October 2017

q3 report

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Market Highlights

Barometer's portfolios remain well positioned in the current environment, as equities participate in strong economic fundamentals globally. Barometer continues to concentrate the portfolios in global businesses which are positively exposed to powerful growth themes. Better than average equity performance was widespread globally in the third quarter, reflecting positive revisions to earnings and economic forecasts.

Barometer models remain constructive, however, at certain times during the quarter defensive measures were taken to protect our clients. In addition, the U.S. dollar (USD) declined against most major currencies after central banks elsewhere unexpectedly raised rates. Barometer hedged some USD exposure to reduce the negative impact on Canadian investors.

Seasonally low trading volumes, mixed with concerns over GDP growth, inaction in Washington, and saber-rattling by North Korea, caused some mid quarter market uncertainty. As the quarter ended, markets moved on to cautious optimism on the potential for tax reform in the U.S.

By quarter end, our long-term themes began to reassert themselves to the benefit of our portfolios. The U.S. economy remains strong, and growth has rebounded in both Europe and China. Economists have coined the term "synchronized global expansion" to describe the phenomena. In Canada, despite a rate hike, a slowing housing market, and a strengthening currency, markets were flat in Q3. On a positive note for Canada, energy prices showed strength late in the quarter.

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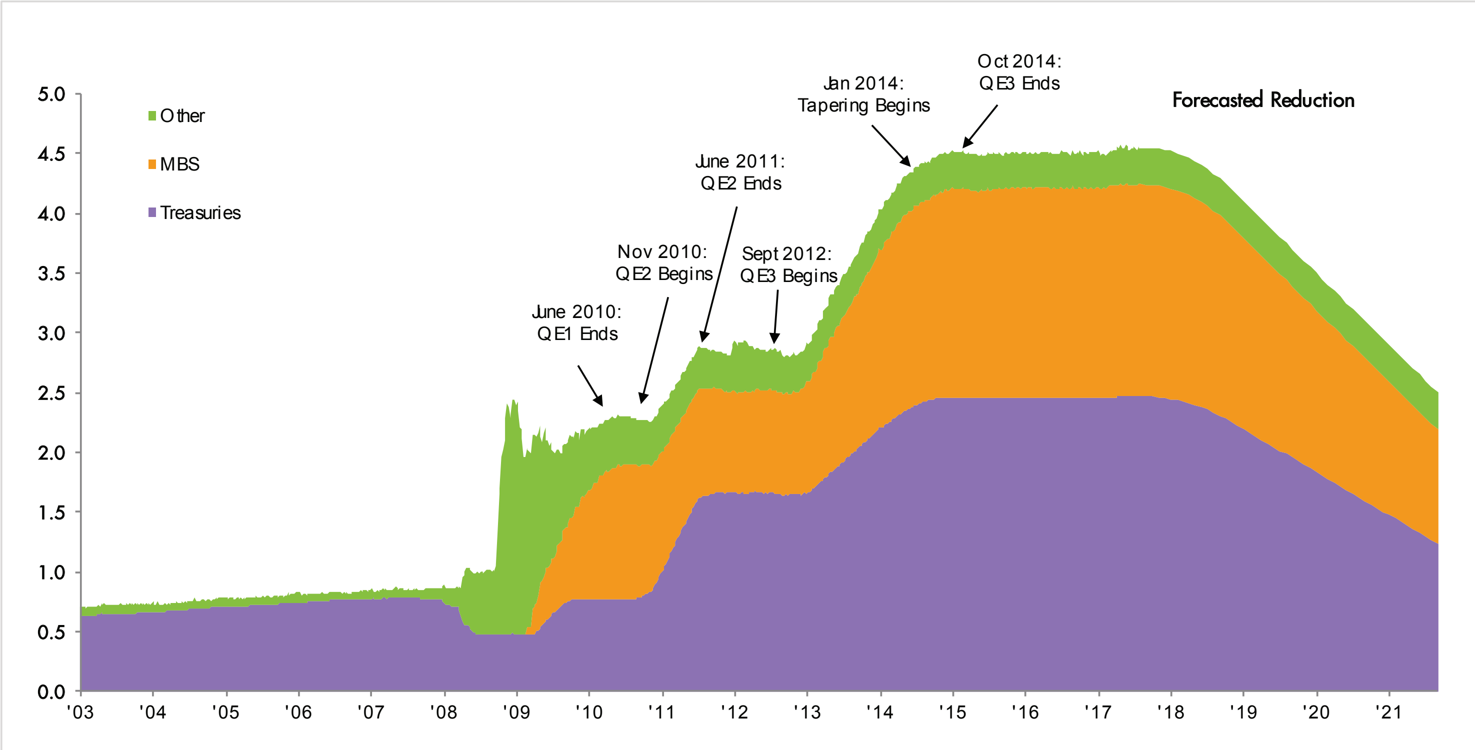
Fed's Balance Sheet: Assets ($ Trillions)



Source: Strategas Research Partners LLC

The bond market was hurt by the unexpected rate hikes in Canada and much of the rest of the world. Fixed Income indexes declined modestly in the quarter. Expected returns in bonds continue to be very low, and further losses in capital are possible. This strengthens the case for an absolute return focused equity portfolio and the Barometer approach.

The environment of unconventional central bank measures is finally beginning to subside. The Federal Reserve has confirmed it will begin to reduce the size of its balance sheet, and other central banks are likely to follow. This decline in the demand for bonds has the potential to put upward pressure on the longer end of the yield curve.

Market Highlights

For our clients we will remain cautious with regards to income-producing securities, bonds, and bond proxies. We will instead focus on companies with strong businesses and the ability to grow dividends. Our portfolios continue to emphasize more economically-sensitive sectors like technology, industrials, materials, and financials. One reality of a rising rate environment is that growth stocks can face multiple contraction, leading to a loss of capital. To protect investor capital, we have trimmed positions in technology as rates have climbed in September.

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Barometer's portfolios continued to be concentrated in stocks whose above average growth make them market leaders. A number of industrial companies like Caterpillar Inc., are benefiting from a recovery in commodities, capital expenditures, and construction globally. We continue to own aerospace & defense companies, as growth in defense spending continues to accelerate. Tensions are rising globally, and the U.S. and its allies need to refurbish aging forces. Video games have emerged as a mass medium dominated by a small number of large global companies like Activision Blizzard Inc. Finally, the balance sheet capacity in banks and rising yields continue to favour financials, especially large U.S banks.

The Tactical Balanced Strategy continues to be selective in fixed income, holds currency hedges, and manages a conservative equity portfolio. Defendable business with strong growth driven by secular themes characterizes stock selection in the Barometer Disciplined Leadership Balanced Fund ("Balanced Fund"). Alphabet Inc. (parent company for Google Inc.) is a good example. The Balanced Fund has largely avoided losses in its fixed income allocation by owning preferred shares of stable Canadian companies like banks. These securities have higher yields and a reset function that protects them from capital depreciation in a rising rate environment.

The Tactical Income Strategy maintained industrials as its largest weight throughout the quarter, favouring market leaders in growing pockets like Rockwell Automation, Inc. Caterpillar was added in the quarter as its business continues to recover with mining capex and growth in the Chinese construction market. The company's parts and services business helped it maintain earnings and its dividend through the longest downturn in decades. New machinery orders are now bringing earnings back to mid cycle levels. The Fund also holds Owens Corning, a supplier of roofing tiles, and D.R. Horton, a large U.S. home builder. We expect residential construction to continue to grow, and the two hurricanes that hit Florida and Houston should provide an additional tailwind.

The Tactical Equity Strategy took steps to manage currency and market risk at weak periods during the quarter, in order to protect capital. The Barometer Disciplined Leadership Equity Fund ("Equity Fund") continues to benefit from gains in growth companies like PayPal Holdings Inc. (an ecommerce payments platform company). The Equity Fund added Celgene Corp., a leading biotechnology company focused on oncology, as the healthcare sector continues to rebound. Celgene's existing portfolio of therapies continues to grow and it has a promising pipeline of new drugs still in trials.

The Global Macro Strategy continues to express confidence in "reflation", through the industrials sector with names in aerospace & defense and transports. It also has a significant weight in investment banks and small cap U.S. stocks. We are also taking advantage of unique growth stories like Chinese internet and gaming sectors, battery technology and the success of economic reforms in India, all through ETF's. We continue to be short fixed income indexes.

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Last quarter the Long Short Strategy was long familiar themes with exposure to the technology, healthcare, and financials sectors. By quarter end, we had added a position in energy to the portfolio.

Looking Forward

We continue to see opportunity in U.S. securities driven by strong economic fundamentals; our models reinforce this view. Technical breadth models are constructive and so is credit. Because of the cooling housing market and a resurgent currency, we think Canadian GDP growth will be under pressure going forward and we are being selective with our Canadian weightings. We expect inflation pressure in the U.S. to pick up as slack in the economy is shrinking and employment growth is accelerating. Our work points to a slow rise in bond yields over the next 12 months. We see market leadership in reflationary sectors namely financials, industrials, and basic materials. Technology remains a large weight as well. ◆

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