ETERNA FINANCIAL GROUP

MARKET REVIEW JUNE 2016

STATISTICS on 2016-06-30

CANADA		
Unemployment rate	6.80%	↓
C.P.I. (May)	1.50%	↓
3 months treasury bills CDA	0.50%	↓
Bonds CDA 5 years	0.61%	↓
Bonds CDA 10 years	1.12%	↓
S&P/TSX	14 065	↓

UNITED STATES		
Unemployment rate	4.90%	↑
C.P.I. (May)	1.00%	↓
3 mths treasury bills US	0.26%	↓
Bonds US 5 years	1.00%	↓
Bonds US 10 years	1.47%	↓
Dow Jones - Industrial	17 930	↑
S&P 500	2 099	↑

CURRENCY		
$ USA / $ CAN	0.7737	↓
$ USA / € Euro	1.1106	↑
¥ Yen / $ USA	103.20	↑

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

ASSET SUMMARY AND ALLOCATION

North American stock markets continued their mid-February momentum into the second quarter of 2016. The Canadian market, among the highest performing on the planet, generated a quarterly return of 5.07%, or 9.84% since the beginning of the year. Global easing measures and the patience of FED regarding a rise in interest rates seem to have reassured North American markets, as the S&P 500 delivered a quarterly increase of 2.48% in Canadian dollars. However, global uncertainties had a more significant impact on international exchanges, while main stock markets yielded negative returns, particularly due to the "Brexit", voted for by 51.9% of the British on June 23. For example, the EAFE index dropped by 1.44% over the last three months, or 10.30% since the beginning of the year. In the bond market, the current rate reduction context resulted in an excellent last-quarter performance of 2.62% for the FTSE-TMX index for Canadian bonds, led by long-term bonds, with a 5.48% increase.

- **Interest rates will remain low for some time.**
- **Cash and bonds are kept to a minimum.**
- **North American stock markets are favoured in this uncertain climate.**
- **Valuation of international markets is still reasonable compared to the U.S. market, and this situation should continue.**
- **We will take advantage of foreign exchange volatility to increase our positions in companies that we favour in the long term.**

Market Indices in Canadian Dollars as of June 30, 2016

	3 months	1 year	3 years *	5 years *
FTSE/TMX - 91 Day Tbill	0.12%	0.49%	0.78%	0.86%
Bonds				
FTSE/TMX - Universe	2.62%	5.22%	5.60%	5.18%
FTSE/TMX - Short term (1-5 years)	0.65%	1.56%	2.73%	2.67%
FTSE/TMX - Private wealth management [1]	1.34%	3.25%	4.15%	3.98%
FTSE/TMX - Mid term (5-10 years)	2.37%	5.78%	6.28%	5.96%
FTSE/TMX - Long term (10+ years)	5.48%	9.90%	9.20%	8.48%
North American Stock Indices				
Canada - S&P/TSX	5.07%	-0.20%	8.27%	4.21%
USA - Standard & Poor's 500	2.48%	8.13%	19.73%	18.97%
USA - Dow Jones	2.09%	8.66%	16.87%	17.18%
International Stock Market Indices				
United Kingdom - FTSE-100	-1.77%	-8.94%	7.97%	7.93%
France - CAC-40	-5.96%	-8.68%	5.96%	1.80%
Germany - DAX	-5.47%	-8.70%	8.48%	6.16%
Japan - Nikkei-225	1.35%	-5.29%	10.56%	10.77%
Hong Kong - Hang Seng	0.07%	-17.71%	7.20%	4.62%
Australia - S&P/ASX 200	-0.02%	-3.70%	3.13%	1.23%
MSCI - EAFE [2]	-1.44%	-6.60%	9.44%	7.91%
Currencies				
$ CAN versus $ U.S.	0.62%	3.44%	7.10%	6.05%

as of June 30, 2016
Source: Bloomberg
*Annualised return

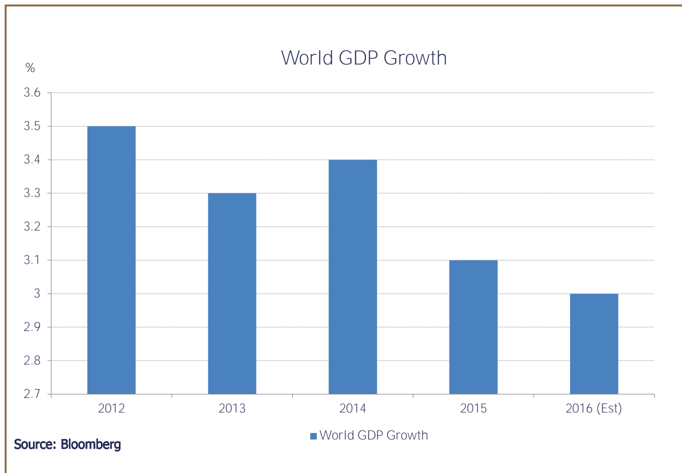
1 FTSE/TMX Universe (60% short term & 40% mid term)
2 Morgan Stanley Capital Index - Europe, Australia & Far East

INVESTMENT MANAGEMENT

« Market analysis, security and expertise for the conduct of your business »

NORTH-AMERICAN ECONOMY AND FIXED-INCOME SECURITIES

According to forecasts, global economic growth for the current year should be at 3%, which represents a slowdown compared to the last two years—3.1% in 2015 and 3.4% in 2014.

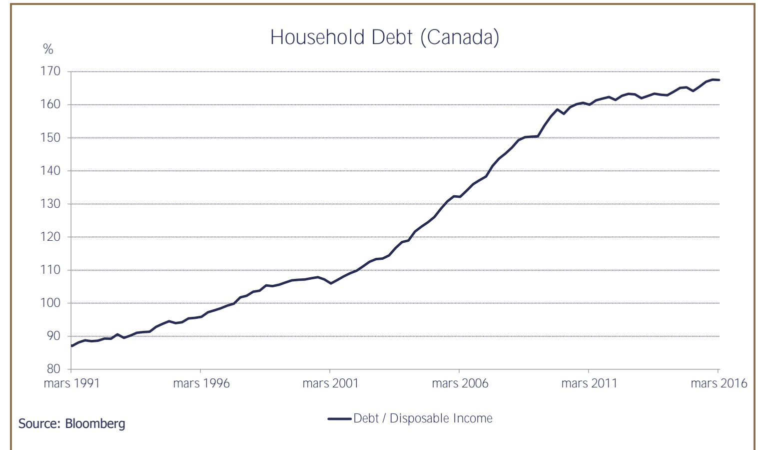


The persistent weakness of GDP growth in several countries in recent years could mean that some may have entered a period of economic stagnation. Even in less affected regions, growth-inhibiting deflationary pressures are mainly attributable to the same causes (aging population, high debt, savings surplus relative to investment needs). Note that the rising trends towards deglobalization and protectionism, and possible barriers to immigration and international trade, could worsen the impact of these economically constraining factors.

Despite all efforts by monetary authorities, we will eventually need fiscal measures to counteract the current economic slowdown and increasing dissatisfaction among the middle and lower classes, whose incomes are stagnating. This popular discontent is reflected in the rise in polls of populist parties and candidates in Europe and in the United States. This policy movement reflects a reversal of trends in deregulation, privatization, tax cuts, fiscal discipline and free trade from the 90s. The historic vote in favour of an exit from the European Union ("Brexit") by a majority of British in the June 23 referendum concretely illustrates the phenomenon of de-globalization.

Regarding high debt levels, solutions provided by central bankers (reduced interest rates, quantitative easing) in recent years have helped contain the risk of default by strongly reducing interest expense on debt incurred, in terms of individuals, corporations and governments. In coming years, extremely accommodative monetary policies and new tools, such as "Helicopter money" could be created to preserve an environment in which high debt levels will be sustainable.

However, there are significant negative aspects to these monetary measures: they lead to the formation of speculative bubbles and to a non-optimal allocation of capital, trigger excessive reductions in risk premiums and lead to negative rates (more than 10 trillion of government bonds currently show negative rates worldwide) that compromise monetary policy transmission mechanisms and credit creation by the banking system.



In the United States, the most recent labour market data surprised investors by revealing a marked slowdown in job creation. Barring a significant rebound in this area, it will be difficult for the FED to increase its key policy rate this year, not to mention political uncertainties from Europe that resulted in an increase of the greenback against major currencies. Moreover, the Federal Reserve has again lowered its long-term prospects for its key rate and revised its projections downward for short-term rates. Finally, its president, Ms. Janet Yellen, admitted that the FED's decision-making members were more willing to embrace the concept of secular stagnation, and that interest rates required to maintain adequate levels of economic growth were very low.

Therefore, our economic assumptions of recent years are now supported by the FED and a large number of investors have rallied to our point of view, i.e. that interest rates will remain low for an extended period. However, we are aware that from current levels, it will be harder to deliver returns similar to those obtained in recent years. Bonds will remain a preferred vehicle to protect capital and, despite possible relatively low returns in coming years, will continue to reduce portfolio volatility.

In the coming quarters, our position on credit will be a defensive one against risk of default. We currently maintain a neutral to slightly short duration compared to our benchmark, and wait for a non-justified movement in interest rates to change it in our various active strategies.

Bonds performed very well in the last quarter due to the increasing aversion of investors to risk, which boosted demand for safe-havens, such as Canadian government securities. During this period, our active bond fund generated a return of 2.62%, or 6.17% over a one-year period, which represents 96 basis points above the FTSE-TMX index for Canadian bonds, which advanced 5.22%. Meanwhile, our short-term fund gained 1.41% in the last quarter, or 3.53% over a one-year period, representing an added value of 29 basis points. Over the past three months, provincial bonds yielded the highest returns (2.51%), followed by municipal (2.14%), federal (1.44%) and corporate (1.26%) bonds. When sorted by maturity, the long-term bonds performed best (5.48%), followed by medium (2.37%) and short (0.65%) components.

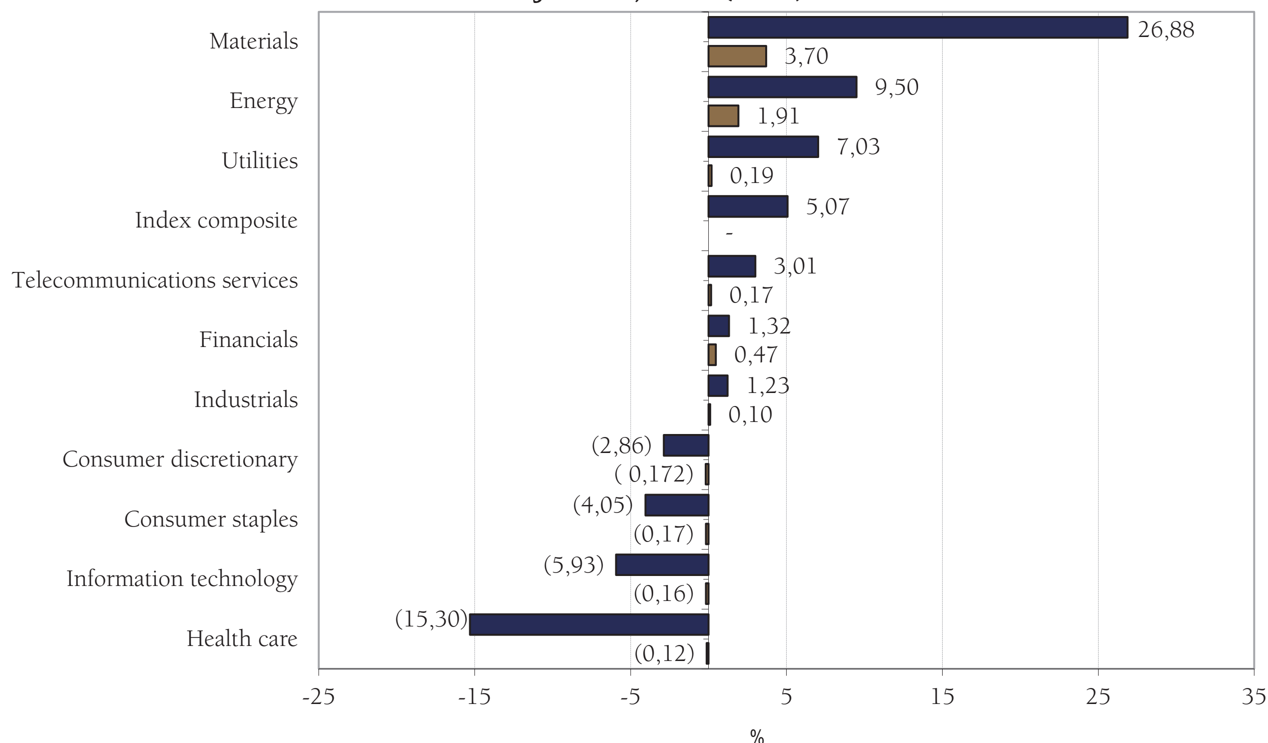
NORTH-AMERICAN EQUITIES

For a second consecutive quarter, cyclical sectors supported the excellent performance of our Canadian stock market, with a 5.07% quarterly return. Although the utilities sector yielded an excellent performance of 7.03%, materials and energy sectors contributed most to the S&P TSX increase, delivering respective returns of 26.88% and 9.50% over three months. In return, consumer and information technology sectors generated negative returns, while the health sector, dominated by the company Valeant, continued its rout and the financial sector, the most important of our benchmark, remained without direction.

The energy sector was influenced by several events that resulted in quarterly growth of 25.8% in the price of oil (WTI). The unsuccessful Doha meeting of several oil-producing countries, which aimed at establishing a production freeze, diverted the attention of investors towards basic indicators. The Fort McMurray forest fires last May had a major impact on the supply of oil available on the market. That said, it is the geopolitical conflicts around the world that explain most unexpected cuts in supply. For example, conflicts between the Nigerian government and rebels have been making headlines in recent months, with the latter orchestrating several attacks on Nigerian oil facilities, jeopardizing production of the largest African producing countries. However, these incidents will only have an impact on oil prices in the short term; despite the expected volatility, fundamental indicators should provide better longer-term support. We maintain an exposure slightly higher than the benchmark, while companies with good balance sheets will benefit from acquisitions at discount.

The materials sector continues to benefit from investment programs and easing in China, even as gold companies, seen by some investors as a safe-haven, delivered excellent returns. Our position in this sector increased slightly, but we avoid gold companies which generate very little value to shareholders. Utilities and telecommunications sectors, composed of high dividend yield companies, tend to thrive in the current environment of low interest rates, generating returns of 17.30% and 14.84%, respectively, since the beginning of 2016. In contrast, the disappointing financial sector was affected by low interest rates and uncertainties associated with current economic growth. These could significantly impact on financial institution balance sheets, despite consistently attractive valuation and dividend payments.

Unlike the first quarter, the U.S. stock market (S&P 500) saw reduced volatility, except for the days following the announcement of the "Brexit". This stability may be related to the FED's presidents' conservative statements regarding potential increase in interest rates, saying the institution would keep an eye on the global economy to guide their decisions. Obviously, the "Brexit" situation in June had a significant impact on the U.S. market, and could serve as a safe-haven for investors fearing a rough patch in international markets. Despite a relatively high valuation, we believe the U.S. market remains a safer choice for short- and medium-term investments, while in the longer term, it should be affected by a return of confidence in European and Middle East markets.



INTERNATIONAL MARKET

In the second quarter of 2016, the international fund had a return of 1.4% and the global focused fund a return of 0.8% compared to -1.4% and 1.0% for their respective benchmarks.

Currently, the theme dominating the discussion in the media is the "Brexit". The exit of Great Britain from the European Union. It surprises me how much credence is given to so same experts who completely failed to foresee the outcome of the referendum when it comes to outlining the potential consequences of this result. This is akin to returning over and over again to a dentist who in the past repeatedly pulled the wrong teeth. During all this media hype, we did what we always do when we look for investment wisdom, i.e. read annual reports of Berkshire Hathaway, Warren Buffett's investment vehicle. In his 1985 report he states:

> Whenever Charlie and I buy common stocks, we approach the transaction as if we were buying into a private business. We look at the economic prospects of the business, the people in charge of running it, and the price we must pay. We do not have in mind any time or price for sale. Indeed, we are willing to hold a stock indefinitely so long as we expect the business to increase in intrinsic value at a satisfactory rate. When investing, we view ourselves as business analysts - not as market analysts, not as macroeconomic analysts, and not even as security analysts.
>
> Our approach makes an active trading market useful, since it periodically presents us with mouth-watering opportunities. But by no means is it essential: a prolonged suspension of trading in the securities we hold would not bother us. Eventually, our economic fate will be determined by the economic fate of the business we own.

This is the most concise and best description of how we approach investing ourselves. The core idea is to identify outstanding companies (in terms of economics and quality of management) and wait for the moment that the market offers them at bargain prices. With this in mind, we welcome market fluctuations driven by temporary headlines like Crimea / Ukraine invasion, Greece debt restructuring, Ebola scare or Brexit fears. It is our CEOs and their teams that we keep a close eye on as opposed to the "saveur du jour" making up the headlines.

We are glad to report that we were able to increase some of our positions during the quarter that we think will turn out as rewarding for our clients over the years to come. Please keep in mind the above insights from Warren Buffett as you read about the market fluctuations that are almost certain to occur over the next couple of quarters.

QUEBEC EQUITIES

Despite equity market volatility during the first quarter of 2016, the Eterna Quebec Equity Fund yielded a 5.0%, return, helped by positions in Richmont Mines, Saputo and 5N Plus. Richmont Mines, a Canadian gold producer, was up more than 65% in this quarter. It benefited from a booming gold sector, related to concerns regarding the global economic outlook, as well as positive prospects for the future production of its main asset, the Ontario-based Island Gold mine. Based on publication of good financial results, Saputo also rose sharply during the quarter. With increasing absolute and relative valuation measures, we took advantage of the 19% rise since the beginning of the year to remove the security from our portfolio. In terms of negative contributions, Stella-Jones dropped by 11% in the quarter, after being a main positive contributor to the year 2015. The potential economic slowdown caused investors to fear reduced demand for railway sleepers. Stella-Jones made an acquisition during the quarter and we continue to expect the company to grow organically and by acquisition in the coming years.

Regarding portfolio changes, we took advantage of February's market decline to increase our investments in Air Canada, WSP Global and Power Corp, while decreasing them in CNS, CAE and CN. We also initiated a position in BRP, which was trading at historically low valuation, before publication of more encouraging results and outlook than expected by the market. In March, as previously mentioned, we disposed of Saputo and increased weight in Air Canada, Stingray, Cogeco and Fiera. As for Cogeco, the company continues to deliver solid results in Canada, while its U.S. operations benefited from an increase in acquisition revenues, positive impact of the currency and good management.