ETERNA FINANCIAL GROUP

MARKET REVIEW MARCH 2018

STATISTICS on 2018-03-31

CANADA

Unemployment rate (February)	5.80%	↓
C.P.I. (February)	2.20%	↑
3 months treasury bills CDA	1.12%	↓
Bonds CDA 5 years	1.97%	↓
Bonds CDA 10 years	2.09%	↓
S&P/TSX	15 367	↓

UNITED STATES

Unemployment rate (February)	4.10%	
C.P.I. (February)	2.20%	↑
3 mths treasury bills US	1.70%	↑
Bonds US 5 years	2.56%	↓
Bonds US 10 years	2.74%	↓
Dow Jones - Industrial	24 103	↓
S&P 500	2 641	↓

CURRENCY

$ USA / $ CAN	0.7755	↑
$ USA / € Euro	1.2324	↓
¥ Yen / $ USA	106.28	↑

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

ASSET SUMMARY AND ALLOCATION

After the lull in 2017, market volatility made a strong return in the first quarter of 2018. Movements were spectacular, especially in February, as stock market indices tumbled drastically by almost 10%, later to rebound. March plunged investors into concern as a tariff war was on the horizon between the United States and China and Amazon and Facebook stocks declined at the end of the month. The former fell back following criticism of the American president regarding their delivery policy and low taxes paid; the latter following revelations about the use of its subscribers' data. In total, the U.S. S&P 500 and Canadian S&P/TSX indices respectively lost 0.8% and 4.5% in the first quarter. All sectors declined, except for information technology supported by CGI, BlackBerry and Spotify. All stock markets are down, with a few regional indices managing to maintain positive returns since December, mainly in emerging markets. The near 2.4% decline of our dollar helped Canadian investors in foreign investments. Meanwhile, the U.S. dollar lost ground against all other currencies. The bond market saw interest rates increase in January and February. In fact, the first wave of stock market decline was triggered by fears of rising interest rates and inflation. In March, the bond market offered a significant rally as signs of economic longer-maturity bonds at their highest rate of return in recent years. For the quarter, the FTSE-TMX index for Canadian bonds returned 0.1%, with long-term federal bonds performing the best at 0.8%.

Despite turmoil in financial markets, expansion continues. Signs of a slowdown have emerged in recent months, but the effects of U.S. tax cuts will be felt over the coming quarters. The recent rise in inflation is not unexpected, as well as rates administered by the U.S. central bank, so that the indices' downward movements in the first quarter appear as a correction following the euphoria at the end of 2017. The purge of some excesses could allow the upward cycle to continue as long as monetary policies do not become more restrictive. As we mentioned at the beginning of the year, greater caution is required at this advanced stage of the cycle and higher quality securities should be favoured.

- Stock indices corrected after reaching new records.
- Global growth remains good, as central banks seek to normalize interest rates before inflation becomes a problem.
- While unemployment rates are low, there is a need to monitor potential wage increases and the ability of businesses to cope with them.
- Market volatility will be higher this year and interest rate curves will further flatten out, as 2018 could be transitional for the business cycle.

Market Indices in Canadian Dollars as of March 31, 2018

	3 months	1 year	3 years *	5 years *
FTSE/TMX - 91 Day Tbill	0.30%	0.76%	0.59%	0.74%
Bonds				
FTSE/TMX - Universe	0.10%	1.36%	1.21%	2.89%
FTSE/TMX - Short term (1-5 years)	0.22%	-0.37%	0.67%	1.56%
FTSE/TMX - Private wealth management [1]	0.14%	-0.41%	0.82%	2.08%
FTSE/TMX - Mid term (5-10 years)	0.01%	-0.49%	1.04%	2.86%
FTSE/TMX - Long term (10+ years)	-0.01%	5.06%	2.05%	4.70%
North American Stock Indices				
Canada - S&P/TSX	-4.52%	1.71%	4.07%	6.93%
USA - Standard & Poor's 500	2.21%	10.56%	11.43%	18.84%
USA - Dow Jones	0.97%	15.80%	14.15%	18.86%
International Stock Market Indices				
United Kingdom - FTSE-100	-0.95%	8.63%	4.02%	9.21%
France - CAC-40	2.42%	12.41%	6.17%	11.00%
Germany - DAX	-1.39%	9.48%	5.63%	13.55%
Japan - Nikkei-225	2.77%	15.20%	8.64%	14.22%
Hong Kong - Hang Seng	3.12%	19.86%	6.70%	11.12%
Australia - S&P/ASX 200	-3.91%	-4.40%	0.08%	1.64%
MSCI - EAFE [2]	1.31%	11.23%	6.14%	11.65%
Currencies				
$ CAN versus $ U.S.	-2.62%	3.14%	-0.56%	-4.86%

as of March 31, 2018
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

Economic policies are at the heart of important issues in 2018. On the one hand, governments have adopted stimulating budgetary and fiscal measures. In the United States, the tax cuts voted last December are expected to be felt during the year, while both households and businesses now benefit from lower tax rates. In addition, Congress has just voted an expenditure program that could result in a federal budget deficit of nearly $1 trillion next year. In Canada, the governments of Ontario and Quebec have just tabled budgets that significantly increase public spending. Meanwhile, the federal government has no intention of reducing the deficit and returning to a balanced budget for several years.

On the other hand, interest rates remain low, allowing households to continue to service their debt, which has significantly increased over the last two years, thus reducing their desire to save. It is worth mentioning the savings rate decline in the United States, which returned near the historic lows of the years 2000 to 2,6%. Central banks have, however, changed their policy. The U.S FED recently raised its rates and has made it clear that it will do so as long as economic conditions allow. The American monetary authorities are sort of in a preventive mode. They are seeking to "normalize" interest rates, which have been kept extremely low since the great recession and are concerned that underlying inflationary pressures will spring up in light of the current environment of expansive fiscal policies and an unemployment rate suggesting full employment. For its part, the European Central Bank is maintaining its current degree of monetary stimulus for now, but clearly demonstrates its intention to reduce monetary easing and raise administered rates, which are still negative. In China, the government recently increased the powers of the People's Bank of China to better regulate the financial sector and reduce its excesses. At home, the Bank of Canada raised its rates in early January, a third increase since 2015, but did not do so in March, noting uncertainties about NAFTA and the weak Canadian dollar, but especially the marked slowdown in the Canadian economy in recent months. Indeed, several signs of weakness have appeared recently: Canada has lost 72,000 jobs since December, GDP fell by 0.1% in February, reducing the annual pace to 2.7% from over 4.5% a year ago, and industrial production slowed sharply. Also, retail sales, manufacturing shipments and home sales are all lower. All this in a context of industrial capacity utilization at its maximum in ten years. We find it difficult to judge the ability of the Canadian economy to support rate increases when we consider the real estate excesses in major regions of the country such as Vancouver and Toronto, uncertainties about free trade, and possible tariff increase. It's a safe bet that several companies are in waiting mode because of these last two factors. The external sector is struggling to contribute to growth due to a trade deficit and low export levels.

Overall, we should expect an increase in employment costs, but this is slow in coming. Markets still expect continued global synchronization and expansion, stable corporate profit margins, increased profitability and rising interest rates. It is therefore important to observe how American households manage their savings and how much companies prefer buying back shares to productive investments. We must also consider the high level of corporate debt. All in all, we believe that the scenario of continued growth at a moderate pace is still most likely. Annual inflation rates will rise temporarily to stabilize after the summer, favouring a gradual and predictable rise in short-term interest rates and a flattening of yield curves.

Bond rates have fallen recently, especially in long maturities, responding positively to turmoil in the stock market. In Canada, shorter-term rates have stabilized following recent signs of weakness. The 10-year federal security rates ended the quarter at 2.10%, just 5 basis points higher than at the end of December. The two-year rates ended March at 1.77% compared to 1.69% at the end of 2017. Provincial credit spreads increased in long maturities during the quarter. Ontario's fiscal position and election timing create discomfort. Federal securities were preferred. This phenomenon of flight to quality was also reflected in corporate securities, which saw their spreads rise in all maturities. Globally, credit spreads opened everywhere, with high-yield securities underperforming in a context of falling interest rates. As for the FTSE-TMX index for Canadian bonds, only the short-term component (2-5 years) and corporate sub-indexes have offered barely positive performances since the beginning of the year.

We have taken little duration risk in our fixed-income asset portfolios so far this year. For shorter-term strategies, we overweighted Quebec municipal securities, which offer a yield of 45 basis points more than that of the province of Quebec. For our Universe mandates, we slightly increased portfolio duration in January and February during the rate hike to reduce it somewhat in March, ending the quarter with a slightly longer duration than the index. We plan to reduce portfolio risk in the second quarter. We are particularly attentive to the evolution of the corporate sector, where spreads remain very low despite the last weeks. As for the provincial sector, the spreads still seem attractive to us; Québec's financial situation is particularly good.

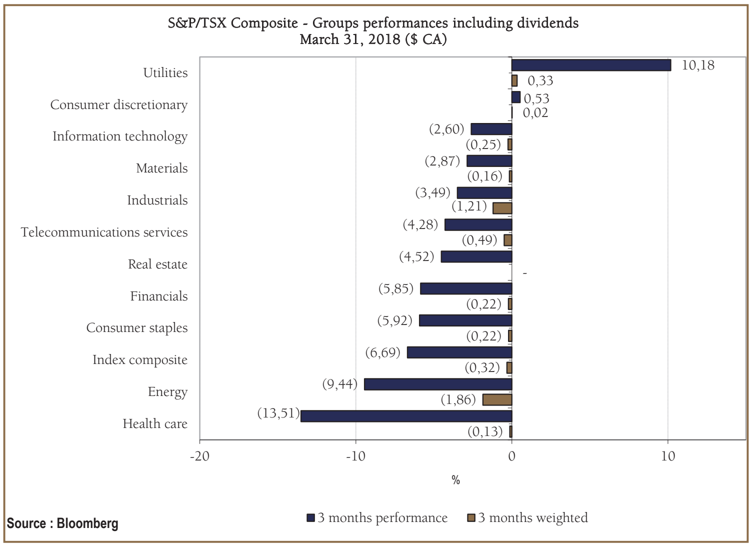
NORTH-AMERICAN EQUITIES

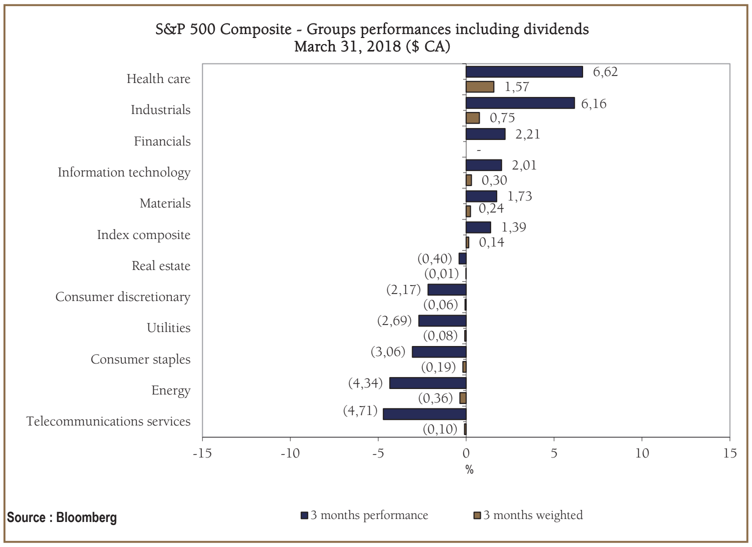
After an excellent end of 2017, the Canadian stock market started the quarter calmly, with little variation. From the third week of January, everything suddenly changed. The S&P/TSX index lost more than 7% over 15 days, in line with its American counterpart. Volatility indices jumped to levels that had not been seen since 2015 as investor confidence, which had seemed unshakable for some quarters, eroded somewhat. The rest of the quarter followed the same scenario– sudden changes in the perception of markets generating significant daily movements in market prices. The Canadian stock market ended the quarter with a 4.5% loss, while all sectors except real estate (0.5%) and information technology (10.2%) did not deliver positive returns. The health sector (-13.5%), which lost its momentum at the end of the year, was the hardest hit. As was the case last year, it was the energy sector (-9.4%) %) which had the biggest negative impact on our Canadian index. Although the price of oil (WTI) rose more than 7% in 2018, Canadian oil (WCS) is slow to materialize this price growth. This puts significant pressure on Canadian companies in this sector, which have lost nearly 20% in the last 15 months.

Throughout the quarter, we maintained our defensive approach that began at the end of 2017, which allowed us to maintain a performance slightly above that of our benchmark (S&P/TSX). Our overexposure to the energy sector cost us a few basis points, but the quality of the companies held in the portfolio, such as Parkland Fuel Corp or Suncor Energy, has largely offset this, generating an added value of more than 1% against the index. Conversely, our investments in certain companies such as Alimentation Couche-Tard or Canadian National Railway had a negative effect on our performance following bad news during recent quarterly results. However, our trust in these companies remains intact, as their structure and philosophy remain unchanged and we continue to believe that these investments will serve us well in the long term, as they have done so well in the past. While concerns about NAFTA and corporate and consumer debt levels remain, we believe that the Canadian market discount to the S&P 500 is at very low levels and could contribute to an interesting return for the Canadian stock market.

On the American side, unlike its Canadian counterpart, the S&P 500 index started the year in force as it gained more than 7% in the first three weeks of the year, due in particular to the announcement of the tax reform of the American president. Volatility then gained the upper hand, as each sharp decline was followed by a strong rebound, and ultimately ended the quarter on a negative note as a tariff war with China emerged and several technology stocks stumbled. The U.S. index ended the first quarter down 0.25%, but Canadian investors were able to benefit from the weakness of our currency to boost this yield to 2.75%. Only the information technology (3.5%) and consumer discretionary (3.1%) sectors delivered positive returns.

In our last quarterly review, we mentioned that the U.S. market performance came from profit growth rather than multiple expansion, as was the case in past years. In the last three months, these two factors have had the opposite





effect on stock market index performance, and this throughout the world. Indeed, as earnings growth continued, valuation multiples contracted to hurt stock market performance. Investors therefore show signs of caution regarding current index levels and consequently contribute to the volatility of the various stock exchanges. As we expect continued volatility in the coming months, our North American investments will remain focused on stocks with attractive valuation ratios and interesting dividend to limit the risks associated with daily stock market upswings, while generating a current income.

INTERNATIONAL EQUITIES

The gross return for the first quarter of 2018 of the global focused fund and EAFE fund respectively was -1.9% and 0.2% versus a return in Canadian dollar of 1.6% and 1.3% for their respective reference indices. Over the last four years, investors in the global focused fund realized an annualized gross return of 12.8% versus a 11.7% return of the reference index. EAFE fund investors achieved an annual gross return of 11.5% versus 8.0% return of the reference index.

Recently we came across this quote from Pablo Picasso:

"When art critics get together they talk about Form and Structure and Meaning. When artists get together they talk about where you can buy cheap turpentine."

What does that have to do with investing?

In today's media dominated world, financial news is often relayed by self-proclaimed experts (the equivalent of Picasso's art critics) that have an instant opinion on any occurrence in the world. They routinely pretend to anticipate the consequences of events like the outbreak of the Zika virus in Brazil or the impact of the independence movement in Catalonia. What they have in confidence and eloquence, they usually lack in rigor of research and accuracy of past predictions. When was the last time you heard one of these pundits answer a question with "I don't know", the most honest answer in an increasingly complex and messy world.

The good news is that for a focused value investor there is no need to care about all these events in order to achieve satisfying returns in the long run. Similar to Picasso's artist whose main concern is to find cheap turpentine, we are constantly on the hunt for undervalued stocks. It is very important to understand that "undervalued" does not necessarily mean "cheap at first glance". With today's technology and abundance of financial databases it is a trivial task to program a computer in order to find stocks that look cheap at first glance (e.g. low price to earnings ratio). An investor following this strategy would soon learn one of the most important lessons in finance (and many other aspects of life as well): If something looks too good to be true, it most likely is not true.

The main task of every value investor is to separate the seemingly cheap from the really undervalued stocks. Contrary to the above mentioned media pundits, we spend no time forecasting the earnings of the next quarter but focus our efforts on finding out where the company will be in five to ten years' time. If in the meantime markets become overly emotional (as they currently seem to be doing) and present us opportunities to buy these shares with even greater discounts it gets us salivating. As every serious lover of Hamburgers will confirm, the fact that your favorite burger outlet just announced a 50% promotion is a cause for joy and not for worry. We currently have plenty of liquidity available and are starting to see some of our favorite stocks being sold at discount prices. We see this as a cause for cheer and are starting to indulge our sweet touth.

The gross return of the Eterna Quebec Equity Fund was -4.6% for the first quarter of 2018, essentially in line with the Morningstar National Bank Quebec Index and S&P/TSX index, both with a return of -4.5%.

With the high volatility of the markets, we made some portfolio moves during this period. In January, seeing excessively optimistic market sentiment measures, we decreased the more market-sensitive stocks, such as SNC Lavalin, Air Canada, National Bank, Intertape Polymer and UniSelect. In return, we increased positions in more defensive stocks such as BCE, Cogeco, Metro, Saputo and Alimentation Couche-Tard. In February, taking advantage of lower markets (and in particular these stocks), we increased positions in Air Canada and SNC Lavalin. Finally, in March, with more neutral stock market sentiment measures, more attractive valuation measures and medium- and long-term economic outlooks still positive, we reduced our cash balance and changed the composition of the portfolio. We decreased positions in Metro, BCE and Power Financial to increase positions in WSP, Osisko Gold Royalties, CAE and CNR, and also initiated positions in Knight Therapeutics, TFI International and Quebecor.

The main positive contributors during the quarter were Bombardier, CGI Group and Air Canada. Bombardier demonstrated a marked improvement in its profit margin with its fourth quarter 2017 results, particularly in its Transportation division, which supported an increase in its free cash flow. The company's transformation plan is taking shape, giving investors confidence that the company could reach its forecasts for 2018 and 2020. For its part, CGI Group continues to implement its digital strategy and increase the proportion of its sales from software that uses its intellectual property, which have a higher profit margin. The company also continues to improve its balance sheet, which could enable it to take advantage of acquisition opportunities.

The main negative contributions came from Alimentation Couche-Tard, Cogeco Communications, TSO3 and Power Financial. Couche-Tard underperformed, mainly due to lower-than-expected U.S. gasoline margins, affected by hurricanes and higher oil price volatility. The latter also experienced negative organic growth in the United States caused by bad weather. As for Cogeco, the overall decline in the telecommunications sector, combined with lower-than-expected results and prospect of Rogers selling its block of shares in the company, pushed the stock down.

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