RAYMOND JAMES | Steele Wealth Management

Fourth Quarter 2014 – "Drowning in Oil"

Oil Prices Plummet As OPEC Rejects Supply Cut Restoring the U.S. As Top Dog

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Oil Price Drop Boosts Markets of Oil Importers and Hurts Exporters

- The S&P/TSX Composite Total Return Index lost 1.5% during the 4th quarter of 2014.
- The more consumer-oriented sectors, Consumer Staples, Health Care, IT, Consumer Discretionary, Financials, Telecom, Industrials and Utilities, led the TSX Composite Index in the quarter while the more business-oriented sectors, Energy and Materials, trailed.
- The decline in oil prices accelerated in Q4, ending at a five and a half year low of $53 (WTI), down from $91 at the end of Q3. Lower than expected oil demand due to perpetually weakening economic growth in China and Europe as well as acutely lower than expected GDP growth in oil producing states led to major revisions in the IEA's oil demand forecasts. The IEA expects oil supply to exceed oil demand until at least Q3 2015, and with oil in storage at multi-year highs, it is likely that oil prices will remain lower for longer. It is important to note that the potential recovery in Iranian production is not incorporated in the IEA's forecasts and low oil prices may force Iran to produce more oil to improve its budgetary situation. If Iranian sanctions are lifted and Iran produces close to capacity, it could add another 2-3 million barrels per day in production. This would likely have a lasting effect on oil prices, especially if OPEC sticks with its position to not intervene in oil markets.
- We expect divergences between oil producing states and oil consuming states to surface. The U.S., European, Chinese and Japanese economies should see improvement while the Russian, Middle Eastern, Venezuelan, Canadian and Australian economies should struggle.
- Though lower oil prices may cause regional recessions in oil producing U.S. states like Texas and North Dakota, lower oil prices should benefit the broad U.S. economy, which still imports ~30% of its oil needs. Canada, a major oil exporter, will see its economy stagnate as recession or stagnation in the oil producing provinces of Alberta, Saskatchewan and Newfoundland are offset by higher growth in the manufacturing-heavy provinces of Ontario and Quebec.
- The European economy has stabilized temporarily at a low rate of economic growth and inflation. Lower oil prices may provide a jolt to economic growth and increase longer term economic growth potential. That said, the situation in Europe is tumultuous as always as Greece heads to the polls in January. Currently leading in the polls is Syriza, a far-left party whose platform is to reverse the austerity measures imposed on Greece in conjunction with its historic bailout program. If Syriza seizes control, investors will once again question the permanence of the Eurozone, potentially sparking another Eurozone crisis.
- Following a sales tax increase, Japan slipped into recession in Q3. In reaction to the news of recession, the Bank of Japan unleashed more stimulus and PM Shinzo Abe delayed a second sales tax hike scheduled for 2015 and called and subsequently won a snap election to consolidate power and provide him with more time to spark growth and inflation in Japan.
- Conditions mirror those that existed just prior to the 1998 Russian debt default. The Russian economy is in freefall as the dual impact of Western sanctions and falling oil prices have caused a credit crunch and forced the Russian central bank to raise interest rates to 17% (from 10.5%) to defend the Ruble, which is down over 50% on the year, as well as bail out several important state companies. The decline in oil prices has the potential to send Russia, Venezuela and potentially Iran into political and social chaos as it has so many times before.

PIMG Model Benchmarking Disclosures

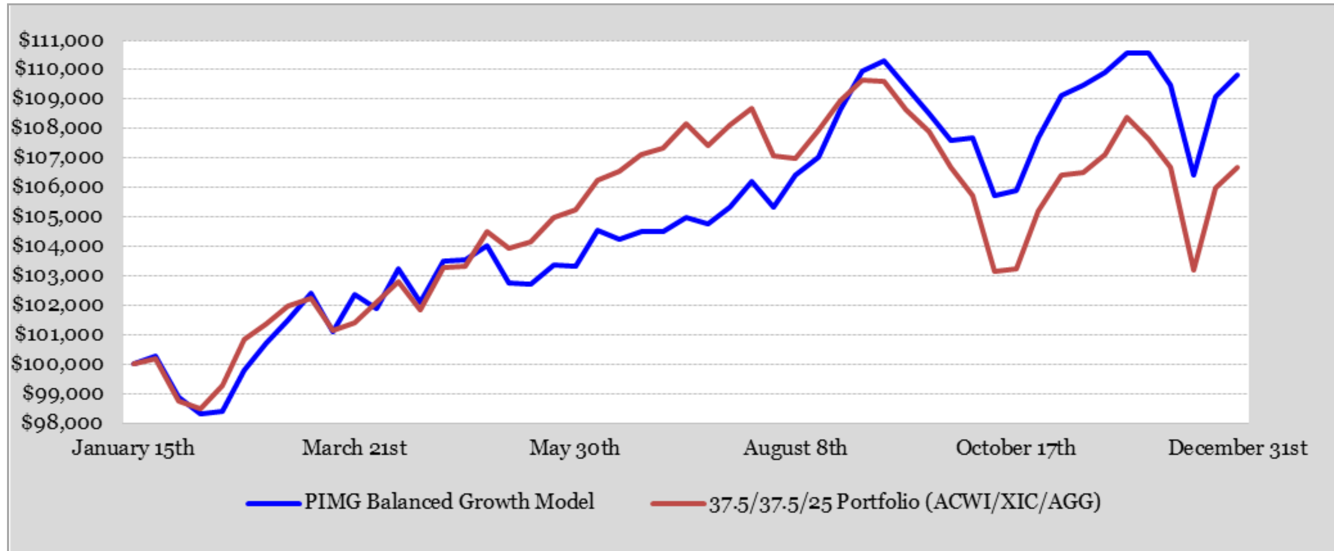
- The numbers presented on the following two pages reflect those of our two models, Balanced Growth and Balanced Income. As a client of Steele Wealth Management, you may or may not have your account linked to one or both of these models. In our discussions prior to signing your PIMG documentation, we outlined which model(s), if any, your accounts would be linked to. If you are unsure whether your account is linked to one or more of these models, please let us know and we can clarify this for you.
- Model returns presented are those of two individual accounts whose returns 100% reflect that of the model's holdings and transactions and are not impacted by deposits or withdrawals that could impact return calculations. The accounts we use to reflect model performance incur a 1% annual investment management fee, charged monthly, which is also subject to 13% HST, charged monthly, for a total cost of 1.13% annually. Your individual account performance may deviate from the model account based on any differences in fees charged relative to the model account, differences in account holdings relative to the model account as well as any deposits or withdrawals made throughout the reporting periods outlined.
- **On January 15th, 2014, we materially changed the composition of our two model portfolios.** We renamed our Tactical Taxable and Tactical Registered models to Balanced Growth and Balanced Income and made major changes to model allocations and exposures. The Tactical Taxable and Tactical Registered models were invested in 80%-85% common equity and 15%-20% preferred equity and our exposure was virtually 100% in Canadian dollars and Canadian companies. The Balanced Growth model has an asset allocation of ~75% common equity and ~25% fixed income, of which half is invested in preferred equity, and roughly 40% exposure to non-Canadian securities. The Balanced Income model has an asset allocation of ~50% common equity and ~50% fixed income, of which a third is invested in preferred equity, and roughly 30% exposure to non-Canadian securities. With these changes, our two models now reflect a more universally appropriate choice, in terms of asset allocation and risk, for the vast majority of our clients and investors in general. As a result, we expect these new models will remain in force for the foreseeable future.
- As a result of the model changes outlined above, we also changed our benchmarks to reflect the new asset allocations and exposures. Benchmark information is detailed in the disclosures at the bottom of the following two pages.

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 December 31st, 2014



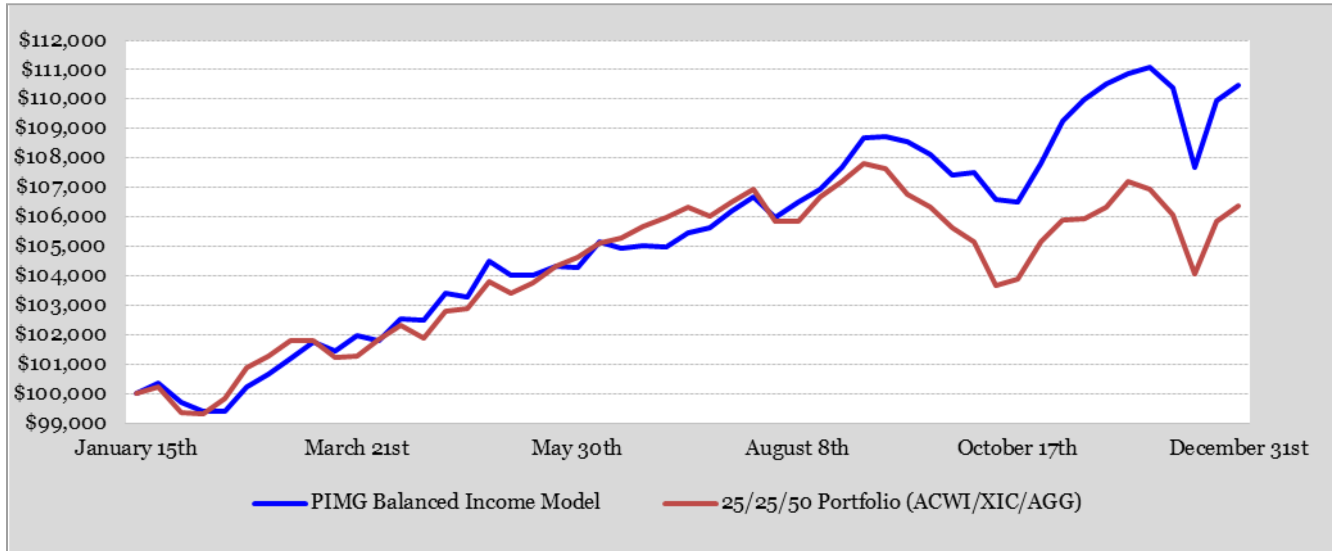
01/15/2014 – 12/31/2014	PIMG Balanced Growth Model	37.5% XIC / 37.5% ACWI / 25% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	9.84%	6.69%	9.45%	4.23%	5.81%
Compound Annual Return	Insufficient Data – Minimum of 1 year required				
Standard Deviation					
Sharpe Ratio					
Largest Monthly Gain	4.16%	3.53%	3.97%	5.20%	1.18%
Largest Monthly Loss	-1.98%	-2.94%	-4.12%	-4.23%	-0.61%
Number of Up Months	8	7	7	8	7
Number of Down Months	4	5	5	4	5
Correlation with Balanced Growth	--	0.89	0.84	0.81	-0.44

PIMG Balanced Growth Model	3 month	6 month	9 month	12 month	3 year	5 year	10 year	Inception
	1.72%	4.33%	6.52%	n/a	n/a	n/a	n/a	9.84%

We have assumed a 1% investment management fee plus 13% HST 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.

Benchmark of iShares XIC/ACWI/AGG (25%/25%/50%)
vs
The PIMG Balanced Income (BI) Model

January 15th, 2014 (Inception of BI Model) to December 31st, 2014



01/15/2014 – 12/31/2014	PIMG Balanced Income Model	25% XIC / 25% ACWI / 50% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	10.49%	6.38%	9.45%	4.23%	5.48%
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	-0.96%	-2.17%	-4.12%	-4.23%	-0.61%
Number of Up Months	9	8	7	8	7
Number of Down Months	3	4	5	4	5
Correlation with Balanced Income	--	0.87	0.85	0.77	-0.38

PIMG Balanced Income Model	3 month	6 month	9 month	12 month	3 year	5 year	10 year	Inception
	2.58%	4.77%	7.80%	n/a	n/a	n/a	n/a	10.49%

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.

PIMG Balanced Growth Model

Gained 2.03% during the quarter (from October 1st to December 31st)

The model's asset allocation as of December 31st was 4.2% cash, 9.5% bonds, 2.3% convertible debentures, 10.3% preferred equity, 7.4% alternatives and 66.3% common equity.

Top five outperformers in Q4 were:

- Progressive Waste Solutions (Industrials/Waste Management) at +19.95%
- Sandvine (Technology/Network Hardware) at +18.05%
- Performance Sports Group (Consumer Discretionary/Branded Sports Goods) at +16.15%
- iShares U.S. Consumer Services (ETF/Consumer Discretionary) at +14.20%
- AMC Networks (Consumer Discretionary/Media) at +13.33%

Top five underperformers in Q4 were:

- Legacy Oil + Gas (Energy/Light Oil) at -61.41%
- Baytex Energy (Energy/Diversified Oil, Non-Oil Sands) at -52.68%
- Pason Systems (Energy/Oilfield Technology Services) at -19.74%
- International Business Machines (Technology/Diversified) at -12.22%
- Fairfax Preferred I (Preferred Share/Fixed Reset) at -6.08%

During Q3, we bought:

- Legacy Oil + Gas (LEG): We purchased a partial position in Legacy after oil broke below $90 and as Legacy shares approached an all-time low. Legacy is one of the lowest cost oil producers in Canada and trades at a major discount to its larger peers, making it an attractive potential takeover target for light oil producers Crescent Point Energy or Baytex Energy.

- Suncor Energy (SU): We purchased a partial position in Suncor during oil's historic decline. Suncor has exposure to some of the best-in-class oil sands projects based on production costs and reliability. Further, we believe Suncor's downstream gas bar business is undervalued by the market and that Suncor could extract significant value if this asset was monetized. We see our investment in Suncor as being the safest way to play the oil market currently as the stability of its gas bar business offsets the declining profitability of its oil extraction business.

- iShares U.S. Consumer Services ETF (IYC): We purchased a full position in iShares IYC at the beginning of the seasonally strong period of the U.S. consumer discretionary sector. The start of this seasonally strong period plus the positive effect that lower oil prices will have on U.S. consumers' finances point to an inordinately strong seasonally strong period for this sector.

- AGF AlphaSector Class (AGF5030): We purchased a full position in AGF AlphaSector in two tranches. AGF AlphaSector provides equal-weight exposure to the U.S. equity market via ETFs and is designed to provide downside protection in periods of high volatility and price declines. AlphaSector should diversify the models' strategy providing more stable returns, help reduce ultimate model drawdown in the event of a market downturn and in turn reduce expected model volatility. This fund is highly complementary to our current strategy.

- Bank of Nova Scotia (BNS): We purchased a full position in Bank of Nova Scotia as it traded at a ~20% discount to its larger peers, Royal Bank of Canada and TD Bank, and a ~10%

discount to smaller peers Bank of Montreal and CIBC. BNS typically trades at a slight discount to larger peers and slight premium to smaller peers. BNS shares have been penalized lately due to poor performance at its Caribbean and Latin American operations but we believe the decline in oil prices will boost tourism and banking activity in many of these economies allow BNS to trade at its historic valuation.

- Enbridge Preferred N (ENB.PR.N): We purchased a partial position in Enbridge Preferred N as it traded near an all-time low and at a yield-to-call of over 5%. We wished to buy a full position of this security but were unable to do so at an acceptable price.

- Enbridge Preferred F (ENB.PR.N): We purchased a partial position in Enbridge Preferred F as it traded near an all-time low and at a yield-to-call of about 5%. We wished to buy a full position of this security but were unable to do so at an acceptable price.

During Q3, we sold:

- iShares U.S. Health Care ETF (IYH): We sold our position in iShares IYH at the end of its seasonally strong period. Strong seasonal performance and a high valuation were enough to convince us to sell and move to greener pastures.

- iShares U.S. Utilities ETF (IDU): We sold our position in iShares IDU at the end of its seasonally strong period. Strong seasonal performance and a high valuation were enough to convince us to sell and move to greener pastures.

- Horizons Seasonal Rotation Class ETF (HAC): We sold part of our position in Horizons HAC as we wished to allocate more of our "alternative asset dollars" to AGF AlphaSector instead. HAC has relatively high management costs and since we use seasonality as part of our investing strategy, we believed exposure to HAC was mostly redundant. We have retained a small position in HAC and will divest these shares when we require funds to invest in new opportunities.

- Progressive Waste Solutions (BIN): We sold half of our position in Progressive due to high valuation. BIN was purchased when it traded at a ~10% discount to its larger peers, Waste Management and Republic Services, and it now trades at a ~10% premium to its larger peers. Momentum in the waste sector appears to be waning which could impact Progressive's ability to grow as expected. We wish to hold onto some BIN as it remains the fastest growing and highest margin waste management company and there is still plenty opportunity for further earnings momentum.

- Pason Systems (PSI): We sold the rest of our position in Pason after having sold the bulk of the position in the previous quarter. We sold Pason in the middle of the oil market rout as we believed it was unfair for Pason, an energy services company, to trade at ~25x trailing earnings and cash flow while many energy producers with similar market caps were trading at 2-3x cash flow. As Pason caters mostly to the North American fracking sector, which should contract meaningfully in a low oil price environment, Pason's earnings and valuation could decline significantly.

- Dundee Corp Preferred B (DC.PR.B): We sold our position in Dundee Corp Preferred B as we grow concerned about the credit quality of the underlying company, Dundee Corp. Dundee

Corp's assets are almost entirely made up of real estate, stakes in energy companies and projects and stakes in precious metals companies and projects. Since 2012, gold market weakness has impaired many of Dundee Corp's assets. During the 2014 oil market rout, Dundee Corp fell further, declining over 40% from August to December. Though we are not worried about imminent failure, we worry that Dundee Corp's credit quality would come into question if the Canadian real estate market began to experience profound weakness. Acting early, we were able to sell this position at a fair price. We were doubly exposed to Dundee Corp through our ownership of both Dundee Corp Preferred B and Dundee Corp Preferred C. We will continue to hold Dundee Preferred C as it only has 18 months until retraction (i.e. maturity) and as Dundee Corp has no long-term debt we are confident Dundee Corp will survive until then.

PIMG Balanced Income Model

Gained 2.91% during the quarter (from October 1st to December 31st)

The model's asset allocation as of December 31st was 1.9% cash, 19.1% bonds, 13.5% convertible debentures, 14.6% preferred equity, 6.8% alternatives and 44.1% common equity.

Top five outperformers in Q4 were:

- Progressive Waste Solutions (Industrials/Waste Management) at +19.95%
- Fortis Inc (Utilities/Diversified) at +13.46%
- BCE Inc (Telecom/Diversified) at +12.54%
- Enbridge Inc (Utilities/Pipelines) at +12.09%
- Agrium Inc (Materials/Fertilizer) at +11.33%

Top five underperformers in Q4 were:

- Crescent Point Energy (Energy/Light Oil) at -31.72%
- H&R REIT Debenture H (4.2 Yr Debenture) at -2.03%
- Artis REIT Debenture F (5.5 Yr Debenture) at -1.87%
- WSP Global (Industrials/Diversified Engineering) at -1.47%
- AGF Floating Rate Income Fund (Mutual Fund/Floating Rate Notes) at -0.50%

During Q3, we bought:

- AGF AlphaSector Class (AGF5030): Same reasoning as the Balanced Growth Model.

- Fairfax Preferred C (FFH.PR.C): We purchased a full position in Fairfax Preferred C after it broke down to an all-time low despite the other Fairfax preferred shares trading within historical ranges. We believe that the shares have a high reset rate and in a normal interest rate environment have a high probability of being called. We expect that we can attain a five-year return of ~7%, which is the security's yield-to-call.

- Enbridge Preferred N (ENB.PR.N): Same reasoning as the Balanced Growth Model.

- Enbridge Preferred F (ENB.PR.N): Same reasoning as the Balanced Growth Model.

During Q3, we sold:

- Horizons Seasonal Rotation Class ETF (HAC): Same reasoning as the Balanced Growth Model.

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

- Dundee Preferred B (DC.PR.B): Same reasoning as the Balanced Growth Model.

- Fairfax Preferred K (FFH.PR.K): We sold our position in Fairfax Preferred K to fund the purchase of Fairfax Preferred C. The odds were high that Fairfax Preferred K would experience price weakness and Fairfax Preferred C would experience price strength due to the differences in yield between the two securities. Fairfax Preferred K had a yield-to-call of ~4% at the time versus Fairfax Preferred C at ~7%.

Going Forward:

As detailed before, the models are designed to outperform in flat to down markets and did just that in Q4, resulting in total model outperformance of 3.15% and 4.11% in 2014. Our underweight position in the Energy and Materials sectors was the primary reason for outperformance. In the Balanced Growth model, we started the quarter ~50% underweight Energy and Materials and ended the quarter ~30% underweight Energy and 50% underweight Materials. The Balanced Income model was 70-90% underweight Energy and Materials throughout the quarter. Despite the rapid decline in stock prices and seemingly better valuations, we believe these sectors will remain under attack due to the breadth of the commodity supply glut, slowing commodity demand growth as a result of tepid economic growth and the potential start of a long-term trend in U.S. dollar strength.

Inflation expectations are falling. The oil price decline combined with near zero growth in the Eurozone, a recession in Japan and declining growth in China all put downward pressure on inflation expectations. Falling inflation expectations arouse worries about global economic growth, even growth of the U.S. economy, currently the cleanest of dirty shirts. Also weighing on inflation expectations is the concern over the Greek snap election scheduled for late January. If Syriza wins, and if Greece and the EU cannot come to terms, investors could have to deal with the possibility of Greece leaving the EU which is bound to produce acute deflationary pressure on the European and world economies as well as global financial stress and contagion. As seen in Q4, bond markets have rallied pushing yields toward all-time lows while broad equity markets have performed well. We believe either the bond market or the equity market is wrong and either the bond market rally will reverse course or equity markets will decline to catch up with the decline in bond yields.

As a result of above average valuations and deflationary pressures, we doubt equity markets will perform extraordinarily well in the coming year. We therefore wish to maintain an equity allocation that is a on the lower end of our allocation range and risk tolerance. The companies that we believe will perform best in the upcoming year are those that should benefit from lower oil prices including Algoma Central, TransForce, Sysco, Canadian Tire, iShares IYC, Performance Sports Group and Progressive Waste. As we believe oil prices could remain depressed for a prolonged period, we will continue to look to invest in companies that will see benefits from lower oil prices. As a result we will naturally tilt towards U.S. equity exposure as most U.S. stocks are oil consumers rather than oil producers. We believe investors will flock to oil consuming names in early 2015 as the concept of $50 oil becomes entrenched in the minds of investors.

We don’t expect to make any major changes to the models’ allocations or holdings in the near-term as we are well positioned to avoid much of the heightened market volatility and take advantage of the low oil price environment.

As at the end of Q4, the models yield 2.4% (Balanced Growth) and 3.8% (Balanced Income) from 2.8% and 3.7% at the end of Q3, compared to the S&P/TSX Composite at a 2.6% dividend yield.

Sincerely,

Steele Wealth Management

The information contained in this report was obtained from sources believed to be reliable, however, we cannot present that it is accurate or complete. Information has been sourced from the RJL Bond Desk or RJ Private Client Solutions, unless otherwise noted. Index and sector returns represented in this commentary are measured using the S&P/TSX Total Return Index and S&P/TSX GICS Sector Indices as detailed in Raymond James Ltd.'s *Insights & Strategies: Quarterly Edition*. This report is provided as a general source of information and should not be considered personal investment advice or solicitation to buy or sell securities. The views expressed are those of the author and not necessarily those of Raymond James Ltd. (Member Canadian Investor Protection Fund).

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