Third Quarter 2014 – "The Land of Opportunity"

North American Economy Shines While the Old World Economy Declines

The Team:

Brian Steele, CA, CPA, CFA

Laura Prust, CPCA

Jeannine Campbell

Kelly Edmonds

Matthew Bell, CFA

U.S. economic activity is at a cycle high; European and Asian activity is near cycle lows

- The S&P/TSX Composite Total Return Index lost 0.6% during the 3rd quarter of 2014.

- The "North America centric" sectors, Consumer Staples, Industrials, Health Care, IT, Consumer Discretionary, Financials and Utilities, led the TSX Composite Index in the quarter while the "foreign centric sectors", Energy, Materials and Telecom, trailed.

- Oil prices fell sharply in the quarter, ending at an 8 month low of $91 (WTI) after hitting a 1 year high of $108 in June. De-escalation of the crises in Ukraine and Iraq, weakening economic growth in Europe and Asia and a spike in Libyan oil production resulted in a tilt toward excess supply.

- Growth divergences between the developed world and emerging markets have continued to widen, driven by strength in the U.S. and contraction in China. U.S. economic activity currently sits at a cycle high with the ISM Manufacturing and Non-Manufacturing Purchasing Manager's Indices (PMIs) sitting at 42 and 80 month highs, respectively, in August. The Canadian economy continues to struggle, but thanks to the economic strength of its #1 trading partner, Canada is experiencing a 1 year high in economic activity as measured by the RBC PMI.

- The Chinese economy appears to be losing steam after several years of mini-stimulus packages have failed to instigate any momentum in an economy with unparalleled industrial and housing market overcapacity. August marked the fourth straight month of property market price declines in China. As housing and housing related activities amount to roughly 20% of Chinese GDP and with China registering the worst housing affordability on the planet, particularly in the major cities of Beijing and Shanghai, this is a worrying but not unexpected trend. In response to a growing anxiety, Chinese policymakers injected $81 billion (USD) into Chinese banks to help stimulate lending in September and will likely need to continue stimulating demand to meet its 7.5% annual GDP target over the coming years.

- In early September, in response to poor economic and inflation data, the European Central Bank (ECB) lowered its main interest rate to 0.05% (from 0.15%) and its deposit rate to -0.2% (from -0.1%), expanded its LTRO program and announced a new quantitative easing program wherein it will purchase European asset-backed securities and covered bonds. Though the announcement disappointed some investors who were looking for American-style quantitative easing, the market responded favourably and marked the ECB's willingness to support the European economy and price levels. In mid-September, Scotland rejected independence in a referendum vote. Several other regions in Spain, Italy and Belgium are lobbying for independence. Rising separatist sentiment poses a challenge to policymakers across Europe as it potentially limits the menu and effectiveness of policy tools.

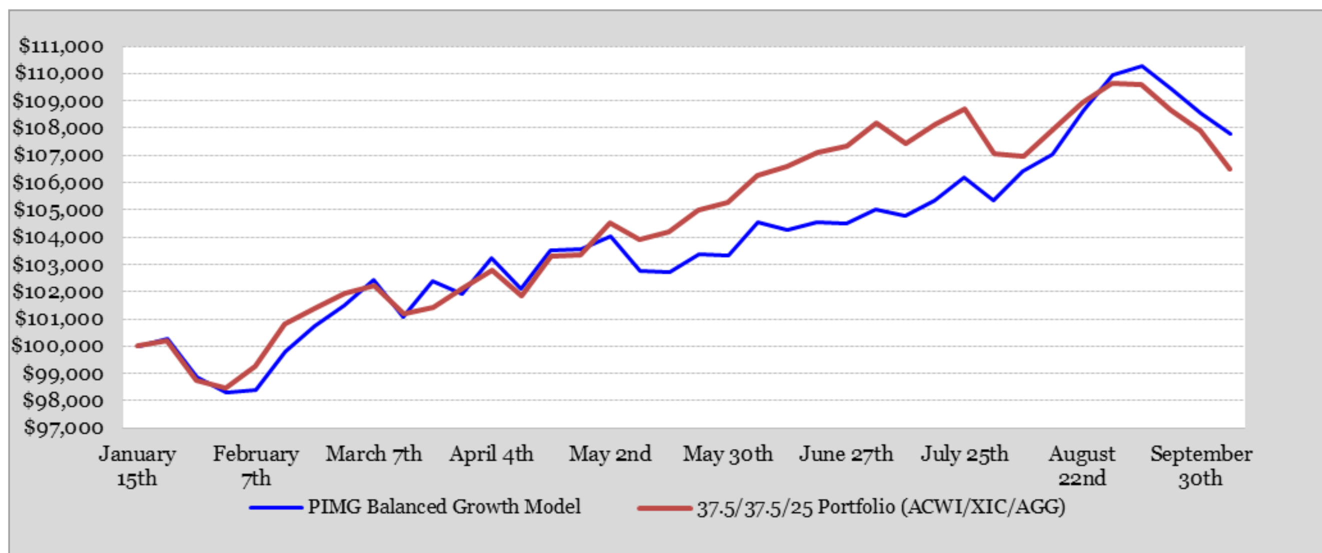
- The U.S. Federal Reserve (Fed) continued to taper its bond purchases, falling to $15 billion annually from $35 billion at the end of Q2. With its bond buying program nearing completion, it is widely expected that the Fed will begin to raise rates in 2015 assuming no change to the economic outlook. The U.S. dollar index recently hit a 14-month high as investors bet on a near-term rise in U.S. interest rates and a near-term decline in interest rates or additional stimulus measures in other major economies (Europe, China and Japan).

Benchmark of iShares XIC/ACWI/AGG (37.5%/37.5%/25%)

vs

The PIMG Balanced Growth (BG) Model

January 15th, 2014 (Inception of BG Model) to September 30th, 2014



01/15/2014 – 09/30/2014	PIMG Balanced Growth Model	37.5% XIC / 37.5% ACWI / 25% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	7.77%	6.48%	10.58%	4.07%	3.73%
Compound Annual Return	Insufficient Data – Minimum of 1 year required				
Standard Deviation					
Sharpe Ratio					
Largest Monthly Gain	4.16%	3.53%	3.97%	5.20%	1.18%
Largest Monthly Loss	-1.68%	-1.50%	-0.46%	-4.23%	-0.25%
Number of Up Months	6	6	6	6	5
Number of Down Months	3	3	3	3	4
Correlation with Balanced Growth	--	0.81	0.76	0.73	-0.36

We have assumed a 1% performance fee when calculating the returns for our PIMG models. To the best of our knowledge, the ETFs used as benchmarks track the indices they represent though material tracking error and misrepresentation can occur which is beyond our control. The 37.5% XIC / 37.5% ACWI / 25% AGG index is an index consisting of 37.5% iShares XIC (S&P/TSX Compositie Index ETF), 37.5% of iShares ACWI (All-Country World Index ETF) and 25% iShares AGG (Barclays Aggregate Bond Fund). Volatility and correlation data are calculated from weekly returns. For the purpose of calculating Sharpe ratios, a risk-free rate of 3% is assumed. All returns presented for the PIMG Models and the ETFs used for comparison are in Canadian dollars. Data used to calculate returns are derived from Market-Q (for ETFs) and Dataphile (for the Models). All returns presented are "total returns", meaning they include all dividend payments & interest payments.

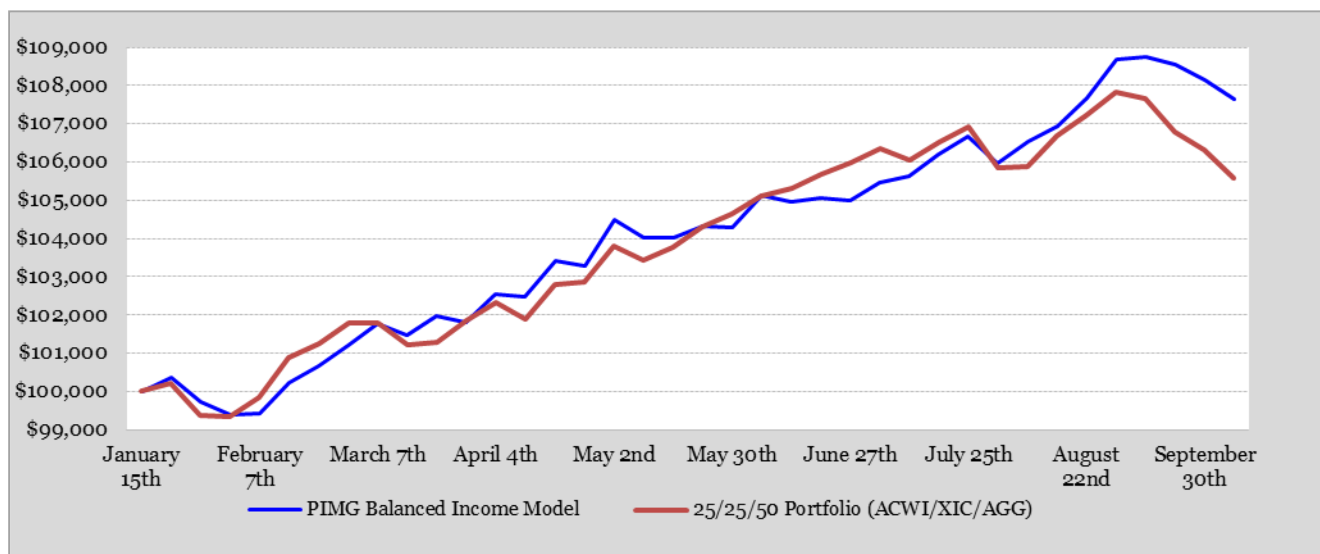
On January 15th, 2014, we materially changed the strategy and holdings of the Tactical Taxable (now Balanced Growth) model. As a result, past performance and benchmark data is not meaningful to the model as it currently stands. The data above are for the January 15th, 2014 to September 30th, 2014 period.

Benchmark of iShares XIC/ACWI/AGG (25%/25%/50%)

vs

The PIMG Balanced Income (BI) Model

January 15th, 2014 (Inception of BI Model) to September 30th, 2014



01/15/2014 – 09/30/2014	PIMG Balanced Income Model	25% XIC / 25% ACWI / 50% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	7.64%	5.59%	10.58%	4.07%	3.73%
Compound Annual Return	Insufficient Data – Minimum of 1 year required				
Standard Deviation					
Sharpe Ratio					
Largest Monthly Gain	2.15%	2.48%	3.97%	5.20%	1.18%
Largest Monthly Loss	-0.61%	-0.65%	-0.46%	-4.23%	-0.15%
Number of Up Months	7	6	6	6	5
Number of Down Months	2	3	3	3	4
Correlation with Balanced Income	--	0.78	0.77	0.69	-0.23

We have assumed a 1% performance fee when calculating the returns for our PIMG models. To the best of our knowledge, the ETFs used as benchmarks track the indices they represent though material tracking error and misrepresentation can occur which is beyond our control. The 25% XIC / 25% ACWI / 50% AGG index is an index consisting of 25% iShares XIC (S&P/TSX Compositie Index ETF), 25% of iShares ACWI (All-Country World Index ETF) and 50% iShares AGG (Barclays Aggregate Bond Fund). Volatility and correlation data are calculated from weekly returns. For the purpose of calculating Sharpe ratios, a risk-free rate of 3% is assumed. All returns presented for the PIMG Models and the ETFs used for comparison are in Canadian dollars. Data used to calculate returns are derived from Market-Q (for ETFs) and Dataphile (for the Models). All returns presented are "total returns", meaning they include all dividend payments & interest payments.

On January 15th, 2014, we materially changed the strategy and holdings of the Tactical Registered (now Balanced Income) model. As a result, past performance and benchmark data is not meaningful to the model as it currently stands. The data above are for the January 15th, 2014 to September 30th, 2014 period.

PIMG Balanced Growth Model

Gained 3.51% during the quarter (from July 1st to September 30th)

The model's asset allocation as of September 30th was 7.5% cash, 9.6% bonds, 2.4% convertible debentures, 12% preferred equity, 4.3% alternatives and 64.2% common equity.

Top five outperformers in Q3 were:

- Tim Hortons (Consumer Discretionary/Food & Beverage) at +35.15%
- Canadian Tire (Consumer Discretionary/Retail) at +12.58%
- TransForce (Industrials/Transportation) at +10.60%
- International Business Machines (Technology/Diversified) at +10.36%
- iShares U.S. Health Care ETF (ETF/Health Care Sector) at +10.07%

Top five underperformers in Q3 were:

- Sandvine (Technology/Network Hardware) at -23.06%
- Baytex Energy (Energy/Diversified Oil, Non-Oil Sands) at -11.13%
- Horizons Seasonal Rotation ETF (ETF/Alternative) at -2.37%
- Algoma Central (Industrials/Shipping) at -1.63%
- Rogers Communications (Telecom/Diversified) at -1.31%

During Q3, we bought:

- Tim Hortons (THI): We established a position in Tim Hortons with proceeds from our Saputo sale. At the time of purchase, THI was attractive trading at 20x trailing earnings, a slight premium to McDonalds but a discount most other peers, and was experiencing same store sales growth of ~2% annually when many of its competitors were experiencing sales declines. THI's product offering continues to expand and most products have been received favourably by customers, particularly the new sandwich offerings. We believed THI was at an inflection point as it same store sales picked up steam and its product offering looks attractive enough to drive store traffic.

- Progressive Waste Solutions (BIN): We established a position in Progressive Waste as the sector was beginning to heat up and Progressive stock had been lagging that of its peers. BIN and its key competitors (Waste Management and Republic Services) had beat earnings estimates two quarters in a row and pricing in the waste management sector appeared to be trending upward. BIN is expected to see meaningful earnings growth starting in the second half of 2014 as new contracts commence. BIN's strong free cash flow should allow for meaningful dividend increases and/or stock buybacks over the coming years. The widespread improvement in the waste management sector may instigate increased acquisition activity which could benefit BIN.

- Brookfield Asset Management Preferred Z (BAM.PR.Z): We established a position in Brookfield AM Preferred Z as it should provide a solid return with little volatility over the next 3.25 years. BAM.PR.Z has a yield-to-retraction (soft) of 3.5%. BAM.PR.Z has a high reset rate

of the 5 year Government of Canada bond rate plus 2.96% and thus has a high chance of being called at its reset date on December 31st, 2017.

During Q3, we sold:

- Saputo (SAP): We sold our position in Saputo due to its high valuation of 25x trailing earnings. Saputo's historical earnings growth rate is only ~5%, about the market's earnings growth rate. To justify its current valuation, Saputo would need to grow at a 10% rate for several years, something we view as implausible for a company of its size in the dairy business. Although we like the stability of the business and Saputo's prospects for overseas expansion, we would need to see its valuation drop by roughly 20% before we became interested again.

- Tim Hortons (THI): We sold our entire position in Tim Hortons in three tranches. The first tranche was sold following a superb quarterly earnings release wherein THI detailed that its same store sales growth rate rose to 2.6% in Canada and 5.9% in the U.S. (versus expectations of 1.4% and 2.3%, respectively). THI had become an outsized position and we wished to reduce the risk associated with this position. The second tranche was sold following the announcement that Burger King was preparing an offer to buy Tim Hortons. THI stock rose sharply on the news and we sold to reduce the risk associated with the position should the rumour turn out to be false. The final tranche was sold following the announcement that Burger King would officially offer to buy Tim Hortons. We are disinterested in owning the combined entity as its valuation is quite lofty considering the declining brand value of the Burger King franchise in North America.

- Pason Systems (PSI): We sold part of our position in Pason in two tranches as it valuation had become lofty. We purchased Pason when it traded at a fair valuation for a high growth oil and gas services stock with no debt of 25x trailing earnings and believed it could eventually attain a technology company valuation of 30-50x earnings. Pason has grown its earnings rapidly since we've owned it and its valuation has risen slightly to 28x trailing earnings. We trimmed our position as Pason's stock price had been fairly steady despite the Energy sector selloff. Due to the fall in oil prices, oil and gas companies may slow or delay their purchases of Pason's systems and services. That said, we wish to maintain a small position as we believe Pason has plenty of growth ahead of it, irrespective of oil price volatility.

- Baytex Energy (BTE): We sold part of our position in Baytex as it had become an oversized positon within the model.

- Consolidated Water Co (CWCO): We sold our position in Consolidated Water following one neutral and two negative quarterly earnings releases. CWCO trades at a rich valuation based on current earnings and unless its earnings can rebound to levels seen at our time of purchase, we see little upside for the stock. We were unclear on the direction of the company's earnings and stock and we have been waiting to opportunistically sell the positon at the right price. Toward the end of the quarter, when we grew increasingly skeptical of the equity market rally, we were presented with the opportunity to sell out of our CWCO at a fair price.

- Chemtrade Debenture Maturing March 31st, 2017 (CHE.DB): We sold our position in the Chemtrade Debenture as the debenture now trades hand-in-hand with the underlying stock and the underlying stock had been particularly strong for a stock with indirect exposure to the Materials and Energy sectors. We see little in the way of upward momentum for Chemtrade stock considering the downward momentum in the Chinese economy and commodity markets.

PIMG Balanced Income Model

Gained 2.52% during the quarter (from July 1st to September 30th)

The model's asset allocation as of September 30th was 0.7% cash, 19.4% bonds, 14.1% convertible debentures, 16.3% preferred equity, 4.4% alternatives and 45.1% common equity.

Top five outperformers in Q3 were:

- Tim Hortons (Consumer Discretionary/Food & Beverage) at +35.15%
- Great-West Lifeco (Financials/Insurance) at +7.75%
- Fortis Inc (Utilities/Diversified) at +7.61%
- Enbridge Inc (Utilities/Pipelines) at +6.58%
- Progressive Waste Solutions (Industrials/Waste Management) at +5.91%

Top five underperformers in Q3 were:

- Crescent Point Energy (Energy/Light Oil) at -13.07%
- Horizons Seasonal Rotation ETF (ETF/Alternative) at -2.37%
- H&R REIT Debenture H (4.2 Yr Debenture) at -1.48%
- WSP Global (Industrials/Diversified Engineering) at -1.46%
- Calloway REIT Debenture B (2.7 Yr Debenture) at -1.32%

During Q3, we bought:

- WSP Global (WSP): We established a position in WSP Global as it is expected to become a dividend growth leader over the next couple of years after it fully digests the Focus and WSP acquisitions. WSP has room to boost its operating leverage and make accretive acquisitions as it has successfully done in the past. Subsequent to our purchase, WSP announced it will acquire Parsons Brinkerhoff (PB), which will transform the company into a truly global diversified pure-play engineering company. PB provides WSP with greater exposure to the fast growing U.S. market and provides WSP with a highly complementary transportation and infrastructure engineering business. Following this purchase, we are even more enthused about owning WSP as its valuation can now shift to that of a global company with a more stable earnings profile.

- Tim Hortons (THI): Same reasoning as the Balanced Growth Model.

- Progressive Waste Solutions (BIN): Same reasoning as the Balanced Growth Model.

- Artis REIT Debenture F Maturing June 30th, 2020 (AX.DB.F): We established a position in Artis Debenture F as it provides a strong baseline yield with optionality on the underlying stock. At the time of purchase, this debenture had a yield-to-maturity of 4.5% and was 3% in

the money. We are bullish on the underlying stock due to the company's high industrial real estate exposure and the ongoing "re-shoring" of North American industry.

<u>During Q3, we sold:</u>

- Saputo (SAP): Same reasoning as the Balanced Growth Model.

- North West Company (NWC): We sold our position in North West as the company posted two consecutive earnings misses which indicated virtually no growth year-over-year. The stock continued to trade at 18.5x trailing earnings and we believe a stock that is not growing should trade at a lesser valuation.

- Tim Hortons (THI): Same reasoning as the Balanced Growth Model.

Going Forward:

In contrast to the second quarter, equity markets saw plenty of volatility and finished the quarter relatively flat. This type of market, one that is flat or up slightly, is perfectly suited to our strategy and as a result, the models outperformed. Our performance got a boost from the quick return realized on our Tim Hortons purchase, the risk reduction measures taken leading into the seasonally weak period of September-October as well as our limited exposure to the highly cyclical Energy and Materials sectors, both of which significantly underperformed the broad market during the quarter. We continue to see the equity markets as richly valued and that a defensive stance is most appropriate. Several bubbles exist in some market segments (e.g. internet and biotech stocks) and the broad equity market is at least somewhat overvalued so the equity market rally remains vulnerable to correction in our opinion.

The ECB's attempts to stymie the decline in Eurozone economic activity have been underwhelming and appear incomplete. Without a "shock and awe" gesture on behalf of the ECB, we are concerned that the Eurozone will continue to experience economic decline and the deflationary pressure will again ignite another European debt crisis, and possibly a global banking crisis. Should investors lose faith in the Eurozone again, it would likely mean they have also lost faith in the ECB and its ability to prevent the decline and/or dissolution of the Eurozone. We have avoided and continue to avoid stocks that have exposure to Eurozone markets.

The models benefitted once again from an above average exposure to the Industrials sector. The Industrials sector is "North America centric" and we believe it can outperform for an extended period as the North American economy looks healthy and strong relative to the rest of the world. We continue to be bearish on the Energy and Materials sectors, firstly because we believe the commodity supercycle is over, primarily due to the winding down of China's economy, and secondly because commodity-linked stocks appear to have gotten ahead of their underlying commodities, for the time being. The Financials sector has performed well recently, but we believe it is running out of steam as its valuation appears historically stretched relative to interest rates.

In mid-September, we tactically reduced our equity positions in our Balanced Growth model, raising our cash balance to over 7% from less than 1%, in preparation for potential market weakness. We will ride out the often volatile months of September and October and reinvest the cash when we feel the time is right. We favour the Consumer Discretionary, Consumer Staples, Industrials, Telecom and Utilities sectors but will consider adding to the Energy and Financials sectors should they experience material price declines.

As at the end of Q3, the models yield 2.7% (Balanced Growth) and 3.7% (Balanced Income) from 2.8% and 3.7% at the end of Q2, compared to the S&P/TSX Composite at a 2.4% dividend yield.

Sincerely,

Steele Wealth Management

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