ETERNA FINANCIAL GROUP

MARKET REVIEW DECEMBER 2019

STATISTICS on 2019-12-31

CANADA		
Unemploy. rate (Nov.)	5.9 %	↑
C.P.I. (Nov.)	2.2 %	↑
3 months treasury bills	1.66 %	↑
Bonds 5 years	1.69 %	↑
Bonds 10 years	1.70 %	↑
S&P/TSX	17 063	↑
UNITED STATES		
Unemploy. rate (Nov.)	3.5 %	↓
C.P.I. (Nov.)	2.1 %	↑
3 mths treasury bills	1.54 %	↓
Bonds 5 years	1.69 %	↑
Bonds 10 years	1.92 %	↑
Dow Jones - Industrial	28 538	↑
S&P 500	3 231	↑
CURRENCY		
$ É.-U. / $ CAN	0.77	↓
$ É.-U. / € Euro	1.12	↓
¥ Yen / $ É.-U.	108.61	↑

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

ASSET SUMMARY AND ALLOCATION

Performance in 2019 was generous, with a spectacular first-quarter rebound from the worst December on record in 2018. The Canadian S&P/TSX index returned 22.9%, while the U.S. S&P500 increased by 31.5%, or 25.3% in Canadian dollars, considering the loonie's 5% hike. The global market returned 21.6% in Canadian dollars. Over a two-year period, returns were 5.8%, 14.1%, and 9.9% respectively. The American markets had a particularly sharp upturn in the last quarter, as investors were buoyed by decreases in Federal Reserve (FED) rates. Amid a marked global slowdown, the FED cut its rates three more times in the second half of 2019. This led to positive expectations for an upturn, boosting stock markets and driving up the bond yield in the final quarter. However, the rates ended 2019 below the levels at end of 2018, providing positive and significant bond market returns, as reflected in the 6.9% FTSE Canada Universe Bond Index performance. Long-term provincial and corporate bonds posted returns of over 13% for the year. For its part, the Bank of Canada maintained its positions, choosing to wait until economic conditions recovered. For now, the Canadian economy is showing a weak GDP growth rate of 1.2% year-over-year. Strong market performance is also supported by stable inflation in the U.S. at almost 2%, while it decreased elsewhere in the world.

We must reiterate and again highlight trade negotiations with China as a key confidence-building factor. The global economic situation is sluggish, with especially sharp declines in European and Asian manufacturing output, but a recession has been averted. The central banks have responded; the ECB resumed its

- **Economic conditions weakened in 2019; industrial production declined.**
- **Central banks responded; the U.S. Federal Reserve cut rates.**
- **The Bank of Canada decided not to act, but the Canadian economy slowed.**
- **If authorities take timely action, an improvement is possible during the year.**
- **Markets were extraordinarily generous in 2019; we can expect less in 2020.**
- **Excess portfolio liquidity will be reinvested in markets upon correction.**

Market Indices in Canadian Dollars as of December 31, 2019

	3 months	1 year	3 years [1]	5 years [1]
FTSE/TMX - 91 Day Tbill	0.38 %	1.61 %	1.18 %	0.94 %
Bonds				
FTSE Canada Universe Bond Index	-0.85 %	6.87 %	3.57 %	3.18 %
FTSE Canada Short Term Overall Bond Index	0.14 %	3.09 %	1.69 %	1.74 %
Eterna Adapted Private Wealth Index [2]	-0.35 %	4.16 %	2.15 %	2.24 %
FTSE Canada Mid Term Overall Bond Index	-1.08 %	5.76 %	2.85 %	3.00 %
FTSE Canada Long Term Overall Bond Index	-1.93 %	12.71 %	6.56 %	5.18 %
North American Stock Indices				
Canada - S&P/TSX	3.17 %	22.88 %	6.89 %	6.28 %
USA - Standard & Poor's 500	6.90 %	25.25 %	13.91 %	14.20 %
USA - Dow Jones	4.55 %	19.40 %	14.36 %	15.12 %
International Stock Market Indices				
United Kingdom - FTSE-100	8.61 %	16.29 %	7.51 %	6.02 %
France - CAC-40	6.28 %	18.03 %	8.09 %	7.73 %
Germany - DAX	8.12 %	17.75 %	6.00 %	7.00 %
Japan - Nikkei-225	6.52 %	14.77 %	8.78 %	10.85 %
Hong Kong - Hang Seng	6.57 %	4.47 %	7.17 %	5.84 %
Australia - S&P/ASX 200	1.96 %	12.46 %	3.47 %	3.49 %
Currencies				
$ CAN versus $ U.S.	1.90 %	4.74 %	1.13 %	-2.25 %

Source : Bloomberg

1. Annual compounded total return.
2 The Eterna Adapted Private Wealth Index is made up of 60% of FTSE Canada Short Term Overall Bond Index and of 40% of FTSE Canada Mid Term Overall Bond Index

purchasing of securities, as did the FED, which also reduced rates, while the Bank of China slashed reserve requirement ratios. Households in the U.S. are doing well with high savings and low interest rates. Households in Canada, on the other hand, are in debt and seeing modest increases in income. There are no new leading indicators on the horizon for 2020, other than Canada, where this indicator has recently risen. In summary, there are still mixed signals and the slow growth scenario is considered the most likely. While monetary policies are timely, or even better, if they continue, we will likely see an economic upturn during this American election year. There is little room for interest rates to drop much further, and if prospects for a better economic situation appear during the year, they may rise slightly. We are looking at lower returns from all markets in 2020.

Michel Pelletier, Vice-President and Senior Fixed Income Manager
Bobby Bureau, Fixed Income Analyst and Assistant Manager

ECONOMY AND FIXED-INCOME SECURITIES

The last half of 2019 brought a policy shift in central banks. While expectations one year ago were for moderate upward normalization of administered interest rates, primarily for the United States, Canada and Europe, the FED cut rates three times in recent months. It also announced a recovery in securities purchases on the markets, as had the Central Bank of Europe. The change of course was necessary in light of an increasingly soft economy marked by a shrinking global manufacturing sector. Although we are not in a recession, manufacturing output is declining globally. In the euro zone, it has fallen by almost 2.5% over the past year, with decreases in four of the last five months. 2019 has been particularly hard on German manufacturing orders, with production down by more than 5% year-on-year. UK production and construction are also down sharply, further handicapped by the lengthy Brexit saga. Industrial production in India fell by 4% in 2019, and in Mexico, too, production has been drastically reduced.

The slowdown continues in China, where industrial company profits dropped over the 12 months to October. Japan's situation is similar, with a 7.5% drop in manufacturing output over 12 months. In a nutshell, deterioration is global and the U.S. was unable to avoid it. Production in the United States was also down, and the ISM manufacturing index dropped below the 50 mark in July, indicating decreased activity. The number of new orders has also fallen and inventories rose faster than shipments. However, U.S. consumers are in good shape; retail sales remain solid and housing starts have recently picked up again. In fact, the overall real estate sector is still strong, probably sustained by recent interest rate cuts. Corporate profits, however, have not improved, with a 7.3% annualized decline in profits in the third quarter. Total U.S. corporate profits were already adjusted by 3% in 2018. Signals are therefore contradictory, but our neighbours to the south of the border have been growing, albeit at a slower pace.

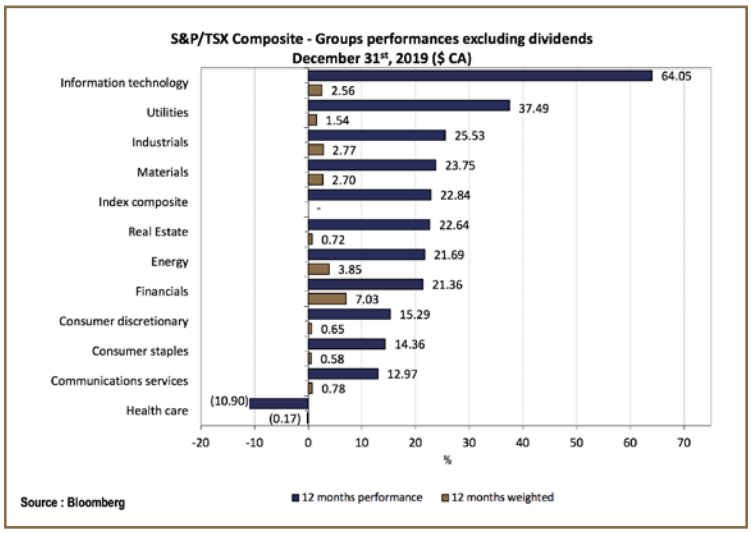
Signals in Canada are just as mixed. Job creation slowed sharply, as the country actually lost jobs in October and November, with manufacturing falling by 2.7% over the 12 months to October. September and October appear to be particularly difficult in Canada, with declining retail sales and new manufacturing orders. The highest level of new orders was in December 2018. Canadian national accounts also showed declining corporate profits in 2019, as they did in 2018. Actual GDP growth was 1.2% as of October. The inflation rate has been under control, fluctuating at around 2%. The Bank of Canada still decided not to follow its counterparts and left its rates unchanged. It should be noted that Canada's leading index has been rising lately, contrary to G7 countries overall. There is a strong focus on uncertainties related to the unfolding trade negotiations with China, although the global trade slowdown dates back several years. As a result, the policymakers are now trying to revive demand with fiscal and monetary policies. Here in Canada, we know the new Government will continue to run high deficits over the next few years. It's the same situation south of the border, where 2020 is an election year. On monetary policy, except in Canada, the central banks reversed their position and the effects may well be felt over the course of the year. We are encouraged, among other things, by the recent rise in the money supply. While bond interest rates finished 2019 lower than they were last year, the fourth quarter showed an increase in interest rates. Investors are heartened by the changing tone of central banks. Continuing the cycle now seems to be the prevailing view. Interest rates still remain low and the search for returns continues, favouring provincial, municipal and corporate securities, which all outperformed the federal government in 2019. Looking ahead, 2020 is as uncertain as 2019, with a number of key factors pointing in the opposite direction. It remains to be seen whether the FED moved quickly enough to avoid an even greater deceleration and whether the Bank of Canada made a mistake by staying put. For now, there are no indications of interest rate hikes any more than there are indications of interest rate stability. The most likely scenario is a very slow continuation of the cycle. But if the policies are timely and successful, conditions should improve over the year and the cycle will break its own longevity record.

In this context, our fixed-income strategies support active term management in a limited interest rate environment and maintenance of our credit positions. We prefer municipal bonds and maintaining corporate risk in the short term, as the valuation of these securities doesn't justify ongoing risks.

Michel Pelletier, Vice-President and Senior Fixed Income Manager
Bobby Bureau, Fixed Income Analyst and Assistant Manager

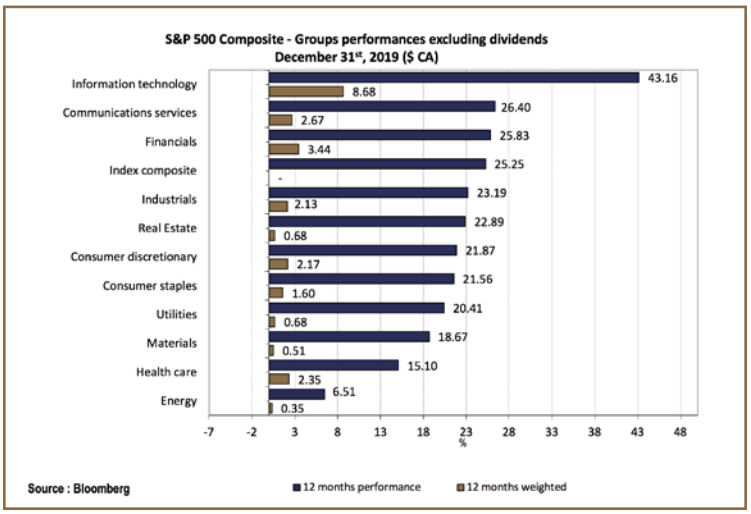
NORTH-AMERICAN EQUITIES

The Canadian stock market is clearly in a similar sequence of quarters. The S&P/TSX Index has continued the momentum of the last three quarters, with a total return of 3.2% for the last three months of 2019. Information technology stocks were once again the strongest performers with 10.8% quarterly return. The materials (7.8%), energy (7.1%) and industrial (5.2%) sectors, which account for a more substantial weighting in the index, were close behind. Conversely, the healthcare (-5.9%), consumer staples (-3.9%), real estate (-2.4%) and discretionary (2.3%) sectors failed to keep pace with the total Canadian index. For 2019 as a whole, investors in the S&P/TSX Index posted an impressive return of 22.9%. However, over half of the increase was in the first quarter, which followed a decrease of more than 10% in the last three months of 2018. Technology companies significantly outperformed the index with a 64.1% return. Interestingly, the sector with the second strongest performance was Utilities (37.5%), particularly recognized for predictable cash flows and appealing dividend yields. Other sectors, such as Consumer Staples (14.4%), Discretionary (15.3%) and Telecommunications (13.0%), delivered strong absolute returns, but were still well below the overall index. Only one sector, Healthcare (-10.9%), failed to deliver shareholder value in 2019. This sector's decline is closely linked to cannabis companies, most of which fell by more than 25%.



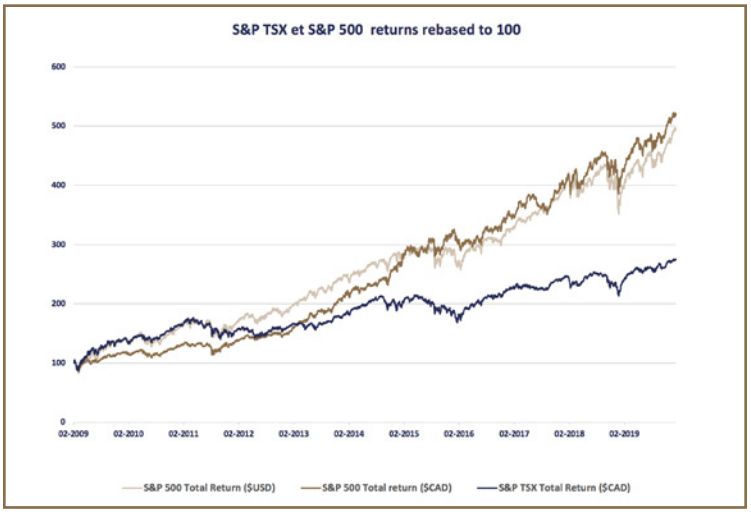
During the first nine months, the Canadian index appeared to be in good shape for outperforming its American counterpart. However, the U.S. S&P500 Index muddied the waters during the last quarter by returning 6.9% in Canadian dollars. The healthcare (12.1%), technology (12.1%) and financial services (8.3%) sectors, all important in the U.S. index, were key contributors to this performance. Only utilities and real estate sectors had negative returns of -1.2% and -2.5%, respectively. Thus, the S&P500 delivered a 25.3% gain in 2019, driven by a positive contribution across all sectors, a vast majority of which generated returns exceeding 20%.

With a loss of confidence in late 2018, 2019 proved to be an unusual year for North American equities. Declining interest rates from the U.S. Federal Reserve (FED), undervaluation of securities and perceptions that the U.S. would resolve its trade tensions all pushed equities upward this year. As a consequence, stock markets are now entering a new decade with slightly less tailwind than in 2019. With the fears of a recession or slower growth, 2020 is likely to be another positive year, but with many surprises and twists. The market increase over the last year is primarily the result of increasing multiples.



A rebound in profit growth during the year will be critical to maintain the upward momentum. Consensus is that investors anticipate stocks will continue to rise over the coming year. However, even the most optimistic analysts forecast a weaker performance, significantly below what 2019 delivered. Meanwhile, we will continue to pursue our equity investments in view of low bond returns and continued easing of the FED's monetary policy. The low interest rates are a benefit to equities and will create a positive market backdrop in 2020. Several factors, however, will generate volatility in 2020. Politics is expected to be at the forefront and the November presidential election will be a key factor. A great deal of market reaction will hinge on the Democratic candidate running against Trump. Investors will be closely scrutinizing the candidate's political and economic plans.

We saw a slowdown in corporate profit growth last year. This could rebound with the clarity of the U.S.-China trade front. The uncertainty created by trade tensions is putting a damper on investment, though spending and productivity could rebound in 2020 as tensions subside. The recent rally of North American equities is supported by a profit recovery scenario, a steeper yield curve and a consistent recovery in value-oriented stocks. This favours three heavyweights in U.S. market capitalization: Technology, Healthcare and Financial.



The sectors that are highly responsive to commodity prices, Energy and Materials, are likely to remain behind. Stock prices in these sectors respond better to inflationary rallies and higher interest rates, a situation which is not our main scenario at the moment. However, the geopolitical events of recent months and renewed tensions in the Middle East suggest the energy sector could make a short-term breakthrough. The tensions will keep putting upward pressure on prices, but over the longer term, the increase in oil prices will primarily come out of global growth.

We will continue to concentrate our various strategies on companies with high dividend yields. It is our belief that dividend-paying companies provide stability and a higher long-term yield. A dividend policy requires corporate leadership to exercise discipline and can help to align interests of management and investors. We understand that this may result in underperformance relative to benchmarks during boom times. Conversely, these companies generally provide more protection when markets are less generous.

Jean Duguay, Senior Manager and Co-Chief Investment Officer
Eric Warren, Portfolio Manager

INTERNATIONAL EQUITIES

In 2019 the gross returns of the Eterna Global Equity Focus Fund, the Eterna International Equity Fund and the Eterna American Equity Fund were respectively 17.59%, 23.10% and 18.98%. Over the last six years investors in these funds respectively realized an annualized gross return of 10.69%, 9.00% and 12.29%.

The beginning of a new decade gives us the opportunity to look beyond the daily humdrum of noise and chatter, and to look at the bigger picture. An avid consumer of news outlets can be forgiven for feeling depressed about the states of affairs on this planet. It feels like an endless series of catastrophes, scandals and disasters. However, reality could not be different.

Progress is all around us. Statistics show that over the past decades humans worldwide have become longer lived, healthier, safer and richer. At the end of last year, the New York Times observed:

> *"Every single day in recent years, another 325,000 people got their first access to electricity. Each day, more than 200,000 got piped water for the first time. And some 650,000 went online for the first time, every single day.*
>
> *Perhaps the greatest calamity for anyone is to lose a child. That used to be common: Historically, almost half of all humans died in childhood. As recently as 1950, 27% of all children still died by age 15. Now that figure has dropped to about 4%."*

But this progress is not noticed by most people because they don't consult statistics; they read media headlines.

Media conceals progress, because their clients, the readers, crave for sudden events rather than gradual trends. Sudden events tend to be bad: an earthquake, a shooting, an epidemic, a financial collapse. Most things that are good happen gradually and comp¬ound over time, such as the elimination of poverty and disease or increases in productivity or margins of an enterprise.

Amos Tversky and Daniel Kahneman were among the first to observe that people dread losses more than they appreciate gains. This guarantees an eager and loyal clientele for the predictions of doomsday prophets of all kinds. However, these pundits are not statisticians who diligently study and adjust historical trends but manipulators who trigger our innate loss aversion with exaggerated tragedies and horror stories.

Who does not remember the dire predictions resulting from the depletion of oil and minerals, a devastating Y2K bug, arsenals of weapons of mass destruction from Saddam Hussein and a worldwide Ebola outbreak? All of them non-events, as we know today.

Here is a simple insight that forms the philosophical underpinning of our investment style:

> *In the long run, advances in science, technology and the spread of reason will benefit the living standards of increasing parts of humanity and the sales and profitability of companies who cater to them directly or indirectly. The most lucrative way to participate in these advances is to own equities in quality companies for long periods of time.*

We concur with Warren Buffett who observed that «Babies born today are the luckiest crop in history» and wish you a happy and prosperous new decade.

Markus Koebler, Vice-president and Senior Global Equity Manager