ETERNA FINANCIAL GROUP

MARKET REVIEW DECEMBER 2016

STATISTICS on 2016-12-31

CANADA		
Unemployment rate	6.90%	↑
C.P.I. (November)	1.20%	↓
3 months treasury bills CDA	0.46%	↓
Bonds CDA 5 years	1.20%	↑
Bonds CDA 10 years	1.83%	↑
S&P/TSX	15 288	↑

UNITED STATES		
Unemployment rate	4.70%	↑
C.P.I. (November)	1.70%	↑
3 mths treasury bills US	0.50%	↑
Bonds US 5 years	1.93%	↑
Bonds US 10 years	2.44%	↑
Dow Jones - Industrial	19 763	↑
S&P 500	2 239	↑

CURRENCY		
$ USA / $ CAN	0.7441	↑
$ USA / € Euro	1.0517	↑
¥ Yen / $ USA	116.96	↓

The arrow indicates the trend since the publication of the last monthly data or end of the month..

ASSET SUMMARY AND ALLOCATION

The year 2016 took many by surprise with unexpected developments such as Brexit and the election of Donald Trump as President of the United States. Stock markets rapidly declined in the hours following the election and some envisioned the worst correction scenarios, which, fortunately, did not last. Markets sharply rebounded and last quarter's results were of particular interest. The Canadian S&P/TSX Index and U.S. S&P 500 yielded total returns of 4.54% and 6.46%, respectively. In 2016, patient investors achieved returns of 21.08% from Canadian equities, 8.90% from U.S. equities and more than 4.57% from the global index. Last year's rising U.S. dollar resulted in declining value for Canadian investors. The loonie edged downward in the fourth quarter, but ended the year slightly higher than the previous year. Bond markets, however, went the other way. A steep rate hike during the fall, especially post-U.S. election, raised fears of tax cuts, increased government spending and higher U.S. FOMC rates. Canadian 10-year maturity rates rose 75 basis points in the fourth quarter to close the year at 1.8%. However, higher interest rates across all maturities resulted in negative performance for the FTSE-TMX index for Canadian bonds (-3.44% in the last quarter), which closed the year at 1.66%.

- Stock markets remain favoured, but much volatility is expected.
- The overall picture remains favourable for continuation of the bull cycle, but emerging markets are probably the most vulnerable to appreciation of the U.S. dollar.
- We maintain a defensive position in our short-term bond strategy. The average duration and maturity in our active strategy are tactically increased above those of the benchmark.
- We will take advantage of the expected volatility to invest recently accumulated cash.

Market Indices in Canadian Dollars as of December 31, 2016

	3 months	1 year	3 years *	5 years *
FTSE/TMX - 91 Day Tbill	0.14%	0.51%	0.68%	0.82%
Bonds				
FTSE/TMX - Universe	-3.44%	1.66%	4.62%	3.23%
FTSE/TMX - Short term (1-5 years)	-0.50%	1.01%	2.23%	2.09%
FTSE/TMX - Private wealth management [1]	-1.55%	1.25%	3.40%	2.80%
FTSE/TMX - Mid term (5-10 years)	-3.12%	1.61%	5.17%	3.88%
FTSE/TMX - Long term (10+ years)	-7.54%	2.47%	7.71%	4.29%
North American Stock Indices				
Canada - S&P/TSX	4.54%	21.08%	7.06%	8.25%
USA - Standard & Poor's 500	6.46%	8.90%	17.76%	21.26%
USA - Dow Jones	11.42%	13.31%	17.59%	19.43%
International Stock Market Indices				
United Kingdom - FTSE-100	1.81%	-2.96%	3.73%	10.22%
France - CAC-40	5.29%	-1.00%	3.09%	10.63%
Germany - DAX	5.21%	0.04%	5.08%	15.95%
Japan - Nikkei-225	3.61%	0.56%	10.11%	14.57%
Hong Kong - Hang Seng	-3.15%	-2.40%	6.11%	9.60%
Australia - S&P/ASX 200	0.65%	3.02%	2.70%	5.39%
MSCI - EAFE [2]	1.81%	-1.76%	6.43%	12.67%
Currencies				
$ CAN versus $ U.S.	-2.39%	2.88%	-8.16%	-5.65%

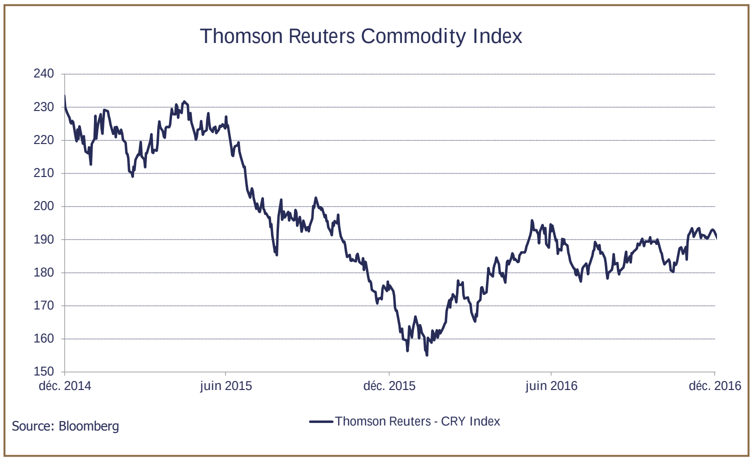
as of December 31, 2016
Source: Bloomberg
*Annualised return

1 FTSE/TMX Universe (60% short term & 40% mid term)

2 Morgan Stanley Capital Index - Europe, Australia & Far East

Notwithstanding political uncertainty caused by Brexit and the American election, global expansion has followed its course. Despite apparent issues, recently published indices show economic recovery in emerging countries and China. Chinese authorities are dealing with growing debt, changing demographics and a shaky financial system. Their monetary policy has again become expansionary and the yuan is gradually devaluing. Part of the recovery is likely reflected in more sustained metal prices.

The rising U.S. dollar and bond rates increase borrowing costs for emerging markets. Statistics show that developed countries are doing well, but not remarkably so. Japan and the euro zone benefit from exceptional expansionary monetary policies and these regions will continue to benefit from the weakening of their currencies to boost their economic activity.



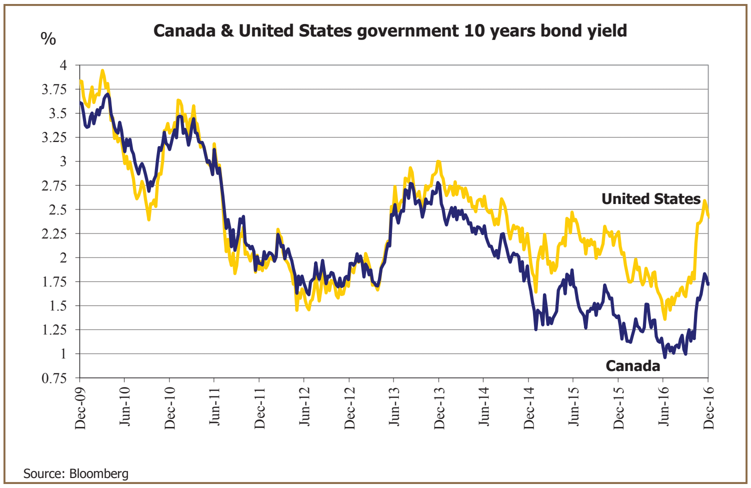
In the United States, growth continues at an acceptable level, while employment shows a slow but steady increase. Inflation is under control and oil prices are again on the increase. The FED should raise its rates, but the number of increases will depend on policies put forward under the Trump administration.

Canada's picture is also mixed. The recession in the western provinces appears to be over, but a lack of productivity remains. Domestic demand is supported by a strong real estate market, but this is expected to fade with the introduction of new restrictive measures by Canadian authorities aimed at curbing price spikes in some regions. The recent rise in mortgage rates will cool the ardour of this market by reducing buyers' borrowing capacity.

Overall, the new year is not causing undue concern. We expect moderate global expansion, modest inflation increase, gradual tightening of monetary policies and currency realignment. The overall picture remains favourable to continuation of the bull cycle. However, we expect greater volatility, as investors' mood swings between hope and disappointment.

At the political level, the measures announced during the election campaign were clear: lower taxes, increased infrastructure spending, increased military spending, review of trade agreements and review of energy and immigration policies. The year 2017 will be marked by a new regime in the United States that contrasts in many ways with our experience over the last 8 years. Investors have anticipated much of these changes, as evidenced by the expected sharp increase in inflation and interest rates in the U.S. and around the world. Mr. Trump's generally inflationary policies should counterbalance for some time, in whole or in part, current structural deflationary pressures. Over several years, this return to inflation will justify an increase of the interest rate range. Rates should also fluctuate in a wider corridor.

Notwithstanding potential increases in Canada, interest rates in 2017 will remain low compared to levels of the past 30 years. Despite a 73-basis-point jump in the fourth quarter, 10-year maturity rates closed the year at 1.72%, one percentage point below their average of the past 10 years and 3.50% below their average of the past 30 years. Even in the worst-case scenario, we do not expect rates to increase by more than 1% in long Canadian maturities over the next 12 months.



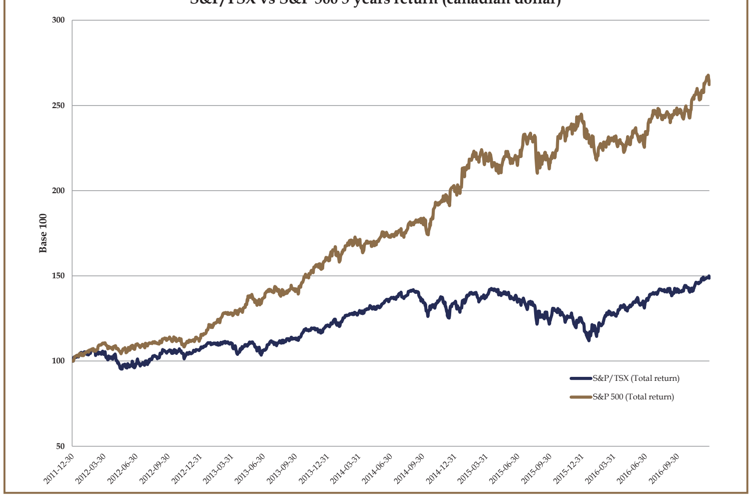
Although the rapid and sharp rise in interest rates is partly justified, we believe that investors' perception of future economic conditions may have outpaced economic reality in the longer term. Current expectations run on positivism with the arrival of the new U.S. president, with apparent underestimation of associated risks if economic statistics do not corroborate expectations. Thus, we believe that the recovery must gather momentum before further significant interest rate hikes.

The rate hike is expected to falter in the shorter term and we foresee a slight decline at the beginning of the year. The "short-to-neutral" defensive strategic bias that has been part of our active strategy since the summer, because of the level of rates we considered too low, has become a tactical position favouring a maturity slightly longer than the benchmark. Due to cyclical inflation and structural deflation in 2017, we expect that rates will increase more for 5-to-10-year maturities than for the long section of the curve. We therefore maintain defensive curve positioning. We also remain cautious about the corporate sector, for which we consider risk premiums generally inadequate, and favour provincial and municipal securities. However, in our private banking strategy, we maintain a defensive position, with shorter average maturity.

The FTSE-TMX index for Canadian bonds generated a gain of 1.66% in 2016. Our active bond strategy generated a return of 2.13%, or 47 basis points above its benchmark. Our strategic and tactical management of duration were our main sources of added value, as were our choices of sectors and securities. The fact that we overweighted Quebec's municipal sector and did not keep any exposure to the province of Alberta during the first two quarters of the year has served us well. However, our preference for corporate issuers offering better credit quality cost us a few basis points in the second half of the year, as lower quality securities yielded better returns. Finally, our private management strategy, which includes securities under 10-year maturity, appreciated by 1.65% in 2016, or 39 basis points above its benchmark.

NORTH-AMERICAN EQUITIES

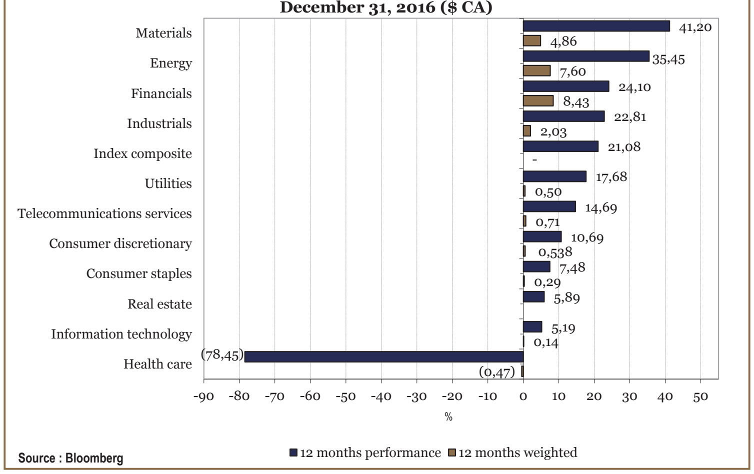
The Canadian equity index (S&P/TSX) maintained its solid fourth-quarter pace, generating a 4.54% return to close the year at 21.08%. The energy, materials and financial services sectors, which negatively impacted returns on the Canadian market in 2015, attracted attention this year for their respective annual returns of 35.45%, 41.20% and 24.10%. A significant rebound in commodity value and excellent stock market reaction of financial companies since the U.S. elections allowed these sectors to deliver attractive returns. Conversely, healthcare was the only sector of the Canadian index that yielded a negative return during the year (-78.45%), led by Valeant, which again lost over one-third of its market capitalization, with a decline of -86.1% for the quarter ending December 31st.



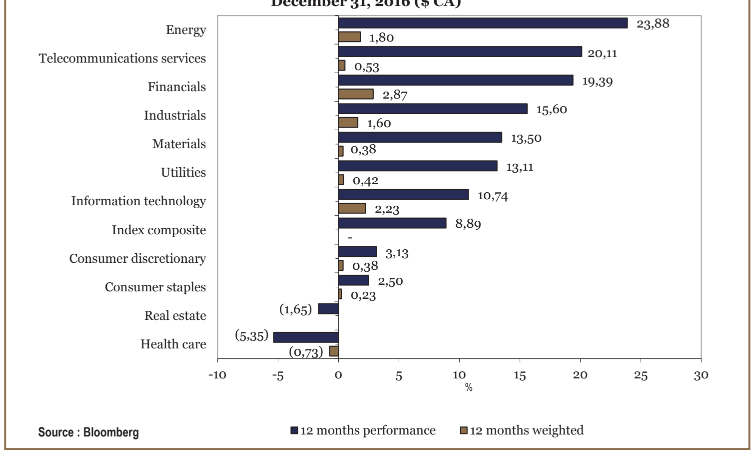
S&P/TSX vs S&P 500 5 years return (canadian dollar)

The Canadian equity strategies established in 2016 enabled us to achieve a return of more than 5.55% over the Toronto Stock Exchange benchmark.

The main contributors were the energy sector, with Vermillon and Canadian Natural Resources gaining 50% and 43%, respectively. In the industrial sector, Russell Metal and Finning showed respective advances of 59% and 40%.



S&P/TSX Composite - Groups performances including dividends December 31, 2016 ($ CA)



S&P 500 Composite - Groups performances including dividends December 31, 2016 ($ CA)

Finally, our financial sector investments were also strong performers, as the National Bank, Royal Bank and TD Bank yielded respective returns of 35.5%, 22.5% and 22.1%. The insurance subsector also contributed, as our top two positions, Industrial Alliance and Sun Life, increased by 21% and 19.5%, respectively. American market growth was impressive following the election of Mr. Trump, as markets seem to have believed Mr. Trump's promise to make America great again. The S&P 500 (CAD) rose 6.46%, while the Dow Jones was up 11.42%. Several securities that we hold showed significant increases during the year, including Caterpillar (+37.35%), Sysco Corp. (+34.03%), Unitedhealth Group (+33.71%), Texas Instrument (+32.08%), Automatic Data Processing (+20.04%), JPMorgan (+30%) and M&T Bank (+27%). These alone represent more than 25% of our strategy.

In 2017, North American financial markets will be strongly influenced by the implementation of policies proposed by Mr. Trump. Favourable prospects are based primarily on the new president's promised growth and inflationary policies. Deregulation may well favour U.S. companies, but the most dangerous promise is to increase fiscal stimulus through tax cuts and increased infrastructure spending. Several North American economic sectors (infrastructure, military, health, financial) are likely to be strongly influenced by the fulfillment of the new president's promises. We believe that, at this point, given the diverging opinions within his own party, that only a portion of these promises will be realized.

The outlook for profits is improving, as are inflation and growth forecasts, but we cannot overlook the risks. It is for this reason that we advocate a cautious and patient approach at the beginning of the year. We remain faithful to the discipline we apply in managing your portfolios.

We anticipate growing speculation, which will cause sudden market movements. We will use these periods of volatility to invest the cash we currently hold. For our Canadian and U.S. strategies, we increased our investments in the industrial, energy, industrial metals, banking and insurance sectors and reduced our positions in consumer staples, communities and communications. The latter are likely to be less favoured in 2017 in a context of slightly higher rates and their valuation remains high.

OUR INTERNATIONAL EQUITIES MANAGER COMMENTS

In the year 2016 the global fund and EAFE fund respectively returned 8.93% and -2.59% versus a return of 4.57% and -1.76% for their respective reference indices. Over the last three years investors in the global focused fund realized an annualized gain of 16.21% versus a 11.58% return of the reference index. EAFE fund investors achieved an annual gain of 8.24% versus a 6.43% return of the reference index.

This is the time of the year when people ask about the outlook for the New Year. Your fund manager got many blank stares and puzzled faces in recent weeks because of his answer to this question, which is: "I have absolutely no idea".

Let us explain. It is an essential part of human nature to look out for so called experts whenever we face uncertainty. This is the reason why Greek and Persian kings consulted oracles and their Roman counterparts employed so called haruspices to read the entrails of sacrificed animals. It is our belief, born out of more than 20 years of experience in financial markets that their modern day equivalents, sometimes called "economists" or "strategists" have less foresight into the future than their ancient forefathers.

As the most glaring example, think of the two big events that shaped 2016, Brexit and the Trump elections. Not a single member of our current flock of haruspices told us of these events in advance. Worse, among those oracles that considered the above events as a tiny but hugely unlikely possibility the consensus was that their occurrence would trigger a massive selloff in equity markets. As we now know, not only was this wrong, exactly the opposite happened.

Your fund manager knows and accepts the fact that the overall economy is too complex a system for anyone to be able to consistently make correct forecasts about its behavior. "We sent people to the moon, why should we not be able to forecast the economic future?" we are sometimes retorted. The answer is that there is a fundamental difference in forecasting the behavior of inanimate material (rockets, the moon etc.) and those of human brains. The former follows well known physical laws whereas we currently do not have a good description of the functioning of the human brain. The first person to have this important insight was the great physicist Isaac Newton, when he complained: "I can calculate the motion of heavenly bodies, but not the madness of people".

Contrary to many professional soothsayers, we thus do not waste a second trying to forecast the unforeseeable. We focus our limited time and attention on finding and analyzing superior companies that are run by honest and capable management. It served us well in the past and we are confident that this is the gift that keeps on giving.

We appreciate the fact that we have clients that share this view of the world, focus on the long term and keep a steady hand even (and especially) when financial markets fluctuate (which they are guaranteed to do, our only prediction for 2017). We wish you all the best for the New Year.

QUEBEC EQUITIES

The Eterna Quebec Equity Fund registered a net yield of 6.44% for the fourth quarter, or 22.04% for the year 2016. This was the eighth consecutive year that Eterna's Quebec Composite outperformed the Canadian TSX Index. The main positive contributor in both the quarter and the year 2016 was Air Canada, which rose in tandem with U.S. airlines, on strength of results, but also due to the mention of Warren Buffet, who initiated positions in airline companies for the first time in his career. With the fourth-quarter recovery of Canadian banks, the National Bank also contributed to performance, particularly with its strong exposure to capital markets. Infrastructure investment pledges in Canada and the United States propelled SNC Lavalin and WSP Global, two world-class engineering firms from Quebec.

In terms of portfolio movements, we invested in Uni-Select, following its decline with quarterly results below expectations. We like the strategy adopted by its new management and the consolidation opportunities that the industry offers. We also increased our position in Lumenpulse, a company specializing in LED lighting solutions, which continues to show organic growth of more than 20% annually and a profit margin with upward potential.

In early November, we reinvested much of the cash that we had in the fund.

ETERNA
GROUPE FINANCIER

wish you a very happy year 2017.
Peace, love and prosperity.

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