MARQUEST
ASSET MANAGEMENT INC.

Fourth Quarter 2015 Review

Market Commentary

As this is our first commentary as fund manager, our review will focus on the most recent couple of months and general observations for the past year. We will also outline our forecast and strategy.

Canada is going through a perfect storm; it is being buffeted by Chinese growth concerns, the OPEC oil-volume strategy and a manufacturing sector that cannot take up the slack. Add to the mix the fact that the Canadian consumer is in worse shape than their cousins to the south. Major cities, such as Toronto and Vancouver, have weathered the storm due to the influx of foreign buyers of real estate in these cities. With oil prices continuing to weaken, the woes of the West continue to weigh on the country. Recessionary forces are in play and it is hard to see any solution until we begin to see stability in Western Canada.

As it relates to Canadian capital markets, we have seen a flight of capital out of our market. "Sell Canada" is constantly being heard, and this has been reflected in the weakness of our dollar. During the year, $10 billion has been withdrawn from Canadian equity funds, the largest outflow ever. Until confidence in our economy and currency returns, the drain will continue.

This pessimism is reflected in 2015's results, in which only one stock in three rose on the TSX last year. The resource area was the hardest hit, with both the energy sector and metals down more than 25%. If not for the oil sands companies, the production group would have been down more than 30%. Many stocks in the resource group are testing their 2008 lows. When one reviews the TSX, it is a bifurcated market, with resource stocks at their lows and a handful of non-resource stocks soaring as a result of the weakened Canadian dollar. This is the worst breadth we have seen since the 2008 financial crisis. While our markets have been cheaper, the heavyweight oil sector has not been this cheap since 1985. Moreover, the 300 basis point spread between the TSX dividend yield (3.4%) and the 10-Year Government bond (1.4%) is the highest ever, which could provide a margin of safety.

So where do we go from here? Could we finally see Canada outperform the U.S. for the first time in five years? Since 1950, the TSX has only fallen once out of nine occurrences in the calendar year following a double digit decline (in 2002 following the downfall of Nortel). While in the near-term we remain cautious on any rebound of the resource area, consensus has pointed toward a rebound for oil in the second half of 2016. Any price stability would be a welcome respite for the western Canadian economy. While we are likely to be more constructive on oil, we are not so positive on the metals. The Chinese economy is shifting from an infrastructure bias to a consumer economy, or at least a more balanced economy. As such, its metals consumption will likely be muted for an extended period. Since this group does not have a major weighting on the TSX, we do not believe it will be a major drag on performance. However, regardless of a rebound, Canada will be hard-pressed to match the performance of our partners to the south.

Portfolio Commentary

When we took over the portfolio, we were active in selling a number of sectors and securities. As an example, we took down the energy weight from double- to single-digits. We reduced our western Canada exposure through the sale of Westshore Terminals, sold two-thirds of our energy holdings, and switched Enbridge to TransCanada Pipeline. We reduced our holding in railways and sold Telus. We added Alimentation Couche-Tard, CGI Group, Sun Life and Manulife. We also reduced our weighting in Canadian banks and added some U.S. banks. Overall, we increased exposure to the U.S.

In 2016, we believe markets will be more volatile. We do not expect the U.S. economy to slip into a recession, but Canada will be hard-pressed to exhibit any growth. Bull markets do not die of old age. While we would not argue that the markets in the U.S. are expensive, we should not forget that breadth south of the border was very weak as well. Many stocks experienced significant corrections.

For 2016, the big themes are:

1) Reflation: With higher interest rates, wage demands on the rise and higher oil prices, we expect to see higher inflation rates in the second half of 2016.

2) Increased volatility: While higher interest rates are not good for markets, we do not believe we will see more than two rate increases. Weakness in China should keep economic optimism in check.

3) U.S. dollar stabilization: As the U.S. dollar stabilizes, global economies should improve and headwinds for earnings dissipate.

4) Stimulus abroad to avert recession: China and Europe likely to continue to stimulate their respective economies.

5) Geopolitical risk returns to the energy trade.

Finally, for the first time in my career, I believe higher interest rates and higher oil prices will be good for the economy and the markets (particularly financials, energy and technology).

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