ETERNA FINANCIAL GROUP

MARKET REVIEW JUNE 2017

STATISTICS on 2017-06-30

CANADA

Unemployment rate (February)	6.60%	↑
C.P.I. (February)	1.30%	↓
3 months treasury bills CDA	0.71%	↑
Bonds CDA 5 years	1.44%	↑
Bonds CDA 10 years	1.79%	↑
S&P/TSX	15 182	↓

UNITED STATES

Unemployment rate (February)	4.30%	↓
C.P.I. (February)	1.90%	↓
3 mths treasury bills US	1.01%	↑
Bonds US 5 years	1.89%	↑
Bonds US 10 years	2.30%	↑
Dow Jones - Industrial	21 350	↑
S&P 500	2 423	↑

CURRENCY

$ USA / $ CAN	0.7714	↓
$ USA / € Euro	1.1426	↓
¥ Yen / $ USA	112.39	↓

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

ASSET SUMMARY AND ALLOCATION

With 2017 now at the halfway point, we see that financial markets had some surprises in store for investors. The first quarter saw bond rates fall, the U.S. dollar weaken and oil and metal prices decline. However, market returns were good overall. The world's major stock markets are on the rise. The global MSCI index soared by more than 7% so far in 2017 and emerging market indices performed even better, with nearly 14%. The second quarter was a little more stressful, especially in June, as volatility rose and bond rates showed increased fluctuation.

The S&P/TSX Canadian index yielded a return of only 0.7% since the beginning of 2017, losing 1.6% in the second quarter, under the weight of the energy, materials and finance sectors. In contrast, the U.S. S&P 500 index provided a return of 3.1% in US$. The Canadian dollar gained 2.7% against its U.S. counterpart in the last quarter. Regarding bond indices, only long-term high-quality securities of the TMX index showed positive returns. As an alternative, it was necessary to hold high-yield securities. Interest rate curves flattened, long-term rates fell, while shorter term interest rates were rising.

Markets face significant corporate debt and a likely increase in key policy rates. Profits are still healthy, but investors could quickly change their assessment. This is why we expect greater volatility in both stock market indices and bond markets.

- Central banks will tend to be less accommodating.
- We still expect volatile interest rates, but with no significant upward trend.
- We will take advantage of expected volatility by increasing our portfolio duration.
- The environment remains favourable to equities and we will take advantage of short-term corrections to increase our investments.

Market Indices in Canadian Dollars as of June 30, 2017	3 months	1 year	3 years *	5 years *
FTSE/TMX - 91 Day Tbill	0.09%	0.45%	0.60%	0.76%
Bonds				
FTSE/TMX - Universe	1.11%	0.02%	3.79%	3.29%
FTSE/TMX - Short term (1-5 years)	-0.42%	0.20%	1.72%	1.94%
FTSE/TMX - Private wealth management [1]	-0.30%	-0.26%	2.55%	2.60%
FTSE/TMX - Mid term (5-10 years)	-0.13%	-0.93%	3.79%	3.58%
FTSE/TMX - Long term (10+ years)	4.11%	0.40%	6.69%	4.88%
North American Stock Indices				
Canada - S&P/TSX	-1.64%	11.05%	3.08%	8.74%
USA - Standard & Poor's 500	0.67%	18.01%	17.06%	20.34%
USA - Dow Jones	1.51%	22.23%	18.56%	19.11%
International Stock Market Indices				
United Kingdom - FTSE-100	2.29%	14.73%	4.05%	10.85%
France - CAC-40	4.15%	24.67%	5.54%	13.01%
Germany - DAX	4.29%	31.36%	8.37%	17.19%
Japan - Nikkei-225	2.50%	18.24%	13.21%	15.04%
Hong Kong - Hang Seng	3.88%	23.27%	10.34%	10.93%
Australia - S&P/ASX 200	-4.33%	12.82%	1.71%	5.98%
MSCI - EAFE [2]	3.63%	20.38%	8.02%	14.11%
Currencies				
$ CAN versus $ U.S.	2.66%	-0.31%	-6.70%	-4.98%

as of June 30, 2017
Source: Bloomberg
*Annualised return

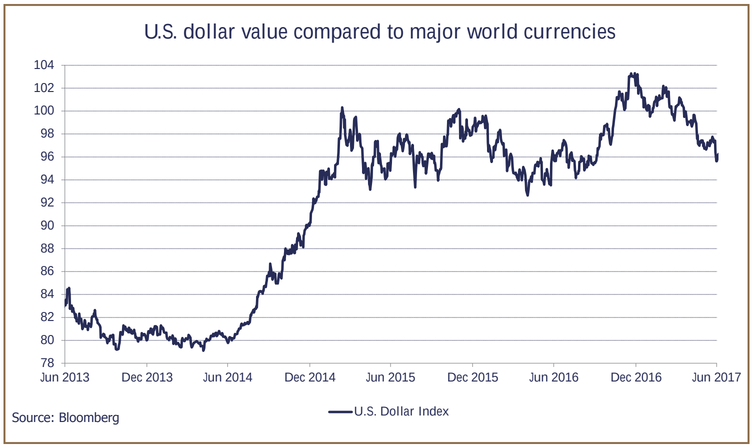
1 FTSE/TMX Universe (60% short term & 40% mid term)

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

NORTH-AMERICAN ECONOMY AND FIXED-INCOME SECURITIES

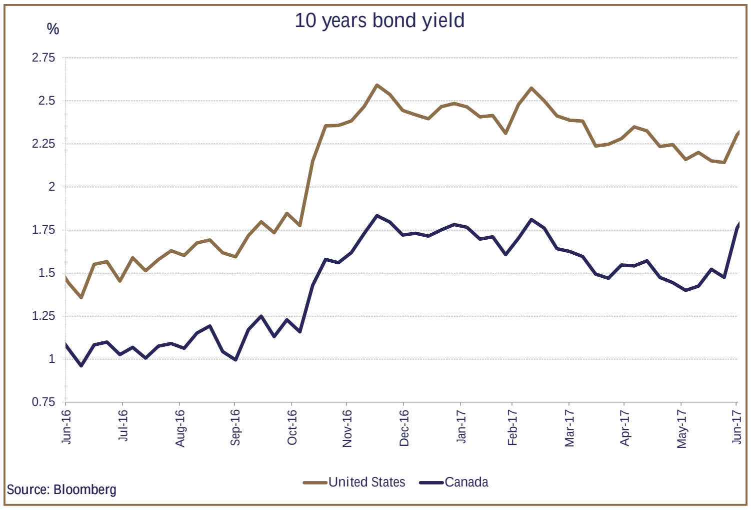
There was little change in the global economic environment during the last quarter, while growth continued. Production continued to rise in Asia, although certain national economies slowed down somewhat. The Japanese economy is doing fairly well. However, China has clearly slowed, as authorities wished. Although domestic demand seems to remain good, the country is still coping with problems of debt and leverage in its financial system. Moody's has, in fact, lowered the Chinese credit rating in recent months. The challenge is to reduce credit dependency while maintaining a targeted growth rate of around 6%.

Europe is doing better. Published statistics show improvement and the central bank is starting to prepare a foundation for a policy change later this year. Confidence and production indices were also better in the second quarter, and there is a new agreement to support Greek debt. Brexit negotiations have begun and, while UK expansion continues, several indicators have weakened. However, the pound sterling has recently regained its footing. The euro, for its part, appreciated in the second quarter by more than 7% against the U.S. dollar. The greenback lost ground against major currencies, and even the Chinese renminbi appreciated by some 1.6%. The Canadian dollar, not to be outdone, rose by more than 2.6%. In the latter case, stabilization of oil prices, a shift in tone by the Bank of Canada and, above all, less negative interest rate differentials compared to U.S. rates, were the determining factors. But the highlight of the quarter was certainly the low inflation rates, virtually everywhere on the planet. Apart from food, few prices are on the rise and excess production capacity is still in place.



In the United States, wage increases have not occurred in spite of a decrease in the unemployment rate. Annual inflation slowed from 2.8% in February to 1.9% in May. During the summer, Americans will benefit from seeing the lowest prices at the pump in a few years, which will support consumption growth. Overall, the U.S. economy is growing, although at a relatively slow pace. This was sufficient for the FED's monetary policy committee to increase target rates. Markets are still debating if there will be further increases this year. Industrial production seems good, although the manufacturing sector remains somewhat lethargic. The automotive sector is stagnating, sales are running out of steam and leasing length is expanding to record terms. Construction starts declined in each of the last three months. New orders for durable goods also decreased in April and May. In short, the situation is mixed. Monetary policy will depend on the economy's ability to generate additional jobs and income and, above all, a little more inflation above the targeted 2%. The FED wants to counter its financial position, which it increased following the 2009 crisis. There needs to be room to maneuver. The external sector will have to contribute. The recent development of the greenback and better performance of the global economy should help. The early composite index is still on the rise.

In Canada, there has been a change of tone. The Bank of Canada is telegraphing its intention to raise rates. Statistics have been better in recent months, but a certain fragility remains. Employment is strong, but wage growth is anemic. Annual inflation was 1.3% in May. The external sector stabilized, with new manufacturing orders increasing and retail sales doing well. However, a sharp rise in housing prices has put the residential sector under pressure. Government actions, mainly in Ontario and British Columbia, had the desired effect on sales.



It remains to be seen if this effect will persist. Housing starts edged downward in April and May. Business investment rebounded in the second quarter, but will need to be even stronger over the coming months. The predicted rise in policy rates reflected in the recent jump in rates of five-year maturities and less, coupled with the rising loonie, may ultimately dampen momentum. The external sector's contribution could also be disappointing if renegotiations of trade agreements (NAFTA) are unsuccessful for Canada. A rise in oil prices would be desirable in this context.

Markets face significant corporate debt and a likely increase in key policy rates. Profits are still healthy, but investors could quickly change their assessment. This is why we expect greater volatility in both stock market indices and bond markets. It should be noted that, recently, high-yield bonds have not performed as well as quality sovereign securities. Global markets reached record levels, with the exception of Canada, currently suffering with low oil prices. Unlike most other advanced economies, the Canadian performance will largely depend on developments in this sector. Overall, we remain confident for the coming months, but some caution and focus on quality titles will be necessary.

During the last quarter, the FTSE-TMX index for Canadian bonds rose 1.11%. This increase is mainly due to a decline in long-term interest rates and narrowing of credit spreads. While long-term securities gained 4.11%, the short-term and medium-term components lost 0.42% and 0.13%, respectively. The Canadian yield curve narrowed in the last quarter with increases ranging from 15 to 30 basis points in maturities of less than 10 years and decreases of nearly 20 basis points in long-term securities. The provincial bond index, with a higher duration than other sectors, gained 2.12%, while municipal, corporate and federal securities appreciated by 1.86%, 1.02% and 0.20%, respectively. Credit spreads on Quebec bonds continued to shrink, helped by the S&P rating agency's enhancement of the province's credit rating (A+ to AA-). This change positions Quebec's provincial credit above Ontario's for the first time in history, while only British Columbia and Saskatchewan now have higher ratings than Quebec.

For the quarter ended June 30, our short- and medium-term bond fund lost 0.20%, which is still higher than the -0.30% decline of the benchmark. The fund currently maintains a slightly defensive strategy and favours Quebec municipal issuers offering high current returns relative to other sectors. Our active strategy appreciated by 1.25% over the period, or 14 basis points above its benchmark. Defensive positioning was maintained throughout the quarter. We benefited from high interest rate movements towards the end of June to reduce our exposure to long-term securities that had largely outperformed the short and medium terms. On the other hand, we increased the weight of bonds with maturities of less than 10 years, where rates increased the most and credit spreads were the most attractive. We also continue to favour issuers with good credit prospects.

NORTH-AMERICAN EQUITIES

The Canadian equity index (S&P/TSX) continued its modest performance from the first quarter, posting a second quarter negative return of 1.64%, bringing the yield to 0.74% since the beginning of 2017. Only the financial, materials and energy sectors, the three most important sectors of the index, generated negative performances over three months, with respective declines of 0.92%, 6.44% and 8.28%. The positive performance of the eight other sectors, led by Healthcare (+13.38%) and Industrial (+6.07%), will not have been sufficient to generate an overall return as attractive as some global stock market indices.

In the U.S., the S&P 500 index performed well with a quarterly 3.09% return in local currencies, about 2.4% less for Canadian investors due to the rising loonie. Telecommunications (-9.23%) and energy (-8.55%) sectors both lost ground over the period, while the health (+4.59%) and industrial (+2 .28%) sectors delivered the best returns.

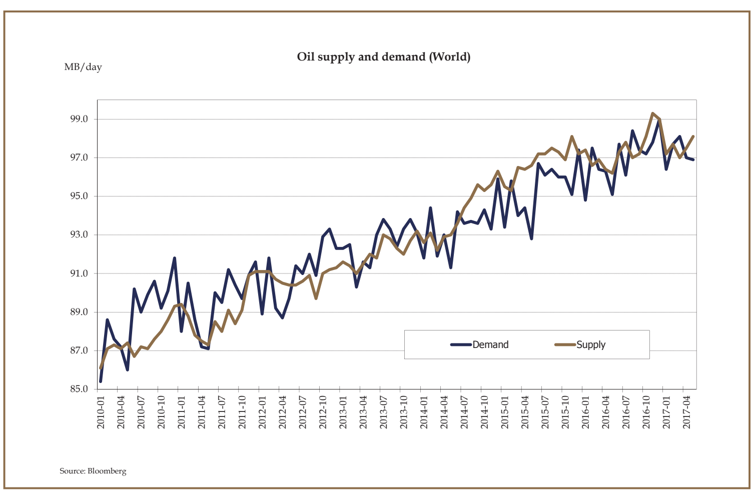
The disappointing performance of the financial sector in the last quarter was due to the effects of the short-term financing crisis of a non-traditional mortgage lender, which undermined confidence in Canadian bank securities. Moreover, the potential impact of higher interest rates on the Canadian real estate sector negatively affected the financial sector. Without ignoring the possibility that these events could recur, we believe that financial institutions will continue to provide investors with good performance in the longer term and we will use any downturn to increase our investment.

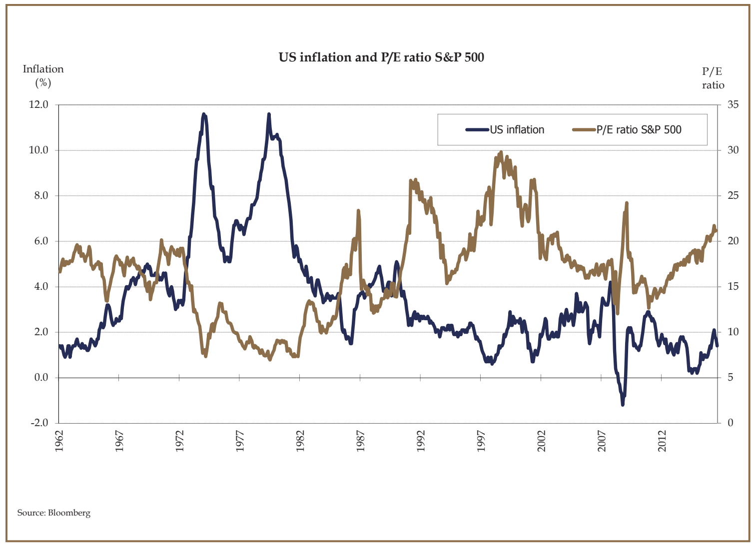
Canada's energy sector is another major area of concern. Even with declining output from OPEC and Russia, equivalent to 1.8 million barrels per day (mbd), prices are down compared to last year's peak. We believe, however, that demand for this raw material will accelerate. As is the case for several years, oil inventories tend to decline in the second half of the year. The holiday season for our southern neighbours has begun and all predict a sharp increase in travel mileage by Americans. The International Energy Agency (IEA) expects consumption to increase by 1.9 mbd for the second half of 2017. This forecast is mainly based on the effects of sustained growth in the U.S. economy and low fuel prices. Although this has cost us a few yield points since the beginning of the year, we maintain our overweight in energy stocks.

All indicators show that U.S. equities are overvalued. Between 1935 and 1995, the price-earning ratio fluctuated around 14 times. Today, it is more than 20 times.

Investors pushed up valuations due to stable growth and low inflation, but mostly because profit margins are much higher than in the past. That said, changes in policies of the FED and other central banks around the world could upset the calm economic atmosphere. We are considering more of a scenario with a slow decline in the U.S. price-earning ratio, but still higher than in the past, rather than a precipitous collapse.

Since the beginning of the year, we have seen a large difference in the return on value and growth, especially in large cap stocks. For example, large cap value stocks yielded 3.60% versus 14.89% for growth stocks. This large spread explains our underperformance relative to the market since the beginning of the year. We are confident that the coming quarters will show a recovery in securities that make up the majority of our U.S. strategy.





OUR INTERNATIONAL EQUITIES MANAGER COMMENTS

In the second quarter of 2017 the global fund and EAFE fund respectively returned -2.06% and 6.34% versus a return of 1.59% and 3.63% for their respective reference indices. Over the last three years investors in the global focused fund realized an annualized gain of 15.81% versus a 12.39% return of the reference index. EAFE fund investors achieved an annual gain of 12.21% versus 8.02% return of the reference index.

The most salient development of global stock markets over the last couple of years has been the meteoritic rise of the so-called FANG stocks (Facebook, Amazon, Netflix and Google). It reminds us of a quote by the distinguished investor and market observer Howard Marks:

"Cyclical ups and downs don't go on forever. But at the extremes, most investors act as if they will".

Stated more colloquially: What the wise man does in the beginning, the fool does in the end. Every bull market can be divided to three distinct phases:

1. In the beginning only very few far-sighted investors identify a new and meaningful trend or development whose price is not yet reflected in market prices.
2. This insight spreads to the majority of market participants and is now fully reflected in the price of stocks and bonds.
3. Now virtually all investors agree with the new trend and project its impact far into the future (in some cases beyond the day of Reckoning as a wag recently pointed out to us)

Phase three is the most dangerous period because a tiny shock to investor's excessive confidence (e.g. missed earnings or external influences like inflation ore interest rate increases) can provoke huge declines in stock prices. This insight is best captured in Warren Buffett's observation:

"The less prudence with which others conduct their affaires, the greater the prudence with which we should conduct our own affaires".

While we wish we had had the wisdom and insight to buy the FANG stocks in Phase one or two we consider it prudent to stay clear of them now that we arguably approach Phase three. Our two rules guiding the stewardship of your investments are:

1. Do not permanently destroy capital
2. Never forget rule number 1.

We believe that this approach will serve our investors well in the long run at the price of occasional relative underperformance as markets gyrate in unpredictable ways over shorter time periods.

QUEBEC EQUITIES

The Eterna Quebec Equity Fund registered a net yield of 8.6% for the second quarter, or 6.8% since the beginning of the year. Year-to-date returns are higher than those of the TSX (0.7%) and in line with the Morningstar National Bank Quebec Index (6.3%). The main positive contributors during the quarter were Lumenpulse, 5N Plus, Air Canada and Canam. In April, a consortium regrouping the CEO of Lumenpulse and Power Energy announced a privatization offer for the company at $21.25, i.e. an 86% premium. In the case of 5N Plus, the implementation of the strategic plan announced in September 2016 and stabilization of results drove valuation multiples to increase from their low levels, pushing the stock up by 87% since the beginning of the year. Air Canada reported an excellent first quarter, primarily in terms of free cash flow generation, as well as its intention to internally repatriate the management of its loyalty program, an updated net opportunity valued at more than $2 billion over 15 years. For Canam, the announcement of its privatization in April (98% premium) explains the excellent performance of the equity during the quarter.

In terms of portfolio movements, with the privatizations of Canam and Lumenpulse, we reinvested cash in several equities, including SNC-Lavalin and Mediagrif. SNC qualifies well, based on our criteria grid, and trades at attractive valuation measures by excluding positions in its infrastructure assets. Mediagrif's attractive valuation and high return on free cash flow led us to increase our position. We also invested in two new equities. The first, Stornoway Diamond, operates Quebec's first diamond mine. We believe that initial production problems can be resolved in the coming quarters. The second, TSO3, is a Quebec-based company which developed one of the world's most efficient low-temperature sterilization systems. We believe that TSO3's sterilization system, marketed by partner Getinge, will have a significant market share in the coming years.

As we are more optimistic towards the stock market, we maintain a higher than normal level of cash on hand. Our medium- and long-term economic outlook remains positive, but we will expect a market correction before reinvesting cash.

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