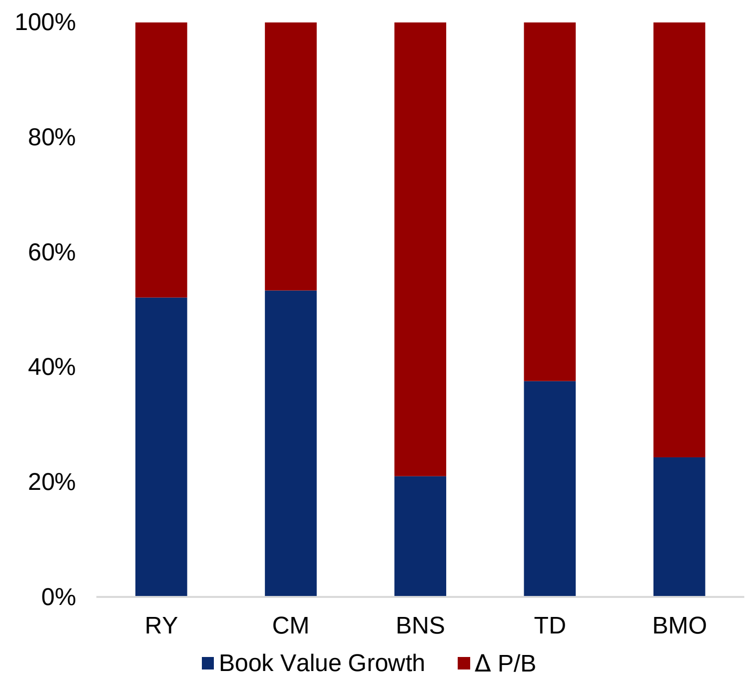
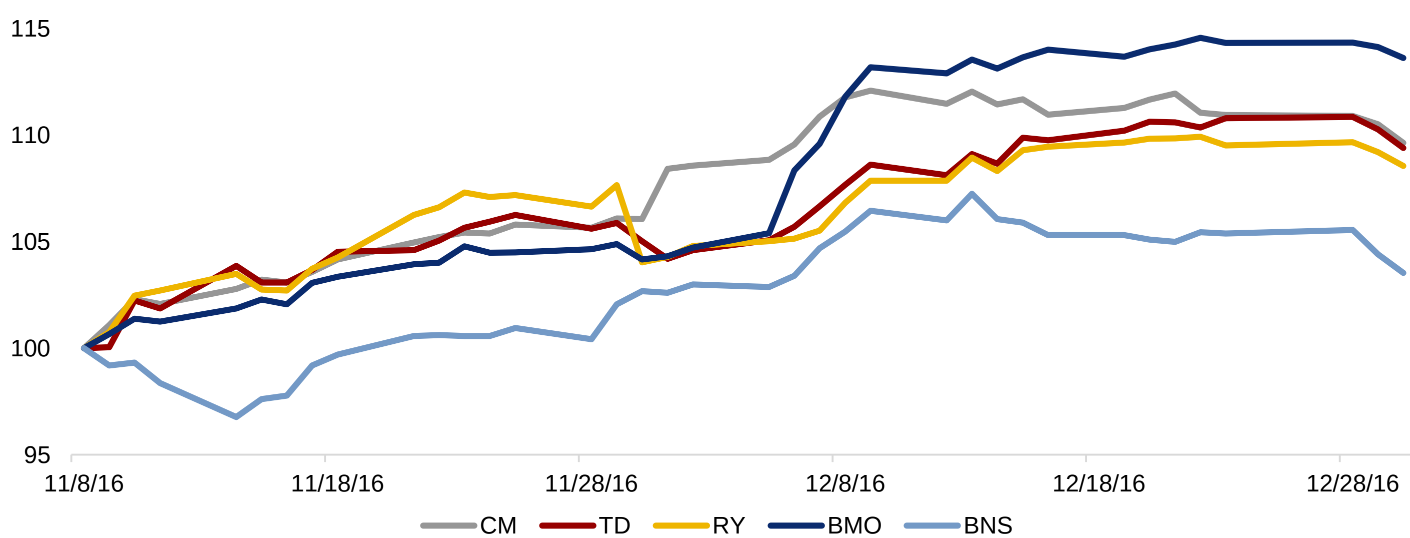


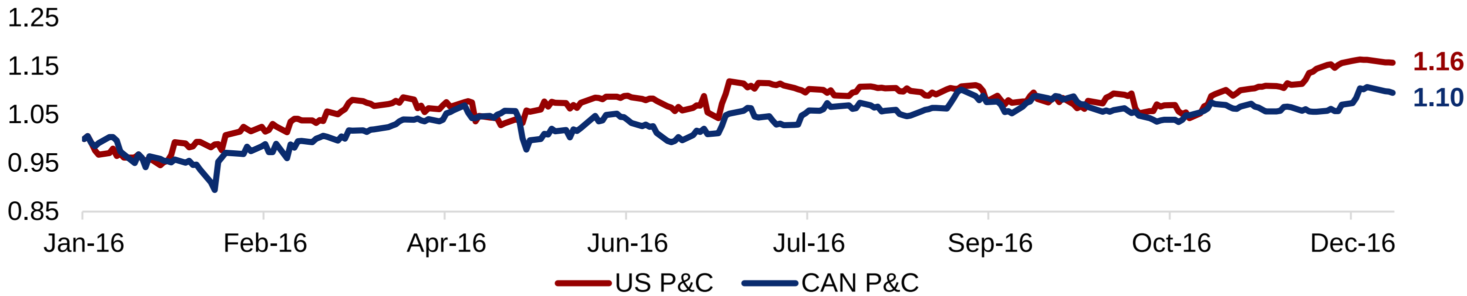
Figure 9: Canadian Bank Performance Since U.S. Election



P&C Insurance

P&C insurance stocks underperformed the Financials sector's benchmark return of 16.5% in 2016; the US BI P&C index returned 15.7% and the Canadian BI P&C index returned 9.5%. Much of the gains in the P&C subsector occurred after the election, especially in the case of American stocks, as investors reacted positively to both an expectation for a more favorable (i.e. higher) interest rate environment and a potential tax reform. (The 20% proposed decline in corporate tax rates is expected to boost earnings of P&C insurance carriers paying the top marginal rate by as much as 30%). Note that while P&C insurance stocks rose on the expectation of higher yields, P&C insurers have a relatively lower beta to interest rates than other constituents of the Financials sector index such as banks and lifecos, thereby contributing to their relative underperformance.

Figure 10: Performance of US and Canadian P&C Indices in 2016



The sector was off to a rocky start in 2016, with P&C commercial pricing rates declining by an average of 4% in Q1 (highlighted in blue in Figure 12). Insurers attempted to grow their underwriting income via aggressive pricing in order to win business. In addition to weak pricing, excess capital weighed on ROEs, with S&P predicting an average pretax ROE of 8.7% in 2016, down from 10.8% in 2015. The year finished with a near all-time low premium-to-surplus ratio of 0.77x, driven by the excess capital across the industry. While a low premium-to-surplus ratio is typically indicative of a high capacity to underwrite new policies, competitive pressures had largely exhausted this use of capital. As a result, we saw a growing focus on returning capital to shareholders, largely via an increase in dividends, with many companies pushing dividend growth rates into the double digits. US multiples continued to remain justifiably below those of their Canadian peers, due to increased competition and more stringent regulation south of the border.

Figure 11: Commercial Insurance Pricing Changes

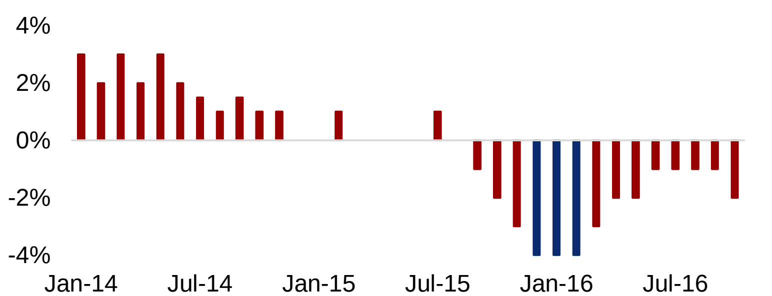
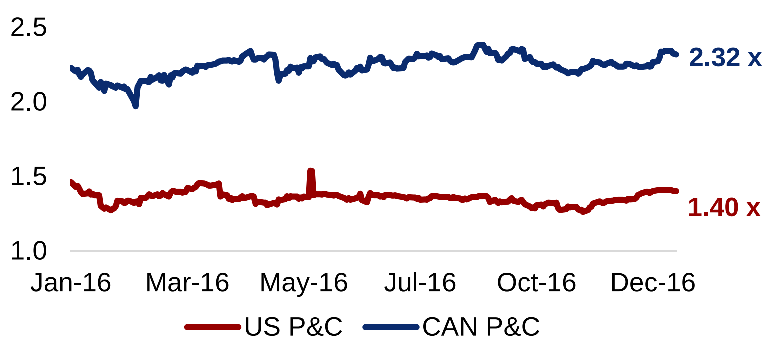


Figure 12: 2016 P&C Historical P/BV Multiples

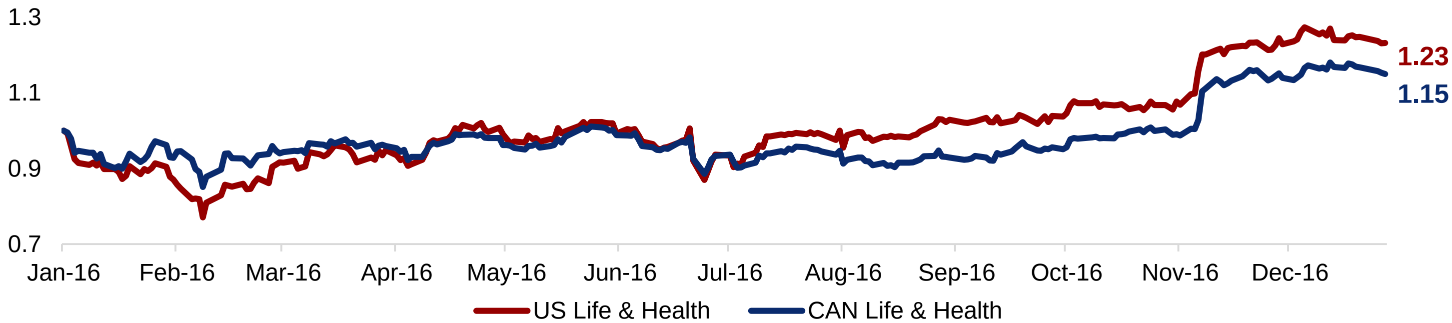


[1] BI P&C Insurance, Adams and Flynn, 03-Jan-2017.
Sources: RBC Capital Markets, Bloomberg

Life and Health Insurance

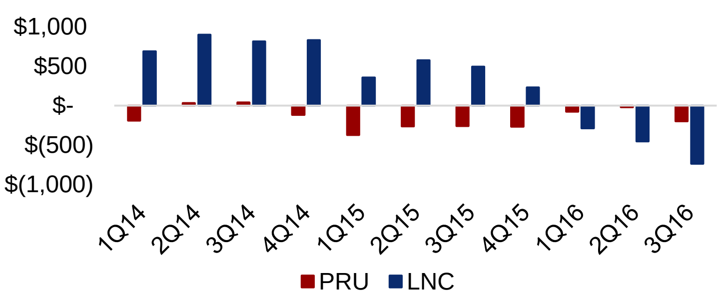
The BI US Life & Health Insurance Index returned 23.2% this year, above the 15.0% return of the Canadian BI Life & Health Insurance Index. The majority of the gains in both the US and the Canadian indices occurred after November 8th; Trump's victory resulted in a more optimistic outlook on the interest rate environment as well as decreased certainty that the DOL's Fiduciary Rule would be implemented.

Figure 13: Life & Health 2016 US and Canada Indices Performance



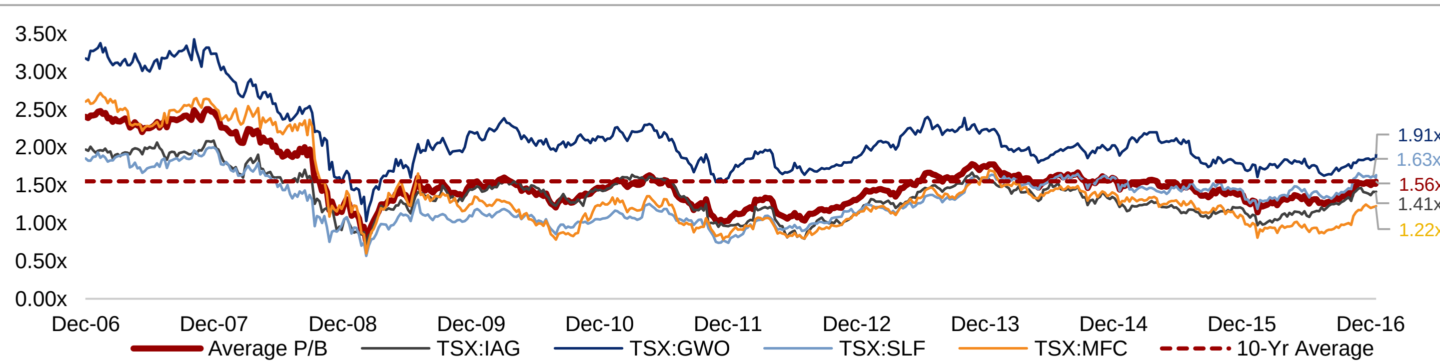
The announcement of the DOL's Fiduciary Rule weighed on the life and health insurance subsector throughout the year as investors priced in an expected decline in variable annuity ("VA") sales. Also putting pressure on VA growth have been sizable net negative flows for the majority of major VA writers, due to an increasing number of withdrawals and surrenders along with relatively constant sales. However, the market's outlook on VAs changed following President Trump's victory. Analysts are predicting that, at the very least, the April 2017 DOL compliance date could be pushed back, and that the revision, or elimination, of the fiduciary rule is now on the table.

Figure 14: VA Book Values ($ mm)



In our view, the rally at the end of 2016 brought market valuations closer to intrinsic valuations. Price-to-book multiple levels for the Canadian and US Life & Health Insurance indices ended the year at 1.35x and 0.93x respectively (14.5% and 12.2% higher than pre-election levels) which is near 10-year historical averages.

Figure 15: Canadian Insurers P/BV Multiples vs. 10-Year Average

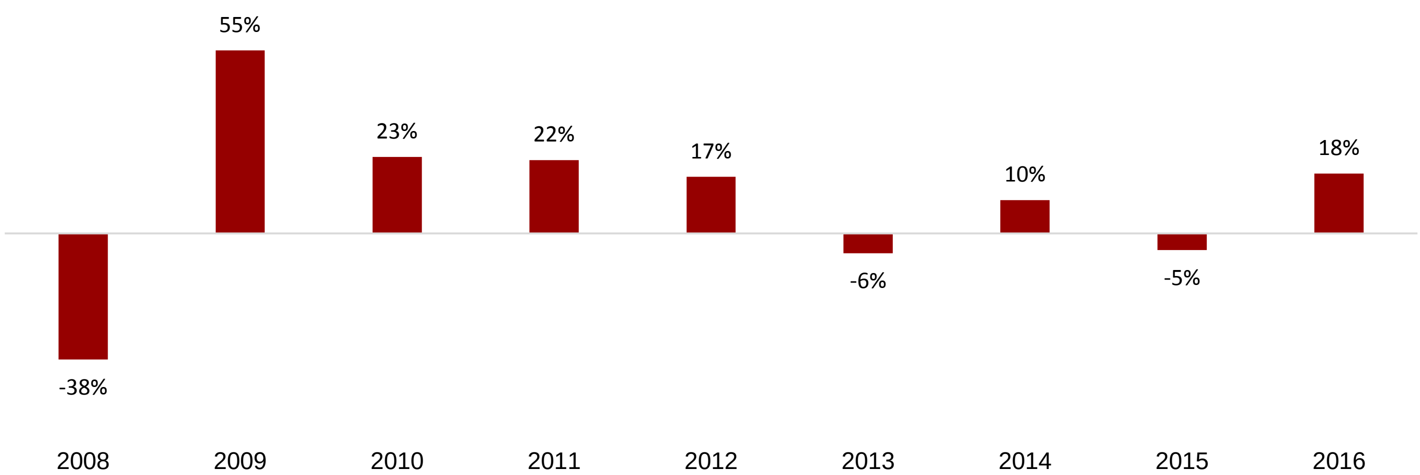


Sources: Bloomberg, RBC Capital Markets, Capital IQ

Canadian REITs

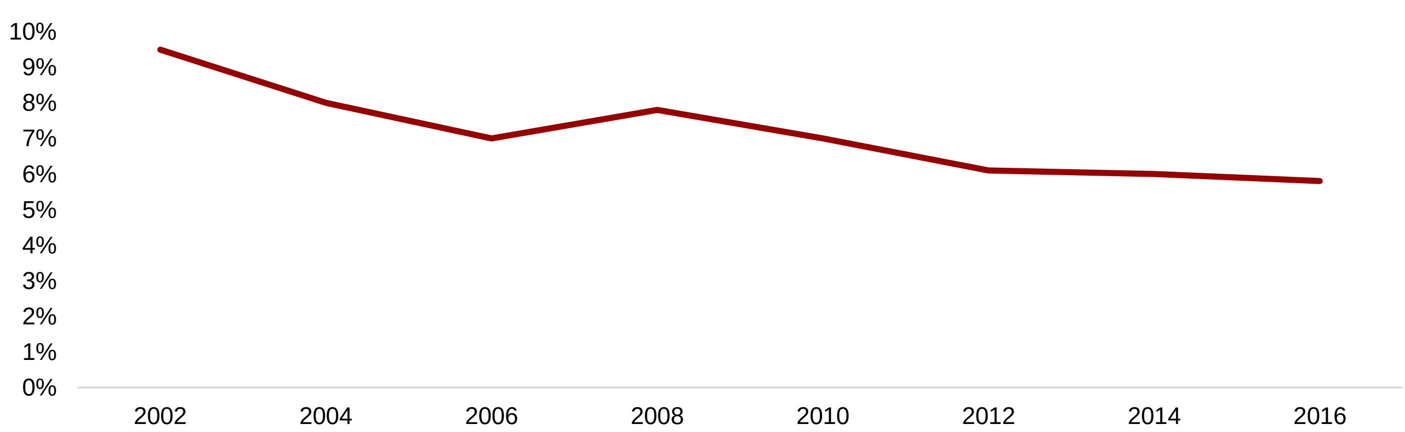
The S&P/TSX Capped REIT Index generated healthy returns of 18% in 2016, slightly lagging behind the S&P/TSX Composite. There were four major factors impacting REIT valuations in 2016. The creation of real estate as its own sector, persistently low GoC yields, continued REIT discounts to NAV and challenging fundamentals, particularly in the Alberta market.

Figure 16: Canadian REIT YoY Return



A large portion of REIT profitability in 2016 came from the compression of cap rates to 15 year lows contributing to higher property valuations. While this reduction in cap rate could be seen as only temporary, and likely to revert to long term averages, we, at DCM, find it important to look at the spread of cap rates over the 10-year GoC bond yield. Though cap rates are at historical lows in the Canadian real estate market, these assets still provide an attractive spread of 486 bps above the 10-yr yield (compared to the 389 bps historical average spread). Given this fact, we see substantial protection of the low cap rates even in a rising rate environment.

Figure 17: National Average Canadian Cap Rate



Sources: Bloomberg, CBRE

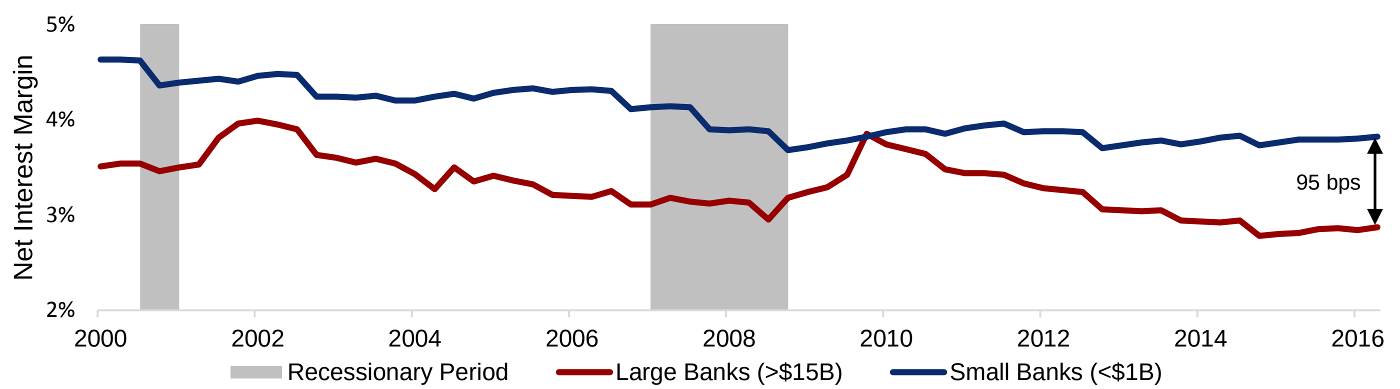
U.S. Banking

Despite a strong rally in the tail end of 2016, we continue to remain bullish on U.S. banks heading into 2017 for three main reasons. First, interest rates are set to increase in the coming years; banks should reap the benefits of a strong net interest margin (NIM) in a rising rate environment, leading to increased profitability. Second, stronger economic growth and lower corporate tax rates should accelerate lending activity. Third, president Trump's pledge to repeal the Dodd-Frank legislation, in addition to other bank regulations, should have a positive impact on banks going forward. We remain cognizant of the various risks associated with our optimistic outlook; Further analysis on the main elements are presented below.

Rising Interest Rates and Net Interest Margins (NIMs)

Heading into 2017, all U.S. banks should benefit from higher rates as they will see NIM expansion. However, we believe that larger U.S. banks will benefit more from fiscal tightening than smaller banks, mainly due to the fact that they traditionally pay less on deposits (when rates are away from the zero boundary). Following the financial crisis, smaller banks have been able to maintain stronger net interest margins than their larger ones, with spreads widening to a 5 year high of 95 bps (Figure 18). With an expansionary monetary policy in place, smaller banks were able to largely reduce their interest paid on deposits (liabilities) and were better positioned to cushion the decline in their interest income. Since larger banks were unwilling to charge their clients negative deposit rates, they were therefore unable to benefit from the lower interest rate environment relative to small banks.

Figure 18: Large vs. Small Banks Net Interest Margins



As we transition into a monetary tightening cycle with 2-3 rate hikes projected for both 2017 and 2018, U.S. banks are well positioned to increase their profitability. The rates that banks pay on deposits will rise more slowly than rates received on their loans, leading to NIM expansion.

It is also important to note that a rise in long-term interest rates would result in a decline in the value of the banks' available-for-sale securities via mark-to-market losses, resulting in weaker accumulated other comprehensive income (AOCI) and capital ratios. A rise in long-term yields could put downward pressure on other comprehensive income, and limit the financial pliability that these firms currently possess. Therefore, we may see a temporary slowdown in M&A activity, share buybacks, and dividend increases in the banking sector.

Figure 19: Accumulated Other Comprehensive Income to Common Equity (as of 9/30/16)

Company	Assets ('000s)	Common Equity ('000s)	AOCI ('000s)	AOCI/Equity
JPMorgan Chase & Co.	2,521,029	228,263	1,474	0.60%
Bank of America	2,195,314	244,863	(1,701)	-0.70%
Wells Fargo & Company	1,942,124	179,916	2,184	1.20%
Citigroup Inc.	1,818,117	212,322	(27,193)	-12.80%

Lending Activity

American banks' lending activity should improve under the Trump administration. With a planned increase in government spending on infrastructure and decrease in corporate taxes, banks should see a significant boost to overall profitability levels. As seen in figure 20, U.S. banks are expecting to see stronger growth in the latter half of 2017 and throughout 2018. This growth is largely driven by improvement in the commercial real estate, industrial, and consumer space. Combined with an increase in interest rates, lending activity growth will likely be the main driver of banks' increased profitability in the coming years.

Figure 20: U.S. Bank Loan Growth

Company	Average Loan Growth	
	'17	'18
BAC	3.2%	5.3%
BBT	4.4%	5.0%
C	5.8%	6.4%
FITB	2.0%	5.8%
PNC	3.0%	4.0%
RF	3.2%	6.5%
STI	5.0%	6.2%
WFC	4.8%	7.0%
Average	**3.9%**	**5.8%**

Regulatory Environment

Heading into 2017, financial regulation has been top-of-mind for investors in the U.S. banking sector. Trump's comments on the repeal of Dodd-Frank have created optimism around financial deregulation. While it is not likely that the entire legislation will be revised, any form of a repeal would serve as a positive for banks across the country. However, most changes are focused on benefiting smaller banks rather than G-SIB banks. Some of the promised amendments could be accomplished through bills that have already been proposed over the past year, which are further explained below:

Jeb Hensarling's bill, the Financial CHOICE Act (FCA), proposed that if a bank has an average leverage ratio above 10% over the past four quarters, they would be exempt from all Basel III regulatory capital and liquidity requirements, and restrictions on capital distributions. In addition, the bill would seek to repeal the Volcker Rule, a federal regulation that prohibits banks from conducting certain investment activities with their own accounts and limits their ownership of and relationship with covered funds.

Richard Shelby's bill, the Financial Regulatory Improvement Act, proposed that the Financial Stability Oversight Council's (FSOC) "systemically important" assets demarcation be raised to $500 billion from $50 billion, the exemption of small banks from the Volcker rule, and increased transparency on FSOC activities.

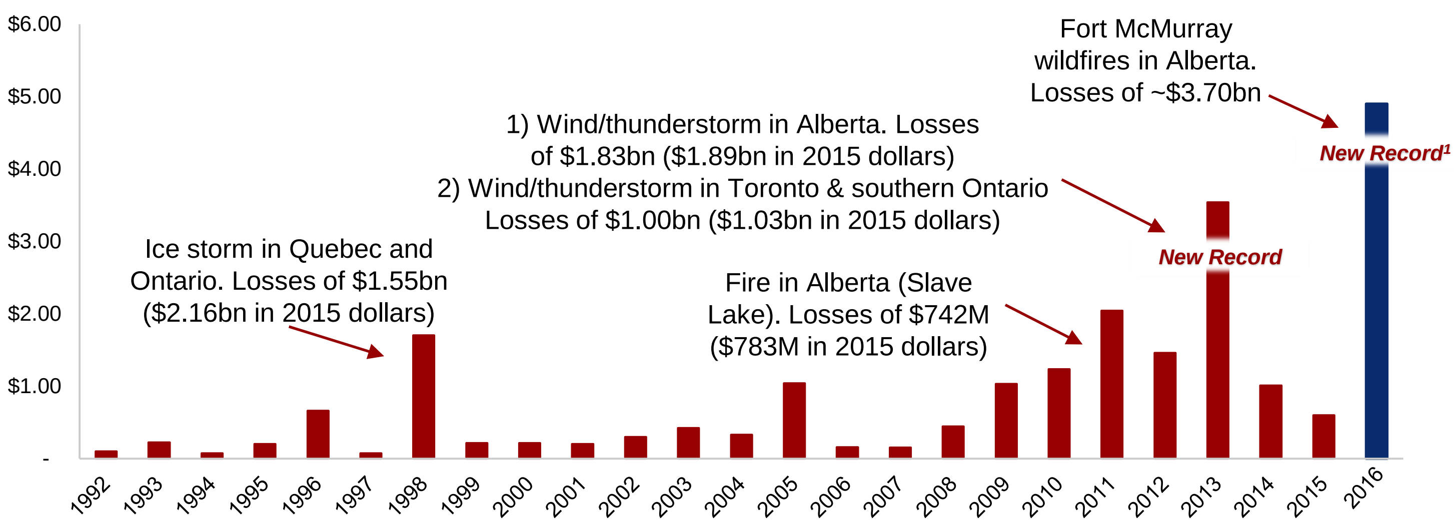
Both aforementioned bills are potential segways into a less stringent regulation environment under the Trump administration, and any implementation will likely propel banks' profitability.

P&C Insurance

As we look ahead, we see a variety of mixed trends affecting the US and Canadian P&C Insurance sector.

In terms of pricing, we do not anticipate further notable declines in P&C rates, largely because many carriers will have limited appetite for further price reductions as their ROEs continue to approach their costs of capital. Also, sizable catastrophe losses in H1 2016 may provide a pricing floor going forward, particularly in the reinsurance subsector. In Canada, insured losses reached an estimated record high of C$4.9 bn according to the Insurance Bureau of Canada, 8.2x higher than the industry's 2015 insured losses figure, largely driven by loss expenses incurred as a result of the Fort McMurray wildfires. Globally, loss and LAE expenses resulting from catastrophe/disaster events are estimated to total $49 bn, 1.3x above that of 2015. The continuation of this loss trend would serve as a catalyst for the recovery of P&C prices, both in direct insurance and reinsurance markets.

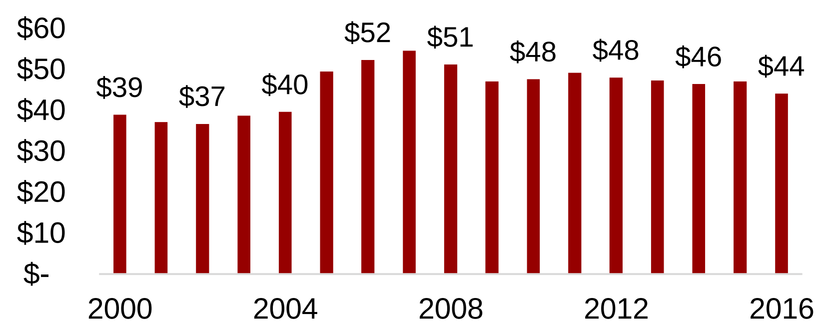
Figure 21: Loss Plus Loss Adjustment Expense for Canadian P&C Carriers (in C$ bn)



Expected Impact of Rising Interest Rates on P&C Performance

We expect that the December 2016 rate hike will serve as the beginning of a gradual recovery period in investment income in the P&C insurance industry. Most carriers' had proactively reduced the duration of their portfolios in anticipation of a rate hike, positioning them to maximize the benefits of the changing interest rate environment through investment income growth. It is important to note that future expectations of higher rates could motivate investors to move capital out of the P&C industry and into securities with a higher beta to interest rates such as lifecos and banks.

Figure 22: P&C US Industry Investment Income ($ bn)



[1] DCM estimate based on Insurance Bureau of Canada's 2016 insured damage estimate as of 2017-01-06.
Sources: IBC Facts 2016, Street research

Life and Health Insurance

As we look ahead to 2017, we will be keeping a keen eye on long-term yields as well as M&A activity, as we expect these to be key drivers of the sub-sector's performance this coming year.

Figure 23: 10-Year Treasury Yields

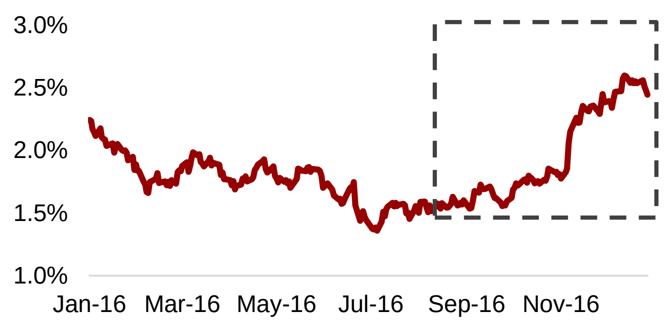
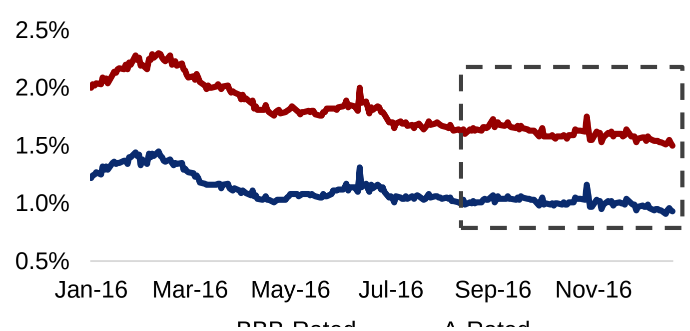


Figure 24: Credit Spreads



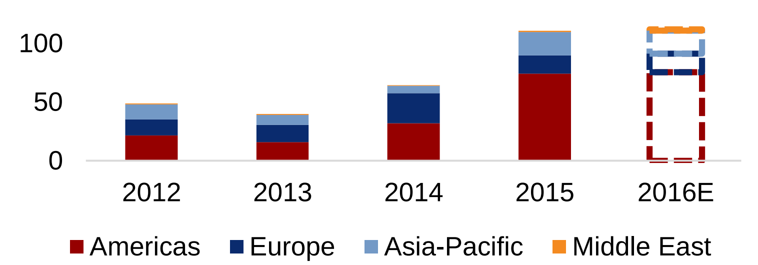
Impact of Changing Interest Rate Environment on the Life & Health Insurance Sector

The favorable interest rate environment anticipated by investors has translated into share price appreciation for life insurance carriers through two main factors. The first, and most obvious, is through the increased investment earnings that are expected to result (assuming rates continue to rise) as insurers reinvest maturing securities into assets with greater yields. The second factor is that a higher interest rate environment decreases the likelihood that life insurance carriers would have to increase statutory reserves, which would in turn decrease the amount of capital insurance carriers could return to shareholders. (Note that most life insurers get an additional kick out of a rise in interest rates due to the long-term nature of their liabilities; the magnitude of this 'additional kick' is dependent on the extent to which the duration of their long-term liabilities exceeds the duration of their assets). We are critical about the first factor and question the degree to which the December rate hike warrants the observed market reaction.

Expected M&A Activity in the Global Life and Health Insurance Sector

M&A activity in the global insurance industry reached record highs in 2015, with total deal value of $111 bn. Since then, transaction levels in the life insurance sector have remained relatively constant. With low levels of investment income hurting profitability, many life insurance carriers sought to improve margins via merger synergies. Looking into 2017, we expect another relatively eventful year of M&A activity, particularly in the US and European markets. While European Solvency II regulations came into play at the beginning of 2016 we anticipate that the majority of the associated benefits will be recognized in 2017, as life insurers have now had time to optimize their portfolios ahead of the divestment of their legacy policies.

Figure 25: Global Insurance Deal Volume ($ bn)



Sources: Bloomberg, EY

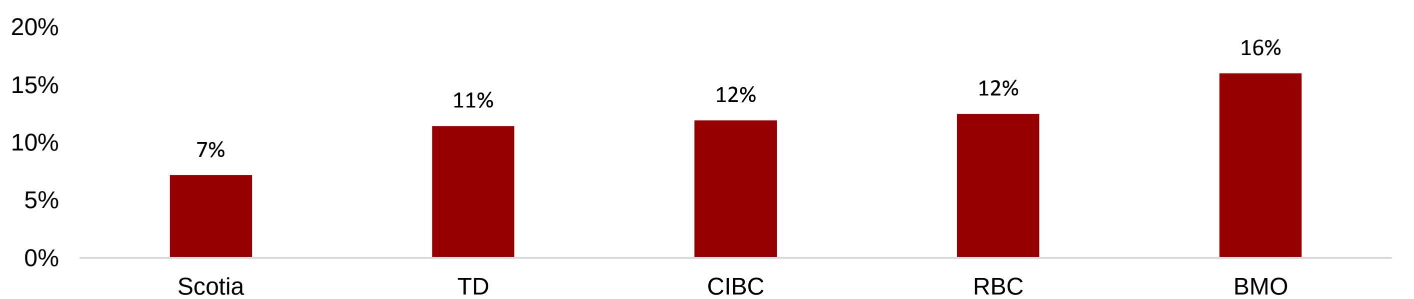
Canadian Banks

2016 marked significant gains for Canadian banks, begging the question: Can the outperformance continue into 2017? At the start of 2016, our outlook for the year was bleak. Oil prices were declining to new lows, economic growth was negligible, and interest rate outlook was flat- all factors of the unsteady ground supporting the Canadian banking industry at the time. Yet despite these headwinds, we saw strong performances amongst the Canadian banks throughout 2016. At DCM, we have identified four main drivers of Canadian bank earnings growth that we will actively monitor in the coming year.

International Exposure

The bulk of international risk facing Canadian banks materializes in the uncertainty surrounding the incoming Trump government. The Republican president brings prospects of higher interest rates, lower corporate tax rates, regulatory reform and improved economic outlook. With these bank tailwinds comes the fear of an increase in anti-trade policy and general caution with regards to Trump's first 100 days in office. Overall, we expect him to bode well for Canadian banks, and expect to see a continuation in the bank rally that followed the election.

Figure 26: Canadian Bank Performance Since US Election



Slowing Consumer Lending Growth

Consumer debt in Canada has grown modestly in 2016, but reached record levels creating reason for concern. We expect this increase in consumer debt to place downward pressure on consumer loan originations in 2017. While acting as a headwind to Canadian banks, we see this risk as no more pressing than it was in 2016.

Figure 27: Credit Market Debt to Disposable Income

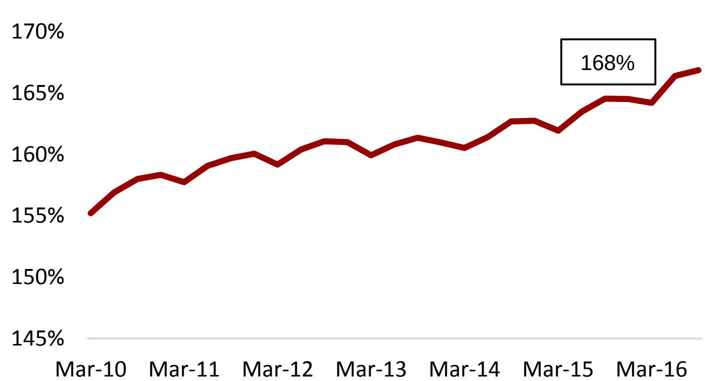
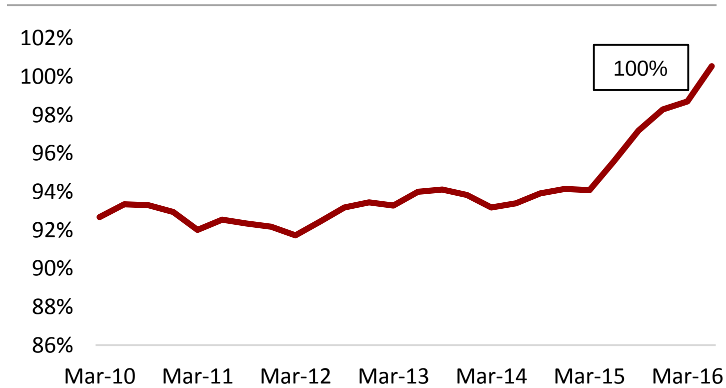


Figure 28: Household Debt to GDP

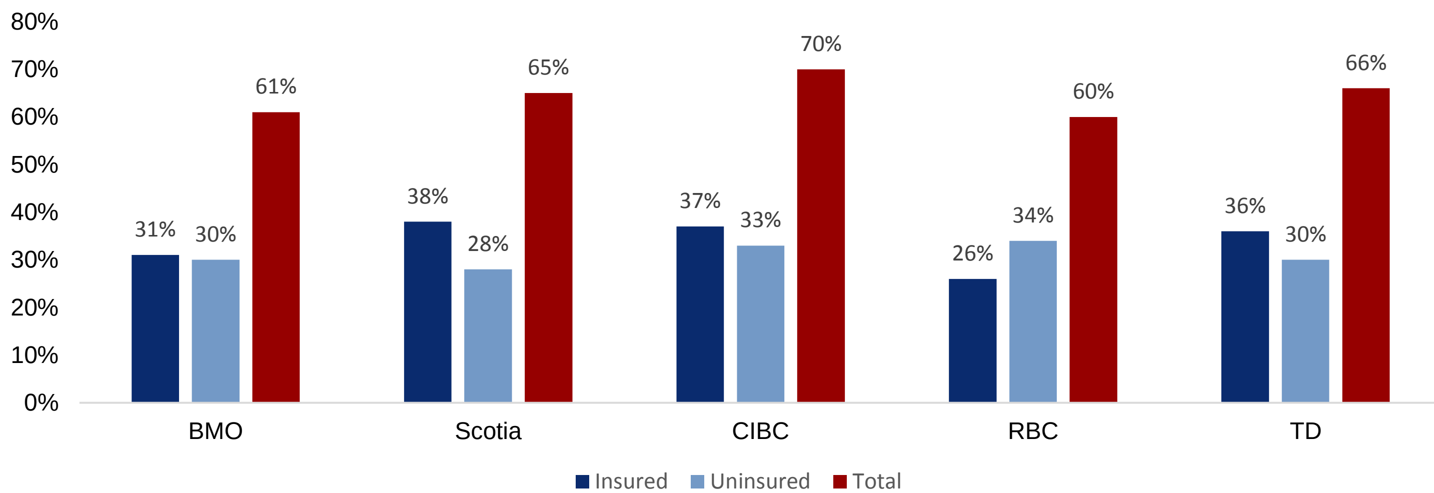


Sources: Bloomberg

Regulatory Risk

The major Canadian regulatory risk facing banks surrounds the recent changes applied to the housing market. In July, the BC government announced an extra 15% land transfer tax to be levied on residential real estate purchases by foreign nationals. This policy change was subsequently followed by three mortgage issuance rule changes. All insured mortgages must now be stress-tested, the government will be more stringent on when it will provide mortgage insurance, and the government will be looking to offload more mortgage risk onto the lenders in coming years. These changes will likely result in slower growth of mortgage originations going forward, as banks will be limited in the value of their new insured mortgages. We see this risk as affecting primarily Ontario and BC housing, as these markets have the highest proportion of homes over $1 million. Mortgage focused companies will be hardest hit, given that they are lacking the sizeable balance sheets necessary to mitigate the risk of the mortgages. It is likely that the increase in mortgage regulation will only negligibly hamper the profitability of Canadian banks in 2017.

Figure 29: Canadian Bank Mortgage Exposure in British Columbia and Ontario



Fintech

Recently considered a major potential disrupter of Canadian banks, at DCM, we view the future of fintech with optimism. With the five major Canadian banks all spending in excess of $1 billion on technology, and half of that gene`rally earmarked towards innovating new ways of banking, we see the Canadian banks as the eventual champions of the fintech industry in Canada. Despite original fears of upstart tech firms replicating traditional banking business lines in a digital format, we believe that these ventures can and will be matched by the Big 5. We look forward to seeing significant cost reductions on the back of efficiency gains due to technology, and expect to only see minor revenue disruption. More importantly, we see the risk of cyber attacks and loss of financial information as the primary technology related risk for banks. We will continue to monitor this risk at DCM, and hope to see cautious and well targeted IT spending coming from the Canadian banks in 2017.

Sources: Bloomberg

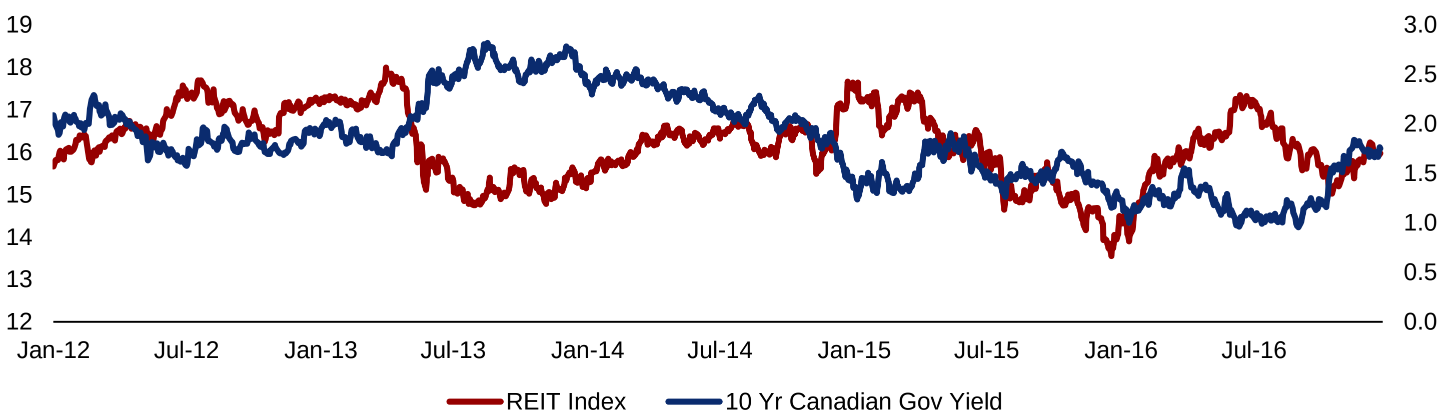
Canadian REITs

We see four key themes impacting the Canadian Real Estate market in 2017. Inflation and interest rates, vacancy, geographic concentration and other sector fundamentals will be important to monitor in 2017.

Inflation and Rising Rates

In any rising rate environment such as the one we are in now, investors typically question real estate's viability as an alternative asset class. Rising interest rates typically lead to higher cap rates, reducing the value of properties and the attractiveness of REIT's high yields. At DCM, however, the appeal of real estate as a hedge against inflation more than offsets the fear of rate hikes. With economic strengthening comes higher rental rates and increased NOI- consequently, we view rate hike related selloffs as a strong opportunity to increase our real estate allocation, and hope to capitalize on the opportunity in the coming year.

Figure 30: REIT Performance vs. Government Yield



Sector Fundamentals

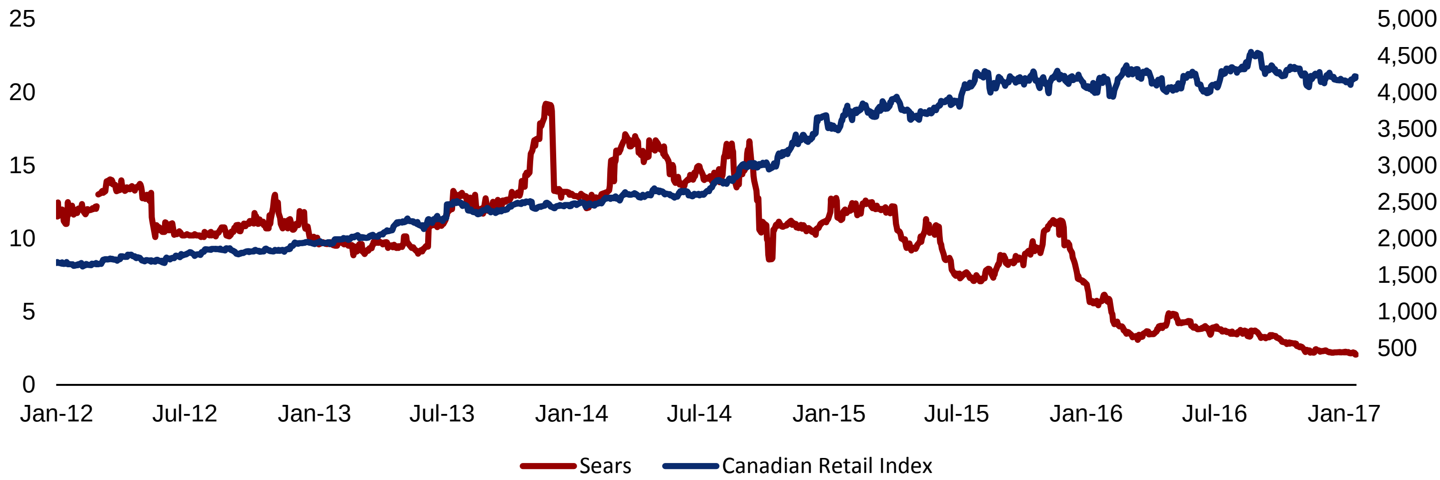
Given the abundance of office vacancy in Canada, we remain cautious in our outlook for office REITs. With Class A office vacancy under 5%, DCM favors REITs focused on higher asset quality investments. Even as construction has fallen from 4% of inventory in 2015 to 2.3% in 2016, we continue to see possibility for further increases in vacancy, notably in Calgary, where persistently low oil prices could contribute another 10% of vacancy in 2017.

Retail Real Estate

Following the collapse of Target Canada, Canadian Retail REITs suffered under the pressure of 21 million square feet of vacant real estate. Over the subsequent lease-up period, we saw the best performance coming from REITs with well located, high quality assets. In 2017, we at DCM see a challenging environment for retail REITs. While vacancy still remains from the failure of Target, well positioned REITs have managed to backfill empty space and stabilize property NOIs. As we learnt throughout the bankruptcy process with Target, with challenging times comes opportunity for superior operators to differentiate themselves. We at DCM see potential to invest in a beat up retail REIT market in 2017 and invest in those best operators undervalued due to market difficulties. We plan on closely monitoring the retail REIT market for attractive buying opportunities.

Sources: Bloomberg, ICSC 2016

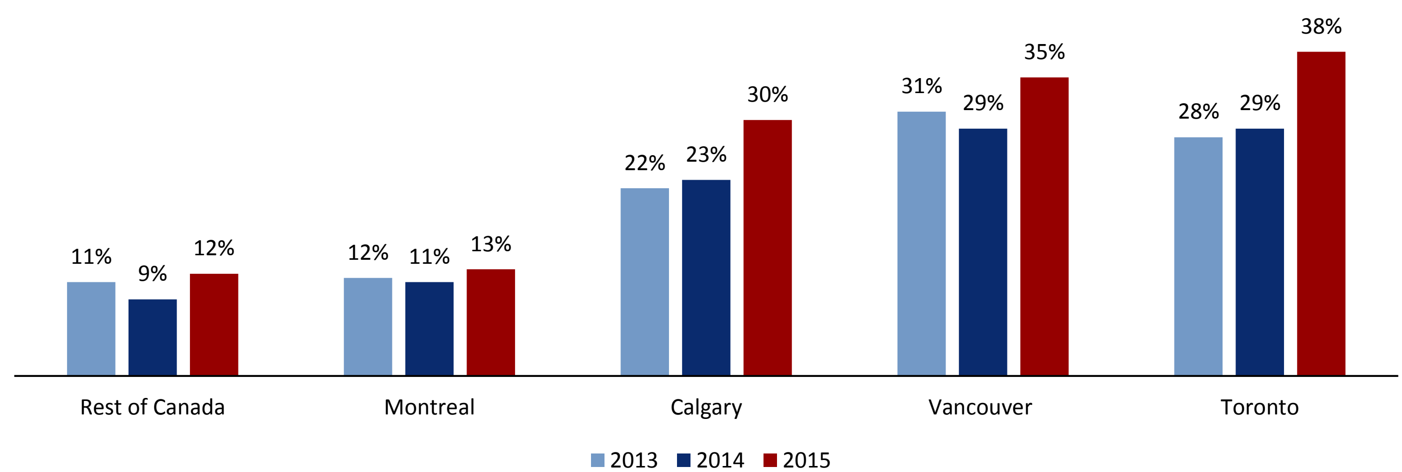
Figure 31: Sears Canada 5-year Performance



Residential Real Estate

Following a year marked by a substantial increase in Canada's mortgage loan to income ratio, increased regulation in the home mortgage industry will likely result in difficult market fundamentals in the residential space. Prior to the new regulation, modest income families could obtain large loans, allowing them to make expensive home purchases. More stringent stress tests will drastically diminish the size of household mortgages, and will likely act as a drag on home sales in the coming year.

Figure 32: Percentage of Mortgages with Loan-to-Income Ratios Greater Than 450%



Sources: Bloomberg, ICSC 2016

Financials Sector

Holdings Review

Industrial Alliance Group (TSX: IAG)

Company Overview

- Industrial Alliance is an insurance and financial services provider headquartered in Quebec City, Canada. It is the 4th largest life insurance provider in the country
- The company operates through four main segments: individual insurance, individual wealth management, group insurance, and group savings and retirement
- In recent years, Industrial Alliance has been expanding its business outside of traditional life insurance into other financial services, with several notable acquisitions in the wealth management subsector

Catalysts

- The acquisition of HollisWealth would boost wealth management earnings, compensating for the loss of the Laurentian Bank distribution channel in 2014
- Replacement of IFRS 4 will put forward the conservatism of Canadian accounting standards for Lifecos versus their U.S. counterparts

Risks

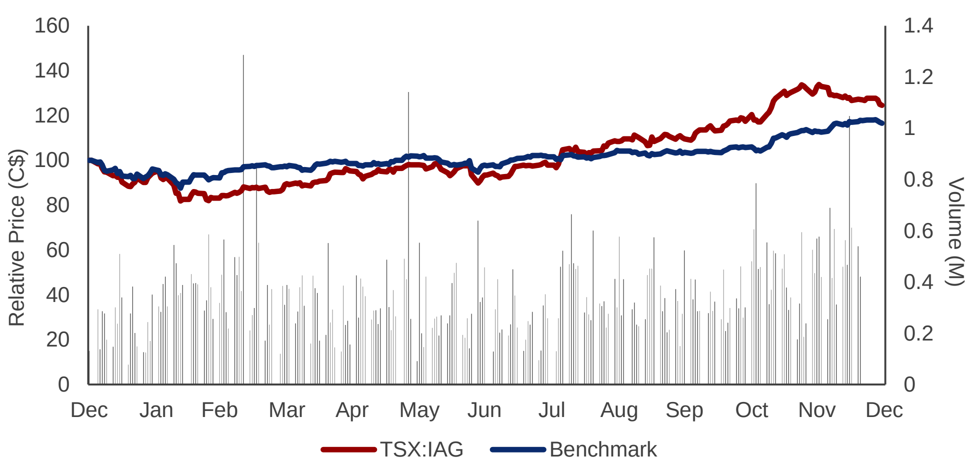
- High sensitivity to interest rates: if interest rates were to decline by 10 bps, IAG's net income would decline by $96 million
- Prolonged net outflows in mutual funds could permanently alter market sentiment of Industrial Alliance's wealth management business

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$53.39
S/O (M)	105.7
Market Cap.	**$5,642.3**
+ Total Debt	$2,406
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$1,253
Enterprise Value	**$6,795.3**
Beta (1-Year)	1.09
Dividend Yield	2.3%
52-Week High	$57.39
52-Week Low	$35.11

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$11,023	$11,726	n.a.
% Growth		*6%*	-
EPS	$3.75	$4.88	$5.24
% Growth		*30%*	*7%*
Return on Equity	9.4%	11.9%	11.9%
% Growth		*26%*	*-1%*
P/E	*14.8x*	*11.3x*	*10.5x*
P/B	*1.4x*	*1.2x*	*1.1x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$40.01*
# of Shares	*2,912*
Value Invested	*$155,472*
Portfolio Weight	*6.11%*
2016 HPR	*24.5%*
HP Benchmark Return	*16.5%*
Excess Return	*8.0%*

Benchmark: 40% U.S. Financials index (IYF), 60% S&P/TSX Capped Financials Index (XFN).
Sources: Company filings, Capital IQ as of 12/31/2016.

Industrial Alliance Group (TSX: IAG)

Investment Thesis

1. **Industrial Alliance's stronger business fundamentals are not reflected in valuation multiples**
   - Despite leading Canadian life insurers on ROE, Industrial Alliance remains discounted on a P/B basis. Moreover, Industrial Alliance has a more conservative business model, holding more investment grade bonds and conservative assets than any other Canadian life insurer
2. **Well positioned to continue its successful wealth management growth strategy**
   - We believe that the market continues to discount part of their wealth management business due to sustained net outflows in mutual funds since losing Laurentian Bank as one of their mutual fund distributors following the expiration of their ten-year contract. We believe, however, that Industrial Alliance is on path to return to net inflows in 2017 as organic and inorganic growth continues
3. **What is the market missing? Canadian accounting policies**
   - Despite stronger business fundamentals, Canadian lifecos trade roughly in-line with their U.S. counterparts. In our view, the market is not properly incorporating the difference in accounting standards between the two countries. Under IFRS, Canadian life insurers are required to change their reserves set aside each quarter, whereas under U.S. GAAP life insurers are not required to do so each quarter. Given the prevailing low interest rate environment, Canadian Lifecos display large reserves whereas U.S. Lifecos are not held to the same standard due to these differences in accounting policies. We expect that Canadian Lifecos will benefit from a multiple expansion once accounting standards between the two countries converge, or in other words, once the U.S. life insurers adopt of IFRS in 2018

Analysis of Performance

After initiating our position in early October 2015 at an average price of $40.01, Industrial Alliance's share price rose to $53.39 by 2016 year end, representing a price appreciation of 31%. The positive share price performance was due to strong and improving operating fundamentals in addition to multiple expansion on an improved outlook. On the operating side, Industrial Alliance has been growing both its underwriting income as well as its investment income. In Q3 2016, net premiums up 20% and interest income was up 5% year-over year. Over the course of 2016, net performance in mutual funds has also been steadily improving, representing the fulfilment of one of our initial investment theses – our analysis initially indicated that the market had overreacted to the loss of Laurentian Bank as their mutual fund dealer. Similar to FY2015, a strong Q3 earnings report and positive investor sentiment following several strategic acquisitions contributed to the narrowing the valuation gap with its peers. The Q3 earnings report indicated that Industrial Alliance now leads Canadian lifecos on return on equity, a key value driver in the industry

Valuation Summary

	Market Cap	1-Year	P/B	P/E		ROE		MCCSR
Name	*C$ millions*	**Beta**	*Q3 2016*	*LTM*	*FY2017*	*LTM*	*Q3 2016*	*Q3 2016*
Great-West Lifeco Inc.	$34,680	0.7	1.9x	13.5x	12.3x	11.6%	13.8%	227.0%
Sun Life Financial Inc.	$31,593	0.7	1.6x	14.2x	13.0x	11.2%	13.4%	221.0%
Manulife Financial Corporation	$47,179	1.6	1.2x	16.5x	11.7x	7.6%	11.1%	234.0%
Industrial Alliance	$5,642	1.1	1.4x	14.8x	11.3x	9.4%	14.7%	218.0%
Average	$29,774	1.0	1.5x	14.7x	12.1x	9.9%	13.3%	225.0%
Median	$33,136	0.9	1.5x	14.5x	12.0x	10.3%	13.6%	224.0%
Industrial Alliance	$5,642	1.1	1.4x	14.8x	11.3x	9.4%	14.7%	218.0%
Premium / (Discount) to Average			*(8.3%)*	*0.2%*	*(6.5%)*			

Sources: Company filings, Capital IQ as of 12/31/2016.

West End Indiana Bancshares, Inc. (OTCMKTS: WEIN)

Company Overview

- West End Bank, S.B. is an Indiana-chartered savings bank founded in 1894 and headquartered in Richmond, Indiana
- West End Indiana Bancshares, Inc. ("West End") was incorporated in June 2011 for the purpose of becoming the savings and loan holding company for West End Bank
- The company provides traditional banking and lending services to individuals, families, and businesses in Indiana. West End recently added online banking services. The bank invests deposits primarily in real estate loans, automobile loans, construction loans and commercial business loans

Catalysts

- West End represents a strong acquisition target, as banks in the Midwest region have seen a lot of M&A activity in recent years
- Since going public, West End has not received any analyst coverage; an increase in exposure could lead to an appreciation in their share price

Risks

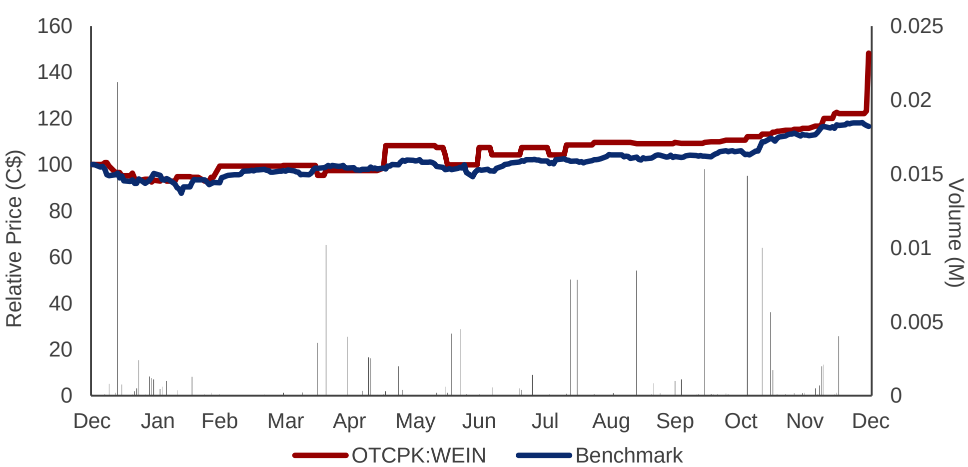
- Given that West End operates in small towns within a limited geographic region, deteriorating economic conditions could pose a serious threat to West End's loans portfolio
- If more banks were to open in these towns, resulting in increasing competitive pressure, West End could experience a net outflow in deposits

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$34.00
S/O (M)	1.1
Market Cap.	**$36.2**
+ Total Debt	$32
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$10
Enterprise Value	**$58.0**
Beta (1-Year)	-0.05
Dividend Yield	0.8%
52-Week High	$34.00
52-Week Low	$21.19

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$12	n.a.	n.a.
% Growth		-	-
EPS	$1.91	n.a.	n.a.
% Growth		-	-
Return on Equity	*6.8%*	n.a.	n.a.
% Growth		-	-
P/E	*17.8x*	n.a.	n.a.
P/B	*1.1x*	n.a.	n.a.

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$31.02*
# of Shares	*1,900*
Value Invested	*$64,600*
Portfolio Weight	*2.54%*
2016 HPR	*48.3%*
HP Benchmark Return	*16.5%*
Excess Return	*31.7%*

Benchmark: 40% U.S. Financials index (IYF), 60% S&P/TSX Capped Financials Index (XFN). Source: Capital IQ as of 12/31/2016.

West End Indiana Bancshares, Inc. (OTCMKTS: WEIN)

Investment Thesis

1. **Significant Improvement in Operating Metrics Driven By Strong Management**
   - Since 2012, West End has continued to improve their margins, operational efficiency, and return to shareholders. More recently, West End has also experienced higher levels of net interest income and greater return on assets and equity this year
   - Despite higher provision for loan losses in Q3 2016, portfolio quality remains high as shown by other key metrics – current nonperforming loans and provision for loan losses as a percentage of interest income remain within historical levels; loan quality is not showing signs of deterioration. We believe that West End continues to have strong business fundamentals and is well positioned for further growth
2. **Ideal Acquisition Target With Strong Precedent For M&A**
   - Since 1993, approximately 62% of companies that converged to full stock ownership after demutualizing have been acquired by or merged with other institutions
   - The average P/B multiple of an acquisition target possessing the same qualifications of WEIN ranges from 1.1x - 1.3x, and West End currently trades within this range
3. **Current Valuation Remain Attractive Relative to Peers**
   - Company is cheap on a P/BV and P/E basis compared to peers in all size and geographic segments
   - Continued improvement in operating performance will make valuation multiples converge with those of peers with higher returns on equity

Analysis of Performance

West End realized strong market performance since DCM initiated a position just over a year ago. Our position is up 44%, with a double digit gain occurring in December 2016 after a small number of trades moved the price up significantly. While the Company's shares are subject to limited trading volume, West End's share price has been moving up as the macro outlook for small U.S. banks has improved. Despite the large price appreciation this past year, we remain confident in West End's ability to generate strong returns heading into 2017. While we do believe there is a high probability that the second point of our thesis – a potential acquisition by a larger competitor – may materialize over the course of the next few years, we remain satisfied in holding the business given their strong fundamentals alone.

Valuation Summary

US Banks	Market Cap	Assets	Net Income	Div Yield	LTM Ratios		Valuation Multiples	
In $ millions					ROE	ROA	P/E	P/B
Large Cap Average	$2,661	$9,462	$107.8	1.2%	10.0%	1.2%	20.4 x	2.2 x
Mid Cap Average	$1,184	$5,027	$43.6	1.2%	7.2%	0.7%	26.9 x	1.8 x
Small Cap Average	$504	$2,877	$19.7	0.8%	7.5%	0.8%	25.5 x	1.7 x
Average	$1,450	$5,789	$57.1	1.1%	8.2%	0.9%	24.3 x	1.9 x
West End Indiana Bancshares	**$36**	**$286**	**$2.0**	**0.8%**	**6.8%**	**0.7%**	**17.8 x**	**1.1 x**
Premium / (Discount) to Mean							*(26.5%)*	*(40.7%)*

Sources: Company filings, Capital IQ as of 12/31/2016.

Dream Office REIT (TSE: D.UN)

Company Overview

- Dream Office is Canada's largest pure-play office REIT
- The company owns 20.8 million square feet of office properties geographically focused in central business districts and suburban office areas
- Dream has 3 asset tiers: Core assets ($2.6bn), Private Market ($1.9bn) and Value Add ($1.0bn)
- Dream has been working towards a Strategic Plan, announced in Q1-16, which involves disposing of $1.2 billion of their Private Market Assets. The goal of the plan is to create a smaller REIT focused on their Core & Value-Add assets

Catalysts

- Continued progress towards achieving the goal of their Strategic Plan announced earlier this year
- Oil price recovery and faster than expected economic recovery in Alberta

Risks

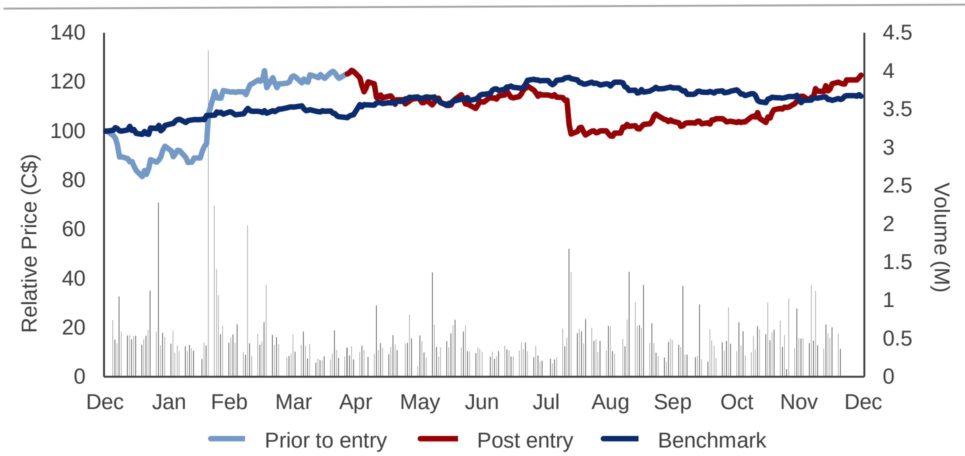
- Given Dream Office REIT's 100% concentration of assets in Canada, the company's lack of country-diversification exposes it to a weak Canadian economy
- Further decrease in market rent rates could be a result of the poor Canadian economy in addition to lower occupancy rates

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$19.55
S/O (M)	114.0
Market Cap.	**$2,228.0**
+ Total Debt	$2,857
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$14
Enterprise Value	**$5,071.2**
Beta (1-Year)	1.15
Dividend Yield	7.6%
52-Week High	$19.87
52-Week Low	$12.97

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$538	$694	$694
% Growth		*29%*	*0%*
EBITDA	$233	$342	$318
% Margin		*47%*	*-7%*
FFO	$290	$254	$229
% Growth		*-12%*	*-10%*
P/FFO	*7.7x*	*8.5x*	*9.2x*
P/AFFO	*8.4x*	*9.4x*	*10.1x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$20.98*
# of Shares	*5,400*
Value Invested	*$105,570*
Portfolio Weight	*4.15%*
2016 HPR	*-0.4%*
HP Benchmark Return	*5.9%*
Excess Return	*(6.3%)*

Dream Office REIT (TSE: D.UN)

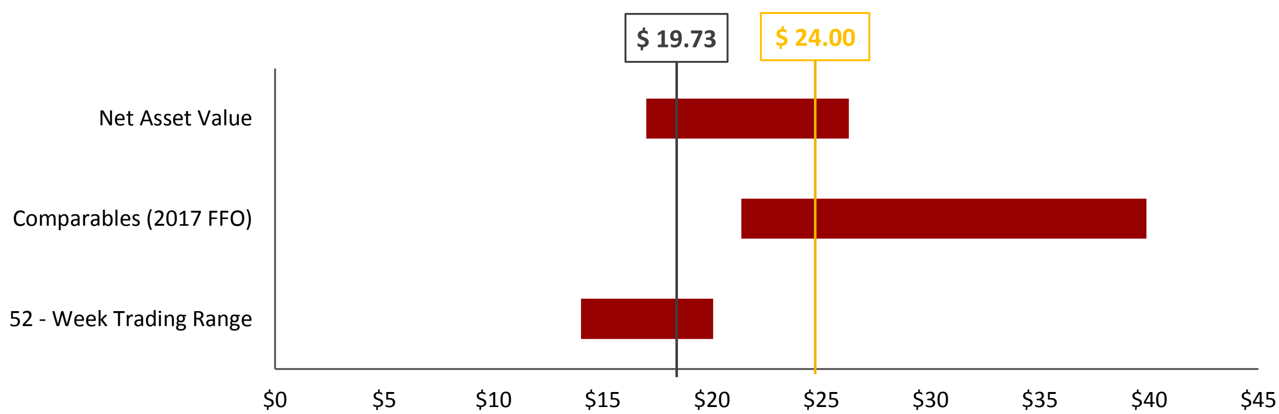
Investment Thesis

1. **Canadian macro environment presents REITs with attractive valuations:** Canadian REITs are trading at significant discounts to their net asset values given the market's negative sentiment on future outlook
   - Initially, DCM predicted that there would be increased demand for Canadian REITs in 2016 given the large divergence between REIT payout yields and 10-Year government yields. However, with the continued low price of oil taking a toll on the Canadian economy, this thesis has yet to materialize. Many Canadian REITs took large asset write-downs this year, mainly in Alberta, which made the companies less attractive to the market. DCM believes that the worst has passed and this thesis should begin to materialize in 2017
2. **Market's reaction to Dream's presence in Alberta is not warranted***:* With Dream's assets in Alberta being written down to essentially zero value, there is very limited downside for the Alberta portfolio going forward
   - As Dream continues to make progress with its Strategic Plan that focuses on core assets, their exposure to Alberta will continue to decline. Moreover, a large portion of Dream's Alberta assets are occupied by the provincial government and other fundamentally strong utility and telecom companies. As a result, this keeps occupancy levels relatively strong
3. **Attractive valuation compared to peers:** 8.9% dividend yield combined with 77% payout ratio provides safe and long term dividends
   - Limited downside, with "core" assets representing ~$14 value per share

Analysis of Performance

Demand for office properties in Canada, especially Alberta, is closely correlated with Canada's economic cycle and we saw this negatively impacted Dream in 2016. In the second quarter, the company announced they were writing down their assets in Alberta by $40 million, causing their share price to drop by ~16% in one day. Since then, the company has been focusing on the goals set out in their Strategic Plan. Of the $1.2 billion Private Market Asset disposition goal set to be achieved in 3 years, $478 million has been sold in just 3 quarters. Additionally, $330 million worth of assets are under contract or in stages of discussion, giving DCM great confidence that the Company will reach their goal. As Dream drives value through their Strategic Plan and focuses on creating a smaller, well diversified portfolio, we believe the company will be able to continue posting strong FFO growth through all stages of the economic cycle. Dream continues to trade at a discount to the NAV of their real estate portfolio and DCM believes that as the company focuses on moving towards a smaller high quality portfolio and invests in share buybacks, this gap will be reduced if not closed

Valuation Summary



Canadian Imperial Bank of Commerce (TSE: CM)

Company Overview

- CIBC is Canada's 5th largest bank in terms of assets and market capitalization
- The bank operates 1,100 branches in Canada, serving more than 11 million customers. It is also a leader in Retail and Business Banking, Wealth Management and Capital Markets
- CIBC has a strong capital position with the highest CET1 ratio of the Big 5 Canadian banks

Catalysts

- Expansion into the US could boost overall performance and diversify its macroeconomic exposure. The acquisition of PrivateBancorp would push CIBC one step further towards this expansion
- Continued recovery in the oil market would significantly reduce perceived risks of Canadian banks' oil-related loan portfolio

Risks

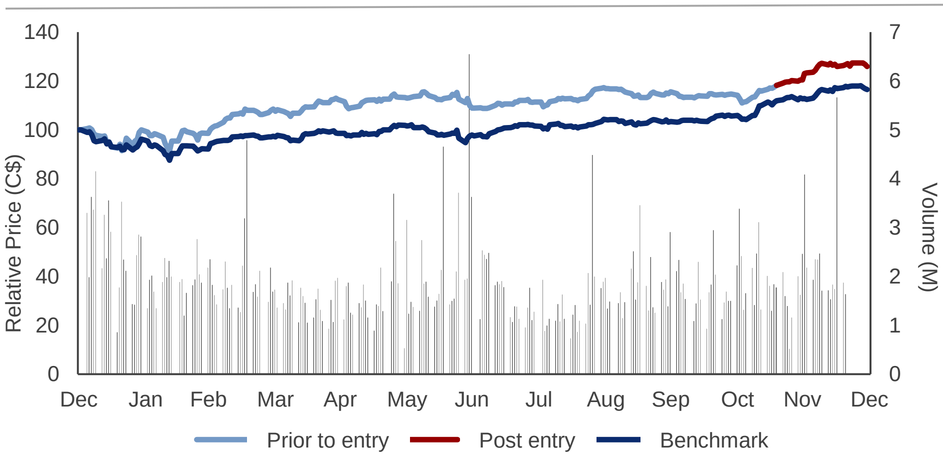
- PrivateBancorp shareholders requiring CIBC to sweeten its offer could add a roadblock in CIBC's expansion plans into the US
- Additional deterioration of the conditions in Alberta and overall the Canadian economy due to sustained low oil prices would hurt loan portfolio

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$109.56
S/O (M)	397.2
Market Cap.	**$43,519.4**
+ Total Debt	$97,871
+ Minority Interest	$201
+ Preferred Shares	$0
- Cash	$3,078
Enterprise Value	**$138,513.4**
Beta (1-Year)	1.01
Dividend Yield	4.5%
52-Week High	$110.86
52-Week Low	$79.51

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$13,985	$16,016	$17,046
% Growth		*15%*	*6%*
EPS	$10.70	$10.20	$10.66
% Growth		*-5%*	*5%*
ROE	*18.0%*	*17.0%*	*16.1%*
%Growth		*-6%*	*-5%*
P/B	*1.9x*	*1.7x*	*1.6x*
P/E	*10.2x*	*10.7x*	*10.3x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$104.02*
# of Shares	*1,350*
Value Invested	*$147,906*
Portfolio Weight	*5.81%*
2016 HPR	*6.5%*
HP Benchmark Return	*4.1%*
Excess Return	*2.3%*

Canadian Imperial Bank of Commerce (TSE: CM)

Investment Thesis

1. **Trading at an attractive valuation compared with other Canadian banks**
    - CIBC is trading at a significant discount in terms of P/E, despite stronger fundamentals and lower risk. The company is trading at a discount from its 2-year, 5-year, and 10-year historical P/B while the other Canadian banks trade in line with their historical averages. DCM believes the fundamentals of the company are being overlooked and CIBC should be trading at a higher multiple
2. **Relative to other Canadian banks, CIBC has favorable exposures to broader macroeconomic trends and factors**
    - Ability to withstand oil & gas shocks: CIBC has been actively taking steps towards reducing any risk associated with oil & gas exposure. Compared to the other Big 5 banks, CIBC has a low proportion of total uninsured residential mortgages in Alberta. CIBC's energy related gross impaired loans have improved and consequently the bank has had reductions in PCLs. We believe CIBC will continue to have lower PCLs than its peers, not as a result of less aggressive estimates, but as a result of the companies' focus on lending to financially stronger clients
    - US growth potential: CIBC is in the process of acquiring regional bank PrivateBancorp – a deal that has been put on hold after the recent U.S. election as the subsequent bank stock rally wiped out the premium CIBC was offering. Both CIBC and PrivateBancorp have said that they remain committed to the initial terms of the deal. This acquisition will be the beginning of their U.S. retail banking expansion and will diversify their exposure to the Canadian economy. Cash flow exposure to the U.S. could be key if the U.S. outperforms Canada
    - CET1 absorbing ability: CIBC has the highest CET1 ratio (11.3%) of the Big 5 banks giving it the ability to absorb more negative shocks coming from the Canadian economy

Analysis of Performance

Since DCM's initiation of this position in November, our position is up 7%, mainly due to the spillover from the rally in U.S. financial stocks that has taken place since the U.S. election. Another contributing factor is the strong Q4-16 earnings CIBC reported, mainly attributable to increased operating leverage, something that DCM believes CIBC will continue to improve as their restructuring changes materialize. Overall, 2016 was a good year for CIBC both in terms of business fundamentals and maintaining its conservative capital structure. As CIBC continues to navigate through a challenging Canadian economy, we expect the company to outperform its peers as it adjusts its strategy and acts to improve its operating efficiency and grows its business in the U.S.

Valuation Summary

Canadian Banks	Market Cap	Assets	Liabilities	Net Income	Div Yield	LTM Ratios		LTM Valuation Multiples	
						ROE	ROA	P/E	P/B
Royal Bank of Canada	$138,548	$1,180,258	$1,108,646	$10,405	3.6%	15.4%	0.9%	13.3x	2.2x
The Bank of Nova Scotia	$92,738	$896,266	$838,445	$7,117	3.9%	13.2%	0.8%	13.0x	1.8x
Bank of Montreal	$63,536	$687,935	$645,607	$4,622	3.6%	11.3%	0.7%	13.7x	1.6x
National Bank of Canada	$18,914	$232,206	$220,104	$1,181	4.0%	10.7%	0.6%	16.0x	1.9x
The Toronto-Dominion Bank	$123,734	$1,176,967	$1,102,753	$8,821	3.3%	12.7%	0.8%	14.0x	1.8x
Average	**$87,494**	**$834,726**	**$783,111**	**$6,429**	**3.7%**	**12.7%**	**0.8%**	**14.0x**	**1.9x**
Median	**$92,738**	**$896,266**	**$838,445**	**$7,117**	**3.6%**	**12.7%**	**0.8%**	**13.7x**	**1.8x**
Canadian Imperial Bank of	**$44,223**	**$501,357**	**$477,684**	**$4,275**	**4.5%**	**18.0%**	**0.9%**	**10.2x**	**1.9x**

Bank of America (NYSE: BAC)

Company Overview

- Bank of America is the 2nd largest U.S. bank by assets and 3rd largest by market capitalization
- The bank operates in 5 segments: Consumer & Business Banking, Consumer Real Estate Services, Global Banking, Global Markets and Global Wealth & Investment Management
- BAC serves ~46 million customers with 4,600 retail locations around the U.S.

Catalysts

- Continued share buyback and dividend increases
- Deregulation of the banking industry (Dodd Frank Act) and lower corporate taxes would boost earnings
- FED rate increases driving improvements in the Net interest margin

Risks

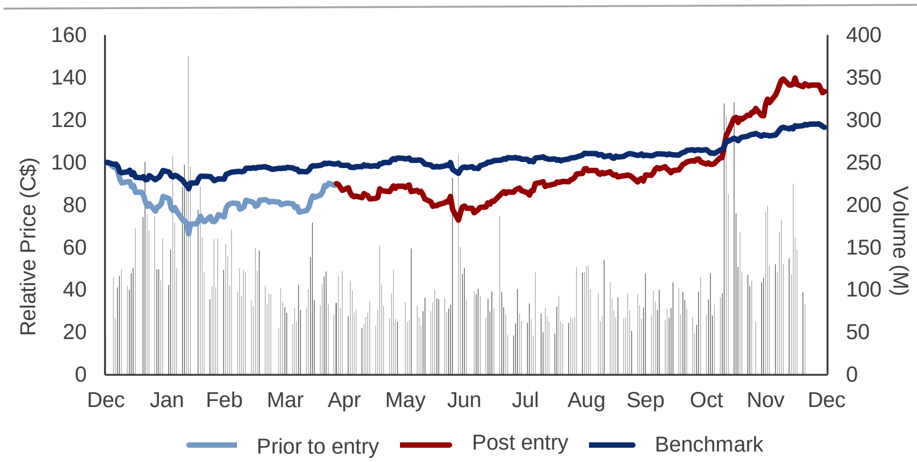
- A shift of the regulatory outlook for U.S. financial institutions could negatively impact market sentiment and reduce valuation multiples across the board
- A deterioration in the U.S. economic outlook could reduce the pace of rate hikes and thereby reduce market optimism about Bank of America

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$22.10
S/O (M)	10105.0
Market Cap.	**$223,321.5**
+ Total Debt	$450,538
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$345,962
Enterprise Value	**$327,897.5**
Beta (1-Year)	1.89
Dividend Yield	1.3%
52-Week High	$23.16
52-Week Low	$10.99

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$84,601	$88,433	$93,471
% Growth		*5%*	*6%*
EPS	$1.50	$1.73	$2.08
% Growth		*15%*	*20%*
ROE	*6.6%*	*7.4%*	*8.6%*
%Growth		*12%*	*16%*
P/B	*0.8x*	*0.9x*	*0.8x*
P/E	*14.7x*	*12.8x*	*10.6x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$18.92*
# of Shares	*5,850*
Value Invested	*$129,285*
Portfolio Weight	*5.08%*
2016 HPR	*48.2%*
HP Benchmark Return	*17.3%*
Excess Return	*30.9%*

Bank of America (NYSE: BAC)

Investment Thesis

1. **Bullish on U.S. Banks: Despite the increase in valuation multiples following the rally after the elections, we remain bullish for 2017**
   - Bank of America has the greatest sensitivity to interest rates relative to its peers because it has a higher proportion of variable rate assets. This means the bank will benefit more from rising rates than its peers in the form of increased net interest income
   - The current macro outlook is attractive for U.S. banks, considering how highly correlated GDP growth and bank valuation is. The focus on job growth in the U.S. will presumably translate into more income in the U.S. economy and more deposit inflows to the U.S. banks, allowing the banks to increase lending. GDP growth could be fueled by increased infrastructure spending, reduced taxes, higher interest rates/inflation and changes in global trade
2. **Clash of Titans: Bank of America and Citigroup are the cheapest among large U.S. banks. In 2016, BAC outperformed Citi by about 17% and BAC remains more attractive due to their:**
   - #1: International and Energy Loans Exposure
   - #2: Less reliability on Macro Events
   - #3: Disclosure and Valuation
3. **Street View: In comparison to J.P. Morgan and Wells Fargo, Bank of America was long disregarded as the black sheep of U.S. banks, but we perceive a shift in paradigm. We continue to believe that BAC's trading multiple will converge closer to those of J.P. Morgan and Wells Fargo.**

Analysis of Performance

Bank of America was our largest individual holding, representing approximately 8% of the portfolio value until we trimmed our position in mid-December for risk management purposes. Bank of America is up 46% since we initiated our position at the end of April, outperforming J.P. Morgan, Citi and Wells Fargo. Bank of America's performance and financial results in 2016 were largely a reflection of macro factors. Global Banking was up 10%, with investment banking fees up 13% to $1.5 billion year-over-year. Trading revenue bolstered operating performance in Q3 and Q4 of 2016. Bank of America, who in previous years has had difficulties with stress tests, passed the Federal Reserve stress test in Q2-16, allowing the bank to execute its plan to increase its dividend by 50% to $0.075 per share beginning in Q3-16. Bank of America finished the year with a 15.8% return above DCM's the U.S. financial benchmark.

Valuation Summary

Big Four U.S. Banks										
Company	Ticker	Market Cap	Beta	Div Yield	Tier 1 Capital	P / B	P / TB	P/E	ROE	Cost / Income
JPMorgan Chase & Co.	JPM	$310,195	1.50	2.2%	12.5%	1.36 x	1.72 x	13.10 x	10.0%	57.6%
Citigroup Inc.	C	$169,929	1.69	1.1%	14.6%	0.80 x	0.92 x	12.68 x	6.4%	58.1%
Wells Fargo & Company	WFC	$277,784	0.97	2.7%	11.4%	1.57 x	1.85 x	13.29 x	11.8%	58.5%
Bank of America Corporation	BAC	232517.12	1.47	1.3%	12.1%	0.96 x	1.36 x	13.43 x	6.3%	65.0%

Energy Sector

2016 Review & 2017 Outlook

By Alaa Hachem, Sabrina Frias, Lambert Lefebvre, Jayden Van, and James Wilson

DCM Performance

Despite some strong performers, the DCM Energy portfolio underperformed our benchmark by 10.1% in 2016 due to some idiosyncratic factors affecting some of our holdings. Our strongest performer over the year, Parex Resources, reached our price target of $11.25 in March as a result of stronger operating netbacks. We therefore exited our position in April.

Our largest contributor of variance was MEG Energy, which significantly underperformed the Canadian E&P benchmark, by 17.4%. The stock underperformed for two reasons. Firstly, market fears over the company's ability to cover interest payments and secondly, concerns that their Surmont project would not be viable in the lower oil price environment. Detailed analysis of holdings performance follows below.

Overview

The first half of 2016 saw a continuation of the oil price slide that began in November 2015. WTI prices hit their lowest point in 12 years, bottoming out at $26.14 on February 10 and slowly recovered over the rest of H1. The major driver behind the initial pick-up in oil prices came from a sharp run-down in US inventories and later in the year from the rumours and eventual agreement by OPEC to freeze supply. 2016 was absolutely a volatile year for energy investors. With prices more than doubling in a 4 month period and scores of North American companies coming perilously close to bankruptcy, timing the market was the key to investing in energy in 2016.

For the majority of H2 oil prices were range-bound, with prices bouncing between $55 at the upper end of the scale and $40 at the lower end. The reason for this is that when oil prices move above $50 production becomes profitable for many shale producers in North America, who naturally respond by increasing their production, which limits further price appreciation. This is further exacerbated by E&P companies bringing production forward, whenever it is cash flow positive, in order to service their high debt levels. Also, as many producers see $50 as a breakeven point, and may be risk averse given their current situation, they are likely to sell futures in order to limit risk, thus limiting future price appreciation.

Figure 1: Benchmark Oil Prices in 2016

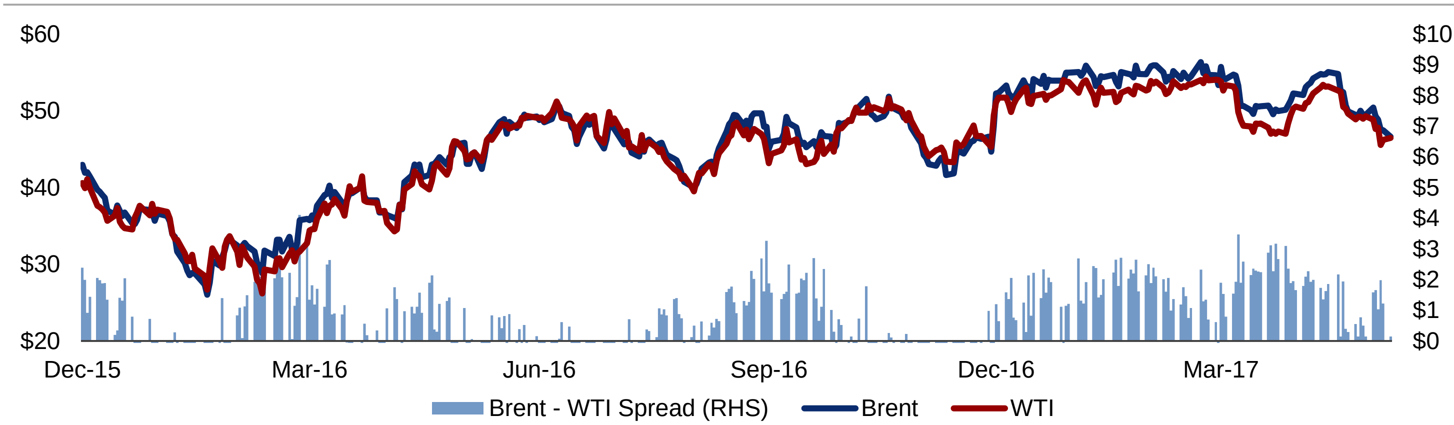


Figure 1 also shows that the spike at the end of November, due to the OPEC freeze, had a much larger impact on Brent. Indeed, the Brent-WTI spread jumped form $1 to $3 on the announcement as the supply cut applies mostly to producers in the Middle East and Africa which sell into the Brent markets, but not American producers who sell in to the WTI market. As international oil prices increase, thanks to the Obama administration's decision to lift the US ban on exporting oil, US producers can increase production to take advantage of this price differential by exporting into foreign markets. Despite the fact that this would tend to put downward pressure on the spread, the futures market is still expecting it to increase going forward due to production increases in North America and production cuts in the Middle East.

OPEC Production Freeze

After a series of uneventful meetings throughout the year, OPEC agreed to a production freeze on November 30th. The terms of the agreement are that OPEC will collectively produce no more that 32.5m barrels per day, with the majority of the cut being made by Saudi Arabia which pledged to cut production by half a million barrels per day to a level of 10 million.

It is worth noting that OPEC production falling to this level, although a cut in nominal terms, means locking in production at a level never seen before July of this year. This issue is further complicated by the fact that almost all OPEC countries have been increasing production in recent months, with November being another record high with production level of 34.2m barrels per day, up from 33.7m in November with Saudi Arabia alone adding 160,000 barrels of daily production. The run-up in production prior to the deal being made is already a red flag on whether the participating countries will choose to honour the production cut or if they will break off and continue to produce at current levels.

Too Good To Be True?

The biggest question hanging over the impending supply agreement is exactly how it will be policed and enforced. As Figure 4 below shows, every country except for Iran, Libya and Nigeria is required to cut their production level in the agreement. Iran is to be allowed to grow production to 3.8m barrels a day, close to its estimated production level before US sanctions, while Libya and Nigeria are to be exempted due to the ongoing civil war in Libya and Boko Haram attacks in Nigeria which have decimated their production capacity.

The 32.5mb/d headline figure is also a source of contention because of how the numbers actually add up. The quotas listed by OPEC add up to a total of 29.8m, however this does exclude Indonesia, Libya and Nigeria. Including Libya and Nigeria's current production levels the quota rises to 32.1m b/d, leaving these two countries only a further 0.4m b/d to raise production, or just 40% of estimated spare capacity. If Libya and Nigeria were to make up half of the difference between current production levels and their pre-crisis levels this would slightly exceed the 32.5m threshold. There is unfortunately no guidance from OPEC on how they estimate production from these countries.

Source: Bloomberg, EIA.

Further mystery comes from the fact that Indonesia has suspended its membership in OPEC, whether by choice or by force is unclear, meaning that its 740,000 b/d of production will not count towards the OPEC total.
Another important question is why there is such a difference in the numbers that the countries report directly to OPEC and those calculated by independent sources. One explanation is that these countries are attempting to increase the headline production cut in order to increase the price impact. The 1.7m b/d cut, based on OPEC numbers sounds significantly more dramatic than the 0.6m cut based on secondary sources.

Figure 2: Historical OPEC Production Levels

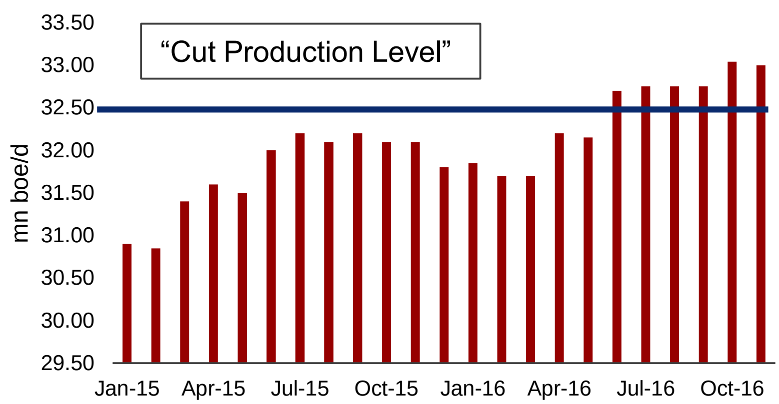


Figure 3: OPEC vs Non-OPEC Production

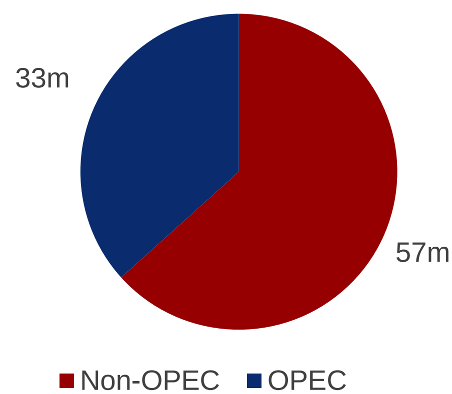
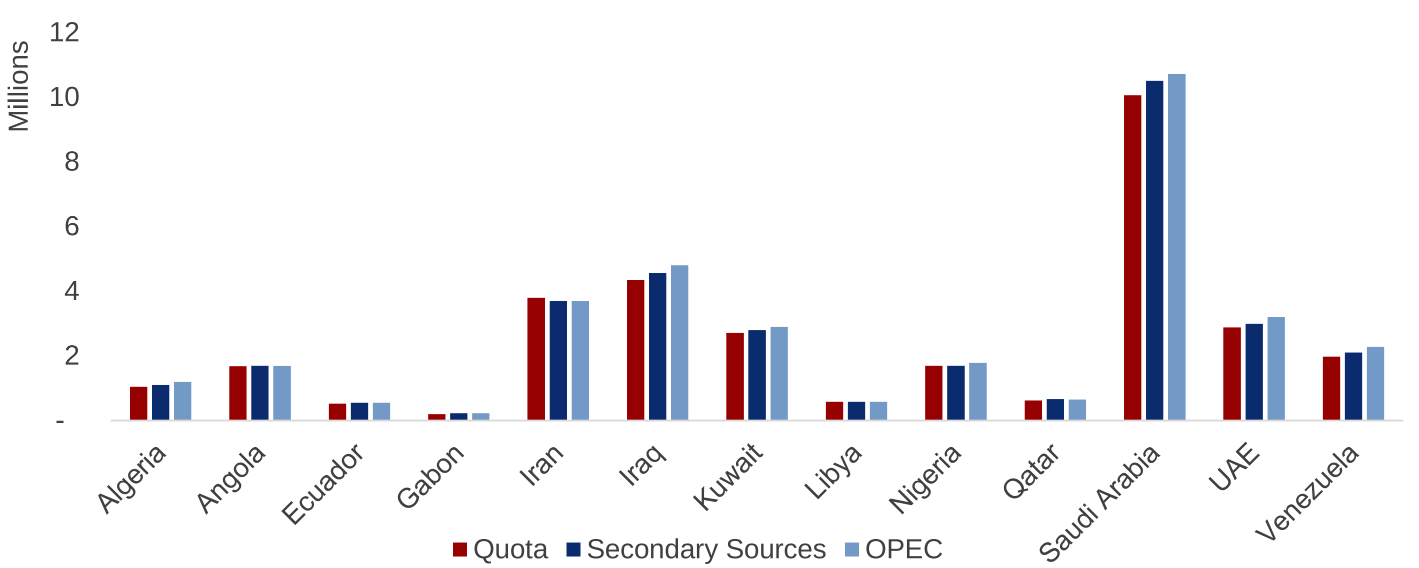


Figure 4: Reported November 2016 Production & Quota Level By Country



All In This Together

A further spanner in the works of a potential OPEC supply deal is the requirement that nobody break their quotas and cheat, something that has already happened in the past. Following the supply freeze agreement of 24.5m b/d in 1994, OPEC members continued to increase their production, hitting 26m b/d by the end of 1996. Again, in response to the 2008 crisis OPEC agreed to limit production to 24.8m, a cut of 4.2m from their previous production levels. Despite this agreement, production averaged 26.3m, with just over half of the cut being honoured.

Source: EIA, OPEC, Bloomberg.

As a result of these historical precedents, as well as the dramatic cuts required for the quotas to be met, the 'window-dressing' by OPEC members and the ambiguity in the quotas, we are sceptical that the supply cut will work in the long run. Even if the cut is honoured from January 2017, we expect oil prices to rise only in the short term before falling again as it becomes clear that the cut is unlikely to be effective in the longer run.

Figure 5: Long Run WTI Prices

The Other Guys

The other key supply factor in this situation is the response of non-OPEC producers, most importantly Russia, which has a poor track record when it comes to compliance.

In March 1999 OPEC and non-OPEC members came to an agreement to control supply, here Russia agreed to cut production by 100,000 b/d. The very next year Russian production actually rose by 50,000 b/d. Beyond this, there are further doubts on the overall supply cut's impact because of OPEC's waning position as a global energy producer. OPEC now accounts for just 37% of global oil production, meaning that they are not able to influence prices as much as they would like to think.

The obvious response for North American producers is to increase their production levels given the higher prices realised. This process has already begun, as shown in Figure 7, with North American producers increasing their rig count by the largest amount weekly in over five years in the immediate aftermath of the announcement and overall rig counts increasing 11% in the month after the OPEC deal. We expect this process to continue and this may explain why the response in crude prices to the OPEC announcement has been so muted.

Source: Bloomberg. OPEC.

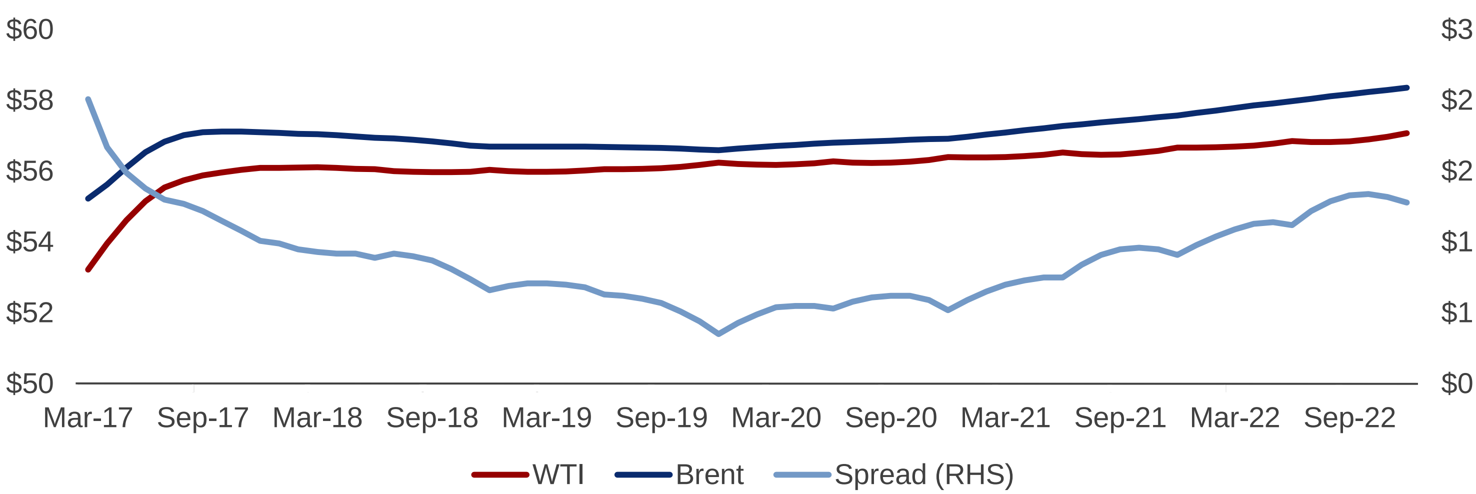
Although prices did jump 15% in a period of 12 days, this still leaves Brent hovering around the $50 mark, considerably lower than it's long term average over the past ten years (Exhibit 5). While this may imply that there is room for prices to increase further, the evidence from the futures curve shows that the market expects limited price appreciation going forward.

Back to Backwardation?

A close look at Figure 6 reveals a portion of backwardation in the futures curve, particularly for WTI, from late 2017 to 2019, as inventories are expected to be depleted in the first half of 2017. This backwardation occurs as speculators expect that following the initial reduction in inventories, producers will increase production to replenish inventories and take advantage of higher spot prices, implying a higher level of supply in the future.

A further factor contributing to the backwardation comes from the hedging programs undertaken by North American producers in response to the OPEC supply agreement. As mentioned before, numerous shale producers see $50-$55 as a profitable price level and so are willing to hedge their production at this point. This contributed to the flattening of the futures curve in this price range for two reasons. Firstly this hedging artificially depresses futures prices and secondly the guaranteed higher prices will encourage North American companies to raise production further which reduces the effectiveness of the OPEC supply deal and increases the likelihood of a breakdown in the agreement.

Figure 6: Oil Futures Curve



Source: Bloomberg. OPEC.

United States Perspective – Review of 2016

Coming into 2016, the three most widely predicted trends for US Energy stocks were mass bankruptcies, reduced capital expenditures and heightened M&A activity. These expectations were quickly realized as WTI bottomed out in February 2016 and U.S. producers moved into survival mode, cutting capital expenditures by 80% compared to 2015 and reducing headcounts across the board. Companies within the upstream sector suffered the most from the low oil prices, and accounted for 79% of the layoffs within the sector. In fact, within the first 10 months of 2016, U.S. energy companies laid off 103,000 people, up 14% from the same period in 2015.

Despite our expectations, M&A activity remained relatively muted throughout 2016 due to the continued volatility in oil prices throughout the year as a result of uncertainty over OPEC's ability to come to an agreement. Throughout the year confidence returned, and companies shifted their focus from survival towards future growth. As a result, M&A activity started picking up. M&A activity in the U.S. was mostly concentrated in the Permian Basin, where 41% of the total 2016 M&A deals took place.

Figure 7: Oil and Gas M&A Deals and Bankruptcies

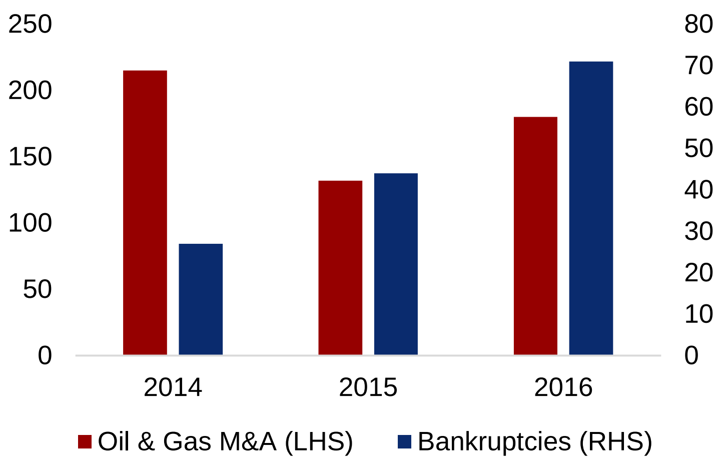
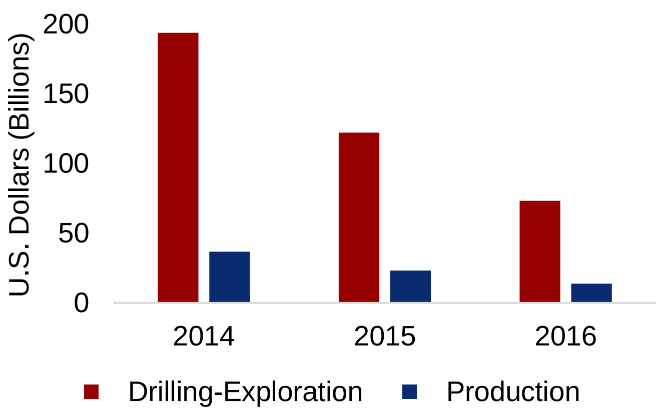


Figure 8: US Oil and Gas Capital Expenditures



Source: EIA, Bloomberg.

Possible Impact of Trump's Presidency

While the details of the incoming Trump administration's energy policy are not clear yet, we have some early indications of what to expect. Trump's appointment of Rex Tillerson, ex-CEO of ExxonMobil, as Secretary of State is an obvious indication that he intends to support the oil industry. Trump could not have made his stance on energy clearer than when he declared "we'll see more fracking, more pipelines, a defanged EPA and no carbon tax" during his victory speech in November. While we are wary of taking Trump at his word, the sentiment of this speech is unmissable.

Trump Continued…

With Republican control of the Presidency, the Senate, and the House, numerous regulatory initiatives that were the hallmark of Obama's energy policy will likely be overturned. President Obama's coal killing Clean Power Plan will have no chance of passing and neither will the bill for a federal carbon tax or cap & trade regime while the ratification of the Paris Climate Accord remains a pipe dream. All three of which are great news for coal mining companies, as shown by the performance of the coal index, which rallied by an average of 36% in the two days following the election results.

While we expect that Trump will stick to the promises he made to coal miners by attempting to revitalize this industry, DCM maintains a bearish view on the long term prospects of the industry. Looking ahead, the coal industry is unsustainable, both in terms of its operations and the declining global demand for the product, due to rising environmental concerns. Moreover, Trump's plans may revitalize a dying industry, but more importantly they will buoy the already booming shale gas industry.

Trump believes, "the shale revolution will unleash massive wealth for American workers and families." If Trump carries out his plans to open onshore and offshore federal lands to oil and gas production and ease pipeline acceptance, all subsectors of the energy industry are set to benefit. TransCanada has already stated its intention to restart talks with the Trump Administration over the Keystone XL pipeline that was previously rejected by the Obama Administration. Furthermore, during his tenure as President-Elect Trump has said that he will "make America energy independent". Specifically he aims to rid the US of "any need to import energy from the OPEC cartel or any other hostile nation." As ever, the specific production encouraging policies that Trump plans to enact are uncertain.

Source: Bloomberg, Baker Hughes.

United States Perspective – Forecast for 2017

With supply and demand projected to come into balance, we expect volatility in oil prices to decline in 2017. The U.S. Energy Information Agency forecasts that the U.S. will become a net exporter of energy in 2017. As liquids imports fall and natural gas and crude exports rise, we expect that these trends will lead to a widening of refining margins as demand for refined product increases and US onshore production increases due to improvements in well-level productivity, drilling activity, and rig efficiency.

We anticipate a resurgence of US shale producers activity in response to the changes in the global oil order we discussed above. North American oil producers should continue their return to drilling in anticipation of higher prices in the near future, accelerated by the expected backwardation in the markets. This backwardation will incentivise producers to sell off existing inventory and bring forward production as much as possible in order to take advantage of higher current oil prices. The evidence of this is already clear from the rise in rig counts over the past six months, as shown in Figure 7.

Figure 9: U.S. Crude Oil and Liquid Fuels Production Forecasts

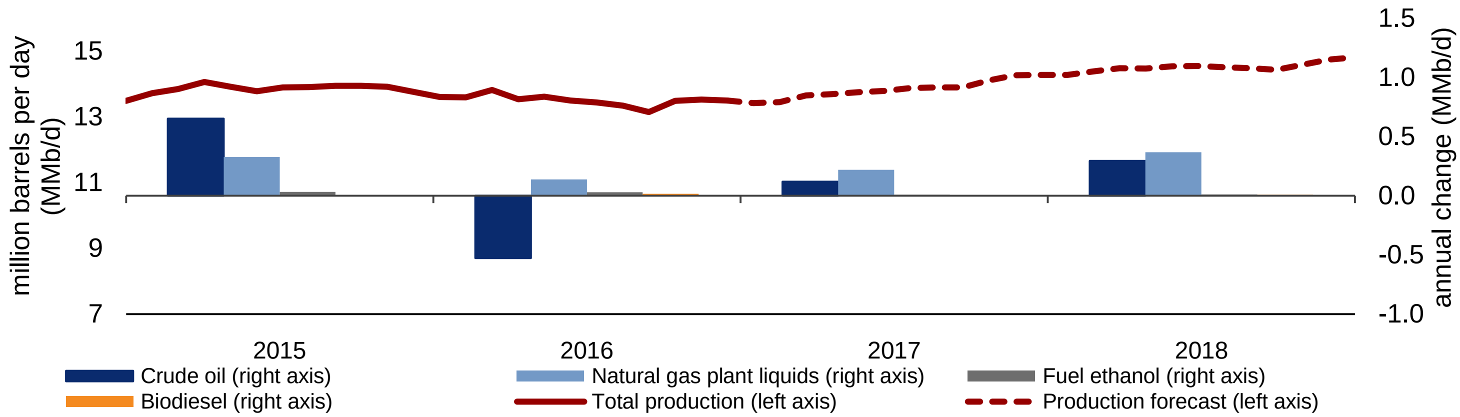
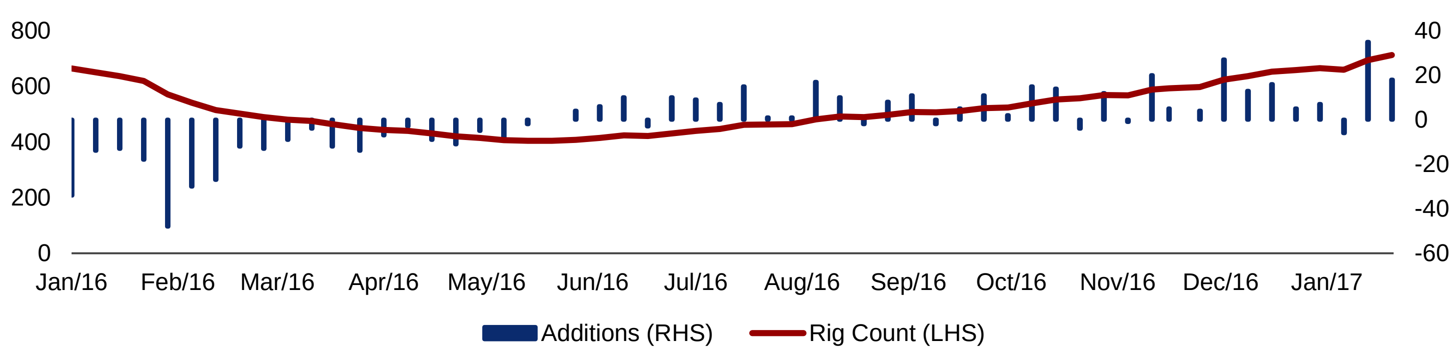


Figure 10: US Rig Counts Over 2016



Source: Bloomberg, Baker Hughes.

Canadian Perspective – Overview of 2016

The Canadian crude oil industry has remained under pressure throughout 2016. Cash starved producers have cut back capital spending intentions, and as a result, the Canadian Association of Petroleum Producers (CAPP) have lowered their Canadian long-term production outlook even further from last year's cut, from 5.3 MMbbl/d by 2030 to 4.9 MMbbl/d.

Just as prospects for Canadian oil producers began to look up, disaster struck in the form of the Fort McMurray wildfires in early May. Several oil sand production sites were temporarily shut down while others reduced operating rates. The U.S. Energy Information Agency estimates that the disruptions to production averaged about 0.8 MMbbl/d in May, with a peak of more than 1.1 MMbbl/d. In total, the disruption amounts to about 30% of Canada's total daily oil production.

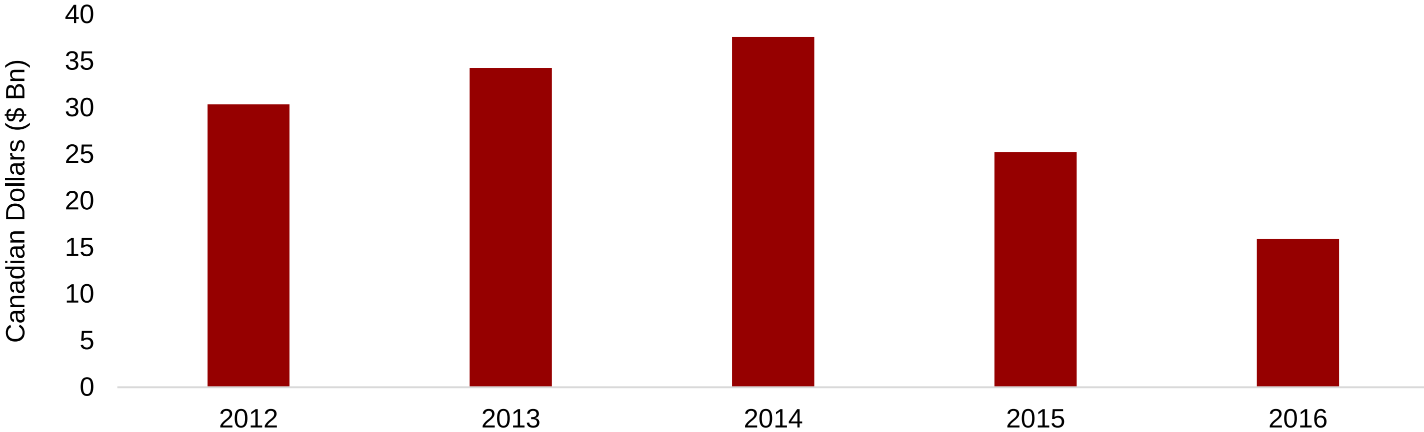
Further, on October 3rd Prime Minister Trudeau announced that Canada would be pursuing a national price on carbon, and a deal was signed in early December by all provinces except for Manitoba and Saskatchewan. As a result, Trudeau's government will likely be up for a legal battle with Canada's energy-production provinces. The carbon price was set at C$10 per metric ton, and will rise by C$10 year each until it reaches C$50 per ton in 2022. Many of the large oil and gas companies supported the carbon pricing initiative as it will weaken the competitiveness of smaller players in the field.

Lastly, while many pipeline projects in Canada were halted or delayed this year due to regulatory restrictions, Kinder Morgan's $6.8 billion Trans Mountain project was approved by the federal cabinet in late November. This crude pipeline expansion triples KMI's current Canadian capacity to 890,000 barrels a day. The pipeline expansion was however, extremely controversial and was opposed by environmental groups, indigenous leaders, and Vancouver Mayor Gregor Robertson, despite being generally popular in BC and very popular in Alberta. This creates a risk that future government regulation could put the project in jeopardy.

Enbridge's Line 3 replacement project was also approved this November. The project doubles Enbridge's capacity to 760,000 barrels per day. Trudeau's decision to approve both projects is a great victory for Canada's oil patch which has been "suffering from falling oil prices, a transportation bottleneck and over-reliance on the U.S. as a buyer". In light of the federal cabinet's decision, The Canadian Association of Petroleum Producers expects crude production in the region to rise about 5% to 4 MMbbl/d in 2017.

Source: Bloomberg as of January 10 2017, CAAP, EIA, CBC, CNBC.

Figure 11: Largest Canadian Energy Companies[1] Capital Expenditure



[1]Canadian energy companies with market capitalization greater than $10 billion

Canadian Perspective – Forecast for 2017

Downstream

The recently approved national minimum price on carbon will negatively impact the fuel refining industry in Canada. This is especially true for refineries in provinces which do not have an existing carbon price scheme such as Saskatchewan, New Brunswick, and Newfoundland, unlike refineries in British Columbia, Alberta, Ontario and Quebec which already pay or are set to pay carbon levies. This regulation may shift demand for refined product towards imports from the US.

Midstream

The forecast for the Canadian midstream sector is starting off quite optimistic, with several midstream companies claiming their top priority is to reinvest free cash flow into growth projects. Furthermore, Donald Trump's presidential victory also puts the Keystone XL project back on the agenda, since Trump mentioned that once in office he would allow TransCanada to resubmit an application.

Upstream

Crude Oil Production

The U.S. Energy Information Agency estimates that Canada's liquid fuels production will grow by about 0.3 MMbbl/d in 2017, in order to make up for the low growth production in 2016 caused by the Alberta wildfires. Despite a sustained period of low oil prices, the EIA forecasts an increase in Canadian crude oil production, mainly since there were several Canadian oil sands projects that were already under construction in 2014 before oil prices began to fall, and are expected to begin production in the next couple of years.

Source: Bloomberg, CAAP, EIA, CBC.

The WCS (Western Canadian Select) prices are currently around $18.42/b, about $15/b below WTI. These WCS price levels suggest that the oil sands projects will most likely be operating at a loss. Nonetheless, the cost to shut down the projects, estimated by the EIA to be around $500 million to $1 billion exceeds their losses in the short-term. However, the EIA forecasts increasing WTI and Brent prices in the next two years, and therefore many of the projects scheduled to come online in 2016 might be profitable. This time-lagged production increase is a hangover from the heydays of the Canadian oil sands industry and is likely to ensure a Canadian supply glut going forward.

Natural Gas Production

Canada's National Energy Board (NEB) forecasts that Canada's natural gas production will increase through the next decade. Exports of natural gas by pipeline to the US are projected to continue to decline to about 2.5 Bcf/d by 2025. This decline is a result of the development of U.S. shale resources, which render the U.S. less reliant on Canadian imports. The NEB further forecasts that in light of declining natural gas exports to the U.S., liquefied natural gas (LNG) exports will be the primary drivers of natural gas production growth in Canada. The future of Canadian natural gas production growth therefore relies heavily on the construction of LNG export capacity. Furthermore, given recent technological advances in horizontal drilling and hydraulic fracturing, the development of tight gas and shale gas resources, specifically in the Western Canadian Sedimentary Basin, is expected to increase.

Risks

The misalignment between the Canadian and U.S. government presents a risk to the Canadian energy sector. While Trump has been adding pro-oil members to key positions such as Secretary of State and the department of energy, Prime Minister Trudeau's government has been moving in the opposite direction by introducing policies such as the minimum carbon price.

Source: Bloomberg, CAAP

Canadian Perspective – Forecast for 2017

Figure 12: Multiples Analysis of the Downstream, Midstream and Upstream Canadian Sectors

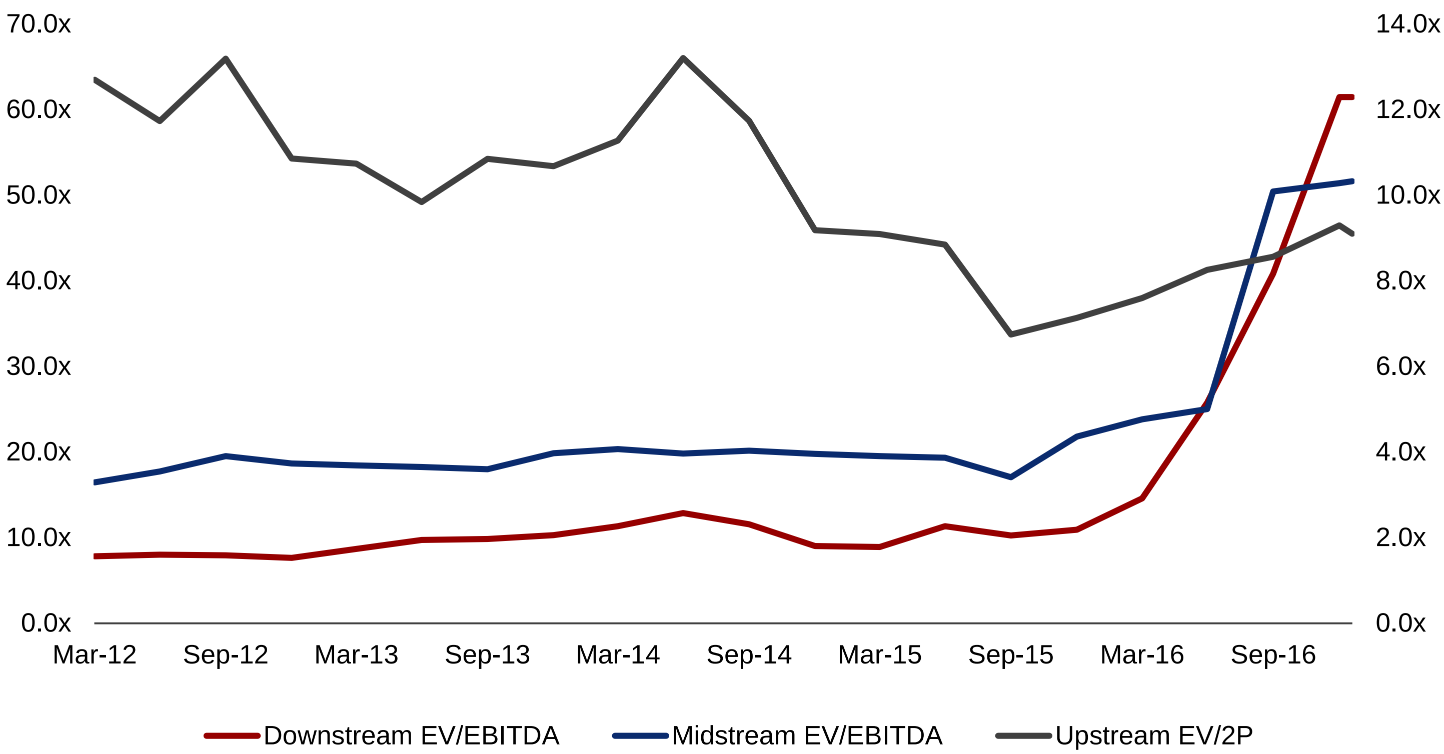


Figure 12 above confirms previous forecasts with regards to the midstream and upstream sectors. The EV/EBITDA Midstream multiple increased significantly from the beginning of 2015, which indicates that the market has a more positive outlook for Canadian midstream companies.

The EV/2P multiple for the upstream sector has increased from 2015, but is still significantly lower than 2014 levels, at 9.1x in 2016 compared to 13.2x in 2014. This demonstrates that while the outlook for the upstream sector has improved since the previous year, prices are not expected to go back to 2014 levels, and instead are expected to reach an equilibrium price slightly above 2015 prices.

However, the EV/EBITDA multiples for the Canadian downstream sector conflict with the expectation that downstream companies will be negatively impacted by the implementation of the carbon pricing policy. Instead, the multiples suggest that downstream companies will have a positive outlook in the near future.

Source: Bloomberg, CAAP

Energy Sector

Holdings Review

Pembina Pipeline Corp. (TSX: PPL)

Company Overview

- Pembina Pipeline Corp. is an integrated midstream energy company operating across Canada and North Dakota in the USA
- Focused on being a pure-play energy infrastructure provider in the Western Canadian Sedimentary Basin and Bakken region
- Pembina has four business segments; Conventional Oil Pipelines, Oil Sands and Heavy Oil Pipelines, Gas Services and Midstream
- PPL focuses on the smaller, arterial, pipelines that deliver oil and gas to larger pipelines such as Keystone and TransCanada
- Pembina is one of the fastest growing players in the Canadian midstream industry with plans to double annual EBITDA between 2016 and 2018

Catalysts

- Regulatory approval for larger pipelines such as Keystone XL increase takeaway demand for Canadian oil and thus for Pembina's arterial pipelines and driving growth beyond 2019
- Higher oil prices lead to greater heavy oil production, in turn increasing demand for C5+ condensates produced via fractionation in midstream business
- Continued supply glut drives up demand for storage

Risks

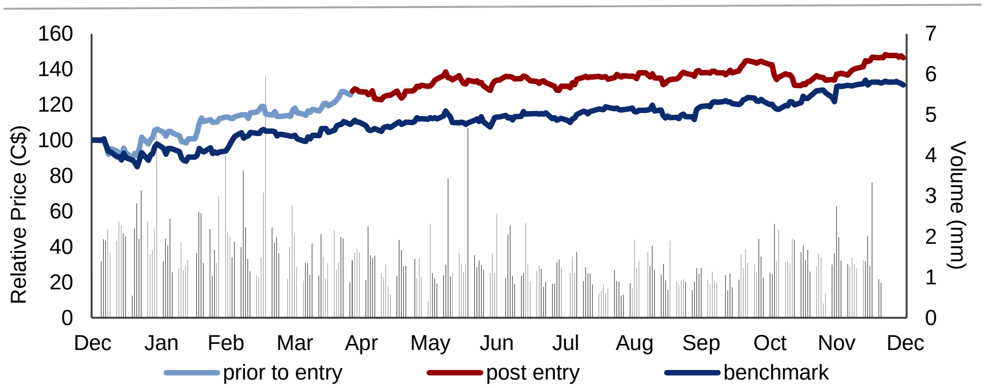
- Regulatory hurdles prevent expected growth in pipeline capacity
- Setbacks in construction process due to poor weather and labour issues could slow realization of Pembina's growth plans
- Counterparty risk from the E&P companies unable to fulfil their contracts

Financial Summary

Public Market Overview	
(values in $mm, as of Dec. 31, 2016)	
Share Price	$41.96
S/O (M)	387.2
Market Cap.	**$16,247**
+ Total Debt	$3,824
+ Minority Interest	$0
+ Preferred Shares	$1,510
- Cash	$40
Enterprise Value	**$21,541**
Beta (1-Year)	1.38
Dividend Yield	4.5%
52-Week High	$42.62
52-Week Low	$27.20

Financials & Multiples	2015	LTM	FY2017E
(values in $mm)			
Revenue	$4,672	$4,280	$6,274
% Growth		*-8%*	*47%*
EBITDA	$951	$1,088	$1,489
% Margin		*14%*	*37%*
EPS	$1.05	$1.16	$1.63
% Growth		*10%*	*41%*
Dividend/Share	$1.80	$1.88	$2.03
% Growth		*4%*	*8%*
ROE	*6.0%*		
ROA	*3.4%*		
ROIC	*4.2%*		

Normalized Stock Price and Sector Benchmark Performance



Benchmark: 40% U.S. Energy index (XLE) in CAD, 60% S&P/TSX Capped Energy Index (XEG).

Position Snapshot

Average Cost	*$37.85*
# of Shares	*2,700*
Value Invested	*$113,292*
Portfolio Weight	*4.45%*
2016 HPR	*14.7%*
HP Benchmark Return	*19.3%*
Excess Return	*(4.5%)*

All figures in CAD

Pembina Pipeline Corp. (TSX: PPL)

Investment Thesis

1. **Market overestimates PPL's exposure to oil prices:** *PPL's performance continues to be tied to that of the overall energy industry and oil benchmarks, despite PPL's business model protecting it from oil price shocks.*
    - Currently 81% of Pembina's operating margin is derived from fixed-fee contracts which do not vary based on oil prices, as this number is expected to rise to 84% by 2018 this should translate to far lower correlation with oil prices
2. **Canadian oil sands exposure creates opportunity rather than threat:** *While Pembina has significant exposure to Canadian oil sands producers we believe that the economics of the industry, and Pembina's contracts, insulate the company from risk.*
    - The market seems to overly discount Pembina due to the share of its earnings coming from heavy oil, a segment that is expected to perform poorly in the future as Canadian oil sands remain unprofitable
    - We believe that this is an overreaction for a number of reasons, firstly 97% of PPL's oil sands exposure comes from companies rated BBB and higher, secondly the share of earnings coming from oil sands has declined year-over-year
3. **Pembina continues to trade at a discount to our valuation:** *We believe that Pembina is still undervalued based on intrinsic and relative valuation*
    - PPL trades at a discount due to our confidence in the Canadian oil sands segment
    - Given Pembina's strong EBITDA margin and growth outlook we believe that it should trade in line with its largest peers in Canada and US players with similar margins and growth profiles

Canadian Oil Sands Exposure

While we do believe that the sun has set on the age of Canadian oil sands as a profitable industry in the long term, we also see Pembina's exposure to the sector as an opportunity. While we do not expect to see significant new drilling in the area for a number of years, unless oil prices return to close to $100, we believe that the economics of the projects mean that companies will continue to produce and be cash flow positive in the region as the majority of capital expenditures have already been made. As a result the businesses operating in this region will continue to produce as long as they are able to cover their variable costs.

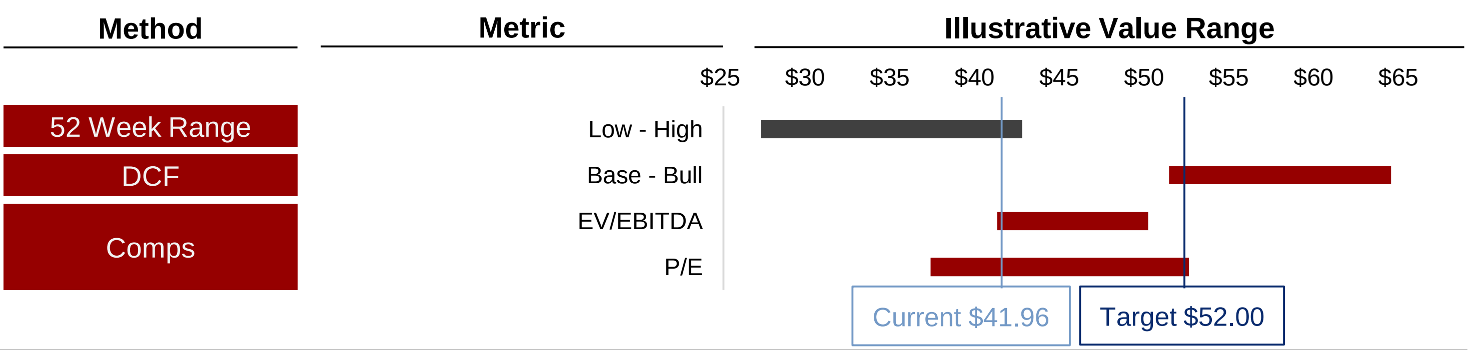
As a result of this, we expect Pembina's overall exposure to the sector to decline, as a percentage of earnings. At present the segment makes up 15% of total EBITDA, however we expect this figure to fall to 9% by 2025.

Analysis of Performance

Throughout our holding period Pembina underperformed our benchmark index, returning 11% versus 15% since we bought PPL, however we believe that this is unwarranted given the fundamentals of the company. When we also take into account the effect of the dividend paid by Pembina, translating to a 3.4% return since we invested, this gap narrows as returns with the dividend for Pembina are 14% vs 17% for the benchmark.

As projects come online over the course of the next 12-18 months we expect to see Pembina perform better as investors begin to see the greater earnings potential and thus we expect the price to converge to what we see as the company's fair value and the fact that the company trades in line with competitors with far lower growth potential but at a discount to those with a more comparable outlook.

Valuation Summary



Marathon Petroleum Corporation (NYSE: MPC)

Company Overview

- Marathon Petroleum (MPC) is a Midstream and Downstream energy company focused on refining, transporting and marketing petroleum products
- MPC operates refineries throughout the Midwest and Gulf Coast of the United States
- MPC operates Midstream operations in conjunction with its Master Limited Partnership (MPLX) and markets its refined products through the Speedway brand of gas stations
- MPC has grown through high-profile acquisitions of the Hess gas stations chain and MarkWest gas transportation and processing facilities (acquired by MPLX)
- MPC has continued to diversify its earnings away from pure refining

Catalysts

- Faster than expected increase in dividends from MPLX (following drop-down of assets) and Speedway (already expecting an increase the dividend to $2Bn/yr from ~$1.1Bn in 2016)
- Acceleration in the asset drop down in the midstream segment and a subsequent increase in distributions
- Management's spin-off plan of Speedway should allow the valuation to converge towards the Sum-Of-The-Parts value that we see

Risks

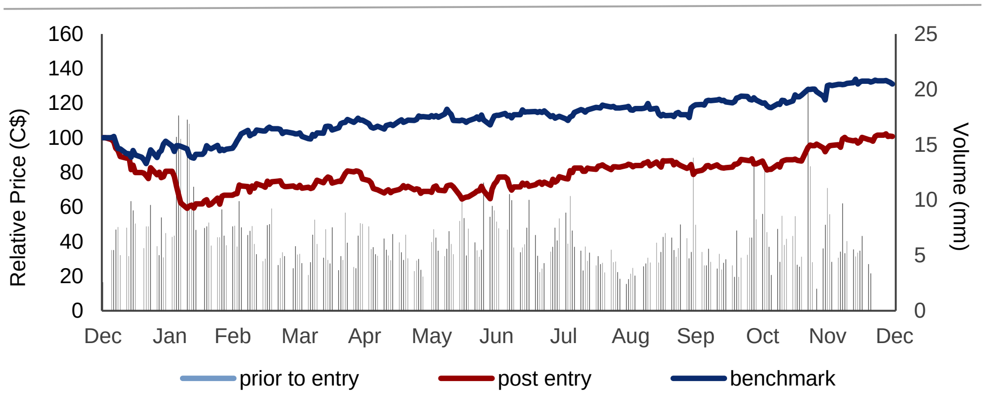
- Refining margins could tighten over the short-term if oil prices continue to increase
- Continued mild winter in the US and Canada could reduce demand for refined products and reduce crack spreads

Financial Summary

Public Market Overview	
(values in $mm, as of Dec. 31, 2016)	
Share Price	$50.35
S/O (M)	527.8
Market Cap.	**$26,575**
+ Total Debt	$10,566
+ Minority Interest	$7,562
+ Preferred Shares	$0
- Cash	$709
Enterprise Value	**$43,994**
Beta (1-Year)	1.76
Dividend Yield	2.9%
52-Week High	$51.12
52-Week Low	$29.63

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $mm)			
Revenue	$54,372	$73,963	$72,625
% Growth		*36%*	*-2%*
EBITDA	$4,426	$5,436	$5,981
% Margin		*23%*	*10%*
EPS	$2.12	$3.50	$3.86
% Growth		*65%*	*10%*
Dividend/Share	$1.32	$1.34	$1.50
% Growth		*2%*	*12%*
ROE	*6.4%*		
ROA	*4.3%*		
ROIC	*6.1%*		

Normalized Stock Price and Sector Benchmark Performance



Benchmark: 40% U.S. Energy index (XLE) in CAD, 60% S&P/TSX Capped Energy Index (XEG).

Position Snapshot

Average Cost	*$54.89*
# of Shares	*940*
Value Invested	*$47,329*
Portfolio Weight	*1.86%*
2016 HPR	*0.7%*
HP Benchmark Return	*31.1%*
Excess Return	*(30.4%)*

All figures in USD

Marathon Petroleum Corporation (NYSE: MPC)

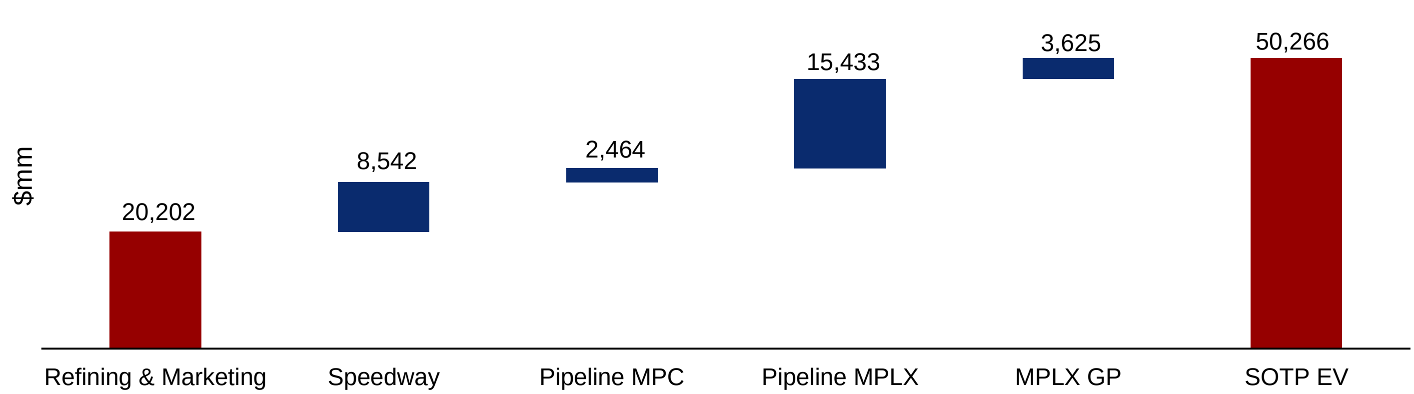
Investment Thesis

1. **Strategically located assets offers more competitive margins than competitors:** *Marathon's assets are primarily located in PADD II and PADD III whereas competitors are exposed to less profitable areas*
    - Refineries and midstream assets focused on PADDs II and III allow Marathon flexibility and access to some of the lowest cost production in the Marcellus and Utica shales
    - Refining and marketing gross margin of $10.75/barrel vs. $8.8/barrel for competitors as of Q3 2016
    - Approval of the Keystone XL pipeline would increase oil supply to the Gulf Coast and cause crack spreads to widen
2. **Drop-down of MLP qualifying assets offers arbitrage opportunity:** *MPC can transfer midstream assets into a separate entity called MPLX, which is a master limited partnership that removes the effect of double taxation*
    - Management announced faster drop down in the coming year with ~$1.4Bn of assets left to drop down
    - MPC has dropped about $600 million of annual EBITDA in 2016, and expects an $250 million to be dropped down in 1H17 and at least $250 million in 2H17
    - Using an 14.5x multiple for this segment, we still think the drop down is underestimated by markets
3. **Diversification of revenue streams reduces commodity exposure:** *Marathon has shown commitment in diversifying from its core refining business to insulate it more from adverse macro events than competitors.*
    - Speedway earnings grew by 5% over the first three quarters, in line with expectations
    - Management announced the creation of a special committee appointed by the MPC Board to conduct a 'full and thorough' review of the Speedway business in an effort to maximize shareholder value with an expectation to announce a plan of action by mid-2017.
    - Management notes the review includes a tax-free separation and other strategic & financial alternatives. We are bullish about this opportunity as Speedway disposes of a different risk profile than the rest of the business, and could potentially trade at a premium to the current market's valuation

Analysis of Performance

After a weak first quarter where MPLX (MPC's master limited partnership) underperformed due to lowered its projected 2016 capital expenditures (capex) and revised down its expected distribution growth rate in response to the ongoing commodity downturn (from 25% per year to only 12-15% per year). MPC also increased leverage on its balance sheet following the MarkWest merger in December (from 3.1 times pre merger to 4.7 times at the beginning of 2016), thus magnifying the impact that lower oil could have on the company. Since Q1-2016, the company has continuously made progress with our thesis points. The company continues to maintain better margins than competitors in the refining segment due to its strategic geographical locations. It has also been continuously dropping down assets into its master limited partnership and has also been growing its downstream gas stations Speedway, to the point that management is now going to look into a potential spin-off. Moving forward into 2017, we are thus confident in holding the stock but we will continue to look to close our position if we see our thesis fully materializing.

Valuation Summary



Crescent Point Energy Corporation (TSX: CPG)

Company Overview

- Crescent Point Energy Corp. is a conventional oil and gas E&P company focused on light and medium oil
- The company operates both in Western Canada and the United States. It is the largest producer in SE Saskatchewan, where it runs a successful Waterflood program
- CPG has 830,180mm barrels of proved plus probable reserves; the majority of which are located in Canada
- January 2016: CPG cut dividends for the first time in 14 years in response to low oil prices
- September 2016: Issued 33.7mm common shares at $19.30 for gross proceeds of $650mm, in order to fund their aggressive capital expenditures plan and paying down debt

Catalysts

- Successful implementation of step out drilling in Flat Lake can be extended to other plays
- CPG has increased spending in its Uinta Plays in order to test for horizontal drilling capabilities. If prices remain above $50/bbl these wells will be economically viable and CPG can begin drilling
- Approval of the Keystone XL would drive down transportation costs and increase demand for CPG's North Dakota and Utah assets

Risks

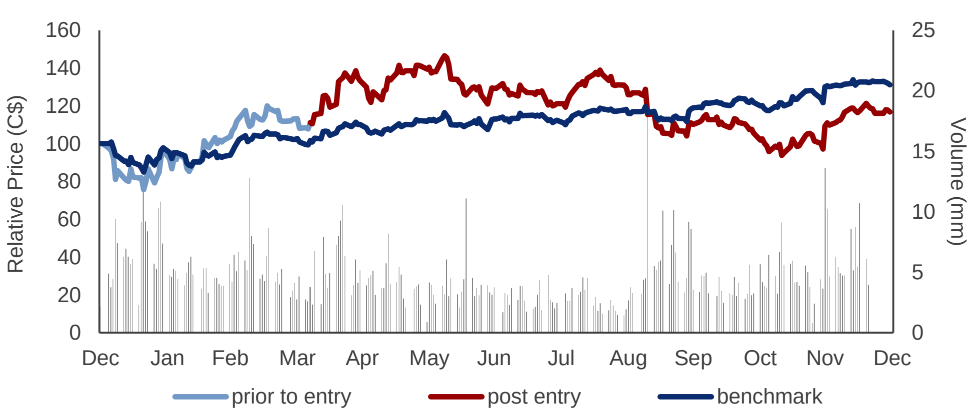
- Conflict over the North Dakota Access Pipeline have not disrupted operations, but if construction begins in 2017 and the protests become more widespread this will hamper operations in the area
- Continued low oil prices put dividend in jeopardy again
- Continues to confirm its status as a "serial equity issuer" and dilutes existing shareholders

Financial Summary

Public Market Overview	
(values in CAD M, as of Dec. 31, 2016)	
Share Price	$18.25
S/O (M)	541.7
Market Cap.	**$9,886.8**
+ Total Debt	$3,800
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$14
Enterprise Value	**$13,672.5**
Beta (1-Year)	2.49
Dividend Yield	2.2%
52-Week High	$22.89
52-Week Low	$11.83

Financials & Multiples	FY2015A	FY2016A	FY2017E
(values in $mm)			
Production (boe/d)	163,631	172,000	183,000
% Growth		*5%*	*6%*
2P Reserves (Mboe)	336,412	678,919	2,331
% Margin		*102%*	*-100%*
EBITDA	$1,078	$1,893	$2,331
% Margin		*76%*	*23%*
EV/EBITDA	*12.7x*	*7.2x*	*5.9x*

Normalized Stock Price and Sector Benchmark Performance



Benchmark: 40% U.S. Energy index (XLE) in CAD, 60% S&P/TSX Capped Energy Index (XEG).

Position Snapshot

Average Cost	*$17.44*
# of Shares	*5,650*
Value Invested	*$103,113*
Portfolio Weight	*4.05%*
2016 HPR	*5.1%*
HP Benchmark Return	*28.8%*
Excess Return	*(23.7%)*

All figures in CAD

Crescent Point Energy Corporation (TSX: CPG)

Investment Thesis

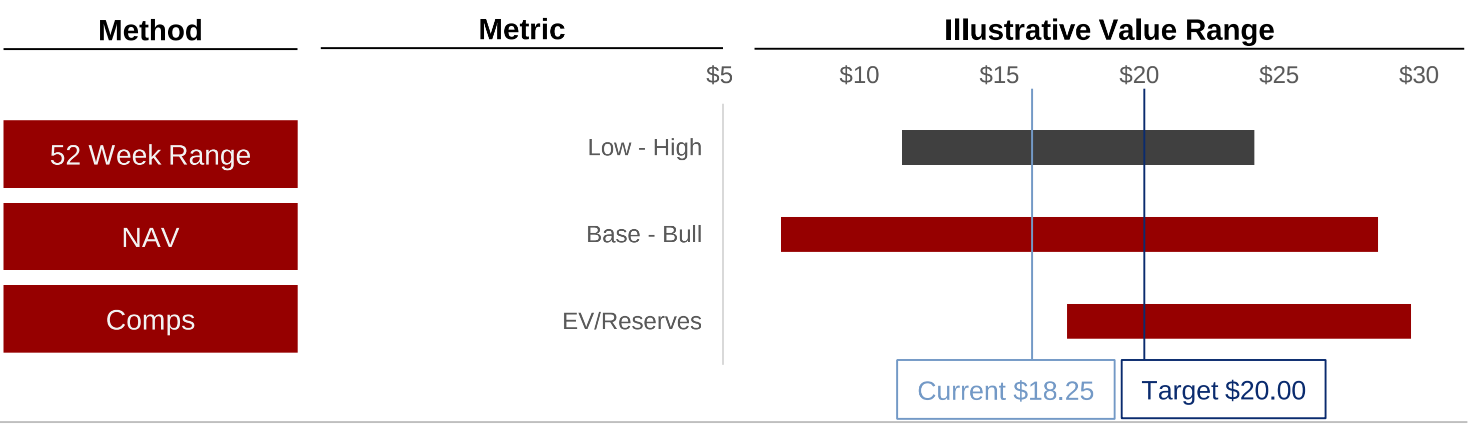
1. **Strategically focused on light oil backed by strong asset base:** *CPG continues to expand its asset base*
   - CPG has 13 years of inventory (2P) with only 3% recovered to date
   - Location in the Bakken region allows CPG to access the same oil as North Dakota peers while costs are denominated in CAD
2. **Ability to grow organically in any environment:** *CPG has continued to grow despite period of low oil prices*
   - In 2016, CPG added 15,000bbl/day of production capacity in its Flat Lake, Viking and Uinta locations
   - Discoveries were made internally, and the development of new plays will be financed by the bought-deal
   - Earlier in the year management claimed growth plans would be financed by cash flow from operations, leaving investors surprised when it announced an SEO and causing the stock to drop 7%
   - The issuance was in keeping with management's guidance as cash flow from operations will be used to finance existing growth plans with the issuance proceeds earmarked for new projects
3. **Competitive advantage of propriety technology**: *Crescent Point's established and new proprietary technology continue to give it an edge over competitors in the area*
   - Flat Lake, where the company has focused the expansion of its proprietary Waterflood technology, has experienced netbacks 24% higher than the corporate average
   - In 2016, CPG further developed its proprietary technology doubling production rates in six months
4. **Healthy balance sheet and coverage ratios:** *CPG enters 2017 with a clean balance sheet*
   - The company completed $650mm of equity financing, a portion of this will be used to pay down debt, albeit the exact amount is unknown.
   - Strong balance sheet allows CPG to be agile in acquiring land when attractive opportunities arise

Analysis of Performance

Since we initiated our position in CPG in April of this year CPG has underperformed our benchmark, returning 5.1% compared to 28.8%. However, for most of the year CPG was trading above the benchmark, that is until September when it announced it's plan to issue $650mm worth of equity, despite management assuring investors that all growth would be financed internally earlier in the year. In response to the news, the stock dropped 7%. This combined with the dividend cut in 2015 has made investors uneasy about management's decisions and what appears to be their relatively diluted share in the company. We believe this feeling to be the reason why Crescent point continues to trade at a discount.

While many of it's peers decided to reduce capital expenditures in 2016 CPG shifted toward exploring its assets for horizontal drilling capabilities and to enhance its proprietary technology. Both of these initiatives have paid off and CPG is set to enter 2017 with an asset base approximately 20% greater than it began 2016 and a more efficient way to access it. Moreover, if oil prices remain the in $50s, as we predict, CPG will be poised to take advantage of the improved commodity price environment. We expect this growth potential to push CPG to outperform.

Valuation Summary



MEG Energy Corporation (TSX: MEG)

Company Overview

- MEG Energy Corporation (MEG) is a pure-play oil sands company developing the southern Athabasca oil sands region of Alberta
- The company currently has 2.99 Bn barrels of 2P reserves and achieved production of 83,404 boe/d in Q3 2016
- Owns 100% working interest in two oil sands projects and 50% interest in the Access Pipeline (from Fort McMurray to Edmonton) and an Edmonton storage terminal
- MEG uses stream-assisted-gravity-drainage (SADG) extraction methods and innovative eMSAGP technology at its Christina Lake production site

Catalysts

- OPEC's decision to cut production by 1.2mm barrels per day could help to increase prices and therefore allow MEG to be profitable, given their current breakeven WTI price of $65.14 CAD ($49.73 USD)
- MEG has increased capital spending on projects for 2017 to $590mm, up 372% from $125mm in 2016
- Sale of the Access Pipeline would provide at least $1.1Bn to be put towards paying off debt

Risks

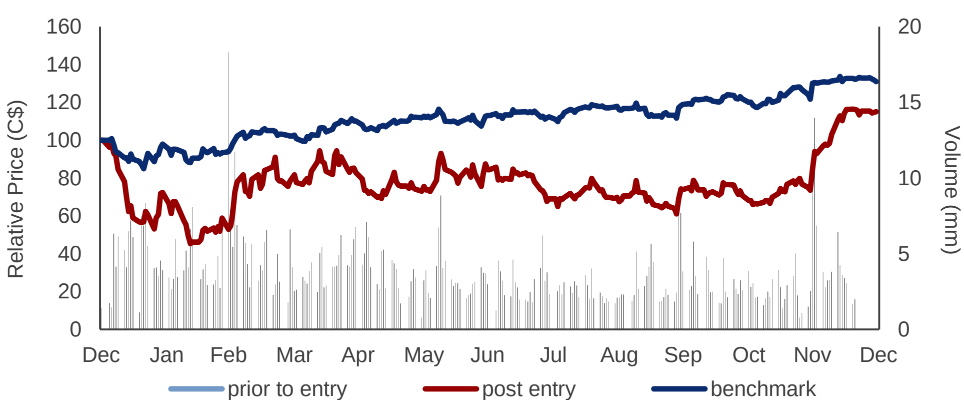
- MEG is still heavily indebted, with around $5Bn million of debt maturing 2020
- Increased crude oil production by U.S. oil and gas companies could offset OPEC's production cut, and keep the equilibrium price in the low-mid $50/bbl range
- Environmental regulation could lead to increased taxes on oil sands production

Financial Summary

Public Market Overview	
(values in $mm, as of Dec. 31, 2016)	
Share Price	$9.23
S/O (M)	226.4
Market Cap.	**$2,090**
+ Total Debt	$4,938
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$103
Enterprise Value	**$6,924**
Beta (1-Year)	3.75
52-Week High	$9.34
52-Week Low	$3.64

Financials & Multiples	FY2015A	FY2016A	FY2017E
(values in $mm)			
Production (boe/d)	80,025	81,531	83,788
% Growth		*2%*	*3%*
Diluted CFPS	-$0.87	-$1.30	$1.58
% Growth		*-49%*	*222%*
Netback	$19.47		
EV/EBITDA	*25.1x*	*20.9x*	*10.6x*
Net Debt/EBITDA	*18.2x*	*15.5x*	*7.6x*

Normalized Stock Price and Sector Benchmark Performance



Benchmark: 40% U.S. Energy index (XLE) in CAD, 60% S&P/TSX Capped Energy Index (XEG).

Position Snapshot

Average Cost	*$33.15*
# of Shares	*5,195*
Value Invested	*$47,950*
Portfolio Weight	*1.88%*
2016 HPR	*15.1%*
HP Benchmark Return	*31.1%*
Excess Return	*(16.0%)*

All figures in CAD

MEG Energy Corporation (TSX: MEG)

Investment Thesis

1. **Overblown sell-off due to negative market sentiment:**
   - Despite a harsh macro environment in 2016, MEG has kept its debt at a manageable level
   - We project that even in an adverse macro environment MEG will be able to cover their interest expenses over the next three years and the company also has the option of selling its stake in the Access Pipeline to pay down debt
   - MEG's undeveloped Surmont properties provide option value to the company if oil prices rise enough for the new project to become profitable
2. **MEG's "hub and spoke" marketing strategy and strategic initiatives:**
   - MEG is proposing a new SAGD (steam-assisted gravity drainage) project in their third location, May River, with an anticipated construction start date of 2019. The plan includes three phases of development, with planned capacities of approximately 40,000 bpd at Phase 1 and Phase 2 and 80,000 bpd at Phase 3
3. **MEG is covering costs despite negative macro outlook:**
   - MEG has been able to cover expenses and keep production flat on a y-o-y basis at $50 per barrel
   - We project MEG to be cash flow positive in 2017, due to increasing oil prices and the long-life time of existing reserves, which require limited incremental capex

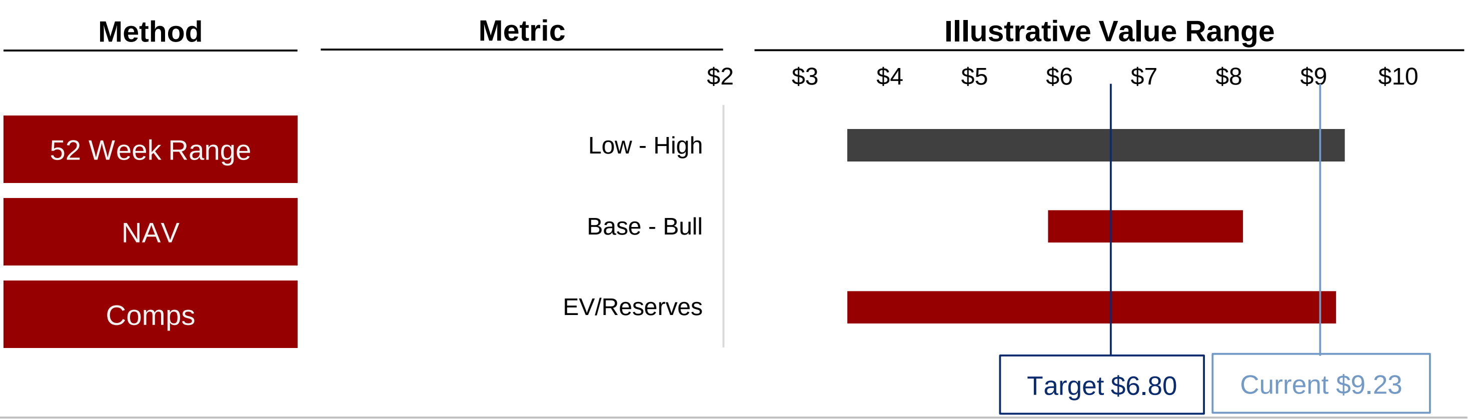
Analysis of Performance

Throughout 2016 MEG underperformed our benchmark, returning 15.1% compared to 37.0%. Company specific issues, such as worries over the ability to refinance the company's debt dominated what should have been a favourable macro environment. In fact, up until November, MEG was down 29% from the beginning of 2016. Most of the stock's price appreciation occurred in the last two months of the year, where it increased by 68.7% from $5.47 per share in November to $9.23 at the end of December.

There are various explanations for these irregular returns, the most compelling of these is that a significant amount of the value of MEG comes from its yet undeveloped Surmont project. Currently, with oil prices close to $50, it would be unprofitable for MEG to begin production at Surmont, however as prices approach the $70-$80 range the likelihood of this project becoming profitable increases. Using options terminology, one could say that the value of the Surmont facility, being extremely out of the money for the majority of 2015 had a low delta which slowly rose as oil prices rose, explaining the large price response to the OPEC announcement.

Following the 2016 year-end, MEG's management announced plans to increase capital expenditure for 2017 to $590-million from $125-million in 2016. The market reacted poorly to this news, with MEG falling 23% in the following two weeks. We believe that this was warranted as the decision to prioritize capital expenditures, at prices we estimate to be below MEG's breakeven cost of production, over paying down the company's debt burden put the company in serious risk, while also being funded through a highly dilutive equity issuance.

Valuation Summary



Emera Inc. (TSX: EMA)

Company Overview

- Emera Inc. is a diversified energy and services company headquartered in Halifax, NS
- Emera invests in electricity generation, transmission and distribution as well as natural gas transmission and utility services
- Emera has significant investments throughout NE North America and four Caribbean countries
- Earnings come from 10% non-regulated utilities and 90% regulated utilities where revenue segments are broken down into the following segments: Nova Scotia Power (NPSI), Emera Maine, Emera Newfoundland/Labrador, Emera Caribbean, Emera Energy and Pipelines

Catalysts

- Well positioned to capitalize on global energy trends of aging infrastructure and environmental concerns
- Acquisition of TECO Energy provides new strategic growth platform for Emera with a combined $6 billion in capital investments planned through 2020
- Exponential technologies are accelerating the momentum behind the electric power industry

Risks

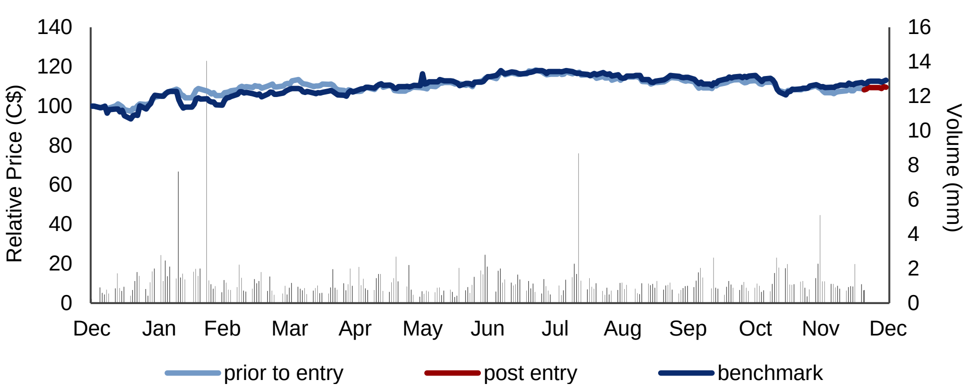
- Current low crude price environment could deter the use of cleaner, renewable energy sources
- Risk of rising long-term interest rates given high capital requirements of power and utilities industry
- Rise of small-scale utility providers pose as competitive threats to large integrated companies by putting downward pressure on prices

Financial Summary

Public Market Overview	
(values in $mm, as of Dec. 31, 2016)	
Share Price	$45.39
S/O (M)	209.9
Market Cap.	**$9,529.3**
+ Total Debt	$15,440
+ Minority Interest	$110
+ Preferred Shares	$0
- Cash	$415
Enterprise Value	**$24,664.3**
Beta (1-Year)	0.67
Dividend Yield	4.6%
52-Week High	$48.97
52-Week Low	$40.32

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $mm)			
Revenue	$3,495	$6,994	$7,404
% Growth		*100%*	*6%*
EBITDA	$1,078	$2,454	$2,628
% Margin		*128%*	*7%*
EPS	$2.21	$2.71	$3.01
% Growth		*23%*	*11%*
EV/EBITDA	*22.9x*	*10.1x*	*9.4x*
P/E	*20.6x*	*16.8x*	*15.1x*

Normalized Stock Price and Sector Benchmark Performance



Benchmark: XUT iShares S&P/TSX Capped Utilities Index ETF

Position Snapshot

Average Cost	*$45.23*
# of Shares	*2,400*
Value Invested	*$108,936*
Portfolio Weight	*4.28%*
2016 HPR	*1.3%*
HP Benchmark Return	*1.7%*
Excess Return	*(0.4%)*

All figures in CAD

Emera Inc. (TSX: EMA)

Investment Thesis

1. **Underappreciated growth profile following integration of TECO acquisition:**
   - Completion of TECO Energy acquisition gives Emera access to new markets in U.S. where the deal is expected to be 5% accretive to EPS in 2017 and 10% accretive by 2019
   - Further U.S. expansion provides geographical diversification to New Mexico and Florida

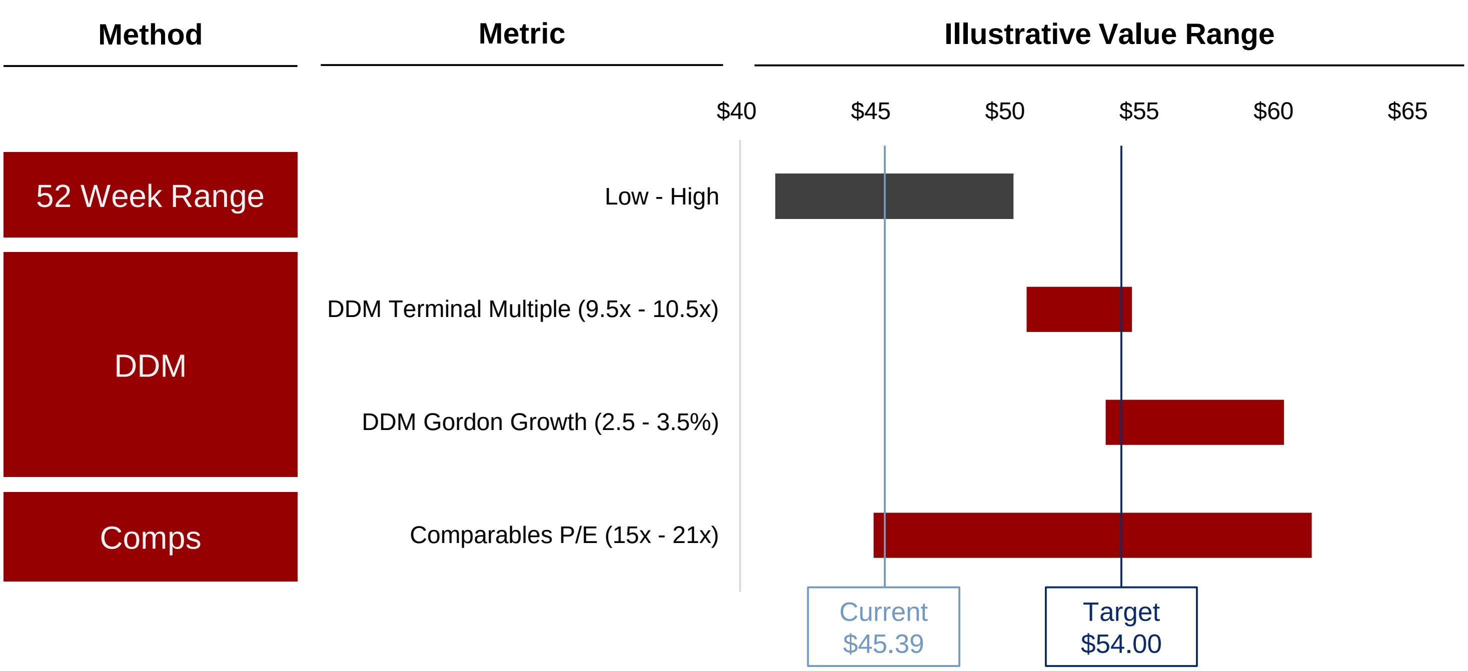
2. **Well positioned to capitalize on rapid growth of renewable energy:**
   - Investment in clean energy projects, Maritime Link and Labrador Island Link, where Emera is part of a larger strategy to address growing demand for more renewable energy. This will enable the transmission of clean and reliable electricity from Newfoundland and Labrador to Nova Scotia
   - Pro-forma USD$6.4Bn capital investment plan to drive growth of renewables (2016-2020)

3. **Attractive valuation and high dividend growth with low business risk:**
   - Attractive investment opportunity to achieve target dividend growth of 8% per year through to 2019 with a low business risk from regulated utility operations
   - Further trades at a discount relative to power and utilities peers on a forward P/E and EV/EBITDA basis

Analysis of Performance

DCM took a position on Emera Inc. near the end of 2016 on December 20 for a total weight of 4.28% of the overall global equity portfolio. Over the short holding period, EMA returned 1.3% which outperformed the utilities benchmark return of 1.7% on a risk-adjusted basis given its 1-year 0.67 beta. When we look at Emera's performance in 2016 prior to entering our position, it is evident that the stock closely tracked the utilities benchmark and remained relatively flat throughout the year. This trend is consistent with the performance of utility companies as cashflows are contractual and often steady in nature. We expect to see Emera's trading multiples converge with peers when the company begins to realize synergies from the TECO Energy acquisition.

Valuation Summary



Technology, Media, & Telecommunications Sector

2016 Review & 2017 Outlook

By Alexander Bibic, Robert Chen, Kendyl Flinn, David Marcovitch, and Tony Ren

DCM Performance

The Global Equity Fund's Technology, Media, and Telecommunications (TMT) sector returned 26.4% in 2016, 17.2% over the sector benchmark, with strong outperformance in both the Technology/Media as well as Telecom subsectors (Figure 1 and Figure 2). Some of our top performers included Time Warner (up 43.1%), Cogent Communication (up 10%), and Intel (up 6.7%). Details are provided in the holdings review section below.

Figure 1: DCM Telecom

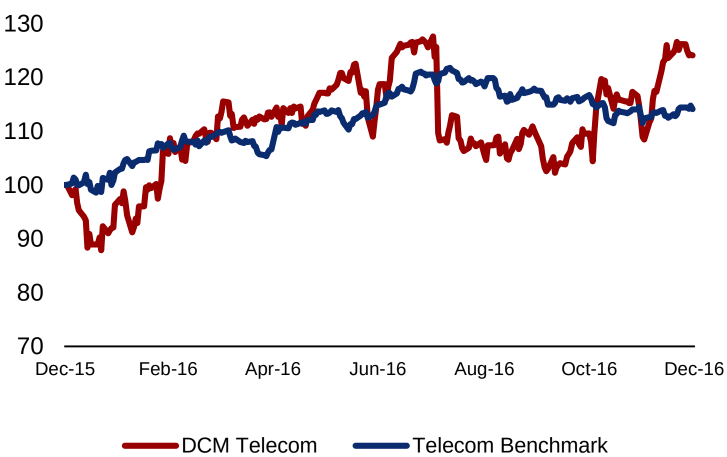
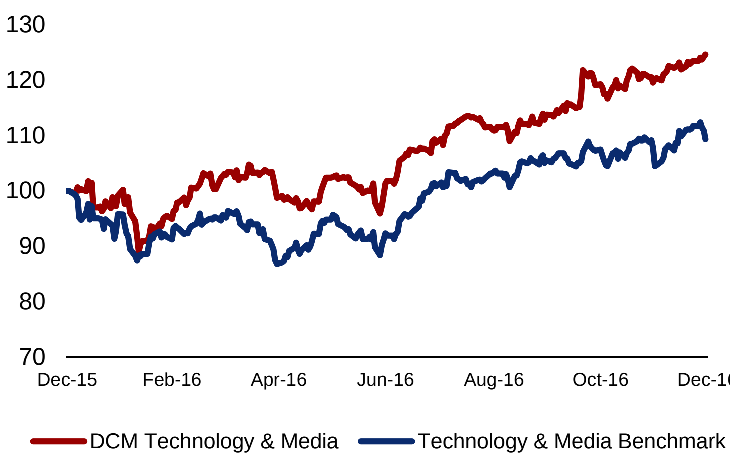


Figure 2: DCM Technology & Media



In terms of subsector allocation in 2016, the team felt there were more opportunities in the technology space and we focused on new investments there. Telecom, however, will become a larger focus for the TMT team in 2017 as we search for underappreciated and innovative companies in the space. It will be particularly interesting to see how companies are impacted by Trump's regulations regarding net neutrality and protectionism. Cogent, and other companies that are wiring the world, will likely face pressure from the new administration on pricing and access. Overall, we remain diversified across multiple sub-industries and are excited to uncover profitable trades as many new and innovative companies keep entering the Technology, Media and Telecommunications sector

2016 Total Shareholder Return Breakdown

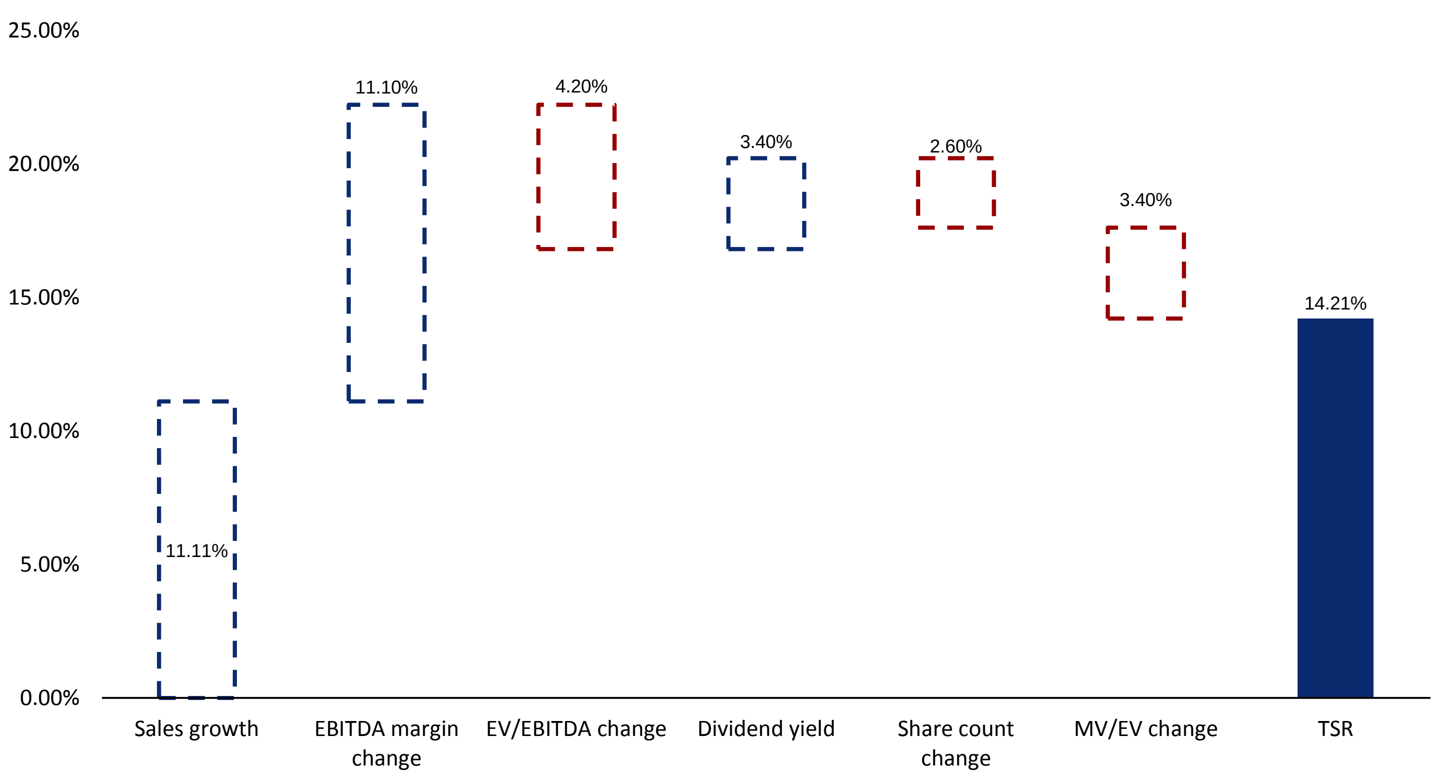
Total shareholder return (TSR) can be attributed to three main factors: changes in short-term fundamentals, changes in long-term expectations, and cash flow effects. Fundamentals can further be broken down into sales growth and EBITDA margin, and the change in EV/EBITDA multiple reflects changes in shareholder expectations of future performance. Finally, cash flow effects include dividend yield, buybacks, and debt repayments (change in MV/EV ratio). The table below lists the top ten S&P 500 companies ranked by 2016 Total Shareholder Return (TSR).

Figure 3: Top S&P 500 Companies by Total Shareholder Return

Company Name	Sector	TSR	Sales growth	Margin change	Multiple change	Dividend yield	Share change	MV/EV change
NVIDIA Corporation	Information Technology	236.38%	6.13%	4.35%	237.25%	0.54%	1.24%	-13.13%
Chesapeake Energy Corporation	Energy	167.65%	-60.08%	31.52%	126.29%	0.00%	-6.80%	76.71%
Southwestern Energy Company	Energy	150.46%	-25.74%	-38.54%	152.48%	0.00%	-7.35%	69.61%
ONEOK, Inc.	Energy	107.44%	8.09%	6.06%	22.50%	4.35%	-0.32%	66.76%
Freeport-McMoRan Inc.	Materials	96.48%	-4.74%	21.68%	8.30%	0.00%	-16.57%	87.80%
Newmont Mining Corporation	Materials	74.25%	0.63%	0.12%	49.94%	0.57%	-2.76%	25.76%
Spectra Energy Corp	Energy	71.01%	-8.20%	9.37%	43.64%	4.19%	-2.35%	24.36%
Applied Materials, Inc.	Information Technology	63.20%	11.88%	13.00%	29.13%	1.18%	8.81%	-0.81%
Quanta Services, Inc.	Industrials	75.91%	3.12%	4.88%	46.91%	0.00%	18.49%	2.51%
Martin Marietta Materials, Inc.	Materials	54.42%	-2.48%	24.74%	25.79%	0.74%	3.92%	1.71%

Only two of the top ten are TMT companies, compared to six in 2015. NVIDIA, the top performer, did exceptionally well as investors expect graphics card sales will increase as VR becomes more main stream. Figure 4 below shows the 2016 return decomposition for the sector as a whole. The main takeaway is that both sales and margin improvements were significant, but that upside was limited due a multiple contraction. The declining multiples are understandable given the frenzy in the space over the past two to three years. Indeed, current valuations imply more reasonable prices in our view.

Figure 4: Sector Total Shareholder Return Decomposition



Semiconductors: Boring But Relevant

For the second straight year, the Information Technology (IT) sector trumped all other sectors in terms of M&A activity. These deals dominated headlines, from Microsoft's acquisition of LinkedIn to the rumours of the sale of the struggling Twitter. Beyond the headlines, the TMT team found the transactions in the semiconductor space to be of particular interest. In fact, four of the top five announced IT deals originated from the semiconductor space. From the record-breaking Qualcomm – NXP deal to Softbank's acquisition of ARM Holdings, we believe that although the semiconductor space may not garner as much public interest as other IT deals, it is still important to analyze this activity and evaluate their valuations and rationales.

Figure 5: Announced Semiconductor Deals Over $5bn

Date	Transaction value (USD MM)	EV/LTM EBITDA	EV/LTM REVENUE	Acquisition Premium	Target	Acquirer
14-Nov-16	$8,651	10.58x	1.23x	38.65%	Harman Int'l	Samsung
2-Nov-16	$5,551	12.43x	2.44x	38.95%	Brocade Communications	Broadcom
27-Oct-16	$46,046	19.48x	5.97x	8.12%	NXP Semiconductors	Qualcomm Inc.
26-Jul-16	$12,870	18.79x	9.04x	26.03%	Linear Technologies	Analog Devices
18-Jul-16	$30,125	52.36x	23.82x	53.35%	ARM Holdings	Softbank Group
Average	**$20,649**	**22.73x**	**8.50x**	**33.02%**		
1-Jun-15	$14,354	24.85x	7.53x	18.06%	Altera	Intel
28-May-15	$29,806	27.00x	3.51x	17.12%	Broadcom	Avago
2-Mar-15	$15,769	15.82x	3.40x	2.15%	Freescale Semiconductor	NXP
Average	**$19,976**	**22.56x**	**4.81x**	**12.44%**		

As shown in Figure 5, it is evident that the number of large-scale semiconductor transactions increased from 2015. There was also an increase in multiples and premiums. While the strategic rationale differ for each deal, the major underlying themes are cost synergies and expected growth of certain sub-verticals. Softbank's acquisition of ARM exemplifies the Japanese Telecom company's bet on the growth of IoT. ARM designs processors for 95% of global smartphones and Softbank was willing to pay such a premium because it believes it can realize synergies by connecting its telecommunications assets with ARM's mobile processor assets.

Qualcomm or Softbank: Who Will Be Correct?

In DCM's 2015 Annual Report, the TMT team outlined that most of the semiconductors growth would come from the automotive sector. While the number of global light vehicle sales is expected to grow linearly, the number of semiconductors per vehicle is expected to grow at a faster rate driven by advances in autonomous driving, infotainment and safety technology. Other than automotive, the total semiconductor market is expected to slow, driven by forces such as lengthening replacement cycles for smartphones and PCs.

Qualcomm is a producer that mainly tailors to the wireless communications end-market. NXP, on the other hand, has the largest market share in the automotive segment. in contrast, Softbank's ARM acquisition banks on synergies in existing competencies rather than exposure to auto semiconductor growth.

This deal represents Qualcomm's attempt to broaden its scope and diversify from the communications end-market. Softbank is trying to increase their exposure to the communications segment while Qualcomm is trying to diversify away. Who is correct? TMT believes that Softbank is on the right track as we expect positive trends in the mobile space going forward. The Qualcomm-NXP deal not only illustrates Qualcomm's effort to broaden their scope, but also sheds light on the trend of integrating business models. There are three types of business models in the semiconductor industry. Fabless producers, in contract to foundry, focus on upstream and downstream operations such as R&D, design and marketing. They outsource the midstream production to foundries, which focuses solely on producing these chips. The IDM model (Integrated Device Manufacturers), is a combination of the two and internalizes every aspect of the value chain. Qualcomm is fabless while NXP is an IDM. The slowing growth of the total market and rising costs of input has forced producers to increase their bottom line through continued expansion. The idea is that with economies of scale, combining the two contrasting models should yield higher efficiency through elimination of head count.

Figure 6: Semi's Growth by Sector

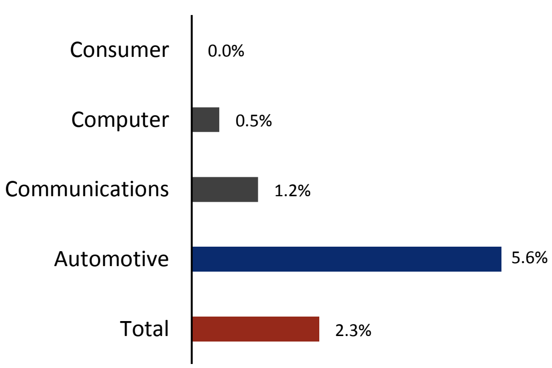


Figure 7: EV/EBITDA and Margin by Sector

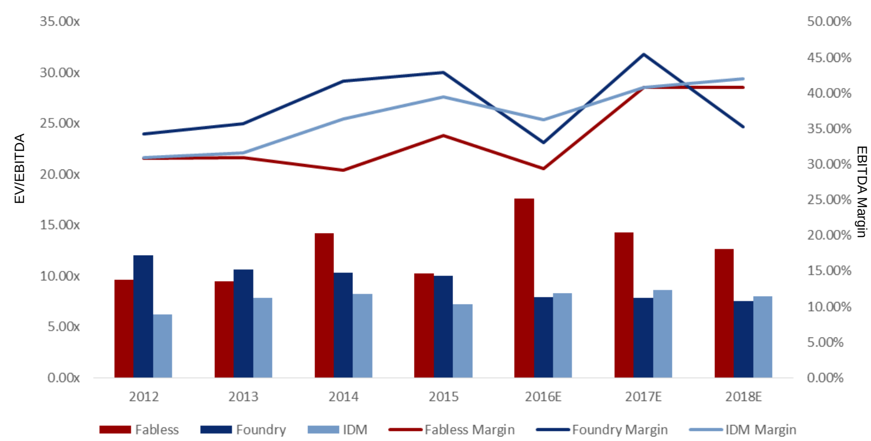


Figure 7 was derived by taking the EV/LTM EBITDA at year-end for the three largest companies for each business model. The figure illustrates that the market is expecting the IDM model to prevail over other models in terms of EBITDA margin by 2018. All else equal, with a relatively constant multiple and slightly expanding margin, the market expects IDM revenues to slightly decline in proportion. Conversely, Fabless producers (such as Qualcomm) are expected to experience margin expansion, while revenues remain relatively constant. The DCM TMT Team disagrees with the market's view of efficiency benefits from combining foundry and fabless models. They share little operational similarities as one develops IP while the other is a manufacturer. Additionally, there is enough competition in the industry whereby internalizing production will not reap significant cost benefits. As such, the TMT team holds the view that this trend towards integration creates short term increases in costs (severance, etc.) and will not necessarily create the long-term shareholder value that the market is expecting.

Relevance to DCM

The TMT team sold our position in Intel on July 20th, 2016 for an annualized return of 26%. Our motivation to sell was based on two factors:

1. Inability to maintain market leading position

- Our original thesis rested on the principle that INTC's competitive advantage lay in its favorable margins from their scale and vertically integrated structure. INTC's strategy to shift from being a market leader in PC to IoT would be restricted by the intense competition. As such, we believe margins will be hindered and it will be a difficult task to replicate their market-leading position in higher growth segments.

2. Timing

- Softbank's recent bid and the subsequent valuation provided good support as a whole for the industry and led INTC to trade near its 52-week high at the time of DCM's exit.
- Q2 PC sales coming from U.S. companies were better than expected and INTC's stock reacted favorably. Given Intel's high exposure to PC's and our long-term bearish view, we thought this temporary optimism proved good timing to sell.

Media Industry Review – Bust, Recovery or Boom?

The media industry is undergoing rapid change due to new innovative methods of content distribution. Moreover, competition for ad dollars, one of the two key sources of revenue for traditional media players, is becoming more competitive as online & mobile advertising companies become more established. With novel content distribution platforms proliferating rapidly, investors are faced with uncertainty with respect to the long-term viability of traditional media players. While skepticism about the media industry has been brewing for years, a Disney earnings release during summer 2015 developed into an industry wide derating. Disney missed estimates, and investors were particularly spooked by ESPN subscriber contraction. If sports viewership, the golden goose of the media sector, was declining, then who knows what's in store for less desirable content assets. Despite more positive results since the release, the market came to the conclusion that cord cutting was not only real, but would significantly impact earnings in the near-term. Assuming the market values media stocks using 15 years of earnings and a 10% cost of equity, we estimate that the sell-off reduced growth expectations for the sector by 2.1%. This figure is roughly in-line with market-wide cord cutting expectations of 2% annually.

Figure 8: Summer 2015 Media Sell-off

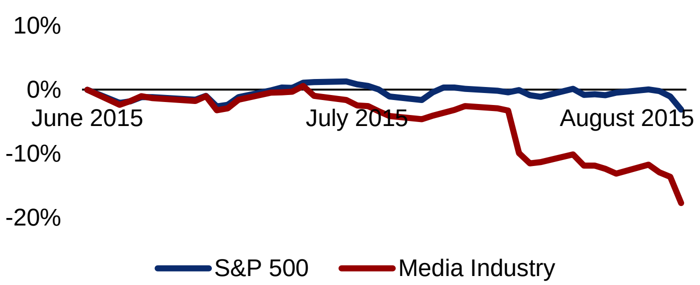
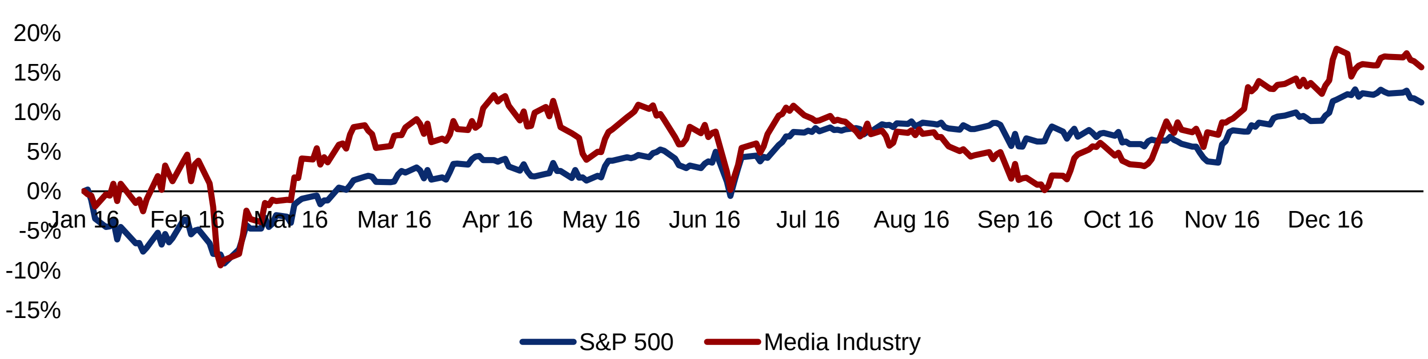


Figure 9: Implied Earnings Derating

	7/20/2015	*8/20/2015*	*Delta*
Sector P/E	*13.5x*	*11.8x*	*1.7x*
Implied Growth	*9.8%*	*7.7%*	*-2.1%*

This year, it seems that the market overacted during the sell-off and valuations have since increased. Surprisingly, there was a resurgence in the TV advertising market. 2016 upfront ad buying was up due to a very strong scatter market in late 2015. TV advertising defied expectations and increased 6% in Q1 2016. Overall, the sector outperformed the S&P 500 by 4.5% over the year.

Figure 10: Performance of Media Industry



Evolution of Cord-cutting

Now, the main debate in media surrounds the meaning and velocity of declining subscribers and ratings. Many new terms have been coined by media analysts to describe subscriber erosion. Cord cutters are those who cancel their TV subscriptions. Cord shavers are those who downgrade their current subscriptions. Cord nevers are millennials who don't have and will likely never have a TV subscription. All these terms are meant to categorize how consumers are reacting to new online platforms for content distribution. Media investors initially believed these changes to be negative, and valuations suffered as subscriber contraction hastened. This year, attitudes have shifted and media stocks have partially recovered from the derating in summer 2015. A key source of concern was substantially lower pricing for OTT offerings vs. TV subscriptions. A Netflix subscription currently runs at approximately $9.99/month. For comparison, Time Warner Cable's basic offering costs $44.99/month. Despite Netflix content spending increasing from $2.8bn in 2012 to $7.0bn in 2015, the increased content licensing revenue would not be enough to compensate for lost subscribers. Attitudes have evolved and it now seems plausible that more expensive online options will proliferate. The seemingly low cost of Netflix is not due to lower content acquisition prices (in fact they may be paying a premium for content), but due to considerably less content available to users. More expensive Live TV options (online cable) provide more content to users and have similar economics to the traditional cable ecosystem. The Live TV market is niche as there are only ~20mm broadband-only homes, but it is expected to grow as cord cutting increases and more platforms come online (Hulu and YouTube Unplugged are expected to be released in H1 2017). Media valuations have recovered as investors have come to terms with the fact that there is more to online media than Netflix.

Figure 11: Historical US Subscriber Count

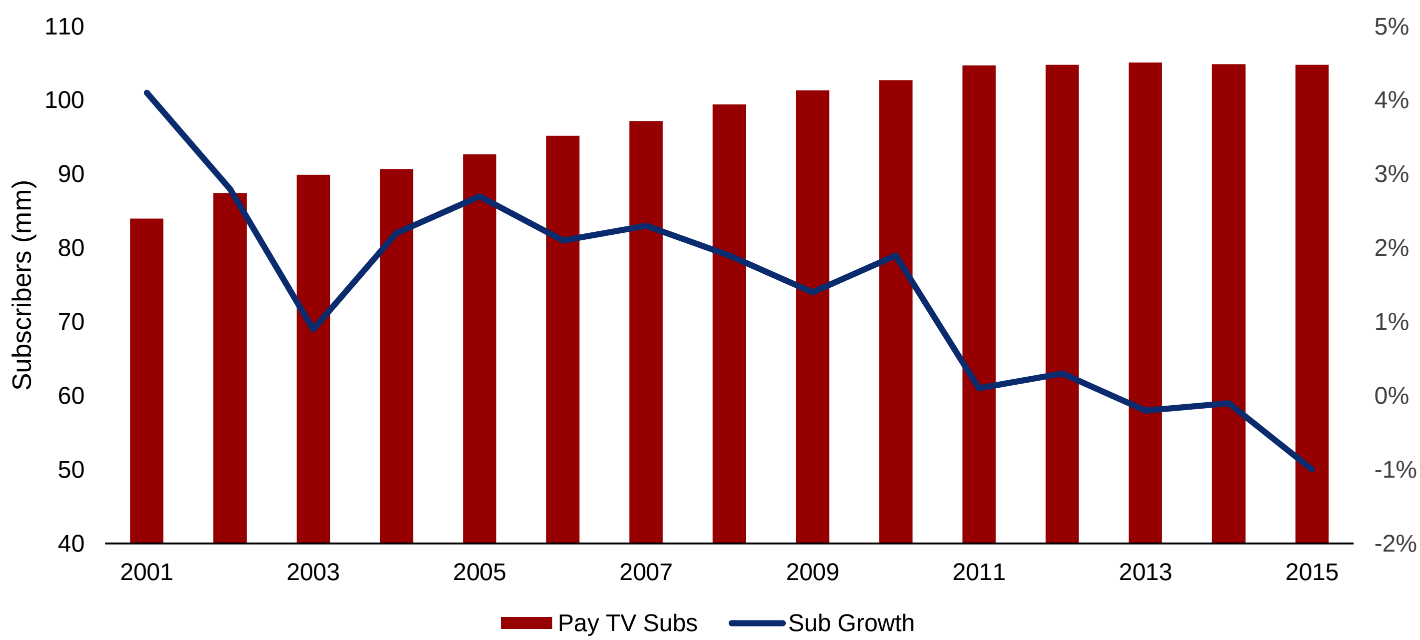


Figure 12: Evolution of Media Landscape

Media M&A

AT&T's pending acquisition of Time Warner and CMCSA's acquisition of DreamWorks has led many to speculate of a revival of media M&A. Telco and Internet companies are likely strategic buyers. Moreover, a repatriation tax holiday may arm Internet companies with additional cash for a large acquisition. The TMT team believes large media M&A is unlikely as most players have significant family ownership. If the Time Warner merger closes, the last media company without significant family ownership is Disney, but its large market cap is a prohibiting factor. While we don't believe there will be a revival in media M&A, we do believe the transition to online media will influence cable companies to become integrated with wireless. The ability of integrated telecom players (AT&T for example) to provide zero-rated mobile services bundled with exclusive content is valuable to consumers, and cable companies will need a wireless footprint in order to compete. Unless new regulation aimed at curbing zero-rated services comes to fruition, we see the likelihood of more mergers between cable and wireless as high.

Conclusion

While media outlook has improved, multiples are still lower than they have been historically. Media currently trades at ~3 turn discount to the S&P 500, and ~4 turn discount to consumer discretionary. Fear of disruption is still a large burden on media valuations. In our view, traditional media is undervalued and these companies will succeed in an online environment. The longstanding slogan that "content is king" will hold true.

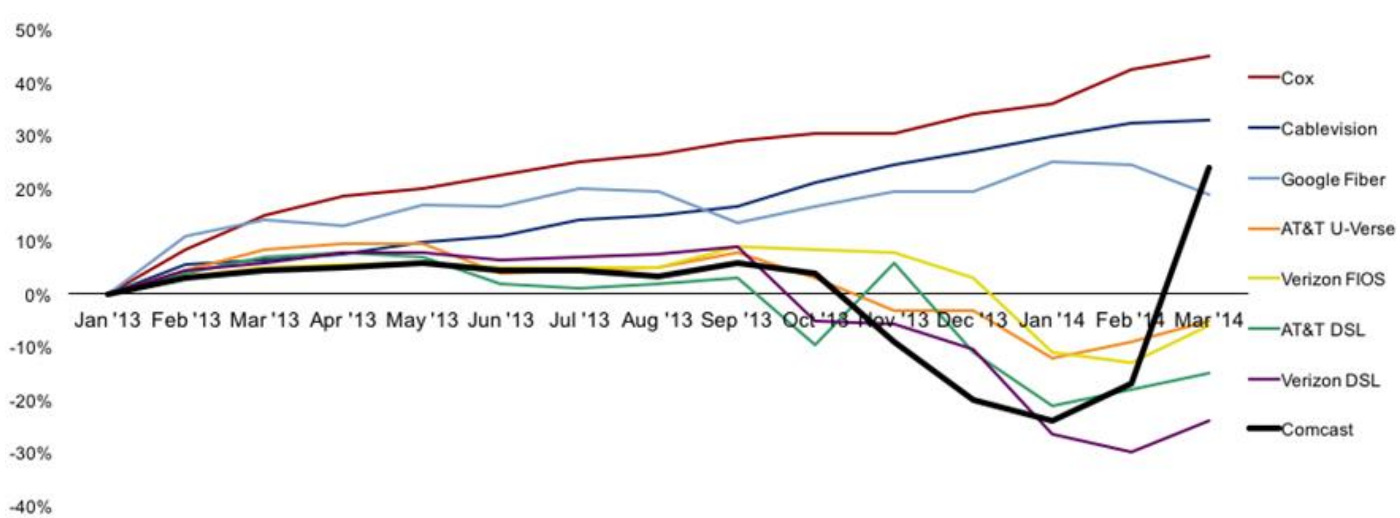
Net Neutrality Primer: All's Fair in Love, War and the Internet

Net neutrality is the concept that all data flow on the internet should be treated equally regardless of end user and content. This paradigm calls for regulation of practices such as throttling (intentional slowing of internet service at the demand of a premium) and content blocking by Internet Service Providers (ISP's). Net neutrality is backed by the rationale that preventing this sort of internecine corporate competition will improve the end-customer experience. In February 2015, the Federal Communications Commission (FCC), which regulates all US communications by radio, TV, wire, satellite, or cable, voted 3-2 to enact a bill which would allow them to assert government authority over the Internet.

Internet Wars: Comcast-Netflix

In 2014, Comcast (ISP) subscribers experienced a sharp decline in Netflix streaming speeds due to growing congestion at Comcast's peering points with third-party ISP's, who would ultimately deliver the content to Netflix users. Although this problem, which hurts both Comcast and Netflix, stemmed from Comcast's infrastructure, they were not as incentivized to fix the glitch, as they are a diversified incumbent and could afford to negotiate with Netflix. However, Netflix, whose sole value comes from delivering high quality, fast content to their customers, had no other option but to resolve the issue immediately. Therefore, Netflix and Comcast entered into an infrastructure upgrade agreement which would create a specialized Netflix content delivery network (CDN) that would directly deliver Netflix content to consumers, entirely at the expense of Netflix. This case was only one instance in an industry-wide theme of incumbent ISP's leveraging the dependency of content providers at the ultimate expense of the customer. This case was a key precedent for future arguments supporting net neutrality. As shown in Figure 13, the Comcast streaming speeds for Netflix dropped severely before shooting back up again after the Comcast-Netflix deal.

Figure 13: 2013 Netflix Streaming Speeds by Major ISP's



The Future Under Trump

Since Trump's rise to presidency in November 2016, the future of net neutrality has become more unclear as the FCC undergoes a transition period under Trump's appointed team. The FCC is composed of five members: a chairman and four commissioners. It must have at least 2 representatives from each political party with the fifth seat traditionally belonging to the presidential party. In December 2016, Tom Wheeler, the former Democrat chairman of the FCC, appointed under Obama's presidency, and a key proponent of net neutrality, announced his resignation. Moreover, Jessica Rosenworcel, another Democrat FCC commissioner was not reenlisted for another term by the Republican Party. This leaves Trump with an immediate Republican majority once Wheeler officially steps down in January and additionally two empty spots to fill. Now that the Republican Party has gotten past the initial logistics and is on the verge of attaining formal enacting power, we can expect to start seeing some initiatives aimed towards rolling back net neutrality. However, much of the regulatory direction still awaits the choice of candidates for the soon-to-be two unfilled spots on the board. Overall, the future of net neutrality is uncertain and we can only wait and see to what extent the new FCC will revoke the previously made regulations.

Relevance to DCM Holdings

Time Warner Inc. (TWX) – Net Neutral

Time Warner Inc. is currently being acquired by AT&T in a high-profile merger pending government approval. A key regulatory concern with the deal is the potential for AT&T to zero-rate their own Time Warner content. Zero-rating means allowing free unlimited data flow for a certain stream of content to the consumer. This service usually costs the content provider a fee from the distribution network but it's a different story when the same company owns both the content distributor and the channels. From an anti-trust perspective, some would argue that this provides the owner of both content and channels with an unfair advantage against other content competitors. However, with the new Republican congress and their views on net neutrality, the regulatory headwinds against this merger could be less of a concern. Finally, Trump has explicitly stated during his campaign trail that he would never let the deal go through. There is also a well-known history of strife between Trump and Time Warner's CNN segment. However, there is still uncertainty as to the follow through willingness and capabilities of Trump on this matter.

Cogent Communications (CCOI) – Slightly Negative

Cogent Communications, a third party corporate-focused ISP, relies on the efficiency of peering points between their network and major ISP's to effectively deliver their service. Cogent has had a history of successful disputes and court cases with these ISP's regarding congestion in these ports and their responsibility to upgrade and pay for that infrastructure as traffic increased. With the enactment of net neutrality enforcement in 2015, incumbent ISP's were pressured into upgrading their ports, thereby increasing the speed and usage for all users, including Cogent, which benefitted free-of-charge. With the new Republican congress in power, however, the feasibility of continued future peering disputes for Cogent may be in question as the new majority favors free, unregulated markets.

VR, AR, AI – What do acronyms mean for TMT?

Timeline: Artificial intelligence technology has rapidly grown in all sectors over the last decade.

- 1950s, Alan Turing invented the first “intelligent” machine
- 1960s, computer controlled tool for handicapped
- 1989, the first computer-controlled car drove 3,000mi
- 1990s, www. spread by web crawler info extraction software
- 2000s, banks use AI for cyber-security and then outsource it
- 2000s, Apple makes Siri and Amazon makes Echo
- 2012, Google Brain is trained to recognize cats in YouTube videos
- 2016 Uber is partnering to make self-driving taxis

Although the technology was first invented in the 1950s, artificial intelligence (AI) became especially popular recently, and it is now integrated into every aspect of our technological experience. Google and Facebook use complex, deep-learning algorithms to study patterns and preferences. Tesla is using machine learning to create self-driving cars. The trend is growing, and is only going to become more prevalent in the future. The umbrella of AI covers a wide range of topics including cognitive computing, deep-learning, machine learning and reasoning, natural language processing, and predictive computing. Going forward, it will be important to identify the segments of AI generating the most value and which companies successfully seize market share. A lot of this understanding can be gleaned through precedent analysis.

Acquisitions In The AI Space

There is a race for market share and relevance in the space as large technology companies are rapidly acquiring to create the best software and lead innovation going forward. Google heads the race with 11 acquisitions in the AI space in 2016; closely followed by Oracle, Yahoo, Intel, Apple, Microsoft, and Salesforce.

The majority of companies acquired are still very young in the life cycle but already have strong VC funding. See the table below for precedent transactions in the space.

Figure 15: M&A Activity Involving AI Firms (Quarterly From 2013-2016)

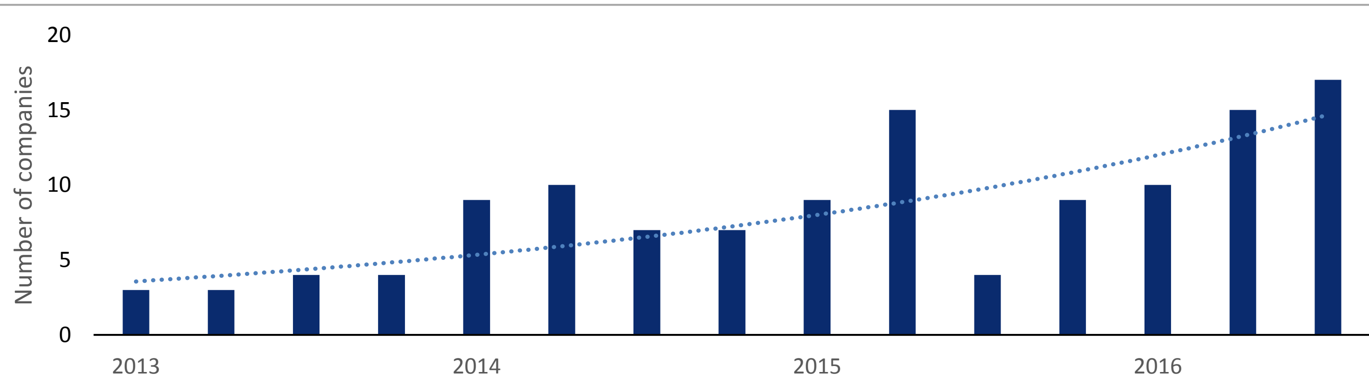


Figure 16: Precedent Transactions

Target	Acquirer	Field	Date	Deal Valuation ($mm)	Private Capital Raised ($mm)
DeepMind	Google	Deep Learning	Jan-14	$650	$50
TellApart	Twitter	Machine Learning	Apr-15	$480	$18
Elastica	Blue Coat System	Cloud Security	Nov-15	$280	$45
SwiftKey	Microsoft	Cognitive Computing	Feb-16	$250	$22
MetaMind	Salesforce	Deep Learning	Jul-16	$33	$8
Turi	Apple	Machine Learning	Aug-16	$200	$25
Nervana	Intel	Deep Learning	Sep-16	$400	$24

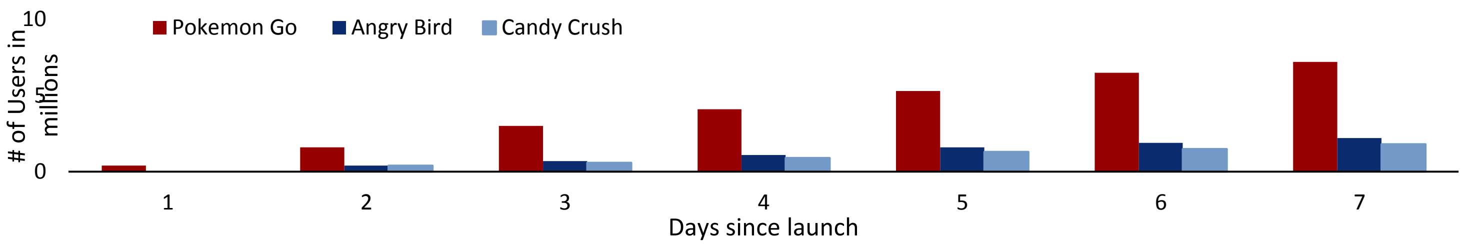
Overblown Fears Stemming From Technology Dependence

A large fear with AI is often that people will lose their jobs to robots as many manual tasks become obsolete or digitized. DCM does not believe this grim picture will necessarily become a reality when evaluating the impact of artificial intelligence. In fact, there are many new job categories created due to increasing dependence on cognitive computing and machine learning. Namely, jobs in engagement, development, supervision, and response to shifts could lead to entirely new segments of demand. People still need to engage with consumers to increase adoption and help the average person understand the positive possibilities coming from new innovation. There will also be drastically increasing demand for people with technical skills in development work. Many new segments would require advanced education, and governmental support can help make basic education to at least a high school level more accessible. Governments in the developed world will likely remain skeptical but supportive of advancing these new technologies in order to remain a front runner in innovation going forward. Governmental support and partnership could help automation be understood as a need for productivity rather than detracting from it. This will allow the sub-sector to flourish and investments to grow larger and larger throughout the future.

Case Study On Modern AR: Pokemon Go

When private game developer Niantic Inc. launched Pokémon Go in June 2016, it was a major success. Nintendo (unaffiliated with the developers of the game) even surged 108% during the hype before shortly falling back down. The game uses players' location to augment reality with the virtual Pokémon world so players can capture characters and collect points. This was the first time augmented reality technology spread so successfully through all levels and sectors of society. The game also exemplified to other industry competitors how popular this sort of technology can become. Since the game was provided on such a straightforward platform, even average consumers could understand and use the technology.

Figure 17: PokemonGO Launch Week Daily Average Users vs Precedents



Who Will Be Impacted?

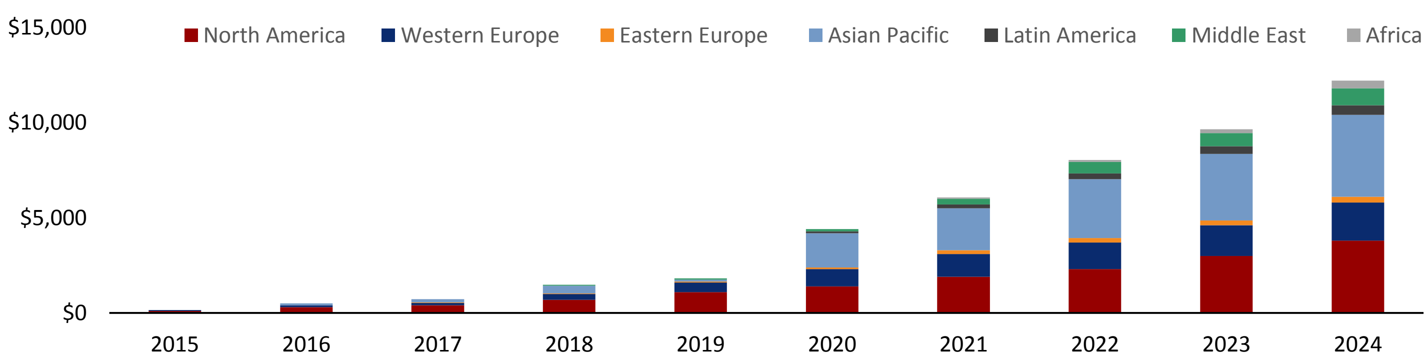
Some form of artificial Intelligence is finding its way into almost every industry in the world. The largest developers are software and internet companies, but telecommunications, research, retail, and marketing are growing in investment every day. With this popularity comes capital from the investment community as well. The founders of eBay and LinkedIn, Pierre Omidyar and Reid Hoffman, announced a $27mm fund dedicated exclusively to funding research into artificial intelligence. As investments and growth become more common, more firms will be entering the IPO market and become potential investments for the DCM team.

Relevance To DCM

DCM is looking at an exciting but volatile investment landscape in many sectors going forward due to the impacts of technology, particularly artificial intelligence. Many firms in the space do not technically fall under TMT given the service brought to customers, but the methods to provide the service would not be possible without technology (Ex. Amazon, Netflix, etc...). TMT is currently taking advantage of the growth in AI through our investment in Solium Capital. Solium's key product is equity compensation planning, but the only value of the firm is in the software platform they provide to customers. The firm's AI application is on the simpler side of machine learning, making it clear for the team to understand and value. The system is able to search, read, and properly file tax documents pertaining to equity compensation initiated or drawn-upon using natural language processing.

Going forward, the TMT team will continue to study the growth in AI and work to understand which segments within the space will succeed going forward.

Figure 18: Growth In AI Revenue By Region



Technology, Media, & Telecommunications Sector

Holdings Review

Apple Inc. (NASDAQ:AAPL)

Company Overview

- Apple is a large-cap, US-based multinational technology company that designs, develops, and sells consumer electronics, computer software, and online services.
- Their products include the iPhone, iPad, iPod, Apple Watch, MacBook, and Apple TV player. Their services include the iTunes Store, iOS App Store, Mac App Store, Apple Pay, and iCloud.
- With $233.7B in revenue in FY 2015, Apple is currently the world's largest information technology company by revenue and the world's largest technology company by total assets.

Risks

- Significant dependency on declining iPhone business (63.3% of FY 2016 net revenues) creates pressures to find other sources of growth.
- Aggressive native smartphone competitors (Oppo, Vivo, Xiaomi, Huawei) could potentially extinguish Apple's presence crucial foreign markets.

Catalysts

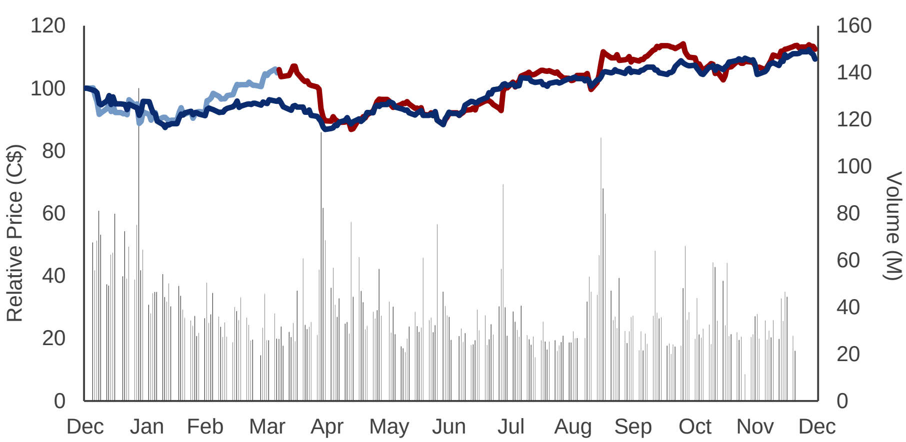
- Newfound growth in Apple Services segment driven by new revenue streams (Apple Pay) and growing installed user base.
- Investments in international markets such as China can derive new sources of revenue growth through market penetration.

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$115.82
S/O (M)	5332.3
Market Cap.	**$617,588.5**
+ Total Debt	$87,039
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$20,484
Enterprise Value	**$684,143.5**
Beta (1-Year)	1.19
Dividend Yield	1.9%
52-Week High	$117.65
52-Week Low	$89.39

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$215,639	$228,382	$242,958
% Growth		*6%*	*6%*
EBITDA	$70,529	$73,746	$80,040
% Margin		*5%*	*9%*
EPS	$8.31	$8.98	$10.04
% Growth		*8%*	*12%*
EV/EBITDA	*9.7x*	*9.3x*	*8.5x*
P/E	*13.9x*	*12.9x*	*11.5x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$143.87*
# of Shares	*550*
Value Invested	*$63,701*
Portfolio Weight	*2.50%*
2016 HPR	*6.1%*
HP Benchmark Return	*13.5%*
Excess Return	*(7.3%)*

Apple Inc. (NASDAQ:AAPL)

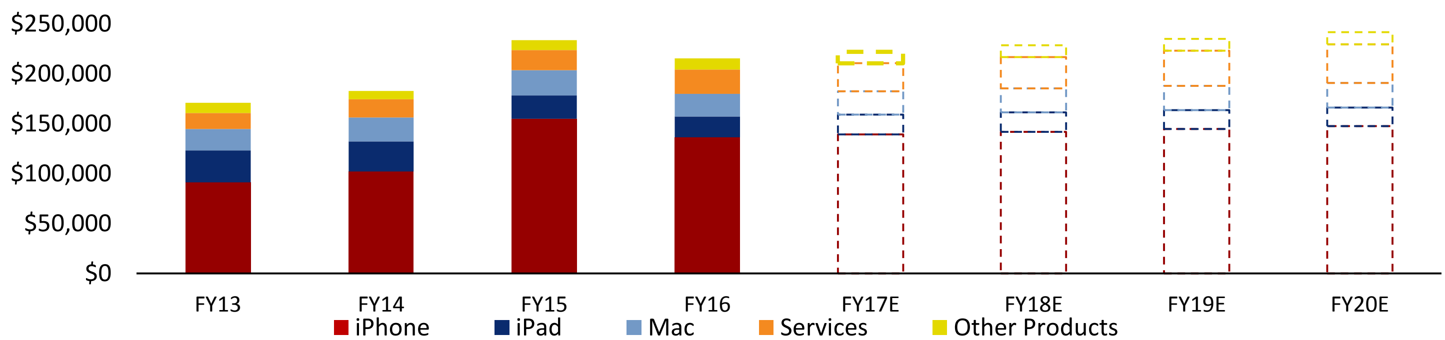
Investment Thesis

1. **Market is over-discounting decline in iPhone revenues**
    - The current DCF model implies that holding all else constant, iPhones sales must decline by 1.1% every year forever for the current discount to be warranted. We believe this implied decline is overly pessimistic and iPhone demand will remain stable in the future.
2. **Silver lining: rapid growth in Apple Services segment**
    - Recent growth in the Apple Services segment, driven by a growing installed user base, higher in-app purchases, and new streams such as Apple Pay, will help cushion net revenue declines.
3. **Still room for growth: internationalization opportunities**
    - Despite maturing iPhone markets in the Americas, Apple has still only achieved tertiary market penetration in crucial growth markets such as China.

Analysis of Performance

Apple Inc. was purchased during late Q2 2016 and has closely tracked the market since then with the exception of a slight rally following the release of the iPhone 7. Despite the declining net iPhone revenues in FY 2016, the stock has remained fairly stable, indicating that the market is withholding conclusions for the release of the iPhone 8 next year. We are comfortable holding the stock under the rationale that iPhone sales declines are being overestimated by the market.

Product Segment DCF Valuation Summary



DCF Output	
($USD millions)	
PV of UFCF (FY17 - FY25)	$316,681.63
PV of Terminal Value (FY25 - Infinity)	$447,818.61
Tax Rate	*25.6%*
Operating Margin	*27.3%*
WACC	*8.0%*
Terminal UFCF Growth Rate	*2.0%*
Implied Enterprise Value	**$764,500.24**
- Current Portion of Long-term Debt	$3,500.00
- Long-term Debt	$75,427.00
- Commercial Paper	$8,105.00
+ Cash & Cash Equivalents	$20,484.00
+ Short-term Marketable Securities	$46,671.00
Implied Equity Value	**$744,623.24**
Fully Diluted Shares Outstanding	5,500
Per Share Value	**$135.39**
Premium (Discount) to Current	14%

Cogent Communications (NASDAQ: CCOI)

Company Overview

- Cogent is a leading global provider of dedicated internet access
- Their network carries ~20% of global internet traffic
- Cogent's unique business model focuses on becoming a low-cost "dumb pipe" to gain market share for large incumbent players
- Cogent operates in two-segments: Corporate and NetCentric
- Corporate mainly focuses on providing fiber-based internet services to corporates customers in high-rise buildings
- Net-centric primarily focuses on selling internet transit to smaller networks

Risks

- Interconnection settlements are slow to resolve due to Net-Neutrality modifications under a Trump-elected FCC Chairman
- Lowering P/MBPS and ARPU's as company is forced to aggressively drop prices to continue "dumb pipe" strategy
- Unexpected increases in Capex as a result of sales team's inability to acquire new tenants in existing building

Catalysts

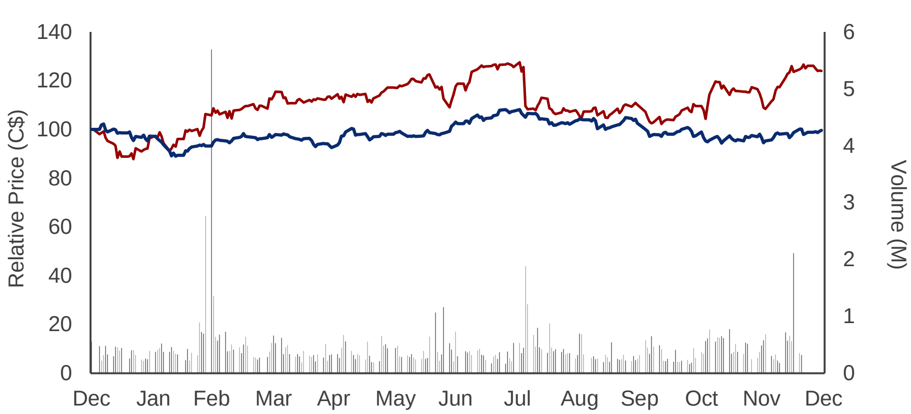
- Growth in net-centric segment due to settlement of interconnection disputes
- Corporate demand for data heavy services increases demand for CCOI's more expensive gigabit Ethernet service

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$41.35
S/O (M)	44.5
Market Cap.	**$1,839.7**
+ Total Debt	$576
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$148
Enterprise Value	**$2,267.3**
Beta (1-Year)	1.21
Dividend Yield	3.9%
52-Week High	$42.53
52-Week Low	$29.28

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$433	$492	$553
% Growth		*14%*	*12%*
EBITDA	$130	$169	$195
% Margin		*30%*	*15%*
EPS	$0.30	$0.68	$1.12
% Growth		*126%*	*64%*
EV/EBITDA	*17.4x*	*13.4x*	*11.6x*
P/E	*136.5x*	*60.5x*	*36.9x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$45.21*
# of Shares	*1,830*
Value Invested	*$75,671*
Portfolio Weight	*2.97%*
2016 HPR	*24.1%*
HP Benchmark Return	*14.1%*
Excess Return	*10.0%*

Cogent Communications (NASDAQ: CCOI)

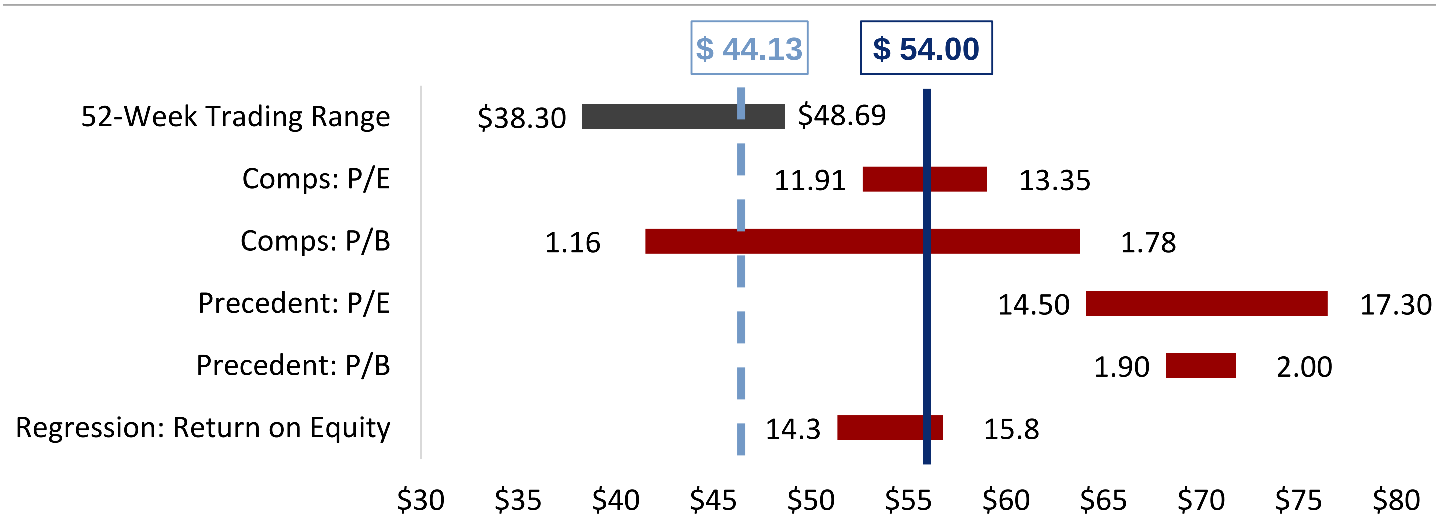
Investment Thesis

1. **Interconnection settlements:** Growth in the net-centric segment will return as interconnection points receive necessary capacity upgrades
    - Almost all disputes are settled (with the exception of Deutsche Telekom). Net-centric revenues grew faster in 2016 than historical rates largely due to these settlements and subsequent traffic growth
2. **Growth in Data Heavy Services**: Consumer shift towards online video will greatly increase global web traffic. In addition, corporate demand for high bandwidth-intensive applications will increase demand for Cogent's 100 Mbps service
    - Traffic continues to grow in line with expectations. However, revenues are affected by the bandwidth pricing headwinds.
3. **Reduction in Capital Intensity:** Capital spending will slow down as Cogent reaches all of its target countries and buildings
    - In Q2 2016, Capex (including capital leases) were much higher than Street expectations, causing the stock to fall 15% after earnings. However, in Q3 2016, capex remained in line with fiscal year expectations which led to the stock's rebound.
4. **Attractive Valuation:** At purchase, our DCF yields a 15% percent up despite recent appreciation
    - The company is trading in line with our updated valuation. We are looking to sell the stock in early 2017.

Analysis of Performance

Cogent had a volatile year but ended on a positive note. The 2Q16 surprise spur in capex caused the stock to trade in line with slower-growing peers' dividend yield, but the 3Q16 results reassured the market that management would remain in line for annual spending estimates. Moving forward, there is a lot of uncertainty with regards to Cogent's future. The strict Net Neutrality legislation implemented by Democrat FCC Chairman Tom Wheeler will most likely become more lenient or repealed under Republican control. President Trump has not stated Mr. Wheeler's successor, but has hired Net Neutrality critics Jeff Eisenach and Mark Jamison to his FCC transition team. As Cogent is a beneficiary of Net Neutrality, combined with our valuation, we believe holding the company provides little upside potential with more downside risk. As such, we will sell in early 2017.

Valuation Summary: Football Field



WebMD (NASDAQ:WBMD)

Company Overview

- WebMD is an internet health information services provider that serves consumers, physicians, other healthcare professionals, employers and health plans.
- WebMD is headquartered in New York, USA but incorporated in Delaware
- WebMD IPO in 2005 at a price of $17.50
- Main mandates are to: 1) help consumers manage their health, 2) make it easier for physicians and healthcare professionals do their jobs, and 3) provide personalized health and benefit information to health plan participants.

Risks

- Traffic-taking competition from peer online health portals (NIH, Mayo Clinic, etc.)
- Potential for future direct-to-consumer advertising regulations imposed by the FDA .
- Medscape dependency: small portion of users (3% of total WebMD traffic) make up large amount of revenue (47% of net revenues).

Catalysts

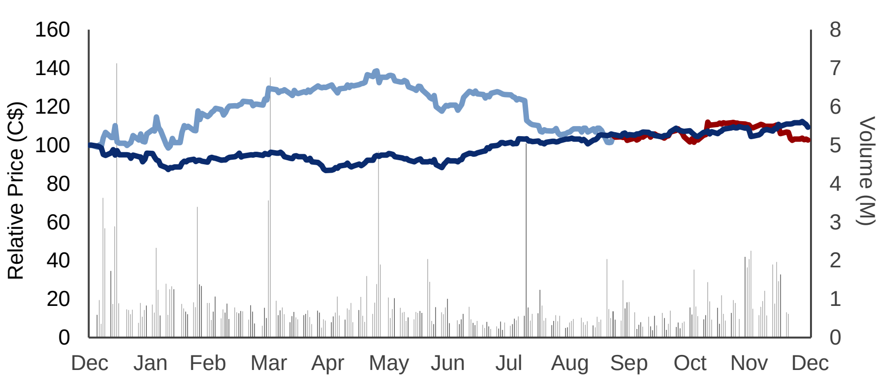
- Costless revenues and virtually no-cost customer acquisition to drive future growth.
- Industry shifts from blockbuster drugs to niche drugs to favor WebMD's advertisement media.
- Increasing visibility on Medscape asset to drive stock value for investors.

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$49.57
S/O (M)	36.7
Market Cap.	**$1,819.2**
+ Total Debt	$1,044
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$89
Enterprise Value	**$2,774.2**
Beta (1-Year)	1.10
Dividend Yield	--
52-Week High	$66.98
52-Week Low	$47.60

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $M)			
Revenue	$690	$743	$785
% Growth		*8%*	*6%*
EBITDA	$177	$248	$262
% Margin		*40%*	*6%*
EPS	$1.79	$2.03	$2.14
% Growth		*13%*	*6%*
EV/EBITDA	*15.7x*	*11.2x*	*10.6x*
P/E	*27.7x*	*24.5x*	*23.2x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$66.09*
# of Shares	*1,200*
Value Invested	*$59,484*
Portfolio Weight	*2.34%*
2016 HPR	*-2.2%*
HP Benchmark Return	*3.6%*
Excess Return	*(5.8%)*

WebMD (NASDAQ:WBMD)

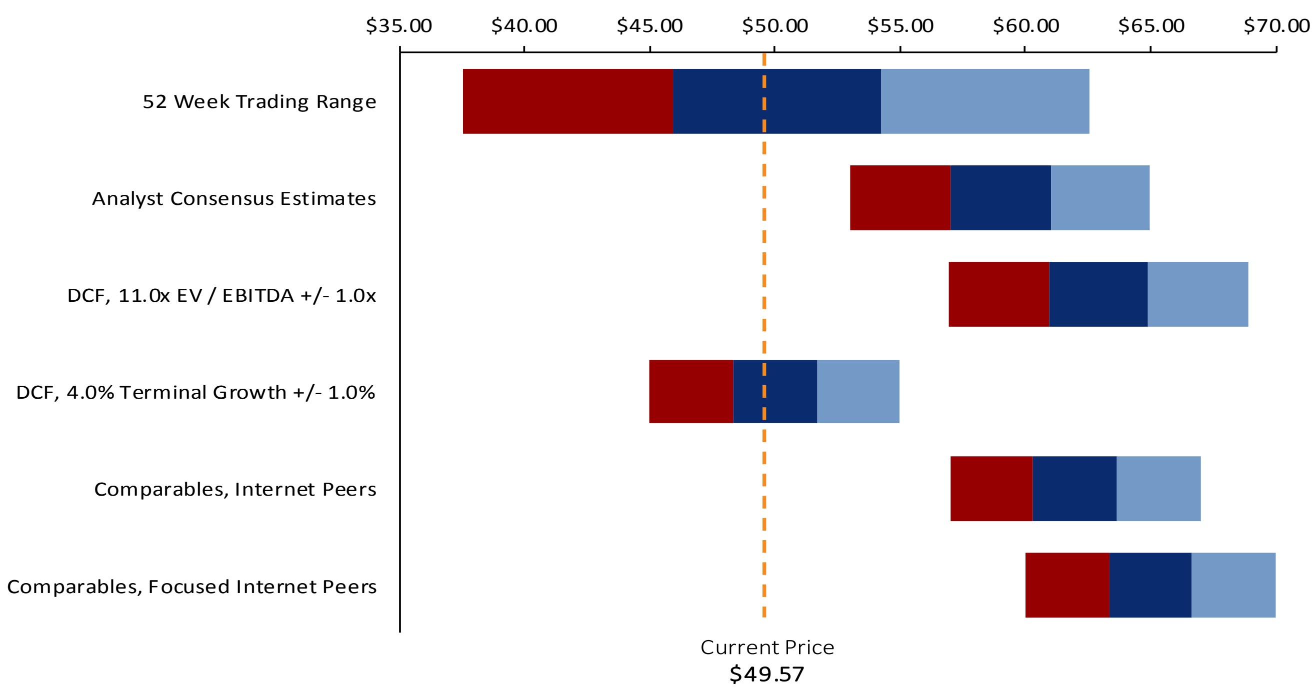
Investment Thesis

1. **Technology: virtually no-cost business model with growth potential in large TAM**
   - WebMD's ability to acquire customers at no cost and grow costless revenues due to their unique business model will allow them to seize future growth in a large TAM.
2. **Healthcare: industry trends, hedged against patent cliff, and optionality in digitization**
   - Industry shift from blockbuster to niche drugs favors online advertisement growth .
   - Large and growing portion of foreseeable near-term "patent-cliff" is composed of biologics patents which have extenuous development cycles for pharma-competitors.
   - Growth in eDetailing segment to be driven by industry hospital consolidation trends.
3. **Fundamentals: financially and operationally sound**
   - M&A sandwich: WebMD is in a comfortable financial position to make strategic acquisitions and is also a favorable acquisition target for a variety of potential buyers.
   - Historical margin improvements to continue driven by WebMD's fixed cost structure.
4. **Hidden value: market is not correctly valuing Medscape asset**
   - Increasing market visibility on Medscape asset will serve as a growth catalyst and help drive stock value.

Analysis of Performance

WebMD was purchased during Q2 2016 and has net slightly underperformed the market despite rallying after the market realized favorable regulatory tailwinds derived by Trump's election. Since the purchase, there have been no significant events which changed our core investment theses. Overall, WebMD remains a fundamentally sound company with favorable industry, technological, and regulatory tailwinds. Thus we are confident holding the stock until our original theses materialize in future operating results.

Valuation Summary: Football Field



Time Warner Inc. (NYSE:TWX)

Company Overview

- Time Warner operates media and entertainment assets through 3 main segments (Turner, HBO, Warner Bros.)
- Turner operates several of the largest U.S cable networks including TNT, TBS, Adult Swim, Cartoon Network and CNN
- HBO is the longest running and most profitable premium pay television service
- Warner Brothers is the world's largest television and film studio (based on revenues)
- Time Inc. spun off in 2012 and Time Warner Cable spun out in 2009

Risks

- Subscriber declines accelerate, which project a dim future for the traditional cable business
- Rapid shift of ad dollars away from television towards desktop and mobile platforms reduces profitability at Turner

Catalysts

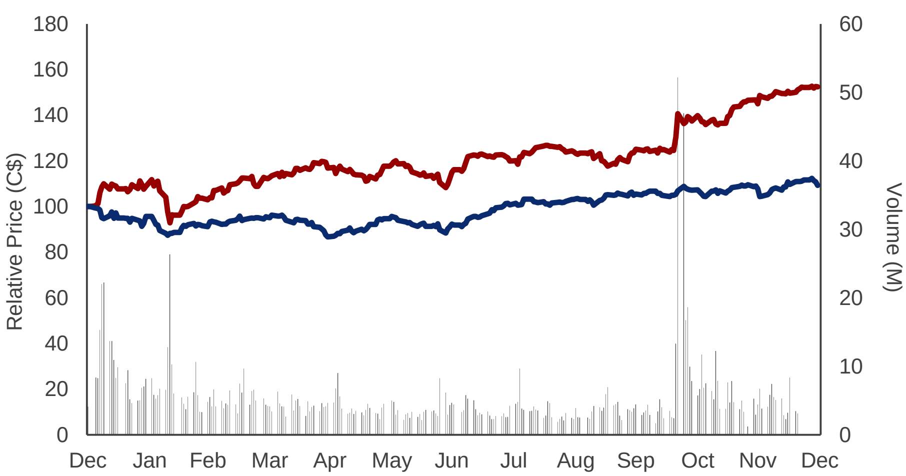
- Regulatory approval of AT&T merger
- New online distribution channels drive up content prices benefiting all divisions
- HBO NOW gains significant online market share without cannibalizing existing sales
- Recent success in the gaming sector (Top US publisher) proves to be sustainable

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$96.53
S/O (M)	771.1
Market Cap.	**$74,437.2**
+ Total Debt	$24,471
+ Minority Interest	$30
+ Preferred Shares	$0
- Cash	$2,308
Enterprise Value	**$96,630.2**
Beta (1-Year)	1.06
Dividend Yield	1.7%
52-Week High	$96.74
52-Week Low	$58.83

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$28,506	$30,813	$32,395
% Growth		*8%*	*5%*
EBITDA	$8,170	$8,863	$9,534
% Margin		*8%*	*8%*
EPS	$5.62	$5.89	$6.50
% Growth		*5%*	*10%*
EV/EBITDA	*11.8x*	*10.9x*	*10.1x*
P/E	*17.2x*	*16.4x*	*14.9x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$101.37*
# of Shares	*1,350*
Value Invested	*$130,316*
Portfolio Weight	*5.12%*
2016 HPR	*52.4%*
HP Benchmark Return	*9.3%*
Excess Return	*43.1%*

Time Warner Inc. (NYSE:TWX)

Investment Thesis

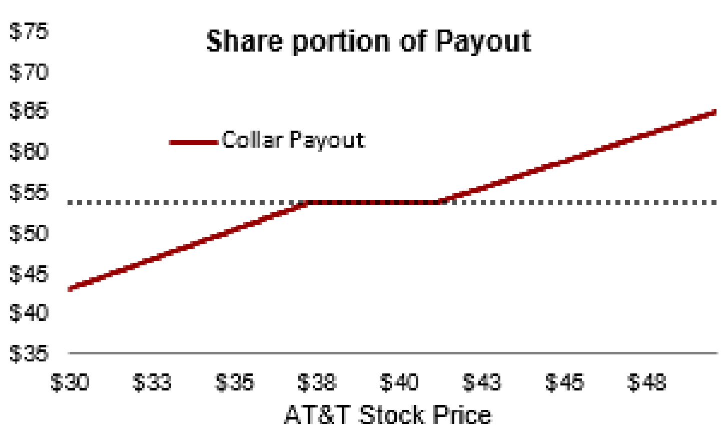
1. **Past media regulatory hurdles have focused on horizontal mergers**
   - AT&T and Time Warner Inc. will be a vertically integrated merger, which is generally less privy to public backlash and intense regulatory scrutiny.
   - A similar deal between Comcast and NBC universal was approved by regulators in 2009
2. **Accelerated consumer adoption of mobile video**
   - AT&T can argue that internalizing the content creators' operations with the distributor's will accelerate the process of optimizing mobile streaming by avoiding the bureaucratic hurdles of contract negotiations and litigations.
   - In addition, AT&T can leverage their data to push customized advertisements to their users, allowing them to compete with the mobile-ad powerhouses of Facebook and Google while enabling better service with digital advertisers.
3. **AT&T will be able to obtain sufficient financing**
   - Based on our analysis of AT&T's pro-forma fundamentals, we see that financing should not be an issue.
   - We estimate pro forma debt to be $144bn and pro forma net debt/EBITDA to be 2.2x.

Analysis of Performance

Over the past year, Time Warner has performed very well with an HPR of ~ 50%. After a poor performance in 2015, TWX rallied due to a stronger advertising market in 2016 and changing investor attitudes towards media. On October 22nd , AT&T announced a cash and share bid for Time Warner. Shares traded at a significant discount to the offer price due to the market's expectation of regulatory headwinds. When the bid was first announced, we calculated the implied probability of the deal going through to be 35%. Shares have continued to rally since the merger announcement mainly due to the expectation of a more business friendly environment under Donald Trump's administration. The expectation of different policy has led to a higher price for AT&T shares. Moreover, it has led some to believe that the Justice Department is more likely to approve the merger. Lastly, many news sources have reported that Trump has privately made additional skeptical comments about the merger, but it remains to be seen what will come of such remarks.

Valuation Summary

Please read our investor letter sent in November for a detailed explanation of our option-based valuation. In short, we were able to calculate the fair value of the collar bid from AT&T using a synthetic portfolio of AT&T stock and options. Here we provided an updated version of our analysis.



Synthetic Replicating Portfolio	
Prices	
Short call	5.68
Long call	2.29
AT&T stock	43.02
PV(cash)	52.87
Bid value	**$109.50**
Fundamentals-based PT	**$103.00**
Probability-weighted PT	**$106.57**

Solium Capital Inc. (TSX: SUM)

Company Overview

- SaaS-based technology that helps companies manage their equity-based compensation administration
- Founded in 1999 and headquartered in Alberta with clients all over the world
- Offer proprietary software to both public and private companies through the Shareworks platform
- Have made a number of acquisitions over the past five years to expand their services and to become a best-in-class provider
- Primarily generate revenue through monthly subscriptions (67%) and trading fees (33%)

Risks

- The company is unable to achieve similar market saturation and margins as it did in the Canadian market
- Unexpected competition enters the space and is able to attract market share

Catalysts

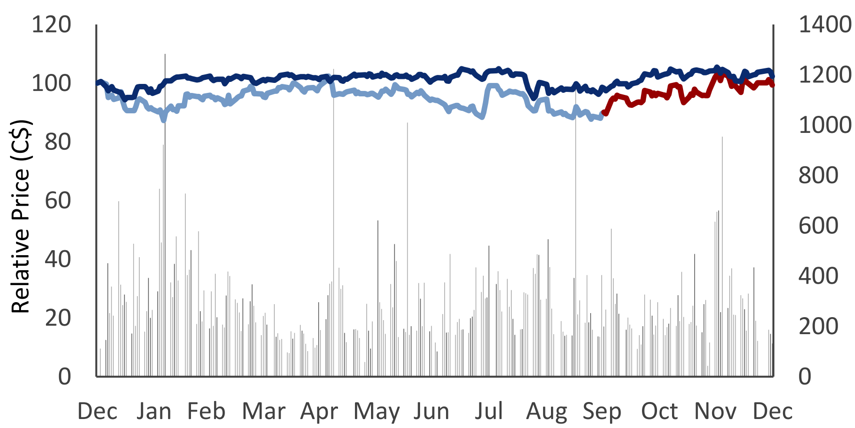
- Created white-label agreement with Morgan Stanley, SUM now serves five banks worldwide
- Huge potential for growth in market share in the US and international markets
- Attractive growing cash pool leading to future buying power and synergetic acquisitions
- Unjustified market discount based on revenue growth and EBITDA margin regression analysis

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$8.44
S/O (M)	50.2
Market Cap.	**$423.9**
+ Total Debt	$0
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$80
Enterprise Value	**$344.2**
Beta (1-Year)	1.20
Dividend Yield	--
52-Week High	$8.74
52-Week Low	$5.86

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $M)			
Revenue	$100	$117	$140
% Growth		*17%*	*20%*
EBITDA	$14	$12	$23
% Margin		*-10%*	*88%*
EPS	$0.12	$0.13	$0.31
% Growth		*7%*	*138%*
EV/EBITDA	*24.8x*	*27.6x*	*14.7x*
P/E	*69.2x*	*64.9x*	*27.2x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$8.73*
# of Shares	*11,400*
Value Invested	*$96,216*
Portfolio Weight	*3.78%*
2016 HPR	*-3.4%*
HP Benchmark Return	*0.7%*
Excess Return	*(4.2%)*

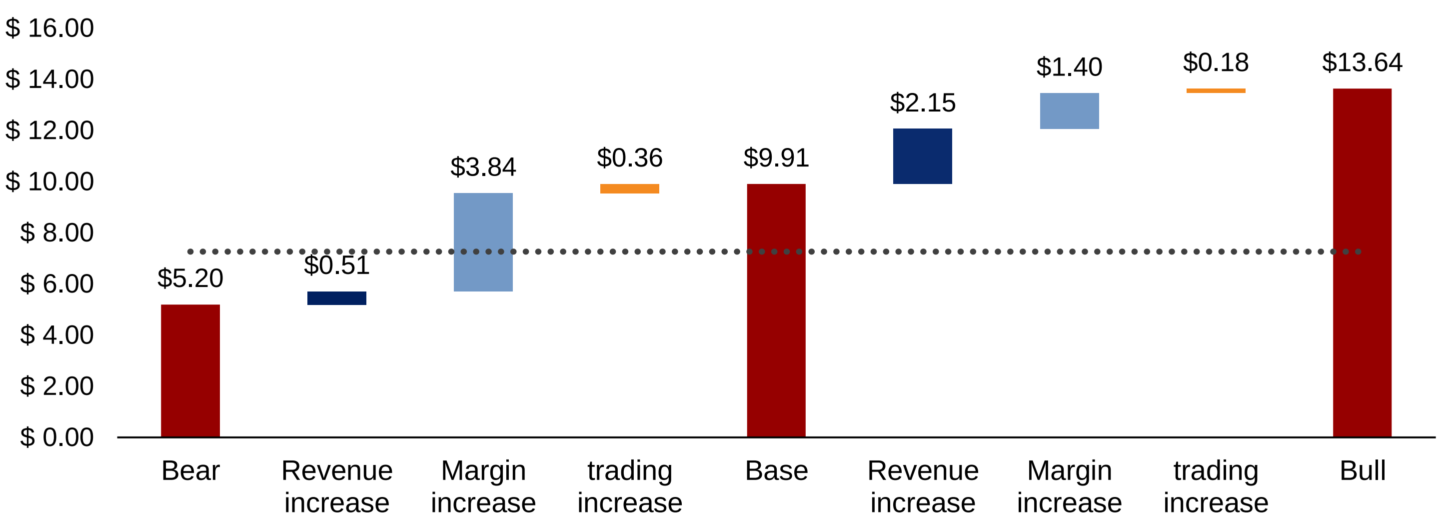
Investment Thesis

1. **Market underappreciating international investments**
   - Solium is focused on investing internationally, which is weighing down firm profitability
   - The rest of the business, however, still has relatively high margins, and there are signs that early international investments are now profitable
2. **Current margins depressed due to volatility in Canadian equity markets**
   - Historical Canadian margins are correlated with the TSX, due to higher trading volume for insider options in market rallies
   - Low margins in 2015/2016 are due to low oil prices, and not indicative of long term margin for the firm, but rather TSX performance
3. **Unseen growth opportunities**
   - Solium's strong balance sheet positions the company to continue making value creating acquisition in the equity administration space and other related industries
4. **Valuation**
   - Solium's Canadian business is sticky with high recurring revenues, which provides downside protection for the majority of the firm's market positioning
   - Realizing a slight increase in international margin could bring large upside

Analysis of Performance

Solium Capital was one of our last investments of 2016 so there has not been any significant movement in the stock since our purchase date. The company returned 30% over the entire year and we expect further appreciation going forward. One of the company's largest gains came after the announcement of an agreement to license their software to Morgan Stanley. Going forward, as Solium continues to sign both large names and expand its private company platform, we expect to see share price appreciation of at least $2 (22%). Additionally, as the company becomes profitable internationally, investors will see a tightening EBITDA margin. The company has very strong organic and inorganic growth, and given Solium only has ~$400mm market capitalization there is still a lot of room to grow into new markets.

Valuation Summary



Consumers Sector

2016 Review & 2017 Outlook

By Noah Gillard, Michael Saskin, and Anish Shah

Sector Performance

The DCM Consumer Discretionary sector realized a -25.0% return in 2016 compared to -1.5% for the sector benchmark. Our consumer discretionary holdings going into 2016 consisted primarily of consumer retail-focused companies: Performance Sports Group (TSE:PSG); and Macy's (NYSE:M) Our under-performance can largely be attributed to Performance Sports Groups, our biggest outperformer of 2016 that floundered this year (down 81.3%), due to a bankruptcy filing in October that has yet to be sorted out given potential takeover bids. Details are provided in the Holdings Review section.

Figure 1: DCM Consumer Discretionary Performance

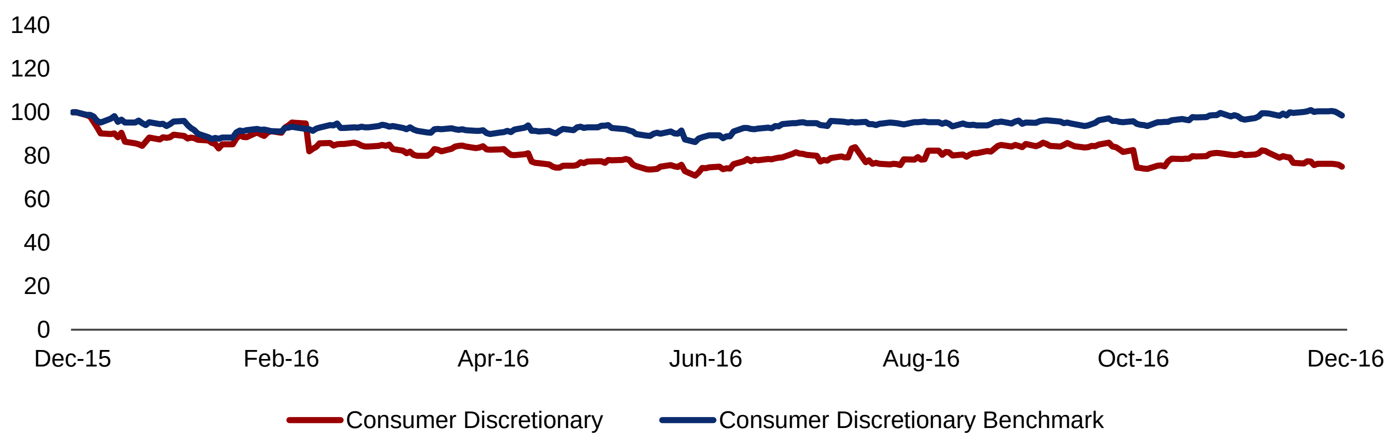


Figure 2: Discretionary Subsector EV/EBITDA

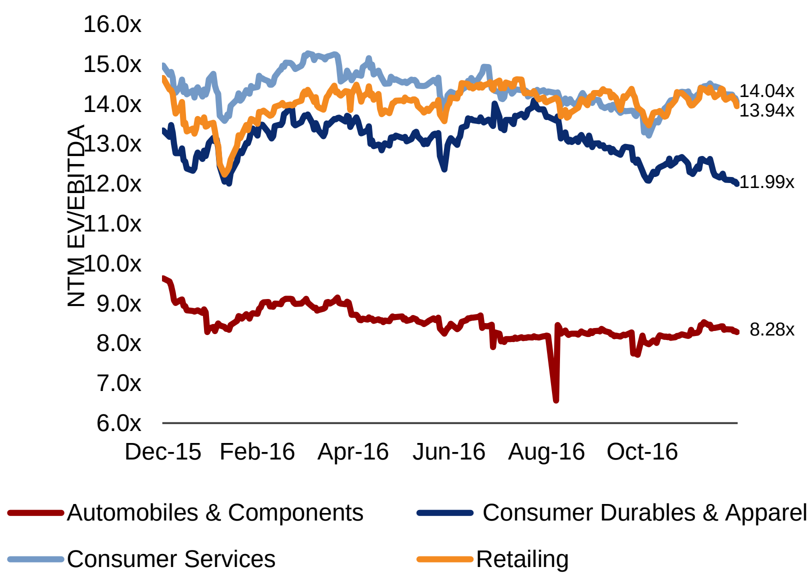
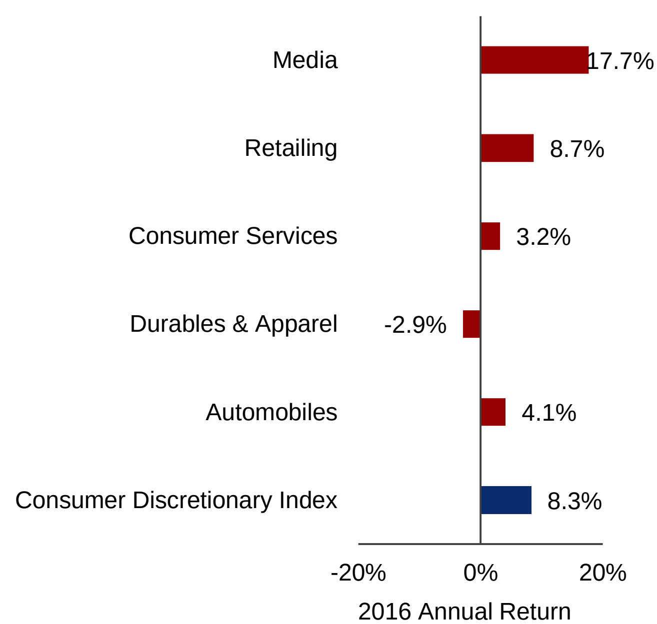


Figure 3: Consumer Disc. Subsector Returns

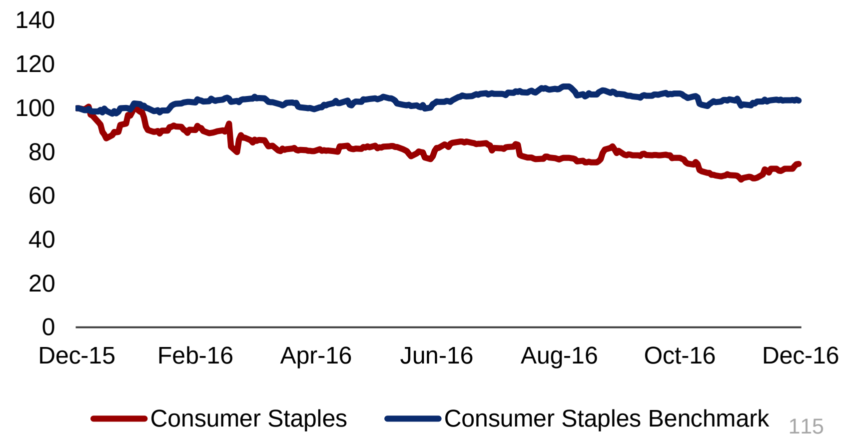


Source: Bloomberg, S&P Capital IQ

Sector Performance

Over the past year, the consumer staples sector blended benchmark realized an annual return of 3.5% while our consumer staples allocation returned -25.5%. This year we continued to believe that Consumer Staples would underperform Consumer Discretionary due to our bullish views on the US economic recovery. We proceeded to rotate away from non-cyclical sectors towards cyclical sectors while continuing to closely match our benchmark.

Figure 4: DCM Consumer Staples Performance



DCM' staples sector holdings going into 2016 consisted of Ten Peaks Coffee (TSX:TPK), which was the main contributor to our underperformance as the stock is down -27.1% since we purchased, and Corby Spirit and Wine (TSE: CSW).

On a subsector level, returns were led by the tobacco products subsector, followed closely by food products, with the worst returns coming from the food & staples retailing sector (Figure 6). Much like retail players in the discretionary sector, food retailers have underperformed because of alternative methods to purchase products online as opposed to typical brick-and-mortar stores. On the other hand, food products companies are up 10.1% on the year largely led by the industry consolidation that occurred in 2015 and normalized produce prices throughout the year.

In December of 2016, we initiated a position in Corby Spirit and Wine (TSE:CSW.A), a leading manufacturer and distributor of premium alcoholic beverages within Canada. Given the companies large brand portfolio, low-cost distribution model, attractive valuation and strong industry trends we are confident this stock will outperform going into 2017. Looking ahead, we will continue to look for great value investments and anticipate rotating out of the sector ETF and into individual names as opportunities present themselves as we did with Corby.

Source: Bloomberg, S&P Capital IQ

Sector Performance

Figure 5: Staples Subsector EV/EBITDA

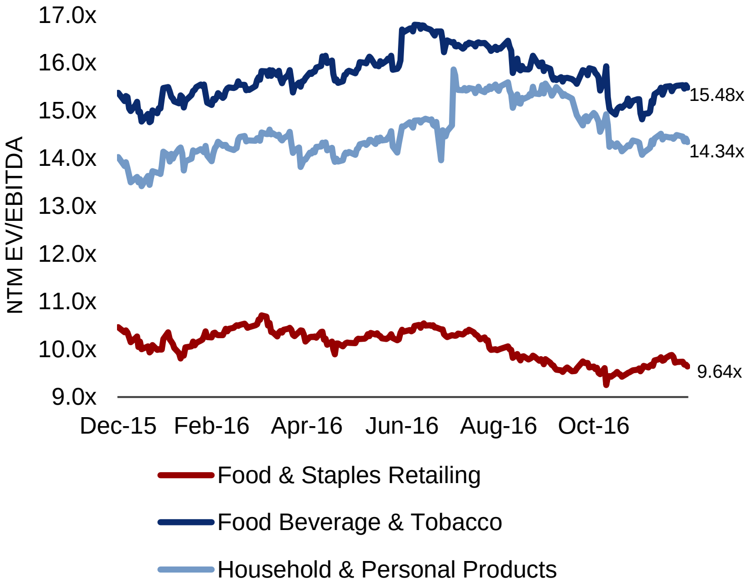
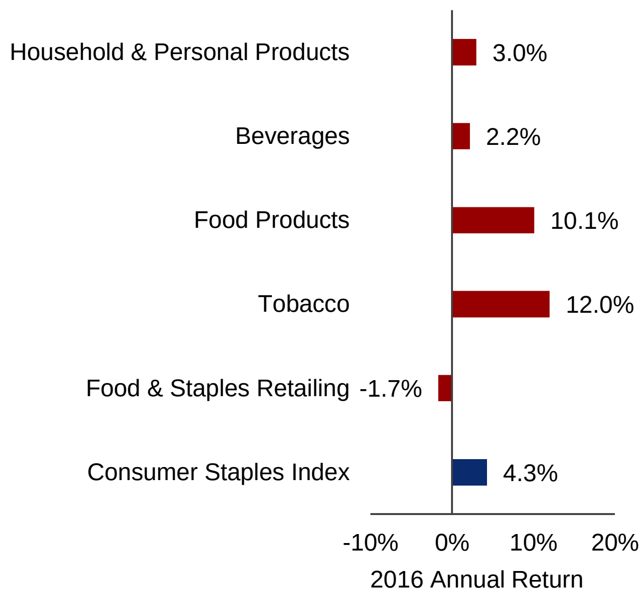


Figure 6: Consumer Staples Subsector Returns



Source: Bloomberg, S&P Capital IQ

Consumer Discretionary

For 2017, we expect to see a continued increase in consumer spending, although at a decelerating pace. Gasoline prices remain low, wages and employment are increasing, and consumer sentiment is at an 8-year high. The tight labor market and rising compensation continue to breed an environment for increased consumer spending. However, trends are signaling a move towards a later phase of the business cycle, and therefore we must be cautious of the effect of rising interest rates, credit policy standards, and commodity prices.

Energy prices have remained low relative to 2015 but have been increasing during the last quarter of 2016. Because most of the savings from lower gas prices are spent and not saved, consumer spending would be adversely affected if these prices continue to rise. This spending is mostly comprised of non-durable goods and services, so we will remain alert for its effect on our holdings like Ten Peaks Coffee. However, as disposable income continues to increase as shown in Figure 10, it should help to counter this decrease. As a result, consumer sentiment continues to increase to its post-recession peak, which is evident in Figure 7.

As shown in Figure 8, we can see that consumer spending has become an increasingly larger component of real GDP. While global business fixed investment remains weak, the economy has been driving its growth through increases in consumer spending.

Figure 7: Consumer Sentiment Index

Figure 8: Components of Global Real GDP

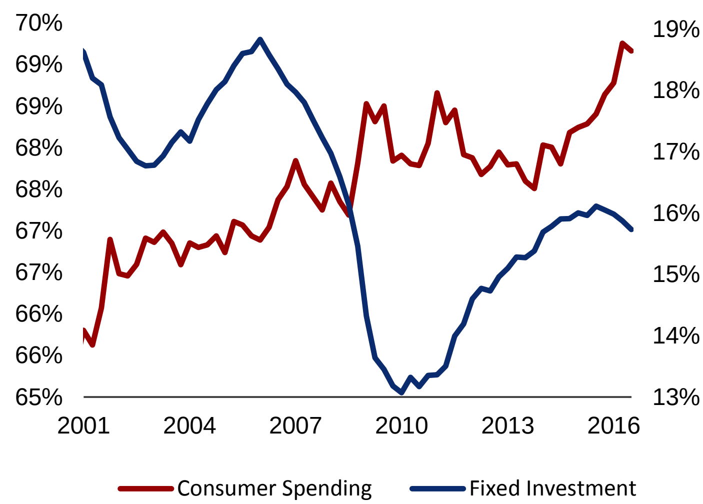
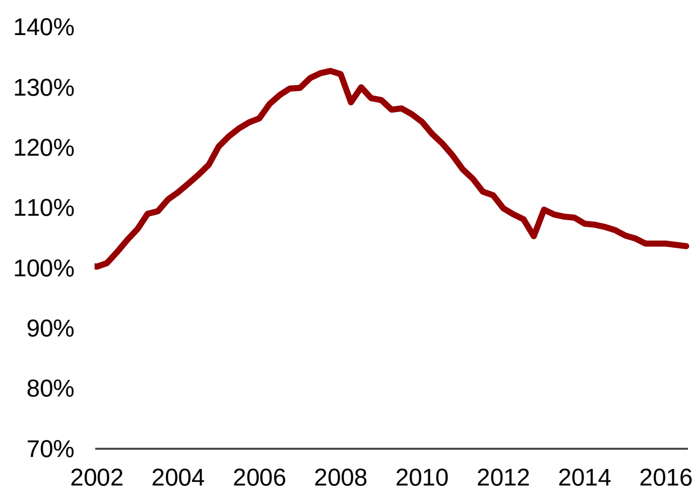


Figure 9: Household Debt-to-Disposable Income



Source: Bloomberg

Consumer Discretionary

In addition to our general outlook we have identified a number of trends that will impact the industry in the coming years. The first trend we see is the continuing divergence between US. and Canadian household debt as a percentage of GDP, as seen in Figure 11. As a result we are more bullish on the US consumer going into 2017.

We also expect to see a growing global consumer class due to strong organic sales growth in emerging markets relative to developed-country markets. By 2025, consumption in these emerging markets will rise to $30 trillion and account for nearly 50% of the world's total, up from $12 trillion (32% of total) in 2010. Therefore, we expect global brands with sales in these markets to be positively affected. As the U.S. dollar continues to strengthen, translation of foreign sales into US dollar terms will put pressure on international companies' revenues earned abroad and act to counter this increase. Thus, we will remain selective within the discretionary space while looking at companies that operate globally.

Another trend that will continue to persist throughout 2017 is the trend towards online sales and e-commerce shopping, as seen in Figure 12. This trend has resulted in traditional brick-and-mortar retailers going online, such as Neiman Marcus which saw 26% of its F2015 sales come from online shopping. At the same time, we also see traditional online retailers moving into the brick-and-mortar space, with traditional online retailers such as Warby Parker ranking as some of the highest grossing PSF retailers in the USA (see Figure 14) and Amazon beginning to open up its first physical store locations.

Figure 11: CAD vs.US Household Debt-to-GDP

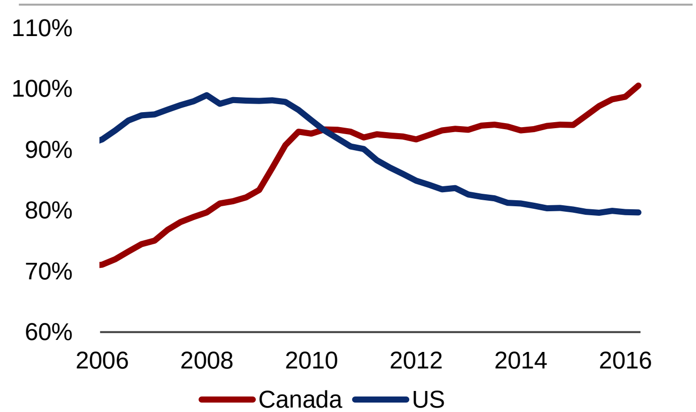


Figure 12: Online Retail Sales as % of total

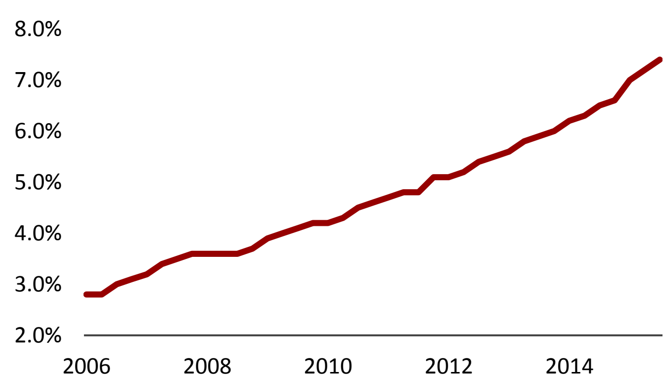
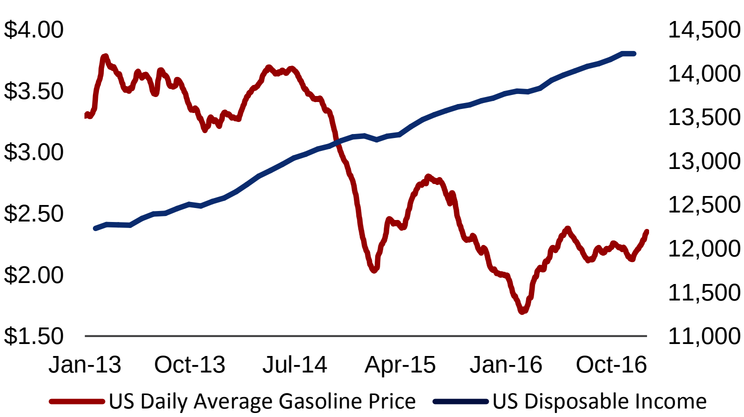


Figure 10: Gas Prices vs. Disposable Income



Source: Bloomberg

Consumer Discretionary

We can see a sustained increase in year over year wage growth in the U.S.. This accelerating growth in salaries will lead to more disposable income for the average U.S. consumer, which we can expect to translate into an increase in spending.

As millennials move into the workforce and earn higher disposable income, we can see a trend towards premiumization. This is driven by their focus on health and wellness, as well as their interest in unique services and craft products. This is another trend we hope to capitalize on in the discretionary space.

Figure 13: US Wage Growth % YoY

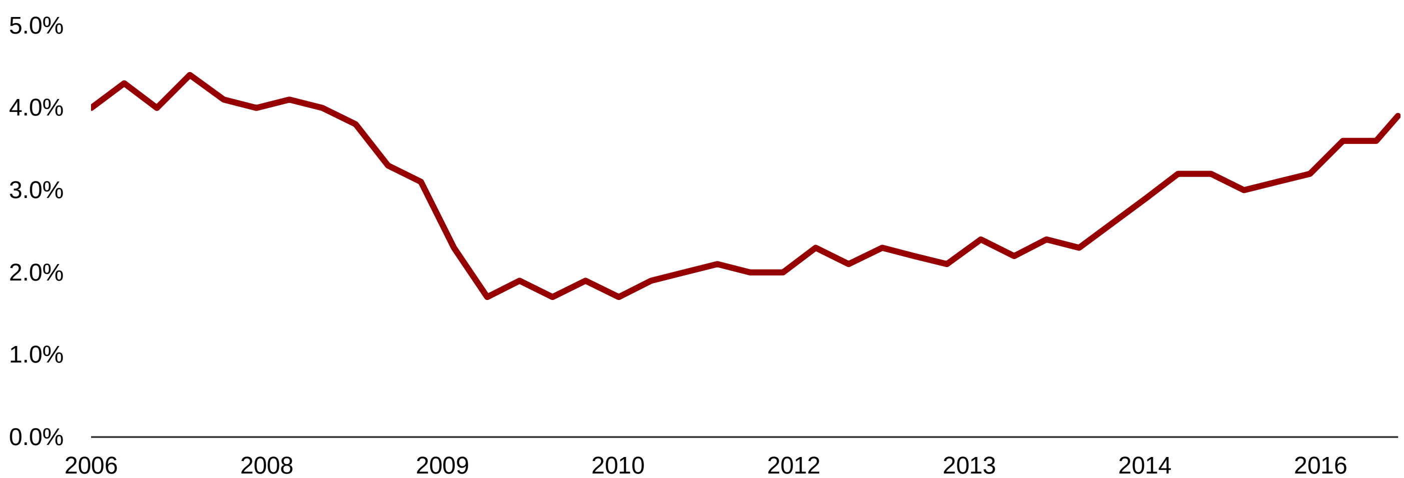
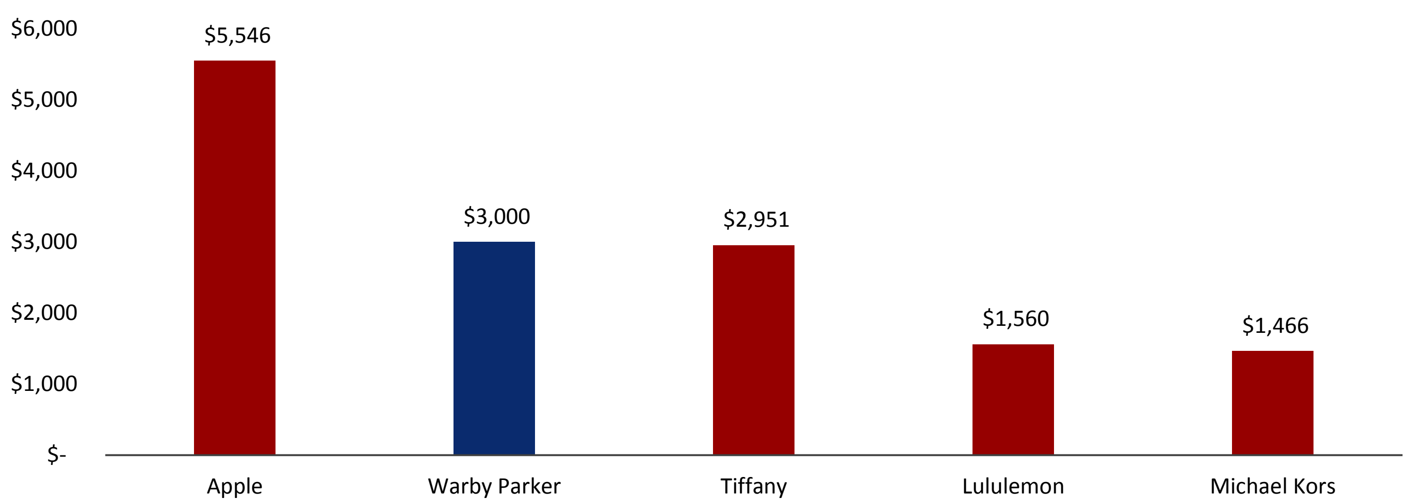


Figure 14: Top 5 Physical Retailers by Sales psf.



Source: Bloomberg

Consumer Staples

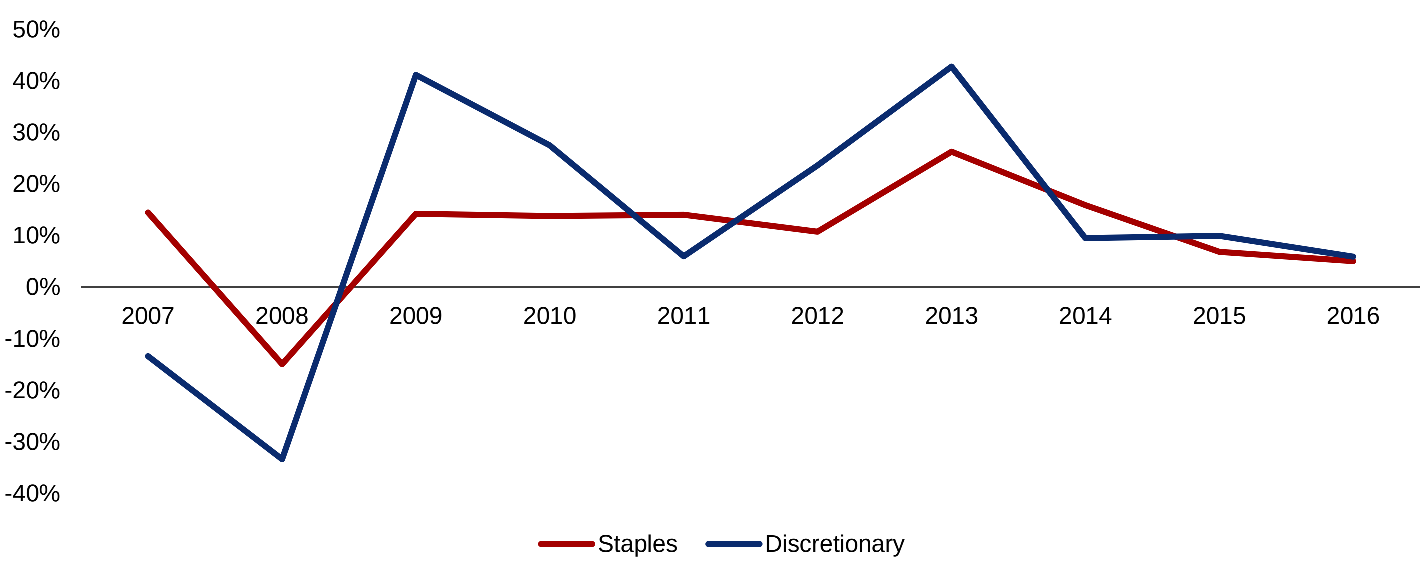
Moving on to consumer staples, we are expecting to see it benefit as well from the rising wages, falling unemployment, and overall moderate economic recovery. That said, the staples subsector has historically underperformed the discretionary subsector in expansionary periods (Figure 15) so we do no believe it stands to gain as much from these factors.

One factor that could negatively affect this sector is the rising interest rate environment. If interest rates go up, yields on stocks will have to rise to compete with higher bond yields, implying downward pressure on prices.

With the uncertainty regarding the Trump Administration, we have seen investors flock to this sector due to its more stable nature compared to other sectors. As Trump's rhetoric continues leave investors feeling uneasy, we can expect even more capital flow to defensive sectors like consumer staples.

A positive trend for staples has been the recent, aggressive cost-cutting in an attempt to create more perceived value for consumers, which is important since companies in this space generally deal with tight profit margins. This could become problematic if commodity prices such as oil continue to rise, as they are important inputs in the manufacturing of consumer staples products, so we will continue to closely monitor any trends in these sectors. This cost-cutting has also led to increased competition as companies enter into price wars with each other, which could eventually lead to a decrease in earnings.

Figure 15: Staples and discretionary sectors average returns over prior 10-year period

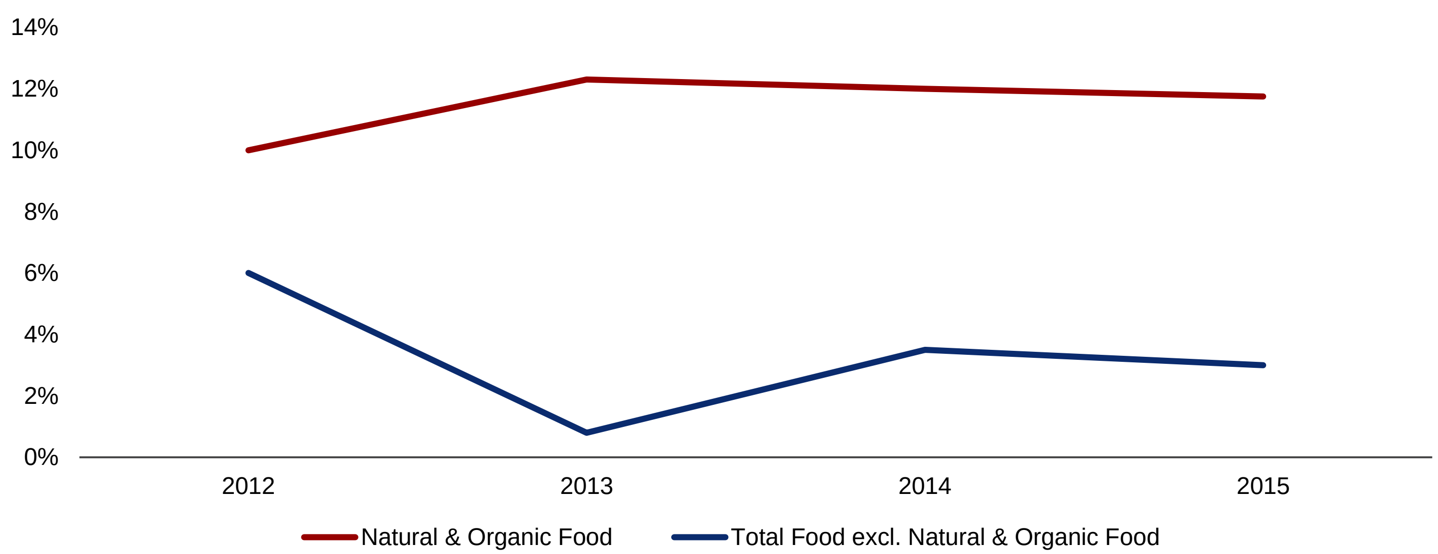


Source: Fidelity Investment Report

Consumer Staples

Additionally, another trend for 2017 will be changing consumer preferences toward local, natural, and organic foods. More and more consumers are straying away from processed and pre-packaged meals in favor of meals prepared at home from whole, raw ingredients. A large driver of this trend is the millennial generation entering the work force. As they earn more income, they prefer to spend the extra money to get fresher ingredients and support local producers. Therefore, we will look for companies that are working on changing their brand image to appear more natural and artisan. This can be done through the elimination of ingredients that are perceived to be harmful and unnatural or by acquiring smaller producers that have the image they are striving for. This is something that we have already seen beginning to occur with companies like Nestle, Kraft, and General Mills pledging to remove all artificial flavors and colors in the next two-three years.

Figure 16: Natural & Organic Food Sales



Source: Bloomberg

Consumers Sector

Holdings Review

Macy's, Inc. (NYSE:M)

Company Overview

- Macy's, Inc. is an omnichannel retail company operating department stores, websites, and mobile
- The retail stores sell a wide range of merchandise including men's, women's, and children's apparel and accessories, cosmetics, home furnishings, and other consumer goods
- Macy's operates its stores under the names of Macy's, Bloomingdale's, Bloomingdale's Outlet, and Bluemercury

Catalysts

- Monetization of under-valued real estate
- Faster than expected margin improvement through a well-executed cost cu}ng program
- Increased growth in off-price business segment

Risks

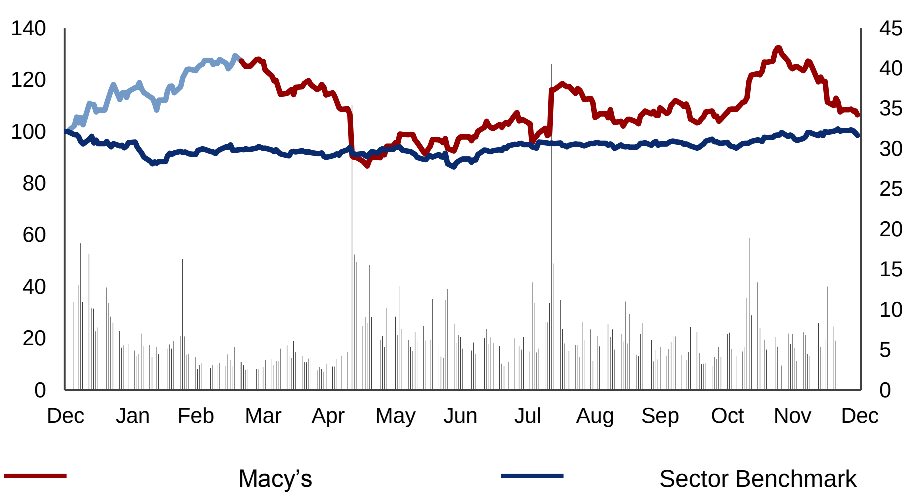
- A misstep in projecting fashion trends that leads to unappealing products and therefore decrease in revenue
- Cyclical headwinds, such as warmer than expected weather, less tourist traffic, stronger, USD, etc.

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$35.81
S/O (M)	305.7
Market Cap.	**$10,946.0**
+ Total Debt	$7,501
+ Minority Interest	$2
+ Preferred Shares	$0
- Cash	$457
Enterprise Value	**$17,992.0**
Beta (1-Year)	1.45
Dividend Yield	5.0%
52-Week High	$44.49
52-Week Low	$29.14

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$26,132	$25,897	$24,818
% Growth		*-1%*	*-4%*
EBITDA	$3,007	$2,903	$2,868
% Margin		*-3%*	*-1%*
EPS	$2.20	$3.04	$3.24
% Growth		*39%*	*7%*
EV/EBITDA	*6.0x*	*6.2x*	*6.3x*
P/E	*16.3x*	*11.8x*	*11.0x*

Market Performance



Position Snapshot

Average Cost	*$55.84*
# of Shares	*1,900*
Value Invested	*$68,039*
Portfolio Weight	*2.67%*
2016 HPR	*-16.3%*
HP Benchmark Return	*5.8%*
Excess Return	*(22.1%)*

All figures in CAD

Source: Bloomberg, S&P Capital IQ, Company Filings

Macy's, Inc. (NYSE:M)

Investment Thesis

1. **Real estate sell-off underway to generate shareholder value**
   - Signed two-year contract with Brookfield Asset Management, giving rights to sell 50 buildings
   - Announced sale of 248,000 sq. ft. Macy's Men Store on Union Square in San Francisco for $250 million
2. **Re-creating the Macy's store portfolio**
   - Still on-track to close 100 stores by early next year
   - Seven specific, under-performing locations disclosed to be sold soon
   - Several new stores opened this quarter, including a Macy's. Backstage and seven Bluemercury specialty stores
3. **Trading below peers despite cost-cutting effort**
   - With an EV/Forward EBITDA of 6.2x, Macy's is trading at an effective 35% discount relative to its peers (median EV/Forward EBITDA of 9.5x)
   - While Macy's currently has a slightly higher gross margin of 39% versus a median of 36% for peers, we expect margins to further improve due to cost-cutting efforts

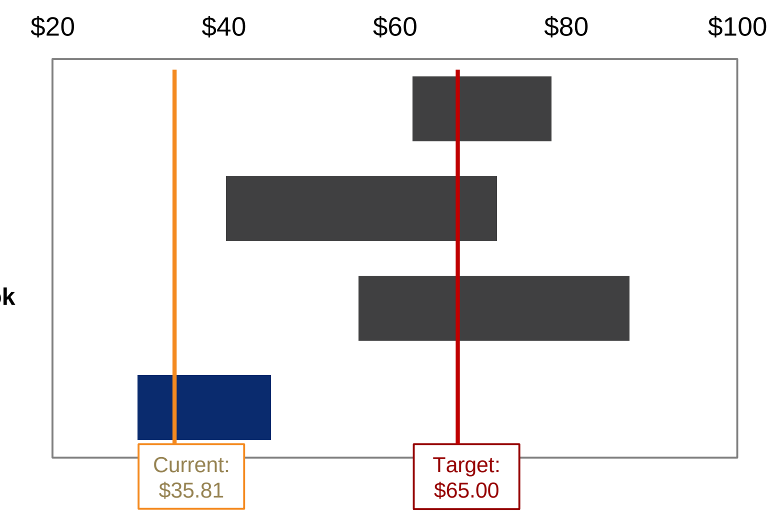
Analysis of Performance

The investment thesis stemmed on our belief that Macy's owned several stores in which the real estate value exceeded the value that it brought in through regular operations. Through a joint-partnership with Brookfield Asset Management, Macy's is planning on selling up to 50 buildings over the next two years. To clarify, this is separate from their planned store closures. The stores that will be closed are chosen because they are under-performing and are becoming too costly to continue to operate in the current retail environment. The sale and closure of stores is the main driver of this stock. News of the 100 planned store closures drove the stock up 17% in early August. Furthermore, when they disclosed their Brookfield partnership as well as the announced sale of a 248,000 square foot Macy's Men Store on Union Square in San Francisco for $250 million, the stock jumped an additional 10% in November. Unfortunately, Macy's has not been able to hold on to these gains due to concerns over holiday sales and earnings forecasts and so it finished the year relatively flat. Going into 2017 we are concerned about declining SSS trends but comforted by Macy's efforts to monetize its extremely valuable real estate portfolio and continued investment into its online platform.

Valuation Summary

Method	Metric
Comps	Median – Mean FY2017E EBITDA
DCF	Terminal Multiple: 4.0x – 8.0x
DCF + Real Estate	~$13B in Real Estate in excess of book value discounted 40%
52 Week Range	Low – High

Illustrative Value Range



Source: Bloomberg, S&P Capital IQ, Company Filings

Corby Spirit and Wine Limited (TSX:CSW.A)

Company Overview

- Corby markets and distributes spirits and imported wines
- Corby produces and sells its own branded products as and earns commissions selling Pernod Ricard brands in Canada
- Pernod Ricard owns 46% of Corby's common shares
- Majority of revenues come from owned brands

Catalysts

- Increased consumer interest in the craft spirit sector
- U.S. adoption of Corby's wholly-owned Canadian brands

Risks

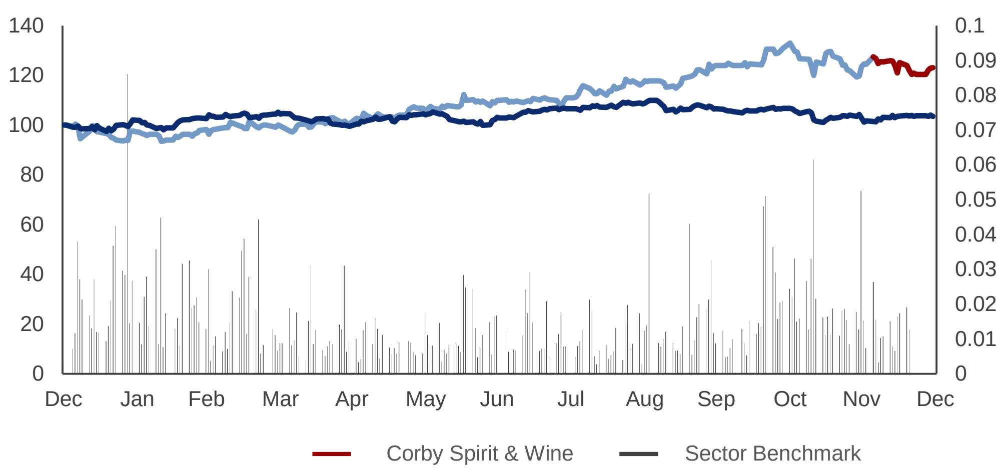
- Failed entrance into the U.S. spirit market
- Pernod-Ricard relationship weakens and distribution contract renegotiated

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$22.31
S/O (M)	28.5
Market Cap.	**$635.1**
+ Total Debt	$0
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$69
Enterprise Value	**$566.0**
Beta (1-Year)	0.37
Dividend Yield	3.8%
52-Week High	$24.12
52-Week Low	$16.94

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$138	$147	$152
% Growth		*6%*	*4%*
EBITDA	$42	$47	$50
% Margin		*11%*	*6%*
EPS	$0.90	$1.01	$1.07
% Growth		*13%*	*6%*
EV/EBITDA	*13.4x*	*12.1x*	*11.3x*
P/E	*24.9x*	*22.1x*	*20.9x*

Market Performance



Position Snapshot

Average Cost	*$23.07*
# of Shares	*4,400*
Value Invested	*$98,164*
Portfolio Weight	*3.86%*
2016 HPR	*-3.4%*
HP Benchmark Return	*2.0%*
Excess Return	*(5.4%)*

All figures in CAD

Source: Bloomberg, S&P Capital IQ, Company Filings

Corby Spirit and Wine Limited (TSX:CSW.A)

Investment Thesis

1. **Recession proof and resilient business model**
   - Economic downturns historically haven't harmed alcohol sales in Canada and in fact often led to sharp increases in total sales thesis
2. **Relationship with Pernod Ricard provides stability and growth prospects**
   - Recently increased commission structure and entered into distribution agreements within the U.S. and the U.K.
   - Potential to grow geographic presence through leveraging their relationship with Pernod
3. **Strong brands in the growing craft spirits space**
   - Corby strategically situated to take advantage of strong growth prospects in the craft spirits space
4. **Valuation**
   - Trades at a significant discount to peers on an EV/EBITDA basis and our model yields a 30% upside in our base case

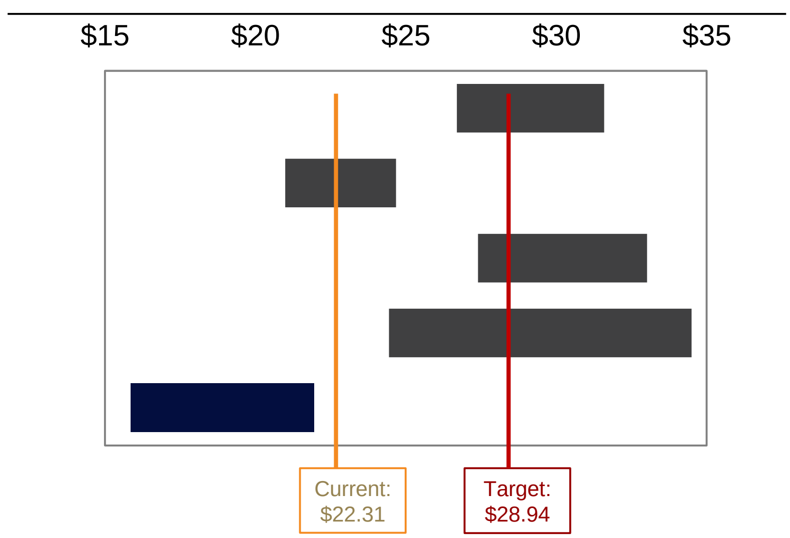
Analysis of Performance

Our investment thesis surrounding Corby Spirit and Wine stems from its recession proof business model and strong industry trends that we think will pave way for substantial growth in the future. Given that we purchased this stock in December 2016, our thesis has yet to materialize but we think looking into 2017 management's focus to strengthen the portfolio of brand offerings will be one of the major thesis points to be realized first. The beverage industry had lack-luster performance throughout 2016, only up 2.2% compared to the broader staples index which was up 4.3%. However, alcoholic beverage companies performed well throughout the year, where brewers like Kirin Holdings and Molson Coors are up 15.9% and 11.5% respectively, and distillers like Constellation Brands is up 3.6%. We think the continued trend towards premiumization and shift in consumer taste towards specialty craft products are additional ways in which Corby is well positioned in 2017 to outperform its competitors. We spoke with CFO of Corby and are very excited about the ambitious growth initiatives he discussed with us.

Valuation Summary

Method	Metric
Comps	Median – Mean FY2017E EBITDA
Precedents	Median – Mean EV/EBITDA (LTM)
DCF	Terminal Multiple: 14.0x – 18.0x
DCF	Gordon Growth: (1.5% - 3.5%)
52 Week Range	Low – High

Illustrative Value Range



Source: Bloomberg, S&P Capital IQ, Company Filings

Performance Sports Group (TSX: PSG)

Company Overview

- Performance Sports Group (formerly Bauer) designs, manufactures, and markets sports equipment and related apparel in the hockey, lacrosse and baseball/softball segments under the BAUER, MISSION, MAVERIK, CASCADE, INARIA, COMBAT, and EASTON brands
- Recent News: On October 31st 2016, Performance Sports Group filed for Chapter 11 Bankruptcy and Sagard Capital gave a "stalking horse bid" of $575 million

Catalysts

- Takeover offer is higher than expected due to competitive bidding process

Risks

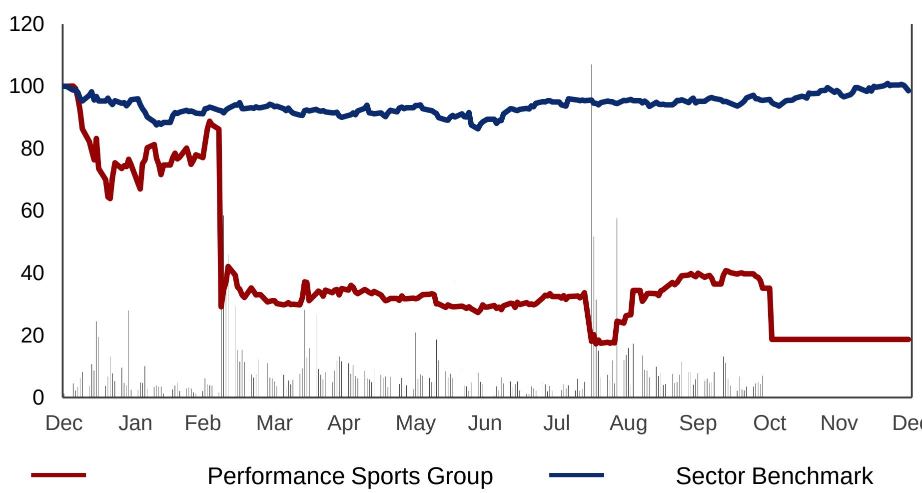
- Sagard Capital purchases PSG for current bid of $575 million, leaving little for current shareholders

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$1.86
S/O (M)	45.6
Market Cap.	**$84.8**
+ Total Debt	$466
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$3
Enterprise Value	**$547.7**
Beta (1-Year)	0.96
Dividend Yield	--
52-Week High	$13.36
52-Week Low	$2.30

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$602	$552	$609
% Growth		*-8%*	*10%*
EBITDA	$33	$45	$69
% Margin		*34%*	*54%*
EPS	-$4.24	$0.04	$0.45
% Growth		*-101%*	*1127%*
EV/EBITDA	*13.8x*	*10.3x*	*6.7x*
P/E	*0.0x*	*0.0x*	*0.0x*

Market Performance



Position Snapshot

Average Cost	*$7.16*
# of Shares	*10,985*
Value Invested	*$3,076*
Portfolio Weight	*0.12%*
2016 HPR	*-81.3%*
HP Benchmark Return	*-1.5%*
Excess Return	*(79.8%)*

All figures in CAD

Source: Bloomberg, S&P Capital IQ, Company Filings

Performance Sports Group (TSX: PSG)

Investment Thesis

1. **Multiple Rerate & Valuation:** *We believed that the company would gain from a multiple rerate as it transformed into a multi-sport platform. Prior to the recent selloff, this was realized and PSG was trading in-line with its peer set.*
    - The company now again trades at a discount to its peers
2. **Renewed & Diversified Growth:** *The company's intrinsic value is heightened by virtue of hockey & diamond sports' high single-digit CAGRs*
3. **Leverage Discount:** *We believed that the market was discounting the value of the EASTON acquisition given the company's high leverage. Company did trade at premium prior to selloff*
    - PSG debt levels are significantly above their peers and despite a 21% reduction in debt over the year, PSG expects its leverage ratio to continue to climb in the short term
    - Due the climbing leverage ratio, a 50 basis point increase in interest rate has been triggered (the term loan is now LIBOR plus 3.5%)

Analysis of Performance

2016 was a challenging year for Performance Sports Group. Their troubles began in early March when they had to decrease their earnings guidance after Sports Authority, a major client of theirs, went bankrupt. This drove the stock down more than 50%. From there, it remained relatively flat until August when it dropped another 50%. This drop was because they missed their filing date with the SEC, causing investors to panic as they were put into temporary default with their creditors due to a covenant violation. However, they managed to negotiate an extension for the filing, pushing the stock back up to above pre-August levels. This gain was short-lived, unfortunately, as they announced their filing for Chapter 11 bankruptcy at the end of October. With this announcement, any trading of the stock on the New York Stock Exchange and the Toronto Stock Exchange was halted, leaving only the over-the-counter equivalent to be freely-traded.

Discussion of Bankruptcy Proceedings

At the moment, Performance Sports Group has entered into an asset purchase agreement for the sale of the Company with a group of investors led by Sagard Capital Partners, a long-term, majority shareholder of the company, and Fairfax Financial Holdings, an investment company based in Toronto. Sagard Capital and Fairfax Financial will serve as the "stalking horse bidder" in a court supervised auction designed to maximize value for the Company's stakeholders. The auction was originally supposed to take place on January 9th, 2017, but bids are now due January 25th, and the auction will take place on January 30th. A hearing on the sale will take place on February 9th, and PSG said it expected the deal to close at the end of Feburary. As previously mentioned, Sagard Capital Partners, who owns 17% of the Company, will open the auction with a $575 million bid – enough to pay for all of the company's secured debt and part of its unsecured debt, with close to nothing left for shareholders. Sagard would also provide $361 million of debtor-in-procession financing. Centerview Partners, PSG"s financial advisor, has executed confidentiality agreements with 30 possible bidders, another five are in the works, according to courts filings. The other prospective buyers include KKR, Bain Capital LP, Apollo Global Management, TPG Capital, and Sycamore Partners. Given the competitive nature of the auction there is a chance that the winning bid could come in much higher than anticipated.

Ten Peaks Coffee Company Inc (TSX:TPK)

Company Overview

- TPK decaffeinates and sells green coffee to coffee retailers and roasters
- Uses the Swiss Water Process, the only 100% chemical-free water process for third-party decaffeination and the world's only consumer branded process
- Located in Burnaby, British Columbia
- The company was formally an income trust which was restructured into a common public corporation in 2011

Catalysts

- Positive volume growth and improvement in earnings and margins
- Increased sell-side coverage
- Development of technology that can capture and commercialize the caffeine extracted as a by product of normal operations, which will act as a supplementary revenue stream

Risks

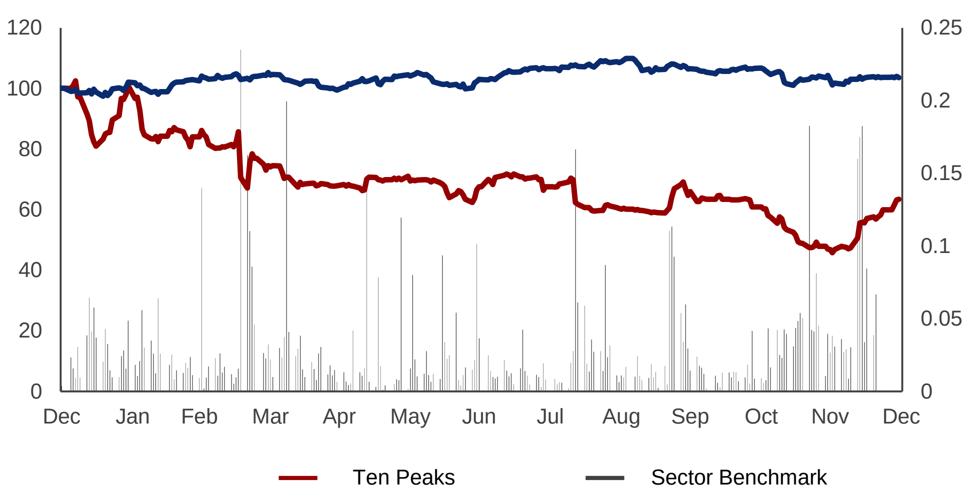
- Customer concentration
- Competition from other methods
- Coffee price volatility

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$7.30
S/O (M)	9.0
Market Cap.	**$66.0**
+ Total Debt	$1
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$7
Enterprise Value	**$59.9**
Beta (1-Year)	1.07
Dividend Yield	3.6%
52-Week High	$11.81
52-Week Low	$5.27

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$81	$0	$0
% Growth		*-100%*	-
EBITDA	$6	$0	$0
% Margin		*-100%*	-
EPS	$0.25	$0.00	$0.00
% Growth		*-100%*	-
EV/EBITDA	*10.2x*	-	-
P/E	*29.3x*	-	-

Market Performance



Position Snapshot

Average Cost	*$10.07*
# of Shares	*10,856*
Value Invested	*$79,249*
Portfolio Weight	*3.11%*
2016 HPR	*-36.6%*
HP Benchmark Return	*3.5%*
Excess Return	*(40.1%)*

All figures in CAD

Source: Bloomberg, S&P Capital IQ, Company Filings

Investment Thesis

1. **Premium position in decaffeination with strong growth runway**
   - Patented Swiss Water Process is the only 100% chemical-free, consumer branded decaffeination process
   - Processing volumes up 39% over past five years; improving gross margins and strong ROIC
   - Expansion plans in place for plant capacity, given growing US and international volumes
2. **Trend towards artisanal, high quality and fair trade coffee (Third Wave) to increase demand and expand total addressable market (TAM)**
   - Specialty coffee growth is promoting a shift from lower-quality chemical decaffeination methods to premium methods
   - TPK currently has approximately 70% market share in Canadian decaf; US market is ~10x the size, providing a large, growing TAM
3. **Valuation is attractive given growth prospects and monopolistic features**
   - Unwarranted discount to high-growth consumer plays based on current and forward EV/EBTIDA
   - DCF base case yields ~25% upside
   - Unrivalled experience, strong trademark and reputation, organic accreditation and best-in-class methodology give TPK a virtual monopoly in the industry

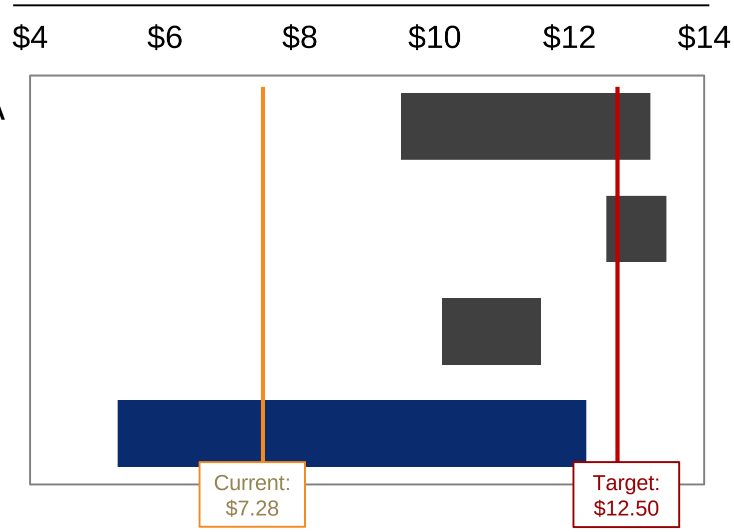
Analysis of Performance

Ten Peaks Coffee experienced a tough year in 2016 due to rising commodity prices, a change of ownership of one of its main accounts, and a temporary shutdown of a production line. The high coffee prices were passed down to their customers, who opted to deplete their current inventory before restocking in hopes of prices lowering by then. Furthermore, one of their largest accounts was purchased by Keurig and is now ordering less volume than in the past. Lastly, Ten Peaks spent the first quarter increasing processing volume capacity at one of their facilities, which forced them to temporarily close down a production line in the process. However, many positives occurred this year as well. Post-construction, this facility can now process more volume than before. They've also managed to increase their margins to offset the decrease in volumes, keeping EBITDA relatively flat. They recently issued $15 million of debt in order to fund construction of a state-of-the-art, large scale production facility. Although the facility will not begin construction until 2018, it highlights management's expectations of higher volumes in the future. Finally, one of their competitors is in the process of having their organic license revoked which could hopefully lead to customer conversion.

Valuation Summary

Method	Metric
Comps	Median – Mean FY2017E EBITDA
DCF	Terminal Multiple: 7.5x – 8.5x
DCF	Gordon Growth: 2.0% -3.0%
52 Week Range	Low – High

Illustrative Value Range



Source: Bloomberg, S&P Capital IQ, Company Filings

Madison Square Garden Company (NYSE:MSG)

Company Overview

- Madison Square Garden Corporation started as its own company in 2010 when it was spun-off from Cablevision
- Significantly owned and controlled by Dolan family, founders of Cablevision and HBO
- World leader in sporting and entertainment events through franchising, real estate, and performances
- Controls portfolio of five sporting teams, seven famous entertainment venues throughout the US, and two exclusive media productions
- MSG exists as a 2015 spin-off from MSG Networks

Catalysts

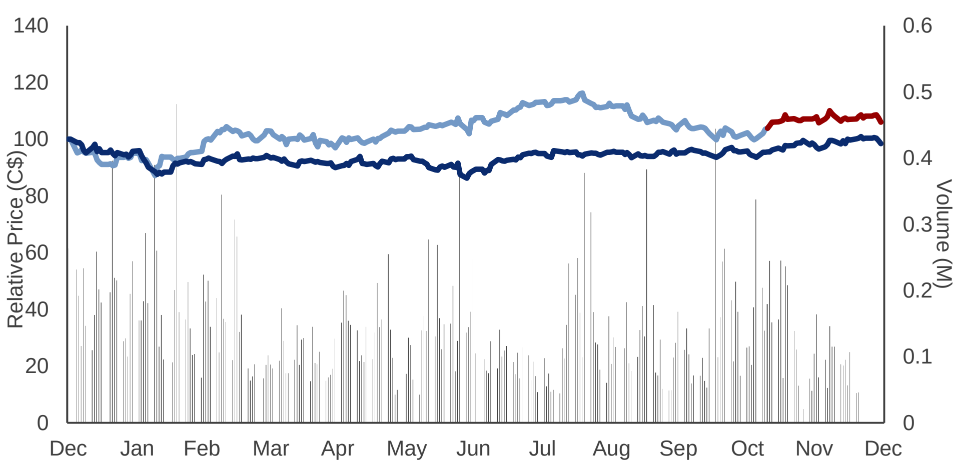
- Tax-free spin off grace period is two years; in 2017 Dolan family could begin transformative acquisition, divestiture, etc.
- Basketball or hockey team goes public and sets benchmark for MSG valuation
- Transparency surrounding tax assets
- Monetization of air rights to third-party developer
- First year of New York Spectacular is successful
- Sale leaseback with 99-year master lease agreement on certain pieces of real estate portfolio
- Deep play-off runs for Knicks and Rangers
- Special dividend (not likely but possible)

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$171.51
S/O (M)	24.0
Market Cap.	**$4,109.8**
+ Total Debt	$0
+ Minority Interest	$11
+ Preferred Shares	$0
- Cash	$1,294
Enterprise Value	**$2,826.8**
Beta (1-Year)	0.94
Dividend Yield	--
52-Week High	$188.12
52-Week Low	$141.00

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$1,147	$1,214	$1,277
% Growth		*6%*	*5%*
EBITDA	$23	$94	$112
% Margin		*301%*	*20%*
EPS	-$4.25	-$0.49	$0.36
% Growth		*-89%*	*-173%*
EV/EBITDA	*121.0x*	*30.2x*	*25.2x*
P/E	*-40.3x*	*-352.3x*	*480.5x*

Market Performance



Position Snapshot

Average Cost	*$226.24*
# of Shares	*350*
Value Invested	*$60,029*
Portfolio Weight	*2.36%*
2016 HPR	*2.1%*
HP Benchmark Return	*3.1%*
Excess Return	*(1.1%)*

Source: Bloomberg, S&P Capital IQ, Company Filings

Madison Square Garden Company (NYSE:MSG)

Investment Thesis

1. **Marquee assets will converge to private market value in the long-run**
   - Newly available publicly traded sports franchises as well as recent precedent transactions will create benchmark for valuing MSG's marquee Knicks and Rangers teams
   - Real estate "trophy property" monetization options will be fully understood by the market as other companies execute on these alternatives
   - Sum-of-the-parts valuation indicates a deep discount to asset value, even when considering a discount to private market values
2. **"Dolan Discount" on large cash balance is based on market perception not fundamentals and transparency surrounding future investments is increasing**
   - Over $400 million of current $1.5 billion cash balance already earmarked for share repurchases and Dolan's have communicated no intentions to spend remaining $1 billion
   - From the consolidated Cablevision entity to today's MSG Co. and MSG Networks spin-offs, there has been significant value creation from the Dolan's dealmaking despite errant spending
3. **Complex "hidden assets" such as NOLs and air rights not fully understood by market**
   - NOLs appear valueless on balance sheet due to a full valuation allowance booked on the operating losses; this will disappear once profitability is proven
   - 2 million square feet of air rights can be monetized by MSG in the future; valuations are increasing given recent precedent transactions

Analysis of Performance

Madison Square Garden Co. was one of our last investments of 2016 so there has not been any significant movement in the stock since our purchase date. We are waiting on several potential high-delta events, most of which involve value creation by separating MSG's core assets. Since November, MSG's stock has tracked the broader index relatively closely and we expect this to be the case until one of our catalysts is realized.

Valuation Summary

MSG Consolidated	
MSG Sports	1,000.0
Real Estate	0.0
Entertainment + Other	2,643.4
2016A Corporate Unallocated Expenses	-136.1
Tax Rate	35%
Capitalization Rate	10%
Total Corporate Overhead	**-476.2**
Total MSG Value	**3,167.2**
Fully Diluted Shares Outstanding	24.1
Per Share Value	**$131.42**
Premium (Discount) to Current	*(19.8%)*

Source: Bloomberg, S&P Capital IQ, Company Filings

Industrials Sector

2016 Review & 2017 Outlook

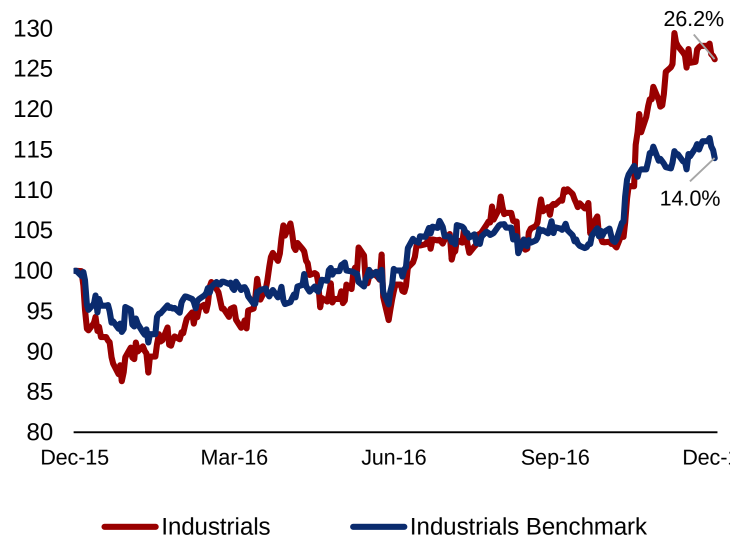
By Andre Cote-Barch and Noah Petkau

DCM and Industrials Benchmark Performance

The DCM Industrials sector returned 26.2% in 2016, compared to 14.0% for the sector benchmark. Industrials was among the top performing sectors last year due in large part to the positive sentiment around President Trump's policies for infrastructure stimulus. DCM's outperformance was driven by our investments in Union Pacific and Pangaea Logistics Solutions.

We invested in Union Pacific Railroad in December 2015 in anticipation of a rail volume recovery. While volumes continued to shrink in 2016, valuations recovered as the market started to price in a recovery. UNP's stock was up 32.6% in 2016, contributing to our outperformance of the Industrials Benchmark. It also slightly outperformed the S&P 500 rail index, which appreciated 31.5% during the year, due to its superior operating metrics (Figure 2). While Union Pacific recently closed the valuation gap with its peers, we still see further upside potential as volume recovery materializes in 2017.

Figure 1: DCM Industrials Performance



DCM also entered a position in Cummins near the end of 2016. The engine manufacturer had seen negative investor sentiment due to a trend of customers integrating engine production in-house. DCM takes the position that these fears are overblown and that Cummins is somewhat insulated from this trend due to its superior engine quality, specialized products, and unparalleled emissions compliance. Driven by end customer demand, we see CMI maintaining current American market share and growing revenues from its relatively high exposure to emerging markets as these regions catch up to Western emissions standards. Our current valuation yields a target price of $155.33, a 13.7% upside to CMI's current price.

Figure 2: UNP Relative Performance

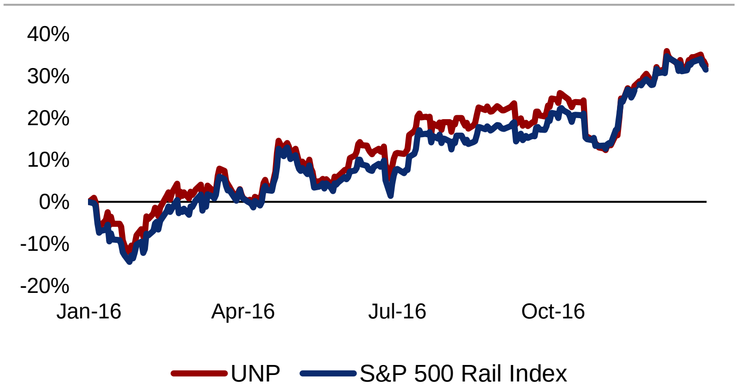
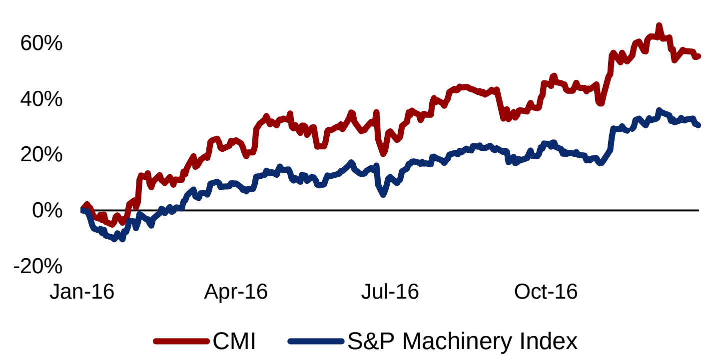


Figure 3: Cummins Relative Performance

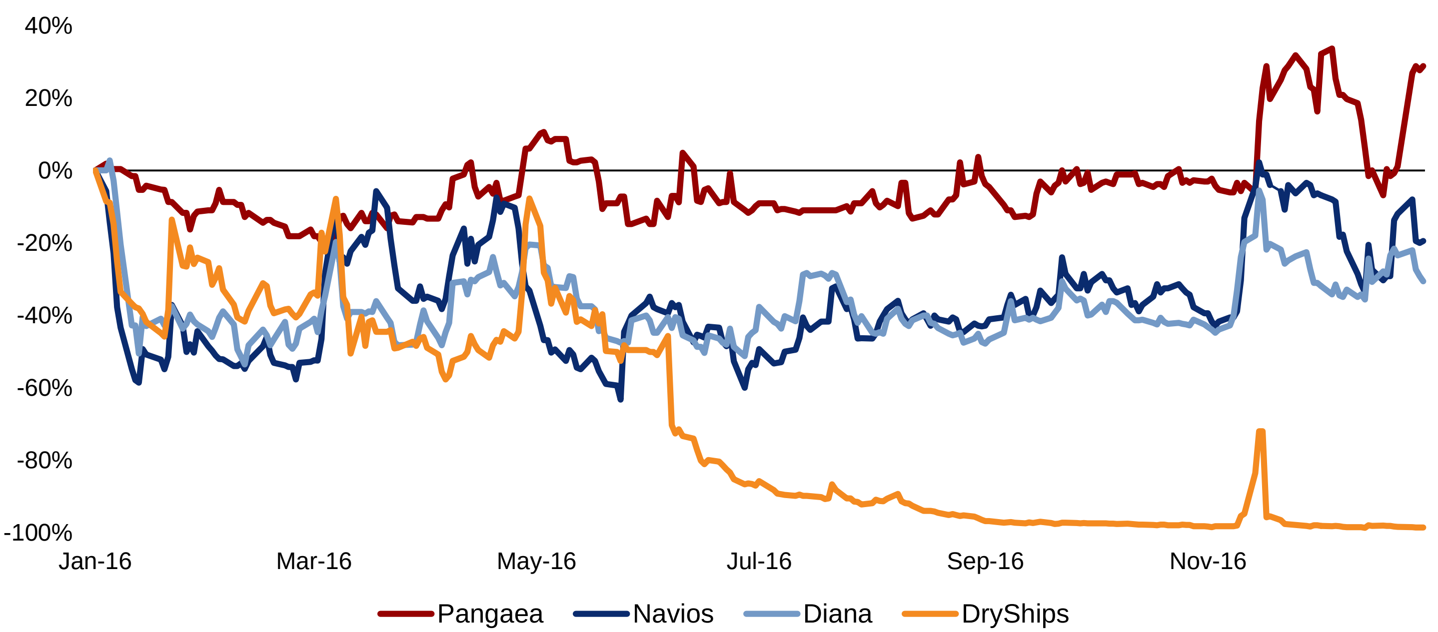


Benchmark: 100% iShares Dow Jones Industrials ETF.

DCM and Industrials Benchmark Performance Continued

After holding for two years, DCM liquidated its position in Pangaea Logistics Solutions December 2 and 5, 2016 at an average exit price of $3.22 USD. PANL generated a 2016 HPR of 21.9% in USD, contributing to our outperformance of the Industrials Index. As shown in Figure 4, PANL consistently outperformed its marine shipping peers in 2016. Although the S&P does not compile a marine shipping index, the dry bulk shipping subsector underperformed both the industrials sector and the market as a whole. DCM initially took a position in PANL at $5.38 in November 2014 and added to the position at $2.65 in April 2016 as we remained convinced in our bottom-up investment thesis. Our thesis was driven by PANL's leading position in the niche market of arctic shipping, which generates premium pricing over the spot rate due to limited supply. Moreover, PANL's focus on obtaining long-term contracts of affreightments (COAs) on less traveled "backhaul" routes allows it to grow revenues and voyage days with less capex than its peers. As shown below, PANL was able to outperform its industry peers during a period of declining freight rates caused by vessel overcapacity. It avoided industry losses as it reduced its exposure to the volatile spot market. It used its small fleet and chartered in-vessels only to meet the demand of its higher margin and fixed rate COA rather than engage in spot chartering. PANL posted positive net income and EBITDA throughout our investment period, while most other shippers were running in the red. Our investment decision in keeping Pangaea hinged on it being a value stock with strong fundamentals. However, following the Trump election, marine shipping saw significant appreciation on speculation of economic growth. We sold our position in PANL partially to free up cash for the purchase of Cummins, but primarily because the equity suddenly rose to a valuation multiple we could not justify within our fundamental valuation framework.

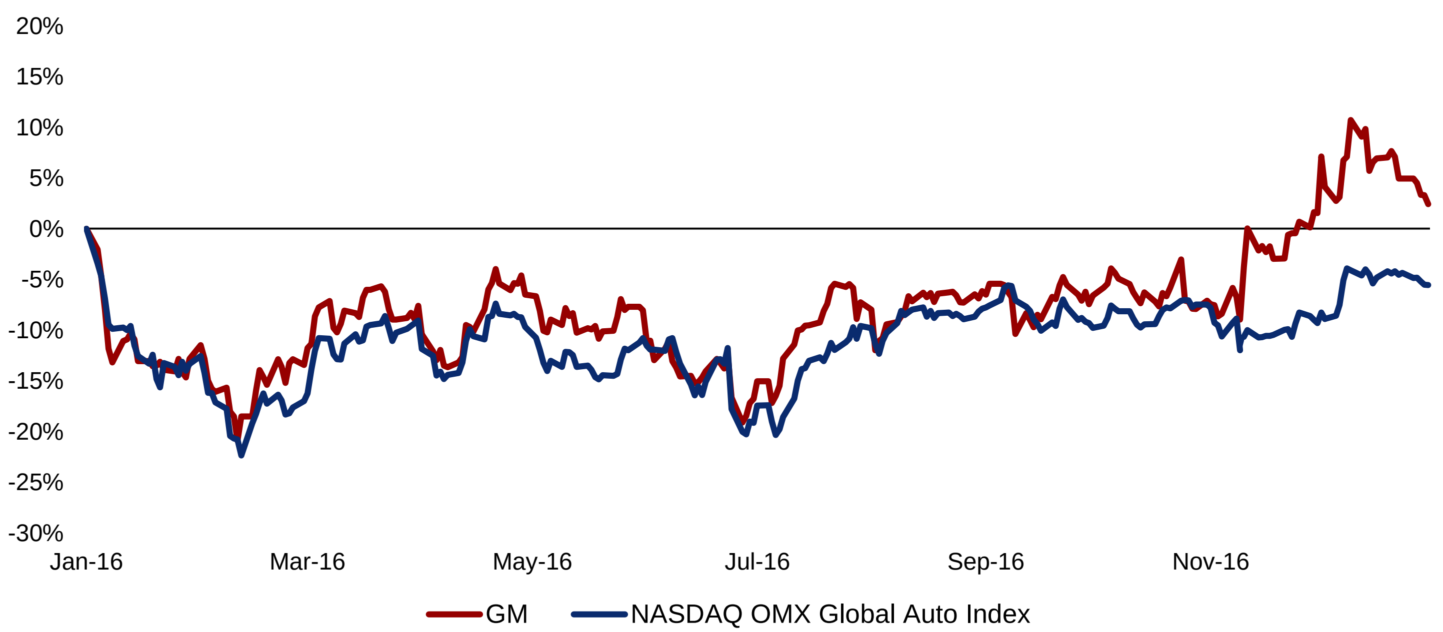
Figure 4: PANL Relative Performance



DCM and Industrials Benchmark Performance Continued

The auto industry is covered by the Industrials Sector while not being included in our benchmark's performance. Our position in GM was exited December 2, 2016 at a price of $35.53 USD in order to allocate resources to the purchase of Cummins as our thesis points on GM had largely been achieved. GM was a drag on our performance as it appreciated just 4.5%, or 7.8% including dividends, as compared to the Industrials benchmark's return of 17.4% as of December 2, 2016. As seen in Figure 5, GM outperformed the Global Auto Index, down 5.5% during the year. It outperformed following the election of Trump as GM generates 72.6% of its net sales in North America. GM beat earnings in all three quarters YTD on strong retail vehicle sales in the U.S. (+2.0% in 2016) and China (+7.1%), but shares traded down on concerns of peak auto sales and Chinese economic uncertainty. We held GM during the year believing the pessimistic view of an auto sales peak was exaggerated, favouring instead an argument of a demand plateau. After Trump's election, this argument was further supported as GDP growth, the biggest driver of sales, is expected to accelerate under new stimulus policies. However, we recognize the industry faces risks from higher interest rates, oil prices, and weakening used car prices. Our sale follows the realization of our thesis of multiple convergence as GM's EV/EBITDA discount to Ford narrowed from a spread of 1.7x to 0.1x, a relative value deserved in part by a higher ROIC of 8.6% compared to 4.0%.

Figure 5: GM Relative Performance



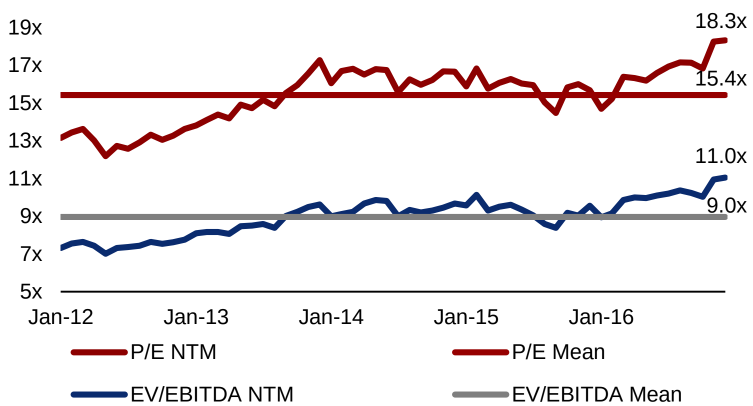
Sector Overview

Industrials Sub-Sectors	1-Year Performance (S&P)	Contribution	Weights (12/30/2016)
Industrial Conglomerates	6.0%	1.3%	19.9%
Machinery	30.5%	4.7%	17.2%
Aerospace & Defense	16.1%	2.6%	15.9%
Road & Rail	31.6%	2.6%	9.1%
Electrical Equipment	17.2%	1.0%	5.9%
Airlines	9.7%	0.6%	5.9%
Professional Services	1.6%	0.1%	5.6%
Air Freight & Logistics	20.7%	1.1%	5.4%
Commercial Services & Supplies	22.8%	1.1%	5.0%
Trading Companies & Distributors	21.3%	0.8%	4.0%
Building Products	5.8%	0.2%	3.3%
Construction & Engineering	32.5%	0.6%	2.0%
Transportation Infrastructure	NA	NA	0.6%
Marine	NA	NA	0.3%
Industrials Sector	**16.1%**		**100%**

The S&P 500 Industrials Index was up 16.1% in 2016 as compared to the S&P 500 which was up 9.5%. The Industrials sector outperformed the S&P 500 prior to and following the election of President Trump. The sub-sectors with the largest absolute performance include construction & engineering (+32.5%), road & rail (+31.6%) and machinery (30.5%). The sub-sectors with the largest contribution to the benchmark's absolute performance were machinery (+4.7%), aerospace and defence (+2.6%) and road & rail (+2.6%).

As seen below, the Industrials sector has seen absolute multiple expansion from a NTM P/E of 15.7x and NTM EV/EBITDA of 9.6x in December 2015 to 18.3x and 11.0x in December 2016, respectively. The sector currently trades at a 18.8% premium on P/E and 23.2% premium on EV/EBITDA to its five year historical average. From the view of relative valuation, the sector currently trades at a premium of 0.7x on P/E to the S&P 500 as compared to a five year historical average which trades in line/slight discount to the S&P 500. The premium multiples are explained as market is pricing in the expected earnings tailwinds of the recovery of commodity exposed industrials and President Trump's stimulus. Companies and analysts have not yet adjusted EPS estimates upwards given the uncertainty of Trump's policies. It is expected that multiples will decline once estimates are revised upwards as Trump's policies are implemented.

Figure 6: Industrials 5Y Absolute Valuation

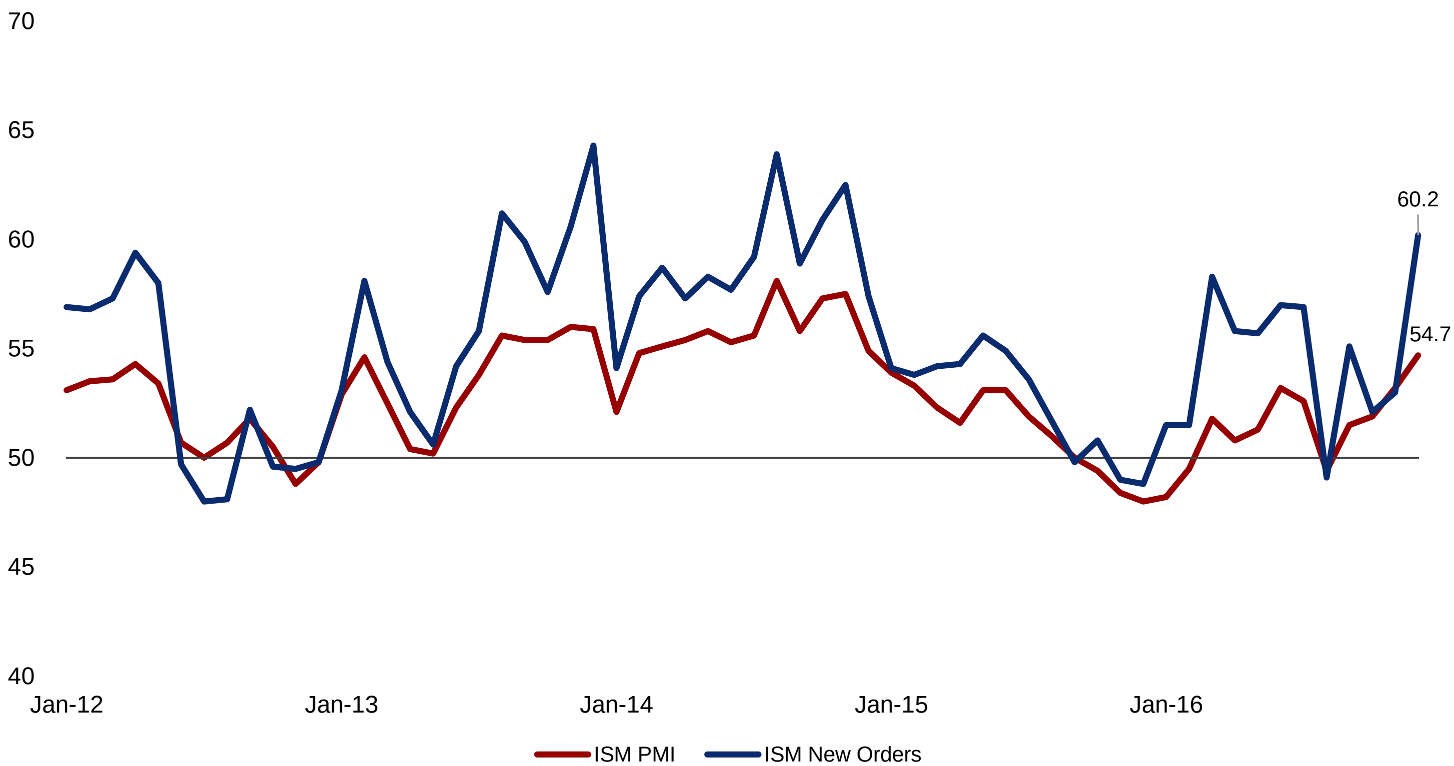


Source: Fidelity Research, Bloomberg, RBC Capital Markets

2016 and 2017 Sector Outlook

Last year the industrials group had a neutral view on the sector given the expectations for negative organic growth. The sector was facing headwinds from lowered commodities capital spending, a slowdown in China and negative foreign exchange effect from an appreciation in the USD. As the sector enters 2017, investor sentiment has improved as fundamentals show signs that industry headwinds are stabilizing. The exception is the foreign exchange headwind as the USD is expected to strengthen in 2017. The Industrial Recession that has affected the sector over the past year and a half is expected to come to an end as revenue growth becomes positive in 2H 2017. However, given high absolute and relative market valuations in the sector, combined with the old economic cycle, we are underweight this cyclical sector.

Figure 7: US PMI and New Orders Index

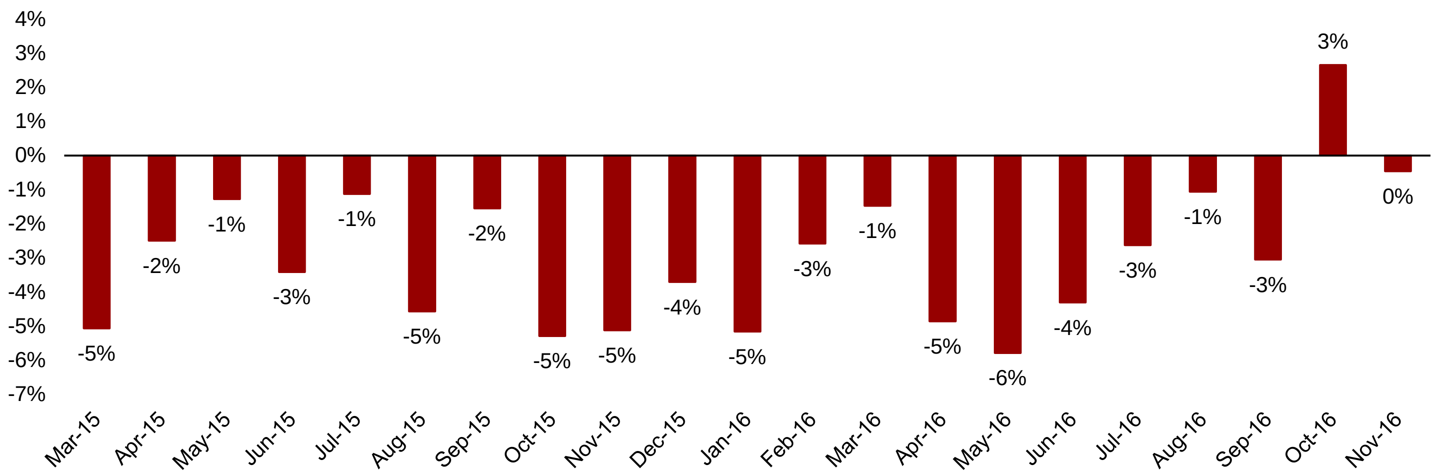


The Purchasing Managers Index (PMI) is an economic indicator of the health of the manufacturing sector. It is based on five major components which measure new orders, inventory, production, supply deliveries and the employment environment. The graph in Figure 7 shows how the PMI index has evolved over time. A reading of above 50%, depicted by the black line, represents an expanding manufacturing sector. During the year, the PMI was above 50% nine of twelve months with the latest reading of 54.7% in December, a high for the year. The PMI New Orders sub-index, a leading indicator of future deliveries, was above 50% eleven out of twelve months in 2016. The sub-index increased 7.2% in December and reached a yearly high of 60.2%.

Source: Goldman Sachs, Bloomberg, ISM, Cass Information Systems, JP Morgan

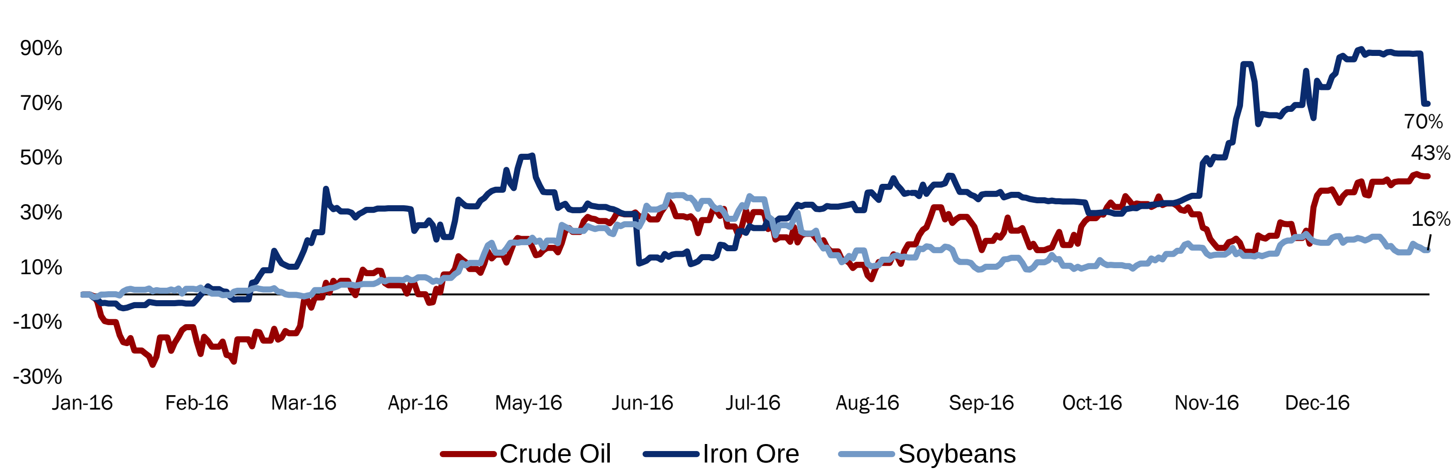
2016 and 2017 Sector Outlook Continued

Figure 8: Cass Freight Index Shipments



The Cass Freight Index is a measure of freight volume shipping activity (primarily truck and rail shipments). The index turned positive in October and was slightly negative in November following nineteen straight YoY declines. Cass attributed the positive momentum to increased parcel and airfreight volumes due to e-commerce, improved truck tonnage and easier YoY volume comparisons for rail and barge. Cass believes the freight recession that has occurred over the past year and half is showing signs of abatement.

Figure 9: Commodity Prices

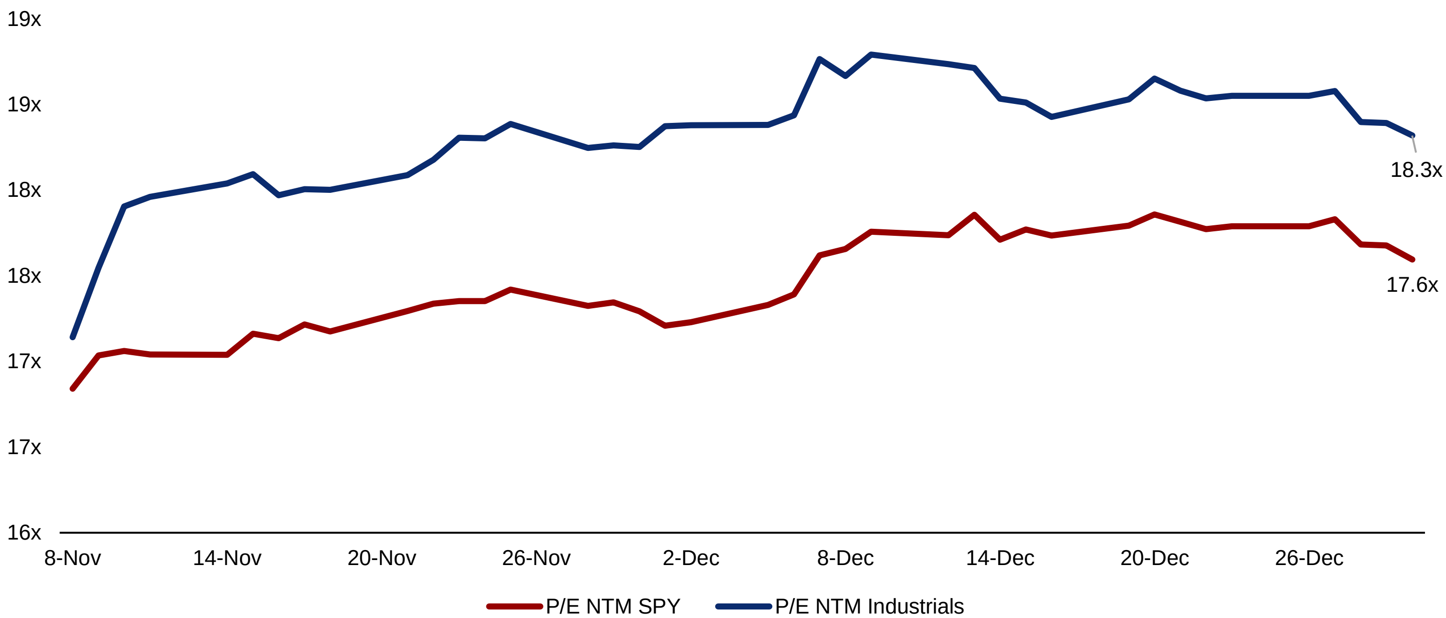


In 2016, commodity prices rose due to decreased supply and improving demand conditions. The earnings of industrial companies are indirectly tied to commodity prices through capital expenditures. As a result, commodity exposed industrials experienced multiple expansion on investor expectations that the long-depressed commodity end markets are bottoming, stabilizing and would recover from trough cycle earnings. The capex forecasts for commodity end markets will be discussed in the machinery sub-sector overview.

Source: Goldman Sachs, Bloomberg, ISM, Cass Information Systems, JP Morgan

2016 and 2017 Sector Outlook Continued

Figure 10: The Trump Bounce: Driven on Expectations



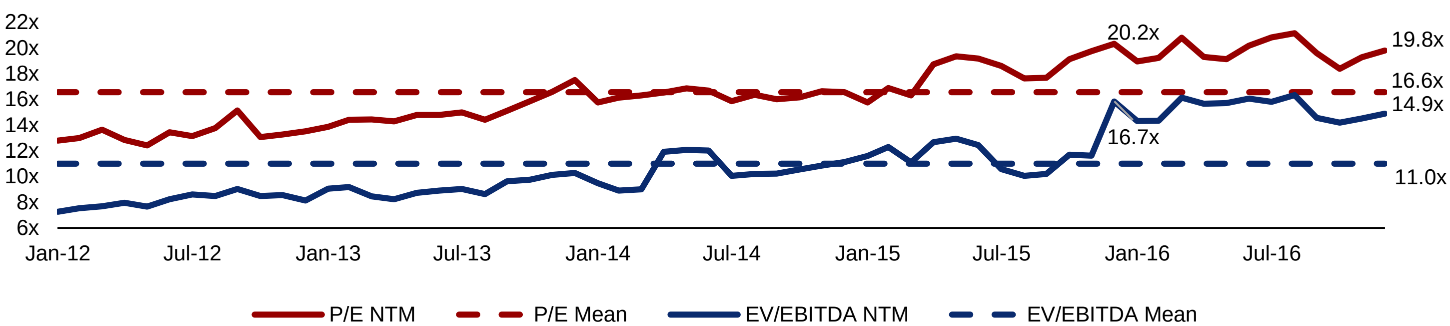
The cyclical Industrials sector outperformed the S&P 500 on the election of President Trump given his expansionary fiscal policies. The Industrials index expanded 7.0% as compared to 4.6% for the S&P 500 following the election. The NTM P/E multiple expanded 6.9% for the Industrials Index as compared to 4.5% for the S&P 500. Trump's policies, including infrastructure stimulus, corporate tax reform and higher defence spending, are expected to boost earnings for industrial companies in late 2017 or 2018. The largest impact on earnings will be corporate tax reform from the current 35% tax rate to 20% under Speaker Ryan's plan or 15% under Trump's plan. This would lead to an 8% increase in net income for Industrial companies in 2017 under Speaker Ryan's plan or a 13% increase under Trump's plan. Moreover, Trump's plan to spend $1 trillion on infrastructure spending over ten years or $100B per year is estimated to boost construction spending by 7% in 2018, supporting increasing demand for equipment. A one-time repatriation tax holiday of 10% is expected to support share buybacks, dividends or M&A.

Source: Bloomberg, Capital IQ, RBC Capital Markets

Industrial Conglomerates – 2016 Overview

The multi-industrials index appreciated by 6.0% in 2016 despite a 1.8% and 10.4% contraction in the NTM P/E and EV/EBITDA multiple, respectively. The sector underperformed the Industrials benchmark as investors preferred cyclical companies as opposed to diversified companies in response to increased commodity prices and Trump's election. The multiples shown in Figure 11 are trading at a premium to the 5 year average of 16.6x and 11.0x, respectively. Valuations appear elevated due to investor expectations of improving organic growth fundamentals.

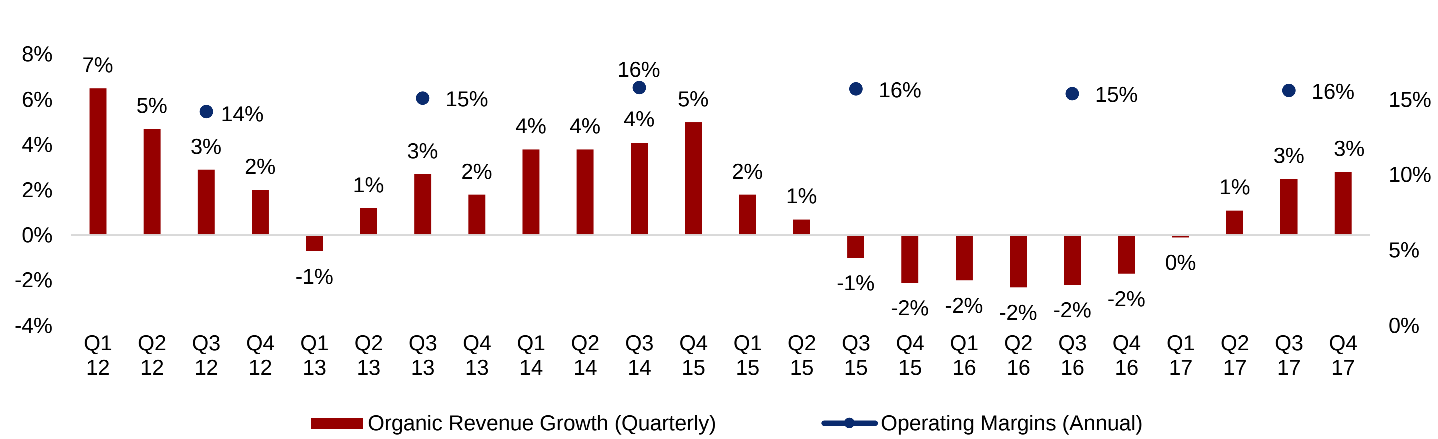
Figure 11: Industrials Conglomerates P/E and EV/EBITDA Evolution



Industrial Conglomerates – 2017 Outlook

Conglomerates are expected to recover from the Industrial recession as positive organic revenue growth of 1.5% is projected for 2017 as compared to -2.0% in 2016. The sector will see a recovery in growth as oil headwinds stabilize. Moreover, operating margins are expected to increase 20 basis points to 15.6% after two years of declines as companies benefit from operating leverage on volume and restructuring efforts taken in 2016 during the Industrial recession. The sector will continue to face a headwind with an expensive currency and higher raw-material prices. M&A activity will continue to be an important trend given low organic growth in the sector since many players have balance-sheet capacity to finance deals.

Figure 12: Industrials Conglomerates Organic Revenue Growth

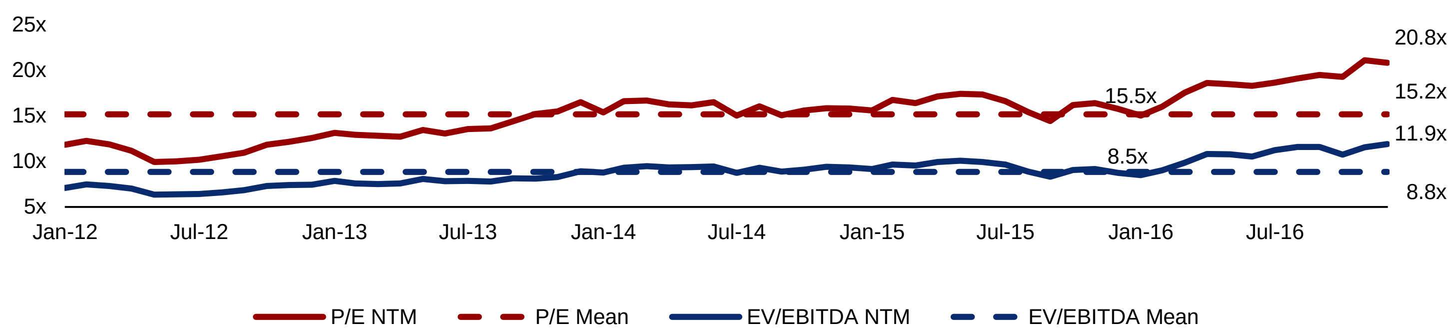


Source: Bloomberg, RBC Capital Markets

Machinery – 2016 Overview

The machinery index appreciated by 30.5% in 2016 due to multiple expansion of 33.9% and 39.5% in the NTM P/E and EV/EBITDA multiple, respectively. The machinery sector outperformed our benchmark as the sub-sector is highly cyclical and levered to the rise in commodity prices. Multiples shown in Figure 13 are trading at a substantial premium to the 5 year average of 15.2x and 8.8x, respectively. Multiples are trading at a large premium to historical averages due to the expectation of recovery from an earnings trough. Two thirds of machinery end markets including energy, mining and agriculture are at historic lows, bottoming after three years of capital spending cuts.

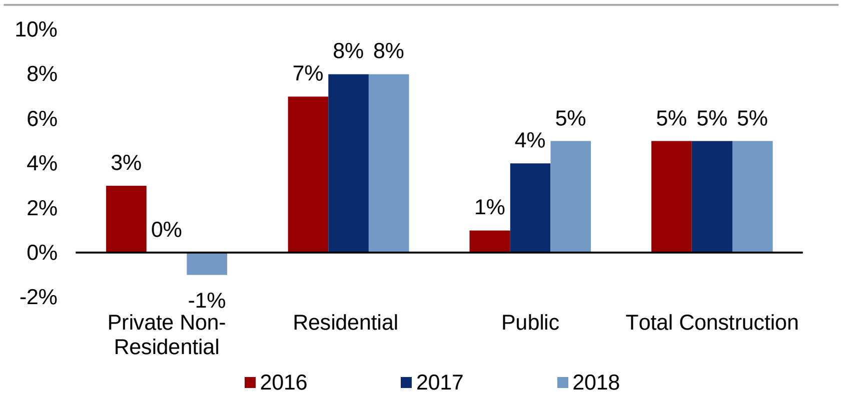
Figure 13: Machinery P/E and EV/EBITDA Evolution



Machinery – 2016 and 2017 Outlook

Total U.S. construction spending is in its sixth year of recovery and is expected to increase 5% in 2016 driven by a 7% increase in residential spending, which represents 48% of total construction spending. Non-residential construction makes up 20% of the revenue of machinery end-markets and has been one of the sole tailwinds for machinery manufacturers in recent years. However, investors are concerned as private non-residential spending, 31% of construction capex, peaks and is expected to turn negative in 2H 2017. Chemicals and Liquefied Natural Gas capex, 10% of private non-residential spending, is expected to see large declines of 20% and 50%, respectively from 2016-2019 due to excess supply. From 2016 to 2019, total construction spending is expected to increase 5% per year as the slowdown in private non-residential spending is offset by strong residential and public spending. The implementation of Trump's full infrastructure stimulus plan of $100B per year would lead to further upside from the spending growth forecasts seen in Figure 14. The full plan would boost construction spending by a total of 7% in 2018.

Figure 14: US Total Construction Spending



Source: Bloomberg, Goldman Sachs

Machinery – 2016 and 2017 Outlook Continued

Oil and gas represents 6% of machinery end market revenue and has faced a headwind over the past two years as energy companies reduced rig count activity and cut capital expenditures in response to lower oil prices. Upstream capital expenditures declined 30% in 2015 and 35% in 2016 as a response to a 46.4% decline in the average daily WTI oil price in 2015 and 10.9% decline in the average daily price in 2016. Crude oil prices recovered in 2016, increasing 43.2% during the year and spurring a 64.6% increase in rig count from the low in May 2016. As implied by the forward curve, oil prices are expected to increase 24.8% on a daily average price basis in 2017 and 2.3% in 2018, resulting in an increase in capital expenditures by 25% and 30%, respectively.

Figure 15: Upstream Capex

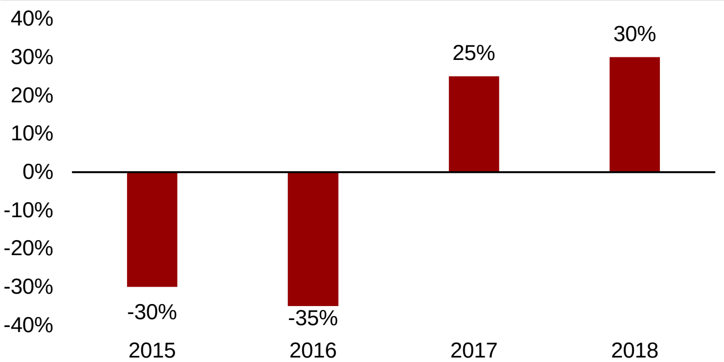
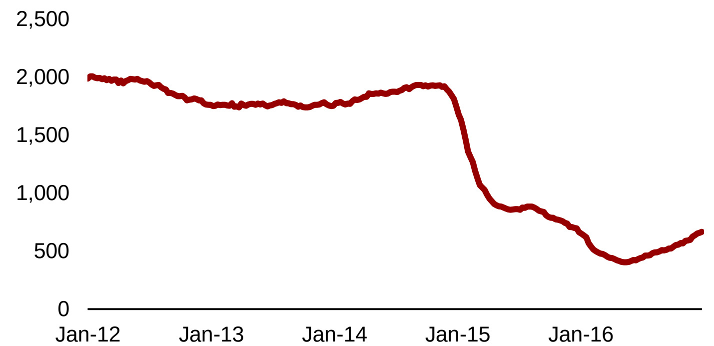


Figure 16: Rig Count



Mining represents 8% of machinery end-market revenue. It has been a headwind to industry earnings due to cuts in capital expenditures as a result of depressed metal prices. The price of iron ore has declined 44.5% from its peak in August 2013. As a result, mining capital expenditures have seen major declines during the past three years. However, sentiment has improved as cuts are expected to moderate in 2017 & 2018. The Parker Bay Index in Figure 18 measures overall equipment sales volume in the largest surface mines. It is down 82% from its peak in Q1 2012. As capex approaches depreciation, replacement demand for ageing equipment will drive growth. Mining capex as a percentage of sales is at a trough and mining equipment's share of capex of 1.5% in 2016 is at trough as compared to the historical average of 10%.

Figure 17: Mining Capex

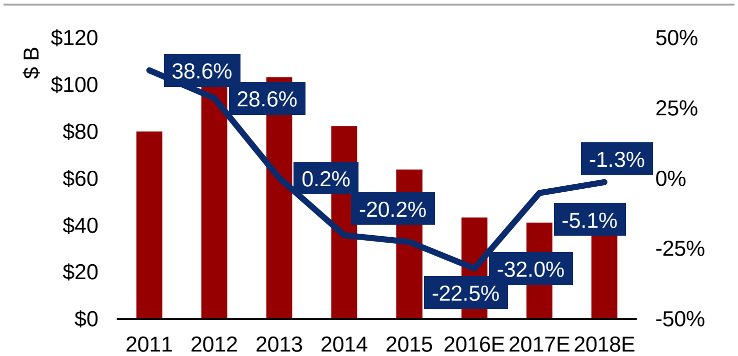
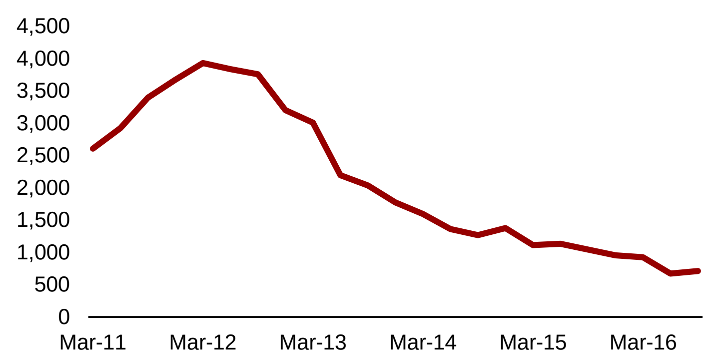


Figure 18: Parker Bay Index

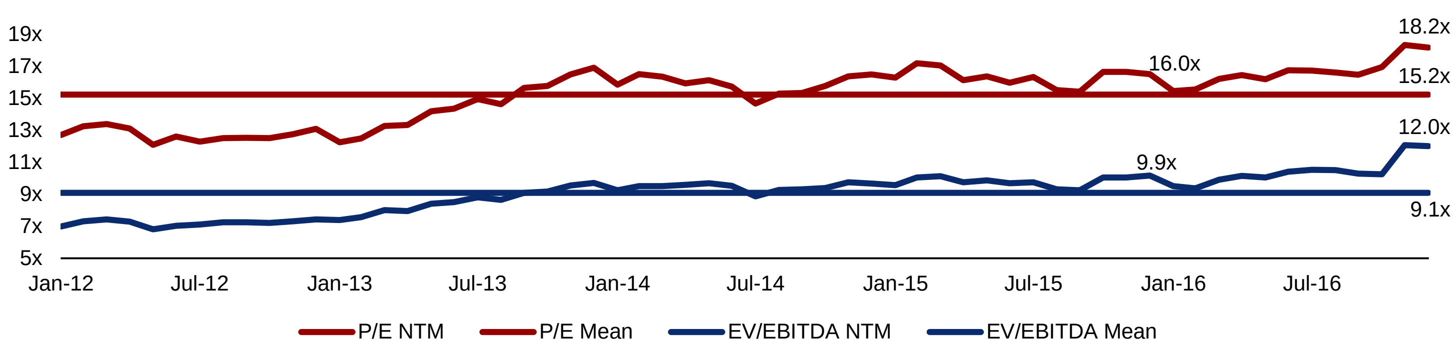


Source: RBC Capital Markets, Goldman Sachs, Bloomberg

Aerospace and Defense – 2016 Overview

The A&D index appreciated by 16.1% in 2016 due to multiple expansion of 13.8% and 20.8% in the NTM P/E and EV/EBITDA multiple, respectively. The A&D index performed in line with our benchmark as defence stocks outperformed while commercial aerospace underperformed due to a declining book-to-bill ratio. Multiples shown in Figure 19 trade at a substantial premium to 5 year averages due to expectations of higher defence spending under Trump, including a lift to the sequester which mandates limits on such expenditures.

Figure 19: Aerospace and Defence P/E and EV/EBITDA Evolution



Aerospace – 2016 and 2017 Outlook

Commercial aerospace underperformed the benchmark in 2016 as the sector deals with a decreasing book-to-bill ratio. Book-to-bill for all commercial aerospace players is expected to be 1.0x in 2016 and to decrease to 0.8x in 2017. Boeing's book-to-bill has been below 1.0x in six of the last seven quarters and is expected to be 0.7x in 2016, below management's expectations of 1.0x. Industry orders have softened due to slowing travel growth, low fuel prices, and record backlogs. Backlog is ten years for Airbus and eight years for Boeing. Given a historical correlation between book-to-bill and multiples (Figure 20), multiples are expected to contract in 2017. Stock returns can be supported by earnings growth due to an expected production ramp-up through 2017 to 2020 (Figure 21).

Figure 20: Boeing Book-to-Bill P/E

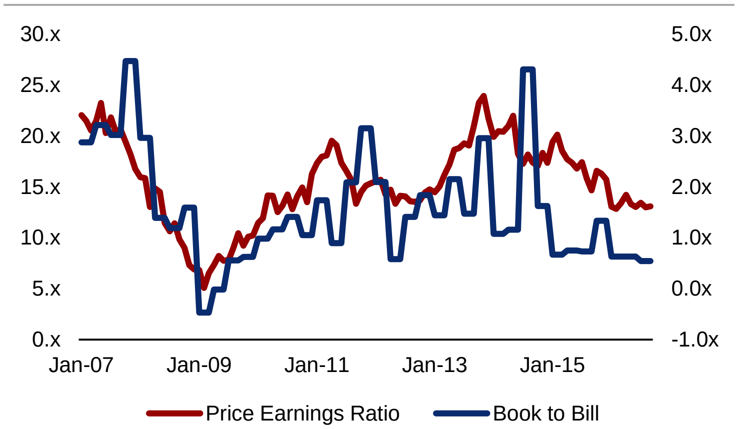
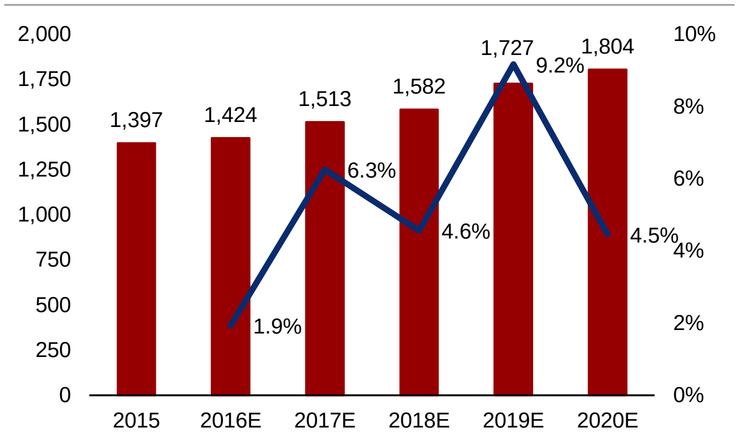


Figure 21: Airbus & Boeing Production

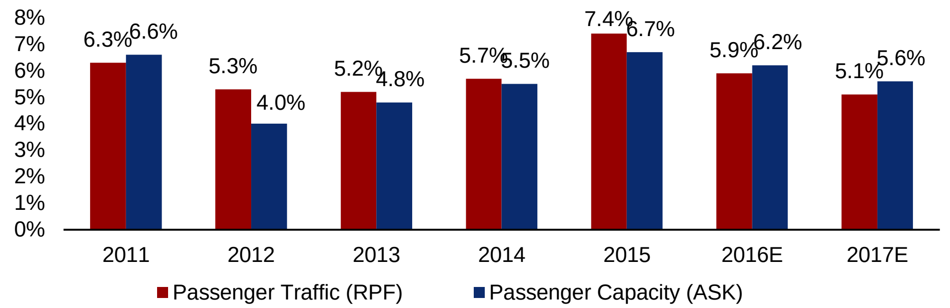


Source: Goldman Sachs, Deutsche Bank, Bloomberg

Aerospace – 2016 and 2017 Outlook Continued

Commercial aerospace is in a mature stage and markets are concerned about slowing aircraft orders due to airline overcapacity. Overcapacity is expected to worsen over the next few years based on current OEM production rates. Passenger capacity is expected to outpace passenger traffic in 2016 & 2017 as seen in Figure 22. Air traffic is expected to slow as the tailwind of low oil prices reducing ticket prices moderates. Another risk to aircraft orders is that airlines are expected to see a 16% decrease profitability in 2017 after a record level in 2016 due to higher fuel costs (which drive 30% of airline expenses) and reduced load factors due to overcapacity. These risks may culminate in OEM production cuts as supply and demand is rebalanced, which would limit OEM stock returns from earnings growth.

Figure 22: Airline Demand and Supply



Defence – 2016 and 2017 Outlook

U.S. defence budget levels are at a trough both on an absolute basis and as a percentage of GDP due to Obama's FY17 Budget (Figure 23). Defence stocks experienced recent multiple expansion on expectations that defence expenditures will be increased by Trump. The increase in 2017 defence spending would be limited as a sequester remains in effect, but the Republican government is expected to repeal this in mid-2017, leading to $500B in reinvestments over ten years. It is expected that ending the sequester would result in CAGR of 5.7% from FY16 to FY21 in the base defence budget, compared to 4.2% CAGR under the sequester. Trump's demands that NATO members meet 2% of GDP spending targets would increase global defence spending as only 5 out 28 members meet this target; European defence spending alone would increase 36% under the target. As has occurred historically, it is expected that further multiple expansion in defence stocks will occur in 2017 as defence budgets actually increase with greater upside to stock returns under the implementation of Trump's complete plan.

Figure 23: Defence Outlays: Obama FY17

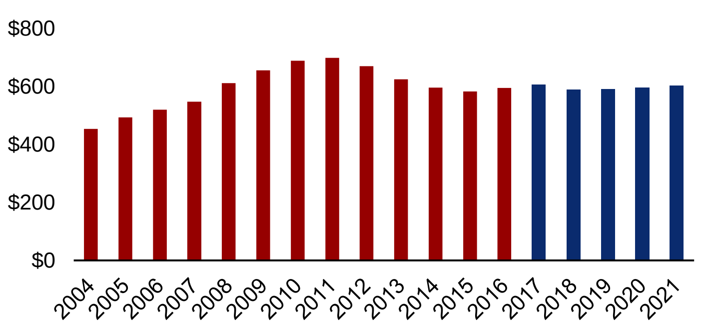
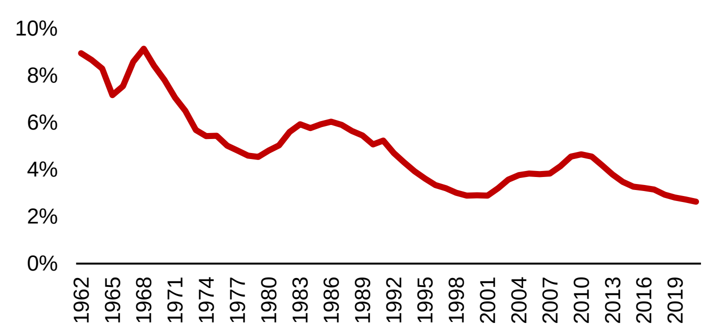


Figure 24: Defence Outlays % of GDP

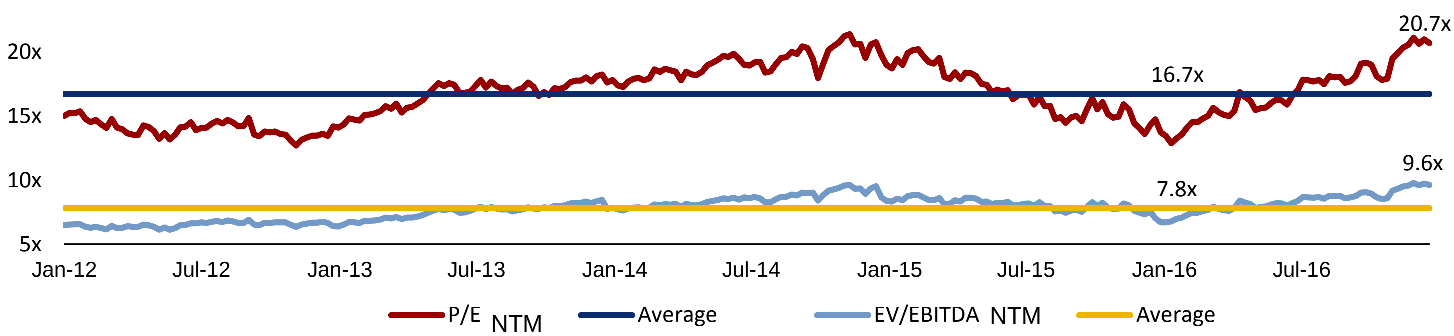


Source: Desjardins, IATA, Bloomberg, Goldman Sachs, Deutsche Bank

Rail – 2016 Overview

The S&P Rail Index rose 32% over the course of 2016 along with a 41% appreciation in P/E and 36% increase in EV/EBITDA. Both multiples ended above their five year average with P/E at 20.7x compared to a five-year average of 16.7x and EV/EBITDA at 10.27x above the 7.8x five-year mean. Multiple expansion occurred in recent months on Trump's election as investors anticipate massive infrastructure spending, which will necessitate transport of large amounts of equipment and raw materials, as well as a reversal in fortunes for coal shipments as Trump has repeatedly spoken in favour of coal manufacturing and use. Multiples are also inflated in relation to underlying performance as the market anticipates a recovery in volumes from poor performance in 2015 through 2016.

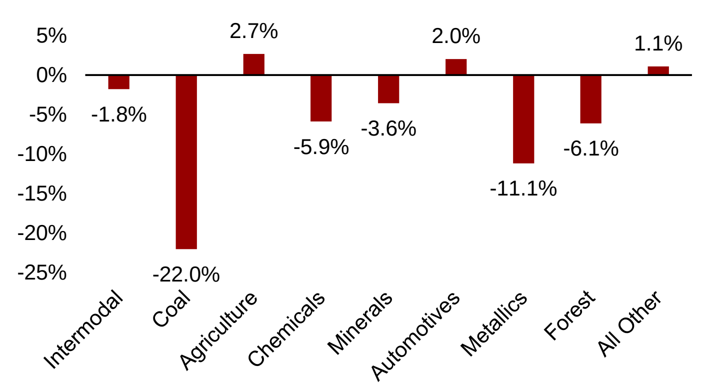
Figure 25: Rail P/E and EV/EBITDA Evolution



Rail – 2016 and 2017 Outlook

Transport volumes drive rail performance and each segment is affected by its own factors. Intermodal transport (container shipments) declined almost 2% in 2016 due to high retail inventory and lacklustre sales. Low oil prices contributed by making trucking more competitive as a rail alternative. Coal saw the biggest decline at -22%, driven by low demand given low natural gas prices. Moreover, high stockpiles among utilities paired with plant shutdown reduced demand, but these trends have played out in 2016. Agricultural shipments saw the largest growth at 2.7% on a large harvest and stronger American exports, especially in light of poor harvest in Brazil. Chemicals fell 5.9% due to a 47% drop in crude-by-rail (13% of segment) as driven by low crude prices, uneconomic origin-destination spreads, and new pipeline capacity. This was partially offset by gains in plastic shipping and a more moderate fall in industrial chemicals (-4%). Metallic Ores and Metals saw a decline of 11.1% due to a combination of plant shutdowns and high truck-served imports. This segment is driven by domestic iron and steel shipments, which have been especially hurt by the strong dollar.

Figure 26: 2016 Change in Volumes



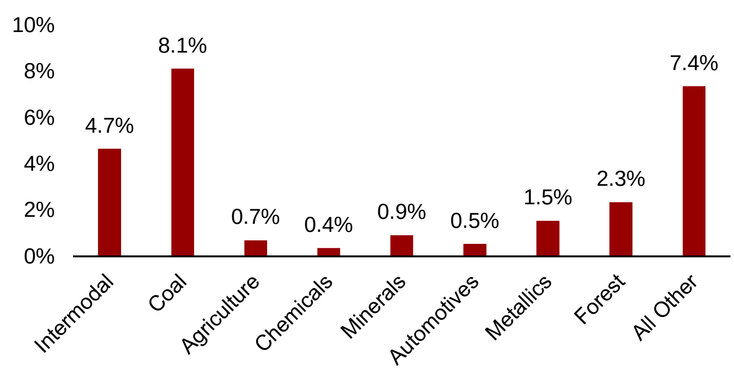
Source: Bloomberg, JP Morgan Equity Research

Rail – 2016 and 2017 Outlook

American rail outlook for 2017 again depends on volumes of various commodities as driven by both overall economic health and idiosyncratic factors. With many negative trends having run their course and easy 2016 comparisons for many segments, volumes are expected to grow across the board. Intermodal transport is forecast to expand in 2017 on improved service, less trucking competition, and international trade growth, while persistently high inventories and modest private consumption growth will continue to prove limiting factors. Cheap natural gas will continue to pressure secular decline in coal use, but stockpiles largely normalized in 2016 and production is expected to increase in the Illinois and Power River Basins (17% and 14% respectively). Although volumes are expected below 2015 levels, percentage growth from an extremely weak 2016 will be high. A strong dollar will continue to pose a threat to agricultural exports and storage capacity is a limiting factor, strong crop usage and overall production growth should drive a double-digit rise in volumes. Chemicals can expect to flatten as crude-by-rail volumes have hit rock bottom and polyethylene plant expansions are expected to drive higher pellet shipments.

Economic growth is expected to be greatly affected by the Trump presidency, so policy warrants discussion. Many campaign promises made by Trump will have direct effects on rail stocks, the greatest of which would be the promised corporate tax cut. If the American tax rate is cut to 20%, it is estimated American rail companies could experience a 23% price appreciation, or 31% appreciation if lowered to 15%. Trump also promised $1 trillion in infrastructure spending which would be a boon for rails only insofar as construction shipments rise, since higher quality roads primarily benefit trucking through reduced truck maintenance and greater timeliness. Tax cuts and infrastructure spending would be most impactful for Union Pacific, CSX, and Norfolk Southern which operate exclusively in America, versus Canadian CP and CN or Mexican-exposed Kansas City Southern. American rails also have the most exposure to coal and Trump has pledged to "end the war on coal" through reduced environmental regulation, however shipments will ultimately be driven by external factors such as natural gas and oil prices which pose continued headwinds. A political climate now favoring pipelines rather than rail can be viewed as negative, but analysts point out that crude-by-rail volumes cannot decline much further, and increased production stimulated by greater flows of crude could ultimately spillover to rail volumes. On a regulatory note, the Surface Transportation Board (STB) is mandated to increase from three members to five, allowing Trump to appoint members predisposed to lighter regulation. Thus we may see a reversal in the STB's intention to implement reciprocal switching, a policy that would hurt rail revenue by forcing rails to share network.

Figure 27: FTR 2017 Volume Forecasts



Source: Bloomberg, JP Morgan Equity Research

Industrials Sector

Holdings Review

Union Pacific (NYSE: UNP)

Company Overview

- Union Pacific Corp. (UNP) was incorporated on July 1, 1969 and is one of America's largest transport companies
- Its principal operating company is North America's premier railroad franchise, covering 23 states across the western two-thirds of the U.S.
- Its track has 32,100 route miles and maintains coordinated schedules with other rail carriers to move freight
- Its business mix comprises of intermodal (20.0%), agricultural (19.5%), chemicals (18.7%), industrial products (18.0%), coal (13.1%), and automotive vehicles (10.8%).

Risks

- Weaker than expected volume recovery
- Failure of core pricing to outpace cost inflation
- Continued low or lower oil prices making trucking more competitive and working against coal shipments as UNP is one of the rails with the most exposure to coal
- International trade war under new president or noncompetitive U.S. manufacturing due to continued USD strength

Catalysts

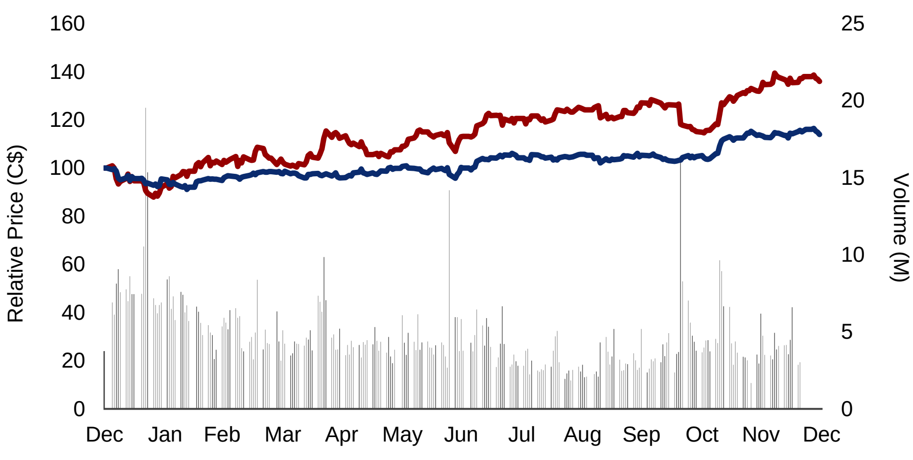
- High rail volume growth on fiscal expansion and recovery in key segments (coal, intermodal)
- Increase in progress towards operating efficiency targets

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$103.68
S/O (M)	824.1
Market Cap.	**$85,444.0**
+ Total Debt	$15,612
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$1,909
Enterprise Value	**$99,147.0**
Beta (1-Year)	0.75
Dividend Yield	2.3%
52-Week High	$106.33
52-Week Low	$67.07

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $M)			
Revenue	$19,981	$20,889	$21,685
% Growth		*5%*	*4%*
EBITDA	$9,260	$9,941	$10,469
% Margin		*7%*	*5%*
EPS	$4.99	$5.62	$6.25
% Growth		*13%*	*11%*
EV/EBITDA	*10.7x*	*10.0x*	*9.5x*
P/E	*20.8x*	*18.5x*	*16.6x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

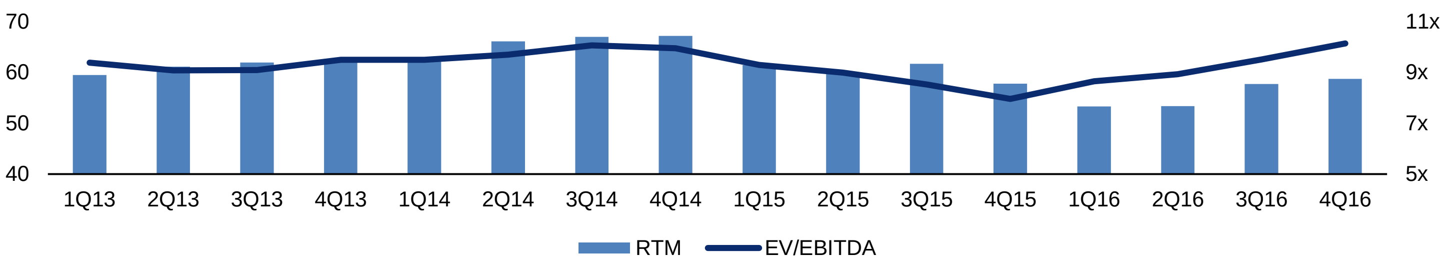
Average Cost	*$107.17*
# of Shares	*885*
Value Invested	*$91,757*
Portfolio Weight	*3.61%*
2016 HPR	*36.0%*
HP Benchmark Return	*14.0%*
Excess Return	*22.0%*

Union Pacific (NYSE: UNP)

Investment Thesis

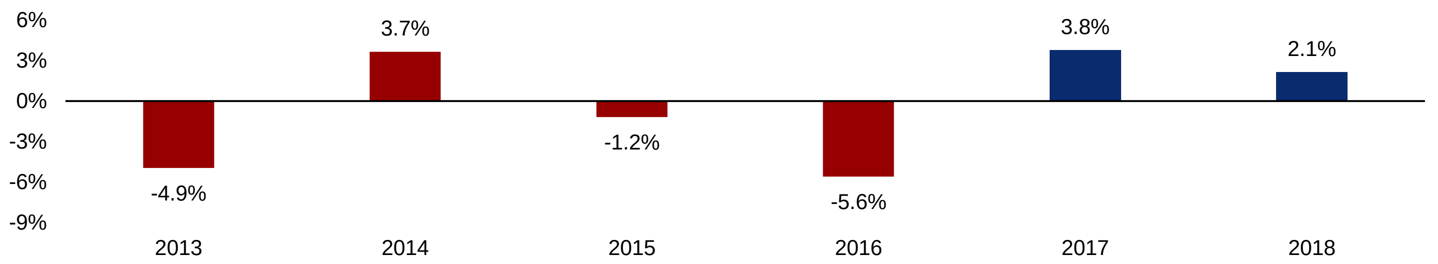
1. **Rail Industry Currently Trades at a Discount Due to Volume Decline in 2015:** *Volumes have yet to rebound, but an expected recovery is now starting to be priced in by the market*
   - Volumes continued to decline in 2016, but recovery priced in as multiples decouple from shipments
   - Recovery in volumes expected as FTR forecasts 3.8% volume increase in 2017 and 2.1% in 2018, indicating upside to stock returns as earnings grow and investors see the full extent of recovery
2. **Best Operator in the Industry:** *Strong operating metrics continued to drive performance*
   - UNP set records with operational improvements from train length to derailments, allowing superior profitability and create a lower cost base going forward into a growing-volume environment
3. **Valuation Yields Upside at Current Price***: Thesis largely materialized as comparable multiples converged and a discount identified in our pitch moved to a fair premium*
   - Comfortable with current relative valuation given UNP has superior fundamentals compared to its peers including a stronger ROE/ROIC and lower leverage levels
   - 7% upside in base case scenario DCF with fairly conservative volume estimates

Thesis #1: Industry Average Revenue Ton Miles (mm) vs. EV / EBITDA Multiple



Revenue Ton Miles, calculated as the weight of freight times the number of miles transported, is a common measure of rail volumes. By quantifying the underlying ability of railways to generate cash, RTM historically drives EV/EBITDA multiples. This relationship generally held in 2016 for UNP, but with valuation multiples deviating positively from underlying volumes. DCM entered the position in anticipation of post-2015 volume recovery driving multiple expansion, which appears to be materializing in reverse as other investors adopt our outlook on future volumes and price in a recovery despite weak fundamentals in 2016.

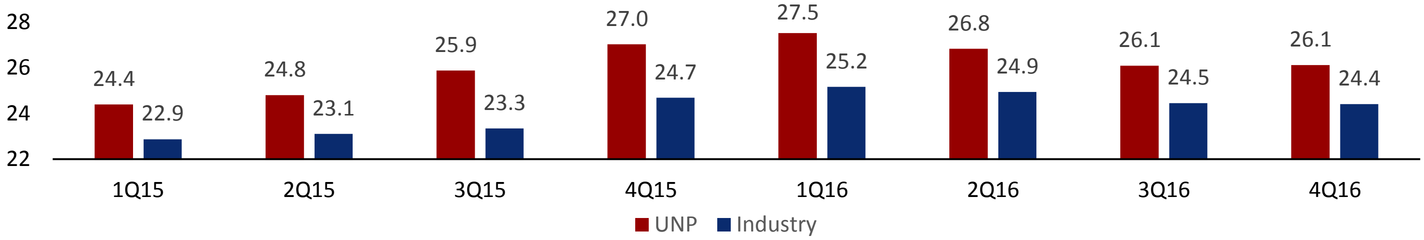
Thesis #1: Industry-Wide Freight Volume Projections



UNP was the worst hit railway by the continued volume decline in 2016 with full year volumes down 7%. The industry is expected to see overall volume fall 5.6%, especially due to a 22% decline in coal volumes. With many headwinds faced in 2016 winding down, volumes are expected to rise to the order of 3.8% in 2017, although volumes would not exceed 2015 levels until 2018. UNP is guiding for low single digit volume growth in 2017. Overall, the volume recovery we foresaw when buying UNP is expected to materialize in 2017.

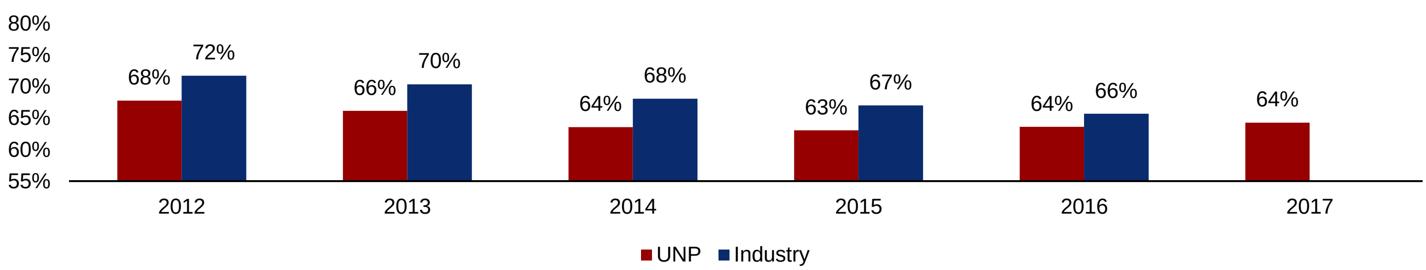
Union Pacific (NYSE: UNP)

Thesis #2: Best Operator: Velocity



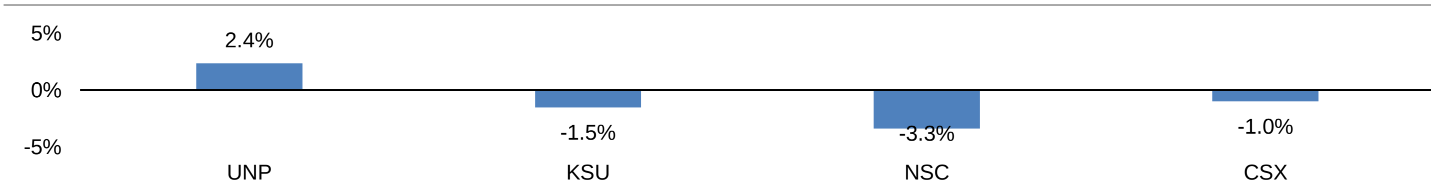
Train Velocity is a measure of operating efficiency for rails in which UNP has historically performed well. UNP defended its industry-leading position in 2016 while both UNP and the industry improved its YoY velocity in three quarters. UNP had record train lengths in 2016 as lengths rose 1-2% YoY each quarter across various segments. Longer trains allow it to carry the same amount of freight in less time. UNP also had a record low recrew rate in 2016, a rate that measures the cost incurred when the first crew has insufficient time to complete the trip and a second must be procured. Moreover, UNP saw fewer derailments during the year and set a record low number of injuries. These productivity improvements allowed cost reduction to partially offset revenue declines, with $450 million in cost savings in 2016. UNP plans to achieve between $350M and $400M of further savings in 2017 through continued productivity initiatives.

Thesis #2: Operating Ratio Setback



The operating ratio, measured as one minus operating margin, is a metric used to calculate cost efficiency for rails. UNP has the lowest such ratio among U.S Class I rails and has a long-term target of 60% by 2019. UNP has been very successful in improving its operating ratio through years of productivity improvements, efficient allocation of resources, and core pricing gains. However, low volumes and high rail inflation led to a slowdown in progress towards its target as the O/R rose slightly to 63.5% in 2016 on volume declines and weaker-than expected pricing. Following weak core pricing in 2H16, analysts have feared continued operating ratio deterioration in 2017. Management insists progress will continue to be made, driven by volume growth and continued success with the G55+0 productivity strategy. UNP expects to improve the O/R in 2017 by pricing above anticipated rail inflation of 3% in 2017. Given historical execution, we are optimistic about long-term ratio improvements in the future.

Thesis #2: Three-Year Compounded Revenue/Revenue-Ton-Miles Growth



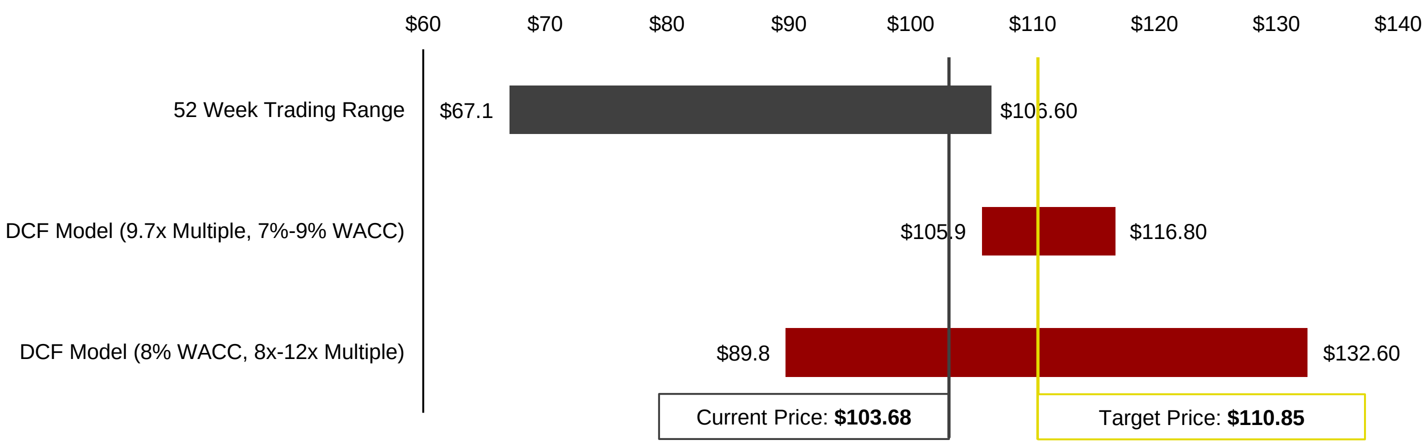
Core pricing in Q3 and Q4 was only 1.5% and 1.0% to 2.3% and 2.8% for CSX. However, UNP maintained the highest growth in Revenue/RTM in 2016. This means UNP was able to grow revenue faster than RTM, indicating strong pricing power relative to volumes and greater profit potential per incremental volume increase. Beyond greater leverage to volume expansion, UNP has compelling growth opportunities, including intermodal expertise driven by the conversion of highway freight to rail using its strong rail network and service offering, as well as greater exposure to growing plastics production through its leading position on the Gulf Coast, the largest chemical production region.

Thesis #3: Relative Valuation Tightening

Company	Mkt Cap	P/E 2016	P/E 2017	EV/EBITDA 2016	EV/EBITDA 2017	ROE	ROIC	5Y Beta	Net Debt to EBITDA	Dvd Yld
	($ B)									
CSX	41.52	20.0 x	22.7 x	9.5 x	10.1 x	14.7 x	7.8 x	1.1 x	2.2 x	1.62%
Kansas City Southern	9.46	19.2 x	16.6 x	10.5 x	9.2 x	12.0 x	8.1 x	1.2 x	2.1 x	1.50%
Norfolk Southern	33.16	16.4 x	18.6 x	8.7 x	9.7 x	12.6 x	5.9 x	1.1 x	2.3 x	2.08%
Average	**28.05**	**18.5x**	**19.3x**	**9.6x**	**9.7x**	**13.1x**	**7.2x**	**1.1x**	**2.2x**	**1.73%**
Median	**33.16**	**19.2x**	**18.6x**	**9.5x**	**9.7x**	**12.6x**	**7.8x**	**1.1x**	**2.2x**	**1.62%**
Union Pacific	**89.50**	**20.4 x**	**18.9 x**	**10.6 x**	**10.7 x**	**20.8 x**	**9.0 x**	**1.1 x**	**1.5 x**	**2.08%**

When DCM bought UNP, it traded at a 10% discount to peers despite historically trading closely in line with the group average. Currently, UNP is trading at a slight premium to peers on both 2017 P/E and EV/EBITDA, closing the valuation gap we first identified and validating our relative value analysis. UNP's strong fundamentals, competitive advantages and market leading position justify a premium valuation as consistently outperforms its industry in return on equity and return on invested capital with lower risk (lower leverage and beta).

Thesis #3: Intrinsic Valuation Still Yields Room for Upside



After updating our intrinsic valuation of UNP, we feel comfortable saying the stock is trading well within our valuation range. Our target price, based on base case assumptions in a multiple-based model, is $110.85, implying a 6.9% upside to UNP's current price. This intrinsic valuation is most significant in that it leaves us feeling comfortable that UNP's current valuation is justified, and has the potential for further appreciation.

Conclusion

DCM initially took a position in UNP as an industry-leader in the rail subsector. As rail equities appreciated in 2016, we have made excellent gains. Volumes continued to fall in 2016, but the expected recovery is beginning to be priced into market multiples. UNP has also continued to defend its leadership in operational efficiency, setting records in train length, recrew rates, and number of accidents. Our initial relative valuation has been validated as the stock closed its gap to peers and now trades at a fair premium. On an intrinsic-value basis, we believe there is still room for a 6.9% appreciation. Our overall assessment leaves us comfortable with UNP at its current valuation and we assign it a hold rating. UNP was one of DCM's best performing equities in 2016, and our performance analysis indicates this was achieved through the realization of our initial investment thesis of volume recovery and relative valuation correction on operational leadership.

Cummins (NYSE: CMI)

Company Overview

- Designs, manufactures, distributes, and services diesel and natural gas engines for highway and off-highway use
- Customers include PACCAR, Daimler, Navistar, Fiat, Chrysler, Volvo, Komatsu, MAN, and Nutzfahrzeuge
- Long-term engine supply agreements with customers on pricing and joint engineering
- Network consists of 600 company owned and independent distributor locations and over 7,200 dealer locations
- Revenue is derived 35% from engine sales, 16% from power systems, 22% from components, and 27% from distribution

Risks

- In-house engine integration trend accelerates on renewed effort from OEM truck makers
- Trade risks such as continued USD strength or trade wars between the U.S. and its international partners
- Trump follows through with rhetoric of cutting the EPA, making Cummins' economic moat in regulatory compliance expertise obsolete

Catalysts

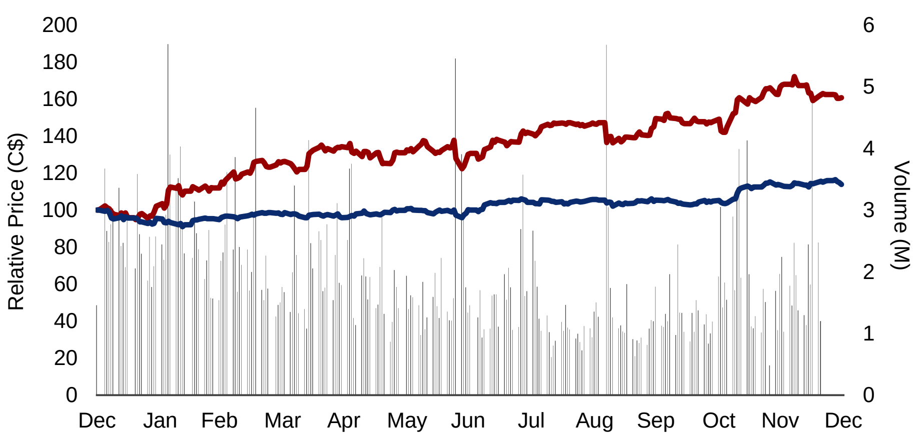
- EPA adoption of more stringent NOx standards as pioneered by the California Environmental Protection Agency Air
- Emerging market growth from trucking fleet retirement and adoption of Western emissions controls

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$136.67
S/O (M)	167.6
Market Cap.	**$22,903.2**
+ Total Debt	$1,949
+ Minority Interest	$330
+ Preferred Shares	$0
- Cash	$1,251
Enterprise Value	**$23,931.2**
Beta (1-Year)	1.06
Dividend Yield	3.0%
52-Week High	$146.46
52-Week Low	$80.72

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$17,772	$16,937	$17,748
% Growth		*-5%*	*5%*
EBITDA	$2,325	$2,447	$2,614
% Margin		*5%*	*7%*
EPS	$6.88	$7.91	$8.94
% Growth		*15%*	*13%*
EV/EBITDA	*10.3x*	*9.8x*	*9.2x*
P/E	*19.9x*	*17.3x*	*15.3x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

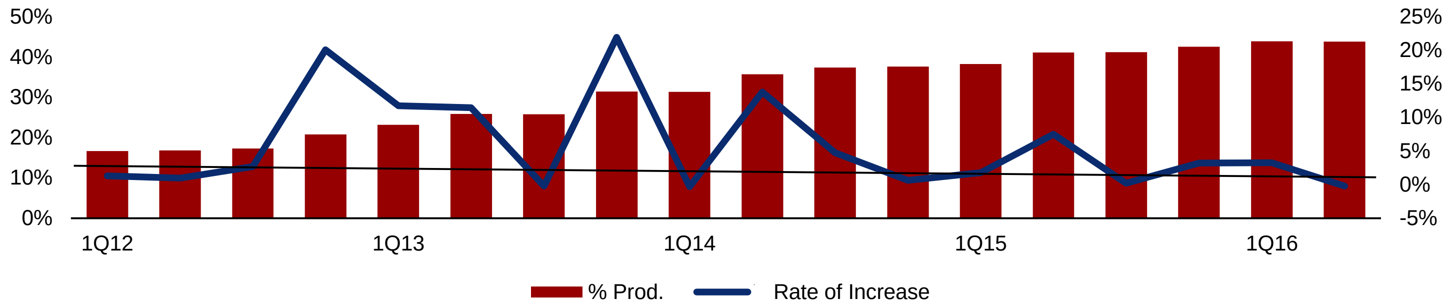
Average Cost	*$184.27*
# of Shares	*550*
Value Invested	*$75,169*
Portfolio Weight	*2.95%*
2016 HPR	*-1.0%*
HP Benchmark Return	*-1.5%*
Excess Return	*0.5%*

Cummins (NYSE: CMI)

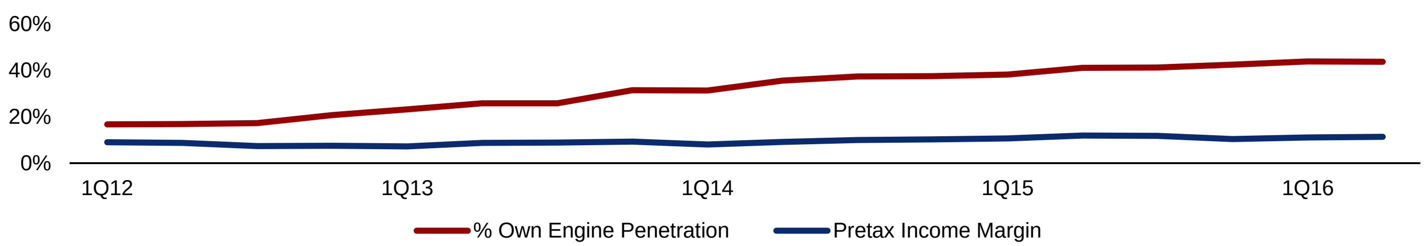
Investment Thesis

1. **Insulation from Further OEM Integration due to Product Quality and Environmental Compliance**
   - Negative sentiment overstated as integration peaked and further integration unprofitable for OEMs
   - Cummins has an economic moat in superior product quality, fuel economy, and advanced compliance
2. **High Exposure to Ramp-up in Emerging Markets through Joint Ventures**
   - Revenue upside as emerging regions adopt higher emissions standards and focus on life-cycle costing
3. **Valuation Yields Upside at Current Price**
   - Trades at 18% discount to trucking peers and 39% discount relative to construction and machinery companies all despite superior fundamental metrics on ROA, ROE, leverage, and growth opportunities
   - DCF valuation yields a 14% upside under relatively conservative assumptions

Thesis #1: Engine Integration at PCAR (Percentage In-house and Rate of Integration)



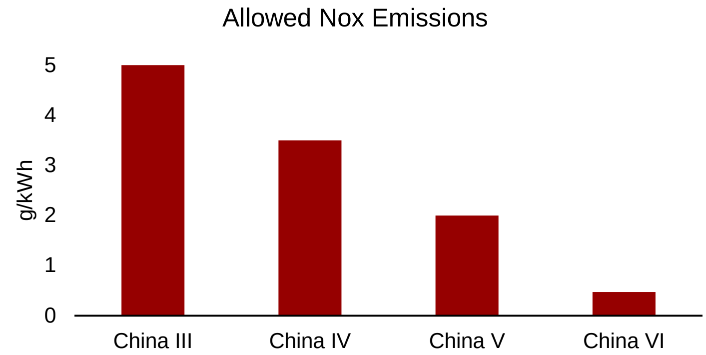
Cummins' largest customer, with 15% of revenue, is Paccar. As a result, its engine integration has had the greatest impact on CMI's performance. Starting in 2011, but losing steam in recent years, integration has slowed from 20% to near 0%. This reflects the difficulty of replicating various engines of diverse specifications. DCM believes this integration has come as far as it can without significant capital investment, which we believe is not a credible next step since the 27% increase in integration over four years was accompanied by only 2% better operating margin. Cummins has an economic moat against integration as it provides superior engines that exceed emissions regulations and fuel economy standards. Truck OEMs like Paccar give customers the option to have a Cummins engine in their vehicles as the overwhelming majority of truckers recognize Cummins as higher quality engines that do not sacrifice power for regulatory compliance. For example, its industry-leading 15L engine (X15) for 2017 and 12L engine (X12) for 2018 exceed 2017 EPA and Euro IV standards and offer 3% fuel economy over 2016 engines (10-20% over 2012 engines)

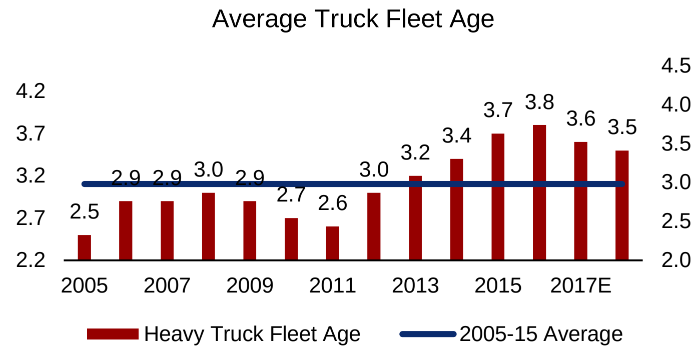


Another area of integration risk was created by Volkswagen's purchase of a 16.6% interest in Navistar, in reaction to which Cummins experienced a 7.3% decrease in its stock price on fears of Volkswagen accelerating engine integration with VW-owned MAN and Scania products. This risk is mitigated by the fact that Navistar already failed in adapting MAN engines to the North American market in 2012 under its EGR brand. Moreover, CMI has an advantage in 15L engines whereas VW specializes in 13L. With these facts notwithstanding, Navistar still only comprises 5% of Cummins' sales, and DCM calculates that the complete loss of Navistar should have only had a -3.3% impact on CMI's valuation.

Cummins (NYSE: CMI)

Thesis #2: Exposure to Emerging Markets

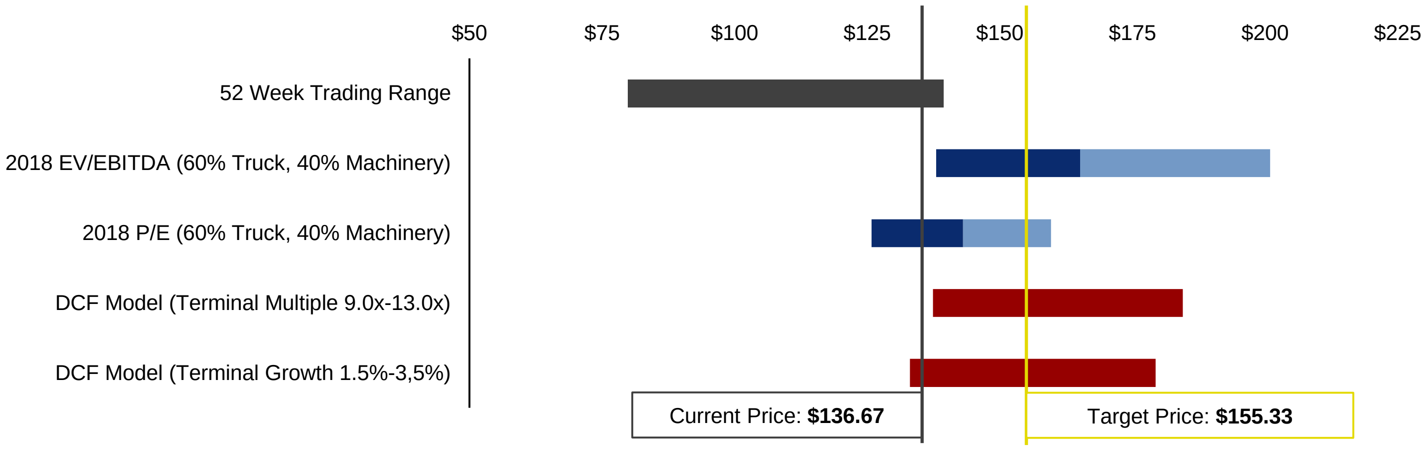




Cummins is the American engine maker with the greatest exposure to emerging markets, which it achieved through decades of fostering Joint Venture relationships. In China, where Cummins has operated for 40 years, it currently has the largest engine market share at 16.5%. Compared to domestic Chinese competitors that are slow to adapt to new regulations, Cummins' specialty in regulation-compliant engines means it stands to gain as China pushes towards stricter emissions standards. Additionally, when emissions standards rise truck markets experience a "pre-buy" phase of purchases in the years before emissions-compliant engines are released. This is because end customers fear higher pricing and reduced performance common to trial-and-error transitions to new standards. Elevated fleet age and economic strength further support continued top-line growth for CMI in China.

Thesis #3: Valuation

Cummins trades at an attractive valuation of only 9.1x 2018 EBITDA, to a trucking industry average of 11.1x. Cummins trades at an even greater discount relative to broad industrial machinery peers, which trade at an average EV/EBITDA of14.8x. Machinery peers are used in our relative valuation as they reflect Cummins' exposure to off-highway markets, as opposed to just in trucking. This discount exists despite superior operating metrics, with an ROE of 16.1% to 11.2% average and lower leverage (0.2x Net Debt/EBITDA to 4.5x average). We attribute this mispricing to worries of a secular decline due to engine integration, a view we disagree with as outlined in our first thesis point. Our target price of $155.33, based on a weighted average of our valuation approaches, implies an upside of 13.7%.



Conclusion

Cummins is a company with a unique position in the trucking value chain as it is a pure-play engine manufacturer. Investor fears of OEM engine integration are overblown as integration slows to a natural limit due to performance and emissions compliance, advantages unique to Cummins' diverse offering of products. Cummins also has greater exposure to growth opportunities in emerging markets, particularly in China, and trades at an unwarranted discount to its peers.

Materials Sector

2016 Review & 2017 Outlook

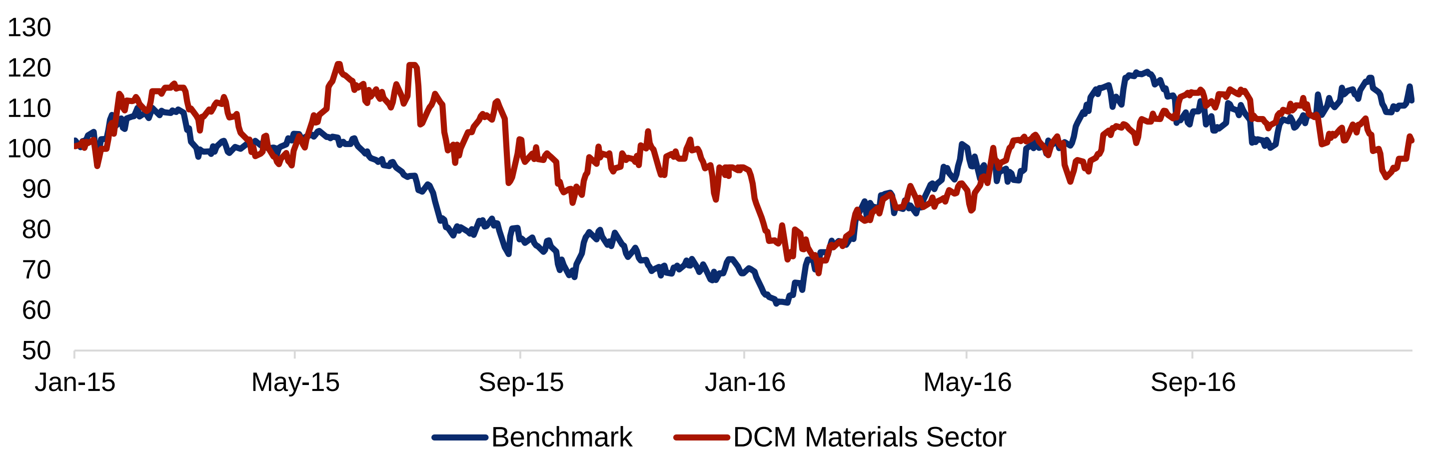
By Sercan Demirtas and Jaskrit Singh

DCM Materials Sector Performance

The Global Equity Fund's Materials sector returned 7.0% in 2016, a 55% underperformance compared to our sector benchmark. As explained below, this underperformance was largely due to underexposure to the high flying metals subsector. In 2016, we continued to focus on companies whose operational flexibility minimized exposure to commodity price fluctuations. Our main holding, Western Forest Products (WEF), a Canadian forest products company, has demonstrated that it is able to offset unfavourable commodity lumber price fluctuations by shifting production towards value added specialty lumber products, which proved to be more stable in terms of demand and pricing. Operational flexibility in our investment choices was our focus going into 2016 from our last annual report as we began researching a new potential investment in the mining space which we believed could have an asymmetric risk and return potential.

While eliminating our metals and mining exposure to names such as Lundin Mining and McEwen Mining benefited DCM greatly in 2015 as we focused on other areas such as forestry, this underweighting was also a significant contributor to our benchmark underperformance in 2016 given that there was a strong rally in gold mining stocks in the first half of 2016. Indeed, had we held our position in McEwen through to the end of 2016, we would have achieved returns in excess of 400%. Nevertheless, we believe that our long term sector positioning was appropriate as holding onto McEwen would have been a highly speculative action, which in hindsight would have been good for performance, but a gamble which would have carried a large amount of risk and uncertainty for our investors nonetheless.

Figure 1: Two Year Benchmarked Sector Performance



Although the DCM Materials sector underperformed the benchmark by 55% in 2016, we outperformed the same benchmark by 26% in 2015. As illustrated in the performance graph in Figure 1, when our two year performance is compared to our benchmark, we were able to achieve similar returns to our benchmark over this time period with significantly lower volatility, only coming in a few percentage points below our benchmark over the two year horizon, despite eliminating all risks associated with investing in the metals and mining industry.

Benchmark: 40% SPDR S&P Metals & Mining ETF (XME), 60% iShares S&P/TSX Capped Materials Index (XMA.TO).

Long Term Performance Focus

Our focus at Desautels Capital Management for the Materials sector has always been to aim to deliver stable positive returns year over year. We recognize that the Materials sector, and especially industries like metals and mining within it, are extremely volatile, and for that very reason, we have been striving to take a prudent and long term focus when considering investments. As illustrated in Figure 2, Desautels Capital Management's Materials sector performance has beat our benchmark for three out of the four previous years. Moreover, even with our underperformance of the benchmark in 2016, we managed to return a stable 7.0% absolute return, yielding an impressive 10.8% cumulative return over the past four years, despite the fall of gold prices from 2013 highs. This is in stark contrast to our benchmark, which returned a significantly lower -8.5% in the same four year period, underperforming DCM by almost 20%. Figure 3 highlights our lower risk profile relative to the sector benchmark.

Figure 2: Comparison of Annual Materials Performance

Return Comparison

Year	DCM Materials Return	Benchmark Return	+/-
2013	4.30%	-8.60%	12.90%
2014	4.50%	-10.40%	14.90%
2015	-5.00%	-31.00%	26.00%
2016	7.00%	62%	-55.00%
Cumulative	10.80%	-8.50%	19.30%

Figure 3: Comparison of Annual Materials Standard Deviation

Standard Deviation Comparison

Year	DCM Materials Return	Benchmark Return	+/-
2015	8.10%	14.20%	-6.10%
2016	11.90%	15.90%	-4.00%

Note: Further commentary on past performance can be accessed in the annual report of the respective year from the DCM website.

Portfolio Review

WestRock, the company which was formed from the merger of MeadWestVaco and RockTenn spun off its chemicals division as a new publicly listed entity named Ingevity, of which DCM received equity ownership following the spinoff. We had exposure to both WestRock and Ingevity for a large part of 2016 and benefited from a rebound in both stocks. In the fourth quarter, DCM closed out both positions given that our original special situations investment thesis for MeadWestVaco had largely materialized.

We initiated a position in Alacer Gold in October of 2016 with the view that the market's negative view of the geo-political situation in Turkey was causing the company to be underappreciated. Finally, we maintained our position in Western Forest Products. Details on Alacer Gold and Western Forest Products are provided in the Holdings Review section.

Forestry & Housing Outlook

Commodity lumber prices saw significant gains in 2016, starting the year at $270 and ending around $330. The biggest challenge the Canadian forestry industry presently faces is with uncertainty regarding the Softwood Lumber Agreement between the U.S. and Canada, which expired on October 12, 2015 with a grace period of one year, in October 2016. As U.S. producers continue to claim that Canadian exporters have an unfair advantage andwhich finished should be restricted from exporting to the U.S., ongoing negotiations for a new agreement dominated much of the forestry industry for Q4 2016. We expect that if another agreement will be reached between the U.S. and Canada in 2017, the deal terms will be much less favorable for Canadian exporters than the original agreement from 2006 given Donald Trump's stance and the fact that the Canadian dollar is significantly weaker, giving a larger advantage to Canadian exporters. Failure to reach an agreement will have repercussions for the whole industry, however Western Forest Products generates its revenues from a varied geography including Chinana and Japan and thus will be less affected than its peers based on our outlook.

We remain bullish on the American housing market and believe that our position in Western Forest Products will benefit accordingly. We also see low but stable growth in the Canadian housing market which also bodes well for the company. A key indicator of growth in the U.S. housing market is the total annual construction spending. Annual U.S. spending on construction dropped by almost one third during the financial crisis of 2008, and has slowly been rebounding over the past several years, reaching pre-crisis levels in 2015. Construction and infrastructure spending is expected to increase significantly as a function of increased spending per project and an increase in the number of construction projects as well. As U.S. states grow more confident of longer term funding as a result of the F.A.S.T Act of 2015, we believe that they will allocate more resources towards public infrastructure projects compared to past years, boosting the sector's revenues.

Note: We began 2017 with two holdings, Alacer Gold and Western Forest Products. We will be looking to introduce a third investment into the Materials portfolio in early 2017 in order to broaden our sub-sector exposure.

Building Materials Commentary

The global building materials industry reported stellar performance in 2016. While the S&P Global 1200 Materials Index reported gains of over 40% during the year, the real winners within the industry were the U.S. focused cement and concrete manufacturers such as U.S. Concrete, Vulcan Materials, and Martin Marietta Materials to name a few, which all gained over 30% in a matter of days following the U.S. election results and the looming possibility of a wall between the U.S. and Mexico. Prior to the election, both candidates had expressed a desire to increase infrastructure spending in the country, which is one explanation for why the stocks have held their gains throughout the rest of the fourth quarter following the election.

Materials Outlook

We believe the Materials sector is moving off a trough in the commodity cycle. Commodities such as copper bottomed out during 2016 but prices have since moved upwards in the last couple of months. This increase in commodity prices is expected to continue and will lend support in earnings growth for companies exposed to commodity prices such as base and precious metals miners. It is important to note that in an industry such as mining, the absorption of oversupply can be a gradual process. Given that mines require long-term planning and high amounts of capital investment, supply does not change significantly in the short run. Miners that have been focusing on cost reduction initiatives in the last few years should see significant improvements in operating margins as commodity prices pick up in 2017.

Another trend likely to benefit the materials and construction sector is the growth in infrastructure spending. Demand for construction materials and metals will be higher in 2017 as the Chinese government looks to stimulate their economy with increased infrastructure spending. A resurgence in U.S. infrastructure spending will provide further support to the sector, and we will keep a close eye on the construction materials sector moving forward.

Figure 4: Annual Construction Spending in the United States

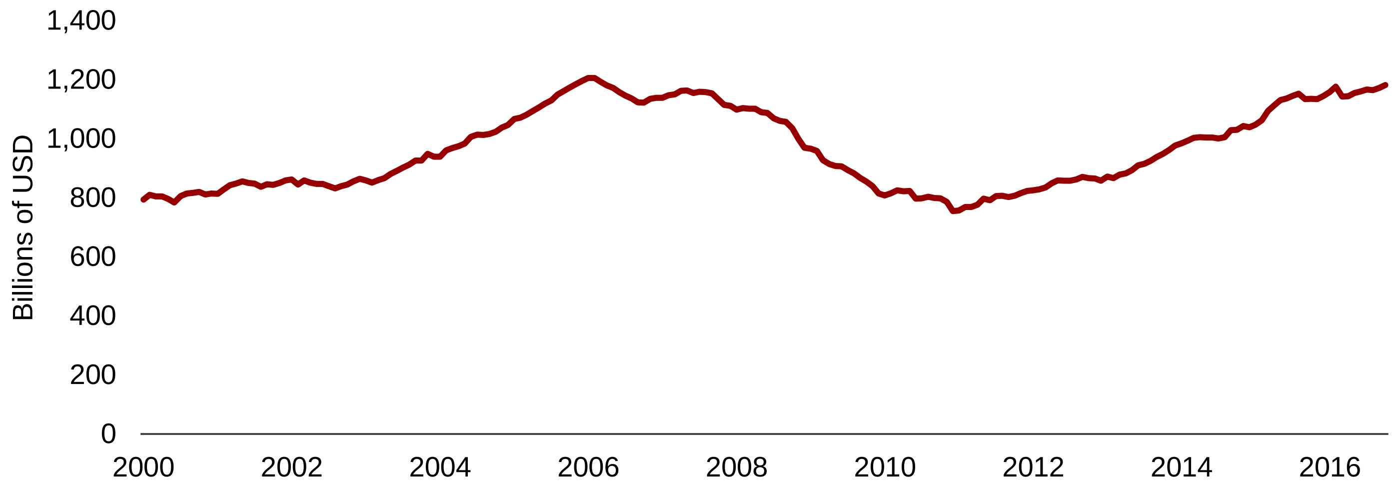


Figure 5: Housing Starts Lagging Underlying Demand

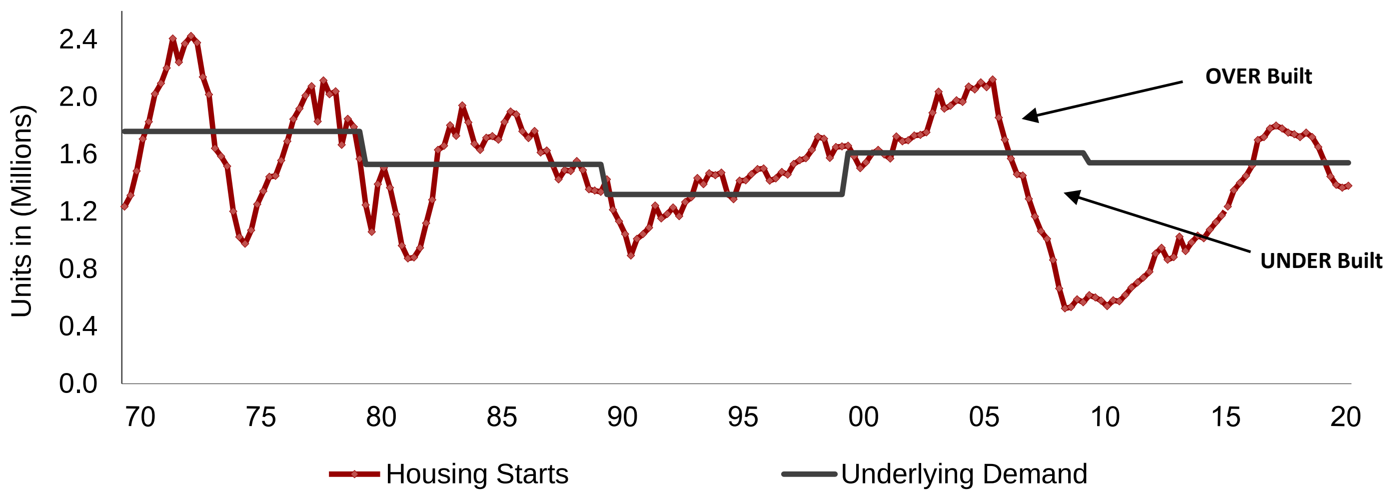
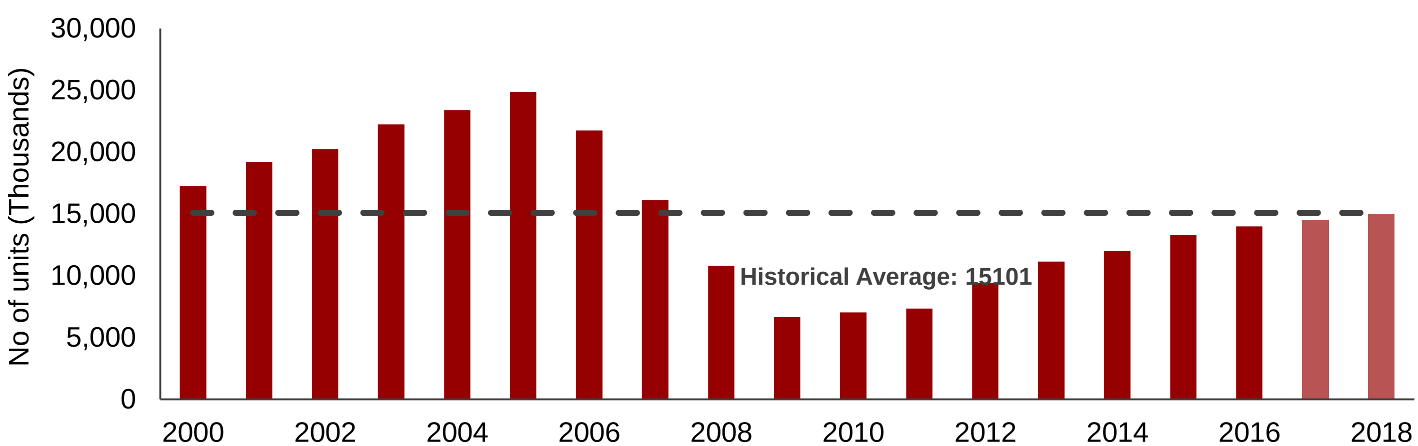


Figure 5 further highlights the current undersupply of houses in the American housing market. We expect the strong current demand for new homes to drive housing starts and expect to see the supply and demand gap slowly closing as we go into 2017 and 2018.

Figure 6: Historical Housing Starts and Forecasts



The bar graph in Figure 6 provides insights on the historical levels of the total housings starts in the U.S. market annually. Considering the recent trend, we expect a full recovery in the housing market in 2016-17 with the continued increase in overall housing starts reaching and surpassing the historical average of 15.1 million annually. We believe our portfolio is well positioned to benefit from these favorable industry drivers.

Gold Outlook

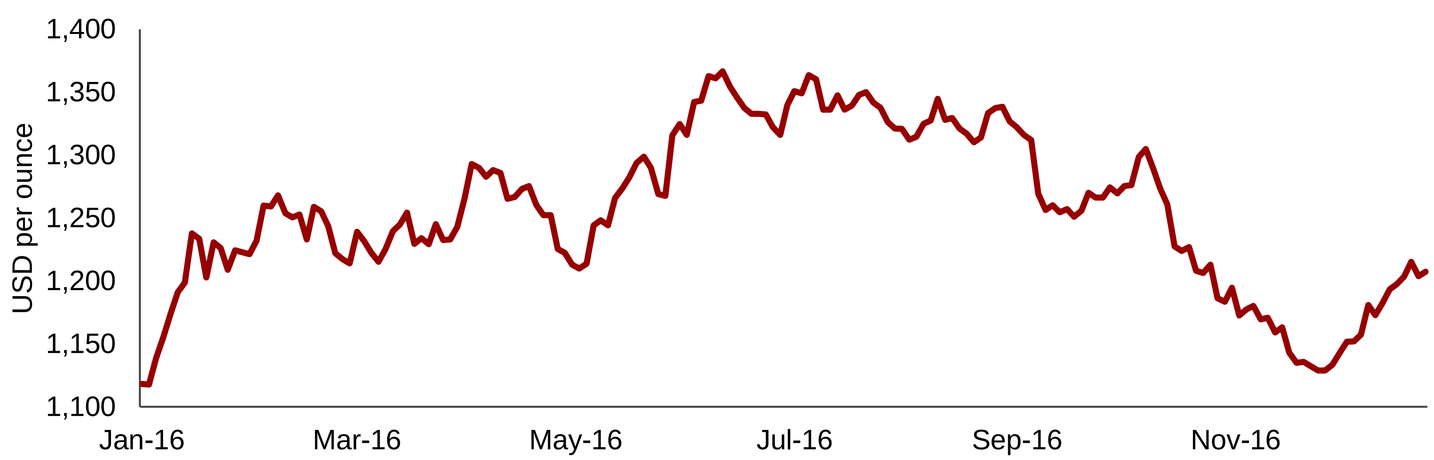
Gold started the year at around $1100 an ounce and reached highs of $1350 during the summer after a very strong rally in the first half of 2016. Despite showing weakness near the end of the year, a rebound in gold prices appears to be underway going into 2017. Given the results of the U.S. election and Brexit, we were surprised not to see a stronger rally in gold prices as we expected would happen under these circumstances.

Nevertheless, physically-backed gold ETFs amassed record inflows of gold this past year, reversing the trend of the past three years. 2017 should be an exciting year for gold prices given the high number of risks and catalysts that could drive gold prices higher. Unexpected outcomes in Hong Kong's Chief Executive Election on March 26, France's Presidential Election in May and Germany's Federal Election on October 22, and potential conflicts in the Middle East could all propel gold prices higher. We also see central banks continue to acquire gold to diversify their reserves.

Consumer demand for gold will be driven by the upcoming Chinese New Year celebrations. The end of the year festive season, which is a big driver of demand for gold in India, was much slower due to the Demonetization drive led by India's Prime Minister. However, as things return to normal in the new year, we expect demand to pick up as the lucrative wedding season begins. In Asian economies, gold demand is usually related to increasing wealth. India witnessed a bountiful monsoon for the first time in three years and this will definitely spur gold demand as gold is the preferred investment choice of low income families.

Despite the strengthening US Dollar and increasing interest rates in the U.S., we remain bullish on gold and believe that our position in Alacer Gold Corporation will benefit accordingly.

Figure 7: One Year Gold Price Performance



Materials Sector

Holdings Review

Western Forest Products (TSX: WEF)

Company Overview

- Western Forest Products is a Canadian softwood products company operating in the coastal region of British Columbia
- The company is primarily engaged in timber harvesting, reforestation, forest management and wood product remanufacturing
- The company owns 7 sawmills representing more than 1.1 billion board feet of production capacity and 2 remanufacturing plants which
- WEF is the largest crown timber tenure holder in Coastal B.C., as well as the largest cedar lumber manufacturer in North America

Catalysts

- Continued recovery of the US housing market driving demand for Canadian wood products
- Favorable lumber/log demand and prices
- Sustained strength of the USD relative the CAD
- Capitalization on current opportunities to capture greater market share in the Asian markets

Risks

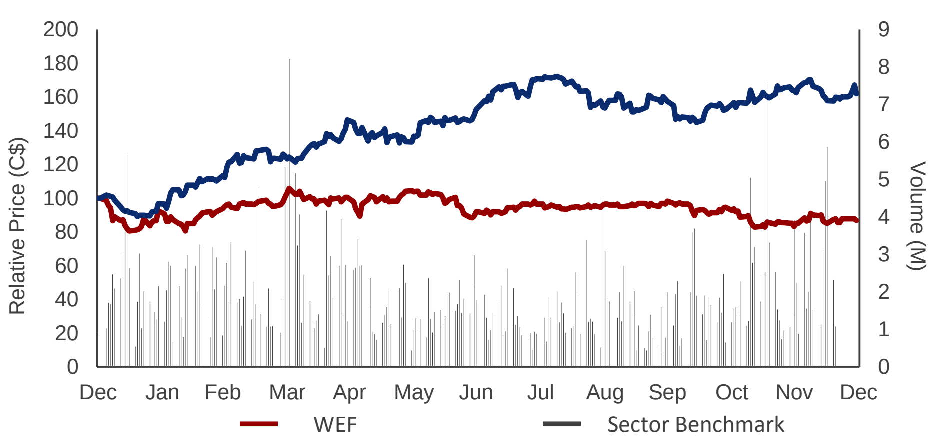
- Failure to negotiate the softwood lumber agreement between Canada and the US
- Higher input costs and potential supply restriction from the Canadian government
- Changes in lumber/log demand and prices leading to a decrease in forecasted top line growth
- Slower recovery of the US housing market

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$1.89
S/O (M)	395.4
Market Cap.	**$747.4**
+ Total Debt	$58
+ Minority Interest	$0
+ Preferred Shares	$0
- Cash	$19
Enterprise Value	**$787.2**
Beta (1-Year)	1.41
Dividend Yield	4.3%
52-Week High	$2.30
52-Week Low	$1.75

Financials & Multiples	LTM	FY2017E	FY2018E
(values in $M)			
Revenue	$1,160	$1,264	$1,298
% Growth		*9%*	*3%*
EBITDA	$132	$149	$155
% Margin		*13%*	*4%*
EPS	$0.17	$0.23	$0.23
% Growth		*37%*	*-1%*
EV/EBITDA	*6.0x*	*5.3x*	*5.1x*
P/E	*11.1x*	*8.1x*	*8.2x*

Normalized Stock Price and Sector Benchmark Performance



Position Snapshot

Average Cost	*$1.98*
# of Shares	*36,191*
Value Invested	*$68,401*
Portfolio Weight	*2.69%*
2016 HPR	*-13.1%*
HP Benchmark Return	*62.0%*
Excess Return	*(75.0%)*

All figures in CAD

Benchmark: 40% SPDR S&P Metals & Mining ETF (XME), 60% iShares S&P/TSX Capped Materials Index (XMA.TO).

Western Forest Products (TSX: WEF)

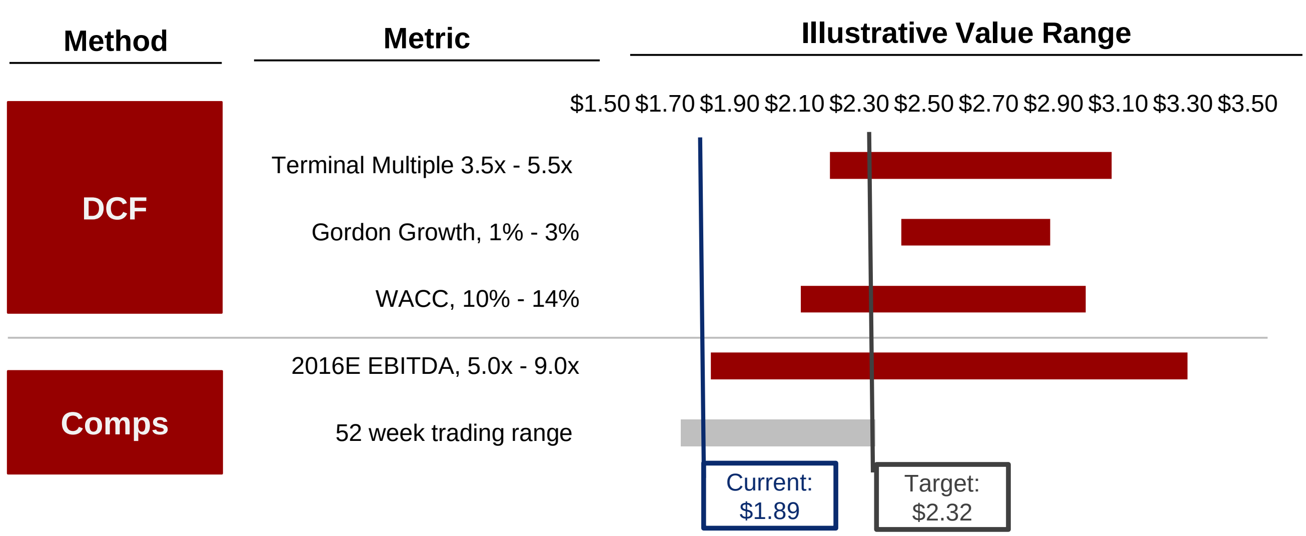
Investment Thesis

1. **Industry tailwinds and favorable macroeconomic trends:** The Canadian forestry industry is set to benefit from the recovery of the United States housing market, which is expected to be fully realized within the next couple of years. Current macroeconomic dynamics yield opportunities for Western Forest Products to capture a greater market share in the North American & Asian markets.
   - The mountain pine beetle infestation is affecting the production levels of WEF's main competitors, which enables the co. to capture greater market share in its key geographies
   - The company focuses on growing its share of the WRC markets in the U.S., which continue to show signs of increasing demand fueled by a strong repair and remodeling activity
2. **Flexible revenue structure and strong financial position:** We believe that Western Forest Products' strategy, which focuses on superior quality, higher margin and less volatile specialty products in terms of demand and pricing fluctuation, is overlooked by investors
   - Diversified & flexible revenue structure both geographically and by product type allows WEF to direct resources to the highest margin opportunity and lowers the company business risk
   - We expect the company's margin focus strategy & recent strategic capital investments to strengthen the company's operating margin going forward
3. **Attractive Valuation:** WEF is trading at a discount to peers on a P/E and EV/EBITDA basis despite a more conservative capital structure, stronger operational flexibility, strong growth prospects, and lower risk profile. We do not believe that WEF's fundamentals call for such a discount and expect the valuation to converge to peers' level.

Analysis of Performance

We initiated our position in Western Forest Products at the end of March 2015, at a price of $1.98. Since the beginning of our holding period, the company has delivered strong quarterly results, despite declines in commodity lumber prices for a brief period. Despite strong and sustained earnings, the stock is currently being discounted due to the uncertainty around the lumber agreement. However, since WEF has lesser exposure to the US market as compared to peers, we expect the stock price to rebound eventually.

Valuation Summary



Alacer Gold Corporation (TSX: ASR)

Company Overview

- Alacer Gold Corporation is an intermediate gold mining company with mine assets in focused solely on Turkey and is listed on the Toronto Stock Exchange and headquartered in the United States. The company has an 80% interest in Copler gold mine in Turkey.
- Recently released a prefeasibility study on its 50% owned Gediktepe (Dursenbeye) project in Western Turkey.
- In 2017, the company is forecasted to produce approximately 180,000 ounces from its Copler gold mine at Total Cash Costs of around $500 per ounce. With a mine life of 2037, the mine is expected produce over four million ounces.

Catalysts

- Future strength in precious metals prices will help the company have a better outlook
- Timely execution an and completion of the Gediktepe project as well as meeting or exceeding the forecasted deposits will be favorable
- Less media coverage of Turkish politics will lower the market's perceived negative outlook

Risks

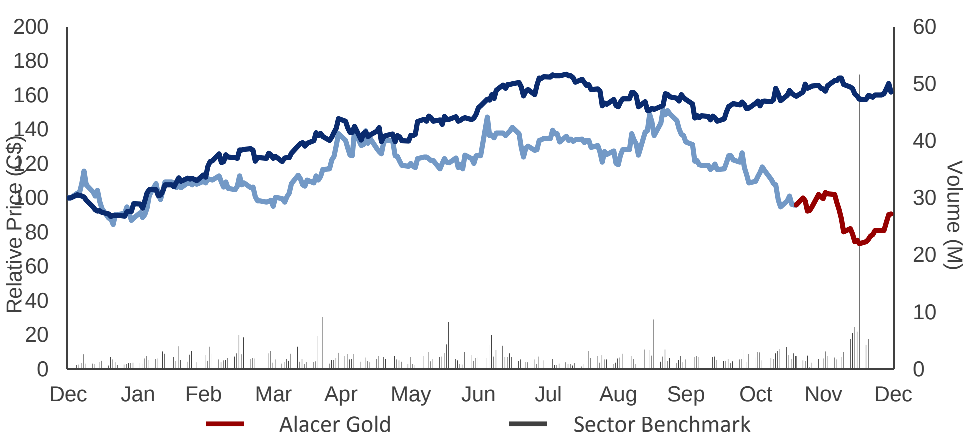
- Lower commodity prices, especially precious metals and gold can impact the company's future outlook negatively
- Geo-political risk may impact the company's perception by the market
- Permitting and operational issues may arise if the Turkish government changes its current policies

Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$2.24
S/O (M)	292.0
Market Cap.	**$654.2**
+ Total Debt	$0
+ Minority Interest	$136
+ Preferred Shares	$0
- Cash	$254
Enterprise Value	**$536.2**
Beta (1-Year)	-0.32
Dividend Yield	--
52-Week High	$3.74
52-Week Low	$1.81

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $M)			
Revenue	$155	$196	$218
% Growth		*27%*	*11%*
EBITDA	$47	$71	$107
% Margin		*51%*	*51%*
EPS	$0.08	$0.07	$0.13
% Growth		*-16%*	*81%*
EV/EBITDA	*11.4x*	*7.6x*	*5.0x*
P/E	*26.8x*	*31.7x*	*17.5x*

Normalized Stock Price and Sector Benchmark Performance



Benchmark: 40% SPDR S&P Metals & Mining ETF (XME), 60% iShares S&P/TSX Capped Materials Index (XMA.TO).

Position Snapshot

Average Cost	*$2.38*
# of Shares	*28,300*
Value Invested	*$63,392*
Portfolio Weight	*2.49%*
2016 HPR	*-5.5%*
HP Benchmark Return	*1.5%*
Excess Return	*(7.0%)*

All figures in CAD

Alacer Gold Corporation (TSX: ASR)

Investment Thesis

1. **Firm Unfairly Punished by Market due to Turkey Focus**
   - Turkey's image has been severely troubled in the media in the wake of an ongoing political situation, the failed coup in July, the refugee crisis and the difficulties with the European Union, as well as the media crackdown and mass firing and arrests of civil servants. While these are very real problems for the country itself, the market is unfairly punishing foreign companies in Turkey such as Alacer Gold or Eldorado Gold while ignoring the immense incentives and benefits these companies gain from operating in Turkey
2. **Strong Potential as a Future Acquisition Target**
   - Gold mining M&A activity has been severely depressed in the past few years and miners have been forced to cut costs and divest assets, especially senior miners
   - Rebound in the gold market will bring interest towards intermediate gold miners such as Alacer Gold from the senior miners who wish to diversify their asset base, acquire high quality assets, average down on their mining costs, and access the mining incentives offered by the Turkish government
3. **Highly Misunderstood Capital Structure and Tax Savings Potential**
   - Alacer benefits from a strong balance sheet with significant hard assets, high liquidity, and conservative capital structure. The company has zero long term debt with over $340mm in cash and cash equivalents which will be used in the development of a new mine
   - The market does not factor in the potential to optimize the debt levels in the long term to improve the company's average cost of capital, and Analysts have widely varying figures used to calculate WACC
4. **Benchmark Alignment & Attractive Valuation**
   - One of the benefits of investing in a gold mining company is that it will allow us to align much better with our underlying benchmark. Gold rallied significantly at the beginning of the year, which we were not able to benefit from due to our lack of exposure

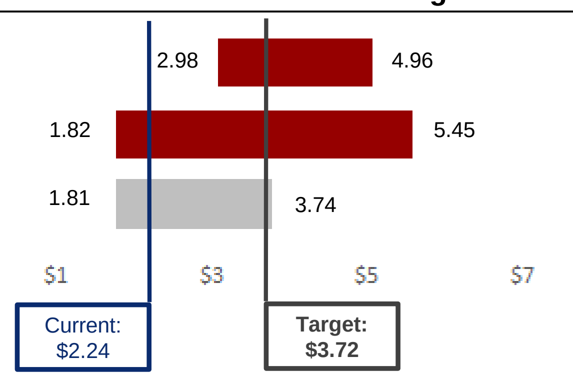
Analysis of Performance

We initiated our position in Alacer Gold Corporation in October 2016 at a price of $2.38. Since the beginning of our holding period, a downturn in precious metals prices like gold caused the stock price to perform worse than expected, bringing it as low as $1.81. Since then, the stock price has rebounded near the levels we initiated our position at. Continued weakening of the Turkish Lira as well as ongoing negative political media coverage of Turkey looms over the company. The Turkish government was not able to finalize the refugee agreement with the European Union by the end of 2016, and the uncertainty will continue onto 2017.

Valuation Summary

Method	Metric
Discounted Cash Flow	5 – 17x EV/EBITDA Exit Multiple
	Worst – Best: 8% WACC
Comparable Trading	52-Week Trading Range

Illustrative Value Range



Healthcare Sector

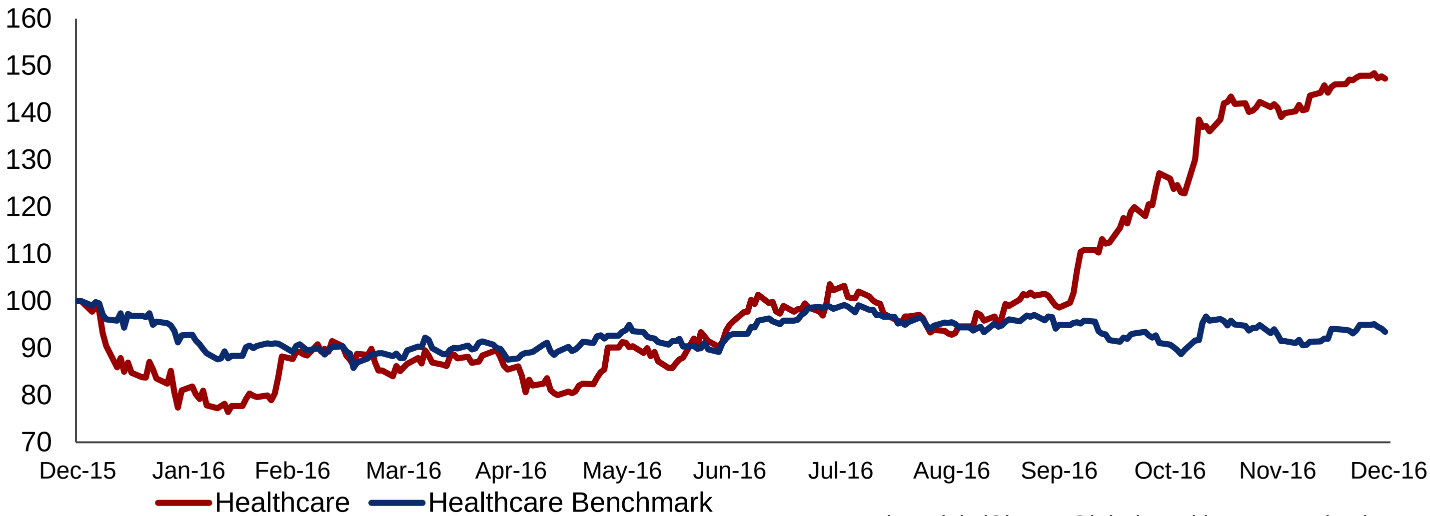
2016 Review & 2017 Outlook

By Michael Fishman, David Meyers, and Thomas Milne

Performance Overview

The Healthcare Sector at Desautels Capital Management is pleased to report 47.3% gross returns in 2016, well in excess of our benchmark's return of negative 6.5%. This outperformance of largely materialized in the second half, when in anticipation of market turbulence, we trimmed our portfolio to hold only CRH Medical and Fresenius Medical Solutions. These securities will be discussed in detail in the "holdings review" section, following a brief overview of 2016's events, as well as our outlook on 2017.

Figure 1: DCM Healthcare Performance



Note: Benchmark is iShares Global Healthcare ETF (IXJ)

Lean Portfolio Positioning in a Turbulent Second Half of 2016 leads to outperformance

The first half of 2016 was a tale of public health crisis. The Ebola epidemic touched millions worldwide, while the Opioid pandemic in North America drove rifts through the healthcare sector as drug producers raced into research and development. This was exacerbated by an early ruling by the Food and Drug Administration to reduce the time and cost of clinical trials in order to accelerate innovation, all in all a favorable half for the pharmaceuticals subspace.

However, as we shift to the second half, we begin to see the most prevalent trend of 2016 in healthcare: volatility. While the most dramatic driver was the election of Donald Trump as the 45th president of the United States, this eclipsed many other second half events exacerbating second half volatility. Public sentiment against price gouging, Biotech sell-off following Hillary Clinton's criticism of Mylan as well as Celgene were but three minor examples that struck fear into the hearts of investors.

As such, the healthcare team decided to bear down, prudently trimming our exposure to pharmaceuticals and biotechnology – focusing our analysis efforts on medical devices and supplies. This was a move that proved profitable, as our lean portfolio returned 48% gross of fees since September. The dramatic success of CRH Medical and Fresenius Medical Solutions have helped to highlight the importance of maintaining a lean portfolio of well understood companies during times of doubt and crisis.

Source: World Health Organization, US Food and Drug Administration, Mylan Company Website, Hilary Clinton Campaign Website

Theme 1: Cyber Security, Database Management and the rise of Technology in Healthcare

What is stopping a hacker from infiltrating an insulin pump?

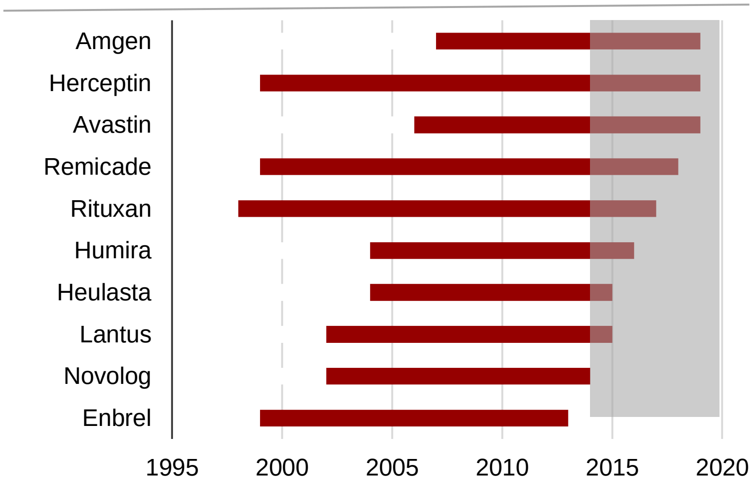
For perhaps the first time ever, the threat of unwanted users gaining access to the medical space has been extended to medical technology. While database managers are all too familiar with the importance of data security, medical device providers would have thought their business to be immune. That is no longer the case; 2016 saw malicious cyber attacks on healthcare transcend data to impact the healthcare service directly. Hackers have gained the ability to take unwanted control of pace makers and insulin pumps, posing a real threat to human wellbeing. This has lead to an emergence of cyber security companies entering the healthcare space, and drove value in companies with well established cyber security protocols, a trend we expect to continue through 2017.

However, not all technology is used for evil. This year, the true ubiquity of digital supply chain was realized in healthcare. This technology connects machines, people, data and other resources to augment overall efficiency. A study by PwC found a digitized supply chain to reduce manufacturing downtime by over 30%. The next step in this proliferation is the entrance of 3D printing to produce small, specific treatments that could solve minor ailments in a decentralized manner. The implications of this trend are widespread, impacting both how new talent is assessed, as well as how post-merger companies integrate their technologies. In 2017 we look forward to AI, Blockchain, Drones, Internet of Things and Virtual Reality to further push technological progress in healthcare.

Theme 2: Emergence of Biosimilars

Perhaps the most widely discussed non-election topic in 2016 was the entrance of Biosimilars - biopharmaceutical drugs designed to have active properties similar to one that has been previously licensed. After years of debate, the Food and Drug Administration has allowed these cheap replacements to enter the US market. With the flood gates opening in 2015, Biosimilars are poised to take away close to $100B in revenue from biologics as they fall off the patent cliff in coming years. With generic drugs representing more than 80% of drugs prescribed, the United States market is ripe for a Biosimilar takeover. While this has only emerged in 2016, it will be a trend to watch out for in the future as more light is shed on feasibility and regulation, with huge potential for profitability in the USA.

Figure 3: Top 10 Biologics 2013-2019 Patent Cliff

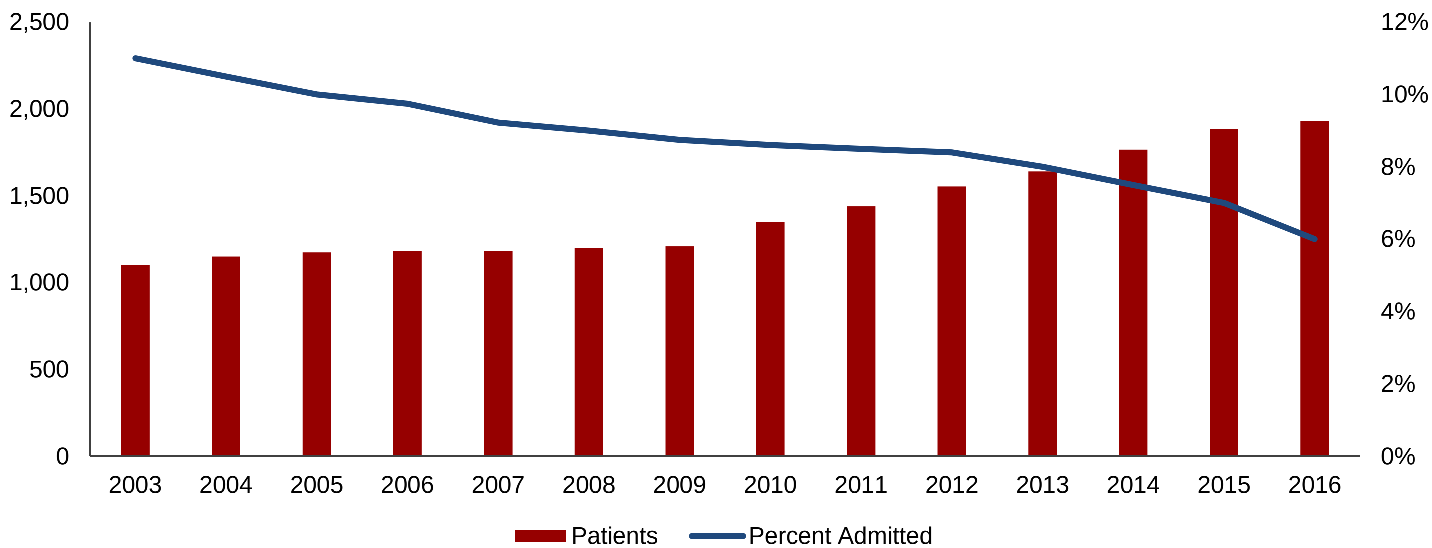


Source: PricewaterHouseCoopers Health Research Institute, US Food and Drug Administration, Amgen, Company website, World Health Organization

Theme 3: Mental Illness and Behavioral Health

The wide-spread implications of behavioural healthcare have been long understood by the medical community, however it was not until 2016 that patients began seeking help en masse. Mental illness is experienced by one in five Americans, with these conditions costing business more that $440B annually. As employers become more active in addressing mental illness, we expect changes to insurance coverage to cover behavioural health to a greater extent. Further, we expect continued R&D spending in the field, as massive sources of funding have been allocated to what the World Health Organization describes as “the leading cause of ill-health and disability worldwide”

Figure 4: Fewer than 6% of Learning Disability Patients obtain their highest level of care



Source: PricewaterHouseCoopers Health Research Institute, US Food and Drug Administration, Amgen, Company website, World Health Organization

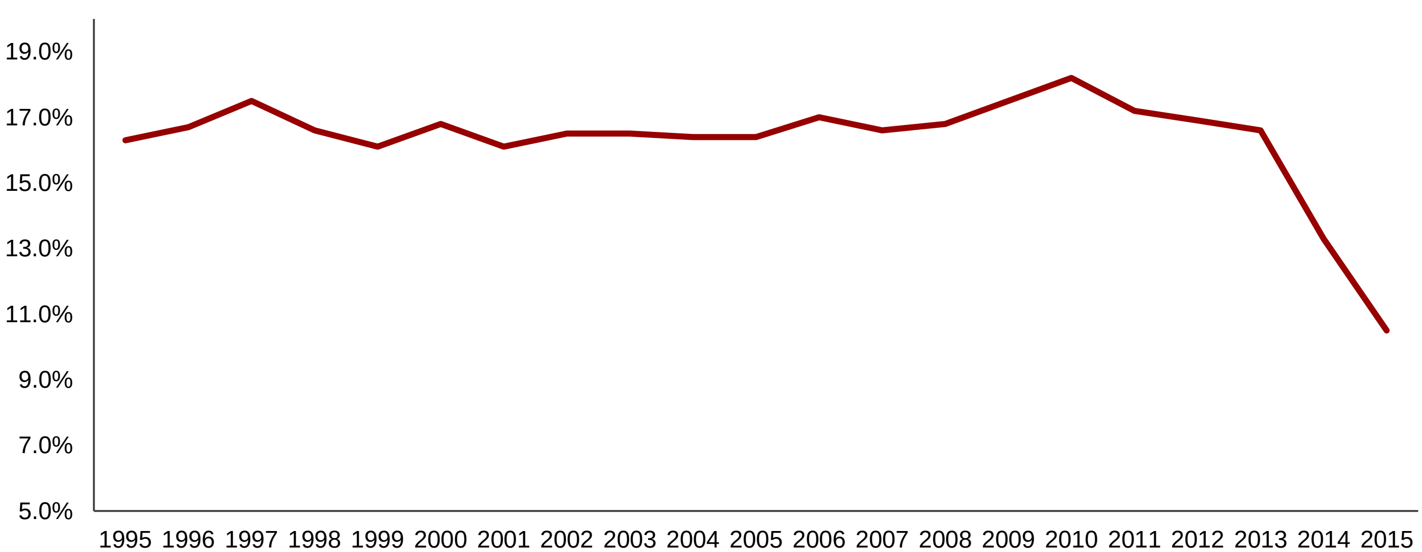
Theme 1: The New American Regime

November 8th, 2016 ushered in a new American political regime and administrative direction for healthcare policy in the United States. The election of Donald Trump, a Republican controlled House of Representatives and Senate as well as an anticipated rightward shift in the Supreme Court, all point to a dramatically changed regulatory environment in healthcare, particularly alarming is the proposed repeal of the Affordable Care Act, which will have immense implications for healthcare investing in 2017. Below is a summary of the Affordable Care Act as well as a review of our outlook on the political and regulatory landscape and their impact on the healthcare sector.

Summary: Affordable Care Act (ACA)

The ACA addressed two fundamental problems in the accessibility and delivery of healthcare in the United States – expanding access to health insurance and increasing patient rights. Before the ACA, on average 16.8% of Americans did not have health insurance annually. The ACA sought to reduce the number of uninsured Americans via an individual mandate to purchase insurance, increased pressure on business to provide coverage for employees and an government online insurance exchanges to provide subsidized products. These programs appeared to successfully reduce the uninsured population from 16.6% in 2013 to 10.5% in 2015 . The ACA also codified increased rights for American patients including prohibiting caps on benefits and denying coverage based on pre-existing conditions.

Figure 4: American Uninsured Rate among Nonelderly, 1995-2015



Source: Politico, Center for Disease Control and Prevention, National Conference of State Legislatures, Bloomberg, Kellogg School of Management

Theme 1: The New American Regime

Repeal of the Affordable Care Act

Congressional leaders, Paul Ryan and Mitch McConnell, and President-elect, Donald Trump, have set the repeal of the ACA as a top priority of the Republican controlled government starting in January. DCM forecasts that the repeal of the ACA will result in the number of uninsured Americans reverting to its historical norm of 16.8%. This implies that roughly 20 million people will loss their health coverage. In addition to this dramatic reduction in healthcare accessibility, the repeal of the ACA will impact several subsectors in the space:

1. Hospitals and Health Facilities

Hospital and health facility companies face significant headwinds going into 2017 including compressing EBITDA margins. DCM forecasts that two factors will reduce EBITDA margins for hospitals in 2017 – an increased number of uninsured patients and health insurer M&A. The repeal of the ACA will dramatically increase the uninsured population within the United States. According to Kellogg professor Craig Garthwaite, hospitals end up covering the medical costs for uninsured patients who go to the emergency room for routine medical procedures. In fact, Garthwaite's research estimates that each uninsured patient adds $900 of cost to the hospital system annually. Furthermore, M&A in the health insurer space will continue to increase purchasing power for providers and reduce hospital margins.

2. Medical Device Manufacturers

On December 18, 2015, the Consolidation Appropriations Act placed a two year moratorium on the medical device tax, a critical component of the ACA. The incoming Trump administration and GOP led Congress will increase certainty in the market and remove this tax from street projections. DCM forecasts that these factors will increase earnings for medical device manufacturers in 2017.

Source: Politico, Center for Disease Control and Prevention, National Conference of State Legislatures, Bloomberg, Kellogg School of Management

Theme 2: Trends in Pharmaceuticals

Over the past year, large cap pharmaceutical firms underperformed against the S&P 500 by 23%, returning -9.6% YoY for 2016. Despite the weak performance in 2016 compared to previous years (2013: 38.3%, 2014: 30.8%, 2015: 8.4%), we expect the pharmaceutical space to rebound in 2017, driven by increased innovation and the removal of pricing risk. Below is an analysis of the major themes and trends in the pharmaceutical industry heading into 2017.

Figure 5: Healthcare Subsector Performance vs. S&P 500

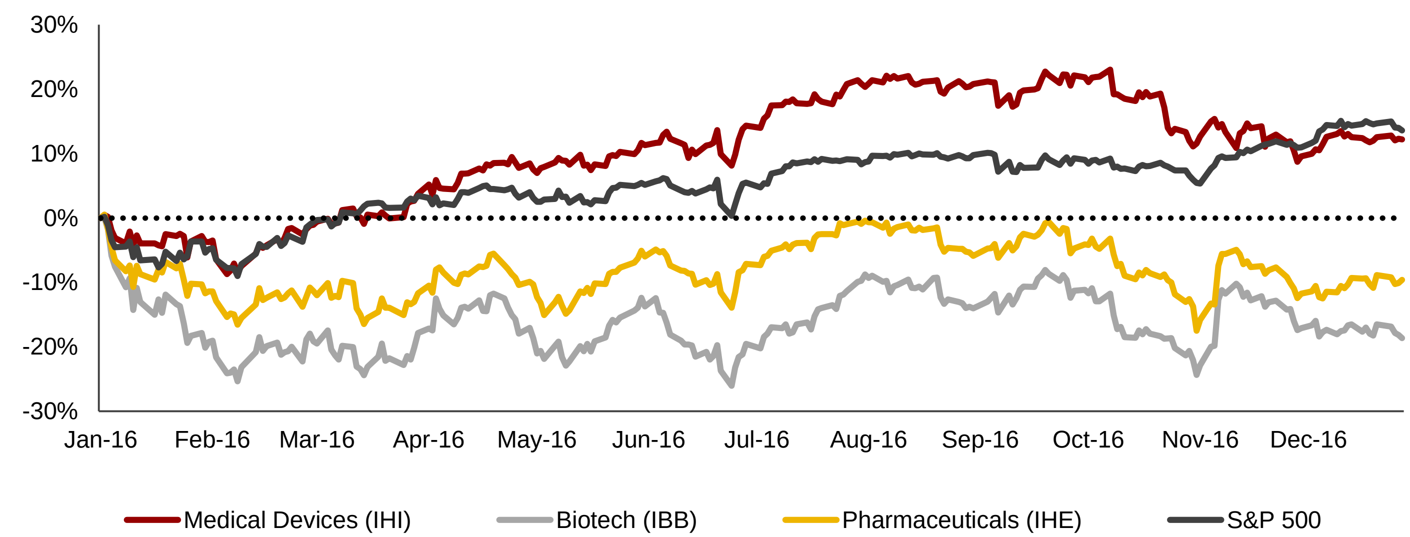
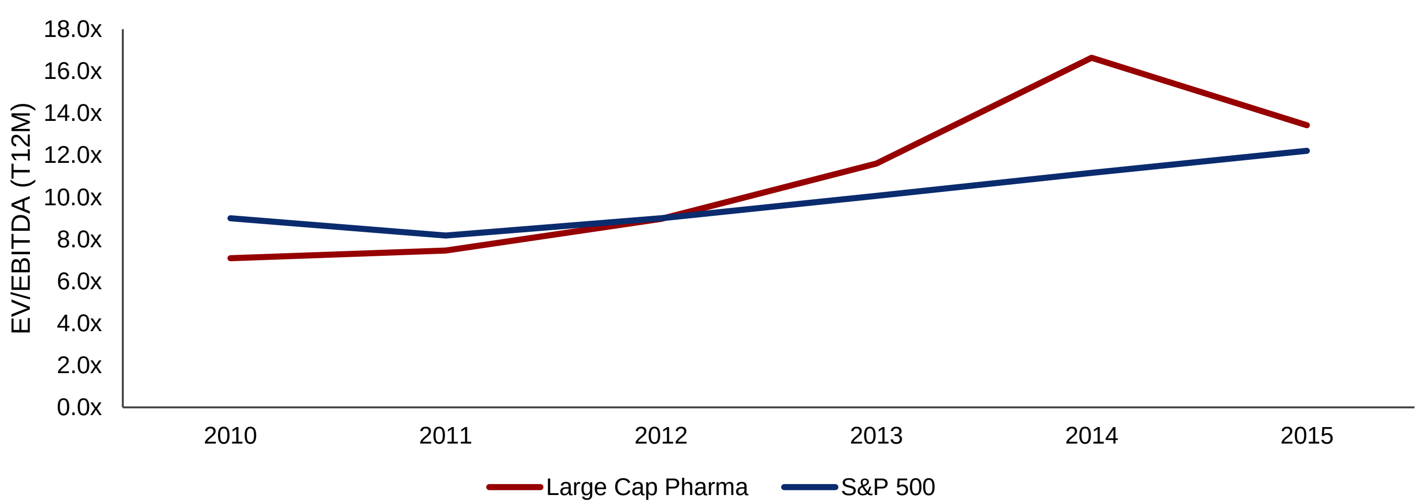


Figure 6: EV/EBITDA Large Cap Pharma vs. S&P 500



Source: Yahoo Finance, Bloomberg, Biotechnology Innovation Organization, Nature

Theme 2: Trends in Pharmaceuticals

Pharmaceutical valuations are correcting to historical norms

Since 2014, large cap pharmaceutical valuations have contracted to their historical alignment with the S&P 500. Driving this convergence was market fears of pricing controls. Despite this historical trend, we believe 2017 will present pharmaceutical firms with many opportunities to expand valuations.

Below are the main value drivers:

Phase III Product Expansion

Large pharmaceutical firms reported a 7.4% increase in drugs in Phase III for FDA approval, totalling 219 drugs. According to the Biotechnology Innovation Organization, the world's largest trade organization for biotechnology firms, roughly 50% of drugs in Phase III get approval for marketing. Furthermore, according to Nature article "The 'big pharma' dilemma: develop new drugs or promote existing ones?", investing in new drugs both increases short and long term value of pharmaceutical firms while promoting existing drugs merely increases short term value. This understanding points to expanding short and long term value for the pharma sector as firms invest in developing more drug offerings.

H.R. 34: 21st Century Cures Act

Passed in December 2016, the 21st Century Cures Act, modernized the FDA approval process. The new law allows pharmaceutical and biotechnology firms to submit "data summaries" rather than conduct full clinical trials to the FDA for certain drugs. This measure both reduces the time and cost of drug development. In addition, the new bill allows pharmaceutical firms to market off-label uses to insurance companies. Both of these legal changes will increase drug company profitability in 2017.

Pricing risk will not materialize

A November 8th, 2016 ballot initiative in California, Proposition 61, which sought to outline the first drug price controls in the United States, failed 54% to 46%. This electoral victory for the pharmaceutical industry means price control precedents will not be established. Furthermore, on the national level, a GOP controlled government has made no indication of wanting to establish restraints on drug pricing.

Source: Yahoo Finance, Bloomberg, Biotechnology Innovation Organization, Nature

Theme 3: China's Growing Importance in Healthcare

Any conversation of the world healthcare market in the recent past has included an analysis of the future of what is pegged as the next big healthcare market, China. According to the most recent statistics, China has nearly 260 million citizens who have a major disease. This, combined with the fact that the number of people 60 years or older has surpassed 202 million, justifies the importance of analyzing the future of healthcare in China. With total government expenditures in healthcare jumping from $156 billion to $357 billion in the five year period from 2006 to 2011, and with spending projected to reach $1 trillion by 2020, assessing the impact of a developing Chinese healthcare industry for multinational healthcare firms is a necessity.

Summary: China's Healthcare Industry

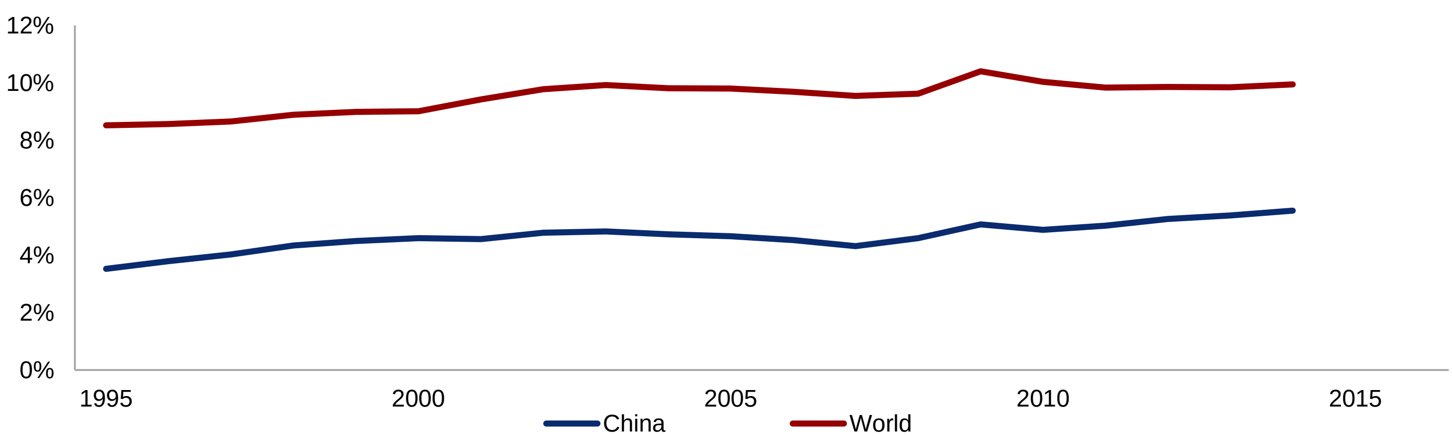
China struggles with a lack of transparency in its healthcare industry. The issue of fair competition and the respect of intellectual property in a cash-strapped and highly demanding healthcare industry, should be taken into consideration when hypothesizing the role of multinational firms in this market in 2017. Although China's healthcare expenditures have been rapidly increasing, they still only represent 5.40% of GDP at most recent estimates, lagging well behind the world average of 9.94%.

Figure 7: A Brief Sub-Industry Analysis

Healthcare Industry Analysis	2006	2011
Pharmaceuticals		
Size	$27 billion	$71 billion
Global Ranking	9	3
Total Revenue of Top 10 Multinationals	$4 billion	$10 billion
Medical Products		
Size	$8 billion	$20 billion
Global Ranking	6	3

Thus, China is expected to see rapid growth in expenditures, annualized at an expected rate of 18.4% from 2014-2018. Necessary progress has also been made with regards to ensuring that citizens are properly covered by insurance, with insurance rates amongst citizens rising from 45% in 2006 to around 96% in the most recent figures. We expect to see higher expenditures and insurance rates in 2017.

Figure 8: Healthcare Expenditures as % of GDP



Source: McKinsey & Company, Deloitte, The World Bank, Global Health-Council of Foreign Relations, The Economist Intelligence Unit

Theme 3: China's Growing Importance in Healthcare

Updates From the 13th Five-Year Plan & Looking to the Future

China's healthcare policy is opaque at the best of times, and for these reasons the Five-Year Plans are a key indicator of the intentions of the Communist Party's leadership. This section will briefly discuss the updates that have come from discussions of the 13th Five-Year Plan, some recent policy updates, and the impact on multinational healthcare players.

1. Private Hospitals & Facilities

In 2012, the Chinese government initiated plans to develop their private healthcare sector. It sought to increase private investment into healthcare facilities, with the ultimate goal of raising the proportion of hospital beds funded by private-sector participants to 20% by 2015. The government fell short of this metric, with some estimates pegging the actual number, as of 2015, at 10%. Although policies are expected to be relaxed in the near future to encourage foreign investment, current regulatory hurdles still cause China to lag their targets and continue to make investment difficult for foreign multinationals. China has made some progress, through easing Foreign Direct Investment(FDI) rules. China now allows 100% foreign ownership of hospitals and has lifted minimum investment thresholds. China is moving in the right direction, and 2017 will likely result in further regulatory reductions.

2. Pharmaceuticals

The most recent Five-Year Plan also suggests that in 2017, China will seek to develop its biomedical industry and continue to welcome private and foreign investments in pharmaceutical R&D. As the Chinese government struggles to cope with ensuring proper treatment and coverage for its citizens, it has sought to provide support and ease regulation on foreign players. Since 2006, 13 of the top 20 pharma firms have established R&D centres in China, which is expected to increase in 2017. This is a market that global pharmaceutical players cannot ignore.

Source: McKinsey & Company, Deloitte, The World Bank, Global Health-Council of Foreign Relations, The Economist Intelligence Unit

Healthcare Sector

Holdings Review

CRH Medical Corp (TSX: CRH)

Company Overview

- CRH Medical is a commercial healthcare products and services company that partners with physicians to improve surgical procedures
- In addition, it is focused on developing innovative products for the prevention and treatment of gastrointestinal diseases, most notably: the O'Reagan System
- CRH operates primarily in the United States, having trained over 2,000 physicians
- Today, and over the past year, CRH continues to grow through acquisitions in the anesthesiology services space. The continued tendency to execute accretive acquisitions has been the driver of CRH's performance

Catalysts

- Continuing to successfully execute favourable acquisitions will be the driver of returns

Risks

- Inability to maintain growth strategy
- Setbacks in construction process due to poor weather and labour issues could slow realization of Pembina's growth plans
- Counterparty risk from the E&P companies Pembina partners with being unable to fulfil their contracts

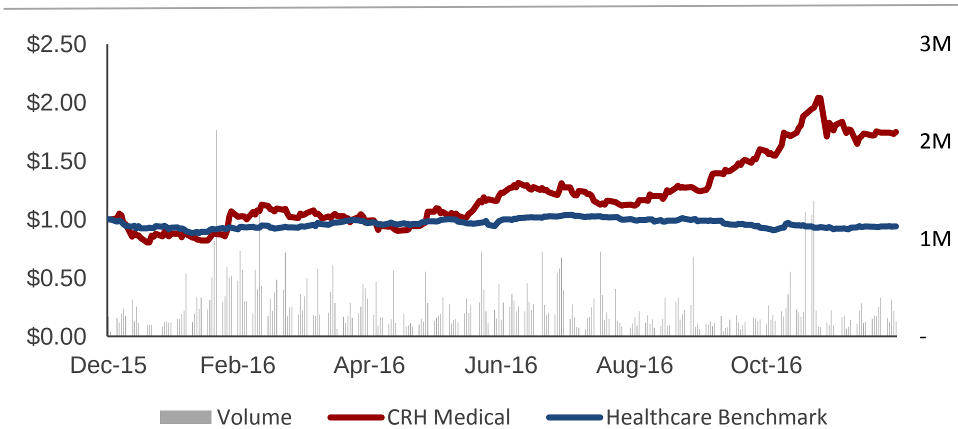
Note: This position was exited in mid November at $7.15 per share

Financial Summary

Public Market Overview	
(Values in C$mm, as of Dec. 31, 2016)	
Share Price	$7.10
Shares Outstanding	72.73
Market Cap.	**$516.38**
+ Total Debt	63.6
+ Minority Interest	$43.51
+ Preferred Equity	0
- Cash	$4.80
Enterprise Value	**$618.70**
Beta (1 year)	1.31
Dividend Yield	0%
52-Week High	$ 3.15
52-Week Low	$ 8.48

Company Fundamentals	2015	2016	2017E
Revenue	46	75	90
Growth %	347%	70%	19%
EBITDA	14	35	42
Margin	31%	47%	47%
EPS	0.04	0.14	0.18
Growth %	71.9%	14.2%	28.2%
ROE	9	22.5	23.2
ROA	11.4	9.4	N/A
ROIC	13.2	10.5	N/A

Normalized Stock Price and Sector Benchmark Performance



Benchmark: iShares Global Healthcare Index (IXJ)

Position Snapshot

Average Cost	$3.86
# of Shares	16,200
Value Invested	$ 62,532
Portfolio Weight	2.46%
2015 HPR	85.2%
HP Benchmark Return	-6.5%
Excess Return	91.7%

All figures in CAD

DESAUTELS | Capital Management Gestion de capitaux

CRH Medical Corp. (TSX: CRH)

Investment Thesis

1. **Robust Business Model: Emerging Consolidator of Services to Gastroenterologists -** *Materialized: after a successful run of acquisitions, the pipeline is beginning to dry up.*

- Historical business is selling medical devices to treat hemorrhoids – a potential $500M annual market, however CRH has recently expanded its presence into much larger, more quickly growing and higher margin anesthesia market
- Good relationships in ASC segment increases CRH's ability to continually grow through acquisitions. That being said, CRH only seeks to acquire anesthesia practices where there are a minimum of five GI physicians conducting endoscopies in GI-specific ASCS with clear plans to grow. This is a shrinking pool of targets in the United States

2. **Safe Space: Industry has No Economic Sensitivity** – *Materialized: Price jump on FDA regulation change*

- Colonoscopies are a medically necessary treatment which patients will not wait for price stabilization to conduct, they should occur in both strong and weak economies. However, CRH's valuation is not driven by their core business, but their ability to conduct acquisitions. This has lead to a realized beta of 1.31 over the past year
- CRH caters to an aging population, an undeniable macroeconomic trend both in the United States and all developed nations. The Food and Drug Administration recently acted to reduce the time and costs of clinical trials to encourage innovation in that space, certainly a positive tailwind for CRH.

3. **Increasing Financial Flexibility and Attractive Valuation** – *Valuation is no longer favorable: P/E ratio of 57x*

- Through 2016, CRH continued to shift its product mix to higher margin services through the acquisition of service providers. This has driven favorable valuations, and was a major driver of the price appreciation. However, continued growth in this space is reliant on a continued ability to execute acquisitions in the gastroenterology space
- CRH continues to maintain a no-divided policy, keeping cash on hand to invest in both development and acquisition. Management suggests that as mush as $60M of capital is available to deploy for acquisitions in 2017
- At the time of purchase, CRH traded well below peers on a multiples basis. Now, however, CRH trades at a P/E ratio of 57x, well above its peer range.

Analysis of Performance

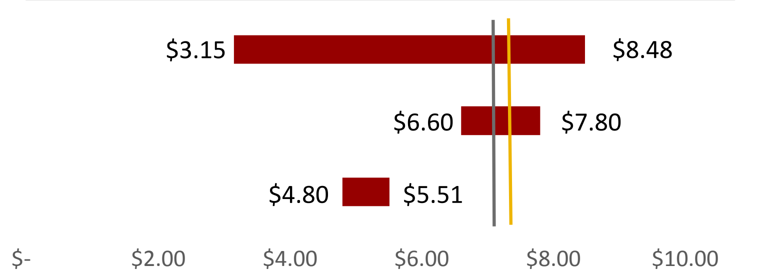
Throughout our holding period CRH Medical was by far and away the most profitable investment in the sector. However, it was also one of our busiest holdings, acquiring Arapahoe, Community Anesthesia, Austin Gastroenterology as well as Johns Creek. This continues with their trend of leveraging relationships in the GI and GI-Ansethesia segment to perform accretive acquisitions. With a growing demand for colonoscopies, GI-focused Anesthesia services have generated strong EBITDA and FCF margins for CRH. However, despite their successful operating and financial metrics, we believe CRH is no longer trading at a favorable valuation, at 25% premium to peers on an EV/EBITDA basis.

Overall, while we remain confident in the fundamental business model, we believe CRH is now trading at the appropriate level, resulting in our decision to exit the position

Valuation Summary

Method	Metric
Historical	52 - Week Range
DCF	Base - Bull
Comps	Forward P/E

Illustrative Value Range



Current Price $7.10 **Exit Price $7.15**

Source: Company Website, Food and Drug Administration, Bloomberg as of 12/31/2016

Fresenius Medical Care AG & Co. (NYSE: FMS)

Company Overview

- Fresenius is a Medical Equipment & Healthcare Facilities provider. Fresenius leads the world market in both Dialysis Products and Dialysis Service Centers Fresenius is focused on expanding its global position for Dialysis Service Centers, with a dominant market share of 36.9%, in what is typically an industry composed of local players
- Fresenius derives its revenue from two product segments: Dialysis Products & Dialysis Service Centers, which comprised 80% and 20% of its 2015 annual revenue respectively
- FMS is an ADR listed on the NYSE that trades primarily on the German Xetra exchange
- Fresenius Medical Care is 30% owned by Fresenius SE, which also owns 100% of the company's general partner, giving it control of Fresenius' board

Catalysts

- Continued growth in client base with respect to private insurance patients, especially in North America
- Reinvigorated growth in international markets with Dialysis Products, as this is the higher gross margin segment (54%) vs (28.55%)
- Cost management must be maintained as the CMS moves toward an ESRD Care Model, including all non-dialysis treatments

Risks

- On Jan 13th, a judge froze a government rule which attempted to constrain dialysis premium-assistance programs (charities). If overturned, industry players would face margin compression
    - Fresenius has the lowest industry exposure at 3% of operating income vs DaVita's 10%
- Fresenius must maintain its favorable payer mix, as a shift towards more Medicare/Medicaid patients could severely reduce margins (reducing revenue per patient by 75%)

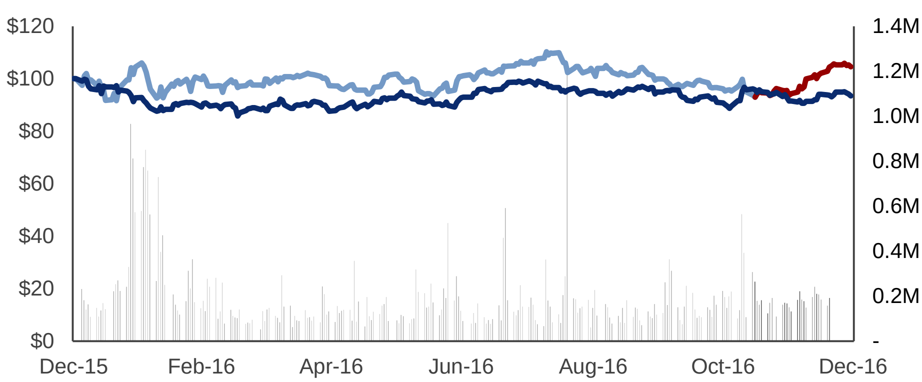
Financial Summary

Public Market Overview	
(values in $M, as of Dec. 31, 2016)	
Share Price	$80.70
S/O (M)	306.2
Market Cap.	**$24,712.0**
+ Total Debt	$9,043
+ Minority Interest	$1,869
+ Preferred Shares	$0
- Cash	$630
Enterprise Value	**$34,994.1**
Beta (1-Year)	0.62
Dividend Yield	1.1%
52-Week High	$85.11
52-Week Low	$70.69

Financials & Multiples	**LTM**	**FY2017E**	**FY2018E**
(values in $M)			
Revenue	$18,003	$19,334	$20,885
% Growth		*7%*	*8%*
EBITDA	$3,196	$3,698	$4,032
% Margin		*16%*	*9%*
EPS	$3.83	$4.45	$4.91
% Growth		*16%*	*10%*
EV/EBITDA	*10.9x*	*9.5x*	*8.7x*
P/E	*21.1x*	*18.2x*	*16.4x*
P/CFPS			
P/NAV			

Note: Financials are quoted in the USD equivalent of the German stock(FME), while the Position Snapshot reflects the true CAD cost of the US ADR holding

Normalized Stock Price and Sector Benchmark Performance



Benchmark: iShares Dow Jones U.S. Healthcare ETF (IYH)

Position Snapshot

Average Cost	*$51.95*
# of Shares	*1,550*
Value Invested	*$65,426*
Portfolio Weight	*2.57%*
2016 HPR	*12.4%*
HP Benchmark Return	*-2.4%*
Excess Return	*14.8%*

All figures in CAD

Fresenius Medical Care AG & Co. (NYSE: FMS)

Investment Thesis

1. **Fresenius is a market leader in an industry experiencing mega-trend growth:** *Fresenius is operating in an industry set to benefit from the undeniable shift towards obesity and an aging population, adding value to the dialysis market*

- Obesity has been linked to 80-85% of all incidences of Type II Diabetes, the leading cause of end-stage renal failure and the main contributor to new dialysis patients world-wide. Worldwide obesity is estimated to rise to 17% of the world's population in 2025 vs 13% currently.

2. **Fresenius is operating in a market with low street coverage:** *Info asymmetry in the market due to poor coverage of the industry, has led the street to forecast compressing margins & low growth, due to the dearth of global info*

- In a highly fragmented market, with FMS being the sole company who operates in more than one large region, there is a severe lack of comprehensive industry data, leading to weak street coverage. Adjusting for double counting on Bloomberg, due to Fresenius' complex structure, industry revenue is understated by 11.45B (17%)

3. **The market misunderstands the effects of a shifting payer mix:** *Fresenius is being improperly discounted by the market, due to their competitors seeing a large margin compression*

- Given Fresenius' history of maintaining an advantageous margin due to their relatively large supply of private insurance patients, we believe the market is improperly discounting the company. FMS has shown resilient EBITDA margins over time, likely a result of their vertical integration, in an industry that has seen margin suppression**.**

4. **The market misunderstands Fresenius' capabilities in china:** *The market has failed to account for an established global position, and an ability to leverage China's rapidly liberalizing healthcare market*

- Fresenius is the dominant player in many emerging markets, with over 5x as many patients treated as its closest competition in Asia. China's rapid evolution of their healthcare system has led to staggering growth rates of dialysis patients, growing 20-30% in 2009. China has pegged dialysis provision as a key issue to solve before 2020

Exchange Rate Fluctuation Exposure

Fresenius is a unique stock due to its status as an ADR. This means a certificate for the stock is purchased through a broker, BNY Mellon for FMS, while the actual stock trades on the German Xetra exchange. ADRs are a convenient way to gain access to shares in a foreign company. Fresenius' ADR shares have high trading volume, ensuring liquidity in the markets, with an average of 179,900 shares traded on average per day. The strengthening of the USD with relation to the EUR(1.073 to 1.056) since the inception of our holding of FMS, has provided amplified returns. DCM's position does expose the fund to exchange rate risk if the USD weakens relative to the EUR, although this risk was fully analyzed and isn't consistent with DCM's economic outlook.

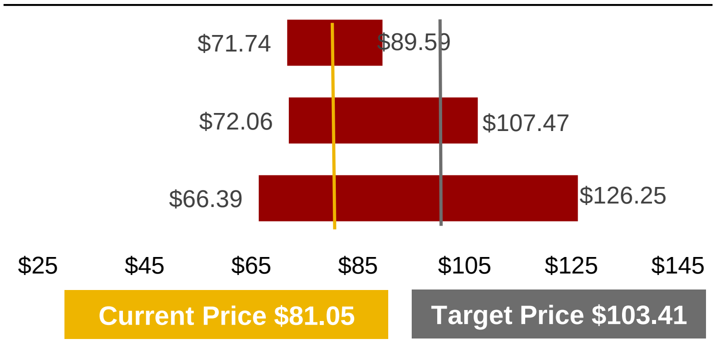
Analysis of Performance

Throughout our holding period, Fresenius outperformed our benchmark index, IYH, returning 12.4% versus (2.4)%. FMS also offers the extra benefit of a 1.1% dividend. Although this performance may look very positive at first glance, much of this outperformance can be attributed to positive exchange rate benefits with only 7.76% of the returns coming from price appreciation. We expect Fresenius' performance to continue to improve, although with a higher percentage of future outperformance coming from price appreciation and less from exchange rate movements. It is our sector's viewpoint that FMS remains discounted with respect to its implicit value.

Valuation Summary

Method	Metric
Historical	52 - Week Range
DCF	Base - Bull
Comps	Forward P/E

Illustrative Value Range



Disclaimer: DCM holds FMS(ADR), quoted values are USD equivalents of FME (Xetra)

Desautels Fixed Income Fund

2016 Performance Summary & Positioning

By Jonathan Kamel, Fixed Income Strategist

Summary

- **2016 Performance:** we returned 0.26%, outperforming our benchmark by 1.01% due to credit selection in our single-name corporate portfolio and our duration positioning
- **US Duration:** We remain short duration relative to our benchmark as we see upside risk to inflation not fully priced-in by the market from subtle labour market dynamics and unintended ramifications from the new administration's 'pro-U.S.' business platform
- **Canada Duration:** We remain short duration relative to our benchmark as we ultimately assign higher probability than the market to future BoC tightening, the result of Canada's ability to rotate towards the non-resource-oriented economy and anticipated labour market inflationary pressures
- **U.S. Credit:** We believe, with credit spreads notably below long-term averages, that present valuations are unjustified based on fundamentals, given indications that corporates are firmly in the intentional releveraging and risk-taking stage of the credit cycle and current factors provide limited cause for this progression to reverse
- **Canada Credit:** Though we believe corporates are shifting to credit-adverse capital allocations, largely as a result of sustained return on internal investment challenges, we expect the trend will be mitigated by improving economic growth in the near-future. We see this as largely priced-in to current IG and HY credit spreads

Fixed Income Fund Performance

Dear Investor,

In what has undoubtedly proven to be a volatile and challenging year for the asset class, the Desautels Fixed Income Fund returned 0.26%, outperforming our benchmark's -0.75% return. Despite limited returns on an absolute basis in 2016, we are pleased that our diligence in engaging in rigorous bottom-up analysis to find mispricing of credit risk continued to support our long-term track record of outperformance against our benchmark on both an absolute and risk-adjusted basis. Since inception, we have returned an annualized excess of 0.81% over our benchmark, helping to generate 1.44% of annual alpha in turn.

Figure 1: Fixed Income Fund Performance and Risk Metrics

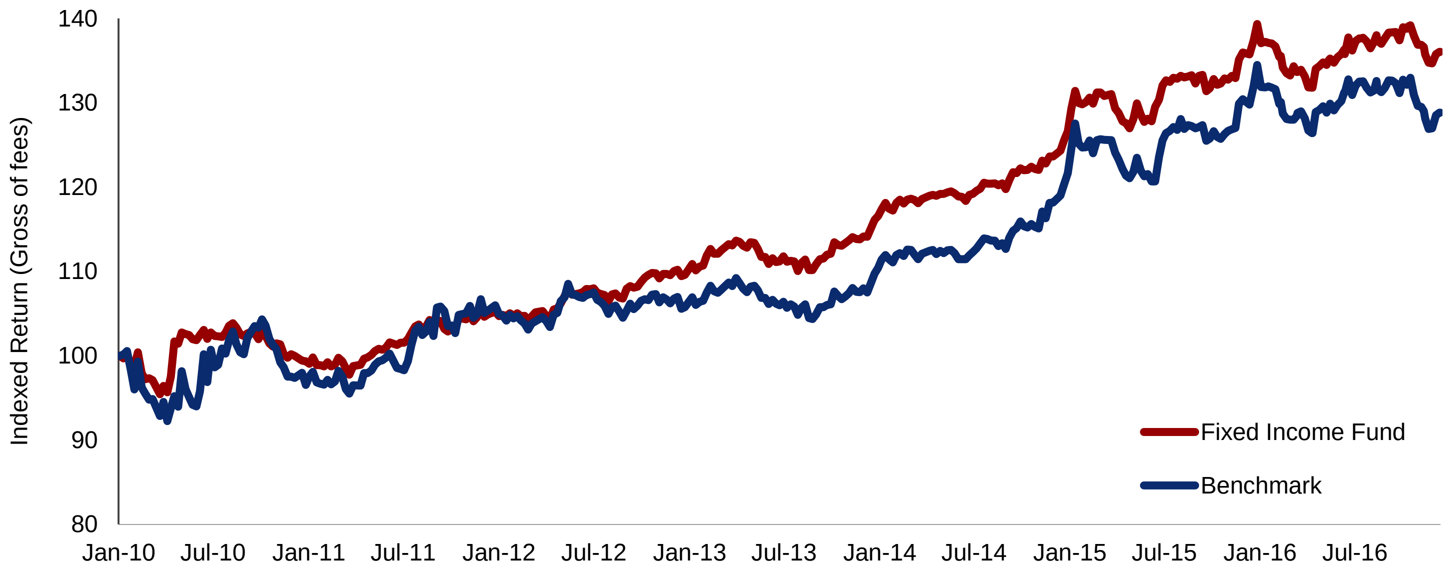
FIXED INCOME FUND RETURNS		As of Dec 31, 2016	
Time Period	Gross Return	Net Return	Benchmark
2016	0.22%	(0.24%)	(0.75%)
Q4 2016	(1.68%)	(1.76%)	(2.86%)
Q3 2016	1.50%	1.37%	1.06%
Q2 2016	2.00%	1.87%	2.17%
Q1 2016	(1.55%)	(1.67%)	(1.04%)
2 Year*	1.38%	1.25%	1.25%
Since Inception*	4.50%	4.02%	3.69%

Returns are annualized.

PERFORMANCE METRICS SINCE INCEPTION				
	Fixed Income Fund		Benchmark	
	2016	Inception	2016	Inception
Annualized Return	0.22%	4.50%	(0.75%)	3.69%
Annualized Std Dev	4.61%	4.74%	5.57%	7.24%
Annualized Sharpe Ratio	-0.47	0.45	-0.56	0.18
Beta	0.78	0.52		
Annualized Alpha	0.3%	1.4%		
Tracking Error	0.27%	0.62%		

Performance metrics are calculated gross of fees.

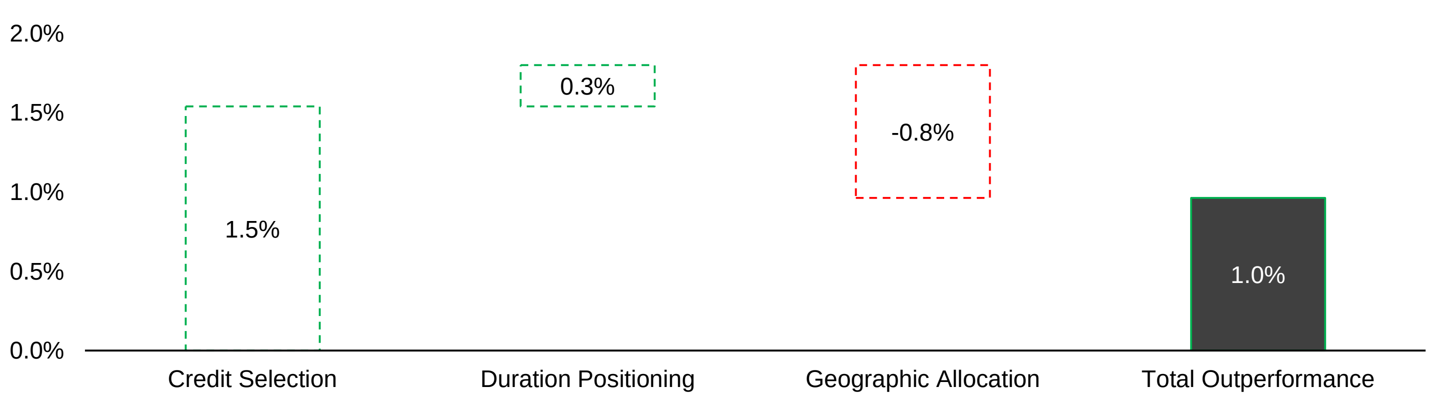
Figure 2: Fixed Income Fund Performance Versus Its Benchmark Since Inception



Benchmark is the Citi World Bond Index from inception to Feb. 8, 2011 and a 45% Barclays Aggregate Bond Index, 45% DEX Universe Bond Index, 10% Citi International Treasury Bond Index blended thereafter, measured in CAD. Fund inception date is January 20, 2010.

Figure 3 shows the key drivers of our relative performance in 2016. Credit selection and duration positioning had a positive contribution over the benchmark's return (+1.5%, and +0.3% respectively). Within credit selection, our 8.3% Canadian High Yield allocation (versus no HY allocation in our benchmark, see Figure 4) was a key contributing factor to the outperformance, the result of a combination of both idiosyncratic drivers amongst our holdings and general market conditions. On the part of factors specific to our HY holdings, it was a case of both an investment thesis materializing and an upside event. We entered a position in Iron Mountain 2021, a records management REIT, on the thesis that investors' signaling of concern over typical M&A execution risk by widening credit spreads on the news of IRM's acquisition of Recall (another major player) was unwarranted. Based on pro-forma analysis, we concluded the acquisition would result in greater operating efficiency and reduced leverage, aided by its equity financing. Our thesis bore out in 2016 as, following the release of consolidated financial

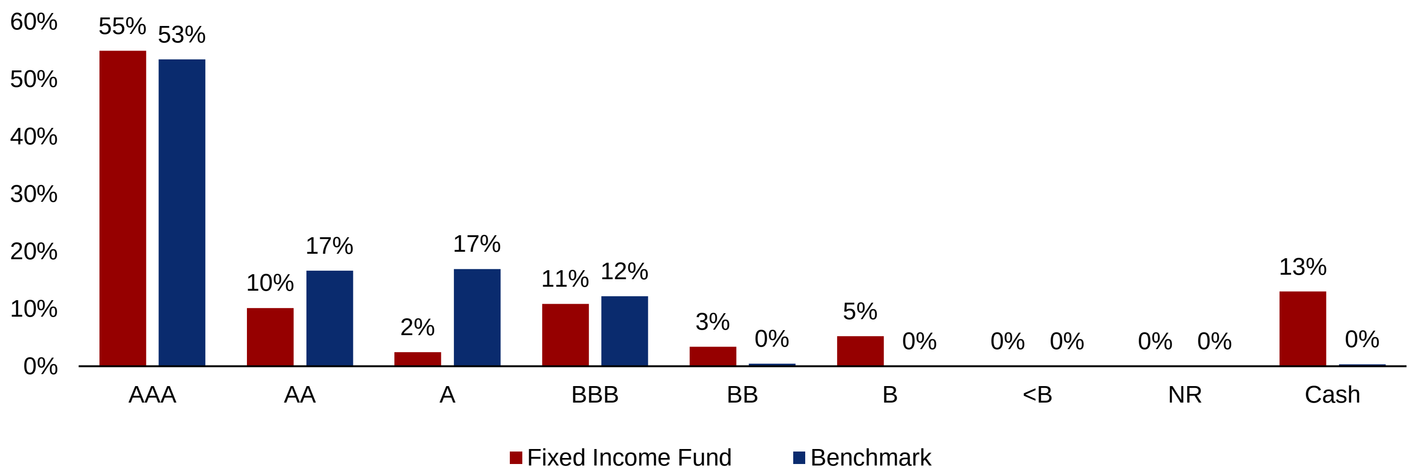
Figure 3: Fixed Income Fund 2016 Relative Performance Attribution



statements with Q2's earnings, IRM's spread tightened 12 bp relative to the HY index.

For one holding's 'upside' event, though our original thesis for DirectCash Payments 2019 postulated DCI would be a consolidator across its ATM markets, in October Cardtronics, a much larger global ATM operator, announced it was acquiring DCI. Our merger analysis following the announcement is included in the Holdings Review section, but the key takeaway is that it caused a 235 bp spread compression relative to the HY index for DCI 2019 (owing to the likely outcome created of a take-out at a necessarily-high premium in the merger).

Figure 4: Fixed Income Fund Credit Rating Exposure



Regarding HY market-wide factors, the sustained recovery and stabilization of oil prices for much of the year eased investor concern over the broader systematic impact on the Canadian economy posed by the sector's weakening. Thus, given the greater macroeconomic sensitivity of HY over IG bonds (owing to default risk, and thus default expectations comprising a larger relative proportion of their total risk premium), this development drove the broad Canadian HY market to appreciably outperform its IG counterpart in 2016, yielding a 52.2% reduction in the HY-IG index spread.

Another key factor in our outperformance was our consistently short duration exposure (see Figure 3). Throughout the year, we held both greater conviction than the market on inflation risk and subsequent necessity of more contractionary Fed policy in the U.S., and the ability to successfully rotate towards a more export-driven, non-resource oriented economy for growth in Canada. We thus maintained a short duration relative to both our U.S. and Canadian benchmarks, averaging 1.3 and 1.5 years respectively. While signs of improvement in economic data and tranquil financial markets in the latter half of the year certainly helped investor expectations shift towards greater growth and less monetary stimulus, it was also Trump's surprise victory and the resulting ignition of the 'reflation' thesis that pushed Canadian and U.S. yields firmly into the upward direction. Thus, the upward shifts observed in U.S. and Canadian yield curves of 13 and 29 bp respectively over the course of 2016 overall enabled our convictions to generate outperformance. As elaborated in our Macro sections below, as we retain a more

Performance and Positioning

Figure 5: Fund Duration Positioning

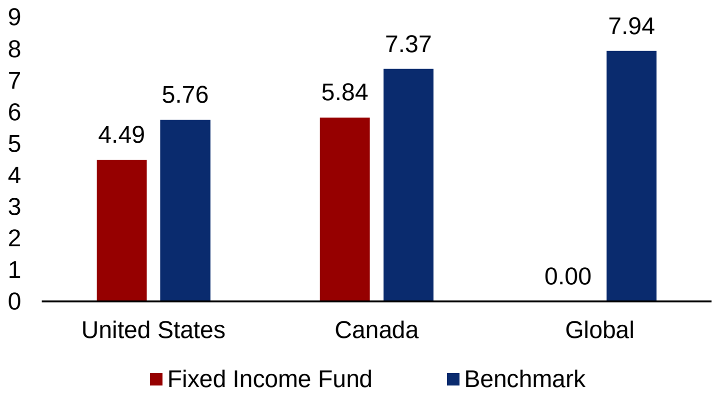
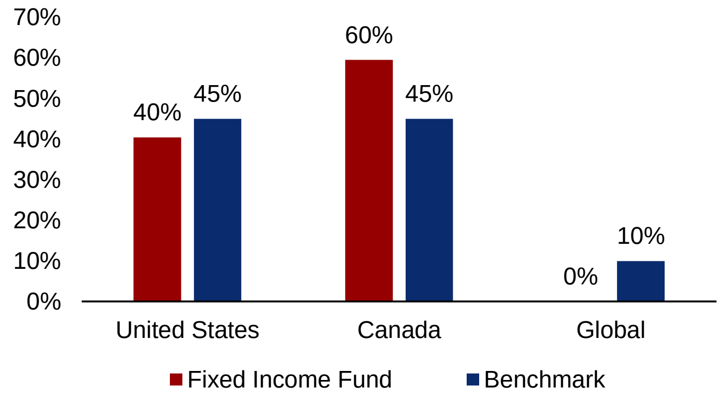


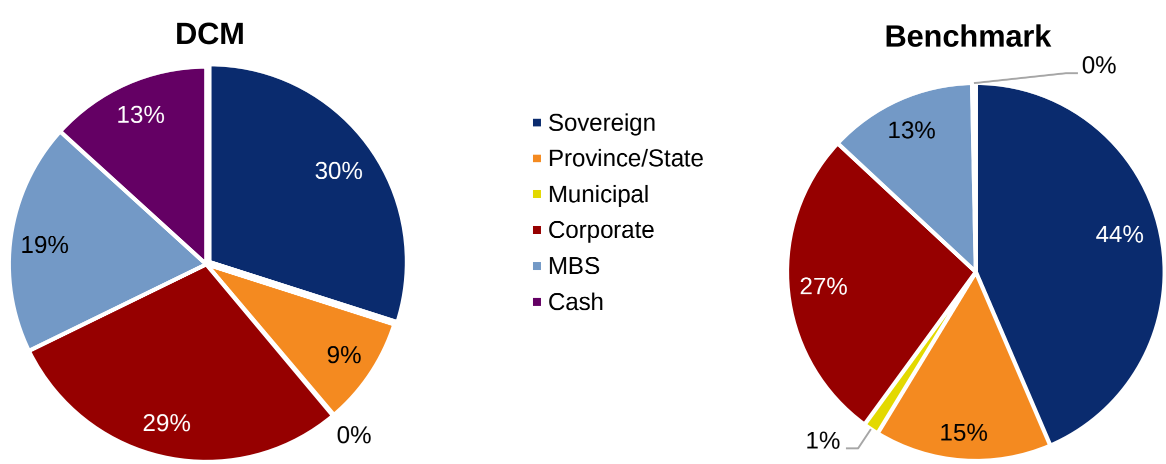
Figure 6: Fund Currency Allocation



hawkish view than the market on the necessity of more contractionary Fed policy and on key macro dynamics more likely to yield a firming than easing of Bank of Canada policy, we maintain our short duration going forward.

The detractor from our relative outperformance in 2016 was geographic allocation. We were overweight Canadian versus U.S. IG corporate exposure relative to our benchmark (at 17.2% and 4.0% respectively in our portfolio, versus 12.2% and 14.7% respectively for our benchmark), due to a more favourable view on Canadian IG pricing relative to the U.S. throughout the year (as elaborated in the Credit sections below and prior newsletters). This positioning was ultimately penalized as the outlook for macroeconomic fundamentals appeared to improve more convincingly in U.S. throughout the year, providing a more conducive environment for general corporate spread compression – leading to 195 bp outperformance for the U.S. over Canadian IG spread index. However, as elaborated in the U.S. Credit section, we believe developments in corporate fundamentals remain incongruous with recent spread movements, and are therefore skeptical this U.S. outperformance can be sustained.

Figure 7: Fixed Income Fund Sector Exposure



Fixed Income Fund Holdings List

Fixed Income Fund Holdings						As of Dec 31, 2016
#	Security Name	Units	Purchase Price	Market Price	Market Value	% of Total
1	ISHARES MBS ETF	550	$106.74	$142.61	$78,434	16.9%
2	BMO LONG FEDERAL BOND INDEX	4,300	18.61	17.45	75,035	16.1%
3	ISHARES 3-7 YEAR TREASURY ETF	300	125.39	164.29	49,288	10.6%
4	CANADIAN DOLLAR	45,013	1.00	1.00	45,013	9.7%
5	PROVINCE OF ALBERTA 2.55% 2022	400	99.54	103.26	41,302	8.9%
6	ISHARES CORE U.S. AGGREGATE BOND ETF	270	143.28	144.91	39,127	8.4%
7	HOME TRUST CO. 3.4% 2018	240	102.31	101.09	24,261	5.2%
8	COGECO CABLE INC. 4.925% 2022	220	109.41	108.97	23,974	5.2%
9	DIRECTCASH PAYMENTS INC. 8.125% 2019	190	102.75	104.31	19,819	4.3%
10	BANK OF AMERICA CORP. 5.15% 2017	170	95.70	101.51	17,257	3.7%
11	IRON MOUNTAIN INC. 6.125% 2021	150	102.99	104.88	15,731	3.4%
12	US DOLLAR	11,458	1.34	1.34	15,365	3.3%
13	ISHARES CANADIAN (IG) CORPORATE BOND ETF	670	21.86	21.26	14,244	3.1%
14	ISHARES IBOXX (U.S.) IG CORPORATE BOND ETF	37	161.37	157.14	5,814	1.3%
Value of Cash & Securities					**$464,665.77**	**100.0%**
Top 5 holdings					$289,072	62.2%
Top 10 holdings					$413,511	89.0%

All figures in Canadian Dollars

Desautels Fixed Income Fund

Fixed Income Markets Review and Outlook

By Jonathan Kamel, Fixed Income Strategist

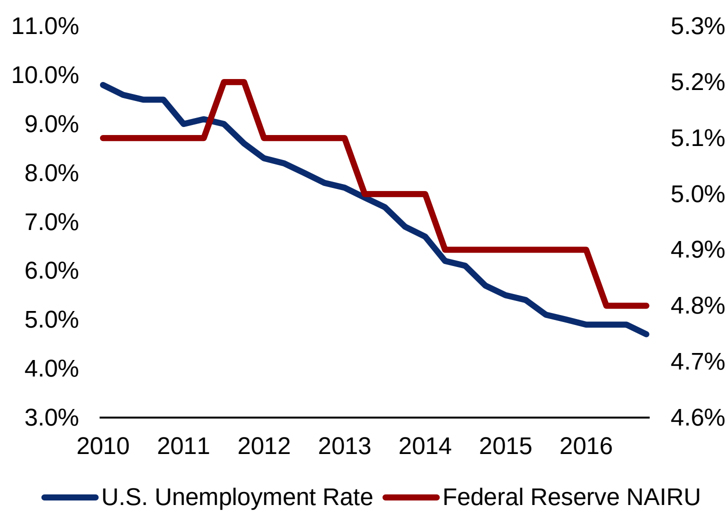
United States Macro and Duration

The election outcome has undoubtedly brought the market to a point of far greater uncertainty than before. As such, positing on where yields are heading has become a more challenging exercise. In the month following the U.S. election, rolling one-month volatility of the UST 10Y yield reached 45.9% (annualized), versus 38.6% in pre-election 2016 and 22.9% over the past 25 years. Amidst this heightened volatility, making the right call on duration will be a key driver in our performance. Analyzing the factors involved in the Fed's decision-making framework, we retain strong conviction on our longstanding short duration positioning relative to our benchmark. This is largely due to subtle dynamics present in the labour market and unintended inflationary consequences of the new administration's 'pro-U.S.' business platform, as described below.

The Labour Market: An Underestimated Source of Pricing Pressure

Recently, the Fed has repeatedly downward revised NAIRU - its target long-run unemployment rate that the U.S. should be at when its output gap closes (see Figure 8). This has been justified on the grounds that continued declines experienced in unemployment rate and fairly robust and accelerating nominal wage growth are not being met by an upturn in inflation that Fed officials were expecting, thus challenging the notion that labour market slack is being eliminated. That conclusion in turn has served as justification by FOMC doves for a continuation of accommodative monetary policy (which, through stimulating demand growth, provides a boost to labour demand). We however believe that this wait-and-see approach to employment currently poses appreciable upside risk to inflation.

Figure 8: Current Fed NAIRU Estimate vs. Unemployment Rate



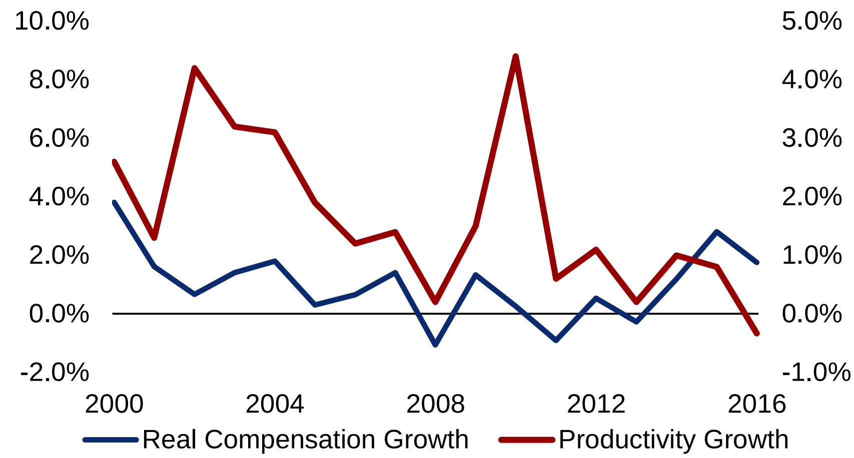
In theory and empirically, increases in wages must be matched by corresponding productivity improvements, or else they place additional margin pressures on firms that cause them to respond via higher prices when possible. The key to this however is real wage growth, not nominal, is necessary for the condition to hold, as only then can one assess if price increases have already been keeping up with firms' rising cost bases (thus offsetting an absence of productivity growth).

Replacing the ubiquitously reported metric of 'average hourly earnings,' with 'real total compensation per hour,' we can see that, unlike what is suggested by nominal figures, real compensation growth through the post-recessionary

Source: Federal Reserve (FRED), St. Louis Fed..

period has been quite benign, averaging 0.8% against the 25-year average of 1.1% (see Figure 9). However, it has notably and consistently picked up in recent quarters, to now stand at an appreciable 1.8% as of 3Q16. We believe this acceleration of real compensation growth is symptomatic of an overly-tight U.S. labour market that continued Fed stimulus has helped to create. Even more concerning, however, is that it has simultaneously occurred with a sharp slowdown in productivity growth, which in fact turned negative in 2016 (see Figure 9).

Figure 9: Comparing U.S. Wage and Productivity Growth

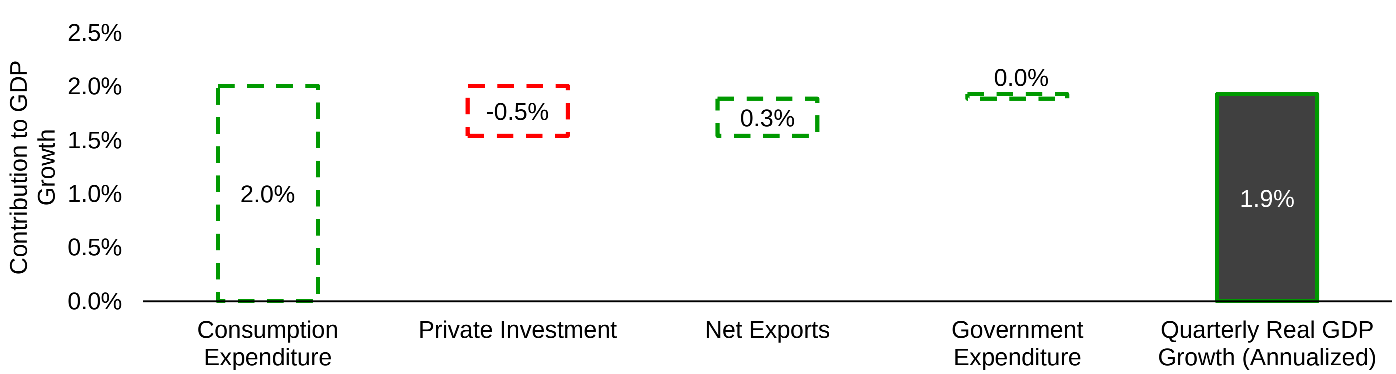


Thus, it is only now, with this widening differential between hikes in real wages paid to employees and the pace of cost-saving productivity gains (the blue and red lines respectively in Figure 9), that firms are beginning to face greater and more consistent margin pressures than before. We therefore see it logical that firms respond by materially raising prices as margin pressures become pent-up. The ultimate result will be a materialization of more rapid and significant inflation from the labour market than dovish Fed officials are expecting.

Analyzing the Levers of U.S. Growth

Importantly, we continue seeing this inflation pressure from the labour market to be quite robust – largely unaffected by who was elected to President – as the issue of eliminated labour market slack would likely need not just a slowing of growth, but an actual economic contraction to reverse. Looking at the potential impact of Trump's election from the lens of various components of GDP, whose respective contribution's to 2016's growth are shown in Figure 10, may be the most constructive means of assessing how the administration will likely impact the Fed's

Figure 10: Decomposition of 2016 U.S. GDP Growth



Source: U.S. Bureau of Economic Analysis, Federal Reserve (FRED).

focal points of the labour market, inflation and growth going forward.

Investment: Short-Term Improvements, Longer-Term Concerns

Investment was an appreciable 47 bp drag on the U.S.'s 2016 2.0% real GDP growth. This is due in no small part to the recent reduction in corporate expectations for returns from internal investment owing to various factors, and thus a slowing in capex spend, as elaborated in the U.S. Credit section below. However, the outlook for this account may be marginally improving going forward. Firstly, though the final state of corporate tax reform is uncertain, the current House GOP tax plan proposes immediate expensing of all capital outlays. Thanks to the time value of money, this would ceteris paribus increase proposed projects' NPVs, and thus the number that are actually accepted and pursued, boosting business investment in-turn. It is however important to note that the upside effect is mitigated by the fact that the current tax code is already in some instances lenient in depreciation allowances, such as the PATH-act's current 50% first-year depreciation expensing.

Secondly, in what has started to take form even before the inauguration day, Trump's pressuring of large firms to replace foreign with domestic investment, while not necessarily causing an overall increase in firms' capital spending, will still increase the portion made on U.S.-produced capital goods. As it is the geographic location of this spending that matters for the purpose of valuing the "Investment" account of U.S. GDP however, the shift will still, all else equal, provide a stimulus to this component of GDP growth.

However, an investment dynamic that has received less mention in the press is the effect on firm costs and efficiency from firms being pressured under Trump to replace foreign with domestic investment in productive capacity (both in terms of people and capital). As a longstanding tenant of neoclassical economics generally accepted today, in open markets firms logically choose to produce goods and services in countries that hold a comparative advantage in a particular product. Thus, the key reason why firms originally opted to make a capital investment in a market other than the U.S. is not a lack of patriotism, but simply to optimize efficiency. By obliging them however to opt for the U.S., capital will be misallocated away from its most productive deployment and efficiency will inevitably be hampered, to the eventual detriment of higher prices passed onto the U.S. consumer. For example, the Center for Automotive Research has estimated that moving automotive production from Mexico to the U.S. will increase per-vehicle manufacturing costs on-average by $1,800 (see Figure 11 for breakdown). We can thus expect greater inflationary pressure to result from this new administration's 'patriotic' focus for businesses.

Figure 11: Cost Differentials in Auto Manufacturing

Per-Vehicle Cost Savings: Mexico vs. U.S. Production	
Assembly Plant Labour	$600
Locally-Sourced Parts	1,500
(Additional Transport Costs)	-300
Total Savings	$1,800

Source: U.S. Tax Foundation, Bloomberg, Center for Automotive Research.

Net Exports: Well-Established Precedents for Inflation

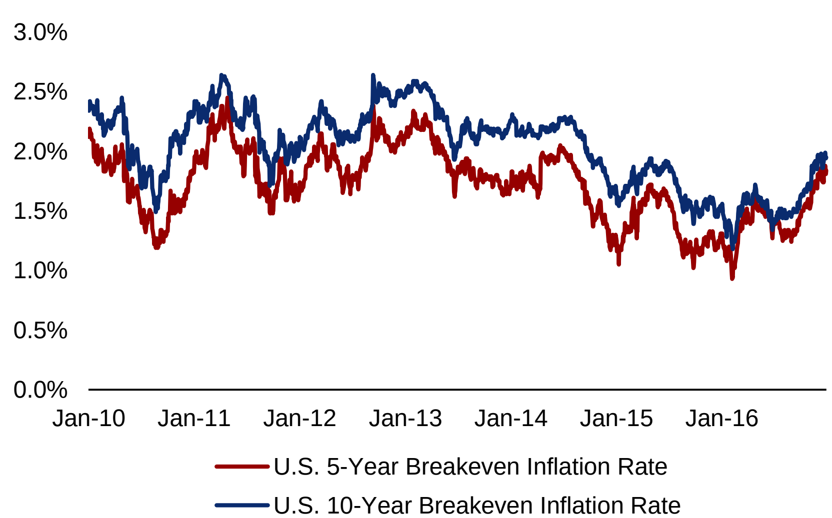
Net exports, which in 2016 contributed an appreciable 17% to total real GDP growth, are a key area of risk, owing to the fact that the new administration may affect changes that both lower growth in this account while simultaneously causing greater pressure on inflation. Firstly, though threats certainly do not translate into policies, under a Trump presidency there is a greater likelihood of protectionism vis-à-vis certain key trading partners. This would create multiple channels of greater inflationary pressure beyond higher consumer prices for final goods that are imported. The most critical would be on firm's input costs, effectively creating a negative supply shock.

For certain inputs, American businesses heavily depend on imports (for example, 90% of U.S. corporate computer equipment investment is sourced from overseas), as other nations have specialized in producing a particular good over a period of many years. It is simply impossible for U.S. domestic productive capacity to quickly configure to satisfy demand for these various key inputs currently fulfilled abroad at their present cost or quality levels, and also gives the firms creating them undue market power. Thus, U.S. firms' cost bases would escalate in the near term, creating the trade-induced supply shock. Countless empirical evidence substantiate the logical end result – an alleviation of resulting margin pressures by raising prices where possible (helping spur inflation). In addition, it is possible that in response to an unprecedented imposition of U.S. protectionist policies, foreign countries impose retaliatory duties; the obvious harm on U.S. exporters would thus reduce growth for this GDP account.

The Fed: to be Placed Between a Rock and a Hard Place

Combining these various factors, it is clear that we have not only held a longstanding hawkish outlook versus consensus for U.S. inflation owing to the aforementioned view of overly-tight labour market dynamics, but it has now been both increased and exposed to notable upside risk as a result of the election outcome. We are skeptical, however, that, even in light of Trump's victory, the market presently shares the same view. Using the differential between TIPS securities' yield and those of Treasuries as a gauge, it is clear investors are now pricing in greater inflation – from a month before the election through till December 30th, the 10-year and 5-year breakeven inflation rates jumped 31 bp and 33 bp to stand at 1.95% and 1.84% respectively (see Figure 12). However, these are by no means remarkable figures. In the past 5 years of the recovery alone, the 10-year and 5-year breakeven rates have averaged 2.02% and 1.73% respectively,

Figure 12: TIPs-Implied U.S. Inflation Expectations

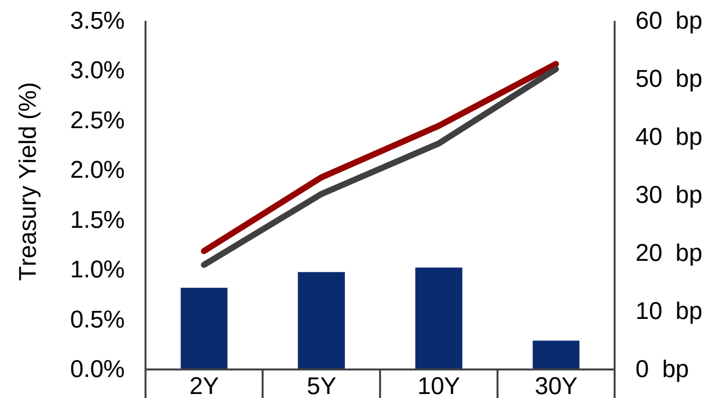


Source: J.P. Morgan Economic Research, Bloomberg as of 12/31/16.

and year-end 2016 figures have both exceeded their current levels as recently as August 2014.

This divergence of opinion may help to explain our disagreement in turn over the outlook for Fed policy. Presently considering the Fed's labour market and inflation mandates in tandem, to us it is only logical that the Fed be obliged, at the very least, to follow through on its dot plot of 3 rate hikes in 2017, as proposed in the first post-election FOMC meeting in December. However, Fed Funds futures (as of year-end 2016) are currently only assigning a 39% probability of 3 or more rate hikes in 2017. Investors may be placated by FOMC members' demonstrated reservation and caution in the minutes of the last meeting, with Yellen describing circumstances as "a cloud of uncertainty." However, having also stated their desire to "stem a potential buildup of inflationary pressure," we see the FOMC having little choice but to act when said pressures, as we expect, do indeed begin to unfold. This will not only lift the short-end of the yield curve more quickly than expected (thus furthering the 'bear flattening' we saw over the course of 2016 – see Figure 13), but as it instigates merited revision to longer-term inflation expectations, greater upward pressure will be placed on the long-end of the curve as well (which is influenced more predominantly by this factor). We are thus comfortable maintaining our 1.3 year duration gap to our U.S. benchmark, anticipating a scenario of higher yields across the curve than the market by the end of 2017.

Figure 13: Change in U.S. Yield Curve over 2016



	2Y	5Y	10Y	30Y
Δ	14.1 bp	16.8 bp	17.5 bp	4.9 bp
12/30/2016	1.19%	1.93%	2.44%	3.07%
12/31/2015	1.05%	1.76%	2.27%	3.02%

Canada Macro and Duration

Non-Resource Exports: Still the Growth Story

DCM has consistently reasoned that greater competitiveness from sustained CAD depreciation and stable U.S. economic growth should provide a sustained trade-based boost to Canada's non-resource sector. Importantly, despite the many calls that Canada's manufacturing industry has permanently lost its output potential owing to structural decline produced by a decade-long period of CAD strength, in the past 2 years we have seen a restoration of real manufacturing exports to steadily grow and approach peak historical output, now standing at 93.4% of the watermark (see Figure 14). We believe this gradual reversal is the result of key sectors such as aircraft and industrial machinery having been shown to indeed be exchange-rate sensitive, but crucially with an accompanying lag that requires a prolonged stretch of CAD depreciation many economists have not been patient

Source: Bloomberg as of 12/31/16, Wall Street Journal, Statistics Canada.

for. This lag is the result of export demand being fairly inelastic in response to currency depreciation in the short term, due to key factors such as pre-existing fixed trade contracts.

Looking forward, our 'base-case' still hypothesizes that Canada's export-oriented non-resource sector will continue to strengthen. Not only as prescribed by economic theory, but empirically speaking, Canadian-U.S. sovereign yield differentials overwhelmingly predict the exchange rate despite the CAD's reputation as a 'petrocurrency'. In the past 5 years, not only has the rolling 1-year correlation between the USD:CAD and U.S.-CAD 2Y differential been appreciably stronger than that with WTI, at 0.72 versus -0.50 (see Figure 15; note the inversion and scaling of WTI price for visibility), but even as correlations with both these variables has increased, the magnitude of that discrepancy has remain unchanged. While the 2Y differential and WTI themselves are also correlated (-0.49 average rolling correlation over the past 5 years), largely as a result of oil prices influencing expectations for near-term Canadian growth, and thus near-term inflation (a driver of 2Y rates), their weaker link indicates the presence of other fundamental factors that can cause expectations driving yield differentials to diverge from movements in commodity markets. This would enable our aforementioned more hawkish view than the market on expected U.S. inflation and rake hikes, coupled with expectations of comparatively more docile Bank of Canada action (discussed further below) to sustain a further divergence between yields and oil resulting from the differing monetary policies, irrespective of oil's potential strengthening. This will in turn ensure a suppressed CAD remains for the foreseeable future, supporting the aforementioned non-energy export industries.

Figure 14: Canada Non-Resource Sector Exports

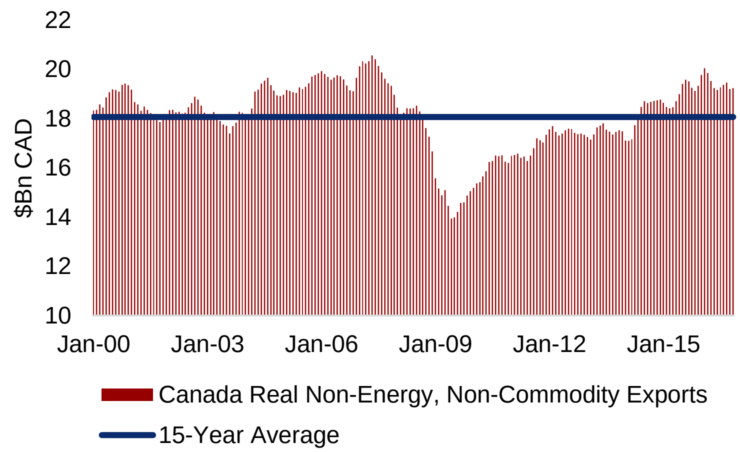
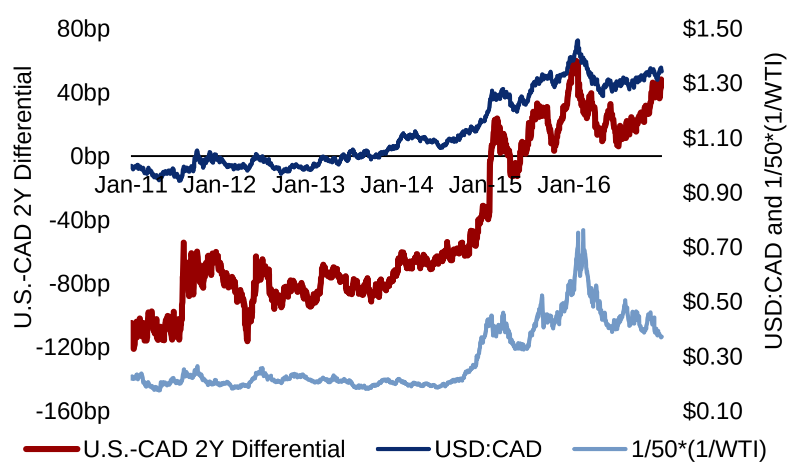


Figure 15: Exchange Rate vs. Yield Differential, Oil



Trump Tactics: How Large a Risk to the Thesis?

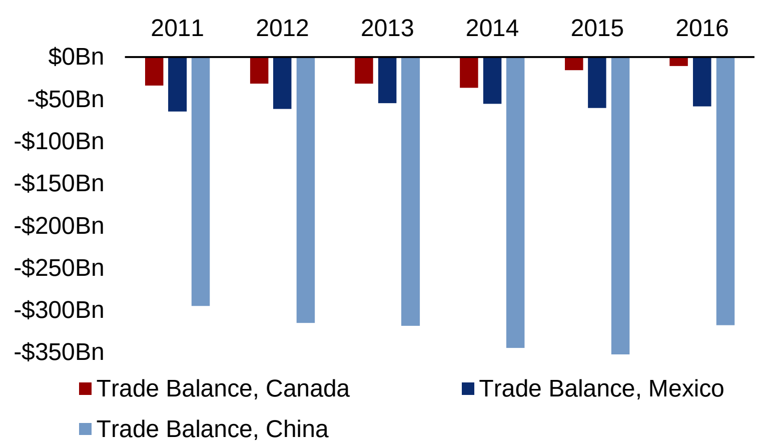
At $389.6 Bn CAD in the LTM period, the U.S., Canada's largest export market, represents 75.2% of total export

Source: Bloomberg as of 12/31/16, Globe and Mail, Statistics Canada.

volume and 5.5% of Canadian GDP. Specific mention of Canada was entirely absent from Trump's protectionist trade rhetoric during the campaign and election, despite the fact that Canada remains the U.S.'s 2nd largest trading partner – helping pacify concern to a degree. However, Canada has recently been mentioned to be included in the new government's desired NAFTA renegotiations, with limited further clarity. Protectionist measures such as import tariffs would obviously pose a significant headwind to the rate of trade between any two nations. This is only amplified by the nature of commerce between Canada and the U.S., which, owing to their shared border and longstanding heavy economic integration, is particularly intertwined. For example, in multiple industries such as in the automotive sector, a specific part crosses the border multiple times before final production is complete.

However, unlike much of the financial press, we do not believe the outcome is inevitable doom and gloom for Canada's exporting base going forward. Firstly, as seen in Figure 16, unlike the nations that remain targets of U.S. protectionist rhetoric, Canada-U.S. trade is both near-balance and rapidly moving closer in that direction. While the U.S. generated a trade shortfall with Mexico and China of -$58.5 Bn and -$317.8 Bn annually in the LTM period, the deficit with Canada was a comparatively minor -$10.6 Bn, and even more critically, shrinking at the fastest rate amongst the 3 nations (-39.5% versus -4.7% and -13.6% LTM respectively). The Trump administration (thus far) has held this greater balance as indicative of present terms of trade with Canada being 'fair' – indeed Schwarzman, head of Trump's strategy and policy forum, said the "balanced trade" and historical relations between the two countries means Canada has "special status," and thus possesses "low risk" of trade disruption. This assertion has been backed by the new U.S. Secretary of Commerce, who publicly stated Canada "does not have a lot to fear" from the new administration. Furthermore, the Trudeau government has proven proactive and pragmatic in addressing potential risks, pursuing extensive dialogue with the new administration before it formally came to power and offering to renegotiate NAFTA before any Canada-specific trade-related criticism emerged. It is however difficult to predict the extent to which this "renegotiated" trade relationship may adversely affect Canada's exporters versus the status quo.

Figure 16: U.S. Trade Deficits (Biggest Partners)



Bank of Canada: Difficult Musings

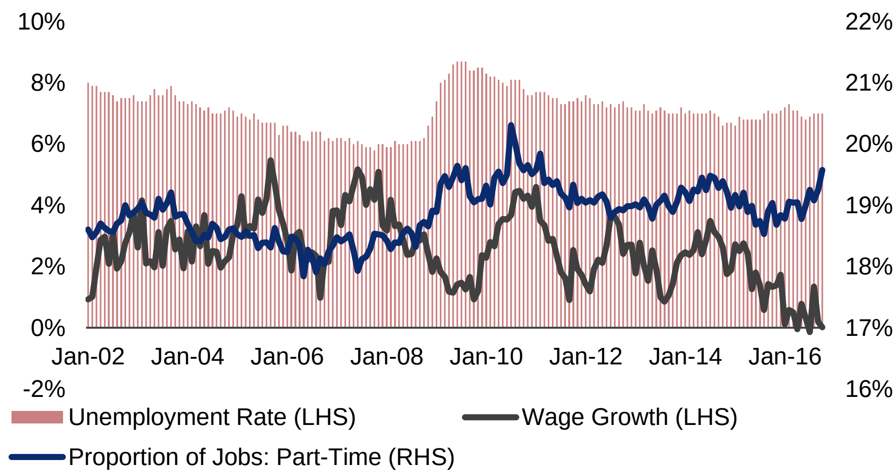
The Trump-induced economic uncertainty above will likely give pause to the Bank of Canada, given Poloz has consistently shared DCM's view that Canada can undergo a structural shift to the non-resource sector as its growth driver via trade. We identify two other key developments that further complicate the outlook for monetary policy.

Source: Bloomberg, U.S. Census Bureau, Wall Street Journal.

The Labour Market: Presently Concerning Fundamentals Belie Future Pressures

The first is the direction of the Canadian labour market. Incremental GDP growth should help to drive further tightening of the labour market in 2017, building on 2016's strong gains to bring the current 6.9% unemployment rate closer to Canada's own natural rate of unemployment (estimated by various economists to be around 6.5%). Despite this, wage growth has been consistently muted, averaging only 0.4% in 2016 against a 15-year average of 2.6% - leading many bank economists to conclude the labour market is unlikely to exert inflationary pressures soon (see Figure 17). Taking a closer look at the composition of job growth reveals why: part time work makes up the vast majority of net job gains, at 71.7% of the total in 2016, leading the percentage of those in part-time jobs to be a growing 19.5% of the total (versus a 18.8% 25-year average).

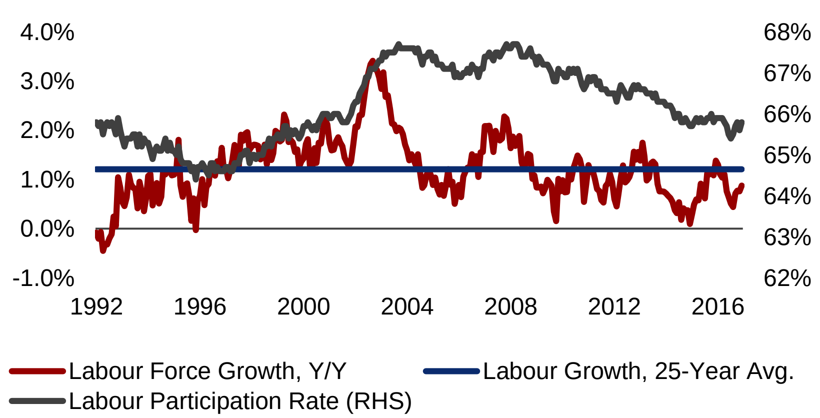
Figure 17: Joblessness, Part-Time Work and Wage Growth



Thus, there is greater slack in the labour market than headline figures suggest, and many entering inherently possess less bargaining power with employers.

However, we believe both cyclical and structural factors are likely to change this dynamic going forward. On the cyclical side, a significant and obvious source of full-time employment in particular that has undergone many quarters of weakness is the energy sector. Oil-producing provinces lost the equivalent of 1% of all full-time jobs in Canada in 2016 alone. Thus, if crude's recovery is sustained, we will likely see this drag begin to lift in 2017. On the secular side are demographic shifts, as Canada is facing an aging population and retirement of baby boomers. Thus, going forward, the labour force will continue growing at slower and slower rates as participation rates remain subdued (as seen in Figure 18, 2016 labour force growth has fallen to 35 bp below the long-term average, concurrent with a continued contraction in participation rate). This will

Figure 18: CAD Labour Force Growth and Participation



Source: Statistics Canada, J.P. Morgan Economic Research, TD Economic Research.

help decrease market slack as labour demand grows with output growth. All-in-all then, while it may appear on the surface that employment is at little risk to pose upward pressure on inflation, we expect that traditional inflationary pressures will begin to emerge from tightening slack in the labour market.

The Canadian Household: Putting Monetary Policy in a Bind

The second key area of monetary policy complication is the Canadian household. As has now been widely publicized, in what has historically proven a dangerous combination, Canadian household indebtedness has been increasing while the housing market has been heating (see Figures 19 and 20). The basic, well-understood risk to

Figure 19: Canada vs. U.S. Housing Prices

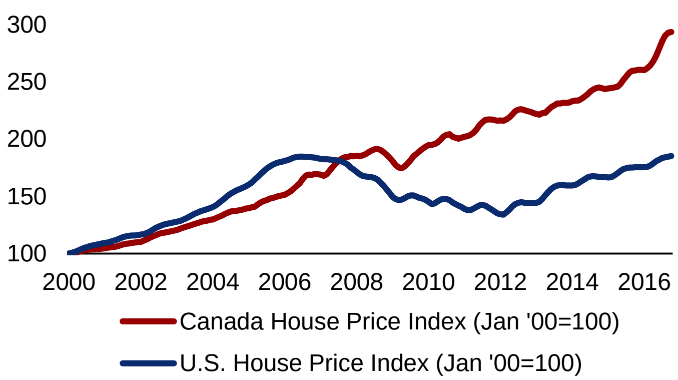
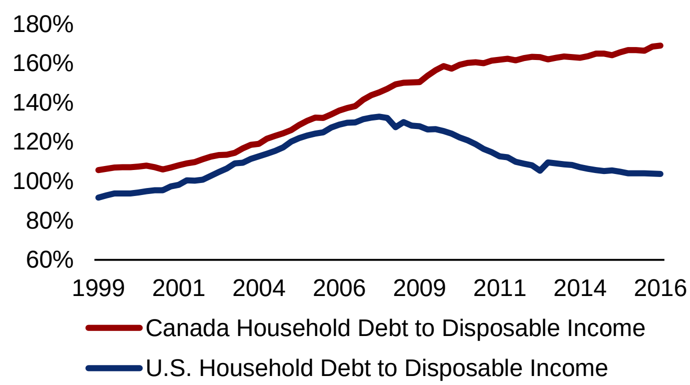


Figure 20: Canada vs. U.S. Household Leverage



this is that a negative economic shock such as a recession may create a domino effect. Highly indebted households begin to default en masse, lenders increase foreclosures, house values begin to correct and a 'reverse wealth effect' takes hold that causes all households to reduce spending – merely aggravating the original shock/recession. Interestingly however, far from causing us to be more dovish on Bank of Canada policy, we see this development as disincentivizing accommodative monetary policy. For example, a rate cut, by placing downward pressure on mortgage rates in turn, would merely encourage further leverage in the system and housing market stimulus, making the aforementioned risk grow further in magnitude and probability. We believe the BoC would do everything in its power to prevent such a development from unfolding; to substantiate, it identified "household debt and housing market imbalances" as the "key vulnerability" to the Canadian financial system in its most recent risk-assessment. This has led the BoC to endorse regulatory measures introduced to constrain access to mortgage credit among other mechanisms intended to cool the housing market in a controlled fashion – progress that would be reversed by introducing monetary stimulus, and only aided by gradual tightening.

Conclusion

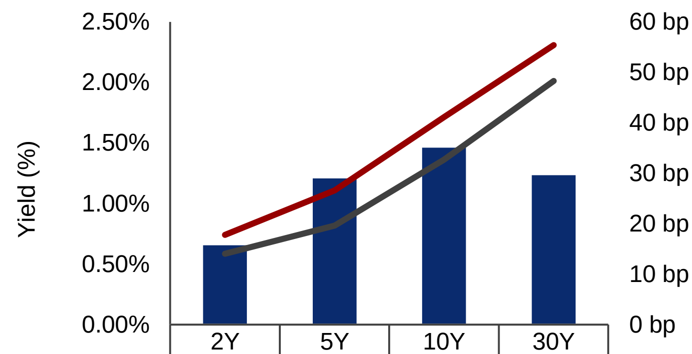
Overall then, we while we concede there are presently difficult-to-gauge risks to the export-driven growth thesis, multiple factors still cause us to have conviction that another cut is not in the cards. Much to the contrary, we

Source: Teranet, U.S. Federal Reserve (FRED), Statistics Canada, Bank of Canada.

help decrease market slack as labour demand grows with output growth. All-in-all then, while it may appear on the surface that employment is at little risk to pose upward pressure on inflation, we expect that traditional inflationary pressures will begin to emerge from tightening slack in the labour market.

We postulate, based on the factors above, that a likely scenario is thus a rate hike in 2017. Though post-U.S. election there was a broad, upward parallel shift in Canadian yields (Figure 21) we believe the market's re-pricing of Canadian rates still undershoots their hypothetical positioning incorporating one interest rate hike by year-end 2017, as futures are presently only pricing a 34% probability of that event. We thus expect to see a modest upwards shift of the CAD yield curve in 2017 on the shift in expectations to both more contractionary monetary policy and higher long-term growth, and on that basis look to maintain our 1.5 year short duration gap to our Canadian benchmark.

Figure 21: Change in CAD Yield Curve over 2016



	2Y	5Y	10Y	30Y
Δ	15.7 bp	29.0 bp	35.1 bp	29.6 bp
12/30/2016	0.74%	1.11%	1.71%	2.31%
11/9/2016	0.59%	0.82%	1.36%	2.01%

United States Credit

In both U.S. IG and HY markets, we have seen a steady and gradual decline in spreads in 2016 following the peak of the risk-off volatility mid-February amid mounting macro-driven investor fears and the collapse of crude. As seen in Figure 22, IG spreads compressed 230 bp (on an option-adjusted basis) in 2016 to stand 0.32 standard deviations below the 15-year average, at 130 bp. The HY index, standing to benefit more from the much-improved investor outlook on U.S. growth and strength of commodities markets owing to the asset class' greater

Figure 22: U.S. Investment Gr. Index Spread

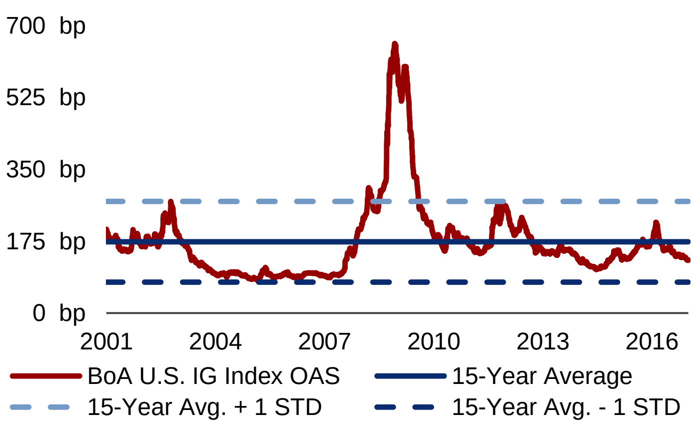
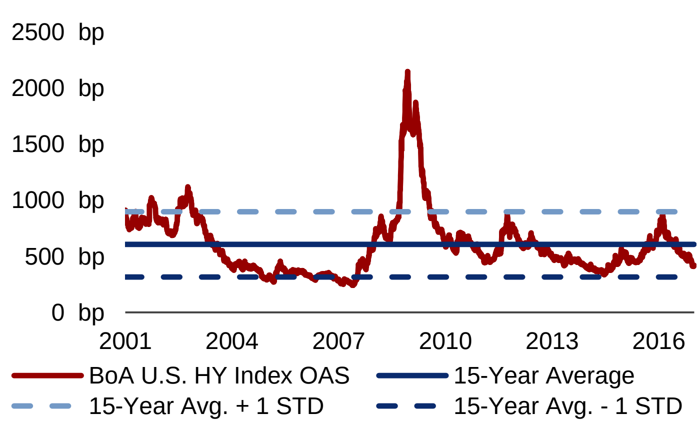


Figure 23: U.S. High Yield Index Spread



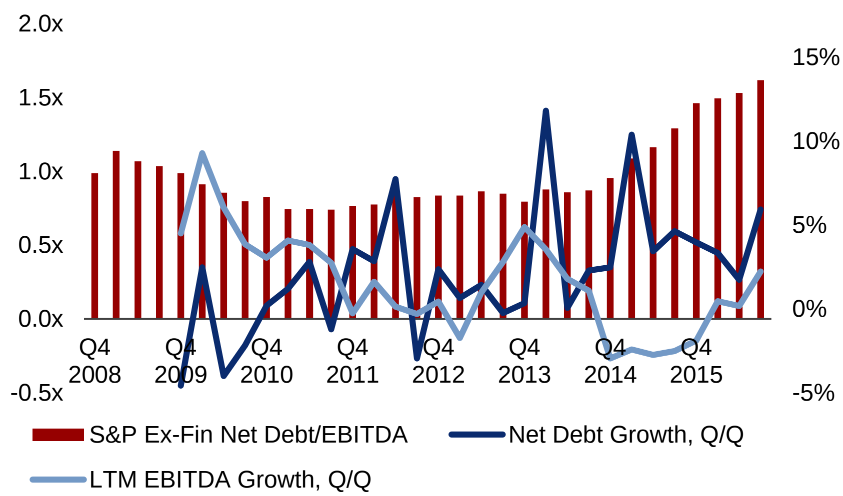
Source: Bloomberg as of 12/31/2016.

aforementioned macroeconomic sensitivity, compressed 273 bp to stand 0.64 deviations below the long-term average, at 422 bp (see Figure 23). Thus, present valuation levels would broadly suggest a time of robust U.S. credit fundamentals. Below, we argue that these optimistic valuations are not quite justified, largely based on where we stand in the U.S. corporate credit cycle.

U.S. Credit Cycle: Firmly in the Releveraging Stage

Looking back at 2016, we saw a clear continuation of the 'enhancing returns' phase of corporate releveraging that precedes an eventual shock and downturn. S&P 500 Ex-Financial Net Debt/EBITDA has steadily climbed to 1.62x as of 3Q16, the highest level since the tail-end of the dot-com credit-bust in 2003. More importantly however, disaggregating this growing leverage into its two attributions (see Figure 24), while over the past 2 years index EBITDA has contracted by -4.8%, net debt has grown 19.0% - ie. intentional relevering has dominated operational in causation. Even excluding the Energy sector and potential distortions from its prolonged cash-flow slump, the trend still fully holds. On a Debt/EBITDA basis, S&P 500 Ex-Financial and Ex-Energy leverage has steadily climbed to reach 2.52x, nearly surpassing the 2.59x peak observed in the depth of the last recession in 2009. We must thus examine each of these leverage attributions in turn to draw a conclusion on our outlook for U.S. corporate credit risk going forward.

Figure 24: S&P Ex-Financial Cash Flow & Debt Metrics



Operational Leverage Attribution: Profitability Headwinds from a Number of Angles

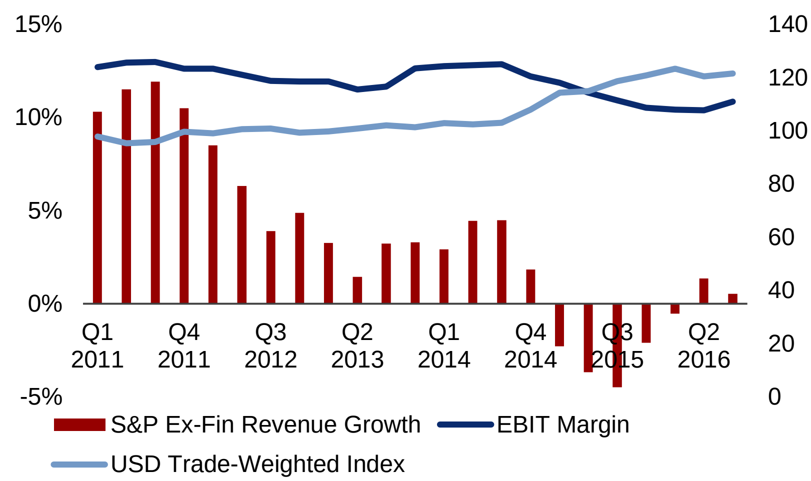
Starting with operational, one key factor behind the recent decline in profitability has been the challenge to revenue growth posed by the consistently strengthening USD, which both reduces translated and unhedged sales from overseas subsidiaries and makes U.S. exports less competitive than those of rival nations abroad. Given 44% of total revenues for S&P 500 firms comes from outside the U.S., said impacts are undoubtedly significant in firms' top-lines. Thus, the consistent 15.8% appreciation in the USD trade-weighted index over the past two years has certainly had a hand in producing the recent stagnation in S&P Ex-Financials revenue growth, which came in at a -0.2% contraction for 2016 (see Figure 25). Given our conviction in further USD strengthening due to a more hawkish stance on rate hikes than the market (elaborated in the U.S. Macro section above), this broad-based drag

Source: Bloomberg as of 12/31/16, U.S. Federal Reserve (FRED), S&P Dow Jones Indices.

will likely thus persist for the foreseeable future.

In addition to this, U.S. corporate margins have also been compressing; the S&P 500 Ex-Financial operating margin has contracted 182 bp over 7 consecutive quarters before staging a modest reversal in Q3 to 10.8% (see Figure 25). We however anticipate various factors will emerge or persist in coming quarters to exacerbate this trend. SG&A is set to receive upward pressure from mounting U.S. real wage growth despite sluggish productivity growth, owing to an overly-tight labour market (as discussed in the U.S. Macro section). Additionally, though the argument could be made that the negative revenue impact posed by an appreciating USD should be somewhat offset by lower costs via a fall in imported input prices, a closer analysis reveals a quite limited extent. Using economic accounts, academic research has estimated 11% of U.S. firms' intermediate inputs are imported, compared to the aforementioned 31% foreign-derived revenues. Thus, as U.S. firms' cost bases are far more 'domestic-centric' than their revenue bases, the net impact of a strengthening USD is inevitably a drag on margins. Lastly, we believe there are meaningful ramifications to corporate profitability from any 'obliged' reallocation of capital investment or input sourcing from abroad as a result of pressures from the Trump administration to 'protect American jobs' or potential protectionist measures. These anti-globalization measures oblige the misallocation of capital to less productive deployments and inhibit firms' ability to optimize efficiency as a result of having to shift to more costly or lower quality domestic inputs, destroying potential firm value in the process.

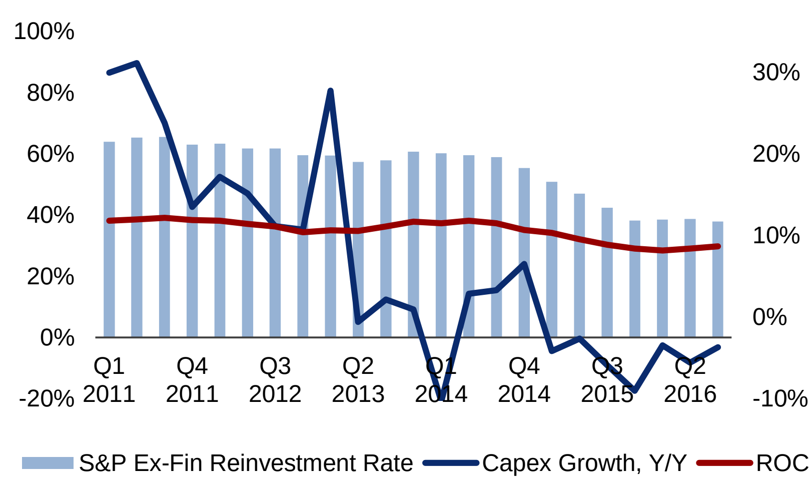
Figure 25: S&P Growth and Margins vs. USD Index



'Intentional' Relevering and the Bottom-Line for U.S. Credit

A key result of slowing growth and weakening profitability we expect to persist is declining ROC, which has steadily contracted over the past 2 years from 11.5% in 3Q14 to 8.7% as of 3Q16 (see Figure 26). This trend would logically lead to dampened return expectations

Figure 26: Comparing S&P ROC to Reinvestment

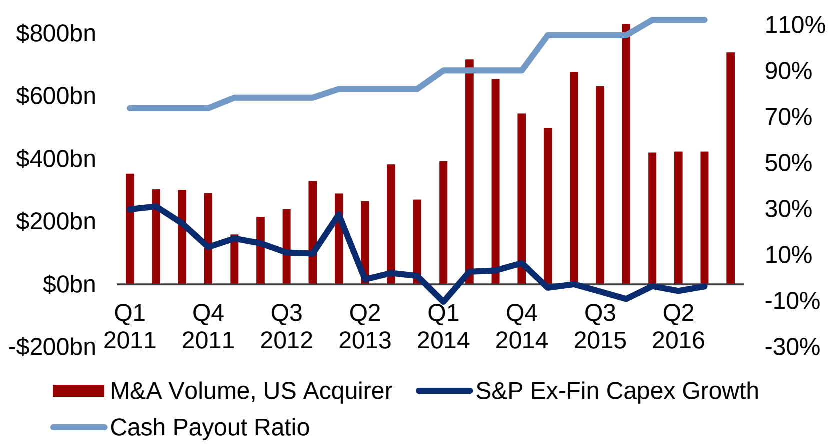


Source: Bloomberg as of 12/31/16, University of Calgary.

for organic capital investment opportunities, which, owing to their typically-lowest execution risk of all growth strategies, remain the optimal form of capital allocation for creditors. This postulation would explain the steady decline in S&P 500 Ex-Financial re-investment rates observed over the past 2 years, from 58.9% 3Q14 to 37.8% in 3Q16, and an average 4.2% Y/Y decline in capex growth for every quarter in 2016 (see Figure 26).

The key implication for creditors is firms, in desiring to maintain shareholder returns from the strong earnings growth witnessed in the years leading out of the recession (averaging 10.1%, versus an essentially flat -0.1% for 2016), are replacing investment to extend existing productive capacity with non-organic means of growth and shareholder payouts (see Figure 27). This inevitably means that the increased leverage on corporate balance sheets is being increasingly spent on far less credit-friendly uses, such as M&A (which typically poses greater execution risk than internal capital investment) and share repurchases.

Figure 27: U.S. Capital Allocation: Unfavourable Shifts



Capital Allocation: A Marked Shift to Credit-Averse Deployments

On the surface, U.S. M&A has been revealing a promising trend for credit-holders in 2016 following 2015's robust 14.0% clip of growth, with U.S.-domiciled acquirer M&A down 23.9%. However, that conclusion would provide a false sense of comfort in the direction of firm's capital allocation decisions, as it overlooks a key facet of 2016's deal-making environment – more intense regulatory scrutiny. 2016 marked the highest value of broken deals since the depths of the financial crisis 8 years ago, with the $767.2 Bn figure representing 22% of all transactions announced. A significant portion of these were thwarted as a result of notably more aggressive U.S. anti-trust action this year. While it is hard to predict with certainty what direction FTC heavy-handedness will take under Trump, given the nominees selected thus far for positions with sway over anti-trust matters, we see it highly likely that regulatory leniency vis-à-vis deal-making will increase. Thus, by enabling a greater proportion of transactions to successfully close, this form of corporate risk-taking is set to once again challenge credit fundamentals further in the U.S.

Examining shareholder payouts, though the present trend may appear somewhat positive on the surface, that conclusion would be misguided. S&P buybacks have modestly contracted throughout the year, down -2.6% overall in 2016. However, we believe that is merely indicative of the clear unsustainability of their present magnitude. As seen in Figure 27, the cash payout ratio (dividends and buybacks as a percentage of earnings) has steadily

Source: Bloomberg as of 12/31/16, New York Times, Factset.

climbed over the past 5 years to exceed 100%, now standing at 112.2% (versus a 15-year average of 84.3%). The only time in history this has prior been observed is in the 2007-2008 period – the start of the last recession, and thus the product of a sudden depression in earnings with payouts not being cut fast enough. There are two key takeaways overall. Firstly, current payout levels and the fact that 21.8% of S&P companies' repurchases presently exceed their FCF makes it near-inevitable that debt is being directly raised for shareholder 'returns'. Secondly, unless earnings now show dramatic growth (which we have argued is unlikely), we therefore see it inevitable that firms be obliged to scale back shareholder returns to sustain cash flow simply to operate. We thus treat any trend of declining buybacks we observe going forward, unless of significant magnitude, to not be indicative of efforts to improve credit quality, but the mere product of necessity.

Corporate Tax Reform: A Potential Driver of Improvement to Credit Fundamentals?

Interestingly, however, despite all the aforementioned means through which the Trump administration may challenge corporate credit quality, certain potentialities under the umbrella of its corporate tax reform may stand to benefit creditors. A loss of the deductibility of interest expense would have mixed effects. On the one hand, it would increase the effective cost of debt relative to the cost of equity, thus shifting optimal leverage downward from the perspective of minimizing a firm's cost of capital. This would logically limit the growth of new debt going forward (and thus capital allocated to credit-averse applications such as M&A and shareholder returns), and, all-else-equal, lead to less levered firms –improving U.S. corporate credit fundamentals on a comparative basis to other markets. However, in the near-term, whether or not the 'overall' corporate tax rate is lowered sufficiently to offset the tax shield lost will impact whether firms would be left with less after-tax cash flow to service current debts.

In addition, full immediate expensing of capital expenditure would help work against our aforementioned view that projected return expectations from internal reinvestment will continue to decline. This in turn would slow the negative trend of capital being increasingly reallocated to deployments such as M&A and buybacks to sustain shareholder returns that we expect will otherwise continue to weigh on U.S. credit fundamentals (though the magnitude of this reversal may prove negligible).

As a final point for tax reform, the proposed move to a territorial tax system in which overseas profits are not subject to U.S. tax would increase effective domestic liquidity of U.S. firms, though how it is used will dictate the ultimate impact on credit quality. If repatriated profits replace incremental leverage for common debt issuance purposes, though it may not have the effect of lowering 'official' financial statement net leverage (debt will not rise, but cash will fall), it would lower firms' 'effective' net leverage (as that cash without the possibility of repatriation is not available to service U.S. debt anyway, and incremental debt issuance would be reduced). However, this scenario of 'substitution' may prove idealistic. Academic research has found that, under last decade's Homeland Investment Act, for every $1 repatriated to the U.S., repurchases increased by $0.79. Given, as mentioned above,

Source: Bloomberg as of 12/31/16, J.P. Morgan Economic Research, Harvard University.

the popularity of this form of capital allocation has only grown since then, it appears much of repatriated profits may merely serve to bolster, rather than replace debt presently raised for the purpose. The end result is effective net leverage remaining unchanged post-tax reform, though 'financial statement' net leverage would increase.

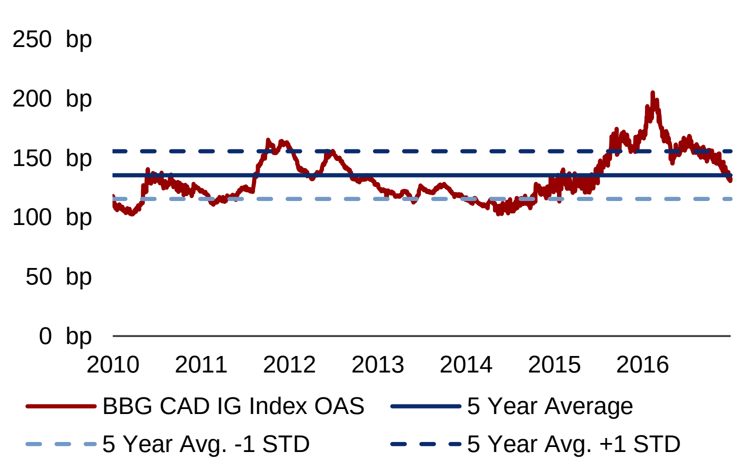
Conclusion

With the outlook above, we therefore conclude U.S. corporate credit fundamentals are entering the later innings of the 'intentional re-leveraging' stage of the credit cycle (preceding the downturn). This is particularly the case in the HY realm, where an additional factor – our more hawkish view than consensus on Fed policy, and thus yields rising higher than expected – spells an additional headwind to credit risk. This lift in yields, given the near-record leverage presently on corporate balance sheets (made manageable by a prolonged period of historically low borrowing costs), will logically cause a more rapid-than-expected deterioration of liquidity and coverage ratios amongst HY issuers in the face of higher funding costs. We thus believe credit risk continues to be unaligned with present U.S. valuation levels discussed, particularly in the HY space given low spreads by historical standards. This causes us to gladly stand by the fund's decision at the start of Q4 to eliminate our (market-wide) U.S. HY exposure at a spread 0.50 standard deviations below the 15-year average. As the new administration's actual policies become clearer and begin to materialize, our outlook on the direction of U.S. corporate credit, much like the market's, will be revised. However, given the present balance of upside and downside risks weighed above, we see it likely that our weary stance will continue to prove merited.

Canada Credit

The much subdued volatility in the Canadian corporate bond market in the latter half of the year has spelt appreciable tightening for credit spreads. As seen in Figure 28, the IG index has compressed 20.9% to 132 bp (on an option-adjusted basis), largely in-line, or 0.15 standard deviations below the post-crisis average at year-end. Meanwhile, the HY index, benefitting from much higher Energy composition (27.0% versus 8.9% for that of IG) with the year's crude rally, has compressed a significant 46.7% to 503 bp. It now stands 1.12 standard deviations below the 3-year average (see Figure 29; more historical data is unavailable for either Canadian credit market). Thus, similar to the American market, present Canadian IG valuations suggest investors view corporate credit fundamentals are healthy. In Canadian HY, that outlook is appreciably more

Figure 28: CAD Investment Gr. Index Spread



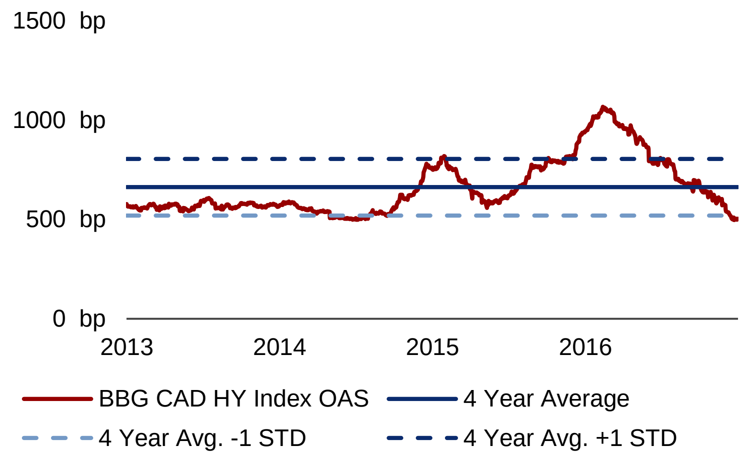
Source: Bloomberg as of 12/31/16, Commerzbank.

bullish. Despite these indications, we believe it is difficult to identify a precise location in the current Canadian credit cycle.

Canadian Credit Cycle: Challenging to Pinpoint

One factor, even more acute than in the U.S., is the recent break in credit risk between the Energy sector and the rest of the Canadian corporate landscape. With sector EBITDA having contracted 67.2% over the past 2 years, the collapse in debt capacity would obviously produce a large distortion to an aggregate analysis of the Canadian market owing to the sector's 21% and 10% composition in the TSX and Canadian corporate bond market respectively. To add further complication, the divergence in current fundamentals between the sector and the broader Canadian market fails to match the direction credit risk appears to be heading in those two realms respectively.

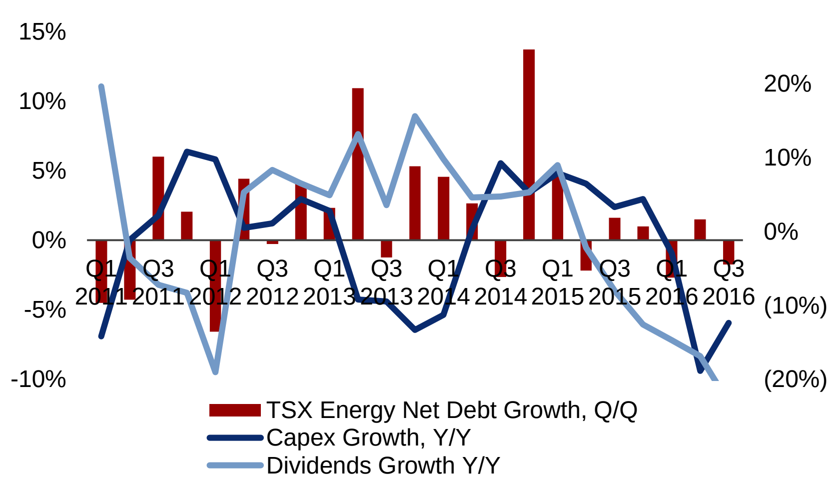
Figure 29: CAD High Yield Index Spread



Energy: A Case of Valuations Overshooting Developments?

In the Energy realm, we have already begun to see noteworthy improvements to credit quality that we believe may be able to be sustained going forward. The obvious, but most significant among these drivers has been the sustained recovery of oil prices over 2016. Particularly given the high fixed-cost nature of oil sands projects representing 46% of all Canadian oil production, a more favourable pricing environment was imperative for 3Q16's first positive sector EBITDA growth and operating margin in 8 quarters. However, Energy issuers are also taking a number of material actions to protect credit quality beyond that (see Figure 30). These include reductions to dividends and capital investment programs to preserve cash flow, with the result of 2016 dividends and capex having already contracted 17.2% and 20.7% Y/Y respectively for the sector. A host of oil and gas firms have also engaged in asset sales and equity issuance for the specific purpose reducing debt and building liquidity, helping debt and net debt fall by -3.7% and -2.0% respectively in 2016.

Figure 30: Energy Sector's Improving Capital Allocation

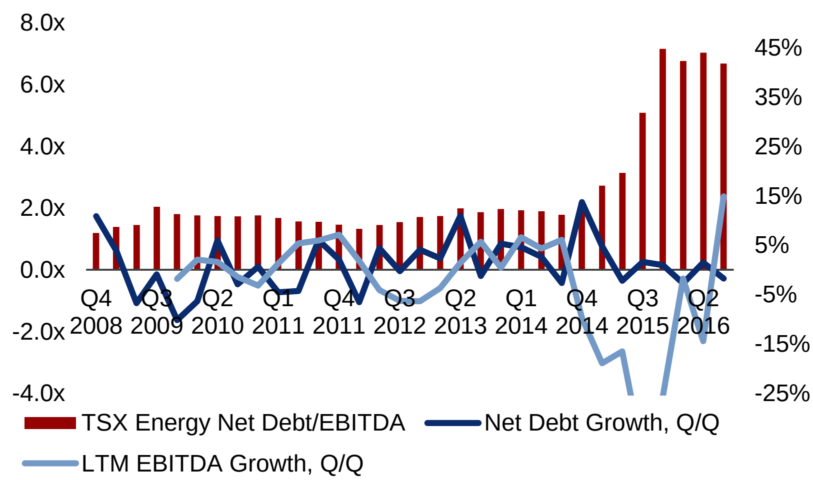


Source: Bloomberg as of 12/31/2016, Ontario Securities Commission, RBC Research.

We believe such credit improvement strategies are likely to continue in 2017. Particularly in the case of larger players, the pressure to preserve ratings and public refinancing ability without escalated borrowing costs will likely be a key consideration that continues to exercise prudence on near-term capital allocation decisions. This is substantiated by looking at the timing of maturities outstanding. We estimate analyst projections of Canadian Energy bond refinancings in 2017 alone to represent roughly 19% of total public debt outstanding for the sector, suggesting a currently high proportion of near-term maturities.

However, reservation points certainly remain for DCM in the space. Though credit fundamentals are headed in the right direction, on absolute terms, current leverage still remains an significant 2.0 standard deviations or 139% above the post-crisis average at 6.68x Net Debt/EBITDA (see Figure 31). It is thus clear that, despite the prudent capital allocation decisions discussed above, any appreciable and stable recovery of sector credit health will remain contingent on a sustained recovery in oil prices. As we are inclined to retain a conservative view on the near-term direction of oil prices, in light of continued spread compression seen in the space we must therefore be careful to scrutinize whether expected returns now indeed compensate for remaining risk on a single-name basis.

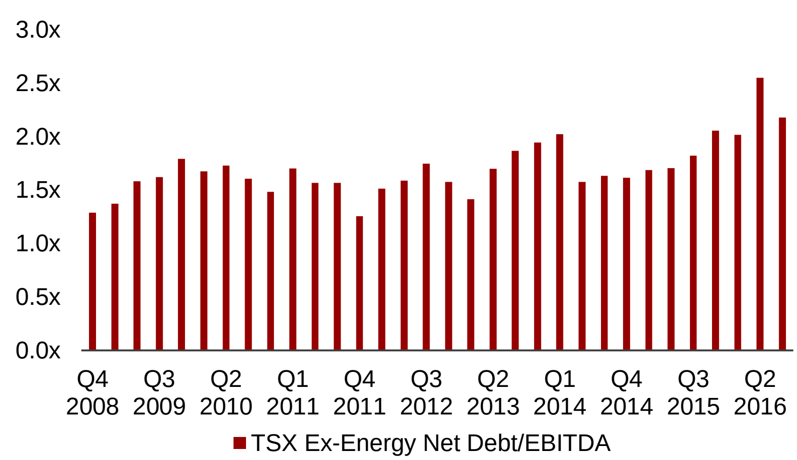
Figure 31: TSX Energy Operating and Credit Metrics



Ex-Energy: A Clearer Picture of the 'Engineering Returns' Phase of Cycle

In the ex-Energy realm, it is apparent we stand in releveraging phase of the Canadian credit cycle. TSX Ex-Energy Net Debt to EBITDA, at 2.18x as of 3Q16, is well above the 1.73x post-crisis average, with leverage having increased 0.36x in the past year alone (see Figure 32). However, the upward climb admittedly has not been as consistent as that observed in the U.S. Disaggregating this growing leverage into its two attributions, we again see both operational and 'intentional'

Figure 32: CAD Ex-Energy Leverage: Creeping Upward

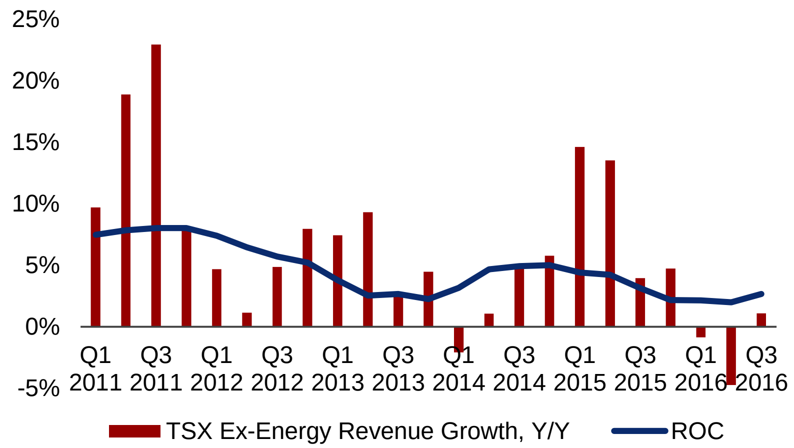


Source: US Bureau of Labor Statistics, Bloomberg.

relevering have been at play – while EBITDA has contracted by 4.9%, Net Debt grown by 8.9% over the past 2 years. Upon examination, in Canada in particular it appears the first factor is an underlying driver of the second.

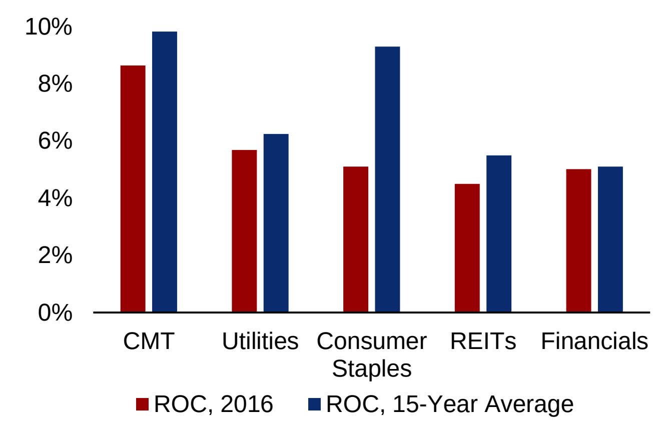
While there is certainly variation by industry, it is undoubtable that Canadian firms' operational performance is being weighed down by a consistently more tepid macroeconomic recovery than the U.S., despite the absence of headwinds such as significant currency appreciation. TSX Ex-Energy revenue growth has in fact been entirely absent in past 12 month period, at 0.0%, with positive quarterly growth for 2016 only recorded in Q3 (see Figure 33).

Figure 33: CAD Ex-Energy Operating Performance



By constraining the potential for organic growth at the firm-level, we believe these macroeconomic conditions are giving rise to suboptimal capital allocation decisions from the perspective of creditors. In a trend similar to that observed in the U.S., it continues to limit return expectations from internal re-investment opportunities; these are only affirmed by actual recent performance. As seen in Figure 34, 2016 Return on Capital on a number of industries entirely excluding the Energy sector (that largely make up the remaining Canadian public debt market) have come in well below their respective 15-year averages, averaging a 140 bp delta respectively.

Figure 34: Historical ROC Comparisons Across CAD Bond Market Sectors



Thus, in the desire to uphold shareholder returns, Canadian firms are also being pushed to replace this lowest-execution risk form of growth strategy. TSX Ex-Energy capex growth has averaged a -3.1% contraction in 2016, with the end result of capex-to-sales trending down to 8.4% versus post-crisis of 10.0% (see Figure 35). On the other hand, we have seen a surge in M&A, with volume including a Canadian acquirer growing at annualized pace of 29.7% over the past 2 years and exceeding 2007's pre-crisis high by $14.6 Bn this year. This trend of increasing capital allocation to higher risk means of growth and away from internal reinvestment also appears to be broad-based across many industries comprising the Canadian public debt market. Given that, over the past 2-year period, leverage has concurrently

Source: Bloomberg as of 12/31/16.

increased on a broad industry basis as well (and now stands well above long-term averages – see Figure 36), it is only logical to conclude that not only are Canadian firms taking on more debt, but they are increasingly allocating debt raised to more credit-averse forms of corporate spending.

From the U.S.: Mitigants to the Pace of M&A and Elevation of Operating Risk

However, we anticipate a few recent and potential factors imposing restraint on this activity going forward via cross-border deal-flow with the U.S., which alone drove 53.3% of total Canadian M&A growth over the past 2 years and now comprises 48.1% of total deal volume. While too early to tell if the new U.S. administration will actually translate the magnitude of their current proposed corporate tax rate cut into law, if it is achieved, it would inevitably weaken, if not eliminate, Canada's historical rate advantage. In doing so, the longstanding rationale of tax-inversion underlying tie-ups between Canadian and U.S. firms would cease to hold – likely reducing overall deal flow with Canada to some extent. In addition, though we see it as a tail risk rather than likelihood that a truly material disruption to the two nations' NAFTA relations occurs, it would obviously pose meaningful roadblock to future cross-border deal-making. The introduction of the mere possibility, by elevating execution risk, may be already beginning to dampen momentum on major transactions still under consideration.

Figure 35: Similarly Concerning Capital Allocation Trends in the Canadian Market

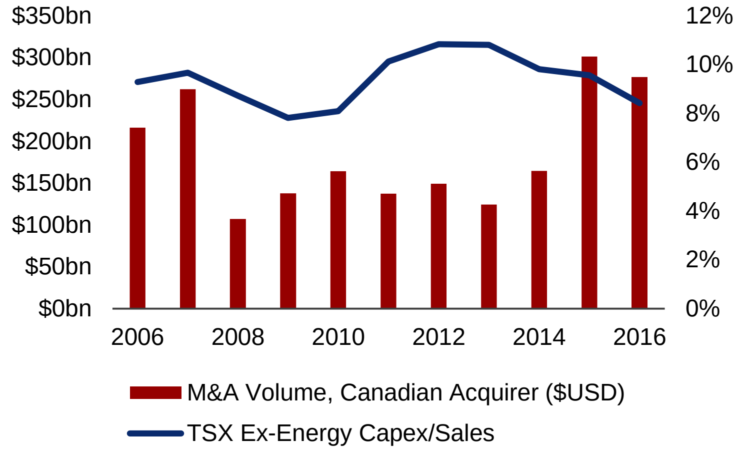
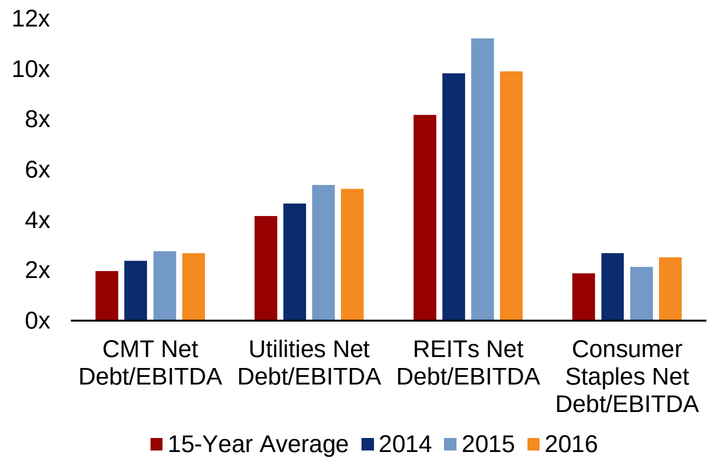


Figure 36: Leverage Trends Across Main CAD Bond Market Sectors



Conclusion

Overall then, our expressed caution on Canadian corporate credit fundamentals across sectors appears at odds with IG spreads levels slightly below long-term levels, and HY spreads having compressed appreciably below them. There are still key caveats however. Though Canadian corporates, like the U.S., broadly fit in the corporate risk-taking stage of the credit cycle, the length of the 'runways' that we believe the two nations possess respectively

Source: Bloomberg as of 12/31/16, Osler Law Firm, Reuters.

to continue on that stage are however different. This is owing to the fact that, as discussed in our Macro section, we maintain that Canada's economic recovery, which has remained much more "L" than "V" shaped in nature, can most likely expect further gradual progress as Canada continues to diversify away from its resource economy, particularly to export-oriented goods and services industries. The prospect of longer-term commodity price stabilization brought about in 2016 further mitigates risk to this thesis of improving macroeconomic health.

However, at general valuation levels such as these, it will still prove more challenging to find instances of excessive return being awarded for true credit risk profiles. As such, DCM's methodical bottom-up approach to analysis is more critical than ever to uncover compelling risk/return mispricing. Furthermore, given recent increases in prominence of 'tail risks' to the Canadian economic outlook as discussed in the Macro section, to act prudently we must direct this analysis toward carefully assessing the robustness of the investment theses we develop to a wider range of economic outcomes. Our most recent pitch and addition to the fund, Dollarama 2021, is a good example of this. This is due not only to its flexibility of shifting between a more cyclical or defensive revenue base, but far greater geographic diversification of its inputs versus peers afforded by a supply chain model that brings assembly/packaging of goods in-house (that, by requiring considerable scale to be economical and investment to develop, is fairly non-imitable). This would help to minimize operating risk from potential trade disruption or FX volatility that have recently come to light with international political developments.

Source: Dollarama Company Filings.

Desautels Fixed Income Fund

Holdings Review

By Charles Yu Feng, Ariane Laurin, and Jun Ng

Cogeco Cable 4.925% 2022

Company Overview

- Quebec-headquartered cableco with 3 main business lines:
  - i) Cogeco Cable (Ontario & Quebec)
  - ii) Atlantic Broadband (US)
  - iii) Enterprise Data Services (North America & UK)
- Cable and Atlantic Broadband segments: Hybrid fiber-coaxial network, offering digital TV, HSI and telephone to business and residential clients
- Enterprise Data Services segment: Cloud, managed hosting, colocation and IT through datacenter network
- Network focused on underserved regions
- The company follows a growth strategy of coverage expansion and tuck-in acquisitions

Catalysts

- Current CRTC proceedings resulting in legislation that more stringently regulates programming price structures
- Following its declaration that internet access is now a basic service, the CRTC puts measures in place to encourage cableco focusing on rural areas to expand service coverage. Creation of a special fund will provide additional financial resources for Cogeco to invest in rural area infrastructure

Risks

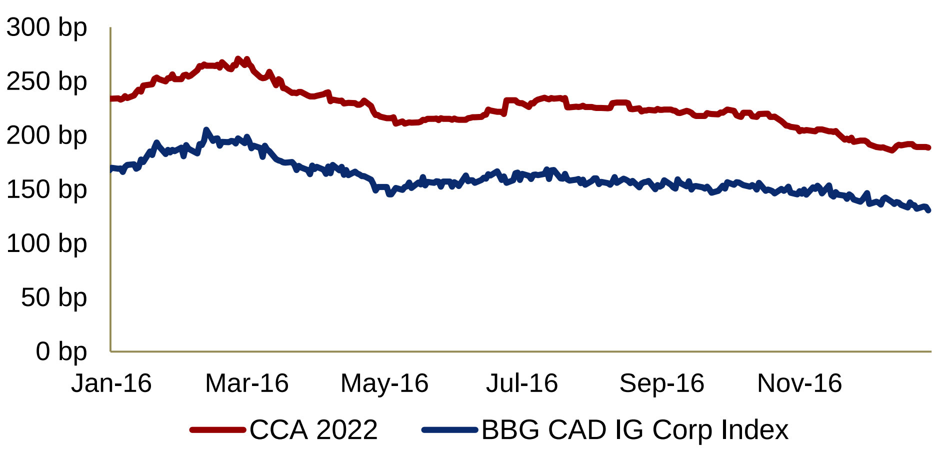
- Accelerated increases in programming costs, particularly in U.S. where the content market is far less regulated, could lead to decreasing margins
- Faster-than-anticipated secular decline in pay TV as households switch to over-the-top content

Financial Summary

Bond Overview	
(as of Dec. 31, 2016)	
Price	108.575 / 109.152
Coupon	4.925%
YTM	2.973%
YTW	2.973%
OAS	172.93 bps
Modified Duration	4.460
Amount Outstanding	200 mm
Seniority	Senior Unsecured
Rating (S&P) / Outlook	BBB- / Stable

Financials	LTM	2016E	2017E
(values in C$mm)			
Revenue	2,184.9	2,215.5	2,244.0
% Growth	*6.9%*	*1.4%*	*1.3%*
Gross Profit	1,007.6	1,021.3	1,034.5
Margin	*46.1%*	*46.1%*	*46.1%*
EBITDA	989.0	980.6	1,003.9
% Growth	*5.9%*	*-0.9%*	*2.4%*
Net Debt / EBITDA	2.91x	3.34x	3.03x

Bond OAS and Rating Category Performance



Position Snapshot

Average Cost	*$109.41*
# of Units	*220*
Value Invested	*$23,974*
Portfolio Weight	*5.2%*
2016 Position HPR	*2.6%*
*2016 Corp Index HPR**	*-1.5%*
Excess Return	*4.1%*

*Sources: Bloomberg, Capital IQ, Company fillings. *Corp Index: 100% FTSE TMX Canada All Corporate Bond Index.*

Cogeco Cable 4.925% 2022

Investment Thesis

1. **Pessimistic investor sentiment towards Canadian cableco outlook overlooks Cogeco's competitive advantage through its geographic positioning:** Cogeco's focus on small towns and rural areas results in limited Fiber to the Home overlap (45%) versus peers, which we postulated to be sustainable due to a CRTC ruling on 'last-mile' colocation that would make rural FTTH deployment economics unattractive for telecos.
   - Cogeco has delivered positive results from lower than expected TV losses and positive impact of bundle offers, in part owing to competition from FTTH overlap continuing to be below peers – EBITDA margin increased 80 bps over the same previous LTM and net Internet customer additions are up 24.92%
   - There are limited change in FTTH overlap in Cogeco's small-town networks, only slightly up from 43% in 4Q15 to currently 45%.
2. **Enterprise unit restructuring period should pave the way for recurring cash flow generation:** Fierce competition with major players such as Google and Amazon Web Services pressured Cogeco to write-off $ 434 mm of its Business ICT assets. In response, it is shifting its focus on niche sectors, such as colocation services.
   - 2016 Business ICT sales were down 4% and EBITDA margin was down 229 bps to 32.6%. The current restructuring phase – consolidation of the two operating segments and completion of two new mega data centers – will allow CCA to achieve more stable CF through economies of scale and differentiation.
3. **The nearing completion of the TiVo digital TV rollout in both the Canadian and U.S. segments and its capex dynamics will generate stronger segment FCF generation:** Similar to Cogeco's Canadian coverage, Atlantic Broadband focuses on rural markets mainly served by telecos, resulting in a limited 25% IPTV overlap in US segment and 43% in Canada.
   - The constant U.S. IPTV overlap and the launch of TiVo have lead to a reduction in the number of video services customers losses – from 35,689 in FY15 to 31,706 in FY16 – and an increase in bundle sales. Bundle subscribers are most attractive to bondholders, possessing highest ARPU and retention rates

As of December 31, 2016			Operating Metrics				Financial Metrics		Bond Valuation	
		Enterprise Value ($ Bn)	EBITDA / Sales	Avg. Network Speed	Sales Growth	Capex / Sales	Net Debt / EBITDA	EBIT / Int. Exp.	S&P Rating	OAS
Shaw Communications (SJR 5.5% 2020)	$	18.73	41.6%	3.00 Mbps	8.9%	22.3%	2.6x	3.8x	BBB-	141.56
Manitoba Telecom (MBT 4.0% 2024)	$	3.64	32.4%	2.24 Mbps	1.0%	14.8%	2.5x	4.1x	BBB	144.65
Rogers Communications (RCI 4.0% 2022)	$	43.59	36.4%	1.67 Mbps	1.7%	18.3%	3.4x	3.6x	BBB+	112.12
Bell (BCE 3% 2022)	$	74.94	37.9%	2.00 Mbps	0.5%	17.3%	2.5x	5.8x	BBB+	116.23
Telus (T 2.35% 2022)	$	1.36	329.9%	2.54 Mbps	-0.6%	3.5%	2.5x	6.7x	BBB+	118.87
Cableco Mean	**$**	**28.45**	**95.6%**	**2.29 Mbps**	**2.3%**	**15.2%**	**2.7x**	**4.8x**		**126.69**
Cogeco Cable (CCA 4.925% 2022)	**$**	**6.10**	**45.2%**	**2.78 Mbps**	**6.5%**	**20.4%**	**2.9x**	**3.7x**	**BBB+**	**118.87**

Analysis of Performance

We initiated our position in Cogeco 2022 on November 17th, 2015 at a spread of 204 bps. Over our holding period, the spread compressed 85 bps and was generally in line with the Canadian investment grade corporate bonds index. CCA 2022 is now 55 bps over the index compared to higher differences of over 75 bps we observed following 3Q16 earnings. We believe the spread compression relative to the index is a result of the turnaround initiated in the Business ICT segment as management chose to shift its focus away from services offered by Internet giants like AWS and Google. As a spread expansion occurred after the $ 434 mm write-off, its compression relative to the index was evenly spread over the second half of the year.

Cogeco 2022's spread has compressed to trade closer to comparable firms' bonds. At pitch date, the bond's spread was higher than peer average by 22 bps; it now stands at 8 bps below. We believe this is partly attributable to CCA achieving higher EBITDA margin and sales growth and reducing leverage relative to its peers versus the same period last year. It is now trading nearly in-line with BCE 2022, RCI 2022 and T 2022 – three BBB+ bonds.

Sources: Bloomberg, Capital IQ, Company fillings, RBC report

DirectCash Payments 8.125% 2019

Company Overview

- DirectCash Payments (DCI) is a $330 mm market cap consumer finance company operating a network of ~21,500 ATMs, selling ATM terminals and offering longer-term transaction processing contracts
- It is the ATM market share leader in Canada and Australasia, and third largest in the UK
- Non-ATM Services include providing access to payment networks, selling and processing prepaid debit and credit cards, and selling of debit terminals

Catalysts

- DCI continues to expand in Autralasia market by making small asset purchase as demonstrated from the acquisition of the Australian assets of GRG and First Data, thus gaining market share and achieving economy of scale
- DCI has recently been authorized to expand its prepaid business into Australia, which will increase transaction volume in non-ATM services segment and allow it to diversify its source of revenue

Risks

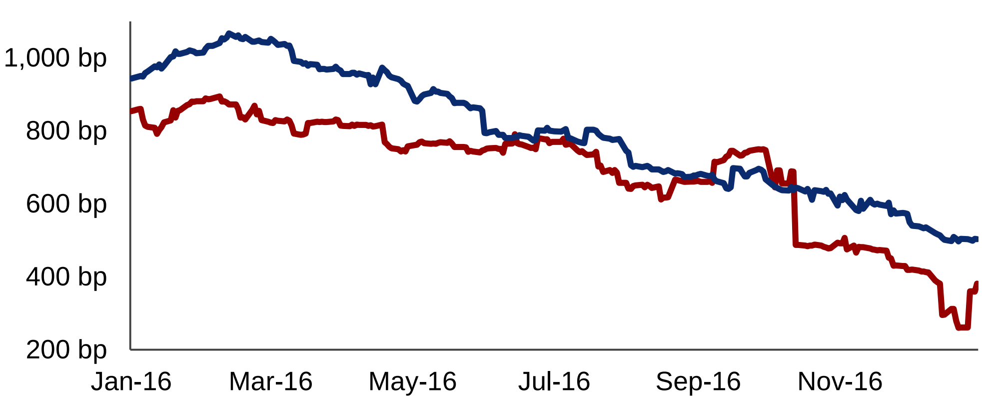
- As DCI's revenues and profitability are largely dependent on transaction volumes at ATMs and Debit Terminals, prepaid cards and CUFI business, a declining use of cash (2% in Canadian market) and entrance of new payment technologies may continue to render ATMs obsolete, thus reducing ATMs transaction volumes

Financial Summary

Bond Overview	
(as of Dec. 31, 2016)	
Price	104.125 / 104.500
Coupon	8.125%
YTM	6.210%
YTW	**N/A
OAS	380.93 bps
Modified Duration	2.242
Amount Outstanding	125 mm
Seniority	Senior unsecured
Rating (S&P) / Outlook	B+ / Stable

Financials	LTM	2016E	2017E
(values in C$mm)			
Revenue	283.2	288.6	321.1
% Growth	*1.2%*	*1.7%*	*11.3%*
Gross Profit	132.9	134.7	148.6
Margin	*46.9%*	*46.8%*	*46.3%*
EBITDA	63.1	65.5	73.3
% Growth	*- 2.5%*	*3.8%*	*11.9%*
Net Debt / EBITDA	4.14x	**N/A	**N/A

Bond OAS-Spread and Rating Category Performance



Position Snapshot

Average Cost	*$102.75*
# of Units	*190*
Value Invested	*$19,819*
Portfolio Weight	*4.3%*
2016 Position HPR	*10.8%*
*2016 Corp Index HPR**	*-1.5%*
Excess Return	*12.2%*

*Sources: Bloomberg, Capital IQ, Company fillings. *Corp Index: 100% FTSE TMX Canada All Corporate Bond Index.*
***Forecasted leverage not available due to acquisition of DCI by CATM completed on January 6th, 2017*

Investment Thesis

1. **Margin improvements via increased focus on non-ATM services, ATM added services:** DCI has pursued margin strategies in all its business segments in light of margin pressures placed by structural decline in its ATM markets
   - Despite a continuous increase in consumer direct charges as well as the enabling of Dynamic Currency Conversion, the American segment's gross margin decreased 83 bps to 48.1% in 2016.
   - In Australasia, gross margin decreased 170 bps to 46.5% because the introduction of tap-and-pay payments lead to a decline in transaction volume.
   - Gross margin for non-ATM services was stable at 61.2% relative to 61.1% last year. Despite the sale of the CashStore business, DCI maintained its margins through expansion of the "Credit Unions and Financial Institutions" (CUFI) transaction processing business.
2. **Revenue stability via ATM contract wins and expansion of Credit Union and Financial institutions (CUFI) business**
   - In the Australasian market, the recent acquisition of 3,500 ATMs from First Data led to a 1.2% increase in revenue and creates potential for further economies of scale. In America, DCI continued its recently initiated expansion in the Mexican market in an effort to offset declining transaction volumes.
   - In Europe, there was a 3.8% reduction in the number of active ATMs due to the removal of lower transacting ones by some of the company's larger merchants. Revenue increased 16.5% as a result of an increase in interchange rate per transactions from £0.274 to £0.289 (introduced by the UK national payments governing organization).
   - As revenue from the "Other Services" segment remained stable, it is safe to assume the CUFI business is growing and therefore compensating the lost sales from the CashStore spin-off in early 2016.
3. **2017 Senior Secured debt rollover possible:** This assumption is rationalized by DCI's operations, which have consistently demonstrated a strong cash flow generation profile and thus stable credit support and debt capacity
   - To fund First Data's assets purchase, DCI sought permission for a temporary elevation of its leverage covenant on its senior debt facility. As a result, total debt increased by 39.1% over the year. Initially concerned that this increase in leverage could affect the 2017 senior secured debt rollover, our concerns were mitigated after Cardtronics announced it would acquire DCI on September 30th. The acquirer is much larger in size and of significantly better credit quality. As explained in the following pages, CATM issued a mandatory call upon transaction closing, resulting in a 8.78% realized yield for DCM.

Analysis of Performance

For the first half year 2016, ATM segment revenue increased by 4.2% Y/Y mainly due to 9.2% Y/Y increase in America segment due to the impact of consumer direct charge increases and enabling of DCC across its terminals. Coupling with the increase in gross profit margin per ATM of 6.8% Y/Y, we see it logical for DCI to increase consumer direct charge and to enable DCC technology across all of its terminal in other markets, helping sustain strong performance in profitability. In Q3, overall revenue fell 3.4% Y/Y mainly due to a decrease of 12% in Australia ATM segment revenue, which is caused by lower ATM transaction volume, as a result of continuous decline in cash usage. The decrease is partially offset by an increase in America and Europe segment by 3.3% and 5.4% respectively due to increase in consumer direct charge and enable of DCC technology in America and increase of interchange rate fees in Europe.

In Q4, DCI 2019's spread compressed ~56 bps following the October 3rd announcement of a merger with Cardtronics, Inc, estimated to close in 1Q17. Upon announcement of the merger, we conducted an analysis to determine all possible outcomes for DCI 2019. Though DCI 2019's indenture specifies Change of Control provision in which the acquirer must place a voluntary tender at a face value of $101 plus accrued interest, because it is voluntary, bondholders would have no obligation to sell DCI 2019 back to CATM at that price. Thus, this was not the only possible merger outcome. We ultimately identified 3 possible options for how CATM could treat DCI 2019 post-acquisition, outlined in the following pages. We developed a valuation of each option from the perspective of net costs to be incurred to CATM which, when assessed together with qualitative factors, were used to determine which conclusion CATM would most likely pursue. This would direct our course of action as DCI 2019 bondholders

DCI 2019 Call Schedule	
First Call Date	**Face Value**
8/8/2016	104.06
8/8/2017	102.03
8/8/2018	100.00

Option 1: Upon transaction closing, CATM only follows through with DCI 2019's CoC Covenant and offers (voluntary) tender at 101 face value + accrued interest

We must first assess the merger's impact on DCI 2019's credit profile to estimate the post-transaction trading price of DCI 2019 assuming the bond is rolled over (a possibility given the CoC tender is voluntary).

FX Rate: CAD:USD	0.76												
		Operating				Credit				Bond			
	EV (Pre-Ann.)	LTM Sales Growth	2016E Sales Growth	EBITDA Margin	FCF Margin	Net Debt/ EBITDA	EBIT/ Int. Exp.	FCF Yield	Credit Rating	Maturity	Rank	Pre-Ann. YTM	Post-Ann. YTM
DCI	325	3.5%	4.2%	22.1%	10.8%	3.23x	0.44x	15.1%	B-	2019	Sr. Unsec.	7.70%	
CART	2,489	9.4%	5.5%	23.4%	22.0%	1.62x	5.34x	41.3%	B+	2022	Sr. Unsec.	4.59%	4.65%
P-F Merged		**8.5%**	**5.3%**	**23.2%**	**20.8%**	**1.85x**	**3.70x**	**34.8%**					

As seen in the table above, the bond's new guarantor is larger, more profitable, and less levered than DCI. The world's largest ATM owner, CATM controls 30.1% of U.S. market share, leads in the highly profitable and growing bank-branding segment, and has diversified its revenue base to geographies with superior growth potential. This has enabled CATM to achieve modest organic growth despite the secular decline in the broader ATM industry. Thus, it is clear DCI 2019's credit profile would materially improve post-acquisition, meriting spread compression.

DirectCash Payments 8.125% 2019

To quantify the financial impact, we conducted a valuation of hypothetical rolled over DCI 2019. We used the current credit spread of CATM's senior unsecured 2022 bond (which, given its further maturity, incorporates conditional default probabilities of years beyond 2019, making it a conservative spread to use), and maturity-matched Canadian risk-free rate. This yielded a price of $110.21, leading us to conclude that no bondholder will voluntarily opt for Option 1' CoC tender, instead choosing to 'hold out' to benefit from price appreciation as spread compresses. We further concluded CATM would be unlikely to leave the debt outstanding, as it would be unwilling to pay a 8.125% coupon in excess of current cost of capital (as it transfers value to bondholders at expense of shareholders).

Credit Spread:	**CATM 2022 OAS**		322
Risk Free Rate:	**CAD 3Y Rate**	+	61
	YTM	=	3.83%

2019 Maturity	**1/31/2017**	**2/8/2017**	**8/8/2017**	**2/7/2018**	**8/8/2018**	**2/8/2019**	**8/8/2019**
FV							100.00
CP		4.06	4.06	4.06	4.06	4.06	4.06
Net CF		4.06	4.06	4.06	4.06	4.06	104.06
NPV	-	4.06	3.98	3.91	3.83	3.76	94.59

Dirty Price	114.12
Clean Price	110.21

Option 2: upon transaction closing, CATM executes mandatory call @ current call schedule price: 104.06 FV (+ accrued interest)

Thus, as a first alternative to Option 1 (which was proven unlikely), CATM can execute a mandatory call post-transaction to extinguish DCI 2019. Our valuation of the net cost to CATM of this option (on a per bond basis) is shown below. As this valuation takes the 'present date' to be as-of-transaction-close (ie. in Q1 2017, when CATM would actually be making this decision and thus valuing these options), no discounting is required for these cash flows, as they would be immediately incurred. Thus, the cost of Option 2 to CATM is -$107.96.

Face Value	$ 100.00
Coupon Rate	8.125%
Most Recent Cpn Date	8/8/2016
Assumed Current Date	1/31/2017

Option 2:	**1/31/2017**
FV	104.06
CP	3.90
Net CF	107.96
NPV	107.96

NPV of Option 2 costs to CATM	107.96

Option 3: CATM waits till call schedule price steps down on 8/8/2017, then executes mandatory call @ step-down price: 102.03 FV (+ accrued interest)

As a final alternative to Option 1, CATM could also choose to wait until DCI 2019's call schedule price steps down on 8/8/2017 from $104.06 to $102.03, and extinguish the bond at this new face value plus accrued interest at that time. This valuation differs from Option 2, as cash flows would be incurred at future points beyond the 'present date' (transaction close), thus requiring discounting. For the discount rate, the relevant credit spread remains the same as Option 1, but the relevant risk-free rate to use becomes the Canadian sovereign of equal maturity (6 months) to the cash flows of this option. This can be seen in the assumptions and table below.

Overall, the cost to CATM of Option 3 we calculated to be -$108.11. This higher cost versus Option 2 is the result of a longer period of interest accrued at a high 8.125% coupon rate, which more than offsets savings from the lower face value that must be paid and discounting effects under Option 3.

Credit Spread:	**CATM 2022 OAS**		322
Risk Free Rate:	**CAD 6M Rate**	+	53
	YTM	=	3.75%

Option 3:	**1/31/2017**	**2/8/2017**	**8/8/2017**
FV			102.03
CP		4.06	4.06
Net CF	-	4.06	106.09
NPV	-	4.06	104.05

NPV of Options 3 costs to CATM	108.11

Conclusion

As Option 2 presented the lowest cost to CATM for treating DCI 2019 post-transaction, we concluded in October that the most likely outcome would be a mandatory call at a face value of $104.06 upon transaction closing in Q1.

This conclusion however assumes that the transaction would go through. We thus conducted an analysis of risks to assess the likelihood of the acquisition closing. The main risk we identified is the acquisition failing to get regulatory approval, given anti-trust concerns could be created by the consolidation of market share in countries where both CATM and DCI operate. The extent of this consolidation is shown below:

Pre-DCI Merger		
Countries	CATM ATMs	Market Share
Canada	1,781	2.7%
U.K.	14,991	21.7%

Post-DCI Merger		
Countries	CATM ATMs	Market Share
Canada	11,001	16.9%
U.K.	20,705	30.0%

The only relevant precedent transaction to evaluate from the perspective of anti-trust treatment was CATM's 2013 acquisition of Cardpoint in U.K. (7,100 ATMs), which resulted in CATM's U.K. market share climbing from 7.3% to 19.2%. As the transaction was announced in August 7th and closed by year-end without any regulatory review, it suggested anti-trust blockage would be unlikely. Furthermore, we could infer the market was pricing in virtually 100% odds of transaction closing, has DCI's equity had been trading within a +/- 0.4% band of its purchase price since the acquisition was announced. Based on these factors, we thus concluded that, even erring on the side of conservatism, it was fair to postulate the transaction would be highly likely to close.

In response, we chose to issue a hold for DCI 2019, in anticipation of the bond's $104.06 call in Q1. Upon transaction closing January 6th, CATM did indeed issue a mandatory call for $104.06, confirming our initial hypothesis, and thus DCI 2019 exited our portfolio for a realized yield to the fund of 8.78%.

Dollarama Inc. 2.337% 2021

Company Overview

- Largest player in the value retail industry in Canada. The company was founded in 1992
    - 1,030 stores out of 1,500 for value-retail, targets 1,400 within the next 3 years
- Sells various types of merchandise at fixed price points between $0.77 and $3.00
- Revenue mix is divided as such: 47% General merchandise; 38% Consumables; 15% Others. Contrary to American dollar store chains, Dollarama does not sell perishable food items
- Direct-store ownership business model, with historical growth strategy focusing both on store count addition and same-store sales (SSS) expansion

Catalysts

- Slower growth in Canadian value retail industry would slow down Dollarama's new store openings growth, thus having lower capex requirements and improved credit metrics

Risks

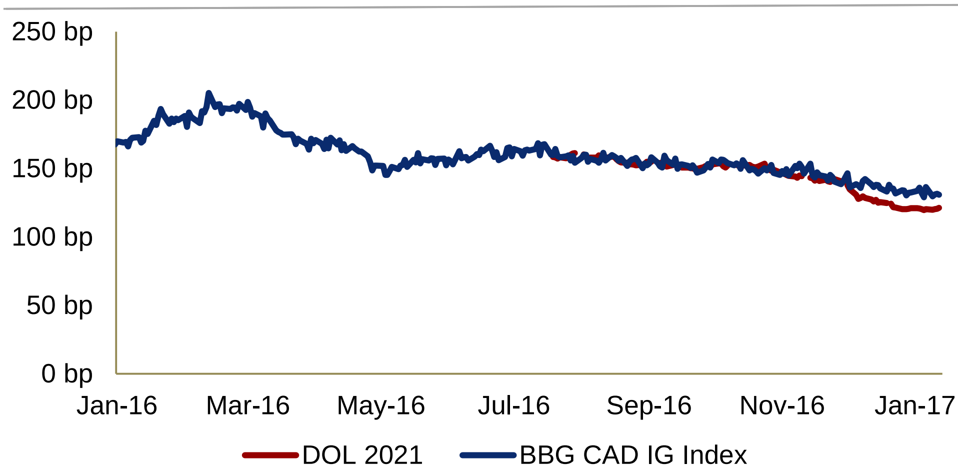
- Competitors start selling dollar-store items online in bulk. Selling those in bulk is the only way to justify the economics of online sales which would draw valuable large volume sales away from DOL
- An unexpected increase in the minimum wage imposing higher SG&A cost, thus raising the operating leverage factor and inhibiting margin expansion
- US price war on groceries between Wal-Mart and dollar stores intensifies and increases negative sentiment towards Canadian value retail

Financial Summary

Bond Overview	
(as of Dec. 31, 2016)	
Price	99.930 / 100.264
Coupon	2.337%
YTM	2.275%
YTW	1.745%
OAS	120.91 bps
Modified Duration	4.282
Amount Outstanding	525 mm
Seniority	Senior unsecured
Rating (S&P) / Outlook	BBB / Stable

Financials	LTM	FY 2017E	FY 2018E
(values in C$mm)			
Revenue	2,875.2	2,947.1	3,268.4
% Growth	*12.6%*	*11.2%*	*10.9%*
Gross Profit	1,121.3	1,140.5	1,248.5
Margin	*39.0%*	*38.7%*	*38.2%*
EBITDA	659.2	682.3	748.5
% Growth	*11.8%*	*3.5%*	*9.7%*
Net Debt / EBITDA	1.82x	1.82x	1.76x

Bond OAS and Rating Category Performance



Position Snapshot

Note: position was entered after Year-End 2016 (1/5/2017). Select statistics as of entry-date shown below:

As of 1/5/2017	
Average Cost	*$100.50*
# of Units	*230*
Value Invested	*$23,368*
Portfolio Weight	*5.0%*

*Sources: Bloomberg, Capital IQ, Company fillings. *Corp Index: 100% FTSE TMX Canada All Corporate Bond Index.*

Dollarama Inc. 2.337% 2021

Investment Thesis

1. **Overestimated threat from competitors understates Dollarama's economic moat:** In the absence of direct competitors, Dollarama is punished by the markets by an overestimated threat from indirect sources of competition like Wal-Mart, Amazon and online sellers, as well as other smaller dollar stores.
   - With 5-7 vs. 1-3 DOL stores per WMT in urban vs. suburban areas, the retailers target different demographics. Dollarama focuses on smaller package sizes, more frequent trips and lower income clients. Additionally market concern from US price war between WMT and dollar stores is unwarranted as it is focused on groceries (20% of Dollar General sales) whereas DOL sells no perishable food
   - In November, Amazon increased merchant storage fees for the holiday period from $16/m^3/month to $23/m^3 /month, reaffirming the notion that selling dollar store items online is not economically viable.
   - DOL's unique direct-sourcing supply chain provides a competitive advantage in terms of input cost stability and product offering. Post-pitch, we've seen sustained improvement in revenue and gross margin; 3QFY17 EBITDAR margin increased 2 bps Y/Y to 29%
2. **Growth dynamics not adverse to creditors**
   - Underpenetrated CAD value-retail market (28,000 ppl/store) relative to US (12,000 ppl/store) & UK (22,000 ppl/store) and penetration discrepancies across provinces provide organic opportunities. Dollarama is best positioned to capitalize on this as dominant industry player with economies of scale
   - However, store count growth economics are not highly averse to creditors due to their low execution risk, driven by minimal capital requirements for store additions ($0.5mm initial capex with <2 years capital payback period) and flexible store leasing format (3rd party leases on 5 year renewal terms)
   - DOLL has additional levers to strengthen FCF generation in a lower-growth scenario, via SSS growth (up 5.1% Y/Y) and continued margin expansion (up 210bp to 39.0% LTM) via operating leverage
3. **Through-the-cycle comparisons to the most defensive staple retailers confirms similar recessionary performance and operating risk for DOL**
   - Observed growth of lower income segments in recessions (from 2008 to 2009, income segment under $30,000 grew 4%) benefits entire value-retail industry
   - This leads to similar counter-cyclical performance for value-retailer compared to most 'defensive' peers in terms of same store sales growth and ROIC, with further deleveraging potential in upcycle environments due to revenue growth and margin expansion opportunities

As of January 3rd, 2017		Operating Metrics				Financing Metrics				Bond Metrics	
		SSS Growth	Rev Growth	EBITDAR Margin	FCF Margin	Adj. Net Debt/ EBITDAR	Adj. Secured/ Total Debt	Adj. FCF/ Net Debt	EBITR Coverage		
Company	EV	LTM	1YE	LTM	LTM	LTM	LTM	LTM	LTM	Mat.	OAS
Metro Inc.	10,745	4.0%	2.9%	14.4%	8.1%	3.7x	82.1%	15.2%	2.8x	2021	105.09
Alimentation Couche-Tard Inc.	38,586	12.1%	11.5%	8.0%	3.0%	1.9x	42.2%	19.3%	7.9x	2020	98.58
Loblaw Companies Limited	38,758	1.9%	2.1%	8.6%	5.5%	3.6x	38.0%	18.0%	2.8x	2020	93.66
Consumer Staples Average	**26,232**	**5.3%**	**4.8%**	**11.3%**	**5.1%**	**3.4x**	**55.0%**	**14.6%**	**4.8x**		**99.11**
Dollarama Inc.	**12,748**	**7.3%**	**11.2%**	**28.5%**	**15.2%**	**2.6x**	**43.2%**	**16.6%**	**8.1x**	**2021**	**112.80**

Analysis of Performance

Because of similar operating risk – defensiveness of the revenue base and degree of operating leverage – we valued DOL 2021's spread relative to consumer staples companies. Based on superior operating and financing metrics, we believe the bond's spread is unwarranted, especially as it is compared to companies that are more discretionary in nature, thus less stable than dollar stores. Following the due diligence process, market conditions had changed, DOL was now trading at a 12.1% spread discount relative to its peers, and thus we decided it was more prudent to wait for a more favorable entry point. On January 3rd, at a discount of 14.2% we decided to initiate a position into DOL 2021 due to I) Conviction that, based on our analysis of peers' spread, further compression was achievable from that point; ii) an absence of specific catalysts that would lead to further spread expansion.

Sources: Bloomberg, Capital IQ, Company fillings

Home Capital Group 3.400% 2018

Company Overview

- Home Capital Group (HCG) is a Canadian deposit-taking institution that provides mortgage and retail lending
- Focusing on providing fixed rate residential mortgages in the Alt-A market, HCG targets immigrants and self-employed individuals whose official credit scores don't reflect their actual credit worthiness
- Besides servicing its own loans, HCG has been acquiring mortgage service rights which generates a stable yearly revenue of 15 bps per $1 of mortgage. In addition, HCG has been securitizing its insured mortgage portfolio off-balance sheet to create lending capacity for higher-margin Traditional (longer term) loans

Catalysts

- Growing proportion of revenues from stable servicing fees, via growth in total loans under administration through the securitization of CMHC-insured loans
- New regulations aiming to tighten mortgage lending standards, although will lower origination rates, is expected to induce mortgages of superior credit quality, and thus improve credit-loss metrics

Risks

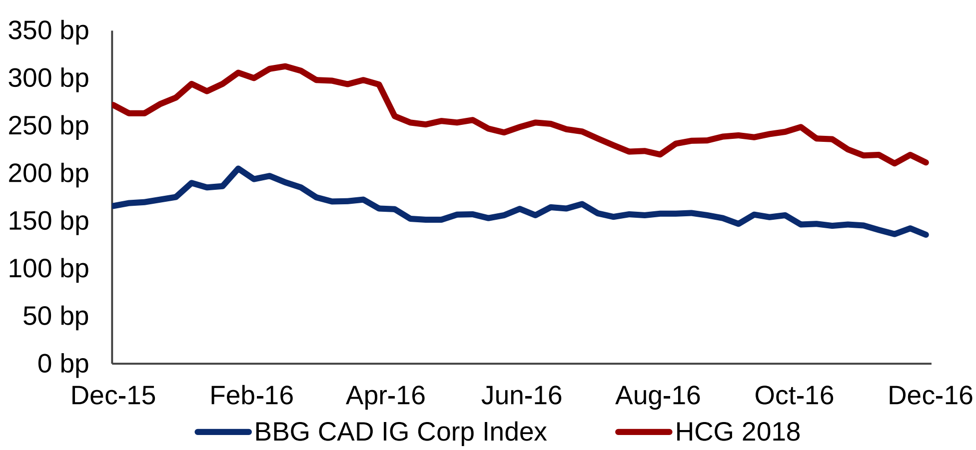
- Potential overheating of the Toronto housing market (85% of HCG's loan book), driven by low interest rate and influx of capital from wealthy foreigners shut out from Vancouver (additional 15% tax applied to foreign buyers), leading to: ii) Increasing credit losses among existing loans; or ii) Market-wide slowdown in originations
- Potential further BoC rate cuts putting downward pressure on rates and interest margins

Financial Summary

Bond Overview	
(as of Dec. 31, 2016)	
Price	101.014/101.248
Coupon	3.400%
YTM	2.752%
YTW	2.752%
OAS	192.9 bps
Modified Duration	1.876
Amount Outstanding	300 mm
Seniority	Senior unsecured
Rating (S&P) / Outlook	BBB / Stable

Financials	**LTM**	**2016E**	**2017E**
(values in C$ mm)			
Net Revenue	585.9	582.7	594.6
% Growth	*-3.5%*	*-0.5%*	*2.0%*
Net Income	266.5	262.8	261.7
% Growth	*-14.7%*	*-1.4%*	*-0.4%*
Servicing Fees	74.2	70.6	71.4
% Growth	*17.4%*	*-4.9%*	*1.1%*
Tier 1 Common Equity	16.5%		

Bond OAS and Rating Category Performance



Position Snapshot

Average Cost	*$102.31*
# of Units	*240*
Value Invested	*$24,261*
Portfolio Weight	*5.2%*
2016 Position HPR	*3.5%*
*2016 Corp Index HPR**	*-1.5%*
Excess Return	*4.9%*

Sources: Bloomberg, Capital IQ, Company fillings

Home Capital Group 3.400% 2018

Investment Thesis

1. **Shift to more stable revenue stream:** Increased securitization and sale of insured loans off-balance sheet allows HCG to grow loans under administration, generating stable servicing fees without growing risk exposure
   - HCG is allowed to de-recognize CMHC-insured loans from its balance sheet upon sale under IFRS standard. As these loan de-recognitions have outpaced loan originations, this has allowed HCG to shrink the on-B/S portfolio (down 1.8% YoY), while still growing total loans under administration, where it derives servicing fees (up 11% YoY as at Sept 30 2016).
   - As default risk is transferred when HCG sells and derecognizes CMHC-insured loans, the stable servicing fee-growth is achieved without HCG growing its actual risk exposure.
2. **Strong credit fundamentals:** HCG's attractive risk profile is being overlooked due to its operations in the sub-prime mortgage market. Despite targeting more risky borrowers that do not fit in the template of major banks, HCG's PCL is at 0.04% YTD, comparing to 0.06% in 2015; NPL averaged only 0.30% over the past three years, lower than the Canadian banks. The improvement in general credit quality is mainly driven by:
   - The tightening of uninsured mortgage lending standard by creating the ACE Plus mortgage product, which is a lower rate mortgage product directed toward lower risk borrowers.
   - Recent cut in servicing fee rates to increase retention rates of existing borrowers, though coming at the expense of servicing fees (decreased 14.3% YoY), should help improve the portfolio's credit quality. HCG has more information available (in the form of detailed internal historical payment history) to assess borrower quality for existing borrowers vs new applicants, leading to superior credit decisioning.
   - Uninsured residential mortgage LTV decreased to 63.6% in 3Q16 from 66.6% last year, largely due to the housing price gains in BC and Ontario.
3. **Attractive valuation:** Though HCG continues to trade at a wider spread that prime banks, the spread difference (mean 58 bps) has narrowed 16% in 2016. HCG continues to now trade at a premium to other specialty lenders, as initially postulated. HCG and prime banks' operating metrics remain in-line with last year, with the most notable difference coming from the improvement of NPL for both HCG and its prime peers (down 2 bp and 3 bp respectively Y/Y), primarily due to the strengthening of general economy.

			Operating Metrics			Leverage	Bond Valuation	
Ticker	**Company Name**	**Market Cap**	**NIM**	**Efficiency Ratio**	**NPL Ratio**	**Tier 1 Cap Ratio**	**OAS**	**DBRS Rating**
Specialty Lender	**Specialty Lender**	(in millions)						
TSX:EQB	Equitable Group	$935	1.8%	34.7%	0.45%	14.6%	175.60	BBBL
TSX:FN	First National Financial Corporation	$1,600	0.5%	32.2%	-	-	306.70	BBBL
	Mean	**$1,267**	**0.9%**	**33.5%**	**0.45%**	**14.6%**	**241.15**	**BBBL**
Prime Banks	**Prime Banks**							
TSX:BNS	The Bank of Nova Scotia	$91,860	1.7%	55.2%	1.11%	12.4%	58.70	AA
TSX:RY	Royal Bank of Canada	$136,110	1.9%	60.2%	0.75%	12.3%	55.60	AA
TSX:CM	Canadian Imperial Bank of Commerce	$44,030	2.1%	57.8%	0.54%	12.8%	60.10	AA
TSX:TD	The Toronto-Dominion Bank	$123,420	2.0%	62.2%	0.60%	12.2%	57.00	AA
TSX:BMO	Bank of Montreal	$62,570	1.8%	61.6%	0.65%	11.6%	60.00	AA
	Mean	**$91,598**	**1.9%**	**59.4%**	**0.73%**	**12.3%**	**58.28**	**AA**
TSX:HCG	**Home Capital Group**	**$1,950**	**2.3%**	**32.2%**	**0.31%**	**16.5%**	**192.90**	**BBBH**

Analysis of Performance

Since the recovery from the falsification scandal, HCG's spread has compressed to 219 bps in August 2016, largely in line with general spread compression in the Canadian IG market. There was, however, a modest spread expansion in 3Q16 (15 bps) after the announcement of new mortgage regulations which restricts on when insurance will be provided for low LTV CMHC-insured mortgages. This stricter qualifying rate will mean that a number of borrowers, especially first-time homeowners would either not qualify or would qualify for a smaller amount of loan than they did previously. Although this is expected to lead to lower origination rates, we see it logical to expect the new loans extended be of superior credit quality as a result of this appreciable tightening lending standards, helping to sustain strong performance on credit-loss metrics. We thus foresee further spread compression for HCG in coming quarters when such performance materializes.

Sources: Bloomberg, Capital IQ, Company fillings

Iron Mountain 6.125% 2021

Company Overview

- Iron Mountain (IRM) is a REIT specializing in records management and physical storage with operations in 36 countries, servicing more than 156,000 organizations, including 94% of the Fortune 1000
- Revenue generation is primarily fueled by a combination of rental and service revenue. Rental revenue is earned on a per cubic foot of storage basis, while service revenue is created through pick-up, delivery, and destruction of stored documents
- IRM recently completed the integration of Recall, an important acquisition closed early in the year, that allows the company to strengthen its positioning as the world leader in records management. This transaction is aligned with the company's goal of diversifying in emerging markets

Catalysts

- Accelerated increase in data storage laws in emerging countries will allow IRM to solidify its positioning in new markets and to generate more stable cash flows through diversification
- Consolidation of market share via equity financing of upcoming acquisitions helping to improve credit quality by reducing leverage while strengthening cash flow stability

Risks

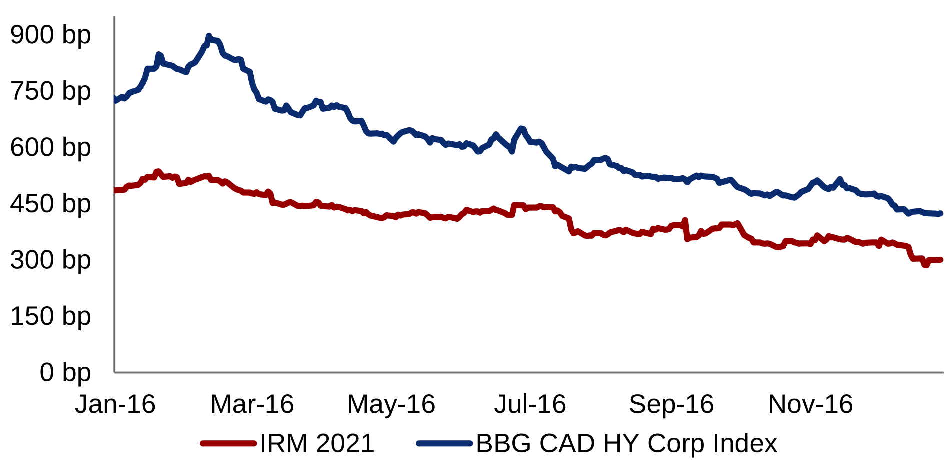
- Earlier-than-expected industry shift to digital records management resulting in a reduction in physical storage needs despite favourable regulatory requirements
- Serial international acquisitions fail to be incorporated correctly into the existing organization. Consequences such as a lack of synergies realization, deterioration of operating and credit metrics as well as a failure to offset added leverage taken on to finance potential acquisition

Financial Summary

Bond Overview	
(as of Dec. 31, 2016)	
Price	104.375 / 105.625
Coupon	6.125%
YTM	4.751%
YTW	2.827%
OAS	288.64 bps
Modified Duration	3.972
Amount Outstanding	200 mm
Seniority	Senior unsecured
Rating (S&P) / Outlook	BB- / Stable

Financials	LTM	2016E	2017E
(values in C$ mm)			
Revenue	3,329.6	3,507.2	3,824.8
% Growth	*10.7%*	*72.4%*	*9.1%*
Gross Profit	1,858.5	1,961.6	2,139.2
Margin	*55.8%*	*55.9%*	*55.9%*
EBITDA	1,000.3	1,077.0	1,265.3
% Growth	*11.8%*	*7.7%*	*17.5%*
Net Debt / EBITDA	6.00x	5.27x	5.77x

Bond OAS and Rating Category Performance



Position Snapshot

Average Cost	*$102.99*
# of Units	*150*
Value Invested	*$15,731*
Portfolio Weight	*3.4%*
2016 Position HPR	*6.8%*
*2016 Corp Index HPR**	*-1.5%*
Excess Return	*8.2%*

*Sources: Bloomberg, Capital IQ, Company fillings. *Corp Index: 100% FTSE TMX Canada All Corporate Bond Index.*

Iron Mountain 6.125% 2021

Investment Thesis

1. **Acquisition of Recall extends durability of business:** Strategic acquisition of Recall will significantly improve operating performance and credit quality moving forward
   - Following new acquisition announcements in emerging markets – Santa Fe and a $50 mm investment to develop the Indian market – this thesis evolved to focus on international diversification rather than a single acquisition. Geographic diversification paves the way for more stable cash flow generation – With high switching costs and a 98% retention rate, acquisitions are the most effective way to acquire new customers.
   - Excluding non-organic growth, revenue from *International* segment increased 9.7% over the second half of the year, providing attractive cash flow growth as developed markets are close to saturation.
2. **Tangible assets with excess capacity provides substantial recourse:** Real estate portfolio with minimal mortgages offers protection in the event of default
   - IRM issued $190 mm senior CAD and AUS notes in the second half of the year, bringing its unsecured debt/PPE coverage to 24.05%, down from 35.35% before the issuance. The company will need to invest more in real estate over the next three years if it wants to achieve its goal of 50% ownership by 2020. Initially attracted by the collateral value real estate investments provide, we see capital expenditures required to reach management's goal as a negative for credit quality, especially since recent acquisitions have drawn IRM away from its target.
3. **More favorable than comparables:** The market is overlooking IRM's superior operating and financial metrics compared to self-storage and industrial REITs.
   - Recent acquisitions have pushed the Net Debt/EBITDA ratio above its peers compared to 5.3x last year. Interest coverage is still above peers, but lower than the 2.1x ratio returned at the end of FY15.

As of December 31, 2016			Operating Metrics			Financial Metrics		Bond Valuation	
		Enterprise Value ($ Bn)	FCF/Sales	1YR Forward Revenue Growth	Operating Margin	Net Debt / EBITDA	EBIT / Int. Exp.	S&P Rating	OAS
Life Storage (LSI 5.54% 2021)	$	5.61	52.8%	22.7%	62.7%	6.53x	3.4x	BBB	151.0
CubeSmart (CUBE 4.8% 2022)	$	6.35	59.4%	20.2%	65.0%	4.94x	2.7x	BBB	145.3
Self-Storage Mean	**$**	**5.98**	**56.1%**	**21.4%**	**63.8%**	**5.73x**	**3.0x**		**148.2**
DCT Industrial (DCT 4.5% 2023	$	6.02	56.6%	8.2%	74.9%	6.13x	1.6x	BBB	214.6
Duke Realty (DRE 3.875% 2021	$	12.33	51.9%	1.3%	65.0%	5.64x	1.7x	BBB+	102.2
Industrials Mean	**$**	**9.17**	**54.3%**	**4.7%**	**70.0%**	**5.88x**	**1.7x**		**158.4**
Iron Mountain (6.125% 2021)	**$**	**14.58**	**11.7%**	**77.7%**	**31.3%**	**6.00x**	**1.9x**	**BB-**	**288.6**

Analysis of Performance

Iron Mountain 2021 is now trading at a 45% and 49% premium over its investment grade self-storage and industrials peers. With the recent completion of the Recall acquisition, we shifted the focus of our first investment thesis to IRM's overall international expansion. We thus maintain conviction in this holding as it strengthens its presence in emerging markets with both tuck-in acquisitions and greenfield investments. With saturated North American and Western European markets, we see greater cash flow generation improvements coming from this expansion to markets with increasing data storage regulation.

On December 21st, 2015, we initiated our position in IRM 2021 at a spread of 460 bps. While the spread had widened to 485 bps by year-end in 2015, it is now trading at 300 bps – a 185 bps compression compared to a 300 bps compression for the Canadian corporate bonds high yield index. The spread stayed relatively stable up to June and the noted compression occurred mostly in the second half of the year. We attribute this movement to the completion of the Recall acquisition, as it starting incorporating financial statements and realizing synergies in the third quarter. Finally, we think the market has yet to realize the potential upside of emerging markets diversification.

Sources: Bloomberg, Capital IQ, Company fillings

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