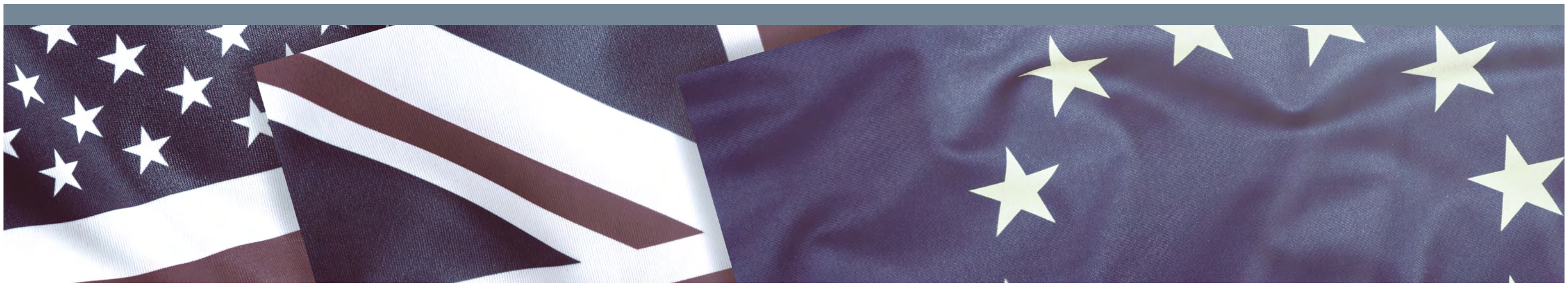
PROFESSIONALS FINANCIAL
PRIVATE MANAGEMENT

FINANCIAL LETTER

WINTER 2017

The Professionals' Financial — Private Management team



QUICK REVIEW OF THE GLOBAL ECONOMY

Economic growth was rather weak last year by historical standards, while the risk of a recession remained low. Geopolitics was in the forefront in 2016, the two main events impacting the markets being the U.K.'s decision to leave the European Union and Donald Trump's election in the United States. Noteworthy economic developments included the late-year rate hike by the U.S. Federal Reserve and the recent agreement between OPEC and non-OPEC oil-producing countries.

TRUMPS'S ARRIVAL BOOSTS THE MARKETS

While Donald Trump's election as president of the United States came as quite a surprise, the market surge following this event, one of the strongest in recent years, was also very surprising. After falling sharply the evening of the vote, global markets rebounded the next day, with Wall Street posting a gain of more than 1% at the close on November 9. It seems that investors were reassured by the conciliatory tone of the populist president-elect's victory speech, some even believing that although the economic measures he promised Americans are still vague, they should be favourable for stocks.

BREXIT: THE FUTURE IS STILL UNCLEAR

London's stock market posted sharp declines in the wake of Britons' vote to leave the European Union, a movement that quickly spread to other equity markets around the world. However, all the losses were recovered in a few days, and the European economy was able to continue its slow expansion. Europe is still not out of danger, though, as there is considerable uncertainty going forward in this post-Brexit period. The U.K.'s new prime minister plans to make her country's exit official in late 2017, and it will then take around two years to negotiate all the terms. Until then, volatility will persist on European and global markets.

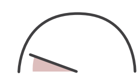
THE FED RAISES ITS RATES AS EXPECTED

As most observers had predicted, the U.S. central bank raised its benchmark rate by a quarter of a percentage point in mid-December, bringing it to 0.75%. This second rate hike in ten years is justified by the strong progress made by the U.S. economy in reaching the Fed's employment and inflation targets, and it will have little impact on U.S. consumers, since the cost of credit remains historically low.

HIGHLIGHTS

- **Surprise election of Donald Trump to the presidency of the United States.**
- **General post-Brexit rally on global stock markets.**
- **Increase in the U.S. Federal Reserve's benchmark rate to 0.75%.**
- **Status quo for the Bank of Canada's policy rate at 0.50%.**
- **Agreement to cut global oil production.**
- **Rise of populism in some areas of the world.**

RISK OF RECESSION IN THE NEXT TWELVE MONTHS ACCORDING TO OUR TEN INDICATORS



VERY LOW

However, some countries could see a flight of capital as investors will want to take advantage of the strength of the U.S. dollar and the higher bond yields that will result. The Fed's discourse suggests more sustained tightening in 2017, the Fed chair having mentioned the possibility of three rate increases.

UPS AND DOWNS FOR OIL

Between June 1 and August 1, 2016, the price of oil fell by approximately 20%, ending the period at close to US$40. Since then, oil has had its ups and downs, but the price has generally trended upwards, closing the year slightly above US$50.

In December, for the first time in eight years, OPEC members and non-members agreed to considerably reduce daily oil production worldwide, which should result in a decrease in inventories and an increase in the price of this commodity. This situation would likely stimulate Canada's economy and that of all other oil-producing nations.

SEMI-ANNUAL FOCUS

REGIME CHANGE IN THE UNITED STATES: FOR THE BETTER OR FOR THE WORSE?

The November 8 election in the U.S. represents a real regime change. Coming in the wake of the populist movement that began with Brexit, it must also be regarded as a clear rejection of the political establishment. Once the initial shock passed, the markets rebounded and the Trump rally has been going strong ever since. In fact, no new president had triggered such a market rally since Lyndon B. Johnson in 1963. In the space of a just a few weeks, even before he officially took office, the new president-elect favourably changed growth and inflation expectations in the United States and other parts of the world, something central banks hadn't been able to do since the 2008-2009 financial crisis.

AN UNPREDICTABLE AND ATYPICAL PRESIDENT

Of course, Donald Trump is nothing like a traditional politician, which largely explains why Americans supported him. There's a good chance that many of the promises he made during the campaign will never come to fruition. Over the next few months, he will probably realize the limits of his power and of his capacity to change things, and he will adjust his discourse and his actions accordingly. In addition, the fact that the Republicans also obtained a majority in the Senate and in the House of Representatives suggests that all these experienced members of his party will have a moderating effect on the new president.

At the time of writing, stock markets are still moving higher on the Trump rally, yields on 10-year U.S. Treasuries have risen, and U.S. economic growth reached 3.3% in the third quarter of 2016. Forecasts for the fourth quarter call for growth of between 2.5% and 3.6%. Will this surprising enthusiasm of the financial markets following the election of a candidate they had actually feared be long-lasting? It all depends on how the new administration will implement the policies put forward by Donald Trump and how it will manage and compensate for its lack of political experience.

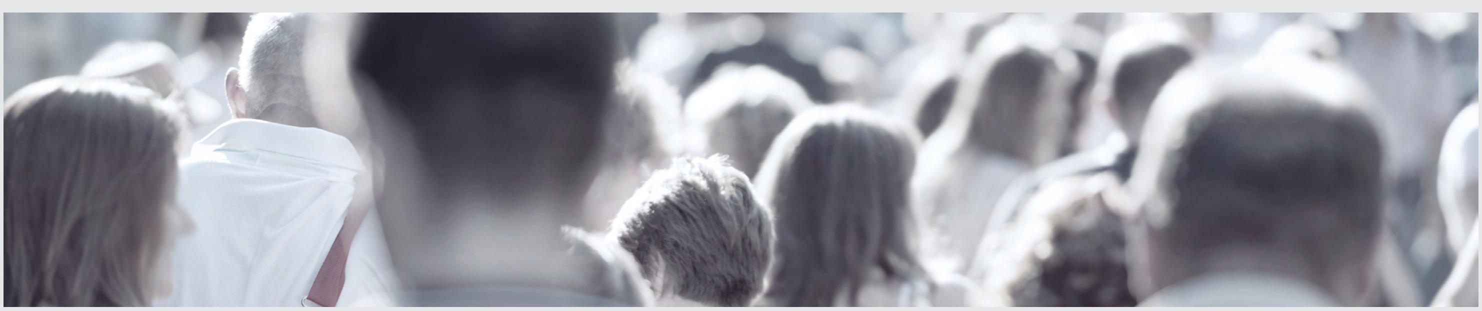
TRUMP : THE PROS AND CONS

PROS

- Pro-growth policies (higher infrastructure spending and lower tax rates for individuals and businesses).
- Improved outlook for corporate profit growth.
- Easing of regulations and government intervention policies.
- Probable increase in job creation.
- Easier passing of laws and less gridlock with Republican control of the Senate and the House of Representatives.
- End of the era of politicians bogged down in interminable administrative procedures.

CONS

- Inflationary policies represent a risk for the markets (expansionary fiscal policy, imposing tariffs on imports from China and Mexico, renegotiation of free trade agreements, curb on immigration).
- Upside adjustment of interest rates.
- High cost of financing pro-growth measures will weigh on the budget deficit.
- Stronger greenback may hurt exports of U.S. multinationals.
- Federal Reserve monetary policy may be more restrictive than expected.
- Inexperience in diplomacy could generate conflicts, particularly with China.



SHOULD WE FEAR THE RISE OF POPULISM?

Over the past few years and particularly in 2016, many events around the world have shown a rise in populism, such as the U.K.'s exit from the European Union, the election of Donald Trump in the United States, and the rejection of Senate reforms by referendum in Italy. In 2017, Europe could well see the populist themes of isolationism and anti-globalization gain even more ground. The elections in France in May and in Germany later in the year may again reflect voters' desire for change. Until now, the markets have shown strong resilience in the face of numerous shocks, but will they continue to rise despite the many uncertainties created by this trend? We'll know more about this during the year…

MARKET PERFORMANCE OVERVIEW

THE STOCK MARKETS ONCE AGAIN SAW CONSIDERABLE VOLATILITY DURING THE SECOND HALF OF 2016, WHILE BOND YIELDS ROSE SLIGHTLY. WE WILL NOW TAKE A CLOSER LOOK AT THIS SITUATION.

/ Fixed-income securities

Bond yields slowly returned to positive territory in most of the major economies, primarily due to the jump in yields following the election of the new U.S. president. For example, since bottoming in July 2016, 10-year U.S. Treasury yields rose by close to 100 basis points to 2.5% at year-end, while yields on Canada government bonds increased by almost 70 basis points.

Global corporate bonds performed well in 2016 and we added some to our portfolios during the year for greater diversification, which proved profitable. The second half was particularly difficult for bonds, with negative returns. However, for the year as a whole, the rate of return was positive.

/ Canadian equities

The Canadian stock market performed exceptionally well in 2016, with a total return of 21.1% for the S&P/TSX index[1]. Many sectors contributed to this strong showing, including materials, energy and financial services.

/ Global equities (including U.S. equities)

In the United States, the S&P 500, the leading U.S. index, gained close to 8.8% for the year in Canadian dollars (12% in U.S. dollars), fluctuating during the presidential campaign before rallying once the markets digested the election results. Generally, small caps were in favour, and since our Canadian and U.S. equity portfolios are significantly weighted towards quality large cap issues, they underperformed the indexes.

The stock markets of many emerging economies posted solid returns in 2016, particularly those of Peru, Russia and Brazil, due primarily to their exposure to natural resources. Their weaker performance relative to markets in developed countries between 2012 and 2015 also explains this much awaited rebound. Returns were weaker in the euro zone, especially since the euro fell 5.95% against the Canadian dollar in 2016.

Britain exceeded the most optimistic expectations, with the London stock market gaining close to 15% in 2016. However, the pound sterling fell sharply following the results of the Brexit vote (18.8% versus the loonie[2]).

In 2016, the decline of foreign currencies against the Canadian dollar affected the global equity return, producing the opposite effect to what happened in 2015. Global equities help diversify the portfolios, while mitigating the volatility associated with Canadian stocks.

[1] Source: RBC Capital Markets
[2] Source: *The Globe and Mail*, December 31, 2016.

THREE FACTORS EXPLAIN WEAK GLOBAL ECONOMIC GROWTH

For the past few years, global economic growth has been around 3% and forecasts for 2017 call for a continuation of this trend. Three key factors explain this relatively modest growth, which has practically become the norm today.

AGING OF THE POPULATION

The proportion of elderly people is growing and they are living longer and longer, but since their income is lower when they stop working, they reduce their spending, which has a negative impact on the economy.

DEVELOPMENT OF ROBOTICS

In many industries, robots now perform many of the tasks that were previously done by workers. But unlike humans, machines don't eat and they don't spend, which curbs consumption growth.

LOWER PRODUCTIVITY GROWTH

Most companies have already made the necessary investments to increase their productivity. Consequently, productivity gains in the workplace no longer contribute as much to economic growth.

MAIN RISK FACTORS IN 2017

- Rise of populism in various regions of the world.
- Strength of euroscepticism and danger for the survival of the European Union.
- Possibility of difficult negotiations between the two parties after Brexit.
- End of the honeymoon between Trump and the financial markets.
- Possible trade and diplomacy frictions between the United States and various countries, including China.
- Rise in interest rates and the U.S. dollar.
- Economic fragility in an era of deleveraging.
- Decelerating growth in China and its impact on the global economy.

IN 2016, QUALITY DIDN'T PAY OFF FOR THE EQUITY PORTFOLIOS!

At Professionals' Financial, we advocate a long-term investment strategy, which is why we focus on quality, well-managed companies that have little debt and sufficient cash.

Unfortunately, these companies were not favoured in 2016, as is often the case when a regime change occurs and causes a market inflection point, which is what happened after Brexit and the U.S. elections.

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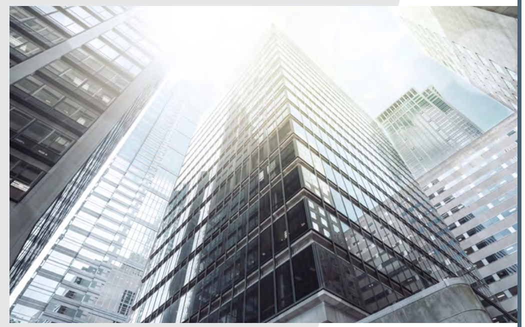
In these circumstances, shares of cyclical small cap companies have performed well, particularly since November 8. The greater leverage that these investments offer can be profitable, but they are also much riskier, which is not compatible with our investment approach.

For example, early in the year, the rate of return on the debt of Teck Resources was more than 30%, which suggested a high risk of default.

Despite everything, the company was one of the top performing stocks in 2016. However, we considered the stock too risky for our portfolios so we didn't buy it.



SOME ENHANCEMENTS TO OUR PORTFOLIOS

Changes were made to some of our portfolios to offer greater diversification, while achieving our objectives of capital protection (mitigation of market declines) and return optimization.

FDP GLOBAL FIXED INCOME PORTFOLIO

In December, external portfolio managers Amundi Canada Inc. and Manulife Asset Management (US and HK) replaced PIMCO Canada Corp. to handle part of the management of this portfolio, while the other part is administered by an in-house team.

FDP ALTERNATIVE STRATEGIES PRIVATE PORTFOLIO

We added three external portfolio managers – Fiera Capital, Connor Clark & Lunn Investment Management and Formula Growth – to diversify the sources of return and risk.

FDP TACTICAL ASSET ALLOCATION PRIVATE PORTFOLIO

We changed the investment policy for this portfolio in December, reducing the target duration from 8.5 years to 4.5 years. The purpose of this adjustment is to reduce the fund's sensitivity to interest rate changes. We believe rates bottomed in July 2016 in the current cycle.

2016 BY THE NUMBERS!

	ACTUAL LEVEL	VARIATION		
	Dec 31, 2016	1st semester	2nd semester	1 year
Interest Rates				
CAD 10 years	1.72	-0.33	0.66	0.33
USD 10 years	2.45	-0.80	0.98	0.18
Currency				
CAD -> USD	0.75	6.49%	-3.16%	3.13%
EUR -> USD	1.05	1.91%	-4.75%	-2.94%
Commodities				
WTI Oil	53.72	30.48%	11.15%	45.03%
GOLD	1,152.27	24.57%	-12.85%	8.56%

MARKET INDICES

North America (CAD)				
S&P/TSX (T.R.)	15,288	9.84%	10.24%	21.08%
S&P 500 (T.R.)	2,239	-2.50%	11.34%	8.56%
International (CAD)				
MSCI World (T.R.)	4,844	-5.48%	10.29%	4.25%
MSCI Europe (T.R.)	5,427	-10.91%	8.40%	-3.43%
MSCI AC Asia Pacific (T.R.)	282	-7.03%	9.40%	1.70%
NIKKEI Japan	19,114	-10.53%	12.51%	0.66%
MSCI Emerging Markets (T.R.)	380	-0.08%	7.89%	7.81%
Bond				
FTSE/TMX Universe	1,011	4.05%	-2.29%	1.66%

Source: Bloomberg