ETERNA FINANCIAL GROUP

QUARTERLY REVIEW SEPTEMBER 2020

SUMMARY AND ASSET ALLOCATION

The financial markets maintained their momentum over the summer. North American stock market indices are up, as are bond market indices. The Toronto Stock Exchange S&P/TSX Canadian Index generated a third-quarter return of 4.7%. The U.S. S&P 500 index posted a return of 8.9% in U.S. dollars, representing 6.5% in Canadian dollars and reflecting the Loonie's strong performance during the quarter. In the fixed income sector, the FTSE Canada Universe Bond Index reported a total return of 0.4%, with corporate bonds leading the way. Assets are underpinned by the massive liquidity pumped into the economy and markets by central banks.

Statistics hint at a comparatively robust recovery in activity following deconfinement in May and June, but recent months have shown some softening of this recovery. The employment situation worldwide is still a serious concern. While unemployment rates are falling, the number of recipients of government assistance is at a historical high, particularly in the United States, with 25 million in September. In Canada, CERB is being converted to unemployment insurance in October. It remains to be seen how households will adjust to the new environment. With a second wave of COVID-19 on the horizon, it is unlikely that recovery will be as quick as some had hoped.

There has been little change in our strategies. We are confident about our selection of securities and anticipate little change in interest rates. However, uncertainties surrounding the pandemic, North American politics and the performance of financial markets are far too great for us to make a decision regarding 2021. However, we are confident that the worst is over.

- **Financial markets performed well during the summer, with stock and bond indices rising steadily.**
- **Deconfinement led to a spectacular second-quarter upturn in activity.**
- **Markets are operating smoothly, and U.S. Federal Reserve and Bank of Canada support programs have not been fully utilized.**
- **Governments are spending unprecedented sums of money to support households and businesses. How far can it stretch with a second wave of COVID-19?**
- **The next few months will indicate the actual recovery compared to the impact of deconfinement.**
- **Stock market indices are boosted by the so-called GAFA+ stocks (Google, Amazon, Facebook, Apple, Microsoft, Tesla). The others are still weak, and several securities represent good long-term values.**
- **We are optimistic that our sector strategies and security selection will prove successful over the long term.**

STATISTICS ON SEPTEMBRE 30, 2020

CANADA		
Unemploy. rate (August)	10.2 %	↓
C.P.I. (August)	0.1 %	
3 months treasury bills	0.13 %	↓
Bonds 5 years	0.36 %	↓
Bonds 10 years	0.56 %	↓
S&P/TSX	16,121	↓

UNITED STATE OF AMERICA		
Unemploy. rate (August)	8.4 %	↓
C.P.I. (August)	1.3 %	↑
3 mths treasury bills	0.09 %	↓
Bonds 5 years	0.28 %	↑
Bonds 10 years	0.68 %	↓
Dow Jones - Industrial	27,782	↓
S&P 500	3,363	↓

DEVISES		
$ USA / $ CAN	0.75	↑
$ USA / € Euro	1.17	↑
¥ Yen / $ USA	105.48	↑

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

ECONOMY AND FIXED-INCOME SECURITIES

The summer's bond market returns were positive. In the third quarter, the FTSE Canada Universe Bond Index was up 0.4%, bringing its year-to-date advance to 8.0%. The quarter was highlighted by outperforming corporate securities, with medium-term securities (maturities between 5 and 10 years) posting the best results. The yield curve rallied slightly over the summer, as rates on 30-year federal bonds moved ahead of shorter-term bonds. This is a reflection of investors' expectations of continued economic recovery and increased government deficits in the longer term. In contrast, central banks were again quite clear about their commitment to flexibility and no increase to interest rates until inflation exceeds 2% on a sustained basis. Many have concluded that administered rates will not change before 2022, if not 2023! This means we have to contend with floor rates for some time to come. Not surprisingly, in this context, investors are taking on more risk and increasing their exposure to corporate bonds. The rush for returns is very real. For now, inflation is not a major threat.

The statistics released over the summer clearly illustrate the rebound in activity that followed deconfinement. Retail sales in both Canada and the U.S. returned to higher levels compared to the beginning of the year. Industrial production also increased sharply. Residential real estate is still extremely strong, indicating low inventory of single-family dwellings as households tend to prefer the suburbs and telecommuting. A potential structural shift may be underway. Currently, the residential sector is driving the economy. However, the service sector is still depressed, hampered by health restrictions. While employment recovered during the summer, unemployment and those receiving exceptional government assistance is at an all-time high. In the United States in September, there were nearly 25 million people benefiting from these measures. Historically, it takes two to three years, and sometimes longer, to recover from job losses during a recession. Patience will be required.

This recession differs greatly from previous ones, in that it is promoted by governments in the context of a pandemic. A number of sectors do not appear to have been affected, while others are in crisis. These include hospitality, catering, tourism, culture and transportation. We are likely experiencing a transfer of wealth in the economy. The coming quarters will reveal consumer and business capacity without government support, as these programs will not last forever. Crisis-induced debt and government support will have to be addressed in the future. Devoting resources to debt will not guarantee vigorous growth without a demographic boom. A higher tax burden is almost inevitable.

Looking to the immediate future, the worst seems to be behind us, although the next few months could be tricky. U.S. banks are already tightening credit criteria for commercial and industrial loans similar to 2008 levels. In terms of relative growth, the U.S. is expected to fare somewhat better, as it entered the crisis with one of the best household balance sheets in recent decades. Indeed, U.S. households carried little debt and enjoyed solid savings relative to disposable income. The Canadian picture differs, as consumer debt has been a concern over the past several quarters. The most likely economic scenario for the coming quarters is a slow, perhaps uneven recovery with low inflation and low interest rates.

In this context, our bond strategies are still centred on overexposure to short- and medium-term municipal bonds for holding to maturity. We also increased our weightings in corporate bonds during the summer to capitalize on wider credit spreads. At quarter-end, we reduced the portion of this long-term exposure following an excellent performance in this sector. For now, the terms of our active strategies are likely to swing between neutral to longer maturities relative to benchmarks, but we realize that there is room for a shift in the medium- to long-term maturities in the coming quarters. Uncertainties remain high because of the pandemic, not to mention the American political context, which could lead to volatility.

Michel Pelletier, Vice-President and Senior Fixed Income Manager

Bobby Bureau, Fixed Income Analyst and Assistant Manager

NORTH AMERICAN STOCK MARKET

With the rapid onset of a second wave, markets continued their momentum for the majority of the summer. While the first two months of the quarter were outstanding, September was the first negative month since last March's debacle. Even with the recent slump, the Canadian S&P/TSX Global Index returned 4.7% for the past three months, while the S&P 500, its U.S. counterpart, posted 6.5% in Canadian currency. In Canada, while health care (-14.3%) and energy (-8.1%) continue to lose ground in 2020, the performance disparity among other sectors was much narrower in the summer than in the second quarter. Canadian technology stocks (3.6%) took a secondary role in the last quarter, with industrial (13.6%), utilities (11%), consumer staples (9.1%) and basic materials (9.1%) sectors leading the charge.

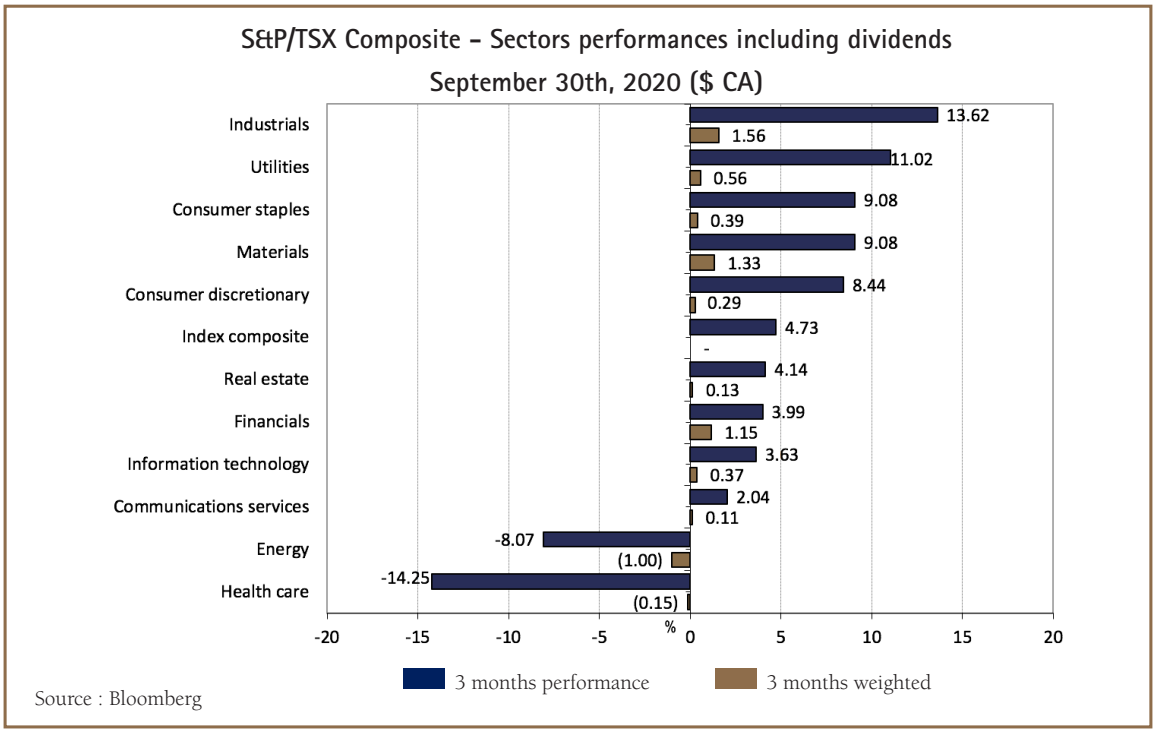
South of the border, the energy sector was at the bottom of the pack, with a quarterly loss of nearly 20%, while real estate (2%) and financial (4.4%) sectors delivered significantly lower returns than the overall index. Again, along with the industrial sector (12.5%), consumer discretionary (15.1%), basic materials (13.3%) and technology (12%) sectors posted the best quarterly figures.

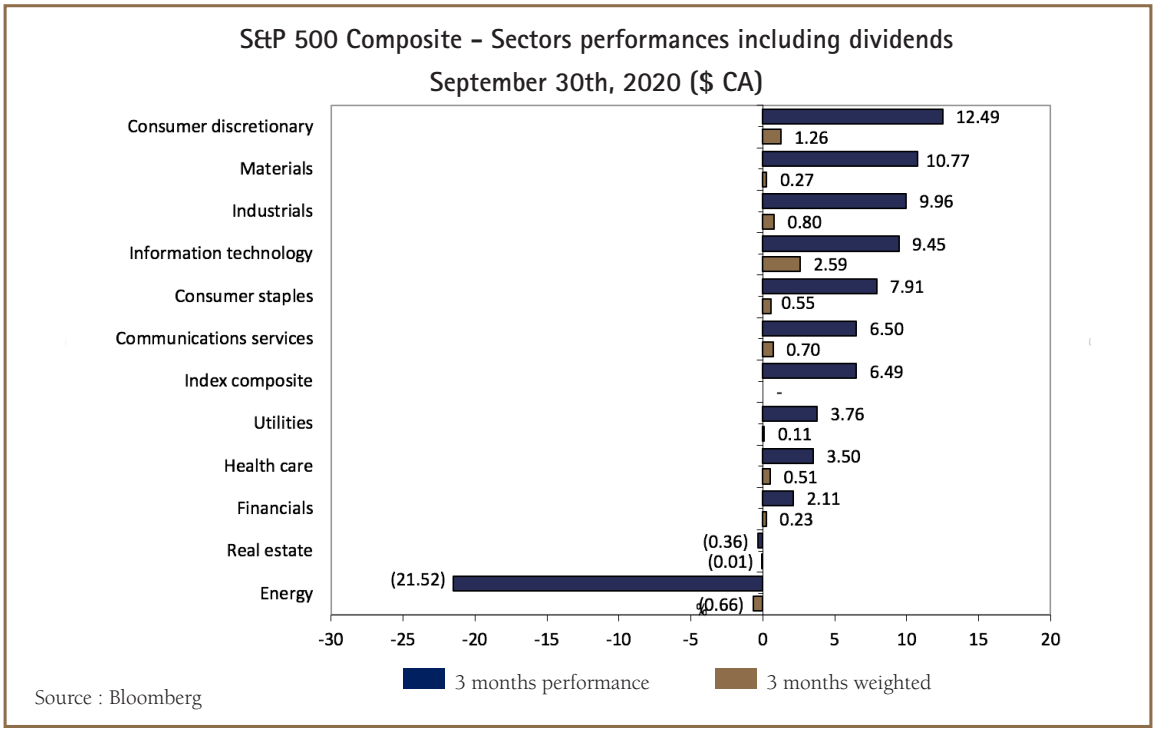
The strong recovery and dominant S&P 500 weighting in technology and consumer discretionary stocks more than offset the March decline in global markets, with the leading U.S. index delivering more than 8% year-to-date returns. On the Canadian side, most of the downturn has also been recovered, with the nine-month loss now only 3.1%. Needless to say, financial and

energy sectors, accounting for more than 38% of the S&P/TSX Index, had a significant negative impact on the total performance, while the currently popular sectors, such as technology and basic materials, were unable to fully offset this impact.

The stock market's recovery from last March's lows suggests to a large majority of investors that the market is overvalued, but the overvaluation is concentrated in very few stocks. Although we expect that a market correction is still possible by year-end, we still believe that the decrease will be limited to securities with recent significant increases. Many companies in the industrial, financial services, energy and communications sectors are valued more in line with current economic conditions. We will be increasing our investments in these sectors once we have a clearer view of the economic situation and the impacts of the resurgence of COVID-19. Moreover, it is important to remember that the elections in the United States will soon influence the direction of the stock exchanges. We remain cautious, but we intend to participate actively in any downturn that we deem temporary.

Jean Duguay, Senior Vice-President, Senior Manager and Co-Chief Investment Officer
Éric Warren, Portfolio Manager





INTERNATIONAL EQUITIES

A cursory look at any newspaper headline these days will be enough to convince even the optimists among us that we are currently experiencing the most testing times in recent history. The uncertainty is palpable with issues including the virus epidemic, a looming recession, upcoming US elections and increasingly violent social polarizations of parts of the population. We remind our readers that risk/uncertainty is a constant ingredient in the life of an investor. What changes it to what degree it is perceived by the investing public. There was a huge amount of risk on December 6, 1941 (the eve of the Pearl Harbor attacks) just as there was on September 10, 2001. The difference to today's situation was the total lack of awareness of it. Only a problem that is known has a chance of being solved.

Andy Grove, the cofounder of the world's largest manufacturer of semiconductors Intel, once said: «Bad companies are destroyed by crisis, good companies survive them, great companies are improved by them.» Great companies benefit from crisis to further improve their competitive position by investing in R&D, marketing und process innovation when weaker competition is forced to aggressively cut cost in order to stay in business. A great business is able to buy back shares in times of crisis when their peers have to issue new securities in order to raise money for survival. We used the last couple of months to systematically review our portfolio given the new realities created by Covid-19. After some adjustments we are confident that our portfolio companies are all well positioned not only to survive this critical juncture but also to prosper in it.

The great historian Will Durant (whose parents emigrated from Quebec to Massachusetts) once observed: "People spend too much time on the last 24 hours and not enough time on the last 6,000 years." His point is that we are too easily spooked by the saliency of what is happening in front of your eyes while forgetting that humanity has successfully faced similar (or even worse) issues many times over in the past. The reason why humans constantly overestimate threats lies in our past. To survive life had to win every day. Death has to win just once. When our life was on the line overestimating threats was a good thing. Evolution made us very risk-averse. However in today's environment, a headline you will never read but which is more adequate most of the time would be "Future usually turns out okay".

While simple numbers or statistics are often more tiresome to consume than lurid tales disseminated by charismatic alarmists they usually give us a better picture than the later. As it turns out, even recessions are not necessarily a bad time to invest in the stock market. Just looking at the numbers we learn that in 8 out of the past 15 recessions stocks were actually positive during the duration of those economic slowdowns. In fact, in 6 out of these past 15 recessions, stocks were up double digits. Let's remember this the next time we see a grisly headline in a newspaper.

Markus Koebler, Vice-president and Senior Global Equity Manager

Market Indices in Canadian Dollars as of September 30, 2020

	3 months	YTD	1 year	2 years[1]	5 years[1]
FTSE/TMX - 91 Day Tbill	0.06 %	0.83 %	1.25 %	1.47 %	1.00 %
Bonds					
FTSE Canada Universe Bond Index	0.44 %	8.00 %	7.08 %	8.38 %	4.26 %
FTSE Canada Short Term Overall Bond Index	0.73 %	4.80 %	4.94 %	4.65 %	2.27 %
Eterna Adapted Private Wealth Index [2]	0.86 %	6.62 %	6.25 %	6.32 %	3.00 %
FTSE Canada Medium Term Universe Bond Index	1.06 %	9.40 %	8.22 %	8.86 %	4.08 %
FTSE Canada Long Term Overall Bond Index	-0.32 %	10.99 %	8.85 %	12.89 %	6.94 %
North American Stock Indices					
Canada - S&P/TSX	4.73 %	-3.09 %	-0.03 %	3.46 %	7.16 %
USA - Standard & Poor's 500	6.49 %	8.28 %	15.76 %	11.13 %	14.00 %
USA - Dow Jones	5.79 %	1.64 %	6.26 %	6.45 %	13.87 %
International Stock Market Indices					
United Kingdom - FTSE-100	-2.14 %	-20.34 %	-13.48 %	-7.19 %	0.02 %
France - CAC-40	-0.81 %	-13.97 %	-8.56 %	-4.72 %	2.34 %
Germany - DAX	5.65 %	2.64 %	10.97 %	4.01 %	6.59 %
Japan - Nikkei-225	3.91 %	3.07 %	9.79 %	3.13 %	8.48 %
Hong Kong - Hang Seng	-6.11 %	-14.21 %	-8.58 %	-6.36 %	2.26 %
Australia - S&P/ASX 200	0.33 %	-8.89 %	-7.10 %	-2.26 %	3.30 %
Currencies					
$ CAN versus $ USA	-1.89 %	2.53 %	0.59 %	1.58 %	0.01 %

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.

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