FOURTH QUARTER REPORT – DECEMBER 31ST, 2018

This was the worst December for US stocks since 1931, but we are quite excited.

MARKET VOLATILITY

Investors started 2018 very positive. Equity markets posted strong returns in 2017, and investors had expected those returns to continue. At the start of the year, investors were overly optimistic and money was pouring into the markets at a record pace. From mid-December to mid-January, a record $58 billion was invested into stock based-mutual funds and exchange traded funds. This was after the US markets increased by 21% in 2017.

What happened after this record amount of money was invested? The markets sold off by over 12% a few weeks later.

Here we are at the end of 2018 and investors have completely changed their expectations. Investors were extremely optimistic, and now are extremely pessimistic after the S&P 500 sold off 20%, the NASDAQ sold off 24%, and the Canadian stock markets sold off 16% from their highs in 2018. Investors are concerned with trade wars, a US recession, falling oil prices, slowing global growth, and rising interest rates. From December 5th to 19th, investors pulled a record $81 billion from the US stock market. *This is the largest outflow from stocks since Lipper began tracking weekly flows in 1992.* This selling happened after the US stock markets had already dropped 15% from their highs.

Investors have repeatedly demonstrated they are horrible at timing the markets. When everything looks good, it's easy to invest. When things are scary, investors change the course by selling into weakness or exiting the market and re-entering when things improve. By then it's usually too late to get back in as markets are higher. This has a significant effect on long-term returns and the reason why most investors have terrible long-term performance.

We do the opposite. We sell high, and buy low instead of buying high and selling low.

One of my favorite statistics (which I've reference before and I will again): *From 1996 to 2016, the S&P500 returned 7.7%/year, a blended portfolio of 60% Stocks and 40% Bonds returned 6.6%/year, and inflation averaged 2.1%/year. During this time frame, the average investor returned 2.3%, almost the same as inflation.* [1]

If you've wondering why investor returns are so poor, 2018 is a perfect example.

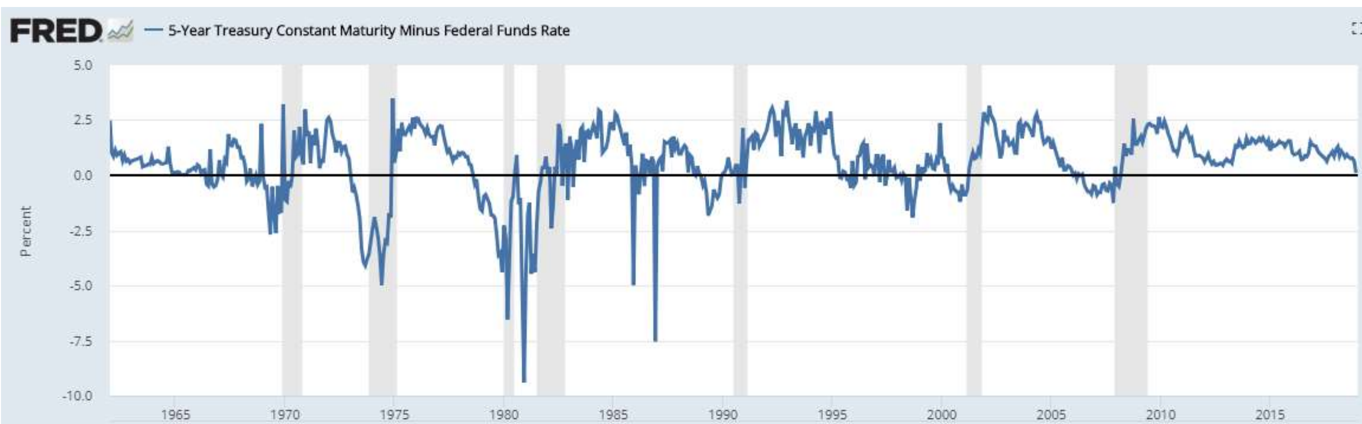
At the end of 2018, corporate profits are up 22%. Stocks started the year trading at 18 times earnings, and traded at 14 times earnings in December. This is the cheapest stocks have been in the last four years. Stocks are cheaper than at the start of 2018, but investors don't want to touch them. They are now trading below historical averages. We are heading into the 3rd year of a presidential cycle in the US which is typically a very strong year in the markets (it's easier to get re-elected when the

[1] Source: DALBAR, Inc. Quantitative Analysis of Investor Behavior, 2016, Bloomberg LP. Bonds: Barclays Capital U.S. Aggregate Bond Index. Average investor return based on DALBAR, Inc. analysis using asset allocation fund and monthly net aggregate mutual fund sales, redemptions and exchanges. Asset allocation funds are U.S. funds that seek high total return by investing in a mix of equities, fixed-income securities and money market instruments. Returns annualized and in US$. S&P 500 Index total return includes reinvested dividends. S&P 500 Index is a broad-based, market-capitalization-weighted index of 500 of the largest and most widely held U.S. stocks. Barclays Capital U.S. Aggregate Bond Index is a broad-based index comprised of publicly traded bonds including the U.S. investment-grade fixed-rate bond market, with components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

economy is doing well), and just because interest rates are rising, it doesn't automatically mean we are heading for a recession.

One indicator we are closely watching is the yield curve, in particular, a yield curve inversion. This occurs when the fed funds rate is higher than the yield on the 5-Year Treasury bond. An inverted yield curve (see chart below) has accurately predicted the last seven recessions over the past 50 years. When this happens, banks sharply curtail lending, leading to a restriction in credit, and a possible recession. An inverted yield curve has accurately predicted the recessions of 1969, 1973, 1980, 1981, 1991, 2001 and 2008. An inversion occurs when the blue line in the graph below crossed below the black straight line that runs across the graph at 0.0%. When this turns negative, it means that the yield curve has inverted. The blue line is the 5-Year Treasury Rate minus the Federal Funds Rate. A negative value for the blue line means that the yield on the short-term interest rate is higher than the long-term rate (a yield curve inversion). The grey areas below indicate a recession.

We haven't seen an inversion occur in 2018. The last yield curve inversion occurred in 2006, followed by a recession in 2008.



WHAT ARE WE CURRENTLY DOING?

Our equity managers started the year with high levels of cash in their portfolio. They couldn't find enticing opportunities. If we can't buy a company at an attractive valuation, we will patiently wait until we can. During the 12% correction in February, there were more opportunities and some extra cash was put to work. Now, with the most recent sell-off at the end of the year, we've been finding a lot of attractive opportunities. We now have very low levels of cash. We haven't been this excited in a very long time. Company valuations are incredibly cheap. We've added to new and existing positions.

We've historically come out of market volatility and drawdowns with stronger returns than the markets. This is because we are very active during these highly volatile times, taking advantage of fear in the markets. This is another way we add long-term value to our clients. During market volatility, things looks scary, and investors are willing to part with their investments for much less than they are worth.

Our allocation to real estate and high-grade bonds has recently done well and is up during the last quarter of 2018 while almost all other asset classes are down.

These are our favourite times, when there are large disconnects between the market price of companies and their intrinsic value. As Warren Buffett says *"It is wise to be fearful when others are greedy and greedy when others are fearful."*

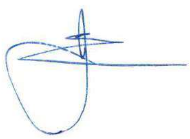
TAX FREE SAVINGS ACCOUNT (TFSA)

For 2019, the contribution limit has increased to $6000, from $5500 in 2018. The maximum TFSA contribution room now sits at $63,500 for individuals or $127,000 for couples. If you aren't utilizing your TFSA account, now is the time. The longer you use it, the greater the long-term benefits.

REGISTERED RETIREMENT SAVINGS PLAN (RRSP)

The last day for an RRSP contribution for 2018 is March 1st, 2019.

-Kind regards,



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