2018 HIM ANNUAL REPORT

DESAUTELS CAPITAL MANAGEMENT
GESTION DE CAPITAUX DESAUTELS

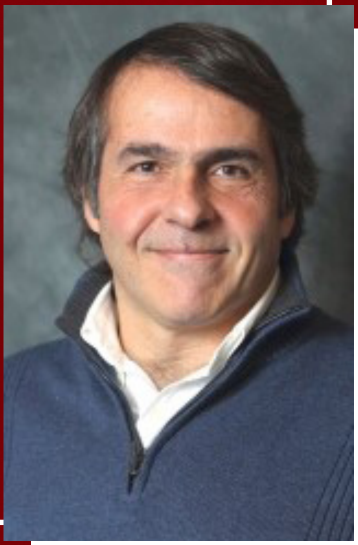
DESAUTELS | McGill

“An investment in knowledge pays the best interest”

- Benjamin Franklin

TABLE OF CONTENTS

A Message from the Strategists	**1**
Executive Team	**2**
Board of Directors	**4**
Our Team	**6**
Global Equity Fund	
2018 Performance	**18**
Equity Markets Review and Outlook	**23**
Geopolitical Outlook and Review	**31**
Risk Management	**36**
Consumers	**42**
Energy	**50**
Financials	**59**
Healthcare	**69**
Industrials	**76**
Materials	**83**
TMT	**89**
Fixed Income Fund	
2018 Performance	**99**
Fixed Income Markets Review and Outlook	**103**
Holdings Review	**109**
Program Alumni	**113**
Disclaimer	**117**



We would like to dedicate this Annual Report to Professor Kenneth Lester. Among his many contributions to McGill, Ken was an avid supporter, and a key contributor to the foundation of Desautels Capital Management. Throughout his tenure at DCM, Ken has impacted the lives of all HIMers, and we are honoured to have been entrusted with his confidence and his unwavering support. We wish him the best of luck, and a memorable retirement.

A MESSAGE FROM THE STRATEGISTS

DEAR INVESTORS,

On behalf of the current Honours in Investment Management students, we would like to thank you, investors, for your continued support. The DCM team feels fortunate to have the opportunity to manage such a fund.

This year marks an important one for our co-founder. As many of you know, Ken Lester is retiring from teaching at McGill and from HIM. Throughout the years, he's given his time to not only teach us, but to truly mentor and challenge us. From the very first class of HIM students to the current one, we'd like to wish Ken a happy and fulfilling retirement. We hope you will enjoy building your own oasis in your Northern cottage and we look forward to reading the books you plan on writing.

On a different note, 2018 has been another successful year in terms of recruitment for HIMers. The strong network of mentors and industry professionals that HIM has come to build, enabled the current class of juniors to secure internships in top consulting firms like Bain & Company as well as major investment banks like Lazard and RBC. Not to be outdone, the senior class will be starting work at top investment banks like PJT Partners, Credit Suisse or RBC while also joining top consulting firms like McKinsey. Lastly, we are delighted to say that the DCM network is expanding in several cities in Canada such as Calgary and Toronto while also extending its presence in Los Angeles and Houston.

At the beginning of the year, as strategists we aimed to continue improving HIM and more broadly DCM. Although there remains work to be done, we can proudly say we accomplished many of the projects we set out for ourselves. Notably, we created a winter bootcamp to complement the traditional September bootcamp so that students could continue improving their modeling skills. One of our proudest accomplishments relates to our efforts to gain funding for competition expenses. This past September, McGill helped us accomplish this goal by granting us significant funding that ultimately enabled HIMers to compete and win First Prize in NIBC, JDC, PRMIA, and many other prestigious competitions. Finally, to improve the pitching and decision making processes, we implemented a new due diligence procedure. Students were now tasked with presenting their answers to the due diligence questions in a separate meeting. Although this is only in its first year, we believe this additional checkpoint will aid DCM in making better decisions and outperforming the market.

As the year ends and we reflect on our experience in the program, we can confidently say we are proud of all that we have accomplished, and thankful for all the opportunities that HIM has offered us. Together, we have pushed DCM forward. Now it is time for the new strategists and class of analysts to build on this progress. We are confident that Rakan and Stanislav will be able to successfully steward the fund and its members toward ever greater heights.

Yours truly,

Victoire Gekas, George Koutsos
Fixed Income Strategist, Global Equity Strategist

Desautels Capital Management

EXECUTIVE TEAM

DESAUTELS CAPITAL MANAGEMENT | GESTION DE CAPITAUX DESAUTELS

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 was until recently the 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.

Anisha Ghosh
Academic Director of the HIM Program

Professor Ghosh joined the Desautels Faculty of Management in 2017, having formerly been a faculty member in the finance area at Carnegie Mellon University's Tepper School of Business. Professor Ghosh's research lies at the interface of macroeconomics and finance and has been published in, among other journals, the Journal of Finance and the Review of Financial Studies. She holds a PhD in Economics from the London School of Economics.

BOARD OF DIRECTORS

DESAUTELS CAPITAL MANAGEMENT | GESTION DE CAPITAUX DESAUTELS

Yves Caron
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.

Eammon McConnell
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.

Richard Pan
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

DESAUTELS CAPITAL MANAGEMENT | GESTION DE CAPITAUX DESAUTELS

WHO MAKES UP DCM?

SPOKEN LANGUAGES	12
FEMALE	30%
AVERAGE GPA	3.80
ENTREPRENEURS	7
COMPETITIONS	17
AWARDS AND SCHOLARSHIPS	14
VARSITY ATHLETES	4

HIM STRATEGISTS

George Koutsos | Global Equity Strategist

Professional Experience

- Consultant
  Monitor Deloitte, Montreal (Incoming 2019)
- Summer Analyst, Global Real Assets
  J.P. Morgan, London (Summer 2018)
- Investment Finance Intern
  PSP Investments, Montreal (Summer 2017)

Victoire Gekas | Fixed Income Strategist

Professional Experience

- Investment Banking Analyst
  Credit Suisse, Toronto (Incoming 2019)
- Investment Banking Summer Analyst
  Credit Suisse, Toronto (Summer 2018)
- Portfolio Management and Operations,
  Global Private Markets Intern
  PSP Investments, Montreal (Summer 2017)

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HIM EXECUTIVES

Josiah Derksen | Risk Manager

Professional Experience

- Investment Banking Summer Analyst
  Morgan Stanley, Toronto (Incoming Summer 2019)
- Private Equity Summer Analyst
  Altas Partners, Toronto (Summer 2018)
- Summer Analyst
  Five Continents Financial, Cayman Islands (Summer 2017)

Eric Van Hees | Chief Operating Officer

Professional Experience

- Investment Banking Analyst
  Evercore, Houston (Incoming 2019)
- Investment Banking Summer Analyst
  RBC Capital Markets, Toronto (2018)
- Summer Analyst
  RBC Capital Markets, Toronto (2017)

Tejas Saggi | Chief Operating Officer

Professional Experience

- Analyst, Strategic Advisory
  PJT Partners, New York (Incoming Summer 2019)
- Summer Analyst, Strategic Advisory
  PJT Partners, New York (Summer 2018)
- Summer Analyst, Private Investments
  CPP Investment Board, Toronto (Summer 2017)

HIM ANALYSTS

Tejas Saggi | Senior Analyst

Professional Experience

- Analyst, Strategic Advisory
  PJT Partners, New York (Incoming Summer 2019)
- Summer Analyst, Strategic Advisory
  PJT Partners, New York (Summer 2018)
- Summer Analyst, Private Investments

Selena Zhu | Junior Analyst

Professional Experience

- Investment Banking Summer Analyst
  Lazard, Los Angeles (Incoming 2019)
- Private Equity & Alternative Investments Summer Analyst
  Palomino Capital Corporation, Montreal (Summer 2018)
- Wealth Management Summer Intern

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HIM ANALYSTS

Ian Jang | Senior Analyst

Professional Experience

- Investment Banking Analyst
  RBC Capital Markets, Toronto (Incoming 2019)
- Investment Banking Summer Analyst
  RBC Capital Markets, Toronto (Summer 2018)
- Private Equity Summer Analyst

Alexandra Ma | Senior Analyst

Professional Experience

- Investment Banking Analyst
  TD Securities, Toronto (Incoming 2019)
- Relationship Investments Summer Analyst
  Canada Pension Plan Investment Board, Toronto (2018)

Timothy Sung | Junior Analyst

Professional Experience

- Private Equity Summer Analyst
  Novacap, Montreal (Summer 2019)
- Management Intern, Private Banking Group
  DBS Bank, Hong Kong (Summer 2018

Roy Chen Zhang | Junior Analyst

Professional Experience

- Capital Markets Summer Analyst
  Haitong Securities (2018)
- Private Equity Analyst Intern
  Hezhong Investments (2018)
- Finance Consultant
  Nyabiosi Adult Education Group (2016)

HIM ANALYSTS

Noah Tomas Petkau | Senior Analyst

Professional Experience

- Associate
  The Boston Consulting Group, Montreal (Incoming 2019)
- Business Analyst
  Roland Berger, Montreal (Summer 2018)
- Investment Analyst
  Fidelity Investments, Toronto (Summer 2017)

Eric Van Hees | Senior Analyst

Professional Experience

- Investment Banking Analyst
  Evercore, Houston (Incoming 2019)
- Investment Banking Summer Analyst
  RBC Capital Markets, Toronto (2018)
- Summer Analyst
  RBC Capital Markets, Toronto (2017)

Alessio Marcogliese | Junior Analyst

Professional Experience

- RBC Capital Markets (Incoming 2019)
- Summer Associate
  Pricewaterhouse Coopers (2018)
- Public Policy Analyst
  Canadian Taxpayers Federation (2017)

Riley Wolever | Junior Analyst

Professional Experience

- Summer Student, Billing Department
  Fortis Alberta, Calgary (Summer 2018)
- Private Equity Summer Analyst
  Ulysses Management, New York (Incoming 2019)

HIM ANALYSTS

Josiah Derksen | Senior Analyst

Professional Experience

- Investment Banking Summer Analyst
  Morgan Stanley, Toronto (Incoming Summer 2019)
- Private Equity Summer Analyst
  Altas Partners, Toronto (Summer 2018)
- Summer Analyst
  Five Continents Financial, Cayman Islands (Summer 2017)

Victoria Perlman | Senior Analyst

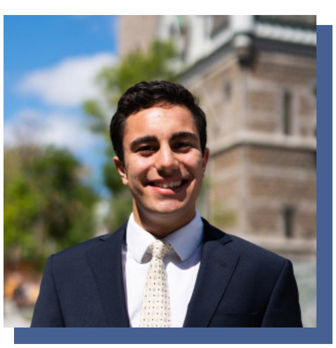
Professional Experience

- Investment Banking Analyst
  RBC Capital Markets, New York (Incoming 2019)
- Wealth Management Summer Intern
  Bank of America Merrill Lynch, Boston (Summer 2017)

Miller Cressman | Junior Analyst

Professional Experience

- Financial Analyst
  L’Oreal Canada, Montreal (Summer 2018)



Jared Gaffe | Junior Analyst

Professional Experience

- Associate Consultant Intern
  Bain & Company, Toronto (Incoming Summer 2019)

HIM ANALYSTS

Émilie Granger | Senior Analyst

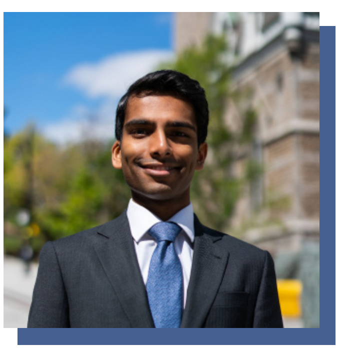
Professional Experience

- Summer Financial Analyst, Restructuring
  Houlihan Lokey, Los Angeles (Summer 2018)
- Summer Analyst, Global Investment Banking
  RBC Capital Markets, Montreal (Summer 2017)
- Summer Analyst, Public Market Investments
  PSP Investments, Montreal (Summer 2016)

Ludovic Van Den Bergen | Senior Analyst

Professional Experience

- Business Analyst
  McKinsey and Company, Montreal (Incoming 2019)
- Summer Business Analyst
  McKinsey and Company, Montreal (Summer 2018)
- Economic Section Intern
  Embassy of Belgium in Iran, Tehran (Summer 2017)



Arasan Thangavelu | Junior Analyst

Professional Experience

- Investment Banking Summer Analyst
  RBC Capital Markets, Toronto (Summer 2019)
- Corporate Banking Summer Analyst
  J.P. Morgan, Toronto (Summer 2018)

HIM ANALYSTS

Kyle Costanzo | Senior Analyst

Professional Experience

- Investment Banking Analyst
  LionTree, New York (Incoming 2019)
- Investment Banking Summer Analyst
  LionTree, New York (Summer 2018)
- Corporate Banking Summer Analyst
  J.P. Morgan, Toronto (Summer 2017)

Cody Jones | Junior Analyst

Professional Experience

- Investment Banking Summer Analyst
  LionTree, New York (Incoming 2019)
- Client Portfolio Analyst
  Assante Wealth Management, Halifax (Summer 2018)
- Financial Advisor Assistant
  Assante Wealth Management, Halifax (Summer 2017)

Rakan Lamy | Junior Analyst

Professional Experience

- Investment Banking Summer Analyst
  RBC, Montreal (Summer 2019)
- Private Equity Summer Analyst
  Novacap, Montreal (Summer 2018)
- Search Fund Summer Analyst
  Snowdon Partners, Montreal (Summer 2017)

HIM ANALYSTS

Thomas Boucher-Charest | Senior Analyst

Professional Experience

- Equity Research Analyst, Global Long/Short
  PSP Investments (Incoming 2019), Montreal
- Equity Research Intern, Global Long/Short
  PSP Investments (September 2017- Present), Montreal
- Summer Analyst, Emerging Market Portfolio,
  PSP Investments (Summer 2017), Montreal

Matei Popescu | Senior Analyst

Professional Experience

- Fundamental Investments Analyst
  Canada Pension Plan Investment Board, Toronto (Incoming 2019)
- Secondaries and Co-Investments Summer Analyst
  Canada Pension Plan Investment Board, Toronto (Summer 2018)

Benjamin Caron | Junior Analyst

Professional Experience

- Summer Investment Banking Analyst
  TD Securities (Incoming 2019)
- Summer Analyst
  BMO Nesbitt Burns (2018)

Stanislav Timoshenko | Junior Analyst

Professional Experience

- Canadian Pension Plan Investment Board, Toronto (Summer 2019)
- Asset Management Summer Analyst (Summer 2018)

HIM ANALYSTS

Andrew Guerrand | Junior Analyst

Professional Experience

- Honours Representative- Department of Economics
- Marathon running (last being Ottawa 2018)
- Learning his fifth language: Mandarin Chinese
- Karaté Shotokan- Black belt (1st Dan)

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ANNUAL REPORT 2018

Global Equity Fund

2018 PERFORMANCE

GEORGE KOUTSOS

DESAUTELS CAPITAL MANAGEMENT

PERFORMANCE SUMMARY

GLOBAL EQUITY FUND

Dear Investors,

The Global Equity Fund returned - 4.9% gross of fees in 2018, compared to - 4.3% for our blended benchmark (60% S&P TSX, 40% S&P 500 in CAD) (Figure 1).

Although volatility had hit record lows in 2017, we didn't believe this would persist. Nonetheless, we entered 2018 with a cautious mindset as major concerns started to form over the horizon. These included trade tensions, potential inflation, rising interest rates, a nearly inverted yield curve, overall global political upheaval, and a US government shutdown. Market volatility did in fact return in 2018, with the VIX hitting 30.1%, its highest level since the 2011 Eurozone crisis. Amazingly, despite the above issues and high volatility, US equity markets continued their upward march throughout the first eleven months of the year. It seemed like nothing would ever tame this 10-year old bull market. That of course all changed in December as we discuss further below.

Figure 1: Global Equity Fund Returns

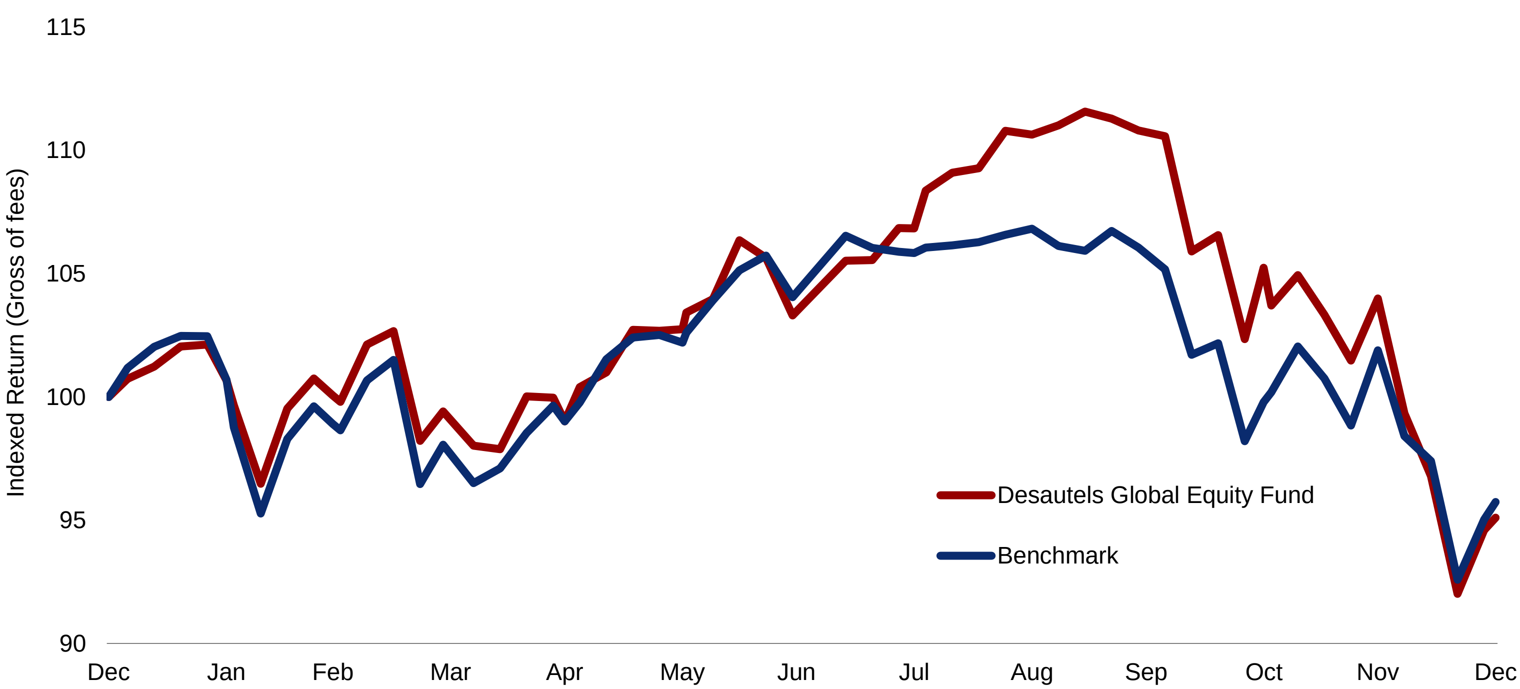
PERFORMANCE METRICS SINCE INCEPTION	Equity Fund	Benchmark
Annualized Return	7.3%	7.7%
Annualized Standard Deviation	12.2%	11.1%
Annualized Sharpe Ratio	0.40	0.48
Beta	0.79	
Annualized Alpha	0.7%	
Tracking Error (Annual)	8.5%	

Performance metrics are calculated gross of fees.

EQUITY PERFORMANCE METRICS 2018	Equity Fund	Benchmark
Annualized Return	(4.9%)	(4.3%)
Annualized Standard Deviation	13.4%	12.7%
Annualized Sharpe Ratio	(0.55)	(0.53)
Beta	0.98	
Annualized Alpha	(0.8%)	
Tracking Error (Annual)	4.9%	

Performance metrics are calculated gross of fees.

Figure 2: Global Equity Fund Performance



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

PERFORMANCE SUMMARY
GLOBAL EQUITY FUND

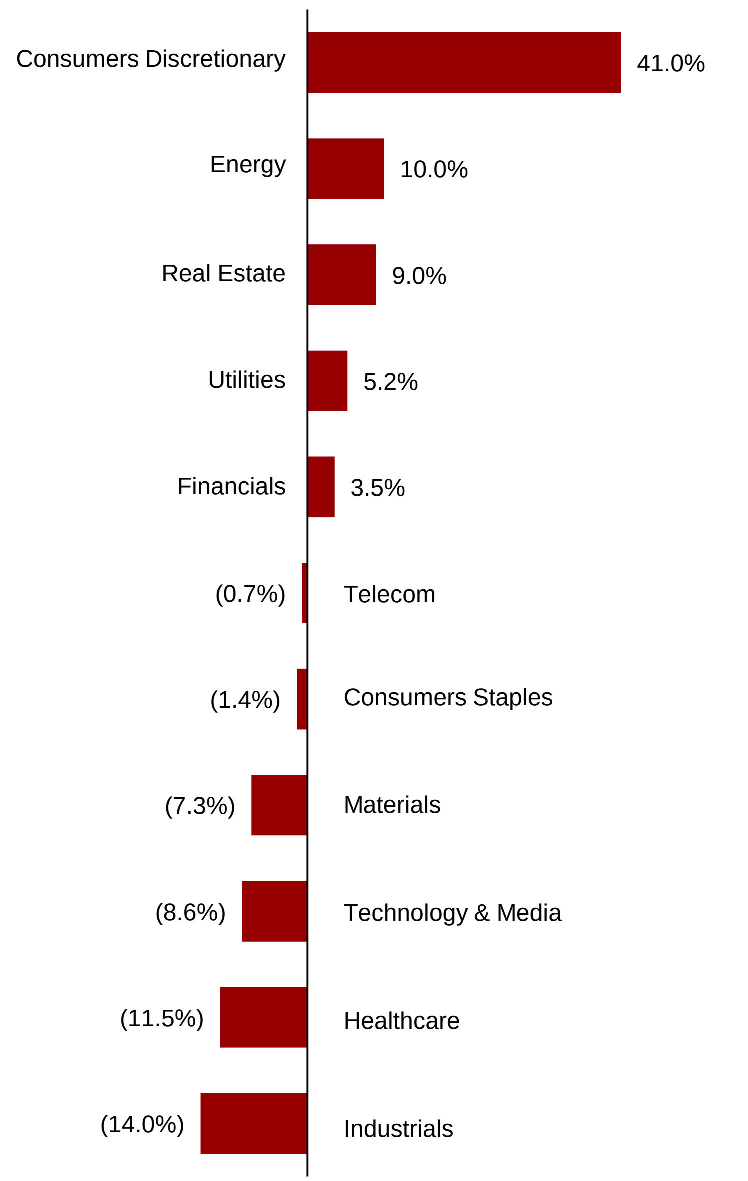
In terms of our relative performance, we did exceptionally well in certain sectors, but underperformed significantly in others (Figure 3). In Consumer Discretionary we returned 41.1%, compared to 0.1% for the sector benchmark, led by strong gains for Aritzia, an upscale women's fashion retailer, and Live Nation, a ticketing and events promoter. As we anticipated, given Aritzia's strong brand and focus on developing their own private labels, the company was able to continue growing same-store sales by double digits each quarter in 2018. Our investment thesis for Live Nation also continued to play out as the company beat earnings expectations and benefitted from the shift of consumer spending habits towards the experience economy. We continue to hold these positions as we remain optimistic on their upside potential.

Other positions that did well this year include Health Insurance Innovations, Apple, Dell Technologies as well as Madison Square Garden. However, we decided to dispose of our positions in these stock as we felt the investment theses had fully materialized. It has taken longer than hoped for some of our holdings to realize their true potential. This is the case for Fincantieri and Boingo Wireless. We remain positive on these companies, as we see great potential for increased cost efficiencies through the integration of their existing yards and the Naval Group joint venture, as well as the accelerating roll-out of 5G across the continent respectively.

To be sure, we got some calls wrong, and exited positions where we felt the investment theses were no longer valid. We sold FMC, a chemical manufacturing company, as it became clear that the spin off their stake in Livent would not produce the expected benefits. Similarly, the potential gold resources and return to political stability in Turkey never materialized for Alacer leading to exit our position in December.

Finally, some notable additions to our portfolio this year included the Stars Group in Consumers Discretionary, Textainer Group in Industrials, Eros in TMT, and Enerplus in Energy. Our investment theses and further details on these and other holdings are provided in the sector sections that follow.

Figure 3: DCM Sector Performance vs Benchmark



PERFORMANCE SUMMARY
GLOBAL EQUITY FUND

Figure 4: Global Equity Fund Current Sector Allocation

Global Equity Fund - Current Sector Allocation

Sector	Global Equity Fund	Benchmark	(+/-)
CAD	6.0%	0.0%	6.0%
Communication Services	9.7%	7.2%	2.6%
USD	1.8%	0.0%	1.8%
Consumer Staples	5.4%	4.7%	0.7%
Utilities	3.7%	3.3%	0.4%
Consumer Discretionary	6.9%	6.8%	0.2%
Health Care	7.2%	7.1%	0.1%
Industrials	9.3%	10.2%	(1.0%)
Information Technology	9.8%	10.9%	(1.1%)
Energy	12.4%	13.9%	(1.5%)
Financials	26.7%	28.8%	(2.1%)
Materials	1.0%	7.1%	(6.0%)
Total	**100.0%**	**100.0%**	**0.0%**

Figure 5: Global Equity Fund Size Exposure

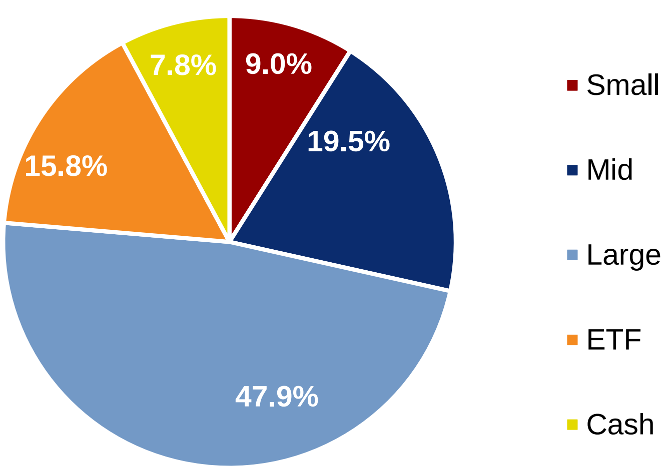
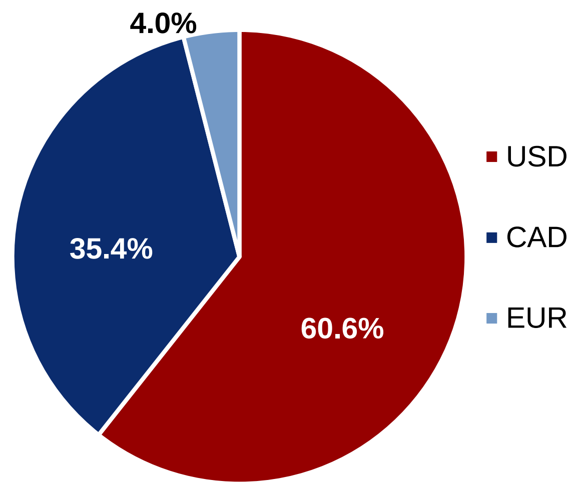


Figure 6: Global Equity Fund Currency Exposure



PERFORMANCE SUMMARY

GLOBAL EQUITY FUND

Figure 7: Global Equity Fund Holdings List

Global Equity Fund Holdings (as of 31/12/2018)								
Security Name	**Sector**	**Currency**	**Size**	**# of Units**	**Local Cost / Unit**	**Local Price / Unit**	**Base Market Value**	**Position Size %**
OAKTREE CAPITAL	Financials	USD	Large	2,990	$39.95	$39.75	$162,329	5.7%
BOINGO WIRELESS INC	Communication Services	USD	Small	4,980	$23.58	$20.57	$139,911	4.9%
CIBC	Financials	CAD	Large	1,350	$104.02	$101.68	$137,268	4.8%
SHIRE PLC	Health Care	USD	Large	575	$152.53	$174.04	$136,680	4.8%
BMO GLOBAL COMM. ETF	Communication Services	CAD	ETF	6,900	$21.70	$19.72	$136,068	4.8%
BANK OF AMERICA	Financials	USD	Large	3,850	$15.01	$24.64	$129,565	4.6%
PEMBINA PIPELINE	Energy	CAD	Large	3,000	$37.85	$40.51	$121,530	4.3%
MARATHON PETROLEUM	Energy	USD	Large	1,500	$44.14	$59.01	$120,894	4.3%
LEGACYTEXAS FINANCIAL	Financials	USD	Mid	2,500	$39.24	$32.09	$109,571	3.9%
EMERA INC	Utilities	CAD	Mid	2,400	$45.23	$43.71	$104,904	3.7%
PROLOGIS INC	Financials	USD	Large	1,270	$62.24	$58.72	$101,854	3.6%
INVESCO DYNAMIC SOFTWARE I	Information Technology	USD	ETF	1,000	$78.33	$73.90	$100,933	3.6%
LOBLAW	Consumer Staples	CAD	Large	1,580	$68.66	$61.11	$96,554	3.4%
LIVE NATION ENTERTAINMENT	Consumer Discretionary	USD	Mid	1,400	$45.44	$49.25	$94,172	3.3%
CUMMINS INC	Industrials	USD	Large	400	$137.83	$133.64	$73,010	2.6%
ADOBE	Information Technology	USD	Large	230	$254.39	$226.24	$71,070	2.5%
FINCANTIERI	Industrials	EUR	Mid	48,610	$1.37	$0.92	$69,976	2.5%
EROS INTERNATIONAL	Information Technology	USD	Large	5,950	$11.70	$8.29	$67,369	2.4%
ISHARES U.S. INSURANCE ETF	Financials	USD	ETF	840	$65.77	$57.72	$66,221	2.3%
ENERPLUS CORP	Energy	CAD	Mid	6,000	$12.42	$10.62	$63,720	2.3%
ISHARES U.S. INDUSTRIALS ETF	Industrials	USD	ETF	355	$133.23	$128.53	$62,319	2.2%
TEXTAINER GROUP	Industrials	USD	Small	4,200	$11.20	$9.96	$57,134	2.0%
ISHARES GLOBAL CONSUMER	Consumer Staples	USD	ETF	900	$45.39	$45.97	$56,507	2.0%
SVB Financial	Financials	USD	Mid	190	$256.38	$189.92	$49,285	1.7%
ARITZIA INC	Consumer Discretionary	CAD	Small	2,800	$12.50	$16.40	$45,920	1.6%
THE STARS GROUP INC	Consumer Discretionary	CAD	Mid	1,990	$27.18	$22.54	$44,855	1.6%
ARC RESOURCES	Energy	CAD	Mid	5,400	$14.94	$8.10	$43,740	1.5%
FRESENIUS MEDICAL CARE	Health Care	EUR	Large	955	$38.63	$32.39	$42,248	1.5%
TELADOC HEALTH	Information Technology	USD	Mid	545	$64.98	$49.57	$36,898	1.3%
SUMMIT MATERIALS INC	Materials	USD	Mid	1,750	$28.57	$12.40	$29,638	1.0%
ISHARES GLOBAL HEALTHCARE	Health Care	CAD	ETF	570	$43.94	$44.59	$25,416	0.9%
OLD PSG WIND DOWN LTD	Consumer Discretionary	CAD	Small	10,985	$7.16	$1.00	$10,985	0.4%
CANADIAN DOLLAR	Cash	CAD	Cash	170,872	–	$1.00	$170,872	6.0%
U.S. DOLLAR	Cash	USD	Cash	37,538	–	$1.00	$51,183	1.8%
						Total	$2,830,596	100.0%

Global Equity Fund

2018 REVIEW & 2019 OUTLOOK

GEORGE KOUTSOS
ANDREW GUERRAND

DESAUTELS CAPITAL MANAGEMENT

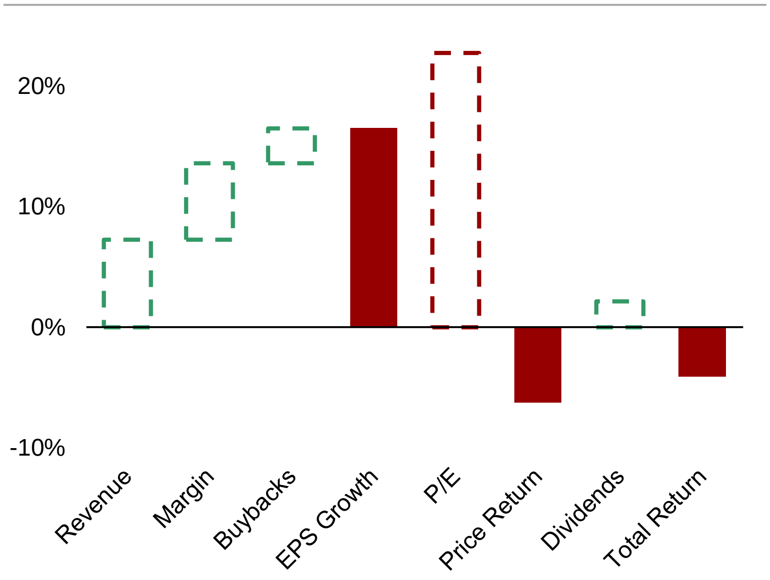
EQUITY MARKETS
2018 REVIEW

THE SLUMBERING GIANT AWAKENS

We entered 2018 with a cautious mindset. Although volatility had hit record lows in 2017, we didn't think this would persist. Major concerns included trade tensions, potential inflation, rising interest rates, a nearly inverted yield curve, overall global political upheaval, and a US government shutdown, to name a few. Indeed, market volatility did return in 2018. Amazingly, despite the above issues, US equity markets continued their upward march throughout the first eleven months of the year. Then came December. While there certainly was some bad news in the month, it was nothing this bull market hadn't shaken off before, and not the type of news we would have expected to cause the S&P 500 to shed 9.2%. But after 10-years of gains, equity investors seemed to be expecting, almost hoping, for a correction, and sentiment changed quickly.

Overall, the S&P 500 lost 6.2% in 2018 after having been up as much as 9.6%, while north of the border, the S&P/TSX Composite shed 11.6%. This is despite both indices meeting their revenue and margin forecasts.

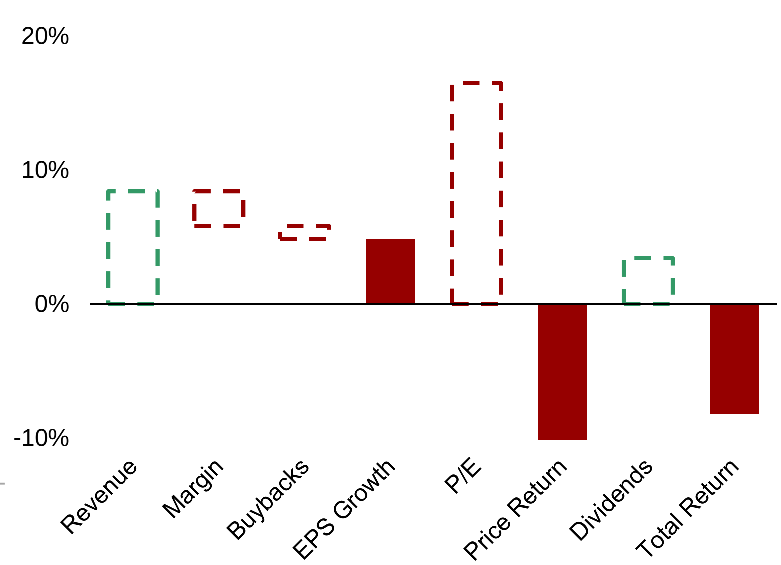
Figure 1: 2018 S&P 500 Performance Breakdown



Source: Bloomberg, Financial Times

One common theme for both markets was multiple compression, in spite of strong and improving operating fundamentals. Breaking down S&P 500 return components for the year, we can see that both revenues and margin expansion significantly increased in 2018. Additionally, record-breaking buybacks helped stem part of losses, as corporations bought back more than $1.3 tn in shares over the year. It is really the P/E multiple compression (-22.7%) that sunk the S&P 500 this year, as investors' fears of slowing growth prompted them to de-rate the broader stock market.

Figure 2: 2018 TSX 500 Performance Breakdown



The story was similar in Canada, strong revenue growth and an increased dividend yield supported the TSX in 2018, but they could not outweigh the decrease in margins, buybacks, as well as the significant decrease in P/E multiples (-16.5%).

The remainder of this report will focus on major themes of the year and our outlook for the market going forward.

EQUITY MARKETS
2018 REVIEW

THE SLUMBERING GIANT AWAKENS

Whereas 2017 saw very little volatility and market instability, 2018 will be remembered as the year political and financial uncertainty returned. With the VIX spiking many times, and reaching a peak of 30.1% in December, a level not seen since 2011 (Eurozone crisis), 2018 was a year where investors had to reassess their risk appetite. But there were few places to hide, with fears of a late-cycle slowdown coupled with rising rates pushing down valuations across a broad spectrum of asset classes (Figure 3).

Over the last 30 years, 2018 was only the 5th time that five asset classes or more ended the year with a negative return. However, in each following year, the S&P 500 returned on average 23% with the lowest returning year yielding nonetheless 10%. Given the sudden and brutal change in market sentiment despite strong and improving operating fundamentals, 2019 is primed to repeat these past successes.

Figure 4: 2017 and 2018 Returns of S&P 500 Sectors

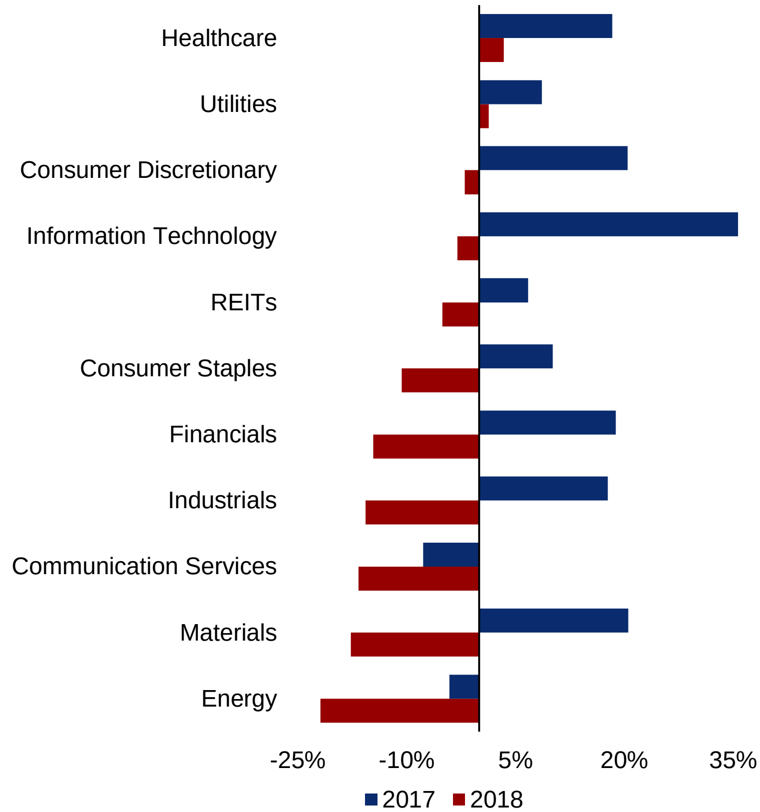
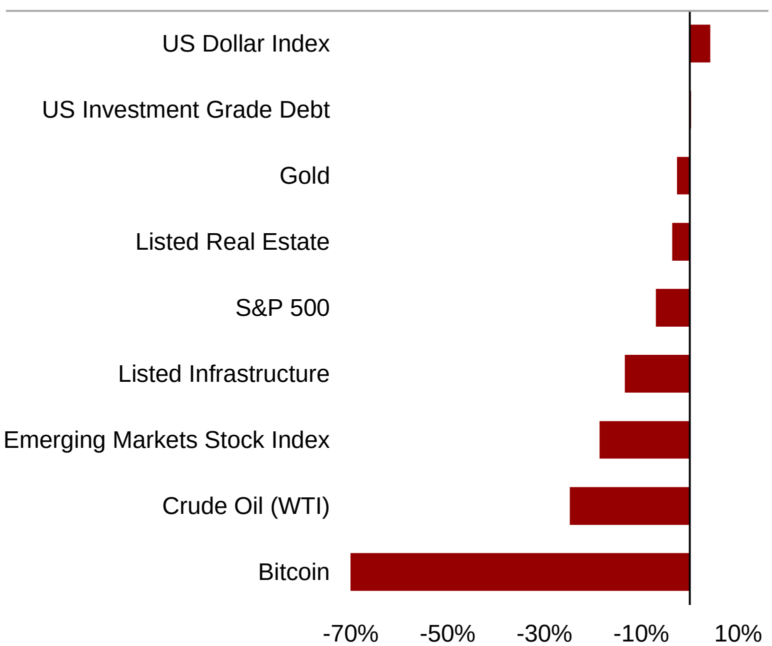


Figure 3: Returns of Asset Classes



Source: Bloomberg, Reuters, Bloomberg, Wall Street Journal

Turning to sectors, it was not surprising to see defensive sectors like Healthcare and Utilities outperform cyclical sectors like Energy, Materials, Communication Services and Industrials (Figure 4). Consumer discretionary was a surprising outperformer in 2018, benefiting from the resurgence of brick & mortar retail as well as the continued increase in discretionary spending.

Another surprise in 2018 was value stock's underperformance (against growth), the 4th time in 5 years. However, it seems as though the reversion to mean multiples was not large enough to cause a breakdown in growth's strategy.

In what follows we focus on four factors that will play a key role in equity markets in 2019: inflation, monetary policy, geopolitics, and fears of slowing global growth.

EQUITY MARKETS
2018 REVIEW

INFLATION AND RATES

Indications that 2018 would not be like the last 10 years, first came on February 2nd, when US hourly earnings figures showed accelerating wage growth and sent markets tumbling by over 10%, and the VIX up to 29%.

The prospect of inflation surpassing 2%, and with it faster than expected interest rate hikes, was a shock for most investors. Indeed, for the better part of the last 10 years, economists have focused on avoiding deflation, and its destructive consequences, while inflation has only been an after-thought.

Two main factors fueled this inflationary fear: accelerating wage growth and the Trump Tax Cuts. Overall, we think these fears are overblown.

Although overall wage growth has increased significantly in the last five years, most of these gains have gone to the supervisory class of workers (i.e. individuals who are either owners or who are employed to direct other employees), which only represents 20% of the total private workforce. It is only very recently that both supervisory and production workers have seen equal gains in their wages. As long as gains for production remain low, inflation should remain subdued.

In terms of the Trump tax cuts, it should be noted that the individual income tax breaks disproportionately accrue to the wealthy, further dampening the increased consumption effect, due to their higher propensity to save. Additionally, although much has been said about the minimum wage increases in America, these hikes will only grow wages of the lowest earners by $5.4 bn, easily dwarfed by the total US wages of approximately $9 tn in 2018. Thus, fears of inflationary pressures building up from these wage increases alone, are overblown and borderline irrational.

To be sure, another tax-cut related concern is its impact on the deficit. Although not directly related to the recent market correction, the long-term consequences of these tax cuts on America's fiscal health are disastrous. The Congressional Budget Office estimates that by 2027 the cumulative deficit, net of any macroeconomic effects, would increase by over a trillion dollars compared to its baseline projections. In doing so, federal debt as a percentage of GDP would reach 94.5% in 2027. In our opinion, this tax bill worryingly strips the federal government of any significant emergency fiscal stimulus for the next recession, without providing any meaningful economic benefits. As Warren Buffet says, it is never wise to “bet against America”. Nonetheless, this provides us with further impetus to diversify the geographic area of our holdings.

Overall, although we don’t see inflation being a big risk for equity markets in 2019, the macroeconomic health of the United States in the long-run is, in our opinion, on shaky footings.

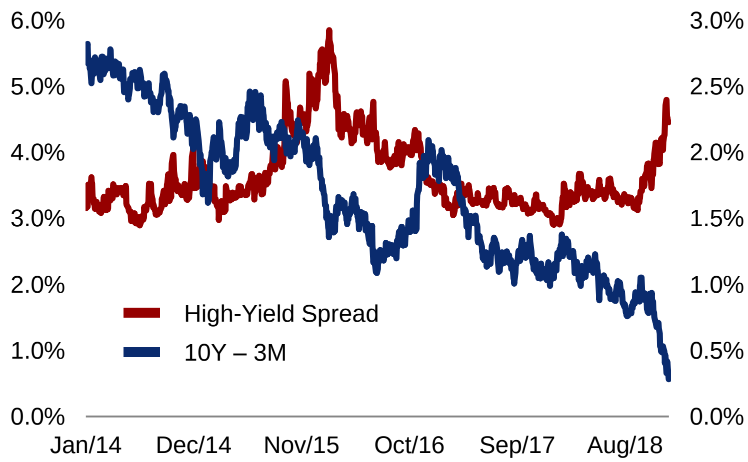
CORPORATE AMERICA’S DIRTY LITTLE SECRET

Nonetheless, for the better part of the year, markets remained sanguine given the perceived strength of the US economy. However, sentiment turned in the fourth quarter, when the yield curve approached inversion, a time-tested harbinger of recessions. The spread between 10-year and 3-month treasuries reached 0.15% at its narrowest (Figure 5). Given our view for muted inflation, we believe there is a possibility that the Fed may prematurely end the economic cycle, although this is not our base case scenario. However, a more imminent threat for Corporate America lurks: the rise in debt servicing costs. Recent volatility has caused high-yield spreads to spike and investors to take stock of their true exposure to low quality investments.

Source: LBO news, Washington Post, Tax Cut and Jobs Act, FRED, Bloomberg, Economic Policy Institute

EQUITY MARKETS
2019 OUTLOOK

Figure 6: High Yield Corporate Debt Spread & US 10-year minus 3-month Treasuries (right)

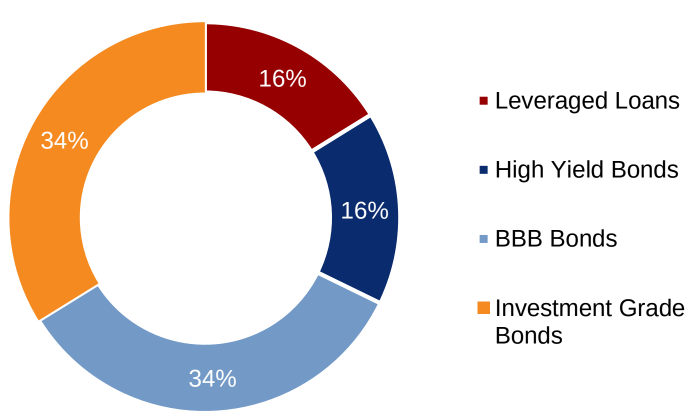


This mountainous debt burden will increasingly need to be refinanced at rates significantly higher than those seen over the last decade, as the graph to the left shows. In fact, more than $380 bn of BBB and high yield bonds as well as leveraged loans will require refinancing in 2019, with this number set to cumulatively hit over $1.55 tn by 2021.

We estimate that a 1% increase in interest rates will result in an additional $15 bn of interest expenses by 2021. When compared to consensus forecasts for the next years, we worryingly conclude the market may be over-estimating total corporate earnings beyond 2019, setting themselves up for another steep decline.

In parallel, after a decade of 'free money', high yield bonds have now grown to more than $1.2 tn, and represent more than 16% of of all corporate debt. At the same time, the leveraged loan market which is comprised of loans akin to junk bonds with more lenient covenants, now exceeds $1.3 tn. Finally, the lowest-rung of investment grade debt, BBB bonds, now represent over 50% of the total corporate investment grade bond market, 3 times larger than in 2008.

Figure 7: US Corporate Debt Breakdown



Source: Bloomberg, FRED

EVENT PREDICTIONS

For the sake of clarity, the following table summarises our main market and geopolitical predictions for year ahead. Extensive analysis of each view can be found in the next section.

Figure 13: DCM Market and Geopolitical Predictions

Political Event	Forecast
Brexit	Remain in EU
Italian Debt Crisis	2020
US Government Shutdown	End before Janurary 31
Number of FED hikes in 2019	1
US - China Trade War	Tariffs remain
Pipelines Expanded in 2019	Enbridge Line 3
Market Volatility	Increase over 2018
S&P 500 Performance	+8 to +15%
Best Performing Market	UK

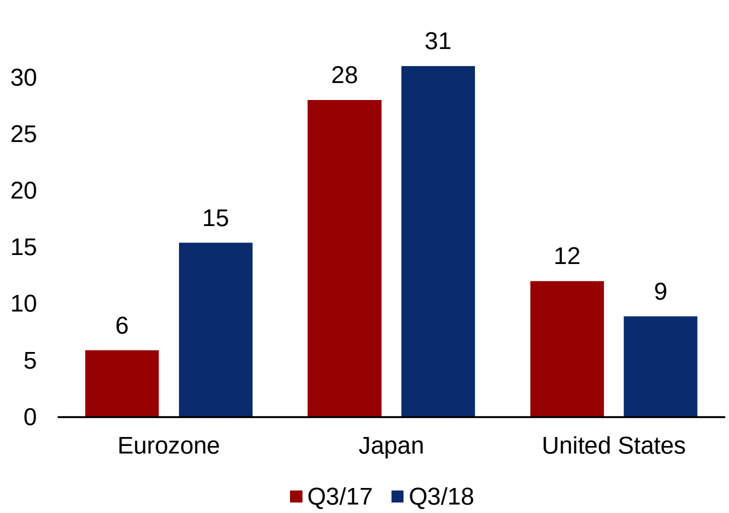
EQUITY MARKETS
2019 OUTLOOK

LEADING THE BOAT IN THE FOG

Although global activity is set to decelerate in the upcoming 1-2 years, DCM is slightly more optimistic than the consensus found on the Street. DCM strongly supports the idea that the geopolitical turmoil to be found inter- and intranationally will not offset a few more pushes from this prolonging economic cycle.

Where one *faux-pas* in the Brexit process or Sino-American tit-for-tat game would most likely plunge the global economic system in an abyss of chaos (among many other situations: France and Macron's ascending unpopularity; Italy's recent difficult relationship with the EU and redenomination risk spillovers), these political jousts will still very likely be maintained for a longer period of time. It is not in any of these 'players' (countries or presidents) interests to be the prime catalyst to the next recession, it is rather more of a game in which one seeks to gain more power over the counterpart without ever burning the bridges between each other. In that, there should be a relatively stable maintaining of tensions that will not directly impede on global economic growth, this till:

Figure 14: Negative growth probabilities, 1-year ahead likelihood (%)



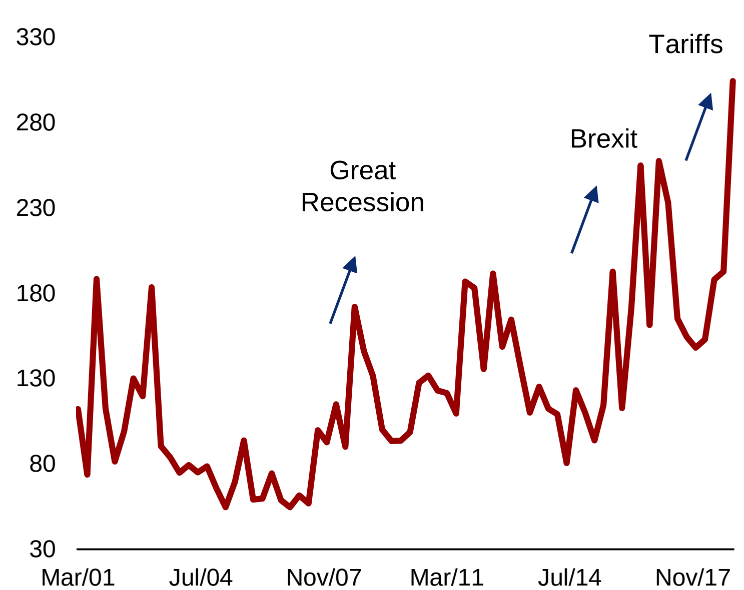
Source: Bloomberg, Policy Uncertainty Index

(i) one sets the light on fire or, *(ii)* a Smorgasbord recession comes into play (ref. Paul Krugman, *New York Times*, 2018).

In a context of elevated policy uncertainty, we expect the composition of growth to progressively shift away from industries exposed to private sector investment, like capital or intermediate goods. The Economic Policy Uncertainty in chart below supports this idea of increasing doubt one should bear in mind for the upcoming months.

The loss of steam in the global engine may be explained, in part, by the cycle coming close to an end. Underlying the slowdown are weaker cyclical conditions in mature markets and reduced support from China and commodity exporters.

Figure 15: Global Economic Policy Uncertainty Index



The weaker outlook for China primarily reflects structural factors, but is amplified by trade tensions with the US. The likelihood of Chinese GDP exceeding 7% growth in two years time is slim, with economists' estimate on the matter at 6.4% on average.

EQUITY MARKETS
2019 OUTLOOK

If 2017 saw rapid investment growth as a key factor driving the recovery of advanced economies, today's elevated policy uncertainty is a major drag on capital spending. Because fixed investment depends on *expectations of growth*, rising uncertainty may prompt firms to postpone or cancel investment projects, especially if accompanied by tighter financial conditions. Subdued demand expectations and rising interest rates in the United States were a major drag on real equity returns in November, accounting for the entirety of the 4.2% annualized decline in the (CPI-adjusted) World MSCI index. The decline was partly offset by low financial stress and slightly positive market sentiment, likely in response to Chairman Powell's comments at month-end.

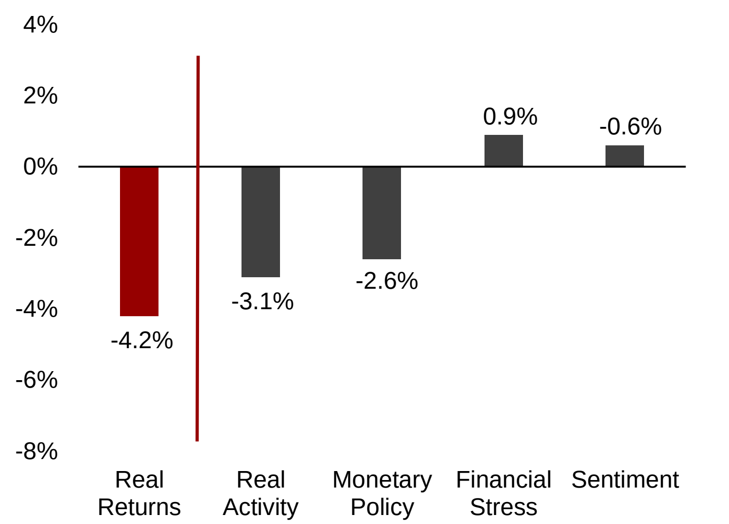
Both inflation and trade are the main components of our US market projections. The Federal Reserve is projected to raise interest rates to 3.5% by the end of 2019 and keep them at that level as the economy slows down, which would coincide with DCM's forecasts.

Figure 16: World MSCI Index

Source: Bloomberg, Policy Uncertainty Index

Given labour unemployment is at staggeringly low levels (3.8%, Jan-18) and capacity utilisation is increasing, it is most likely that monetary policy will remain contractionary given inflationary pressures from the labour market. Wages projected to pick up by over 4% in 2020, elevated asset prices in some markets and heightened leverage in the non-financial corporate sector all justify the introduction of macro-prudential measures.

Figure 17: Drivers decomposition – World MSCI annualized returns



Upper-North, Canada's economic growth is projected to remain strong albeit shy numbers in the ballpark of 2% by 2020. While legalization of cannabis will contribute 0.2 percentage point to the level of real GDP in 2019, momentum is rather to be found in business investment, projected to reach 5.8% in 2020.

Canada's economy is to be considered relatively healthy given record low levels of unemployment and inflation only to edge up to slightly over 2%. Hourly wage growth is rising and will receive a further boost from increases in provincial minimum wages over the next few years.

EQUITY MARKETS

2019 OUTLOOK

Yet, DCM believes the Canadian economy remains 'strong' due in large part to the 60% of the Canadian economic output attributed to personal consumption. Given personal consumption and housing trends are highly correlated and that housing trends are slowing down, one should keep track of this. Finally, the price of crude oil, notably of WCS, has become increasingly volatile due to domestic pipeline constraints. A healthy energy sector is not only critical for business investment, but also exports, as energy products account for nearly 20% of total Canadian exports. Thus, DCM believes the conditions surrounding crude production, further highlighted in Energy's outlook (page 54) will taper Canadian growth. This thesis supports our estimate of a 2% economic growth for 2019-2020.

EQUITY ALLOCATION

In conclusion, although risks to global growth abound from multiple sources, we remain optimistic that this historically long economic cycle can sustain itself for another 1-2 years. However, this year's volatility and steep decline has taught us many lessons vis-à-vis our own sector and geographic allocation.

Indeed, going forward we will maintain our fund's proportion in cash, and money market funds, while gradually increasing our exposure to more defensive sectors such as healthcare, consumer staples, and utilities. We will also seek to take positions in our main geopolitical predictions for the year through stock or ETF selection. Additionally, the depreciation of many emerging market currencies in 2018 proved to be a drag on our returns. This leads us to slightly decrease our exposure to emerging markets for 2019. Finally, as we've often mentioned throughout the years, the role of technological disruptions on the global economy is only set to increase. Consequently, we will continue to seek out companies leading their sector's tech revolution.

DCM NOTE

As the year comes to an end, we celebrate many milestones: the changing of the guard, the retirement of one of the co-founders, and our 10-year anniversary.

Indeed, we are beginning to hand off student leadership roles to the incoming seniors. I would like to take this opportunity to congratulate my good friend, Rakan Lamy, on his election as Global Equity Strategist and to thank every student for their contribution to the program this year. I am confident that the Honours in Investment Management program and DCM will continue to thrive under his leadership, and that the junior class of analysts will continue to propel DCM forward.

This year also marks the retirement of DCM's Co-Chief Investment Officer, Ken Lester. For over 20 years, Ken has run Lester Asset Management, taught at McGill, and presided over DCM. Without him, the fund would not nearly be as successful. He has, without a doubt, left a mark on each and every student of this program and for this we are extremely grateful. Although he will be sorely missed, he will always be a member of our DCM family.

Finally, 2020 marks the year 10-year anniversary of the Global Equity and Fixed Income Funds. We plan on marking this special occasion with many initiatives throughout the year. The Honours in Investment Management Program is a unique experience, but none of it would be possible without the generous support of the numerous benefactors and investors of our fund.

I'd like to end this section, and my tenure as Strategist, by expressing my sincerest gratitude for the unwavering faith and support you place in us. I can confidently say that every student, current and past, has seen their life forever transformed by this program.

Yours Truly,

George Koutsos

Source: Bloomberg, OECD

ANNUAL REPORT 2018

Global Equity Fund

GEOPOLITICAL OUTLOOK AND REVIEW

GEORGE KOUTSOS
ANDREW GUERRAND

DESAUTELS CAPITAL MANAGEMENT

EQUITY MARKETS
2019 OUTLOOK

SOME MEN JUST WANT TO WATCH THE WORLD BURN

This year saw the return of geopolitical insecurity. With the renunciation of the Iran nuclear deal, Sino-American trade tensions, Italian budget conflicts and Brexit deal-making, 2018 was an eventful year in politics.

The year kicked off with trade tensions between the United States and most of its partners. By February, we were already through 6 rounds of NAFTA negotiations. Although, the USMCA was negotiated in a relatively short time frame, most other geopolitical tensions persist, with their effect weighing on both global markets and growth prospects, as witnessed by the graph below.

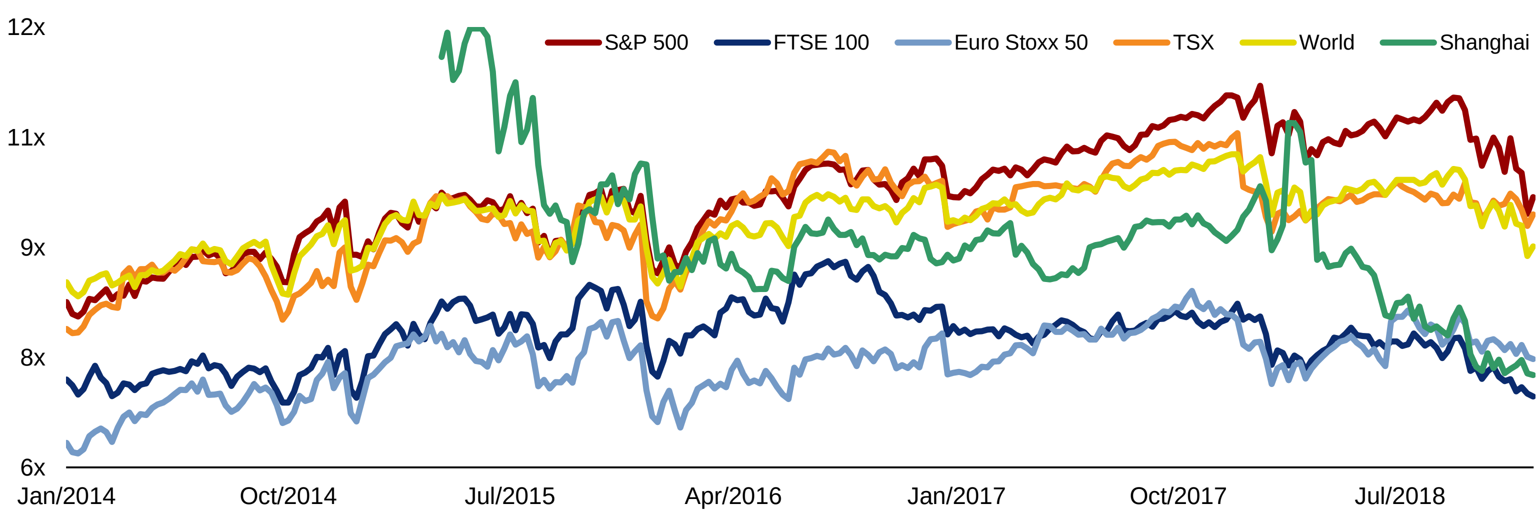
Trump's trade actions targeted allies and competing countries alike. In the first three months of 2018, Trump imposed steel and aluminum tariffs on most steel producing countries, threatened China, and even mused of taxing German automobiles. Since then, tensions have only escalated, as the US has imposed a 10% tariff on over $250 bn of Chinese goods. The breadth of these tariffs has now come to haunt economists, and market analysts. Fears of a slowing global economy, and growth prospects being irrevocably harmed are on every mind.

At DCM, our view is trade tensions are here to stay. Trump's inability to pass any meaningful legislation in a divided Congress will force him to turn to foreign policy as his only vehicle for political deal-making. We would expect to see a reversal if America tips into a recession.

Across the pond, in the United Kingdom, Brexit defined headlines for the better part of the year. Even before the Chequers fiasco, Theresa May faced hostility from Europe, from the opposition parties, and from within her own party. Yet, the prime minister persevered through each crisis and debacle, trudging ever closer to a clean and soft exit from the European Union.

It is only in December, when the exit agreement was negotiated and signed, that May's deal and political survival were seriously threatened. Brexit reality hit MPs, and opposition to her deal surfaced from all sides, forcing her to pull the vote on her deal, before the ink could even dry. May then spent a week blazing through European capitals trying to obtain last-minute assurances, However, the most serious threat came right before Christmas when Tories voted on whether

Figure 8: Global Equities Valuations (FW EV/EBITDA)



Source: Bloomberg, Financial Times, USMCA, DCM, Financial Times, The Guardian

EQUITY MARKETS
2019 OUTLOOK

MAY'S NINE LIVES

they had confidence in May's leadership. Although she narrowly survived the vote, more than a third of her own party opposed her. This turmoil is emblematic of the Brexit process so far.

As we rapidly approach March 29th, the official exit deadline, Britain is at a crossroads: a second referendum, no-deal Brexit, renunciation of Article 50, new general elections, or approving May's exit deal. We maintain the view at DCM, that the end result will be a **BREMAIN**. Indeed, given European leaders' unwillingness to reopen the agreement, there is very little room for meaningful changes. Coupled with the far-reaching opposition in Parliament, and low support in polls, we do not expect May's deal to pass. The cross-party Europhile majority essentially rules out any no-deal Brexit possibility. Finally, a general election will not solve any of the underlying issues of the Brexit debate, as no better deal can be negotiated. This leaves us with two favorable options: a referendum or withdrawing Article 50.

Although uncertainty may rise in the short-run, we believe that the British Pound, and UK stock market, one of the most undervalued will rally from their depressed levels, resulting in the best performance of 2019.

A two-hour flight away, populists once again shook the political establishment and markets, this time in Italy. Matteo Salvini of the League and Luigi Di Maio of the Five Star Movement, joined forces to form a populist coalition government in Italy.

Although markets were initially unsettled, most political and financial analysts did not believe the coalition would fulfill their campaign promises given the prohibitive costs and the parties' opposing ideologies. This held true for the majority of the year, as most laws or acts by the coalition were largely rhetoric. However in November, the budget negotiations threw a wrench in the Italian market's stability. To honour their campaign promises, the budget included a basic universal income, a reduction in the retirement age for pensions, and lower taxes. Consequently, the Italian 10-year credit spreads (over the German Bunds) shot up to levels not seen since the end of the Eurozone Crisis, as seen in the chart below. The budget was subsequently rejected by the European Commission, and modified by the coalition to reduce the size of the deficit, leading to calmer markets.

Figure 9: USD/GBP & FTSE 100 FW EV/EBITDA (right)

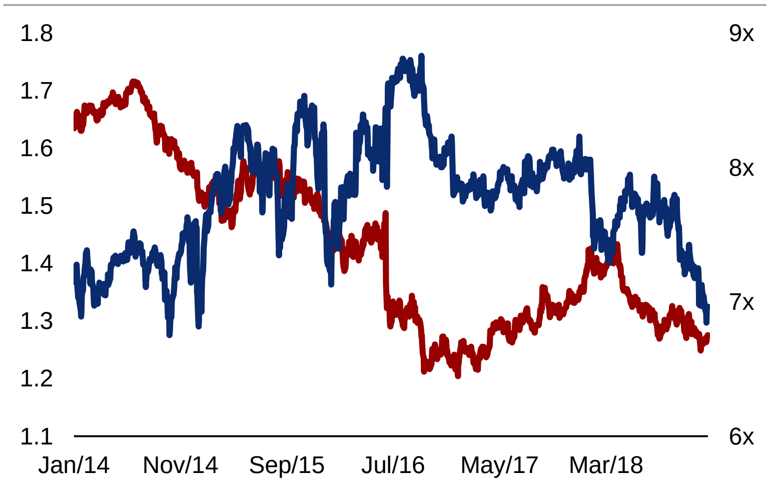
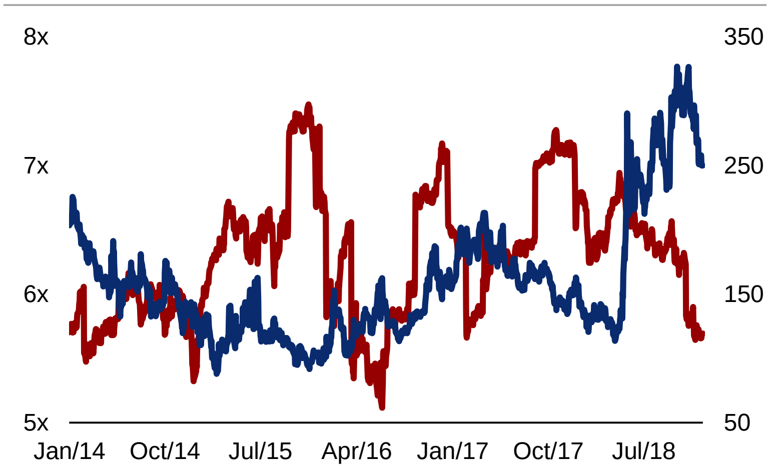


Figure 10: MIB FW EV/EBITDA & BTP – Bund (right)



Source: Bloomberg, Financial Times, Politico

EQUITY MARKETS
2019 OUTLOOK

THE TRUMP BUBBLE DEFLATES

Longer term, we do not hold a favorable view on Italian domestically-focused securities. We view Italian sovereign debt as a ticking time-bomb, which could ultimately lead to the exit of one of the founding partners of the Euro. On this backdrop, we will limit our investments to companies that generate the majority of their revenue abroad, and with a local cost base (Lira). Our reasoning behind this is that a newly denominated Lira, would likely depreciate in its initial years.

Back to the United States, 2018 was a year of many political events. Just this past November, the Democrats swept the House of Representatives in the midterm elections. Power in Congress is now evenly split between both parties, as we head into the next presidential election cycle.

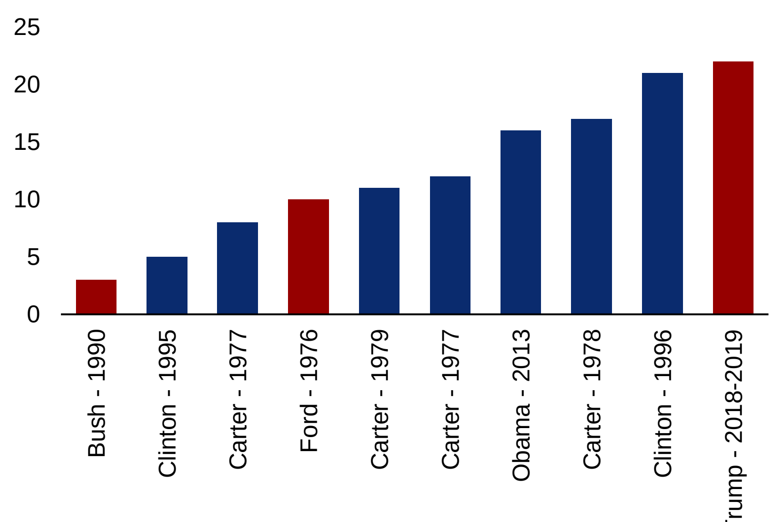
This increases the likelihood of confrontation through subpoenas and inquiries, and decreases the probability that any of Trump's policy goals will be achieved. Consequently, as previously alluded to, we believe that any subsequent political uncertainty will revolve around the Mueller probe and its conclusions, as well as Trump's pivot towards foreign policy, and by extension trade goals. A direct corollary of this shift of power, and approaching elections is the prolonged government shutdown. Seeking to obtain $5 bn in funding for his wall, Trump has pledged to veto any budget that does not contain these resources.

Trump's position will increasingly becoming tenuous after the new year, once Democrats officially take control of the House. Although, this is only a partial government shutdown (25% of government spending is affected), S&P nonetheless estimates the loss to the American economy at $6.5 bn per week. In a time where investors are increasingly worried about US growth prospects, this shutdown only compounds the feeling. All in all, as long as the shutdown is not prolonged for many months, we do not see this as having a significant impact on the economy. The true threat to market and business sentiments will only come if the shutdown prevents a debt-ceiling deal (March 1st). However, we see this is an unlikely, and estimate the stand-off will be resolved by the end of January.

Not to be outdone by the likes of Erdogan, Trump also worryingly challenged Jerome Powell, FED chairman over the pace of interest rate hikes this past year. It was even rumoured that Trump was considering firing him. This places Powell in a difficult position going forward, because any indication that the FED will slow interest rate hikes, could embolden Trump.

Overall, after this challenging, and tumultuous year, we've realised that the market is starting to sour on Trump. We believe the market's tolerance for Trump's erratic behaviour and policies has fallen. These acts are no longer shrugged off. The Trump bubble has deflated and his actions now actively weigh on the market.

Figure 11: Longest US Government Shutdowns (days)



Source: Bloomberg, CNN

EQUITY MARKETS
2019 OUTLOOK

LE DÉLUGE

Finally, DCM's view is that American political uncertainty will not fade away in 2019, but may even increase. Indeed, as the Mueller probe nears its end with potential indictments of Trump family members, and even the President himself, and as Trump pivots towards foreign policy to assert his influence, there is much room for political discord and volatility.

To conclude this section, Canada experienced less political uncertainty than most other regions in 2018. Major events include the effective legalisation of cannabis in October, the new USMCA trade deal, and the Canadian crude crisis. We will focus on the Canadian crude crisis, as we have already analysed the USMCA deal in a previous newsletter.

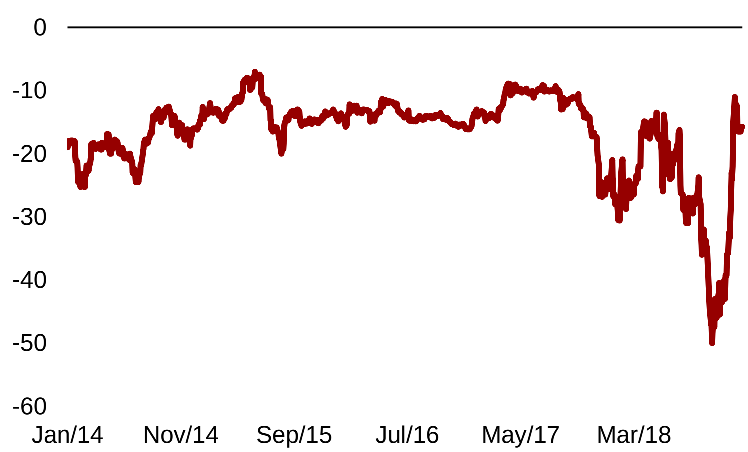
Over the year, WTI crude oil prices peaked at 75$, on the back of a general market upturn, strong economic fundamentals, and the possibility of a supply crunch from the resumption of US sanctions against Iran. A microcosm of the volatile pricing dynamics in the oil market is apparent when examining Canada's local price index, the Western Canada Select. The price of crude in Alberta at one point hit $10 a barrel, with a corresponding differential of over $40 with the WTI.

This wide gap stems from Canada's inability to build pipelines for exporting crude oil. In the past 3 years, Northern Gateway and Energy East have both been abandoned either by regulators or their corporate sponsors for lack of support from local populations. In a bid to increase pipeline capacity, the Trudeau government went as far as to nationalise the Transmountain pipeline. However, even this expansion has now stalled as the courts ruled that the government proceeded too quickly through the National Energy Board's approval process.

At such depressed levels, it was estimated that the WCS – WTI differential cost the Canadian economy $80 mm a day. This crisis prompted the Albertan government to mandate production cuts across the province, while also seeking to purchase 7,000 crude tankers for shipment by rail.

Although, these measures allowed the WCS price to recover, we believe that they are only temporary solutions. As long as energy companies and oil-dependent governments are unable to garner local population support and social acceptability for their pipeline projects, we do not see Canadian energy dynamics fundamentally improving irrespective of price movements in WTI. Consequently, we are underweight Canadian energy stocks for the foreseeable future, and thus equally pessimistic on the aggregate Canadian market performance.

Figure 12: WTI – WCS Differential ($ USD)



Source: Bloomberg, The Globe and Mail

ANNUAL REPORT 2018

Risk Management

2018 REVIEW & 2019 OUTLOOK

Josiah Derksen

DESAUTELS CAPITAL MANAGEMENT

RISK MANAGEMENT
2018 OVERVIEW

NEW TOOLS AND A NEW MANDATE

DCM investment decisions are not only guided by investment theses and valuation, but also by overall risk assessment and alignment with our macroeconomic and sector-specific views. Some of the risk metrics we track include rolling betas and standard deviations, Value-at-Risk (VaR), tracking error, and marginal contribution to risk.

Every year we try to build upon our existing analytical skillset, with the ultimate goal of building a portfolio with an optimal risk-return tradeoff. This year we also focused on worst case scenario analysis for individual positions, based on both qualitative and advanced quantitative techniques to better understand the resilience of our investments to leverage, industry headwinds, commodity prices, and market corrections in the face of record high valuations.

As a recent example, when modelling a junior mining company, we ran a Monte Carlo simulation using non-normal multivariate copulas to capture dynamic correlations between various commodity prices and FX rates, while also taking into account certain real options the company could exercise. The lessons learned during this analysis proved to be very valuable. Shortly thereafter a team of four HIM students (Emilie Granger, Ian Jiang, Ludovic Van Den Bergen, and Roy Chen Zhang), won first place and a $10,000 prize at the PRMIA International Risk Management Competition, where many of the same quantitative techniques were used.

Our view is that risk management and analytics should also play a key role in the investment process. To this end, we have decided to expand the mandate of the risk management team. Starting in the Fall our team will not only continue to develop risk management tools, but we will also directly support sectors with relevant quantitative analysis to support valuation and investment theses. We have a number of current and incoming students with excellent quantitative and programming skills who are passionate about quantitative analysis and ideally suited for the team's new mandate.

2018 REVIEW

In 2018, the equity fund realized an annualized standard deviation of 13.4%, slightly lower compared to the benchmark 12.7%. This is largely attributable to the fund's deviation from the benchmark during July through August. Additionally, the equity fund continues to measure the VaR of the equity fund through historical simulation on a daily basis. As displayed in Figure 2, the equity fund has a 1-day 1% VaR of 9.1% ($257K) compared with 9.7% ($272K) for its benchmark. This is down from 3.4% and 3.3% in 2017, suggesting increased volatility for 2018. This is expected due to the low volatility nature of 2017, in relative terms. The broad market sell off in October, coupled with the partial U.S. government shutdown in late December, ultimately led to a higher standard deviation for the fund in 2018 compared to 2017 at 13.4% and 6.7%, respectively.

Source: Bloomberg

RISK MANAGEMENT
MARKET RISK EXPOSURE

Figure 1: Performance Metrics

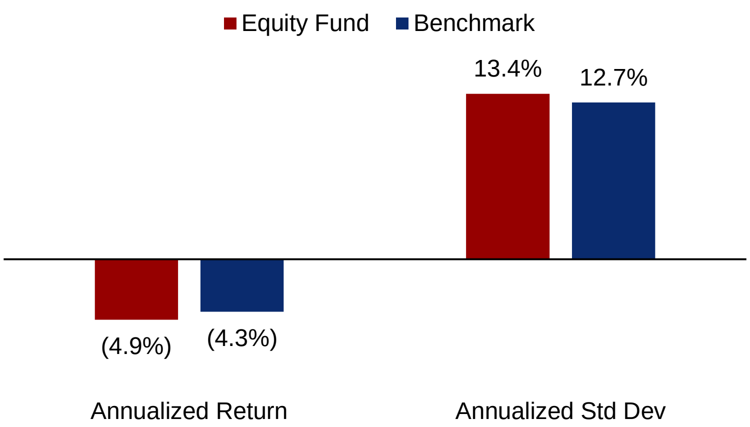
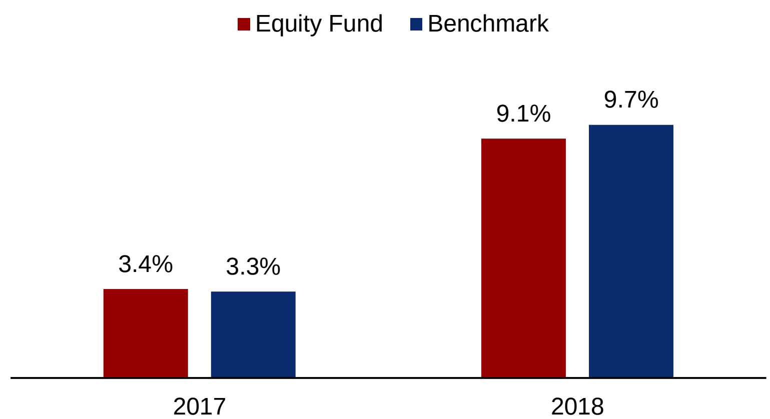
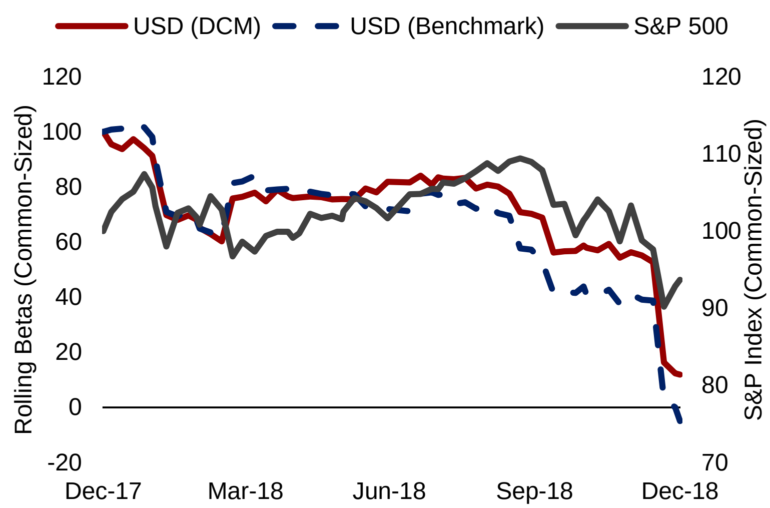


Figure 2: 1-Day 1% VaR



MARKET RISK FACTORS REVIEW

Figure 3: Common-Sized 1-Year Rolling Beta with USD[(1)]



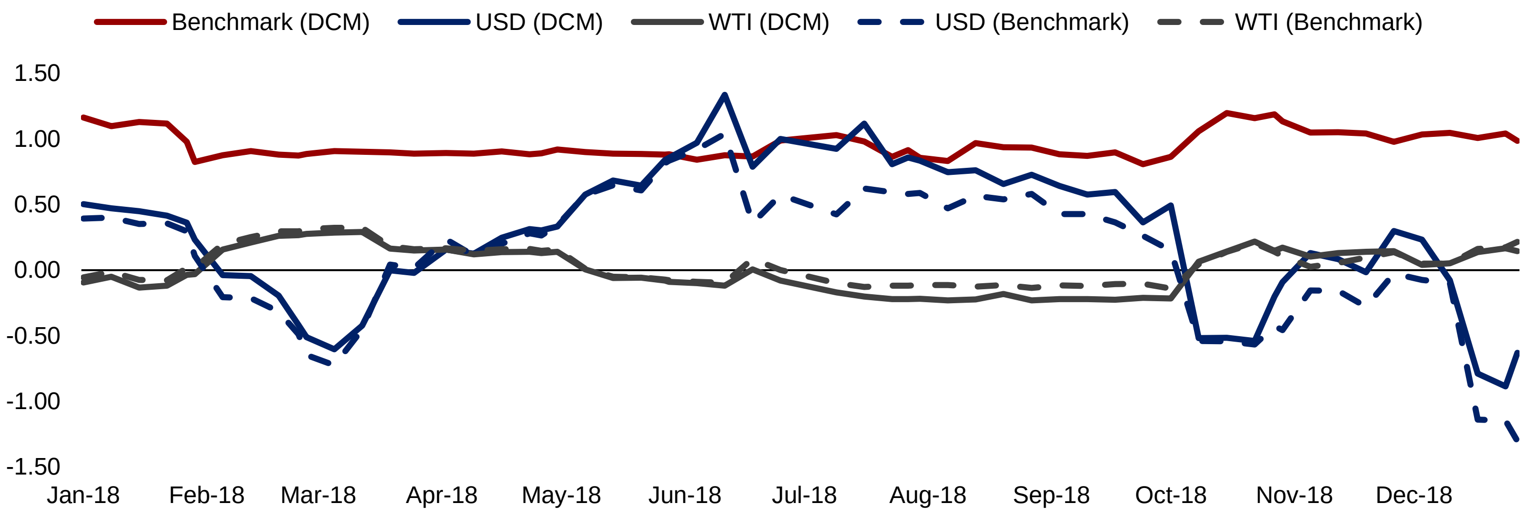
In addition to previously mentioned risk measures, DCM also places importance on monitoring external pressures. We examine exposure to our blended stock market benchmark, oil, and the USD/CAD exchange rate. To better understand our sensitivity to these factors, rolling betas are computed at the end of each week using a lookback period of 3 and 12 months. The results provide a measure of our portfolio's alignment with our views and, more specifically, exposure to market, commodity, and foreign exchange risk. Additionally, this tool helps in understanding divergence in relative performance. In 2018, the Global Equity Fund had an overweight allocation to U.S. assets (60%) compared with the benchmark (40%). During the year the US Dollar appreciated over the Canadian Dollar (1.26 to 1.36), working in favour of the fund. Interestingly, DCM's exposure to the USD appeared to co-move with the broader US equity market (Figure 3). Further, DCM and the benchmark became less exposed to exchange rate risk, ending the year with 12-month rolling betas of 0.07 and -0.03, respectively. In other words, DCM's returns are becoming less reliant on and driven by foreign exchange exposure, and more reliant on market factors. With the US economic cycle nearing an end, our fund managers will begin to reduce our overweight position in US assets, replacing these holdings with Canadian holdings, moving closer to the 40% U.S. and 60% Canadian weighting of the benchmark.

(1) Starting point of 100 for both Betas on December 31st, 2017.
Source: Bloomberg

RISK MANAGEMENT

MARKET RISK EXPOSURE

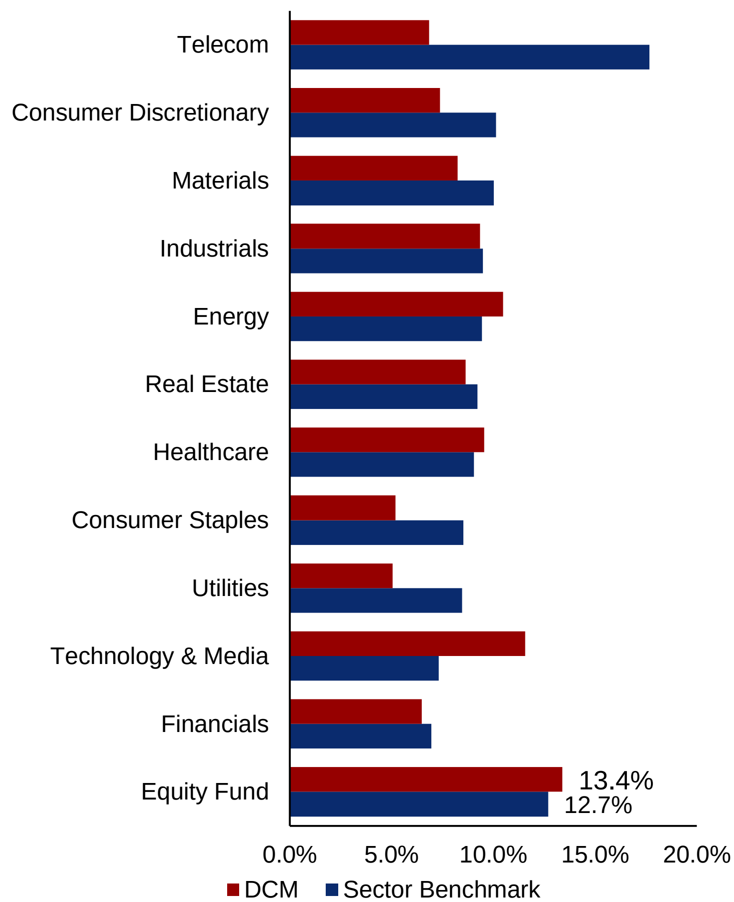
Figure 4: Risk Exposure – 3-Month Rolling Betas(2)



VOLATILITY ANALYSIS

In 2018, our fund managers made an effort to allocate cash to ETFs for sectors that were underweight compared to the benchmark. The Global Equity Fund now has 26 individual holdings and 6 ETFs, representing a well-diversified portfolio. This is reflected by the fund's YTD volatility of 13.4%, slightly higher compared to the benchmark 12.7%. Since inception, these numbers are more favorable with Global Equity Fund and benchmark annualized volatilities of 12.2% and 11.1%, respectively. Comparing sector-level volatility with sector benchmark volatility enables us to analyze the relative risk of each sector. A typical DCM sector holds 2 to 4 individual holdings, and potentially a sector ETF depending on the fund manager's allocation of capital. Due to a lower number of individual holdings, it is normal that our fully invested sectors display higher volatilities than their benchmarks. Telecom and Consumer Discretionary represented the two sectors with the highest volatility (Figure 5). High volatility in the Consumer Discretionary sector was coupled with significant excess return above the benchmark of 41%, while Telecom

Figure 5: Annualized 12-Month Volatility by Sector

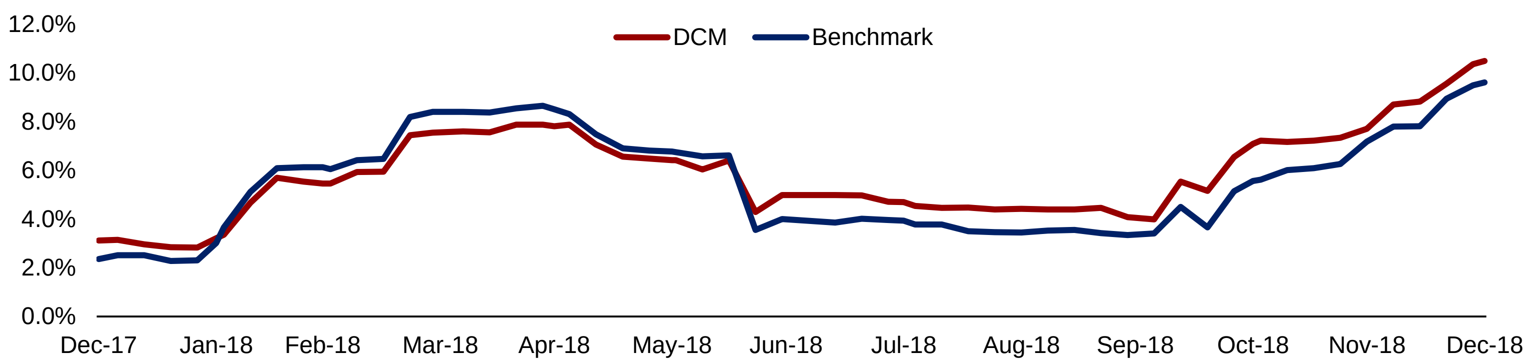


(2) Solid lines represent our rolling exposure to the risk factors, and dotted lines represent our benchmark's exposure to the risk factors
Source: Bloomberg

RISK MANAGEMENT
IDIOSYNCRATIC RISK EXPOSURE

underperformed by 0.7%. Consumer Discretionary gained from substantial gains in Aritzia and Live Nation, supplemented by gains in Madison Square Garden before the closing of the position in April 2018. Figure 6 shows the 3-month rolling volatilities of the Global Equity Fund and its benchmark. Volatility movements were largely in line with the benchmark throughout 2018, with DCM outstripping benchmark volatility in June, as the US Dollar appreciated and equity markets rallied.

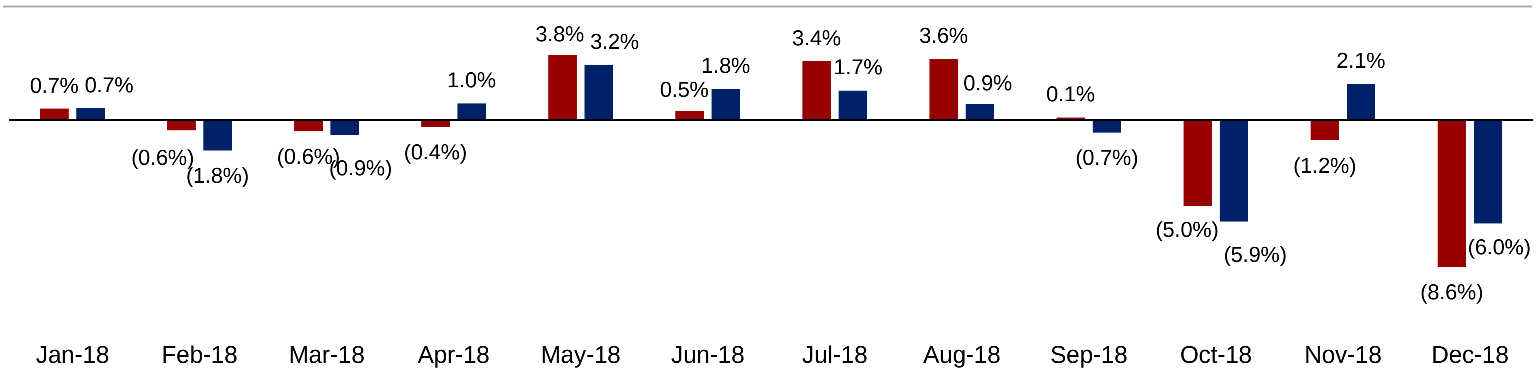
Figure 4: Risk Exposure – 3-Month Rolling Betas



RETURNS ANALYSIS

The Global Equity Fund had a gross return of -4.9% in 2018, representing a slight underperformance compared to the benchmark -4.3%. Figure 7 (below) displays the gross monthly returns of the Global Equity Fund compared with the benchmark. The annualized performance was dragged down by two market corrections during the year, specifically during the October sell-off and partial U.S. government shutdown in late December. The poorest performers during December included SVB Financial Group (-25%) and Fresenius Medical Care (-21%), with top performers including iShares S&P/TSX Capped Materials Index ETF +6%, Loblaw Companies 0%, and Shire PLC (-1%). Interestingly, the equity fund experienced more positive than negative weeks during the year, however weekly returns display negative skewness, with the magnitude of negative returns exceeding positive returns on an absolute basis (Figure 8). Due to underperformance this year, with slightly higher volatility than the benchmark, the Global Equity Fund's annualized Sharpe ratio since inception has decreased, now 0.40 versus the benchmark 0.48.

Figure 7: Monthly DCM (Gross) and Benchmark Returns

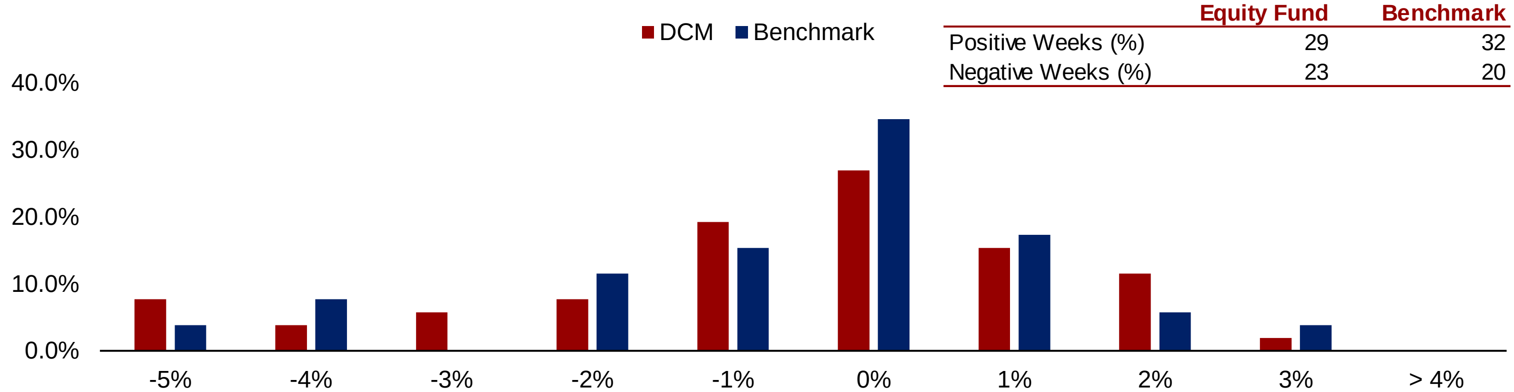


Source: Bloomberg

RISK MANAGEMENT
IDIOSYNCRATIC RISK EXPOSURE

Figure 8: Distribution of Weekly Returns in 2018

	Equity Fund	Benchmark
Positive Weeks (%)	29	32
Negative Weeks (%)	23	20



Source: Bloomberg

CONSUMERS

2018 REVIEW & 2019 OUTLOOK

TEJAS SAGGI
SELENA ZHU

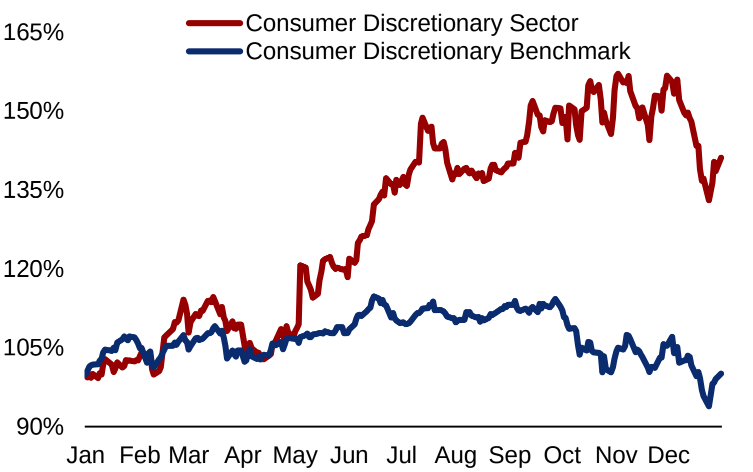
CONSUMERS
2018: A TALE OF TWO HALVES

PERFORMANCE OVERVIEW

As with other equity market sectors, the Discretionary sector performed exceptionally well early in 2018. In fact, Discretionary was up 10% half-way through the year, outpacing all other sectors bar technology. However, this momentum withered away as investor concerns regarding rising rates, the US-China trade-war, and a US government shutdown trumped any catalysts from a growing US economy. Indeed, the Consumer Discretionary sector finished the year with a mediocre 0.1% return, ranking 5^{th} among the 11 sectors. Similarly, the Consumer Staples sector performed poorly, returning (1.7%).

However, DCM's Consumers portfolio was well-positioned to capitalize on trends and neutralize investor concerns. Particularly, as seen in Figure 1, the Discretionary sector performed exceptionally, returning an alpha of 41%. This alpha is attributable to holdings in Aritzia and Live Nation Entertainment, which returned 29% and 26% respectively. Unfortunately, DCM's Staples sector could not withstand the shifting tide of sentiment, underperforming the benchmark by (3.2%).

Figure 1: DCM Consumer Discretionary Performance

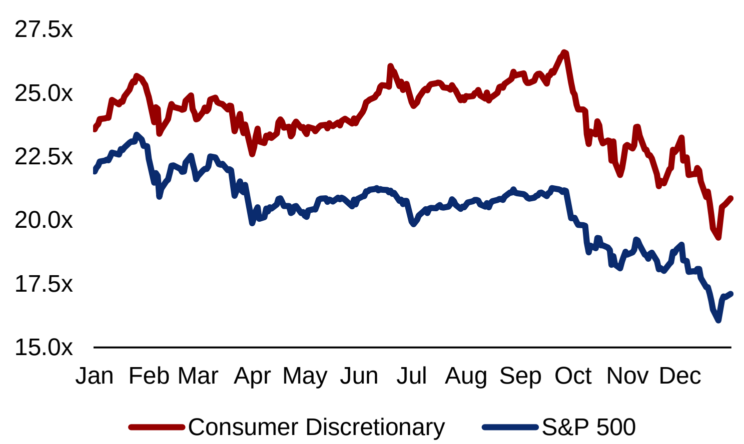


Source: Bloomberg

DISCRETIONARY PERFORMANCE HURT BY MULTIPLE CONTRACTION

The Discretionary sector's performance, especially towards the end of 2018, is largely attributable to a contraction in P/E multiples. While Discretionary P/E multiples soared in the beginning of the year on the back of global synchronized growth, the reversal of this sentiment soon fueled a contraction in multiples, as seen in Figure 2, and a dampened performance. As value investors, we are cautious not to invest in companies with inflated valuations as these companies tend to be hit the hardest during market sell-offs. As a result, the DCM Discretionary sector performed well over the later half of 2018, generating alpha of 13%.

Figure 2: S&P Consumer Discretionary P/E Multiples



SLUGGISH STAPLES

Typically, Staples companies outperform their discretionary counterparts in a down year due to their defensive nature, making Staples' 2018 performance all the more surprising this year. However, 2018 was unique in that, while the market slumped, the general economy continued to grow. With economic indicators such as discretionary income and business investment growing, consumers were not necessarily turning towards staples products. The result was a sluggish Staples performance.

CONSUMERS

CONSUMER DISCRETIONARY OUTLOOK

MACROECONOMIC OUTLOOK

Following a strong 2018 economy supported by robust growth, low unemployment, and bolstered consumer confidence, 2019 will be a year of transition for companies in the Consumer Discretionary sector. A rising rate environment coupled with potential inflationary pressures suggest the business cycle is approaching the later stages of expansion, where Discretionary stocks tend to underperform. Although the Fed's rate hikes will not significantly affect Discretionary stocks due to the gradual nature of the rise, we still expect the increase in the cost of borrowing to decrease discretionary spending.

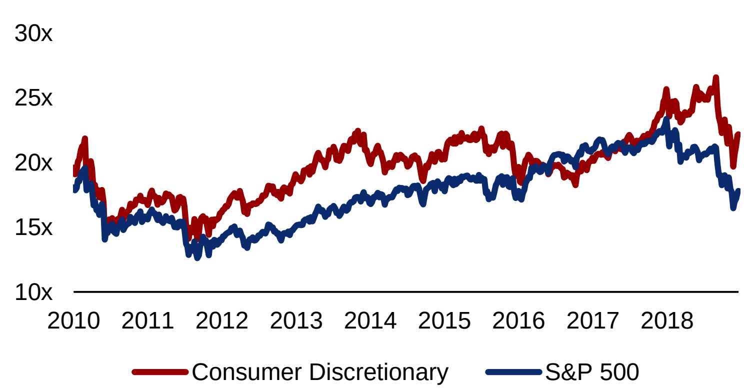
In 2018, retailers accumulated significant savings through tax cuts, which trickled down to consumers in the form of lower prices. However, as the full impact of the tax reform becomes priced into the market, we believe that the effects of tax cuts will begin to wither away in 2019. Moreover, as geopolitical tensions continue to rock the economy, imposed tariffs are expected to adversely impact consumer companies, raising doubts about firms' abilities to absorb the associated damages. With the escalation of the US-China trade war, higher tariffs will contribute to inflationary pressures due to higher input costs and consumer prices. So far, the US has imposed tariffs on $253 bn of Chinese imports while threatening tariffs on another $267 bn of goods. Due to the lagged effects of tariffs, we expect newly imposed and possibly further tariffs to significantly dent consumer and business confidence in 2019. As Consumer Discretionary stocks tend to lag during periods of sluggish macroeconomic growth, looking forward, we believe that Discretionary stocks on average may lose their edge and move more in line with the broader market.

VALUATIONS

In 2018, valuation for Consumer Discretionary stocks reached an all-time high, peaking above pre-2008 levels. Multiples at such high levels suggest the Discretionary sector was relatively overvalued compared to its historical average. However, towards the end of 2018, the market demonstrated signs of correction, pulling down the entire market and in particular, the high-flying Discretionary sector (Figure 3).

Despite the recent correction, moving forward, we believe that valuations for the sector will remain at levels higher than the historical average due to Discretionary's severe overvaluation in previous years. Comparing the sector's estimated long term growth rate of 14% to S&P 500's long term growth rate of 10%, we believe that Discretionary's superior multiples are partially attributable to its higher earnings growth potential relative to S&P 500. Looking forward, we expect the multiple contraction witnessed at the end of 2018 to continue into 2019, albeit less intensively. This creates an opportunity for us to uncover undervalued companies in a sea of overvalued Discretionary stocks during a period of normalizing, yet not fully corrected valuations. Accordingly, taking into account the dampened market prospects, we will favour companies that are poised to outperform in the case of a milder economy.

Figure 3: Consumer Discretionary P/E Multiples



Source: BBC, Bloomberg, Deloitte, Forbes

CONSUMERS

CONSUMER DISCRETIONARY OUTLOOK

TRENDS WITHIN DISCRETIONARY

The Consumers sector has reached an inflection point, hit with a slew of disruptions threatening to alter market dynamics. Consumers, increasingly empowered by technological advancements, have raised their expectations, pushing companies to adapt to the changing landscape of the industry. As companies evolve to adapt to these changes, we have identified three trends we expect to drive performance in 2019.

1. DIGITALIZATION

As technological advancements continue to define customer expectations, we expect companies to address this shift by digitalizing their entire value chain, from the supply chain to product offerings. In fact, according to studies conducted by PwC, the percentage of a typical company's total financial value that is driven by digitalization will increase noticeably with time, from 24% in 2014 to 86% in 2019. Thus, we expect the trend of increased digitalization to drive incremental value across a company's value chain. Our recent investment in The Stars Group, a leading provider of online betting, poker, and gaming brands, exemplifies our focus on investing in companies that leverage this trend to capture growth opportunities. Supported by a proprietary technology platform that is considered the most scalable in the industry, The Stars Group is well positioned to capitalize on opportunities in the online gaming industry, whose forecasted market growth surpasses that of the physical gaming industry. Given the firm's technological superiority, The Stars Group will be able to enter new markets with its existing platform through plug-and-play, gaining the first-mover advantage and bypassing the risks associated with physical gaming operations.

2. E-COMMERCE

E-commerce is no longer just an option, but rather a requirement for success, especially in the hyper-competitive, technology-disrupted retail industry. The rise and dominance of Amazon over the past few years best demonstrates the undeniable importance of this trend. However, while we expect the consumer shift towards e-commerce to become increasingly prevalent, we recognize that some companies with a strong foothold in e-commerce are overvalued. Accordingly, we will aim to identify e-commerce focused, yet undervalued retailers. Our investment in Aritzia, a fashion brand with a strong e-commerce presence that was trading below peers, aligns with our strategy.

3. HYPER-PERSONALIZATION

As retailers begin to understand the importance of tailoring their offerings to each specific buyer, we believe that the trend of hyper-personalization will be increasingly leveraged to provide each client with a personalized and unique shopping experience. Data analytics will be a key enabler of this trend, allowing retailers to predict and influence buyers' purchasing decisions. According to research conducted by BCG, companies that focus on personalizing customer experiences will witness elevated growth rates. Thus, we will aim to identify companies that employ this trend to differentiate their brand and build brand loyalty.

LOOKING FORWARD

In 2019, we will aim to identify companies that are at the forefront of these trends to capitalize on concrete, realizable operational superiorities. We believe this is especially important during a period of market volatility and dampened performance.

Source: BCG, PwC, The Stars Group

CONSUMERS

CONSUMER STAPLES OUTLOOK

2019 TAILWINDS

Given the prevailing volatility in the broader market, we expect Consumer Staples to shine brighter in 2019 relative to their lacklustre performance in 2018. The Staples sector will be bolstered by waning investor confidence in the overall market, due to geopolitical tensions and sluggish investor sentiments, which plays to the sector's increased attractiveness during periods of market volatility. Thus, we believe that Consumer Staples could experience an inflow of capital as investors begin to seek stability in their portfolios.

2019 HEADWINDS

Rising transportation costs will continue to exert pressure on the Consumer Staples sector in 2019. Given the trucking industry's unending struggle with a growing driver shortage, trucking costs will continue to rise as long as the capacity crunch remains unsolved. Staples companies have already begun to realize the scale of the impact of increased transportation costs which threaten to compress profit margins and further dampening business confidence. Staples giants such as General Mills and Kellogg's have warned of rising logistics costs, while Hershey's raised consumer prices to offset incremental costs, denting consumer wallets.

Input costs are also expected to rise in 2019, the impact of which will trickle down to consumer prices. In particular, Trump's tariffs on commodities will directly feed into the input cost increase, having already affected many Staples conglomerates this year. Following the enactment of a 10% tariff on imported aluminum, Coca-Cola raised its soda prices to combat the rising cost of aluminum. Moving forward, as geopolitical tensions continue to rock the economy, doubts about companies' abilities to absorb higher input costs will only intensify.

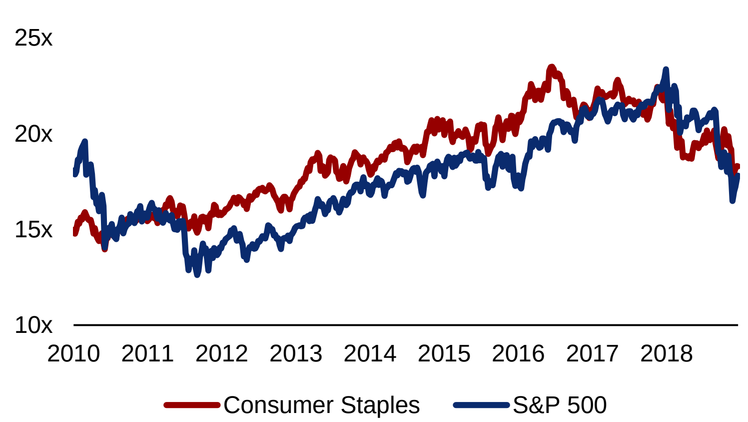
The Consumer Staples sector is no stranger to the e-commerce trend, which instigated the shift away from brick and mortar to online stores. In the grocery industry, the shift was best embodied by Amazon's acquisition of Whole Foods which established an omni-channel business model, sending tremors throughout the industry. Thus, as the increasing prevalence of e-commerce threatens to crimp market share, Staples companies must employ online channels to offset the headwind and maintain their competitive position.

OVERALL OUTLOOK

Our recent investment in Loblaw demonstrates our focus on identifying companies that will withstand and in turn capitalize on some of 2019's headwinds. Our belief in the importance of being technologically savvy is embodied in our investment in Loblaw, a firm at the forefront of the e-commerce trend in the Canadian grocery industry.

Moving forward, in 2019, we expect the Consumer Staples sector to move in line with the broader market, with an edge if market volatility persists. However, the multiple headwinds facing the Staples sector, some of which unavoidable, may offset any potential gains from an increase in overall market volatility.

Figure 4: Consumer Staples P/E Multiples



Source: Charles Schwab, CNN, Forbes, Freight Waves

CONSUMERS

2018 HOLDINGS REVIEW

LIVE NATION ENTERTAINMENT (NYSE: LYV)

COMPANY OVERVIEW

- Live Nation Entertainment is the world's largest ticket seller and live entertainment promoter
- The company was formed from the merger of Live Nation and Ticketmaster in 2010
- The company reports three business segments: Concerts, Ticketing, and Sponsorship & Advertising
- The company primarily promotes live music events but also sells tickets for all forms of live entertainment, including sporting events

CATALYSTS

- Improvements in onsite monetization initiatives such as food and beverage, VIP, and parking services will bolster average spending per fan
- Successful implementation of new technologies - digital ticketing, Verified Fan, and partnership with facial recognition firm Blink Identity - will drive ticketing growth

RISKS

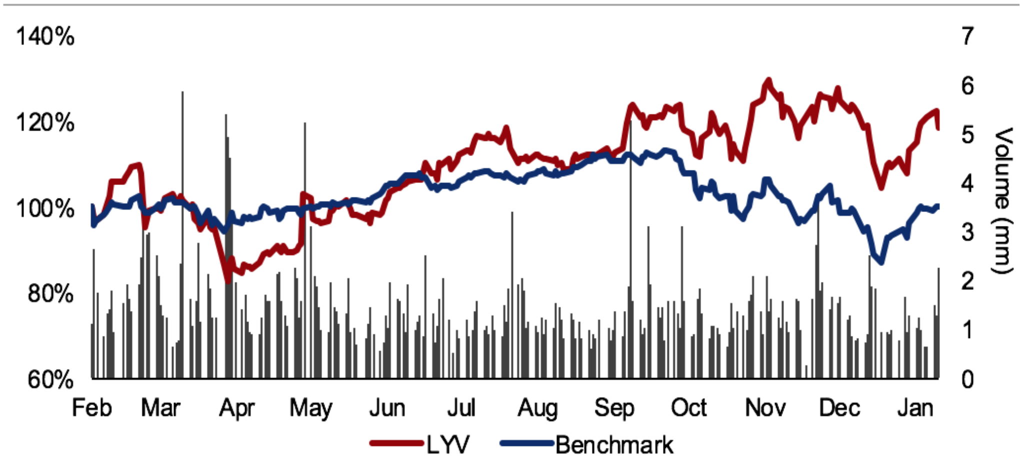
- Allegations that Live Nation violated antitrust law regulations under the consent decree formed as part of the Live Nation and Ticketmaster merger
- Stricter regulation surrounding secondary ticket sales may negatively impact ticketing revenue and margins

INVESTMENT THESES

1. **Margins are poised to expand due to**
    - Ancillary revenue growth outpacing non-ancillary revenue growth, resulting in margin expansion in Concerts
        - Ancillary revenue margins (~50%) are greater than those of non-ancillary revenue margins (<1%)
        - Increase in festival events and enhanced onsite hospitality services drive growth in onsite monetization
    - Secondary ticketing growth outpacing primary ticketing growth, resulting in margin expansion in Ticketing
        - Secondary ticketing margins (~72%) are greater than those of primary ticketing margins (~15%)
        - Proliferation of "bots", spiking gross transaction volumes and growing secondary ticketing market
    - Ticketing growth outpacing Concerts growth, resulting in margin expansion on the firm-level
        - Ticketing margins (~10%) are greater than those of Concerts margins (<1%)
        - Vertical model incentivizes venues to partner with Ticketmaster to secure Concerts contracts; Ticketmaster gains more business, which in turn attracts more venue partners, creating a flywheel loop

We decided to <u>HOLD</u> LYV until margins reached 8%

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Bloomberg, Company Filings

POSITION SNAPSHOT

Average Cost (USD)	$45.44
# of Shares	1,400
Value Invested	$94,027
Portfolio Weight	3.45%
2018 HPR	25.50%
2018 HP Benchmark Return	0.05%
Excess Return	25.45%

THE STARS GROUP (TSE:TSGI)

COMPANY OVERVIEW

- The Stars Group is a provider of global gaming brands that are leaders in the online betting, poker, and gaming markets
- The company operates in Europe, Australia, and the Americas, holding licenses in 21 jurisdictions
- The Stars Group acquired Sky Betting and Gaming, a leading provider of online sports betting services, in 2018, gaining a more balanced product portfolio and a greater share of the global online gaming market
- The company was formerly known as Amaya and changed its name to The Stars Group in August 2017

CATALYSTS

- Legalization of sports betting in more US states will allow The Stars Group to enter these new markets with its existing sports betting platform through plug-and-play, gaining a first-mover advantage
- Sky Betting and Gaming operates a strong e-sports betting platform that could drive value if the platform were to become popularized

RISKS

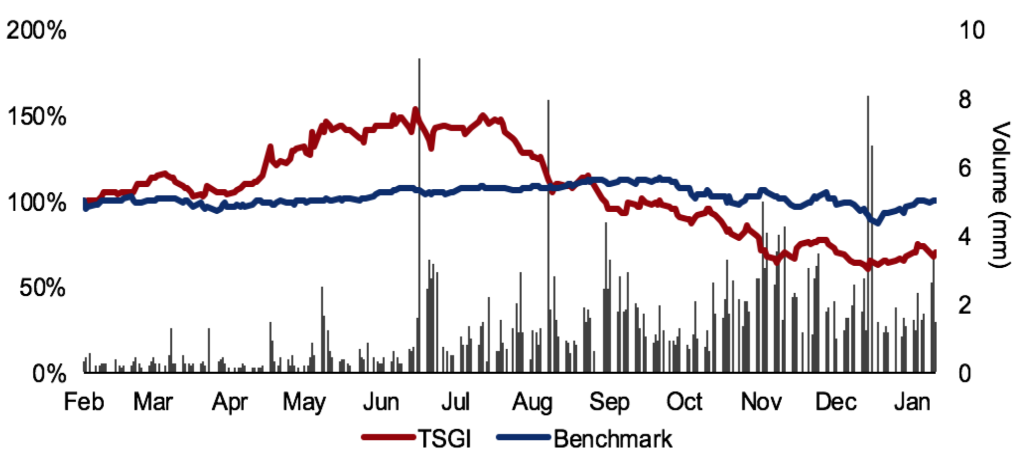
- Known to issue equity to fund acquisitions, thus diluting existing shareholders
- Issued a considerable amount of debt (~6x NTM EBITDA) to acquire Sky Betting and Gaming

INVESTMENT THESES

1. **Market is wrongly grouping in TSG with physical gambling companies which are underperforming due to industry headwinds**
   - Casino stocks dropped on physical operators' earnings misses, Macau revenue underperformance, and weakened event bookings in Las Vegas; TSG is not exposed to any of these risks as an online operator
   - Between August and October, TSG lost ~30% in market value due to physical gambling operator woes. We believe the decline in TSG's share price is unwarranted
2. **Despite the MGM/GVC joint venture, TSG is poised to become a leader in the US gaming market**
   - SBG's success in the UK as the fastest growing online gaming operator can be easily transferred to the US due to the plug-and-play nature of its platform, allowing TSG to gain a first-mover advantage in the US
   - The cross-selling opportunity to Stars' existing customer base within the US is amplified by TSG's flywheel business model which results in cross-selling between Poker, Casino, and Sports Betting

We decided to <u>HOLD</u> TSG until revenue growth reached 20%

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Bloomberg, Company Filings

POSITION SNAPSHOT

Average Cost (CAD)	$27.18
# of Shares	1,990
Value Invested	$44,855
Portfolio Weight	1.65%
2018 HPR	(16.36%)
2018 HP Benchmark Return	(0.86%)
Excess Return	(15.50%)

ENERGY

2018 REVIEW & 2019 OUTLOOK

ALESSIO MARCOGLIESE
NOAH PETKAU
ERIC VAN HEES
RILEY WOLEVER

ENERGY PERFORMANCE
WEATHERING THE STORM

DCM PERFORMANCE

The DCM Energy and Utilities sectors returned -12.6% and -7.0% in 2018, representing an outperformance of 10.0% and 5.2% vs. their respective benchmarks (Figures 1 and 2). Our benchmarks are based on 60% - 40% Canadian - US sector exposures. Energy was among the worst performing sector in 2018, with massive losses in Q4 amid collapsing oil prices.

Figure 1: DCM Energy Sector Performance

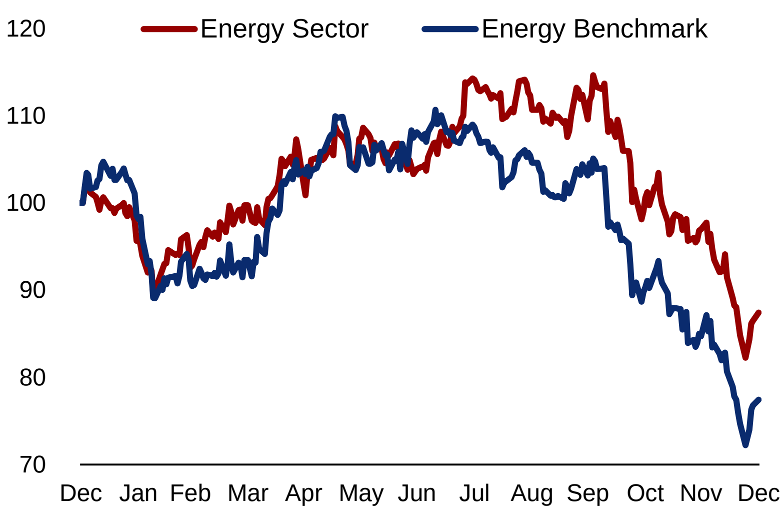
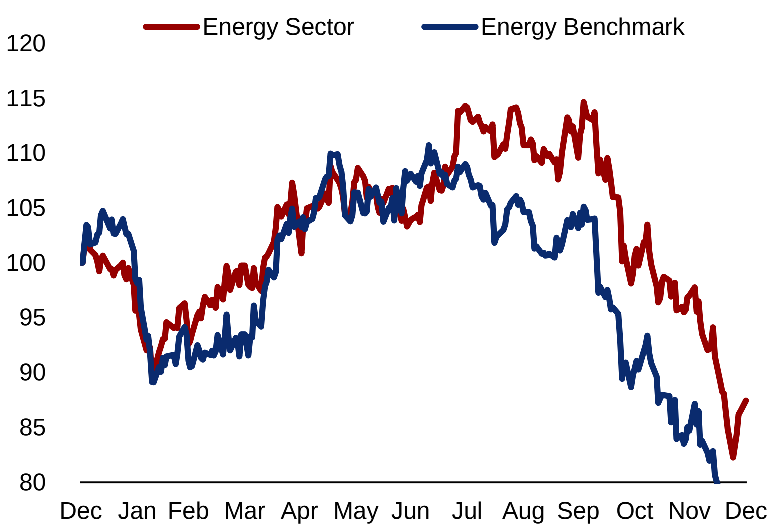


Figure 2: DCM Utility Sector Performance



Source: Bloomberg, CapIQ, DCM

2018 HOLDINGS PERFORMANCE

ARC Resources (TSX:ARX) – Returned **- 45%**

Enerplus (TSX:ERP) – Returned **- 15%**

Emera (TSX:EMA) – Returned **- 7%**

Marathon Petroleum (NYSE:MPC) – Returned **- 3%**

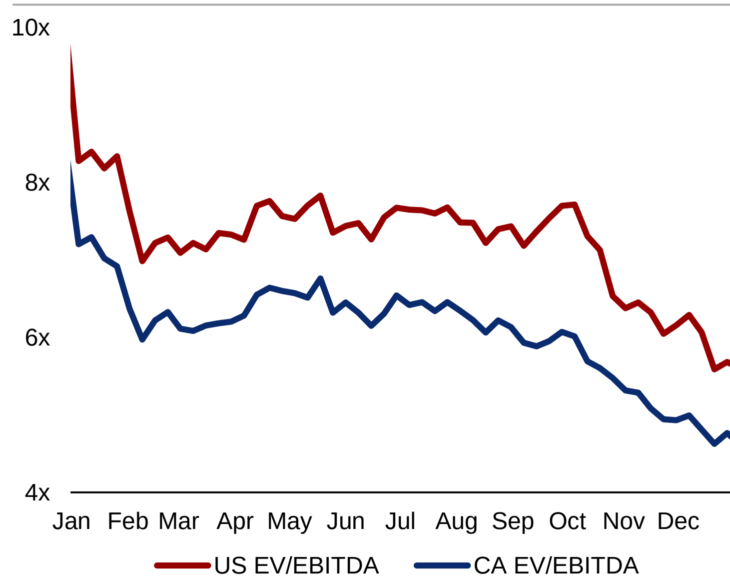
Pembina (TSX:PPL) - Returned **- 11%**

Our five holdings provided exposure to most verticals in the Energy sector including, Upstream, Midstream, Downstream and Utilities. What follows is an overview of the factors that influenced 2018's performance, as well as key tailwinds for 2019.

COMPRESSED MULTIPLES

E&P companies struggled through 2018 due to a variety of issues including oil price deterioration, political turmoil, uncertain demand outlook and pipeline bottlenecks, which we will dive deeper into later. Due to a variety of headwinds Canadian producers continue to trade at a discount to US producers. In summary, the upstream vertical had a difficult 2018, which significantly affected both DCM and its benchmark's performance.

Figure 3: Upstream Vertical Valuation



ENERGY

A ROLLERCOASTER YEAR

DEMAND AND SUPPLY SEESAW

Global demand for crude oil reached 100 mm barrels per day for the first time in 2018, driven by increasing demand from Asian countries. For much of the year, the price of oil was buoyed by the continued threats of US sanctions on Iran, alloyed by doubts as to their effectiveness. However, by the time they were finally implemented in early November, the sanctions and the subsequent decrease in supply did little to prevent the global price slide that began in early October.

Since the implementation in November, Iran has repeatedly said that they will continue to export oil despite the sanctions. Before they even began however, Iran had already seen a reduction by one third in their oil exports.

Massive increases in production from Russia, Saudi Arabia, and especially the United States made up for the reductions from Venezuela and Iran in the latter half of the year. This resulted in the supply glut that contributed to the slide in early October.

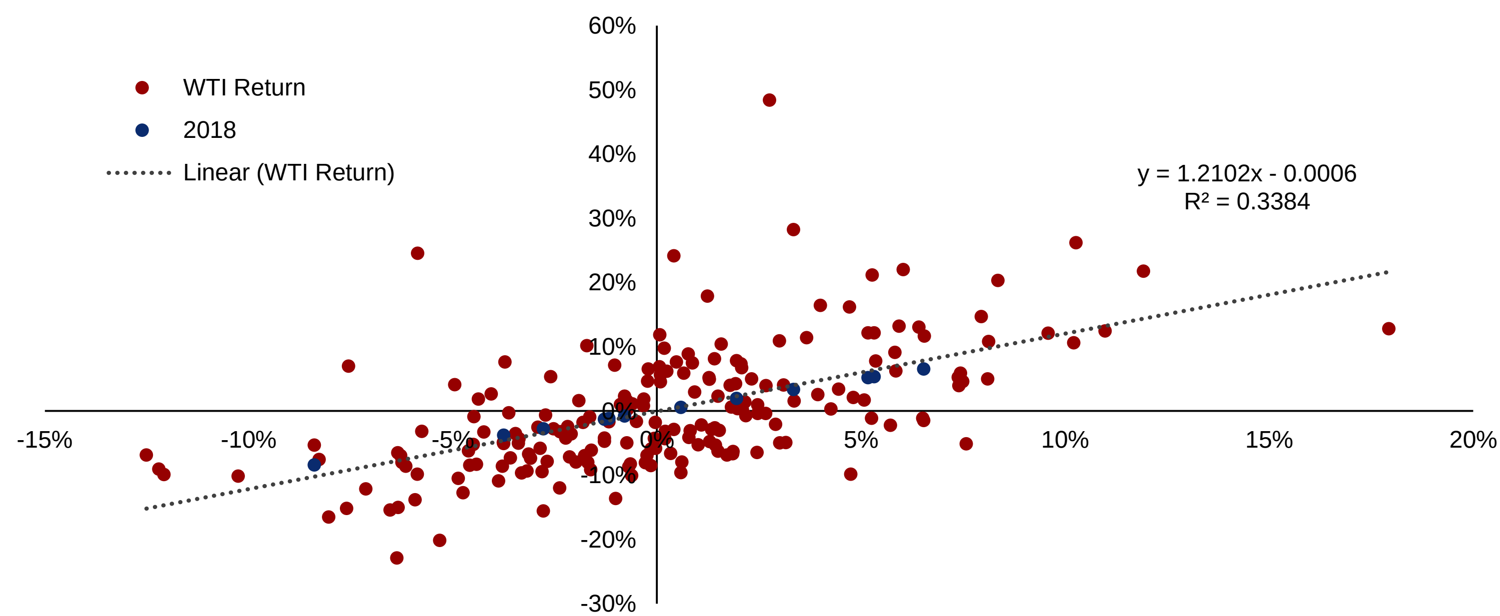
Combined with the global fears of economic slowdown in the latter half of the year, prices tumbled more than 35% from their peaks

A regression analysis of the data in Figure 3, a comparison of Energy sector and WTI returns over the last 15 years, finds an R square of 33.8%. Plotting the data for the annual returns of WTI versus the Energy Sector - S&P 500 difference, and comparing the line of best fit to the results for 2018, we find a good prediction of 2018 energy returns from movements in WTI, indicating greater market efficiency (movement predicted by WTI) than in previous years.

WILD WEST WESTERN SELECT

Canadian crude oil blend prices saw a turbulent year, with persistent discounts relative to WTI being a recurring theme. Canadian oil faced numerous headwinds, with the worsening global economic outlook, the persistent transportation backlog out of Alberta, and the increasingly unclear regulatory environment in Canada and Alberta depressing Canadian valuations relative to American peers.

Figure 4: Return on WTI compared to the difference between US Energy and S&P 500 weekly returns



Source: Bloomberg, Forbes, BBC, IEA, ICIS

ENERGY
A ROLLERCOASTER YEAR

The lack of capacity to export Canadian oil has been a primary issue for Canadian upstream producers through 2018. With several Midwest refineries undergoing refitting and the Energy East and Northern Gateway projects having already been cancelled, much of the oil patch's hopes are on the Trans Mountain and Line 3 pipeline projects. Although the National Energy Board (NEB) approved the Trans Mountain Expansion project in 2013, the approval was overturned by the Federal Court of Appeal in August 2018 for insufficient consultation with First Nations communities along the route. The project would nearly triple the existing capacity of 300,000 barrels which flow through the line every day from Alberta to B.C. In May, the Federal government purchased the pipeline from Kinder Morgan for C$4.5 bn, following which the stock rose 9.2%. The report on the current phase of consultations is due from the NEB on February 22nd, 2019.

In addition to the transportation backlog, a recurring issue affecting Canadian energy equities has been doubt surrounding the regulatory approval process. With Bill C-69, "An Act to enact the Impact Assessment Act" in front of the Senate, Canadian operators fear a lengthening of the existing approval process for natural resource projects.

Mirroring the issues facing oil, natural gas has faced similar transportation headwinds. In a move to pick up on this demand, 2018 saw the approval of the CoastalLink natural gas pipeline and liquefaction terminal in BC from Dawson Creek to Kitimat, where an LNG terminal will be established by LNG Canada, a joint project by Shell, Petronas, Petrochina, Mitsubishi, and the Korea Gas Corporation. The historically significant Henry Hub-AECO differential remains large because of the glut of natural gas stored in Western Canada. With Canadian gas trading at roughly one-third the US price, DCM's Emera holding has been largely free of this issue given their non-Western exposure.

DCM's Pembina Pipelines investment has been moving to meet the demand for transportation of natural gas, with an expansion planned in 2019 in the Peace Country and the development of an LNG project in Oregon.

One of our portfolio's upstream securities, Enerplus, has largely been viewed as a Canadian producer, and as such trades at a depressed Canadian multiple, even though it operates to a significant degree in the US. Firms such as Trans Canada have been rebranding (as TC Energy) to chip away at these market-induced Canadian discounts.

Figure 5: Multiples Compression Going Into 2019

Company	EV / Daily Production 2017	EV / Daily Production 2018	EV/EBITDA 2017	EV/EBITDA 2018	EV/Reserves 2017	EV/Reserves 2018
Canadian Oil and Gas						
Enerplus	39.0x	43.6x	5.8x	6.1x	11.9x	6.6x
Imperial Oil	109.3x	105.3x	14.5x	9.5x	23.3x	13.6x
Vermilion Energy	100.3x	-	10.9x	9.3x	38.7x	36.0x
Cenovus Energy	48.9x	48.2x	10.5x	13.7x	4.4x	3.9x
Gran Tierra Energy	47.8x	60.4x	6.4x	4.9x	21.5x	20.2x
MEG Energy	71.0x	56.4x	8.5x	8.4x	4.1x	3.9x
Peyto Exploration	36.6x	35.1x	6.2x	5.2x	-	-
CNRL	86.4x	66.6x	10.3x	6.2x	8.7x	6.9x
Average	**67.4x**	**59.4x**	**9.1x**	**7.9x**	**16.1x**	**13.0x**
Median	**59.9x**	**56.4x**	**9.4x**	**7.3x**	**11.9x**	**6.9x**

Finally, reflecting these challenges, Canadian producers have seen a decrease in reserve, production, and earnings multiples from 2017 to 2018, as seen in *Figure 4*, with the EV/Production multiples for instance shrinking an average of 11.9% over the year.

Decidedly, 2018 was a tumultuous and bruising year for many crude oil producing companies. Thus, it is all the more important that DCM gets it outlook right for the coming year.

Source: Bloomberg, Forbes, BBC, IEA, ICIS

ENERGY
A TURBULENT YEAR

2019 GLOBAL CRUDE OUTLOOK

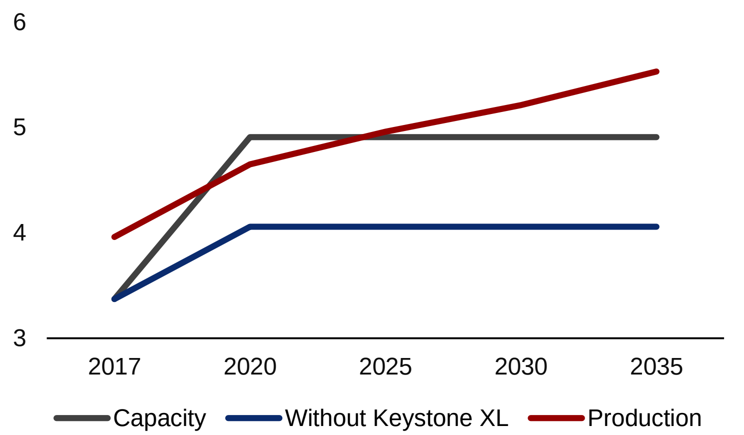
Despite the tumultuous year in oil, the global price of crude did rally in the early parts of January 2019. In regards to our holdings, we believe that they currently have strong fundamentals that will immunize them from crude price volatility. Meanwhile, our equities, particularly in the upstream sub-sector, are strongly affected by the commodity's price. A catalyst for Canadian crude looking into 2019 is the rising fear of tensions between the United States and China. Both countries are the largest consumers of energy, and tariffs could hamper their economic prospects. Although the trade war focuses primarily on metals, China has recently imposed tariffs on American LNG, and may seek to import more Canadian crude as the conflict drags on. On a brighter note, India will likely continue to have an increasing demand for oil, given that they are forecasted to maintain a GDP growth rate of 7.5% over the next few years. This increased growth places India in a position to surpass China in crude consumption. At DCM, we believe India will be a strong catalyst for price appreciation of crude oil in 2019. In light of these uncertainties, DCM believes that both WTI and Brent will generate minimal gains.

CANADIAN LANDSCAPE

The Canadian political atmosphere has been unfavorable to this sector, to say the least. Governments are currently contemplating how to alleviate the situation for Canadian E&P companies. Two main policies can help cut into the WTI-WCS discount differential. These policies include i) the approval of pipelines (i.e. Trans Mountain) and ii) governmental economic assistance. Although DCM believes that the prospects for the Trans Mountain pipeline remain strong, the latter policy option is a more realistic form of aid for the industry.

A cut in royalties is a central policy plan proposed by the United Conservative Party in Canada. This could have a minor roll-over effect on some of our Canadian equities, especially ARC, and to a lesser extent, Enerplus. A cut in royalties can still provide support, but will realistically only contribute to a $2-3 reduction to the current discount. The main driver to watch in 2019 is the pipeline approval process. Two elections in 2019 will have a significant impact on our position: the Alberta provincial election and the Federal election. Their outcomes will dictate the strength with which the Canadian government supports the industry.

Figure 6: Canadian Pipeline capacity vs. forecasted production (mm BOE/D)



Alberta has cut production by 8.7%, circa 325,000 BOE/D, of the 3.7 million produced daily. Due to lack of infrastructure, their backlog amounts to 190,000 BOE/D. These cuts are broken down between producers of 10,000 BOE/D or more (25 E&P companies).

In the case that no additional infrastructure is built, we expect the differential to increase to around 15-20$ depending on the volatility of global crude prices. The Albertan government will acquire locomotives and rail cars to carry 120,000 BOE/D to carry the additional crude back on the market from the cuts.

Source: Library of Parliament, AER, Bloomberg, CNBC, Transmountain, Kinder Morgan, Openparliament.ca, Coastal Gas Link

ENERGY
A TURBULENT YEAR

There are a few pipeline projects in the works. Notably, the expansion of Enbridge's Line 3 will reduce backlog by 95,000. The Trans Mountain pipeline extension would triple capacity from 300,000 to 893,000 BOE/D. These two pipelines which we believe have strong prospects would bring well needed relief. Therefore we see the WCS differential hovering around 12-13$. The construction of Keystone XL would be a bonus catalyst further bolstering Albertan oil prices. As shown by the graph, the construction of these pipelines removes the need for rail until 2025. This would lower transportation costs, but rail and auto-cars may still be required if Alberta continues to increase its production (figure 5).

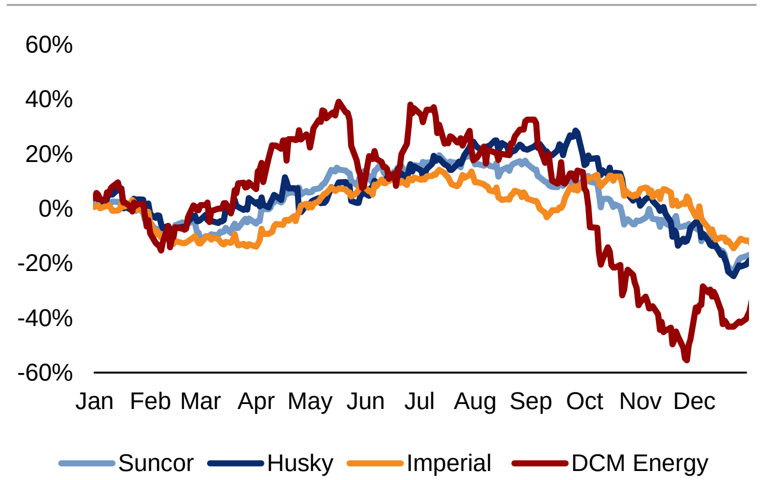
Although an increase in the trade tensions between the United States and China would be detrimental to global energy demand and oil prices, it could help Canadian players, who would stand to benefit from Chinese tariffs on American supply, as the country seeks to increase its Canadian crude imports.

PIPELINE FORECAST

The main theme in Canadian energy remains infrastructure. In early January, some protesters contested the Shell LNG projects.

The construction of this project could reap tremendous benefits for our Canadian players by cutting cost and exposing it to the second largest consumer of energy globally. Although this project is mainly natural gas driven, it would provide strong support to the Canadian energy sector. WCS could see relief mainly through two major contested pipelines: Trans Mountain and Keystone XL. The environmental report for Trans Mountain will be published in February. If the expansion is approved, this would increase total BOE/D from 300,000 to 893,000. Analysis by CAPP estimates that this would provide a substantial cut in the discount with WTI. Keystone XL remains in a legal battle and the recent government shutdown may increase the delay in the project. Judge Brian Morris of Montana caused a major setback for the pipeline back in November by requiring additional consultation. The project is currently projected to begin in early June but will initiate some pre-construction in February. In sum, the main catalysts looking into 2019 for Canadian energy are: construction of proper infrastructure, support from provincial and federal governments and most importantly, cooperation from First Nations. We anticipate that sector support will come primarily from the Albertan government. The construction prospects of Trans Mountain and Keystone XL remain fickle for 2019. Despite the uncertainty, we believe the market is overly bearish on these projects. We are not overly optimistic on the price of WCS but not as pessimistic as the market. In the ensuing year, DCM will be limiting its exposure to Canadian upstream companies. Meanwhile, we will consider integrated majors, which may stand to benefit in this uncertain climate. Given the depressed price, a significant wave of consolidation may emerge. Midstream tends to be more stable and upstream is heavily asset sensitive, while integrated majors are somewhere in the middle. The inclusion of an integrated major could bring more stability to our portfolio.

Figure 6: Canadian Integrated Majors



Source: API, Forbes,

ENERGY

2018 HOLDINGS REVIEW

Emera Incorporated (TSE: EMA)

COMPANY OVERVIEW

- Emera is engaged in the generation, transmission, and distribution of electricity to various customers. The company is also involved in gas transmission and utility energy services businesses; and the provision of energy marketing, trading, and other energy asset management services
- Emera transports re-gasified liquefied natural gas to consumers in the northeastern United States through its 145-kilometre pipeline in New Brunswick
- The company operates both in Canada and the United States, where it owns and operates Tampa Electric (TECO), which has operations in Florida and in New Mexico in coal and solar power generation

CATALYSTS

- Shift towards more favorable North American policy environment for renewables-weighted electricity generation would favor Emera over domestic competitors
- Another divestiture like that of November 2018's sale to the Carlyle group could see a repeat of the stock rally that followed as Emera cut down on total debt

RISKS

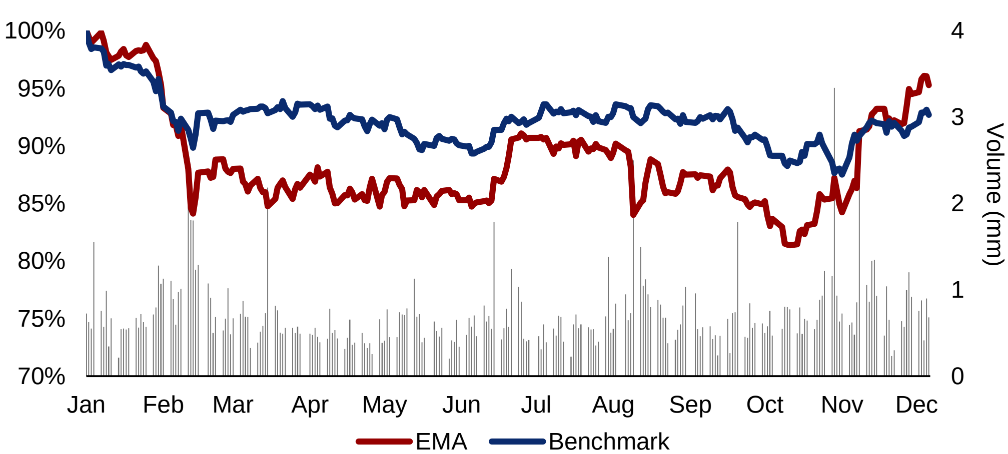
- Another year of extreme weather events along the eastern seaboard could lead to more 'Black Swan' losses – such as those seen this October in New England

INVESTMENT THESES

1. **Underappreciated growth profile following integration of TECO acquisition**
   - Growth achieved but can no longer be considered under-appreciated – TECO is long-since acquired and performing, and Emera has since divested of several assets to reduce debt (see November 2018 divestiture of New England assets)
2. **Well positioned to capitalize on rapid growth of renewable energy**
   - In 2018, Emera continued capital expenditures on the Florida solar expansion, with a majority of capex in the US
3. **Attractive valuation and high dividend growth with low business risk**
   - The thesis to watch, low business risk remains true but dividend growth has been lower than initially forecast. Previously lower than industry average P/BV has largely disappeared

We decided to <u>HOLD</u> EMA until the advantages of operating in credit supportive jurisdictions with increasingly pro-renewables policies is reflected in the stock price, manifested as stable prices above current levels and a return to industry average P/BV and P/E ratios of 1.64 and 21.26 respectively

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: TD, Bloomberg, CapIQ, Company filings

POSITION SNAPSHOT

Average Cost (CAD)	*$45.23*
# of Shares	*2,400*
Value Invested	*$104,904*
Portfolio Weight	*4%*
2018 HPR	*(7%)*
2018 HP Benchmark Return	*(12%)*
Excess Return	*5%*

Marathon Petroleum Corporation (NYSE: MPC)

COMPANY OVERVIEW

- Marathon Petroleum is a US-based oil company with operations in both the Midstream and Downstream of the energy sector
- Marathon is involved in the refining, transportation, and marketing of petroleum products. Following its 2018 acquisition of competitor Andeavor, Marathon has become the largest independent refiner in the United States, operating refineries throughout the Midwest and Gulf Coast of the United States
- Its Midstream operations are carried out with MPC's Master Limited Partnerships (MPLX) and it markets its final products through Speedway gas stations and convenience stores

CATALYSTS

- Widening of crude oil price differentials between regions across Marathon's large North American footprint will allow Marathon to capitalize on its greater flexibility in purchasing versus peers
- Refinery downtime among Midwest competitors due to repairs and upgrades

RISKS

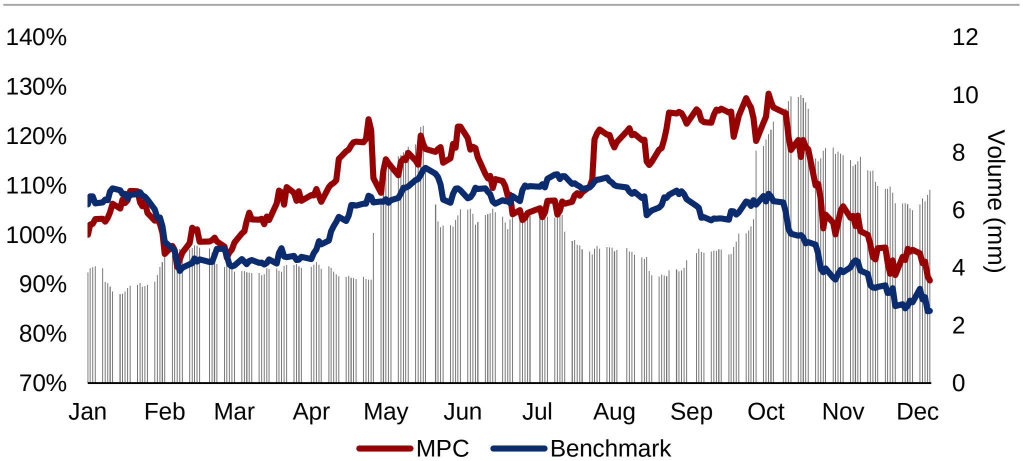
- An economic slowdown could reduce demand for refined petroleum products
- Continued Canadian production cuts or expansion of transport capacity could lead to a closing gap between WCS and WTI, thereby negating Marathon's geographic cost advantage

INVESTMENT THESES

1. **Strategically located assets**
   - The discount of Canadian WCS versus American WTI, driven by backlogs generated by insufficient transport capacity, reached a high of $50 per barrel in the fall of 2018, but production cuts imposed by the Albertan government have caused the price differential to narrow to about $10 per barrel in January 2019
2. **MLP structure's dropdown value**
   - Marathon continues to benefit from the MLP structure of its midstream segment, with the company making new dropdowns of refining logistics and fuel distribution services
3. **Diversification of revenue streams**
   - In addition to existing diversification across Midstream and Downstream segments, at the end of 2018 the company announced plans to acquire two American long-haul pipelines and a Gulf Coast export terminal

The final months of 2018 saw Marathon facing headwinds of compressing retail margins and unfavourable shifts in regional price differentials; despite these challenges, we decided to HOLD MPC on the strength of its geographic cost advantage and its revenue diversity

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Scotiabank, Bloomberg, Company filings

POSITION SNAPSHOT

Average Cost (CAD)	*$46.30*
# of Shares	*1,500*
Value Invested	*$120,708*
Portfolio Weight	*4%*
2018 HPR	*(3%)*
2018 HP Benchmark Return	*(23%)*
Excess Return	*20%*

ANNUAL REPORT 2018

FINANCIALS

2018 REVIEW & 2019 OUTLOOK

MILLER CRESSMAN
JOSIAH DERKSEN
JARED GAFFE
VICTORIA PERLMAN

DESAUTELS CAPITAL MANAGEMENT

FINANCIALS
2018 SECTOR REVIEW

SECTOR OVERVIEW

In 2016 & 2017, the financial sector performed exceptionally well. Moving into 2018, it was forecasted to be one of the best performing sectors once again. Strong US economic growth, rising rates and several tax cuts were all supposed to spur the sector. However, instead of market-beating returns, the sector's total return of -8.8% trailed the S&P 500 by nearly 7%. This was likely due to the fact that these tailwinds were well understood by the market and had already been priced in. As a result, the sector spent most of the year in a lull. Additionally, as the spread between the 2 & 30 year US treasury yields fell from 85 bps down to just 48 bps by the end of 2018, the financials sector performance mirrored this slide. The Fed's rate hikes in the second half of 2018 and the long-term rates remaining low, flattened the yield curve, leading to second half underperformance for the financials sector. Additionally, the sector's strong correlation to the broader equity market, growing US - China trade tensions, and a US government shutdown have all lowered corporate confidence amplifying the sector's underperformance in 2018.

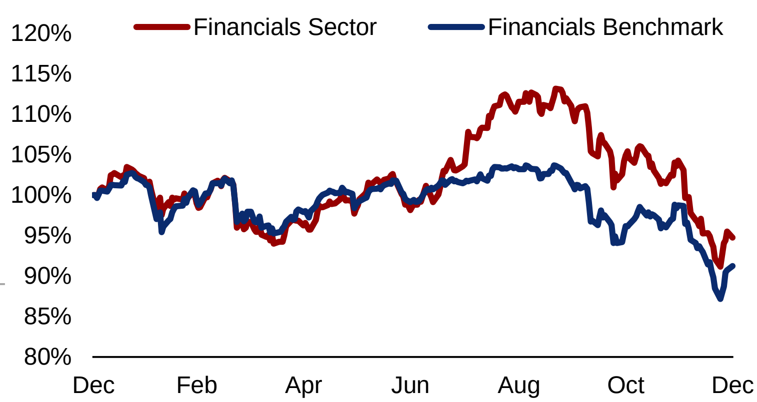
Figure 1: 30 minus 2 Year US Treasury Yield Spread

Source: Bloomberg

In terms of legal changes, Congress passed legislation that repealed some of the post-2008 regulations that were imposed on financial institutions. One of these changes was to move the SIFI (systematically important financial institutions) threshold from $50 bn to $250 bn. These thresholds resulted in many smaller banks foregoing growth through M&A, which had been the modus operandi for avoiding the additional complexities and costs that would come with increased oversight from the Fed.

DCM's financial portfolio outperformed the benchmark in large part to our exposure to the healthcare sector due to the partial repeal of the ACA. In particular, Health Insurance Innovations (HIIQ) gained more than 60% from when we first initiated our position.

Figure 2: Financials Sector 2018 Performance



In closing , the financial sector is the heartbeat of the overall US economy. History has shown that when financial stocks underperform the benchmark, it often leads to weakness for the rest of the stock market. This stems from the sensitivity of stocks to virtually all financial sector verticals. If a deterioration of the sector continues, this may be a harbinger of things to come for the rest of the market in 2019.

FINANCIALS
2018 SECTOR REVIEW

ASSET MANAGEMENT

2018 was a difficult year for asset managers, with active managers especially struggling. As a sector, asset management equities shed 25% of their market value in 2018, with the average P/E multiple falling from 17.9x to 10.9x. The overwhelming majority of this contraction occurred in December as a part of the larger market sell off, and mirrored the financial sector as a whole; despite little change in EPS quarter-over-quarter, AM stocks suffered in Q4 as a result of negative market sentiment.

In 2018, 16 of the top 20 funds in terms of net inflows were passive funds and ETFs. In a bull market, active funds are having trouble justifying their higher fees. Indeed, over 86% of US active funds have underperformed their benchmark, net of fees, over the 10 year period between 2007 and 2017. ETF inflows are highly correlated with market performance, with managers seeing outflows in bear markets. We will be looking to see how this trend continues as we enter the 10th year of a bull market.

Even though ROIC among US asset managers increased to its highest level over the last five years, funds increased their dividend payout ratios to retain uncertain investors (Figure 3). Over the past 5 years, the payout ratios of active managers have risen as P/E multiples have contracted despite high ROICs, signaling a prioritization of shareholder retention over reinvesting funds at a high ROIC.

US BANKING

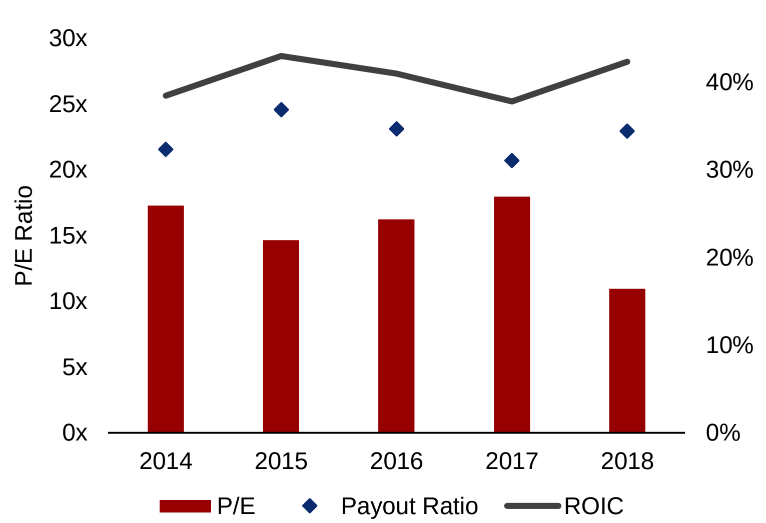
After a strong end to 2017, US banks' valuation multiples saw compression in 2018. A substantial market correction and trade uncertainty got the better of the American financial sector in the latter half of 2018. The average P/E ratio among US banks fell from 17.2x to 10.7x, and the average P/B ratio decreased to 1.12x from 1.49x a year earlier. On the aggregate, US bank stocks depreciated by 21% over the course of the year.

May 2018 saw the introduction of the Crapo bill, which increased the threshold for a bank to be considered a systematically important financial institution from $50 bn to $250 bn. This decreased the number of banks deemed "too big to fail" from 45 to 14. The mid-size banks that no longer have SIFI designation now have less stringent capitalization requirements, and can operate with more capital flexibility and lower regulatory costs.

CANADIAN BANKING

After a record-setting 2017, Canadian bank equities slowed down in 2018, returning - 8% on average. The mean ROE among the big six banks fell from 15.5% at the end of 2017 to 15.3%, while loan growth slowed over the course of the year due to uncertainties surrounding NAFTA trade negotiations and rising interest rates. With interest rates rising and economic growth slowing, Canadian banks have seen an increasing level of credit losses, with the big six banks seeing a 14% increase in provisions for credit losses.

Figure 3: Dividend Payout Among Asset Managers



Source: Bloomberg, Deloitte, Company Filings.

FINANCIALS

2018 SECTOR REVIEW

The combination of decreasing loan growth and worsening credit quality has led to a contraction in valuation multiples: the average P/E ratio fell to 9.8x, well below the 10Y average of 10.9x, and the average P/B ratio fell below the 10Y average of 1.9x to 1.5x. However, Canadian banks have record-high CET1 ratios, reflecting a well capitalized banking system. This is very comforting for us given the elevated uncertainty in the global economy.

P&C INSURANCE

Following a record year of losses due to natural catastrophes in 2017, US P&C insurers saw a strong recovery in 2018, especially in the first half of the year. Increasing interest rates, higher investment income and strong economic growth all boosted results for P&C insurers. Premiums grew an average of 12.7% in the first half of 2018 - an increase of nearly 77% YoY. This resulted from P&C premiums' correlation with the numerous natural catastrophes that occurred in 2017. In other developed markets, premiums grew at a much slower 1.9%. In developing markets, premiums grew at a rate of 6.1%, decreasing by nearly 37% YoY mainly due to China's growth rate being cut in half to around 10%. In terms of valuation, P&C insurers saw an average price decrease of 3.4% in 2018, while EPS increased nearly 77%, due to increasing premiums. Additionally, ROE was 10.35%, up 42% YoY while ROA was 2.29%, up 54% YoY.

L&A INSURANCE

2018 was a very different story for those in the L&A business. In 2Q18, individual life insurance sales in the US grew by a modest 2% after three straight quarterly declines. In other developed markets, premiums fell 2.6% while in developed nations sales rose 14%.

However, should Congress pass the Retirement Enchancement Savings Act, this could encourage distribution of 401(k) balances into guaranteed lifetime income streams. Premiums have not grown through the first half of 2018, while net income is down 12% and life insurance applications are also down 0.3%. With several internal and external pressures to cope with, it is in the hands of individual insurers to adapt quickly to a rapidly changing environment.

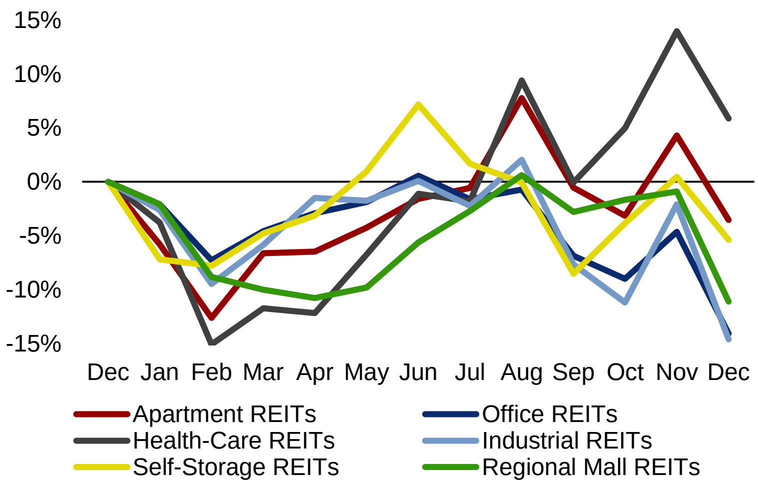
REAL ESTATE INVESTMENT TRUSTS

North American mid/large cap REITs returned -8.7% this year, trailing the S&P 500's 6.2% fall. This was mostly due to a rising treasury yield and also a broader equity market selloff in late 2018. P/FFO subsequently fell to 15.8x by the end of 2018 down from 17.1x at year end 2017. SSNOI growth was 2.7%, recovering from its dip to 2.1% in 1Q18. Rent growth was the key driver for this as occupancy remained relatively stable through the year at around 96%. Interestingly, REITs rallied in late 2018 as the 10 year Treasury yield breached 3%. This shows that if underlying fundamentals are strong and driving demand, REITs are able to do well even in a rising rate environment. While historically the most sensitive to interest rate increases, healthcare REITs were actually the best performing REIT sector in 2018, up 0.8%. An aging population of Baby Boomers has increased demand for healthcare space and improved their results for 2018. Cold-storage and marijuana REITs were the best performing sub-sectors in 2018 as they are exposed to unique growth opportunities such as the rise of eCommerce and the expansion of marijuana legalization. Additionally, most REITs traded at a discount of P/NAV, which fueled an uptick in M&A.

Source: Bloomberg, Deloitte, Company Filings.

FINANCIALS
2018 SECTOR REVIEW& OUTLOOK

Figure 4: 2018 REIT Returns by Sector



ASSET MANAGEMENT

In the face of global investor uncertainty, fund managers are placing a stronger emphasis on customer service and relationship management to retain funds, especially active fund managers. With the gap in flows between active and passive funds increasing, active managers must find a way to add value to investors to justify high fees.

In addition to relationship management, an increasing number of active funds are adopting the "fulcrum" fee model, charging a small base fee if the fund does not outperform its benchmark, then an additional performance-based fee if the fund achieves alpha.

Another potential value-creator for fund managers is access to different markets and products. We have begun to see active funds use access to alternative asset classes and emerging markets to differentiate themselves from low-cost passive investment vehicles and retain capital. We expect to see this trend continue into 2019; as interest rates rise and economic growth slows, there will be a wealth of opportunities for distressed investment and investor uncertainty could lead to capital inflows for "expert" active investors. In an environment with global economic growth slowing and high geopolitical uncertainty, we will look to active asset managers to make gains over their passive counterparts.

US BANKING

Entering 2019, there is a lot of uncertainty in the US market. Following Sino-American trade tensions and interest rates rises, bank stocks took a large hit in the market fall of the latter half of 2018. Amid concerns about the financial sector's worst year since the 2008 financial crisis, it is worth noting that the American banking system is in much better shape than it was 10 years ago. The average US bank has a common equity tier 1 ratio of 13.14%, the highest level since the adoption of the Basel III capitalization requirements. Furthermore, the US banking system has a non-performing loan ratio of 1.02%, the lowest level since 2007.

Regional banks should continue to benefit from the Crapo bill, which came into effect in May. The mid-size banks that no longer have SIFI designation now have less stringent capitalization requirements, and can operate with more capital flexibility and lower regulatory costs. We will be looking to see if these banks can utilize the new regulations to create value in 2019.

In the current environment, we will be looking to regional banks for potential investments. In addition to the benefits of the Crapo Bill, these banks have improved their ability to assess client risk, an important competency in an uncertain economic environment.

Source: Bloomberg, PwC, Deloitte, Nareit

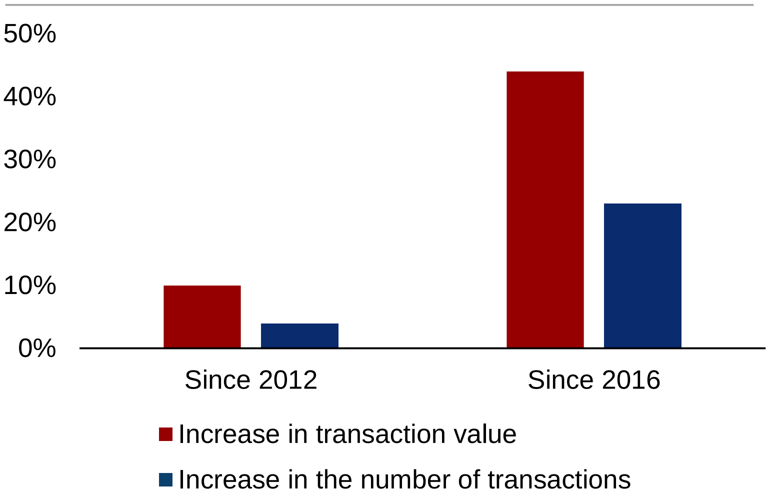
FINANCIALS
SECTOR OUTLOOK

CANADIAN BANKING

The trend of growing investment in digital banking should continue into 2019. In 2018, remote transactions – via electronic fund transfers and online transfers – represented 91% of the total transaction value in Canada but only 25% of the total volume (in terms of number of transactions), signaling a growing trend of business being comfortable engaging in large transactions digitally. With business opting to bank electronically, and using digital platforms for payroll as well as large transactions, cybersecurity and data governance are becoming increasingly important. We should see banks invest heavily in these functions.

The latter half of 2018 saw mortgage growth reach a 3.4% annual rate, the lowest since 2001, and house prices fail to increase for the first time in 10 years. The Bank of Canada projects this trend to continue into 2019 in the wake of efforts to limit foreign buyers and rising interest rates. We will be looking to see whether Canadian banks can offset decreasing mortgage income with higher net interest margins. In the current environment, we maintain a positive outlook on the Canadian banks.

Figure 5: Changes in Electronic Payment Volume



INSURANCE

Moving into 2019, the main concern for insurers will be the possibility of a recession as early as 2020. Specifically, L&A carriers will be mindful of a potential recession as high unemployment would cause many to lose employment related health insurance. Insurers must be careful and focus on lowering costs & improving operational efficiency while adapting to an increasingly digital economy.

The rise of cloud provides a unique opportunity for insurers in 2019. Carriers are currently under pressure to deliver a digital presence and the cloud provides the best opportunity to develop applications with the necessary speed, scalability and flexibility. These technologies would enable telematics insurance for products & automobiles requiring investments in technology that accommodate the large amounts of data and processing power required to run such programs. In 2016, 13% of insurers reported cloud as a core-business capability, with an increase to 26% in 2018 and this figure is expected to further accelerate in 2019.

The need for new and innovative products will force insurers to collaborate with Insurtechs, who can aid in the modernization of policies, allowing quicker rollouts and more meaningful tracking of trends and customer data. Consumers are demanding products that may be activated or deactivated as needed and are not confined to the rigidity of traditional plans. Additionally, insurers must be wary of new regulation, specifically surrounding the sales of US annuity products, as insurers will be required to act in the "best interest" of the customer, which could dampen sales growth. There is little doubt that such a law will be adopted in the coming year, but there is uncertainty about whether this change will occur at the state or federal level.

Source: Bank of Canada, Bloomberg, Congress.gov, Deloitte, Payments Canada, RBC, Statista.

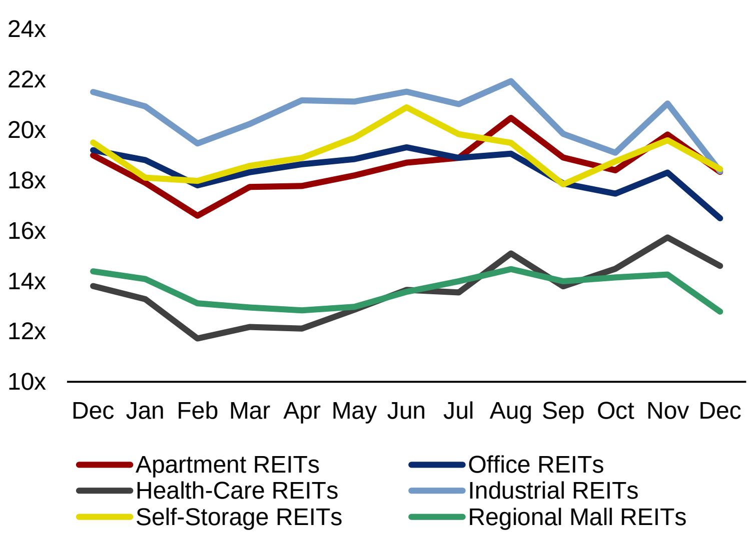
FINANCIALS
SECTOR OUTLOOK

FIG expects L&A insurance's performance to be strongly tied to the overall economic environment while P&C insurance performance will largely be driven by the timing and severity of potential natural disasters. As such, we are more bullish on L&A as 2019 is expected to be a fairly severe year for natural disasters.

REAL ESTATE INVESTMENT TRUSTS

Technology is poised to have a large impact on REIT managers as investors and consumers alike push for innovations that will enhance the tenant experience and operational efficiency of REITs. As per Deloitte's survey of CRE managers worldwide, 52% of respondents believe that tech advancements will have the largest impact on properties over the next 3 years and 80% believe CRE managers must implement predictive analytics for property management to stay competitive. It is a perfect time for CRE managers to make buildings future ready and accommodate the technological changes around the world. In 2019, REITs are poised for a strong year. Barring a recession, full employment, increasing wages and solid GDP growth are all set to improve operational results moving into 2019. Slowing interest rate hikes will further benefit REITs. We see rent growth to keep pushing SSNOI growth as occupancy stabilizes to around 96%. Additionally, we expect developers to slow construction as current supply is outpacing demand, barring the industrials sector. We are most bullish on the single-family home subsector of REITs as inflated housing costs are causing a supply shortage and making long-term single-family REIT fundamentals look highly favourable moving into 2019.

Figure 5: NTM REIT FFO by Sector



Source: Bloomberg, Deloitte, PwC

CONCLUSION

Moving into 2019, the FIG team is most bullish on the Real Estate Investment Trust subsector. With rents expected to grow and interest rate hikes slowing, we expect SSNOI to increase. The slowdown in new construction will allow REITs to fully realize the benefits of the economic headwinds the sector is currently experiencing. The coming year should be a strong one for REITs, and we will be looking to invest in the single-family REIT subsector.

FINANCIALS

2018 HOLDINGS REVIEW

OAKTREE CAPITAL GROUP LLC (NYSE: OAK)

COMPANY OVERVIEW

- Oaktree Capital Group is an American asset manager that specializes in alternative investment strategies
- With $123.5 bn USD in AUM, Oaktree is one of the largest credit investors in the world, and the world's largest investor in distressed debt
- Oaktree currently holds $21.4 bn in dry powder, a near-record amount
- Oaktree operates open and closed end funds specializing in distressed debt, high yield bonds, private debt, private equity, real assets and special situations
- Clients include 73 of the America's 100 largest pension funds, 38 state governments, university endowments and sovereign wealth funds

CATALYSTS

- Potential elimination of Dodd-Frank stress testing requirements for investment advisors
  - H.R. 4566 passed the House and is currently being evaluated by the Senate Committee on Banking, Housing, and Urban Affairs
- Growth in distressed debt opportunities in the event of an economic slowdown

RISKS

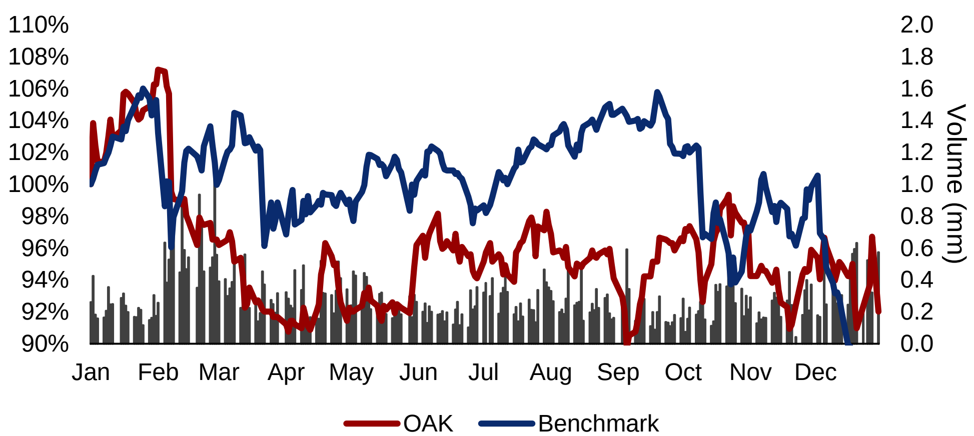
- Implementation of the SEC's liquidity risk-management rule
  - Effective September 2018, the SEC enacted additional liquidity capital disclosure requirements for asset managers
  - We will be monitoring the effects on Oaktree moving forward

INVESTMENT THESES

1. **Wealth of opportunities in the distressed debt space**
   - At the initiation of DCM's position, high yield spreads were historically low. Periods of narrow spreads are often followed by significant spread widening, leading to significant drops in high yield prices. Historically, increases in high yield bond issuances have been followed by a surge in defaults and bankruptcies
   - Oaktree has not yet launched its new distressed debt fund. We will be looking for the fund to launch as we see cyclical changes in the economy and widening spreads
2. **Expertise in alternate offerings will increase economic cycle diversification**
   - Control investing to fill the end of the bull cycle "gap"
3. **Attractive valuation with conservative assumptions**
   - Original price target of $52 yields a 30% upside for DCM, together with a dividend yield of 7%

We have decided to HOLD OAK, looking to gain as spreads widen and Opportunities Xb is launched in 2019

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Company Filings, Bloomberg, FRED.

POSITION SNAPSHOT

Average Cost	$39.95
# of Shares	2,990
Value Invested	$162,079
Portfolio Weight	6%
2018 HPR	6%
HP Benchmark Return	(7%)
Excess Return	13%

PROLOGIS (NYSE: PLD)

COMPANY OVERVIEW

- Prologis is the world leader in logistics real estate with a focus on B2B and online fulfilment categories - their biggest tenant is Amazon
- Prologis leverages the latest technology in property management to enhance the tenant experience
- Founded in 1983 as AMB Property Corporation and merged with Prologis in 2011
- The company has operations in 19 countries worldwide with a bias towards high-barrier, high growth markets with their most significant portfolios in North America, Europe and Asia
- The company is headquartered in San Francisco, California

CATALYSTS

- Ability to capitalize on global expansion and future developments to drive NAV growth
- Increased exposure to eCommerce based tenants (Amazon) and to last mile properties
- Slowing of interest rate hikes

RISKS

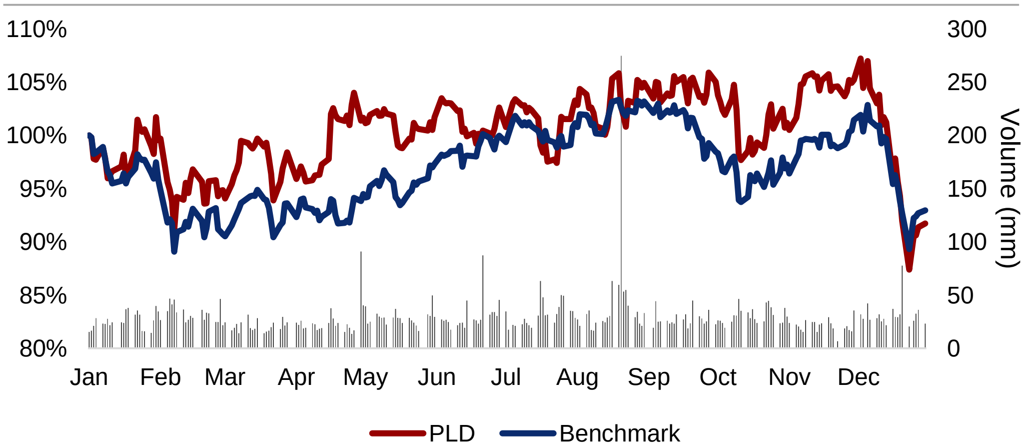
- Inability to capitalize on global expansion will negatively impact NAV growth
- Slowing market growth will diminish future expansion opportunities
- Trade tensions will slow down consumption growth trends

INVESTMENT THESES

1. **Strong economic moat**
   - Pricing power: Prologis' strong pricing power is demonstrated through their 4.1% SSNOI growth while only increasing occupancy rates by 0.1%.
   - Low leverage: Prologis has carefully managed their new development and acquisition costs ($474M:3Q18 vs their proceeds from disposition of $462M:3Q18) to help lower Net Debt/EBITDA to 5.43x for 3Q18.
2. **Growth opportunity**
   - Prologis acquired American Industrial REIT DCT for $8.5B in 3Q18 to expand their exposure to high growth North-American markets such as SoCal, NY/NJ & Chicago
3. **Attractive valuation**
   - Prologis trades at a P/NAV discount of 2.2%; showing improvement from our previously calculated discount of 4.5% and still above the broader REIT currently trading at a discount of 6.1%

With several years of industrial growth still to be expected, we will continue to <u>HOLD</u> PLD in the long-run

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Barclays, Bloomberg, Company Filings

POSITION SNAPSHOT

Average Cost	$62.24
# of Shares	1,270
Value Invested	$101,697
Portfolio Weight	4%
2018 HPR	2%
HP Benchmark Return	9%
Excess Return	(7%)

ANNUAL REPORT 2018

HEALTHCARE

2018 REVIEW & 2019 OUTLOOK

EMILIE GRANGER
ARASAN THANGAVELU
LUDOVIC VAN DEN BERGEN

DESAUTELS CAPITAL MANAGEMENT

HEALTHCARE
2018 REVIEW

A MIXED YEAR IN HEALTHCARE

Healthcare returned 4.6% in 2018, outperforming a 5.2% decline in the S&P 500. Interestingly, this outperformance was not driven by the sector's defensive qualities. Rather, healthcare's strong performance throughout the first three quarters was driven by positive clinical data and market optimism in biotechnology (1.5 beta) and medical devices (1.1 beta). Earnings surprises for large firms were also generally positive. With a sector beta of 1.1, outperformance was concentrated before the general market sell-off which began in October. DCM Healthcare returned 3.4% relative to a 12.6% return in our benchmark. These figures incorporate USD appreciation over the year. Our underperformance was mainly driven by a 33.1% fall in our Fresenius position, spurred by revenue guidance cuts due to continued difficulties in calcimimetics. Our position in a CAD-hedged healthcare ETF also underperformed, returning 0% versus a 13% return in our USD benchmark. Moving on to outperformers, we benefited from the largest healthcare transaction of the year as our Shire position returned 23.7%. Our Pfizer position, which we sold in April, returned 30.7%. These figures represent our respective HPR in each position.

TRIGGERS FOR THE DOWNTURN

The primary drivers of healthcare's poor performance from October onwards were not healthcare-specific. US-China and US-Canada trade tensions, as well as a rising cost of borrowing, spurred a general sell-off in US equity markets. Healthcare was caught up in this sell-off. Several healthcare-specific concerns compounded this poor performance in Q4. In December, a Texan US District Court ruled to invalidate the Affordable Care Act (ACA). While the ACA will continue to be enforced as the case makes its way through the US appeals process, the ruling has created long-run uncertainty in regards to the reimbursement environment in the US. Concerns over regulatory action supressing drug prices have also risen since the Democrats' success in the US midterm elections, in which they took control of the House of Representatives.

BIOTECHNOLOGY CONTRACTION

While EV/Revenue multiples remained flat in healthcare, we saw significant contraction in biotechnology (7.2x in 2017 to a multi-year low of 6.3x in 2018) as concerns over high valuations for early stage firms grew, while multiples expanded in the S&P 500 (2.4x to 2.5x).

Figure 1: Healthcare Performance versus S&P 500

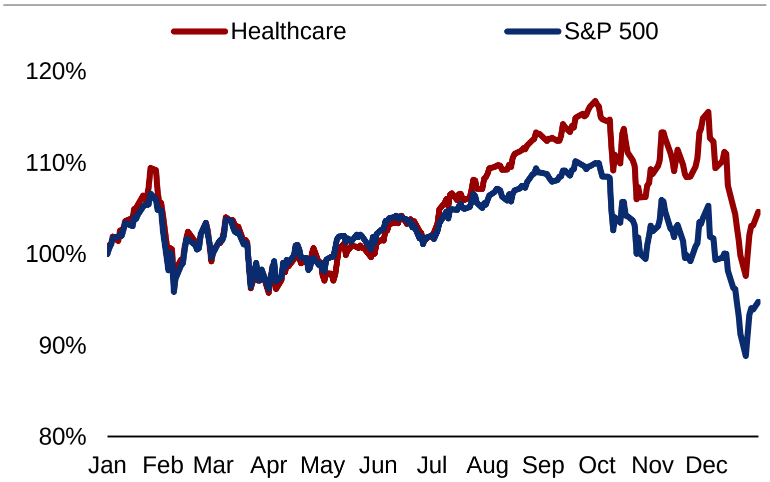
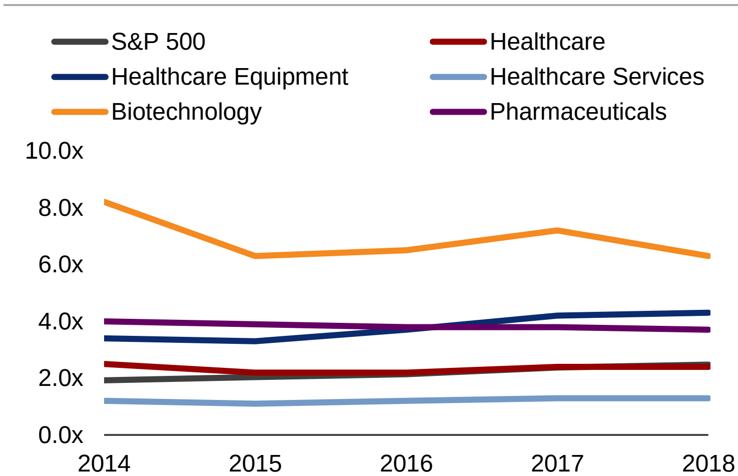


Figure 2: Sub-Sector EV/Revenue Multiples



Source: CapIQ

HEALTHCARE
2019 OUTLOOK – BIOPHARMA

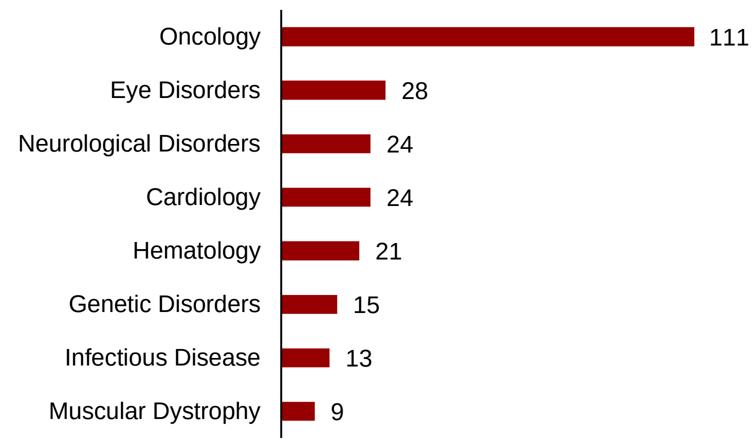
OPPORTUNITIES IN BIOPHARMA

We project that 2019 will be a mixed year for biopharma as increased volatility will make it more difficult for early stage biopharma firms to access capital, perhaps spurring a downturn in the sub-sector. However, following the aforementioned multiple contraction in the sub-sector to multi-year lows, we see opportunities for value in gene therapy. Increased M&A activity and rising acquisition premiums will be tailwinds in 2019 as well.

PIVOTAL YEAR IN GENE THERAPY

Gene and cell therapy are finally resulting in commercial medicines. In oncology, Novartis' CAR-T therapy Kymriah received FDA approval in 2018. Spark's Luxturna was the first gene therapy in eye disorders to receive FDA approval. The excitement surrounding gene therapy has resulted in high valuations for early stage firms. For instance, muscular dystrophy focused Sarepta Therapeutics is trading at 29.7x EV/Revenue versus an average of 6.3x in biotechnology. If firms in this class are unable to produce clinical results in 2019, valuations will continue to contract. While this is a headwind for the sub-sector as a whole, we see opportunities for value by picking clinical winners.

Figure 4: Gene Therapies by Major Treatment Areas



RISING ACQUISITION PREMIUMS

We saw an uptick in M&A activity this year in biopharma, with firms taking advantage of contracting multiples in biotechnology to capture growth. This was the case in this year's largest deals, with Sanofi and Takeda taking advantage of sell-offs in Bioverativ and Shire with their respective $11 bn and $81 bn takeouts. We expect this trend to continue into 2019, especially if biotechnology continues to sell-off alongside the broader market. With acquisition premiums rising, particularly in the $10 bn+ valuation range, we believe mid-cap biotechnology will be attractive in 2019.

Figure 3: Gene Therapies by Clinical Stage

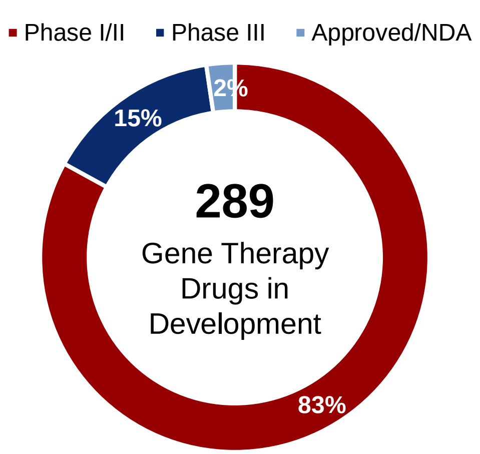
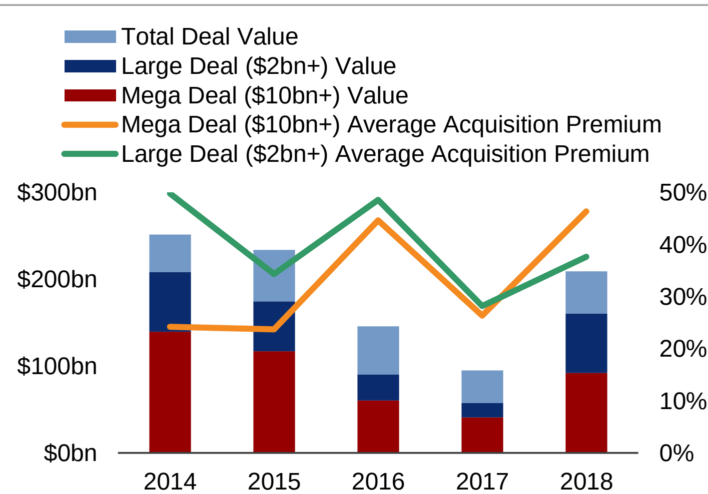


Figure 5: Biopharma Deal Value and Premiums



Sources: FDA, The Pharmaceutical Research and Manufacturers of America, CapIQ

HEALTHCARE
2019 OUTLOOK – MEDICAL DEVICES

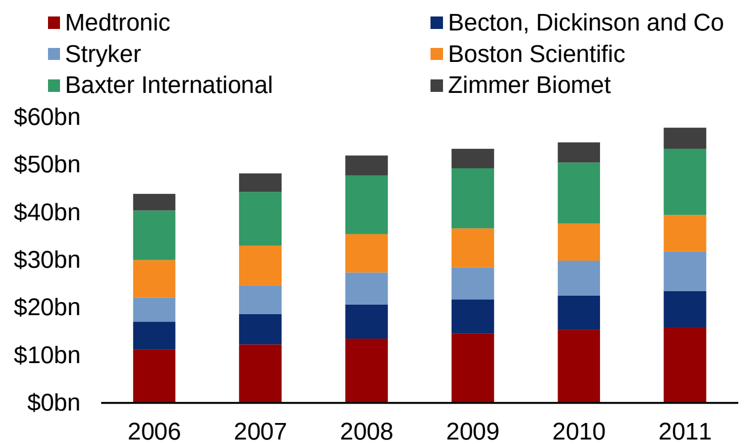
MEDICAL DEVICES UNDERVALUED

We believe that the medical devices sub-sector will offer significant value in 2019. We find the large diversified players in the space to be undervalued, with much of the growth in the space being incorrectly attributed to smaller and more specialized device manufacturers.

LARGE PLAYER PESSIMISM

Medical devices is one of the few sub-sectors in healthcare experiencing significant multiple expansion, with EV/Revenue multiples rising from 3.6x in 2015 to 4.7x today. The market believes growth in the sub-sector will exceed overall sector growth in the coming years. Yet, when looking at where in the sector this growth has been allocated, we see that the diversified large players in medical devices have underperformed medical devices as a whole. As much of the innovation that will spur high growth in the sub-sector is occurring at smaller, more specialized firms, the market's optimism for smaller medical device firms is understandable. However, moving forward, we believe that ongoing consolidation in the sub-sector will funnel this growth to the larger incumbents. The resilient nature of the medical devices business model is also attractive.

Figure 7: Large Players' Revenues during 2008 Crisis



FDA DEVICE APPROVALS UP

New device approvals continue to show an upward trend over recent years as the FDA continues to loosen its approval standards. The continued uptick in De Novo device approvals, which are used for low risk devices and do not require any clinical data, is especially promising. While less than ten De Novo devices were approved in each year prior to 2013, approvals have shot up to 31 in 2017 and 44 in 2018. 2018 was the first year in which the number of De Novo approvals exceeded new PMA/HDE approvals. We will increase our exposure to De Novo focused firms in 2019.

Figure 6: Large Players' Relative Performance

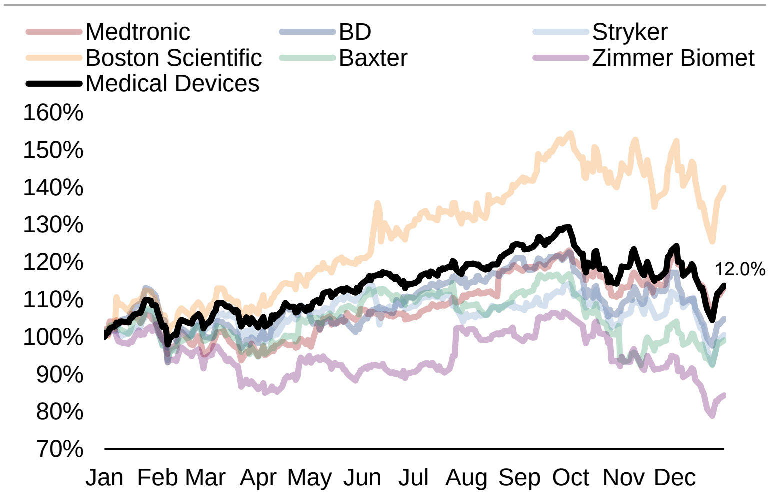
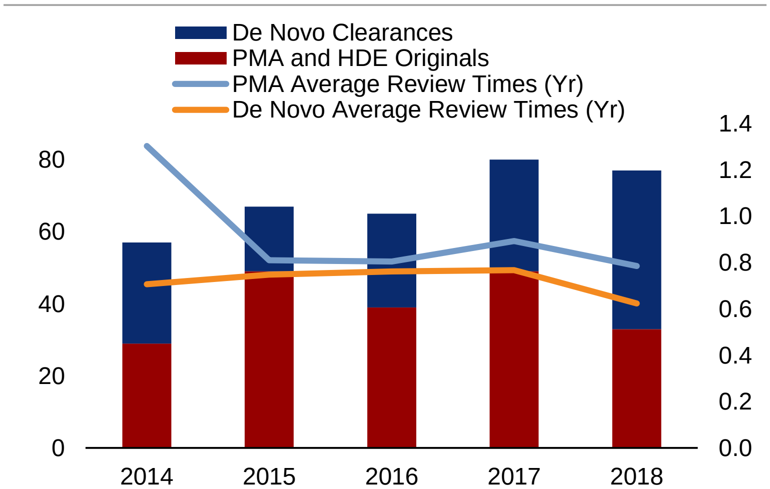


Figure 8: FDA Device Approvals and Approval Times



Sources: FDA, CapIQ

HEALTHCARE

2018 HOLDINGS REVIEW

SHIRE PLC (NASDAQ: SHPG)

COMPANY OVERVIEW

- Shire was a leading global biotechnology firm based in Ireland which focused on developing and marketing innovative medicines for patients with rare diseases and other specialized conditions
- The firm focused on developing treatments in immunology, hematology, neuroscience, internal medicine, and genetic diseases
- In December, Takeda completed its cash-stock acquisition of Shire for $81 bn or ~$189 per ADR-equivalent shares
- Shire rose 23.7% over our holding period in 2018, mainly driven by merger news, while our healthcare benchmark rose 4.6% at constant currency
- Shire shares were de-listed and canceled in January

CATALYSTS

- Increased scale and global dominance as the Takeda-Shire combined entity will be one of the largest biopharma players in the world
- Continued strength in Takhzyro (lanadelumab) US launch, and lanadelumab approval in the EU

RISKS

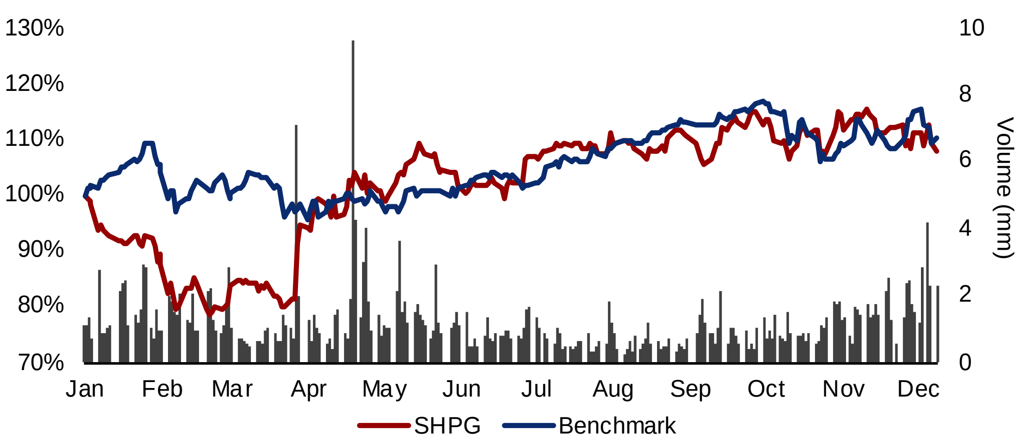
- Significant debt load of the combined entity
- Shire's focus on rare diseases provided several operational advantages (tax credits, fee waivers, funding grants for clinical trials, extended patent and exclusivity duration); these will be mitigated when the rare disease business is combined with Takeda's broader pharmaceutical portfolio

INVESTMENT THESES

1. **Market has an unjustified obsession with Shire's debt load**
   - Shire's net debt currently stands at $15.2 bn, down 26% YoY – a $2.3 bn debt paydown was conducted with the proceeds of the oncology division sale to Servier (completed in August)
   - Net Debt / EBITDA has fallen to 2.3x from 2.7x in 2Q18 and 3.3x in 3Q17, surpassing the firm's 2018 leverage target of 2.5x – speed of deleveraging has exceeded market expectations
2. **Market is overly discounting the impact of competition in hematology**
   - Hematology revenues declined by 1% YoY, with growth in hemophilia compensating for an 11% decline in inhibitor-based therapies – franchise is shrinking much slower relative to market expectations
3. **Market is underrating Shire's strong pipeline**
   - US initial launch stocking of HAE drug Takhzyro (lanadelumab) came in at $51 mm, 10x greater than Street forecasts and two years earlier – these sales levels were not expected until 2020

We decided to <u>SELL</u> the Takeda shares received as part of the acquisition as our theses have materialized

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Sources: Company Filings, CapIQ

POSITION SNAPSHOT

In CAD, unless noted	
Average Cost (USD)	$152.53
# of Shares	575
Value Invested	$136,470
Portfolio Weight	5.01%
2018 HPR	23.69%
2018 HP Benchmark	12.80%
Excess Return	10.89%

FRESENIUS MEDICAL CARE AG & CO. KGAA (NYSE: FMS)

COMPANY OVERVIEW

- Fresenius Medical Care is a leading global kidney dialysis firm based in Germany
- The firm is vertically integrated, generating revenues through both the sale of dialysis equipment (dialysis products segment) and the treatment of kidney diseases such as end-stage renal disease through dialysis (kidney care facilities segment)
- Fresenius shares fell 33.1% in 2018, severely lagging US healthcare at 4.6% at constant currency
- This decline can be attributed to decreased revenue growth guidance, falling to 2-3% from 5-7% for 2018. This was spurred by continued difficulties in calcimimetics
- Loss of investor confidence in management following their recent loss of credibility

CATALYSTS

- The opening of 79 de novo clinics in the US was delayed due to slower than expected government approval timelines – this is expected to reverse in 2019 once private third-party clinic surveyors become permitted
- Growing diabetic population and market share in APAC region

RISKS

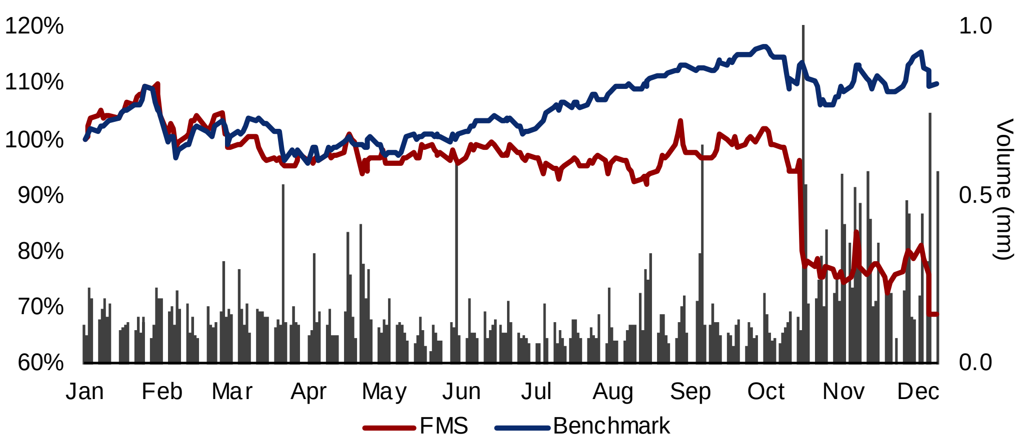
- Further possible growth slowdown in Care Coordination which would adversely impact margins
- Increased payer pressure from public payers due to reclassification of calcimimetics under Medicare
- Potential FX headwinds in LATAM, namely Argentina

INVESTMENT THESES

1. **Market underestimates margins and revenue growth**
   - YTD Revenues grew 3% YoY at cc on a comparable basis despite continued difficulties in calcimimetics
   - FDA approval of Amgen's IV calcimimetic Parsabiv caused a shift of calcimimetic drugs from Part D reimbursement classification under Medicare to Part B. This has reduced Medicare reimbursements for calcimimetics by including them in the ESRD prospective payment system payment bundle
   - Care Coordination experienced significant headwinds in 2018. YTD revenues declined 31% YoY at cc, with only 4% of the decline being attributable to the Sound Physicians divesture
   - Care Coordination now only accounts for 7% of total sales, down from more than 15% at the end of 2017 – we no longer see Care Coordination as a driver of growth for Fresenius
2. **Market misunderstands industry size and long-run growth trends**
   - The diabetic population in Asia is expected to grow from 241 mm in 2018 to 334 mm by 2024 –strong YoY revenue growth of 8% (cc) shows that Fresenius continues to be the dominate dialysis player in APAC

We decided to <u>HOLD</u> FMS as we believe the market has overreacted to guidance cut

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Sources: Company Filings, CapIQ

POSITION SNAPSHOT

In CAD, unless noted	
Average Cost (USD)	$38.63
# of Shares	955
Value Invested	$42,183
Portfolio Weight	1.55%
2018 HPR	(33.14%)
2018 HP Benchmark	12.58%
Excess Return	(45.71%)

INDUSTRIALS

2018 REVIEW & 2019 OUTLOOK

IAN JIANG
ALEXANDRA MA
TIMOTHY SUNG
ROY CHEN ZHANG

DESAUTELS CAPITAL MANAGEMENT

INDUSTRIALS
SECTOR PERFORMANCE

2018 PERFORMANCE

The DCM Industrials sector delivered lackluster performance in 2018, returning -19.4%, undershooting our sector benchmark by 14.6%.

Performance lagged primarily due to our new position in Fincantieri, an Italian ship-building company that has since returned -35.0%. The decline was the product of heightened political uncertainty in Italy, and a one-off production alignment issue that resulted in an unexpected hit to margins in the Offshore segment. We believe the issue is temporary and continue to remain optimistic on Fincantieri, which continues to trade at a discount to struggling shipbuilding peers while capitalizing on a resilient cruise market. We are also hearing positive news regarding a possible joint venture with Naval Group, a combination that would produce substantial cost synergies that have yet to be priced in by the market in our view.

We also started to trim our position in Cummins, an American engine manufacturer, as our theses are materializing. However, we continue to hold as we are encouraged by favourable emerging market conditions for truck engines, and Cummins' steep discount to trucking peers.

2019 OUTLOOK FOR INDUSTRIALS

Industrials performance lagged the S&P 500 due to trade tensions and slowing GDP growth. The blanketed pessimism, however, has yielded depressed multiples within the sector, which made for some attractive investment opportunities. This is the rationale behind our recent investment in Textainer, a container leasing company. The firm is currently valued by the market at multiples comparable to what it traded at during the global recession despite robust demand for leasing.

Despite sluggish industrial performance last year, our sector outlook remains optimistic as the Industrial Production Index and Capex investment, which are key drivers of Industrials growth, continue to increase amidst the aforementioned pressures. This suggests that businesses are still confident enough to invest in new projects that will create value for the sector.

We also anticipate large waves of private and public spending in infrastructure as the economy is currently ill-prepared for the rapid increase in urbanization. This trend will particularly benefit Construction and Engineering companies, which are already taking advantage of an increase in private-public partnerships.

Figure 1: Industrials Performance vs. Benchmark

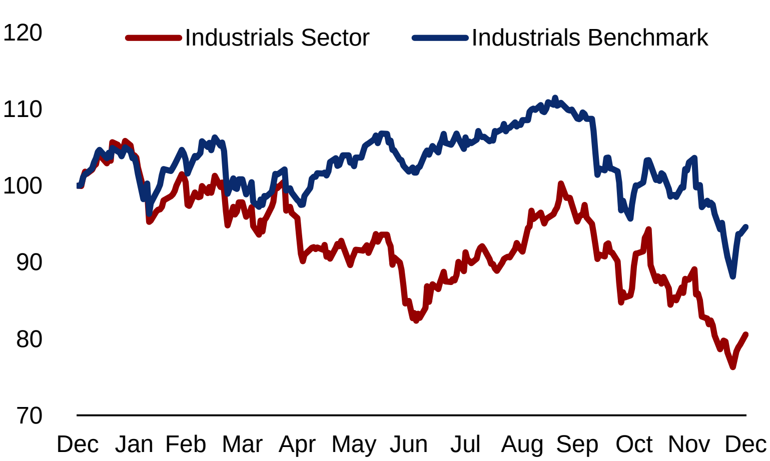
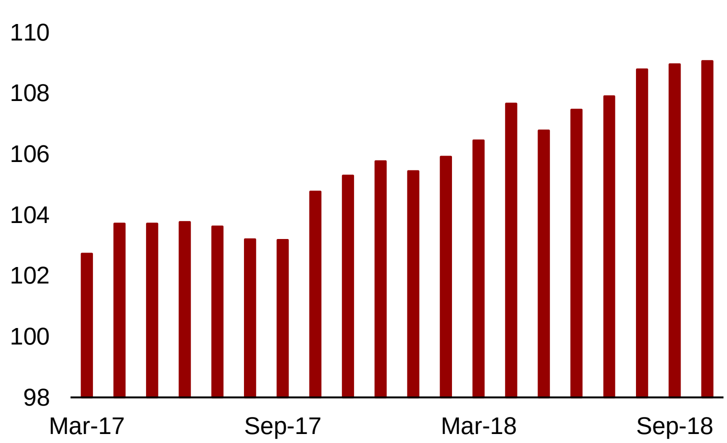


Figure 2: Industrial Production Index (Indexed to 2012)



Source: Bloomberg,

CAPITAL GOODS
UNIQUE PLAYS IN 2019

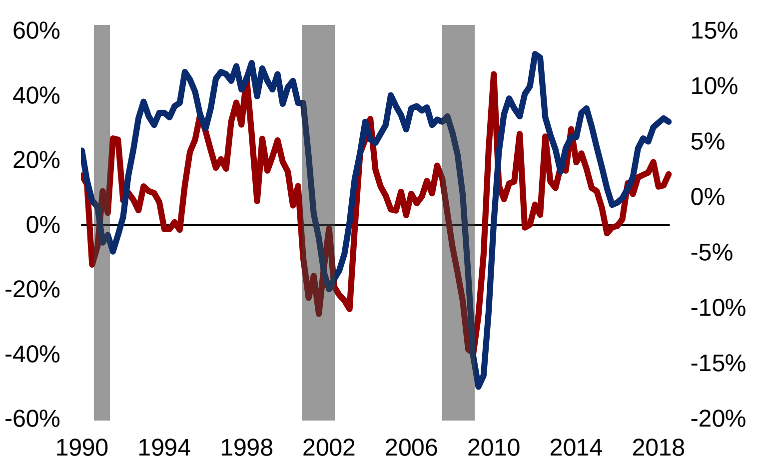
THE CASE FOR CAPITAL GOODS

Heading out of a very uncertain December, it is clear that macro uncertainty will play a big role for the Industrials sector in 2019. As such we prefer sub-sectors that are less exposed to both short-term shocks and long-term economic slowdown. The Capital Goods sub-sector, which focuses on the production and maintenance of Capital Equipment for commercial and private clients, is especially promising in our view. The sub-sector is inherently geographically diversified, with almost a third of revenue originating in emerging markets. Additionally, the sub-sector shows unique potential for strong growth heading into 2019 in both developed and emerging markets.

In the United States, for example, there has been a temporary break between equities earnings growth and capex across the board. Earlier reaction patterns in the past two decades indicate that capex historically closes large gaps within six months after the gap is observed. In other words, stellar earnings results do not typically translate into higher revenues for the Capital Goods sub-industry until half a year later.

DEVELOPED MARKETS

Figure 3: US Corporate Profits vs Capital Expenditure (Right)

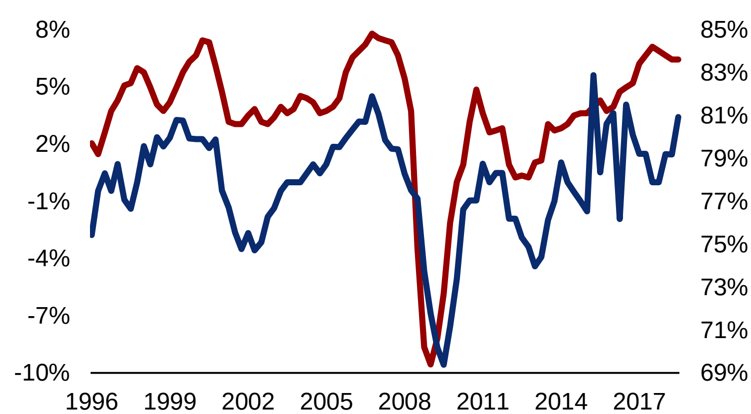


Source: Datastream, Eurostat, IBES

This latency will give us excellent potential for good plays within the sub-sector in the coming months.

Current pricing has placed the sub-sector in-line with the rest of the American markets, and consistent with the sub-sector's prior performance. It is clear that there is a high likelihood of the market not yet realizing this relationship. By capitalizing on this before the gains realize for capital goods companies, we stand to benefit from subsequent rallies on higher earnings and performance numbers reported by producers.

Figure 4: Eurozone Capital Expenditure vs. Capital Goods Capacity Utilization (Right)



Europe's figures tell a similar story: we have reached record levels of capacity utilization but companies have yet to purchase new capital goods in response. We expect European capex to play a similar game of catch-up in the coming year and a normalization of capacity utilization.

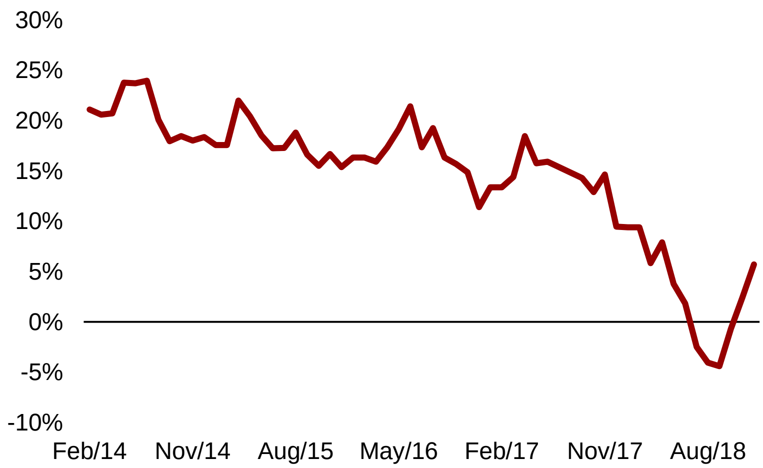
EMERGING MARKETS

We also like the emerging markets outlook for Capital Goods, albeit for different reasons. China has reached a critical point of rebound after record fixed asset investment lows, and is on the verge of a new period of policy-backed rebound. Any potential resolution of current trade tensions is also likely to give extra momentum to resurgent growth at home and abroad.

AEROSPACE & DEFENCE

TAKING OFF IN 2019

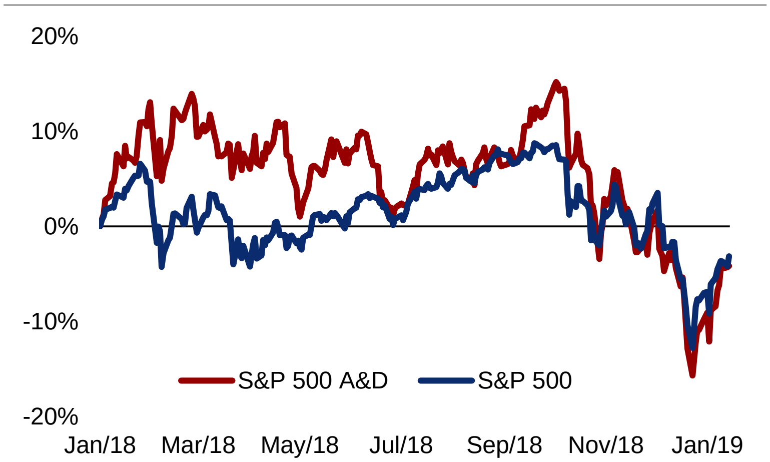
Figure 5: China Infrastructure Fixed Asset Investments (y-o-y%)



WHY A&D IS ON OUR RADAR

The Aerospace and Defence (A&D) sector outperformed the market by over 18% last year. The sector ended the year with a significant dive due to market sell-offs and budget uncertainties in light of the American announcement of withdrawal from Syria and the subsequent exit of US Secretary of Defence Jim Mattis. However, we believe that the industry is wrongly discounted as long-term defence demand is unlikely to significantly decrease, and aerospace remains undersupplied, like much of the Capital Goods sub-sector.

Figure 6: A&D Index vs. S&P 500



Source: Datastream, US Department of Defence, Barclays

Given an unjustified discount, we believe the industry is particularly attractive not just as a medium-to-long-term value play, but also as an effective way of reducing the vulnerability of our portfolio in uncertain times.

We also see the aviation industry being drastically transformed in the upcoming years with the emergence of a larger and more resilient after-market (reselling and maintenance) for aircraft, and rebounding demand for new business jets on the tail of rising corporate capex.

Despite the current American government shutdown, there is still ample room for optimism in Defence. With the FY2019 DoD Appropriations Bill already signed into law, the Defence Department has dodged the need for a Continuing Resolution, unlike many other government institutions. The new bill includes a significant (5% higher) allocation towards modernization (updating outdated equipment, and separate from infrastructure), shifted more so away from short-cycle defence consumables (including missiles and ammunition) and more so towards Capital Goods (most notably aircraft and equipment). We expect high modernization growth in 2019 benefitting companies that operate in both Aerospace and Defence.

DEFENDING OUR PORTFOLIO

A&D is a particularly useful industry for hedging against broader market trends. Defence expenditure has proven quite resilient during market downturns, with modernization expenditures last peaking in the 2007-2009 period. Aerospace demand is similarly more subject to long-term growth planning and shielded from short-term consumption and wage shocks. Aerospace (and aviation in general) also demonstrates inverse correlation with oil prices (unsurprising since it's the biggest input cost for all aircraft operators), a potentially desirable quirk given our high oil exposure elsewhere in the portfolio.

INDUSTRIALS

2018 HOLDINGS REVIEW

CUMMINS INC. (NYSE:CMI)

COMPANY OVERVIEW

- Cummins designs and manufactures diesel and natural gas engines
- Main business segments include Engine, Distribution, Components, and Power Generation; the majority of customers consist of manufacturers of heavy duty on-highway trucks and off-highway industrial vehicles
- CMI has an extensive global footprint through its joint ventures, wholly-owned operations and distributors in the United States, China, India, South Korea, Mexico and Sweden

CATALYSTS

- Increased industrial revenue due to recovering demand in global mining and NA oil and gas markets
- Chinese adoption of NS6 emission standards would help CMI gain market share

RISKS

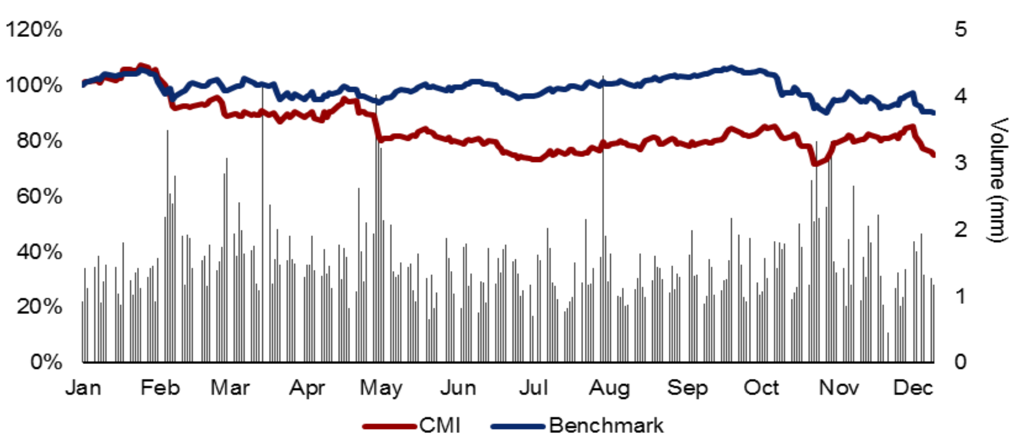
- Chinese economic slowdown represents a significant concern for joint ventures sales
- Potential risk of future product recalls

INVESTMENT THESES

1. **Industry-leading operator insulated from negative sentiment due to product quality and compliance**
   - CMI maintains a market share of 31-34% in the heavy duty truck engines sector and 72-75% in the medium duty truck sector
   - Minimal market reaction despite 500,000 engine recalls in July due to emissions control systems issues
2. **High exposure to ramp-up in emerging markets through its joint ventures**
   - Emerging market sales in India up by 20%, with maintained revenue growth in China
3. **Valuation continues to yield upside at current price**
   - CMI continues to trade at a discount to its peers on a forward P/E and EV/EBITDA basis

We maintain a HOLD recommendation on CMI with a price target of $155.33

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Bloomberg

POSITION SNAPSHOT

In CAD, unless noted

Average Cost (USD)	$137.83
# of Shares	400
Value Invested	$72,898
Portfolio Weight	3%
2018 HPR	(18%)
2018 HP Benchmark Return	(5%)
Excess Return	(13%)

TEXTAINER GROUP HOLDINGS LTD. (NYSE:TGH)

COMPANY OVERVIEW

- Textainer is based in San Francisco engaging in the purchase, ownership, management, leasing, and disposal of a fleet of intermodal containers globally
- TGH supplies standard dry freight, specialized, and refrigerated containers to the majority of the world's leading shipping lines
- Textainer is also the primary supplier of containers to the US Military

CATALYSTS

- US and China reach an agreement resolving trade conflict
- Continued consolidation of the shipping container industry
- China's One Belt Initiative generating increased localized trade

RISKS

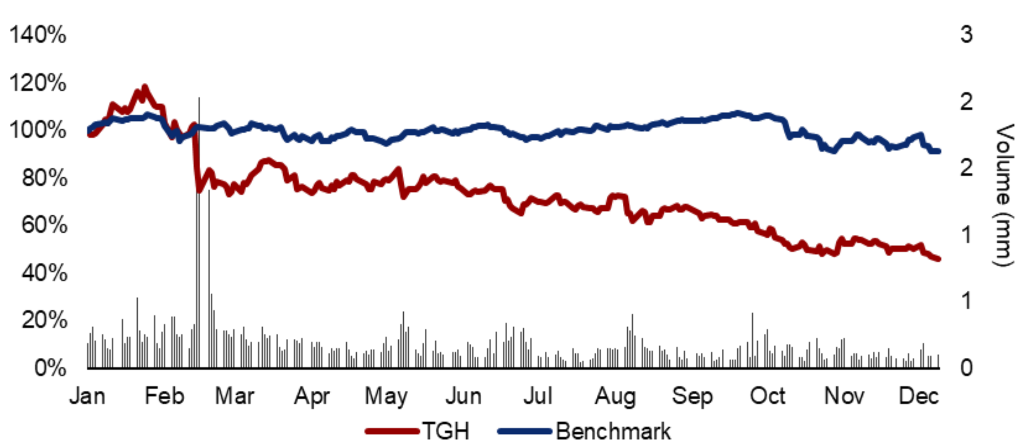
- US trade tariff escalation on Chinese imports
- TGH customer concentration within the Asian market

INVESTMENT THESES

1. **Current market valuation comparable to peak global recession levels despite robust macroeconomic indicators and favorable container trends**
   - Global trade war set to impact the US more significantly than East Asia (2% GDP loss differential)
   - China's trade balance is expected to increase by $5 bn YoY despite implemented tariffs
   - TGH looking to benefit from growing localized trade shift given its geographic exposure weighted towards Asia
2. **Leasing containers set to benefit from contract renewals with high rates and volume**
   - Current market rates of containers 30% higher than average contracted rates
   - TGH has over 500,000 CEU of leases expiring within the next two years to be renegotiated

We maintain a <u>HOLD</u> recommendation on TGH with a price target of $18.95

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Bloomberg, ECB

POSITION SNAPSHOT

In CAD, unless noted

Average Cost (USD)	$11.12
# of Shares	4,200
Value Invested	$57,046
Portfolio Weight	2%
2018 HPR	(6%)
2018 HP Benchmark Return	(3%)
Excess Return	(3%)

MATERIALS

2018 REVIEW & 2019 OUTLOOK

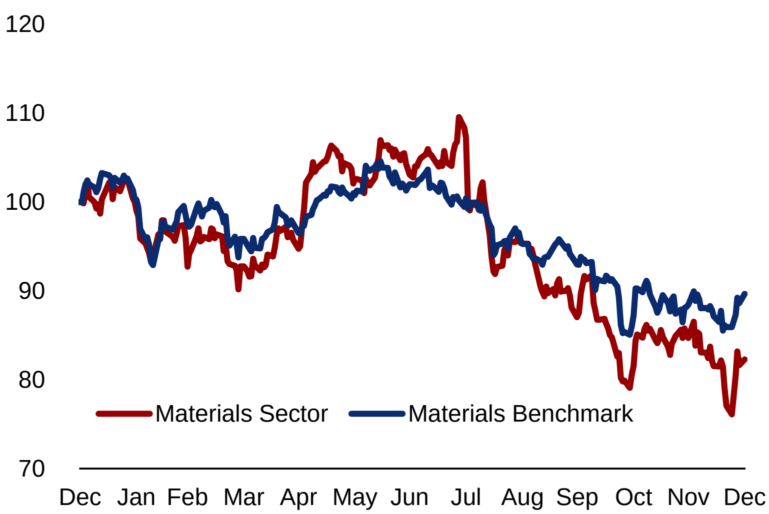
IAN JIANG
ALEXANDRA MA
TIMOTHY SUNG
ROY CHEN ZHANG

MATERIALS
2018 PERFORMANCE

OVERALL PERFORMANCE

The Materials sector benchmark returned -10.3% in 2018, driven primarily by underperformance in Basic Materials on the back of slowing economic growth. The base metals, agricultural chemicals, construction materials, and forestry product subsectors all experienced double digit losses this past year.

Figure 1: DCM Materials Performance



The DCM Materials sector underperformed our benchmark by 7.4%, due to our position in Summit Materials (SUM). The American cement and concrete producer's share price fell 56.4% over the year, fueled by weather-impacted lower revenues and lower than expected earnings as explained further below.

Our second holding, Alacer Gold (ASR), performed relatively well, returning 16.2% in 2018. Given the significant share price volatility throughout the year, as well as the slow materialization of our investment theses surrounding the company's Turkish operations, we made the decision to sell ASR at the beginning of 2019.

CONSTRUCTION:LABOUR AND RISING COSTS

Although declining fuel prices in December lowered costs for construction inputs, most services and materials experienced increases in year-over-year costs.

Looking at specific business segments for Summit, net revenues in the aggregates and products business increased through to the third quarter, with organic sales volumes increasing between 2 - 3%. However, within the Cement segment, low demand coupled with weak levels of US single-family housing starts resulted in declining year-over-year revenues. These macroeconomic factors coupled with higher raw material, freight, and storage costs have resulted in negative earnings surprises.

HOUSTON: HURRICANES AND WET WEATHER

Poor weather conditions had a large impact on Summit's revenues this past year. With construction revenues weighted towards the back end of the fiscal year, record levels of rainfall in many parts of Texas throughout the year have further pushed back sales that were expected to be generated through the various reconstruction and housing projects in the aftermath of Hurricane Harvey in 2017. With several disaster relief bills currently in the pipeline within the House and the Senate, we expect the continued funding of projects and earnings to finally materialize within the first half of 2019.

Source: Bloomberg

MATERIALS
2019 OUTLOOK

LOOKING FORWARD

For 2019, our aim is to identify attractive subsectors within the broader Materials sector that are well supported by macroeconomic trends and commodity prices. As such, we will be focusing on the Precious Metals and Agrochemicals subsectors as we search for potential investments to add to our portfolio moving forward in 2019.

PRECIOUS METAL OPTIMISM

With the US dollar peaking and the current interest rate environment, precious metals including gold and silver continue to hold a strong potential upside going into 2019. The maturing US economic cycle and Fed rate outlook towards slowed economic growth have recently been pushing up the price of gold, often seen as a viable hedge during inflationary environments. Gold ended 2018 on a strong note, outperforming global equities and commodities within the fourth quarter. Both spot gold and US gold futures have been nearing $1,300 per ounce amidst the increased market volatility.

Figure 2: Dow Jones Precious Metals Index Performance

Source: Bloomberg

Palladium has also been presenting itself as an attractive investment opportunity in recent months. Palladium is a key component in catalytic converters used to convert toxic gases and pollutants in automobile exhausts. With the growth of environmental regulation in transportation and the implementation of Stage VI emissions standards in China, demand for palladium has been increasing.

Market supply has yet to meet the growing demand. Palladium as a by-product of platinum and nickel mining has experienced lagged price increase. With current market conditions and countries like China beginning to stockpile the metal, palladium looks to continue its rise as a lucrative precious metal in limited supply.

MIXED SIGNALS IN US CONSTRUCTION

Current positive macroeconomic fundamentals have carried on to the beginning of 2019 for the Building Materials sector. Looking at historical bellwethers of performance, approved US infrastructure spending, and GDP growth have continued to increase at a steady clip. We also believe that the US cement market has not yet reached the peak of the market cycle, as compared to China and the UK. In fact, US cement consumption remains 25% below peak 2005 levels at 12.25 million tonnes. However, declining construction backlogs and weak numbers for new housing starts point to an eventual transition between new home construction to existing space reutilization, leading to less future construction. Within a rising interest rate environment, we may see consumers increasingly shift from buying to renting homes in the upcoming year, leading to decreasing demand for products sold by upstream materials companies.

MATERIALS
2019 OUTLOOK

AGROCHEMICALS AND FERTILIZERS

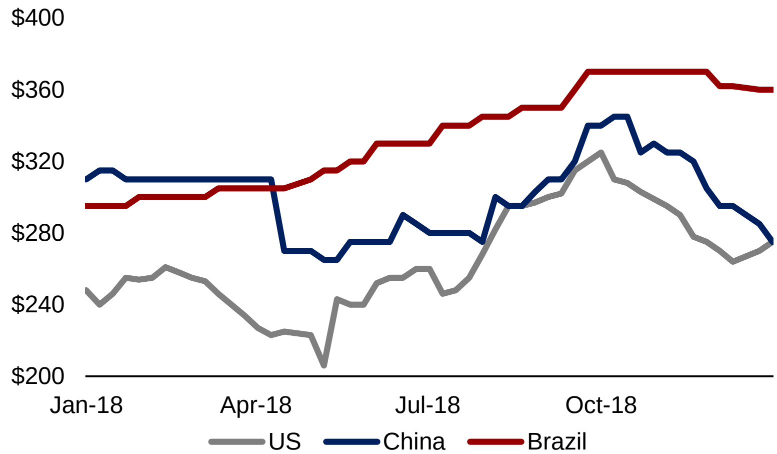
Agricultural chemical producers are set for upwards earnings growth potential in 2019, with increasingly cost efficient operations, synergies realized from acquisitions and consolidation, as well as rising crop prices.

Within the last five years, a supply glut in the fertilizer industry has resulted in major producers, including K+S, and Uralkali, to pull back production and reduce mixed costs. Suppliers will continue to focus on cost savings throughout 2019. However, prices of potash, nitrogen, and phosphate have risen since mid-2018 and have for the most part resisted fourth quarter seasonal declines at the end of 2018. Price movement has been mainly driven by recovering crop prices. Cash prices for US soybeans began to recover during December when China resumed purchases. Average US cash corn prices have also reached their highest levels since early June of last year.

INDUSTRY CONSOLIDATION

To combat falling prices, the industry is set to continue a pattern of consolidation through mergers and acquisitions to better control production costs. With the merger of Canadian companies Potash Corporation and Agrium being finalized in 2018, the newly formed firm Nutrien has become the world's largest potash producer, controlling over 60% of North American production. In conjunction with Canpotex, the Canadian cartel handling overseas sales, shareholders seem set to benefit from the potential opportunity for legal price controls.

Figure 3: Global Fertilizer Prices ($USD/ST)



TECHNOLOGY IMPLEMENTATION

Various farmers are looking towards the integration of technology within their crop production as a means of minimizing spending on traditional chemicals. The USDA estimated that chemicals represented 11% of US corn farmers' operating costs in 2017. While large players such as Monsanto have developed more efficient chemical systems, Microsoft has also entered the space at the beginning of the year, looking to implement AI and farm data management solutions to better help farmers make decisions. Within the last five years, agricultural chemical leaders including DuPont, Bayer, and Deere have been increasingly looking to invest in digital technologies, a trend we see continuing moving forward into 2019. With improved technology and production processes, fertilizer prices may continue to experience significant downward pressures and pricing competition throughout the upcoming year. Traditional producers with early integration of new technologies are set to benefit from additional cross selling opportunities. Overall, we see the Precious Metals and Agrochemicals sub-sectors as the best performing in 2019.

Source: Bloomberg

MATERIALS

2018 HOLDINGS REVIEW

SUMMIT MATERIALS (NYSE:SUM)

COMPANY OVERVIEW

- Summit Materials is a construction materials company that along with its subsidiaries, produces and sells aggregates, cement, ready-mix concrete, and asphalt paving mix primarily in the United States
- The company owns and operates quarries, cement and concrete plants, as well as landfills.
- Summit serves the public infrastructure, residential construction, and non-residential construction markets
- Summit has been underperforming the market and the index due to macroeconomic concerns regarding inflation, trade, and otherwise volatile demand for cement and concrete

CATALYSTS

- Further consolidation in Summit's key markets
- Expansion of infrastructure initiatives whether through private-sector incentives or public works projects
- Resolution of trade tensions could inject newfound momentum into the sector and spark demand

RISKS

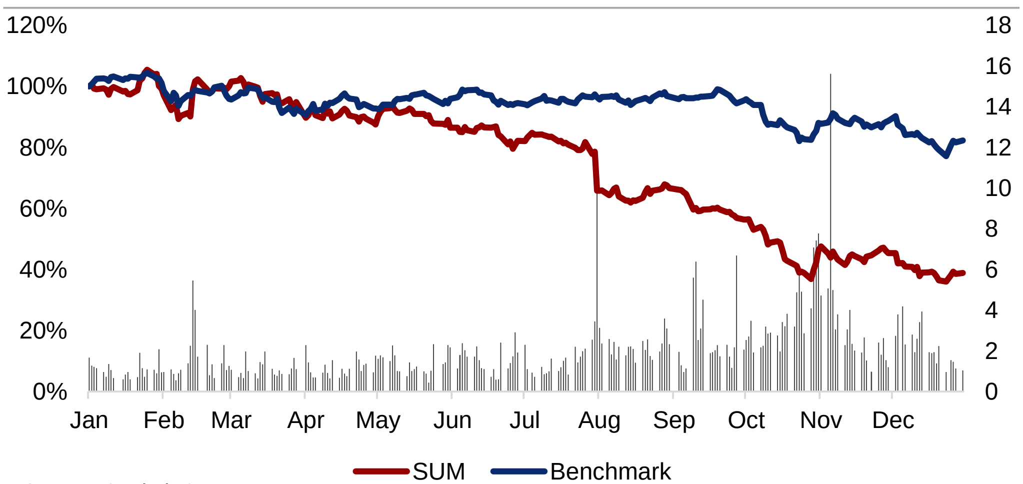
- Higher inflation pressures may further exacerbate the financing situation of highly levered industrial firms, as the inflation differential between inputs and sales is not favorable for Summit
- Demand for new residential constructions falling in a rising rate environment

INVESTMENT THESES

1. **Summit suffers from an unjustified size discount**
   - Although not as well-established in coastal regions, Summit is present in the Midwest and Deep South, where they are still positioned to capture strong growth in regions such as Western Texas
2. **Well-positioned with attractive valuations relative to market**
   - Given that Summit has dramatically underperformed the index in the past year, we still have adequate reason to believe that the stock remains undervalued by the market
3. **Industry tailwinds may favor Summit's cyclical operations structure**
   - Summit is largely immune from short-term economic uncertainties, and as a counter-cyclical company is likely to weather economic downturns better and rally later into its operating cycle

We decided to <u>HOLD</u> SUM until our theses have materialized over the firm's business cycle

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Source: Capital IQ

POSITION SNAPSHOT

Average Cost (USD)	$28.57
# of Shares	1,750
Value Invested	$29,592
Portfolio Weight	1%
2018 HPR	(53%)
2018 HP Benchmark Return	(7%)
Excess Return	(46%)

ANNUAL REPORT 2018

TECHNOLOGY, MEDIA & TELECOM

2018 REVIEW & 2019 OUTLOOK

KYLE COSTANZO
CODY JONES
RAKAN LAMY

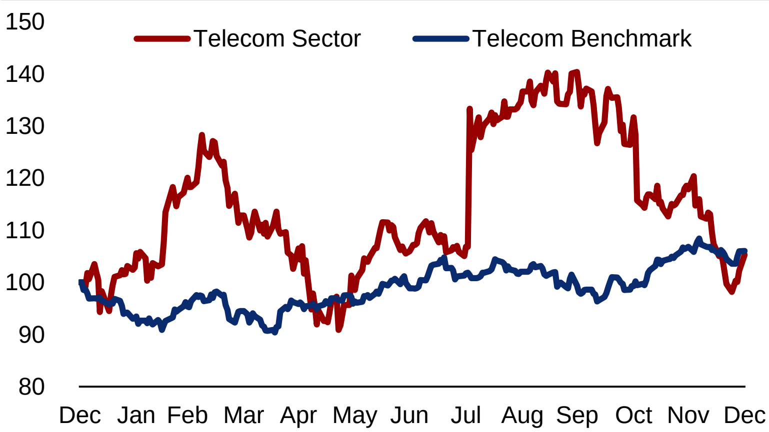
DESAUTELS CAPITAL MANAGEMENT

TMT
2018 REVIEW - A VOLATILE YEAR

OVERVIEW

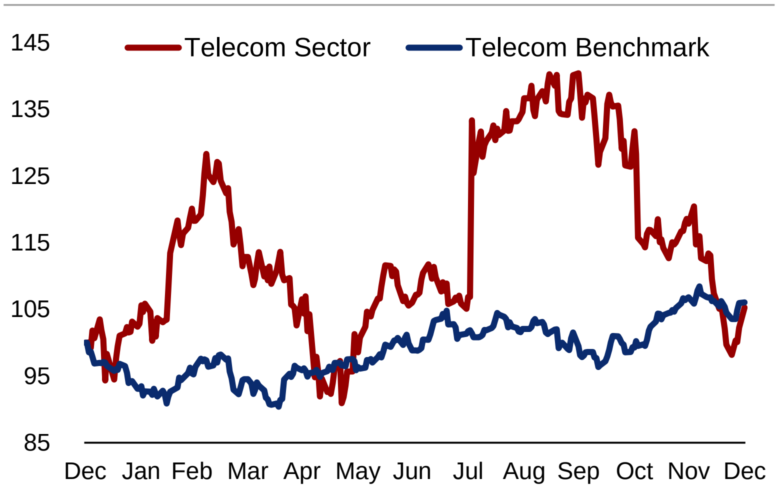
The Global Equity Fund's Technology & Media sector returned (2.0%) in 2018, vs. a 6.6% return for the Technology and Media benchmark. Underperformance was largely due to losses in Eros, a leading Indian OTT content provider and Teladoc, a major player in the Telehealth space. Despite the losses, we remain optimistic about these companies' long-term growth opportunities as explained further below.

Figure 1: Tech & Media Performance vs Benchmark



In Telecom we achieved a 5.3% return in 2018 vs. a 6.0% return for the benchmark. This was led by Boingo Wireless, which returned -1% in 2018 due to overall market uncertainty and an unprofitable Q3.

Figure 2: Telecom Performance vs Benchmark



Source: Bloomberg, Deloitte, PwC, ValueWalk, New York Times

TECHNOLOGY

2018 was a very exciting year in the technology sub-sector. Strong market confidence in the first 9 months of the year pushed the market capitalization of the largest technology stocks to levels never seen before, with Apple becoming the first company ever to hit the $1 tn mark. In fact, 7 of the 8 largest companies in the world are now technology stocks. However, these companies were also the ones that were hit the hardest during the sell-off in the last three months of the year, with most technology stocks decreasing by double-digits. This can be attributed to companies such as Twitter and Facebook missing top-line growth expectations and therefore decreasing their future growth guidance, which ultimately translated into multiple contraction.

Semi-conductor companies, which performed extremely well in 2017, experienced a tough reality-check. The large increase in demand for chips in 2017 turned out to be short lived, partly because of the burst of the cryptocurrency bubble. Supply growth has outpaced demand growth, which led to companies such as AMD and Nvidia seeing their stock prices drop nearly 50%.

Finally, 2018 has also seen its fair share of controversies, most notably Facebook and the Cambridge Analytica scandal. It was revealed that Cambridge Analytica had harvested the personal data of millions of Facebook profiles, which led Facebook's stock to plummet by over 20%. Although the stock has since recovered, this has led many people to worry about technology companies' misuse of personal data and the negative effect this would have on their profits.

MEDIA

One of the major trends we have seen in media is the continuing shift from traditional media such as cable TV

TMT
2018 REVIEW - A VOLATILE YEAR

to digital media like over-the-top content (OTT). Leaders in the OTT space such as Netflix and Amazon were among last year's best performers, pushing traditional distribution companies to enter the space, primarily through M&A. Therefore, this has led to mega-transactions such as the merger between Disney and Fox. Both Disney and Time Warner (HBO) have announced their decision to launch their own OTT platforms in early 2019, which has created some uncertainty in the media sector as investors are still eager to see who will come out as the winner of this increasingly competitive market. At DCM, we decided to capitalize on this trend by entering a position in Eros International, the leading Indian OTT content provider due to what we believed was an underappreciated subscriber growth potential. Even though Eros' stock has not performed well in 2018, it has proved its ability to quickly grow its subscribers' base and we believe this will be recognized by the market sooner than later.

TELECOMMUNICATIONS

Of the three sub-sectors in TMT, telecommunications was the worst performer. This was mostly caused by decreasing growth rates due to increased competition between current industry players. In response to this, telecom companies have been exploring other avenues, including consolidation: Comcast has tried to acquire both Fox and Sky, while the Sprint/T-Mobile merger is set to close soon.

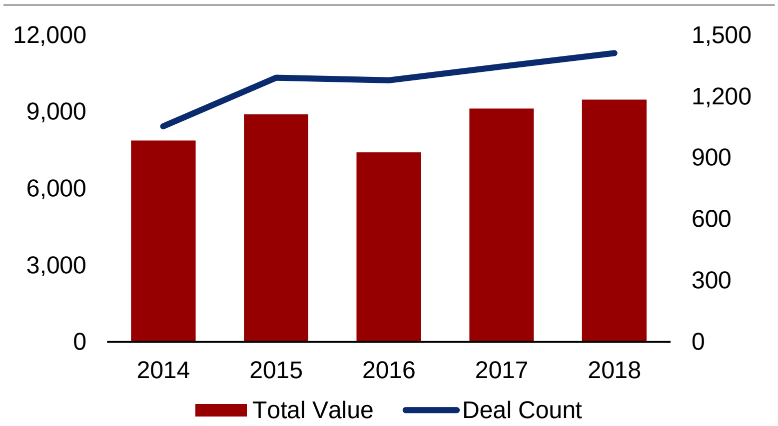
The interest in 5G technology became especially clear in 2018, with over 150 operators in 70 countries already having conducted 5G tests throughout the year. Various nascent technologies such as virtual reality and Internet of things will need 5G technology in order to operate, which means that telecom companies can expect their top line to start growing faster as 5G is rolled out and adoption picks up. Moreover, this will act as a catalyst for companies using small cells to deliver Internet, such as Boingo Wireless (DCM position initiated in late 2017).

M&A ACTIVITY

2018 also saw a continuation of the upward trend in TMT M&A activity, both in terms of deal count and total value (Figure 4). The latter increased 3.9% year-on-year, mostly driven by a significant increase in technology transactions. Media and telecommunications deal activity was a little slower in 2018, but saw several mega-deals, including AT&T's $105 billion acquisition of Time Warner. The dismissal of the Department of Justice's anti-trust case against that deal also opened up opportunities for other telecom companies seeking to enter the booming media market.

In some instances, this led to bidding wars, which pushed valuations higher, such as in the case of Disney's pending $84.1 bn acquisition of 21st Century Fox, a price much higher than the originally proposed $68.4 bn, as Comcast also bid for Fox's assets.

Figure 3: TMT M&A Deal Count and Value ($ bn)



Taking a look at the multiples paid in the 2018 transactions (Figure 5), we can see that both EBITDA and revenue multiples have slightly contracted in 2018, a sign of investors becoming less optimistic about these

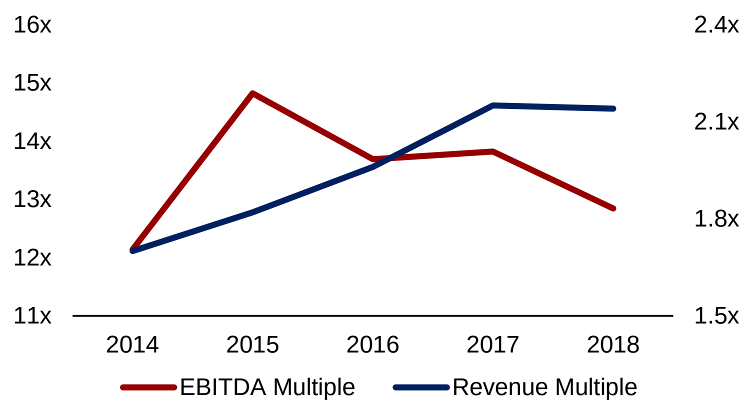
Source: Bloomberg, Deloitte, PwC, CNBC, Goldman Sachs, Newswire, TelecomReview, Capital IQ, New York Times

TMT

2018 REVIEW - A VOLATILE YEAR

companies' growth potential. Finally, it is interesting to note that revenue multiples have consistently increased over the past 5 years while EBITDA multiples contracted, which would mean that margins are expanding. This makes sense as many TMT companies have shifted over the past years to a subscription model where they have initially adopted a market skimming strategy, and are now becoming more profitable as their customer base becomes more established.

Figure 4: TMT Transaction Multiples



MULTIPLE COMPRESSION

At the end of 2018, the technology subsector suffered a fair bit of multiple compression alongside the general market with the subsector's EV / Forward EBITDA multiple falling from a high of 13.05x in March to end the year at 10.82x, just above its historical average of 10.45x. Going into 2019, it seems all but inevitable that this trend will continue as the market as a whole shows more signs of pessimism.

Despite these recent compressions, which seem to be rooted in concerns affecting the overall market, there are many current trends in tech that DCM believes will carry into 2019 that will help companies and individuals spend less and work smarter.

MARTECH – MARKETING AS A SCIENCE

Marketing Tech – or MarTech for short – is a new trend in business that allows companies to use software based on data analytics and other emerging technologies to optimize their marketing strategies and better target consumers.

One of the key advantages MarTech has over traditional marketing is that it helps companies lower costs and optimize spending. For example, estimates say that over the next five years, roughly 80% of company dialogue with customers will be carried out by bots which represents an opportunity for companies to cut expenditure on marketing personnel.

Another capability that MarTech will bring to companies is the ability to learn more about customers and use these insights to tailor advertising to individuals. This is done by way of AI and will allow companies to effectively build a virtual army of marketing staff to better meet customer needs in combination with chatbots.

Due to DCM's belief that MarTech will grow as an increasingly important tool for businesses across many industries, we chose to initiate a position in Adobe Systems in November as they command a significant presence in the MarTech space.

TELEHEALTH – HEALTHCARE FROM A DISTANCE

Another industry that DCM believes is poised for technological disruption in 2019 is healthcare. It is estimated that about 80% of total US healthcare costs come from patients with chronic conditions and that the 65+ age group in the US is expected to increase 55% by the year 2030.

Source: Bloomberg, Deloitte, PwC, CNBC, Goldman Sachs, Newswire, TelecomReview, Capital IQ, CNN, Forrester, Nucleus Research Smart Insights, Statista, Forbes, Advisory Board, HGP, NCBI, CBS News

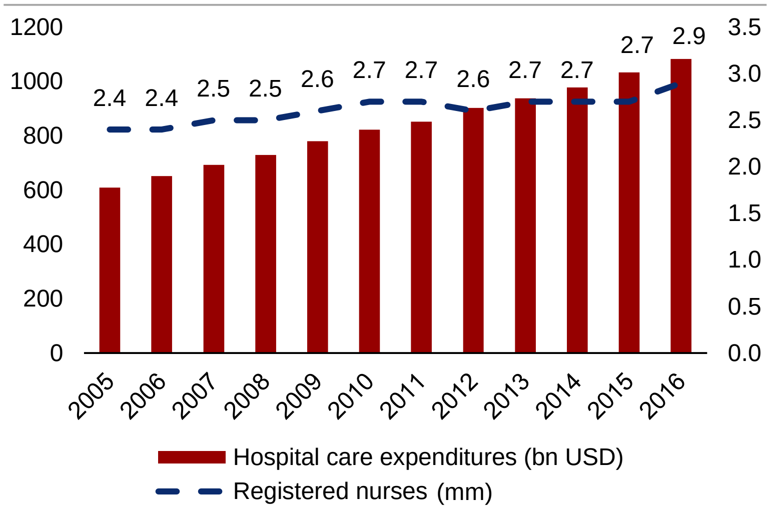
TECHNOLOGY

OPTIMIZATION VIA SMARTER TECH

With significant capacity-related issues such as a shortage of medical personnel imposing constraints on the US healthcare system, Telehealth creates an opportunity for practitioners and patients to save time and resources.

As shown in Figure 6, healthcare expenditure expanded steadily while the number of registered nurses has remained relatively stagnant. While required spending on care has increased, the number of registered nurses available to support the growing healthcare system has not, which has been a major driver of the aforementioned capacity issues.

Figure 5: US registered nurse count vs annual expenditure on hospital care



The US Bureau of Labor Statistics estimates that 1.1 million more nurses will be required to taper the current shortage, which will be a relatively difficult obstacle to overcome. Telehealth could serve as a modern way to resolve these capacity issues.

The first major benefit of Telehealth is the effect that it has on patient wait times. For example, in the case of Teladoc Health, a major telehealth player, the median response time for a patient to see a doctor is under 10 minutes. This is in comparison to a survey of 3,700 US emergency rooms that showed an average wait time of 30 minutes just for patients who were not admitted at the end of their consultation. With these results in mind, telehealth represents an opportunity to reduce patient wait times and emergency room crowding.

This, along with other forms of telehealth such as remote patient monitoring, mobile health and tele-mental health all represent ways in which the healthcare industry is evolving to better optimize patient care and target many of today's most widespread issues such as chronic illness and mental health. The market for telehealth worldwide is expected to grow to $19.5 bn by 2025 and DCM believes that this represents a huge opportunity should adoption continue to grow.

One of the key barriers to adoption for telehealth has been reimbursement. Historically, the Centre for Medicare and Medicaid Services used a very specific definition for which applications of telehealth would be eligible for reimbursement which included stipulations on the geographical locations of the patient and provider and the actual services.

However, in late 2018, the CMS approved an expansion of the number of reimbursable telehealth services including treatment for opioid addiction. This expansion represents an important step in making telehealth an even more viable and attractive opportunity.

To capitalize on the aforementioned trend, DCM recently invested in Teladoc Health, a telehealth provider specializing in remote video consultations between specialists and patients. Teladoc's stock returned 37% in 2018. DCM continues to hold Teladoc due to our belief that the company is poised to realize superior benefits from the growth of telehealth as an industry leader.

Source: Bloomberg, Capital IQ, CNN, Forrester, Nucleus Research, Deloitte, Smart Insights, Statista, Forbes, Advisory Board, HGP, NCBI, CBS News, Credit Suisse, Everyday Health, healthcare informatics, meditelecare, telequality, CMS, NCBI, Salesforce, Enterprise Management 360

TECHNOLOGY

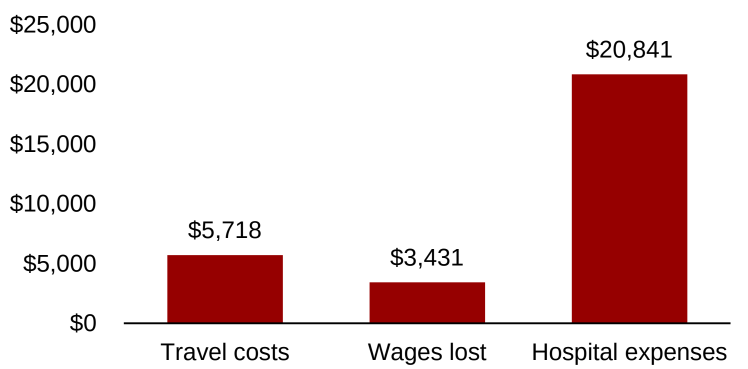
OPTIMIZATION VIA SMARTER TECH

SOFTWARE-AS-A-SERVICE – IT'S ALL IN THE CLOUD

Another major trend that DCM has identified in the TMT space for 2019 is the Software-as-a-Service model. SaaS is a model for software that involves providing services by way of the internet. This means software users no longer need to purchase installation disks and can access software on any internet-enabled computer. Some of biggest companies in the space include Salesforce, Box, Oracle, Intuit and Slack.

Generally, SaaS users pay through subscription and are able to receive software upgrades by way of the internet and do not have to worry about the hassle of upgrading the software themselves as this is done by the developer.

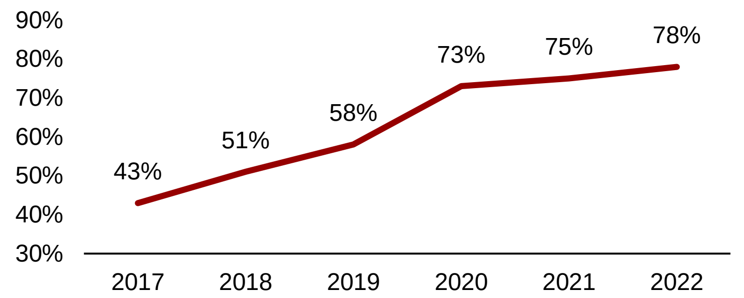
Figure 6: Expected savings to patients and/or facilities per year from telehealth use (USD)



As can be seen in Figure 8, 73% of surveyed organizations foresee the percentage of their business applications that use SaaS reaching 80% by 2020.

Clearly, the lower maintenance requirements and other user-friendly characteristics make SaaS an attractive value proposition for businesses that do not want to spend the time and resources to manage and maintain the software themselves. In addition, SaaS-based applications are much more user-friendly, meaning companies need to spend less time training employees to use said software.

Figure 7: % of Organizations Predicting When 80% of Their Business Applications will Be SaaS-Based



As a new way to use software, SaaS companies are integrating many of today's cutting-edge technologies into their products. For example, beyond SaaS' use of cloud technology to store application data, many are also integrating artificial intelligence to make their products smarter as well. For example, Adobe's Experience Cloud product line utilizes Adobe Sensei, their AI platform, to better optimize user marketing programs. Integration of AI into SaaS products will allow new capabilities that will optimize their performance for users.

In addition, a new trend that is being talked about for 2019 is "Vertical SaaS" which is SaaS that is more industry-specialized in comparison to "Horizontal SaaS" which serves a broader range of clients. These applications will allow users to perform tasks tailored to their own industry requirements and represents an opportunity for SaaS players to better customize products for user needs.

VALUATION IMPLICATIONS

As technology has often moved with the rest of the market, it is difficult to say what sector-specific trends will be strong enough to overcome broader macro

Source: Credit Suisse, Everyday Health, healthcare informatics, meditelecare, telequality, CMS, NCBI, Salesforce, Enterprise Management 360, Statista, Bloomberg, Healthcare IT News, datapine, Finances Onlines, Salesforce

MEDIA & TELECOM

5G, MERGERS & CONTENT SHIFTS

headwinds and tailwinds. With that said, the trends mentioned above constitute some of the ways in which technology is being used to revolutionize multiple subsectors and industries, to optimize the world of business and everyday life. In addition, should there be a recession in the near future, many of these trends mentioned above, which provide customers the opportunity to save money, could prove to be successful alternatives as companies and individuals look to cut overhead costs.

INVASION & CONSOLIDATION

With the 2018 merger between AT&T and Time Warner consummated, following a court victory over the Department of Justice and its antitrust concerns, it would appear that the M&A floodgates have been opened. Since the merger was allowed, Disney shareholders voted to acquire 21st Century Fox assets following a bidding war with Comcast. Comcast then acquired broadcaster Sky.

Much of this consolidation has occurred in response to the threat of new entrants as tech titans continue to move into the content creation and distribution space. Qatalyst CEO George Boutros recently said "the large tech platforms, such as Amazon, Netflix and Alphabet have become very credible competitors to the media and telecom companies, and are certainly creating a lot of pressure on them" and that "this was a factor in the judge's approval of the AT&T/Time Warner deal". All of this points to the fact that it is increasingly easier for tech companies to disintermediate content creators in order to distribute their own in-house media and capture all of the value.

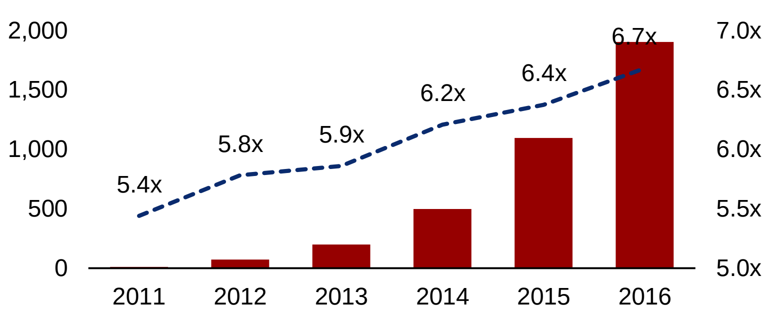
As companies continue to consolidate, this could be a catalyst for multiple expansion (in the days following approval of AT&T/Time Warner, Media and Telecom's respective EV / Forward EBITDA multiples expanded). Further multiple expansion in 2019 could be driven by the market anticipating more strategic M&A which will likely come along with premiums paid to current shareholders.

Despite the uptick in M&A action that media and telecom saw in 2018, it remains to be seen if this trend will continue into 2019 as markets continue to grow pessimistic. However, if multiples compress due to macro factors, companies with adequate resources could see opportunities to make acquisitions at attractive valuations.

5G ROLLOUT CONTINUES

One of the biggest expectations for 5G is that it will require significant investment in equipment buildouts in order to install the new technology required to support the networks. Any reduction in these expectations could mean a change in investor cash flow expectations and potential multiple expansion. As shown in Figure 9, Telecom multiples saw consistent expansion following the launch of 4G. Should the launch of 5G go smoothly in terms of adoption and expense management, this pattern could repeat itself. DCM has chosen to maintain a hold position on Boingo Wireless as the company's small cell business should continue to see the benefits of the ongoing 5G rollout.

Figure 8: Telecom Industry Valuation (EV/FW EBITDA) vs. Global LTE Subscribers Per Year (right; mm)



Source: Finances Online, datapine.com, Salesforce, Boingo Wireless Investor Relations, The New York Times, Capacity Media, Global News, Capital IQ, NBC News, Deloitte, BBC, Business Insider, Statista

ANNUAL REPORT 2018

TECHNOLOGY, MEDIA & TELECOM

2018 HOLDINGS REVIEW

DESAUTELS CAPITAL MANAGEMENT

BOINGO WIRELESS INC. (NASDAQ:WIFI)

COMPANY OVERVIEW

- Boingo Wireless is a leading global provider of wireless connectivity solutions for smartphones, tablets, laptops, wearables and other wireless-enabled consumer devices
- It has solutions for a variety of different consumers including: military, corporations, consumers and advertisers
- Boingo generates revenue in 4 ways:
  - Subscription basis network access
  - Long term contracts for access to DAS networks
  - Display advertisements on sign-in pages
  - Arrangements with wholesale Wi-Fi providers

CATALYSTS

- Increasing demand for adequate cellular coverage – Boingo's Distributed Antenna System (DAS) expertise and leading market share are primed to capture industry tailwind
- 2019 5G rollout, creating increased demand for DAS systems to improve cellular connectivity
- Increase in US Government defence spending

RISKS

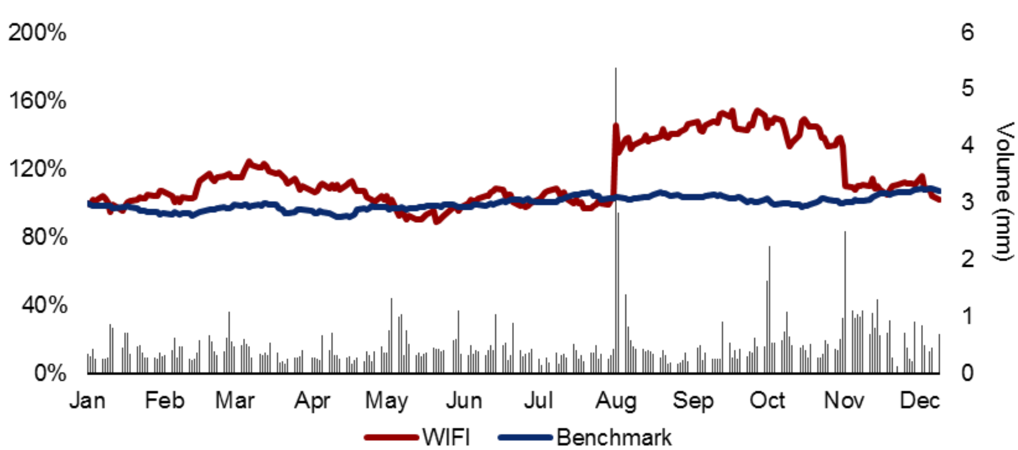
- Large telecommunications companies developing DAS systems internally to support their network and cutting out Boingo
- Loss of long-term contracts, leading to lower ARR

INVESTMENT THESES

1. **Boingo is best positioned to capitalize on network densification**
   - Existing contracts with 2 of the big 4 telecoms and several airports/venues across the US
   - Boingo already has 54 DAS networks in place (up from 37 last year) and 73 projects in the pipeline allowing for a swift expansion of their network
2. **Boingo is well placed to take advantage of military tailwinds**
   - National Defence authorization act plans to increase troop count which should reduce the vacant spots in existing Military bases where Boingo has contracts in place thus increase total addressable market
   - New versions of the law have been signed on December 2017 and August 2018, both significantly increasing the defence budget ($677 bn for FY 2018 and $717 bn for FY 2019)
3. **Ideal acquisition target for multiple sub-verticals**
   - Boingo has already established long term contracts with key customers and in key markets making it an excellent strategic option for an acquirer – potentially leading to significant cost synergies between small cells and Wi-Fi. However, there has been no indication by management that talks are currently being held

We decided to HOLD WIFI until yearly revenue growth goes below 15%

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Sources: Bloomberg, CapIQ, Company filings

POSITION SNAPSHOT

In CAD, unless noted

Average Cost (USD)	$23.58
# of Shares	4,980
Value Invested	$139,696
Portfolio Weight	5%
2018 HPR	(1%)
2018 HP Benchmark Return	6%
Excess Return	(7%)

TELADOC HEALTH INC. (NYSE:TDOC)

COMPANY OVERVIEW

- Teladoc is a telehealth company that uses telephone and videoconferencing technology to provide on-demand remote medical care via mobile devices, the internet, video and phone
- It was founded in 2001 and had its IPO in 2015
- Currently the largest telehealth company in the world with operations in 120 countries and 22 million registered clients
- Teladoc generates revenue in 2 ways:
  - Subscription fees (84% of FY2018 sales)
  - Visit fees (16% of FY2018 sales)

CATALYSTS

- Regulatory tailwinds such as higher reimbursement rates for telehealth products would lead to an increase in Teladoc's total addressable market and utilization
- Further medical resource shortages such as labour leading to a higher pace of conversion from traditional medicine to telehealth

RISKS

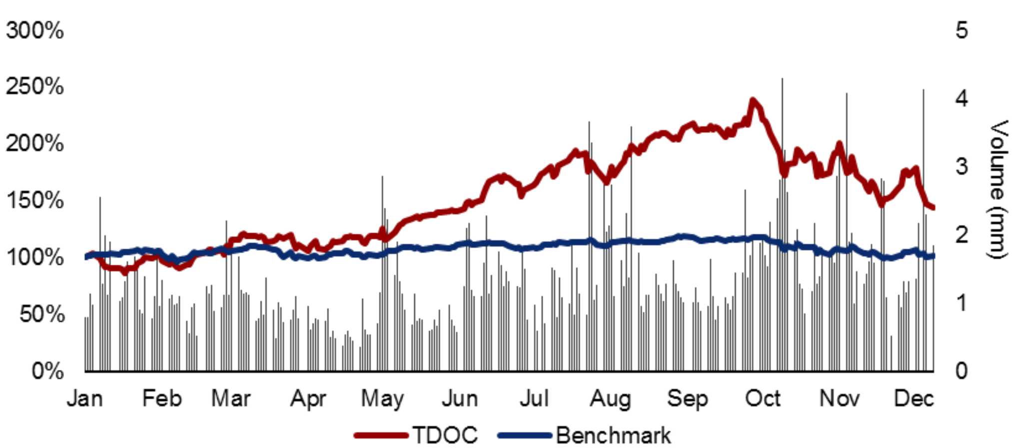
- Potential resistance from the political institutions
- Loss of major clients, as new companies enter this fairly nascent market

INVESTMENT THESES

1. **Telehealth opportunity misunderstood by the market, leading to Teladoc's TAM being underestimated**
   - The healthcare system in developed countries is in trouble due to rising costs and labour shortages
   - This industry is receiving support from both parties in the US which will lead to increased reimbursement from health plans (the CMS recently approved new billing codes for telehealth reimbursement)
2. **Teladoc's leading position will allow it to capitalize on barriers to entry in order to increase market share**
   - Over the past 3 years, Teladoc has been consistently beating both short-term and longer-term earnings estimates, demonstrating a misunderstanding from the market of the company's growth potential
   - It operates in a winner-takes-all industry because of significant network effects, and it is poised to profit from this as it has the first mover advantage and a superior platform/system
3. **Market underestimating the effect the new regulatory environment will have on utilization rates**
   - Teladoc's unique business model allows it to reach customers more effectively versus competitors and greatly profit from the new Cadillac Tax, which will drive utilization

We decided to <u>HOLD</u> TDOC until yearly revenue growth goes below 20%

STOCK PRICE AND SECTOR BENCHMARK PERFORMANCE



Sources: Bloomberg, CapIQ, Company filings, CMS.gov

POSITION SNAPSHOT

In CAD, unless noted

Average Cost (USD)	$64.98
# of Shares	545
Value Invested	$36,841
Portfolio Weight	1%
2018 HPR	(21%)
2018 HP Benchmark Return	(7%)
Excess Return	(14%)

ANNUAL REPORT 2018

Fixed Income Fund

2018 PERFORMANCE

Thomas Boucher-Charest
Benjamin Caron
Victoire Gekas
Matei Popescu
Stanislav Timoshenko
Sonia Torres Olvera

DESAUTELS CAPITAL MANAGEMENT

Performance Summary
Fixed Income Fund

2018 in Review

Dear Investors,

We are pleased to report that the Desautels Fixed Income Fund returned 4.1% in 2018, compared to 3.5% for our benchmark. Most of our gains were realized in December as turmoil in the stock market led investors to the safety of bonds. Our outperformance in 2018 was partially due to an overweight USD exposure near the end of the year as well as solid performance from our individual credit names. Since inception, the Fixed Income Fund has generated an annualized return of 3.7%, outpacing our benchmark by 0.6%.

In 2018, we added 407 International and Alimentation Couche Tard to our portfolio, and sold Ford Credit Canada. Further details and analysis are provided in the sections below.

As the academic year comes to a close, we would like to thank our investors for their continued support of the program. Managing a real fund has given us an amazing learning opportunity that would otherwise not be possible. We would also like to introduce our newly elected Fixed Income strategist, Stanislav Timoshenko. Stanislav is a passionate fixed income investor and will be looking to lead the team in our quest to generate alpha for our investors.

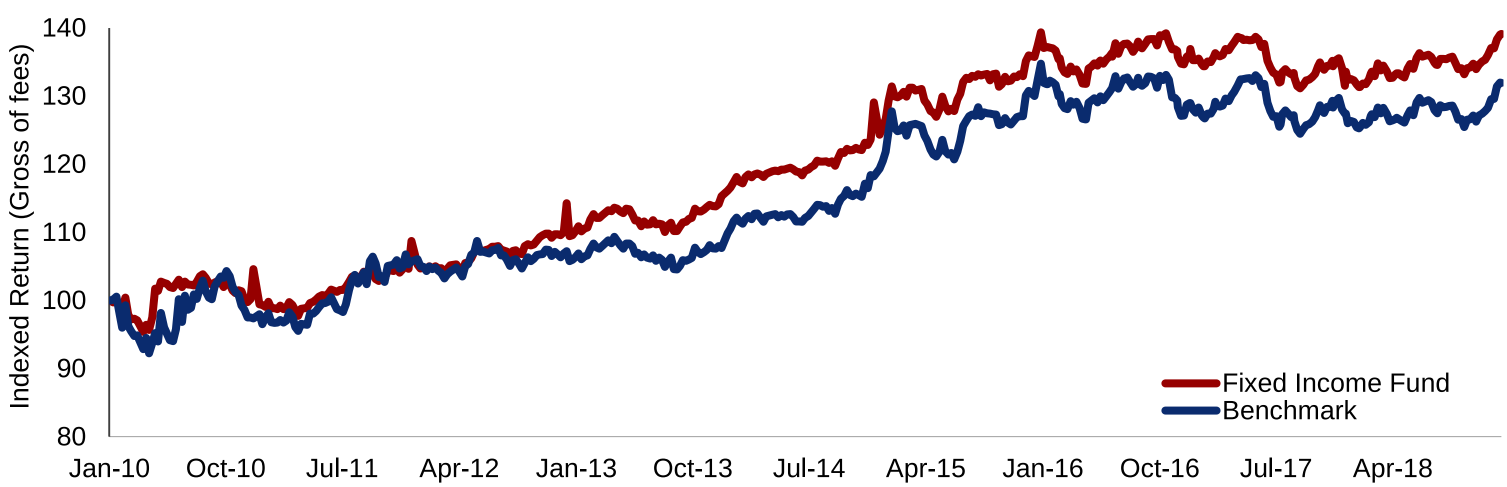
FIXED INCOME METRICS SINCE INCEPTION	Fixed Income Fund	Benchmark
Annualized Return	3.7%	3.1%
Annualized Std Dev	5.9%	6.7%
Annualized Sharpe Ratio	0.22	0.10
Beta	0.55	
Annualized Alpha	0.9%	
Tracking Error	0.8%	

Performance metrics are calculated gross of fees.

FIXED INCOME METRICS 2018	Fixed Income Fund	Benchmark
Return	4.1%	3.5%
Standard Deviation	3.9%	4.1%
Sharpe Ratio	0.44	0.27
Beta	0.84	
Alpha	0.8%	
Tracking Error	0.3%	

Performance metrics are calculated gross of fees.

Figure 1: Fixed Income Fund Performance since Inception



**Note: Performance is calculated gross of fees. 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.*

Performance Summary
Fixed Income Fund

Figure 2: Fixed Income Fund Credit Rating Exposure

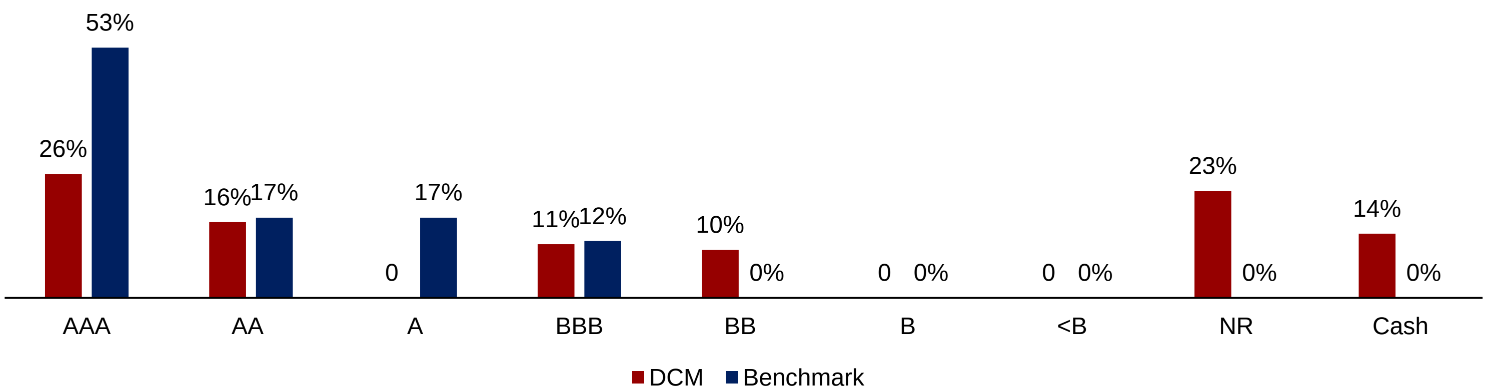


Figure 3: Fixed Income Fund Sector Exposure

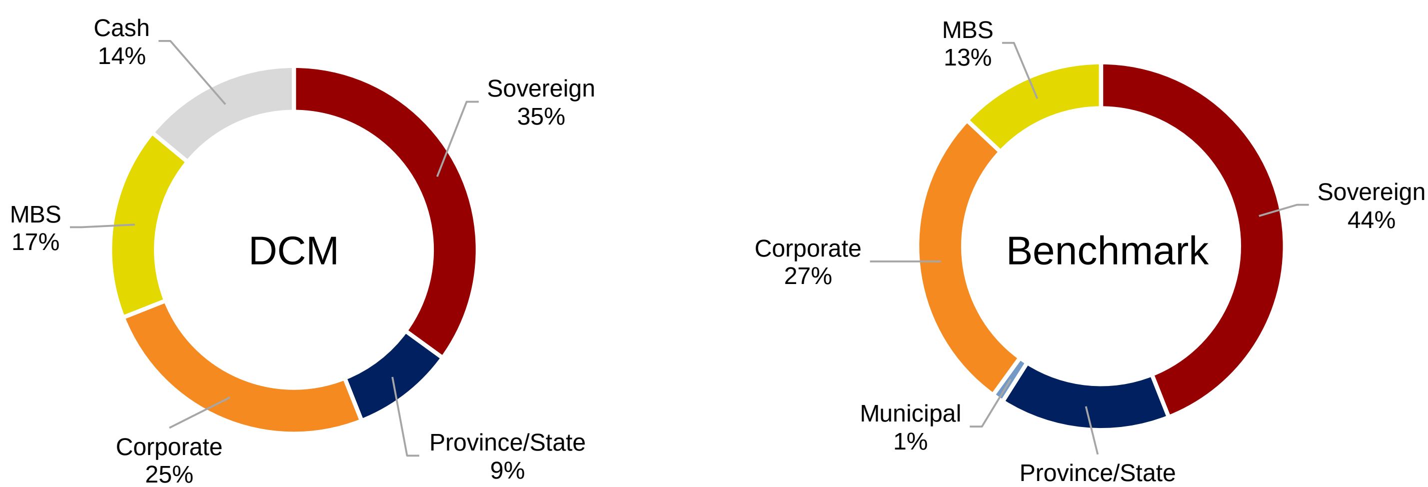


Figure 4: Fixed Income Fund Duration Positioning

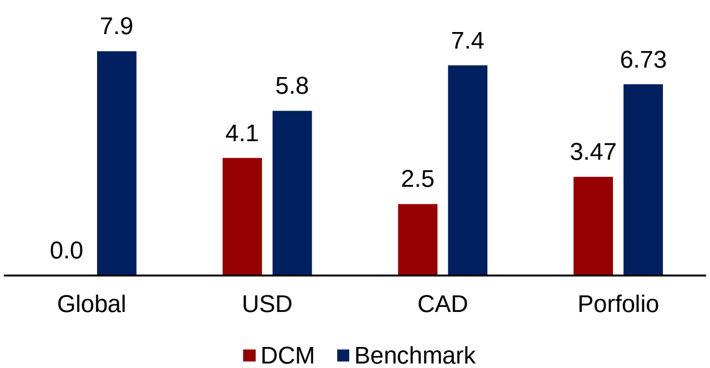
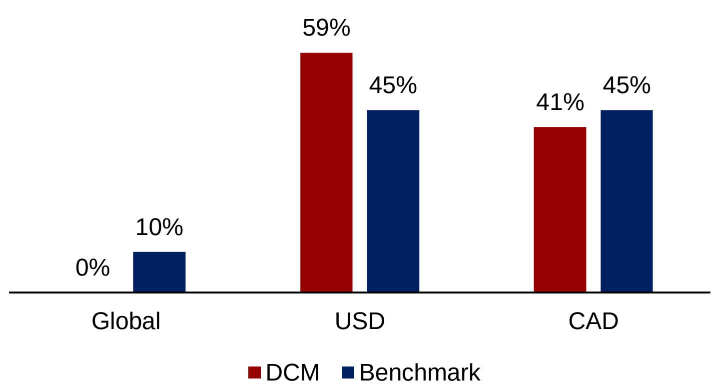


Figure 5: Fixed Income Fund Currency Allocation



Source: Bloomberg

Performance Summary
Fixed Income Fund

Figure 6: Fixed Income Fund Holdings, December 31, 2018

#	Security Name		Currency	Duration	Rating	Units	Local Price	Local Value	Base Value	%
Corporate Bonds										
1	Alimentation Couche Tard	3.319% 2019	CAD	0.91	BBB	20,000	100.5	20,097	20,097	4%
2	Cogeco Cable	4.925% 2022	CAD	3.13	BB	22,000	104.1	22,902	22,902	5%
3	Dollarama	2.337% 2021	CAD	2.72	NR	23,000	97.8	22,494	22,494	5%
4	407 International	2.470% 2022	CAD	3.63	BBB	20,000	98.5	19,704	19,704	4%
5	Russel Metals	6.000% 2022	CAD	0.54	BB	25,000	100.1	25,013	25,013	5%
Provincial Bond										
6	Province of Alberta	2.550% 2022	CAD	3.98	AA	40,000	100.5	40,182	40,182	9%
ETFs										
7	Ishares Canadian Corporate		CAD	6.43	BBB	670	20.6	13,822	13,822	3%
8	Ishares Core U.S.		USD	6.29	AAA	270	106.5	28,752	39,270	8%
9	Ishares Iboxx IG		USD	8.85	NR	37	112.8	4,174	5,701	1%
10	Ishares MBS ETF		USD	5.83	NR	550	104.7	57,558	78,612	17%
11	Ishares ST Corporate		USD	2.57	AA	500	51.6	25,820	35,265	7%
12	Ishares 3-7 year Treasury		USD	4.50	AAA	300	121.4	36,420	49,742	11%
13	Schwab ST U.S. Treasury		USD	2.40	AAA	510	49.9	25,454	34,765	7%
Cash										
14	USD		USD	0.00				26,171	35,744	8%
15	CAD		CAD	0.00				28,372	28,372	6%
					Total				471,687	100%

Source: Bloomberg

ANNUAL REPORT 2018

Fixed Income Markets

2018 REVIEW & 2019 OUTLOOK

DESAUTELS CAPITAL MANAGEMENT

FIXED INCOME
THE FED PUT

And then came December

The first 11 months of 2018 were marked by a continuation of the 9-year equity bull market coupled with creeping signs of inflation. The Fed's tone was turning hawkish and markets were pricing in multiple rate hikes in 2019 and even 2020. But that all changed in December, as the stock market collapsed, rates fell, bonds rallied, and the Fed's tone took a dovish turn.

While macro data did not appear to support a dramatic change in monetary policy, the market nonetheless anticipated a more dovish Fed, and rate hike expectations evaporated. This phenomenon is not new. In "The Economics of the Fed Put" (Cieslak & Vissing-Jorgenssen, 2017), the authors find that "Negative stock returns realized between FOMC meetings are a more powerful predictor of subsequent federal funds target rate changes than almost all macroeconomic news releases." And the Fed Put seems to have done its job, for now, with US equity markets completely erasing December losses and looking to set new all time highs.

The Fed's year-end change of tone is clearly exemplified in the FOMC statements below:

"The Committee judges that some further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, […] over the medium term." FOMC December 2018 Press Conference

"In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range[…]." FOMC January 2019 Press Conference

Figure 1: US Rates in 2018

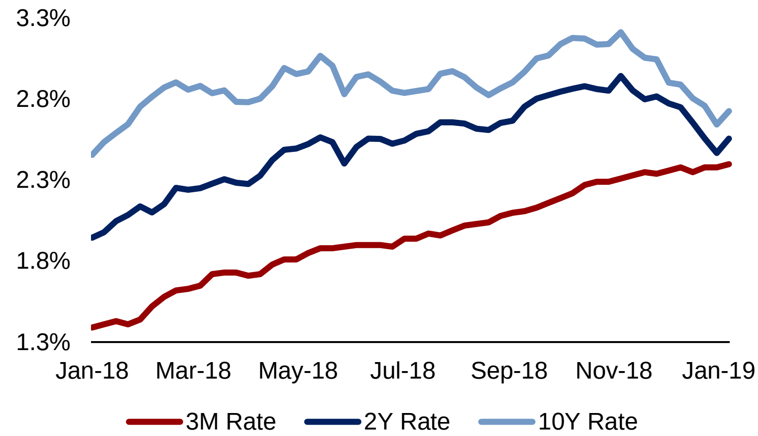
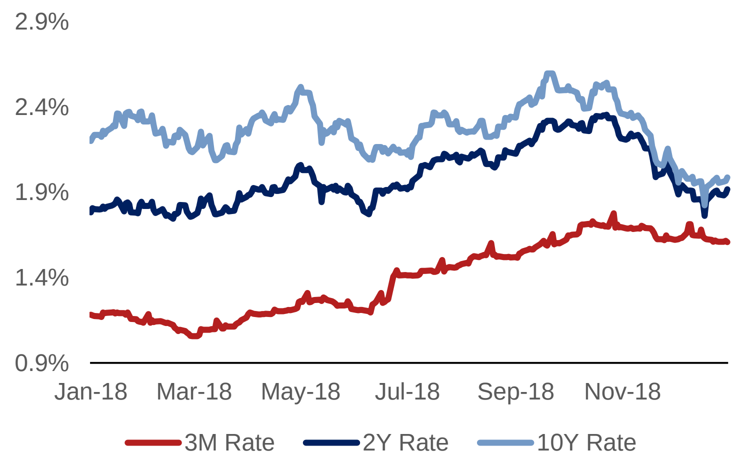


Figure 2: Canada Rates in 2018



Will Canada Keep Following?

Throughout 2018, the Bank of Canada followed the Fed's rate hikes fairly closely, with the Canadian policy rate increasing 75 bps vs. 100bp in the US. We expand on this in our currency commentary below, but note that there has been a recent shift in the two central banks' positions: the BoC is now more hawkish than the Fed as it sees inflation as a more serious long-term threat.

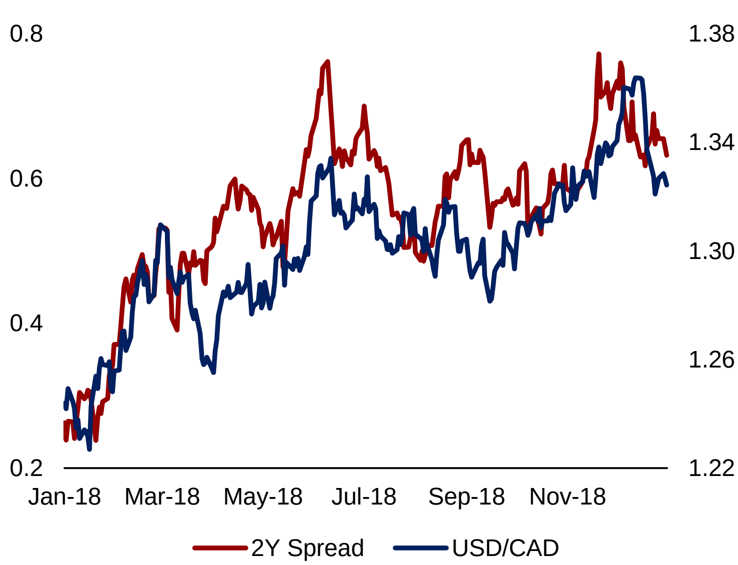
Source: Bloomberg

FIXED INCOME
LAGGING LOONIE

Canadian Dollar Still Weak

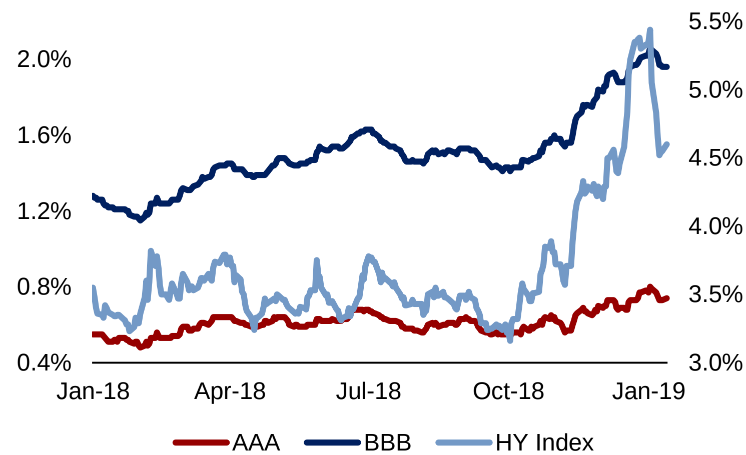
The relationship between the USDCAD exchange rate and the spread in the countries' short-term yields continued throughout the last quarter of 2018, to the detriment of the Canadian dollar. Indeed, our 14% overweight exposure to the USD in Q4 contributed to our outperformance in 2018. We continue to maintain a mildly bearish view on the loonie, based partially on transportation problems that Canadian oil producers continue to face. As stated earlier, however, Stephen Poloz, the BoC chairman, had a more hawkish tone than his Fed counterpart, arguing that he understood the stress that raising rates would put on Canadians but never implied it would mean the BoC would stop doing so. In contrast, Fed chairman Jerome Powell has been much more dovish in his recent speeches, indicating that the Fed would take somewhat of a break in raising rates. As usual, it will be very important to closely monitor central bank rhetoric in the weeks and months to come.

Figure 3: USDCAD and the 2-Year Yield Spread



Source: Bloomberg

Figure 4: IG and HY Credit Spreads

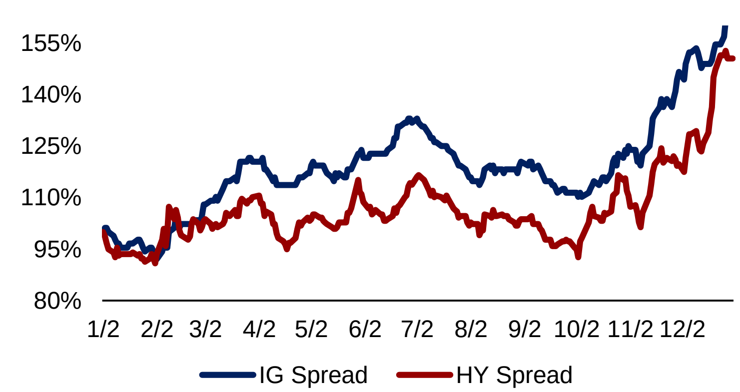


Credit Spreads and Lower Growth

2017 credit trends continued in the first half of 2018. Investment Grade spreads continued expanding as investors, satisfied with higher yields from Treasuries, slowly moved from IG bonds to Government securities. At the same time, strong economic data and earnings results boosted expectations for risky companies' ability to pay off their debt; further tightening HY spreads.

But all that changed in December as more companies lowered earnings guidance. HY spreads reacted fairly quickly as investors started to question these companies' ability to pay off or rollover their debt. AAA bond spreads did not react as much since slower growth would typically not put them at significant risk of default.

Figure 5: IG vs. HY 2018 Indexed OAS



FIXED INCOME
A MILD RIDE

Despite a poor December, high-yield outperformed investment grade in 2018 (Figure 7). To a certain extent, the HY outperformance was driven by fundamental factors but technical factors, like issuance, also played a role. Issuances in 2018 were down year-over-year in both IG and HY to $1.2tr and $156bn for both credit qualities respectively (Figure 8). For IG, the 2018 issuance figure represents a roughly 15% decline year-over-year whereas the decline for HY represents a 45% decline from 2017 levels. The significant decrease in HY issuance appears to have helped the asset class.

The decline in issuances in 2018 was expected given US tax reforms, which helped firms repatriate overseas cash and/or simply pay lower tax bills. In both cases, the increase in cash flow helped firms finance operations through cash from operations rather than relying on debt issuances. Street research suggests tax reform explains most of the decline in issuances for HY, whereas a spike in M&A-related debt issuances brought more supply to the IG market, somewhat offsetting the impact of tax reform.

Fundamentally, IG should be better positioned to navigate through the typical late-cycle pressures compared to HY. Of course, IG bonds have much stronger balance sheets, based on Net Debt/EBITDA and interest coverage measures (Figure 7 & 8). In our view, the extra yield one can get in HY is not enough to compensate for the differences in balance sheet risk. It is also our belief that IG credit quality holds more firms that are "late-cycle" resilient. We define this as firms that would be able to offset/pass-through the inevitable pricing pressure that rises in an ever-tightening market. In the United States, the tight labor markets should naturally lead to inflation as well as an increasing difficulty for companies to fill the necessary "low-wage"

Figure 6: IG vs. HY 2018 Issuances

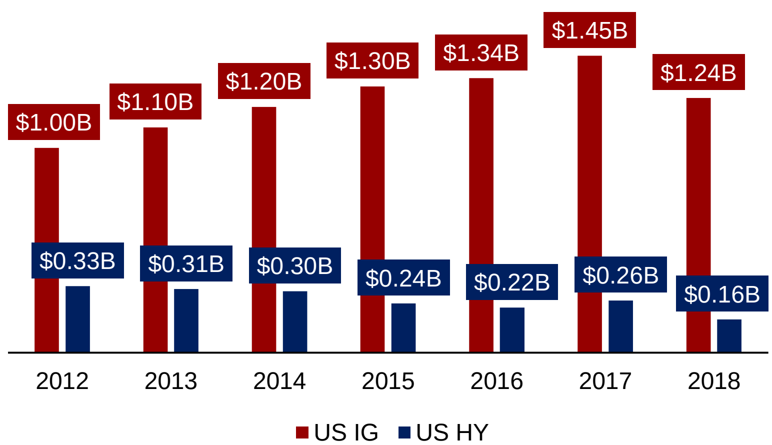


Figure 7: IG vs. HY Leverage Ratio

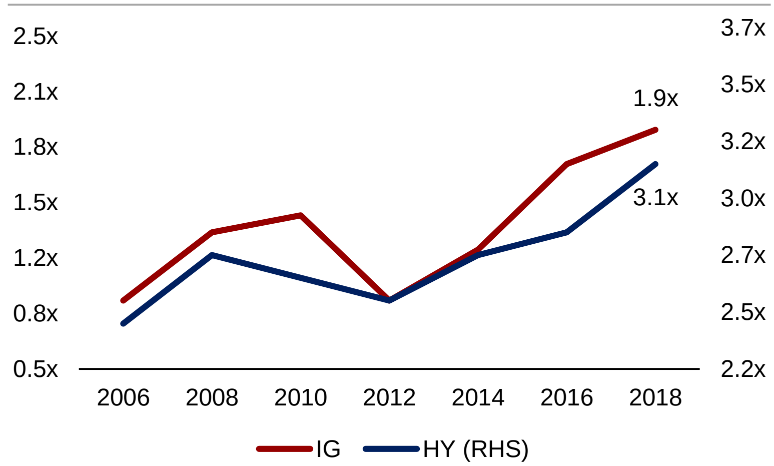
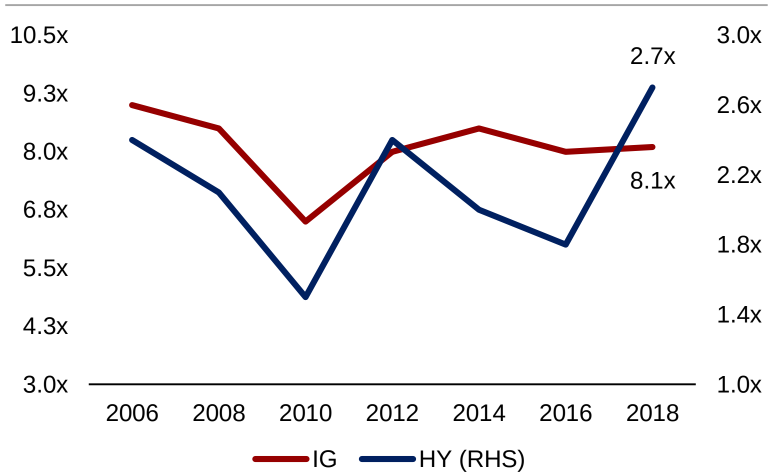


Figure 8: IG vs. HY Interest Coverage Ratio



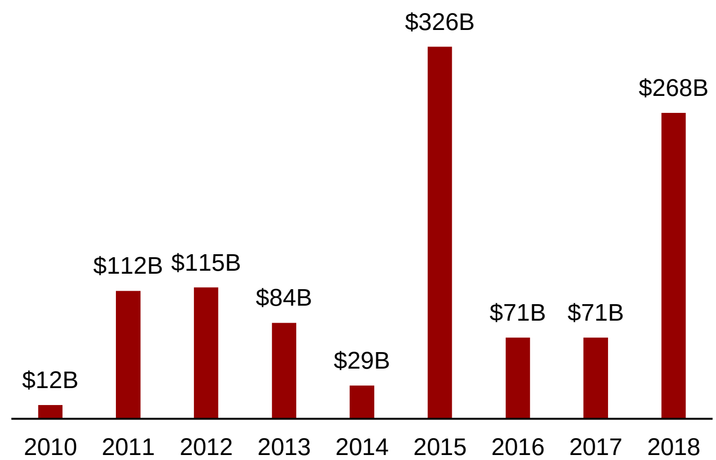
Sources: Bloomberg, Goldman Sachs, JP Morgan, S&P

FIXED INCOME
A MILD RIDE

jobs. We believe the retail, consumer discretionary and healthcare sectors to be particularly challenged in a period of rising costs.

Lastly, we note that close to $268bn in A-rated bonds were downgraded to BBB bonds in 2018 – second to 2015 in most downgrades since the financial crisis (Figure 9). Street commentary points to a general weakening in financial health of A-rated firms through the increase in leverage for shareholder returns or M&A activity. Of particular concern going forward is the risk of "fallen angels" – BBB bonds getting downgraded into HY territory. Mass-downgrades to HY from IG could have significant effect on IG given that nearly half of IG bonds are BBB rated.

Figure 9: Downgrades from A to BBB

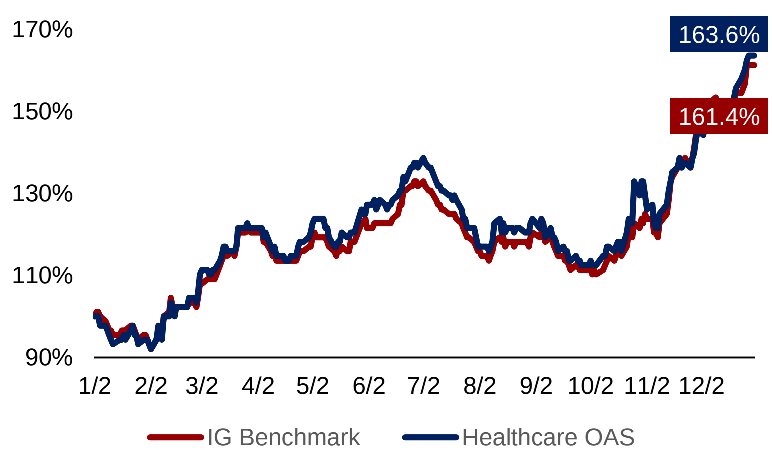


Sector Outlooks

Negative view on Healthcare (~9% of IG):

The healthcare sector makes up roughly 9% of total outstanding investment grade debt. We started the year with a negative outlook on the sector for two key reasons: 1) Likely mega-M&A activity following tax reform allowing for significant cash repatriation as well as certain large-pharmaceutical companies voicing interest in large acquisitions. 2) Drug pricing pressure due from regulators leading to weakening of fundamentals for pharmaceuticals. With Democrats now controlling the house of representatives, it is likely government action will be taken to reign in on drug pricing – perhaps one of the few bi-partisan bills that would pass through the US government.

Figure 10: IG Healthcare vs. Benchmark Indexed OAS



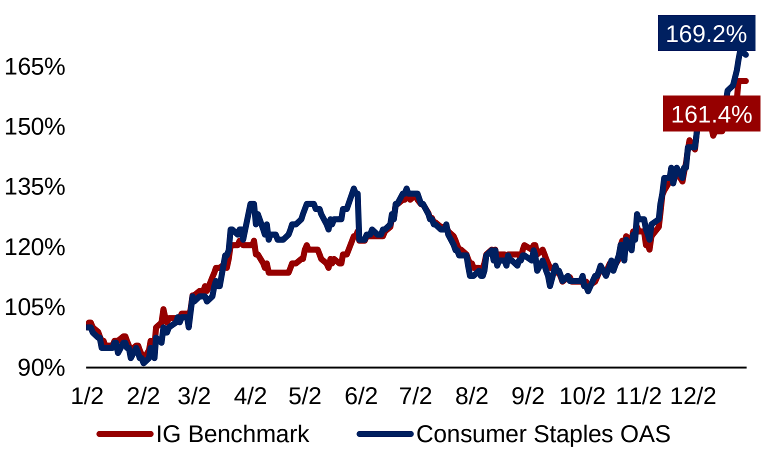
Sources: Bloomberg, Goldman Sachs, JP Morgan, S&P

FIXED INCOME
A MILD RIDE

Negative view on Staples (~6.5% of IG):

Consumer Staples makes up roughly 6.5% of total outstanding investment grade debt. We have a negative outlook on the sector for the following two reasons: 1) limited ability to offset inflationary pressures and 2) underlying staples business struggling to compete against technologically-enabled competitors – given already sizable market share, limited room for growth. Combined with the fact that most consumer staple companies hold a large amount of debt on their balance sheet make for a difficult road ahead if underlying fundamentals continue to decline.

Figure 11: IG Consumer Staples vs. Benchmark Indexed OAS



Sources: Bloomberg, Goldman Sachs, JP Morgan, S&P

Figure 12: US Yield Curve

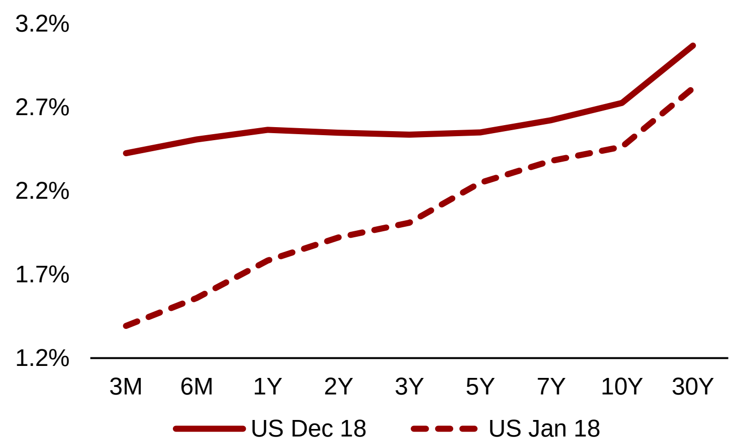
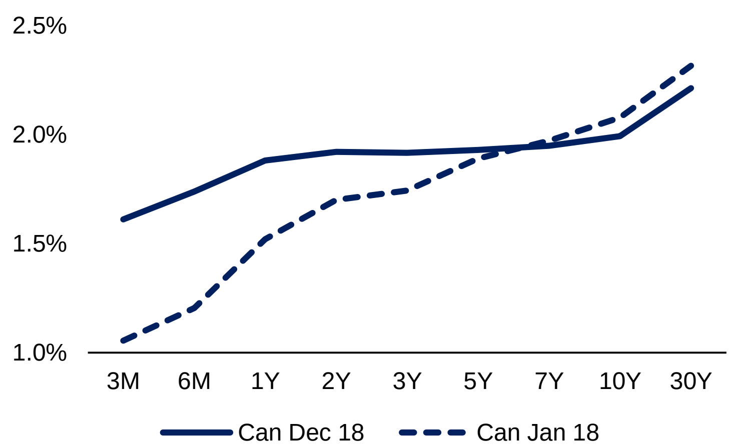


Figure 13: Canadian Yield Curve



Yield Curves Flatten

Lastly, we note that with short-term policy rate hikes throughout the year, followed by the December bond market rally, it is no surprise that USD and CAD yield curves ended 2018 a lot flatter than they started. While the US 10-year yield ended the year 16bps higher, the CAD 10-year yield was 7bps lower, a reflection of the relative economic weakness seen north of the border. Market participants have been keeping a close eye on a possible yield curve inversion and its implication for a possible recession. Indeed, the US 3-month/10-year curve inverted at the end of March, but so far equity markets are ignoring the historic warning sign.

ANNUAL REPORT 2018

Fixed Income Fund

2018 HOLDINGS REVIEW

DESAUTELS CAPITAL MANAGEMENT

ALIMENTATION COUCHE-TARD INC. (ATDBCN 3.319% 2019)

COMPANY OVERVIEW

- Alimentation Couche-Tard is a global leader in the convenience store industry with a network comprising of approximately 16,000 locations across the North America, Europe as well as Asia and other territories
- Through the vast network of stores, the company distributes convenience store products and offers road transportation fuel. Gas station services (road transportation fuel) segment made up to 74% of revenues in FY18
- Alimentation Couche-Tard continues to grow its revenues mainly through acquiring other industry players. In FY18, the company's revenues reached $51.4bn with the operating income of $2.0bn

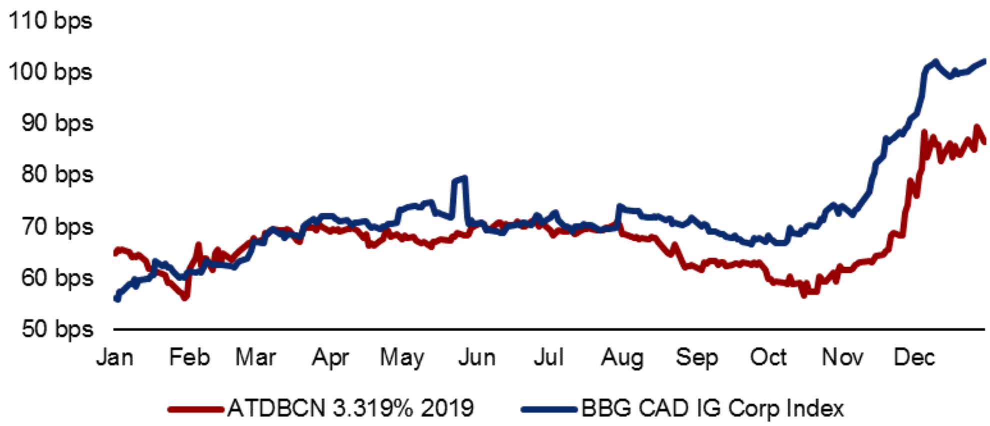
INVESTMENT CONSIDERATIONS: RISKS & MITIGATIONS

1. **Significant exposure to oil & gas industry results in the dependency of the company's revenues on highly volatile fuel prices**
   - The company maintains stable cash inflows despite having volatile revenues. The stability is achieved by the company's ability to set a fixed nominal margin on the fuel making cash flows independent of oil prices
   - Absence of strong correlation between oil prices, volumes of fuel demanded/sold and ATD's fuel margins results in predictable cash inflows
2. **Frequent M&A activities result in cash outflows and higher Net Debt levels**
   - Despite its frequent engagement in M&A activities, the company is able to maintain a growing cash balance sufficient to service its mandatory debt obligations which includes the repayment of ATDBCN 3.319% 2019
   - The company deleverages rapidly and is committed to maintain Net Debt/EBITDAR of 2.1x
3. **Economic slowdown negatively impacts consumer demand for discretionary goods and services**
   - Tobacco (38% of merchandise revenues) and alcohol products which drive the company's merchandise segment are price inelastic and independent of economic conditions of a country

CONCLUSION: INVESTMENT DECISION

- Senior Unsecured debt of Alimentation Couche-Tard presents a low risk investment opportunity due to the company's ability to mitigate aforementioned major risks
- Investing in ATDBCN 3.319% 2019 is in line with the Fixed Income Fund's strategy of maintaining a strong position in investment grade bonds with short-term duration

BOND AND BENCHMARK CREDIT SPREADS



Source: Bloomberg 01/12/2019, Company filings

POSITION SNAPSHOT

Initiated In	Dec-18
# Units	20,000
Local Price	100.5
Local Currency	CAD
Rating	BBB
Duration	0.91
Portfolio Weight	4.00%

COGECO COMMUNICATIONS INC. (CCACN 4.925% 2022)

COMPANY OVERVIEW

- Cogeco is a cable company headquartered in Quebec. It operates two cable divisions in Ontario, Quebec and the United States and one business ICT Services division
- The company acquired MetroCast, a cableco that operates in five states in the Northern United States, for $1.4bn. Cogeco's Net Debt/EBITDA metric grew to 3.8x, from 2.5x, following the acquisition. The company is currently in the process of deleveraging
- The company reported C$2.4bn of gross revenues and C$660.0mm of operating income for FY 2018

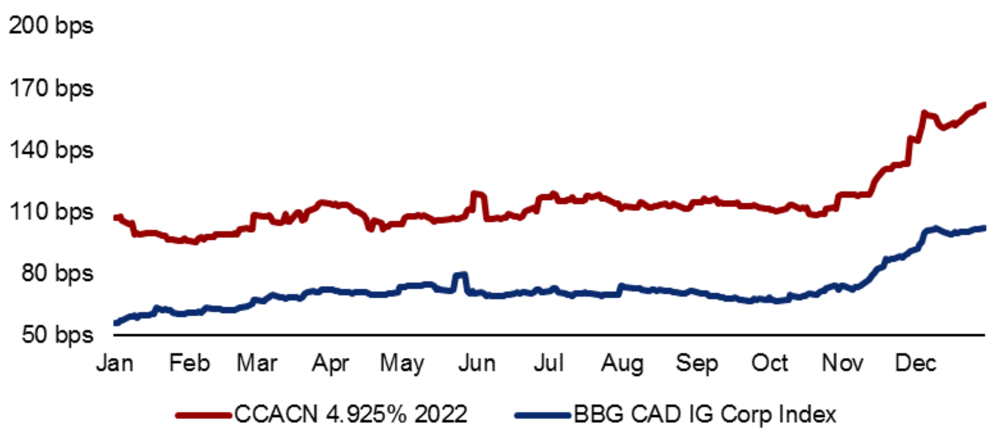
INVESTMENT CONSIDERATIONS: RISKS & MITIGATIONS

1. **Pessimistic investor sentiment towards Canadian cableco outlook overlooks Cogeco's competitive advantage through its geographic positioning**
   - The company continues to maintain its stable cash flows through the strategic geographic positioning
   - Declining users of landlines are reflected in decreasing numbers of customers for the service. Nevertheless, it is offset by upselling in the internet segment with higher speed internet, reflecting a higher average revenue per primary service user from $169.15 to $173.90
2. **Bumpy Enterprise unit growth period should pave the way for recurring cash flow generation**
   - The ICT segment has seen a constant decline in revenues over the year, but is expected to turnaround with the opening of a new data center for a specific longtime client in Kirkland, Ontario
3. **The nearing completion of the TiVo digital TV rollout in both the Canadian and U.S. segments and its capex dynamics of the TiVo will generate stronger segment FCF generation**
   - The new TiVo 4 Voice Activated System started to rollout in the fourth quarter. The system is expected to mitigate the decline in video users with a new modern interface and access to Netflix and YouTube

CONCLUSION: INVESTMENT DECISION

- While the acquisition had a negative impact over every credit metric, the company was able to increase the average revenue per primary service user in the US segment from C$235.62 to C$280.02 with different upselling strategies. In addition, the acquisition allowed the company to increase their footprint in the United States
- Fixed Income Fund holds the bond as Cogeco continues to focus on upselling and improving customer retention rates while maintaining a strong balance sheet with a goal to reach Net Debt/EBITDA of 3.0x by the end of 2019

BOND AND BENCHMARK CREDIT SPREADS



Source: Company filings, Bloomberg 12/01/2019

POSITION SNAPSHOT

Initiated In	Nov-15
# Units	22,000
Local Price	104.1
Local Currency	CAD
Rating	BB
Duration	3.13
Portfolio Weight	5.00%

407 INTERNATIONAL INC. (ETRHWY 2.47% 2022)

COMPANY OVERVIEW

- 407 International Inc. through its subsidiary 407 ETR is responsible for operating, maintaining, expanding and managing Highway 407 under a concession agreement that is scheduled to expire in 2098
- Highway 407 is an all-electronic open-access toll highway in the Northern part of Greater Toronto Area. The highway with the gross length of 108km stretches from Burlington, ON to Pickering, ON and connects surrounding suburbs to such employment megazones as Toronto, Mississauga, Vaughan, etc.
- The company reported C$1.6bn of LTM gross revenues and C$1.1bn of LTM operating income

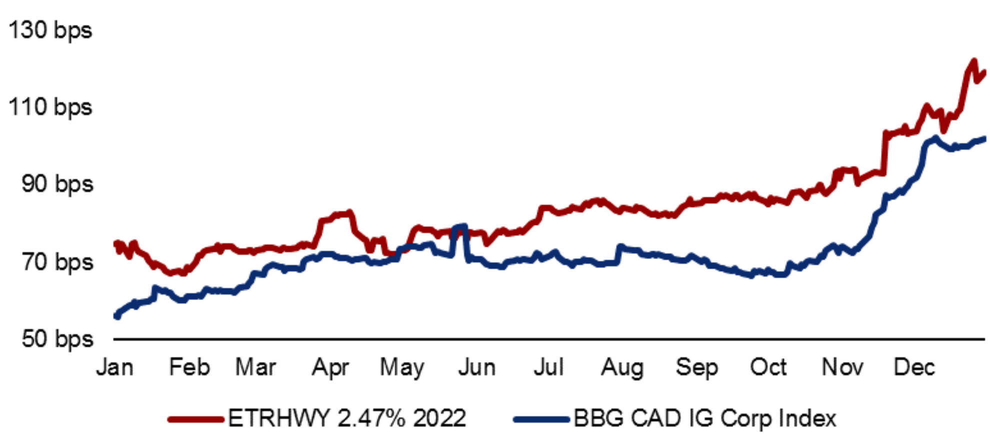
INVESTMENT CONSIDERATIONS: RISKS & MITIGATIONS

1. **Low volatility and high predictability of cash flows mitigate the risks associated with investing in subordinated debt**
   - Revenues and cost are stable with low downside potential during an economic downturn. 407 ETR has had constant revenue growth of 10% CAGR while costs only grew at a 5% CAGR with a gross profit margin improving to 79%. The high operating leverage nature of the business profits largely from more use users
   - The nature of the assets helps mitigate risk during recessions. Revenue increased at a 5.9% CAGR during the 2008 recession and the company has never presented a decrease in revenue and operation cash flow
2. **Strong economic moat significantly contributes to the attractiveness of the investment**
   - Short maturation of our bond mitigates the possible implementation of alternative commuting means such as a new highway or GO Transit expansion.
   - Suburbs population growth outpacing Toronto's growth combined with already high population density in Toronto will positively impact expected revenues for 407 ETR. More commuters towards Toronto, or other GTA cities, related to suburbs expansion and shipping trucks will favor this traffic jam free alternatives

CONCLUSION: INVESTMENT DECISION

- Short-term duration 407 ETR Secured Subordinated debt, BBB rated, with considerable yield represents a low risk investment due to the company's high predictability of cash flows, low risk of new entrants and government backing interests
- ETRHWY 2.47% 2022 investing is in-line with the Fund's strategy of maintaining a position in investment grade with short-term duration bonds as we dive into a rate hiking environment

BOND AND BENCHMARK CREDIT SPREADS



Source: Company filings, Bloomberg 14/01/2019

POSITION SNAPSHOT

Initiated In	Dec-18
# Units	20,000
Local Price	98.5
Local Currency	CAD
Rating	BBB
Duration	3.63
Portfolio Weight	5.00%

PROGRAM ALUMNI

DESAUTELS CAPITAL MANAGEMENT | GESTION DE CAPITAUX DESAUTELS

Alexander Bibic, 2018
Robert Chen, 2018
Mackenzie Chisholm, 2018
Charles Feng, 2018
Antoine Francoeur, 2018
Sabrina Frias, 2018
Noah Gillard, 2018
Alaa Hachem, 2018
Ariane Laurin, 2018
David Meyers, 2018
Thomas Milne, 2018
Noah Petkau, 2018
Jaskrit Singh, 2018
Olivier Babin, 2017
Quentin Batista, 2017

Neil Corber, 2017
Andre Cote-Barch, 2017
Sercan Demirtas, 2017
Michael Fishman, 2017
Kendyl Flinn, 2017
Jonathan Kamel, 2017
Lambert Lefebvre, 2017
David Marcovitch, 2017
Adam Marcovitz, 2017
Meagan Prins, 2017
Tony Ren, 2017
Michael Saskin, 2017
Lambert Lefebvre, 2017
David Marcovitch, 2017
Adam Marcovitz, 2017

Meagan Prins, 2017
Tony Ren, 2017
Michael Saskin, 2017
Anish Shah, 2017
Jayden Van, 2017
Jamie Wilson, 2017
Drew Allen, 2016
Naomie Gendron, 2016
Peter Huo, 2016
Christophe Lussier, 2016
Jordan Owen, 2016
Philippe Rich, 2016
Alexandre Verroneau, 2016
Henri St-Pierre, 2016
Sean Saggi, 2016

Christie Wei, 2016

Angel Bohorquez Colombo, 2015

Colton Dick, 2015

Edouard Gaudry, 2015

Joe Kaprielian, 2015

Xavier Le Sieur, 2015

Andrew Marcovitch, 2015

Alyssa Obert, 2015

Debra Kelsall, 2015

Jeremy Kertzer, 2015

Daniel Kraminer, 2015

Daniel Sorek, 2015

Alexandra Witteveen, 2015

Belal Yassine, 2015

Alan Ang, 2014

Simon Bibeau, 2014

Nicholas Bigelow, 2014

Rene Boissonnault, 2014

Alexandre Castonguay, 2014

Mohammad Chowdhury, 2014

Nicholas Di Giorgio, 2014

Mak Doric, 2014

Samantha Fu, 2014

Rami Karabibar, 2014

Tyler Maxey, 2014

Stefano Reghelin, 2014

Anna Wright, 2014

Shuang Yun, 2014

Ali Abdullah, 2013

Mohammad Awada, 2013

Rafael Barroso, 2013

Simon Bouchard, 2013

Michael Commisso, 2013

Ivan Di, 2013

Fedric Garnier-Landurie, 2013

Karolina Kosciolek, 2013

Andy Macdonald, 2013

Zeeshan Maqsood, 2013

Antonino Piazza, 2013

Fei Qi, 2013

Shawn Raza, 2013

Emily Ren, 2013

Noah Senecal, 2013

Jimmy Xie, 2013

Max Adelson, 2012

Marc-Antoine Allen, 2012

Matthew Corbett, 2012

Nicolas Bellemare, 2012

Adam Duffy, 2012

Roberta Klein, 2012

Jakub Kucmierz, 2012

Phillip Levy, 2012

Molly Newborn, 2012

Shimone Slomowitz, 2012

Amirali Assef, 2011

Matthieu Boulianne, 2011

Tigran Karapetian, 2011

Mark Li, 2011

Michal Marszal, 2011

Gregory Randolph, 2011

Jamie Tucker, 2011

Erdel Altintas, 2010

Gabriel Bonnel, 2010

Neil Cuggy, 2010

Emir Coskun, 2010

Fatoumata Dianae, 2010

Bronwyn James, 2010

Hadi Kamzi, 2010

Jason Kirsh, 2010

Kyle Marta, 2010

Sarah Mahaffy, 2010

Philippe Morissette, 2010

Daniel Peretz, 2010

Brian Rosen, 2010

Thibaud Sonntag, 2010

John Tarraf, 2010

Raja Uppuluri, 2010

Jehangir Vevaina, 2010

Shu Wai Chi, 2010

Lincoln Zheng, 2010

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