RAYMOND JAMES | Steele Wealth Management

Second Quarter 2016

"Investors Head for the Brexit, Sort Of"

Markets Steady Aside from the Brexit Vote Which Helped Provide Near-Term Stimulus and Long-term Uncertainty

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Brexit Referendum Dominates the Headlines and Puts Central Banks on Hold

- The S&P/TSX Composite Total Return Index gained 5.1% during the 2nd quarter of 2016.

- The energy, materials, and utilities sectors led the S&P/TSX Composite Index in the quarter while the consumer discretionary, consumer staples, financials, health care, industrials, information technology and telecom sectors trailed.

- The S&P/TSX Composite continued its outperformance versus the S&P 500 in the second quarter, making up much of the relative losses experienced in late 2015. The Canadian equity market outperformed the S&P 500 by 2.6%, driven mostly by gains in energy and gold stocks.

- The price of oil was ~US$48 (WTI) at end of trading on June 30, up ~26% from the end of the first quarter and up ~85% from the 12-year low of ~$26 hit in mid-February. Oil prices were buoyed by supply disruptions in Canada and Nigeria. The Fort McMurray wildfire temporarily shut down more than 1.1 million barrels of oil per day from the Canadian oil sands and it is estimated that upwards of 40 million barrels of production will be lost as a result of the wildfire. In Nigeria, militants had been attacking and capturing key oil infrastructure throughout the first half of 2016, successfully taking over 1 million barrels per day of production offline at the peak of violence in late May. Production from Canada and Nigeria has since been fully restored as the wildfire in Fort McMurray has passed and as the Nigerian military and the militants reached a cease-fire agreement. We expect oil supply concerns to resurface and for oil prices to come under pressure in the latter half of 2016.

- On June 23, UK referendum results showed that 52% of United Kingdom citizens voted in favour of the United Kingdom leaving the European Union (EU). Prediction markets had only attributed a 20%-25% chance of this occurrence in the days leading up to the vote. Shortly after the referendum results were released, the British pound fell more than 10% versus the U.S. dollar, UK and European equity futures fell 7%+ and North American equity futures fell 4%+. Equity market weakness continued early into the following week but markets soon recovered as interest rates across the globe hit new lows and the British and European governments threw around the possibility of additional monetary and fiscal stimulus in the coming days and months. As the near-term effects of Brexit are expected to be minimal due to the 2+ year negotiation period with the EU, the near-term environment is positive for the world economy and equities due the immediate effect of much lower interest rates. That said, a Brexit, if followed through with, is expected to have a materially negative effect on the European economies and could create serious problems for Europe's financial system. While broad equity markets rallied to or above pre-Brexit vote levels shortly after the vote, European bank stocks did not, highlighting their fragility in a post-Brexit vote world.

- Prior to the Brexit vote, markets expected one to two U.S. interest rate hikes in 2016, in line with Federal Reserve guidance. Following the vote, markets are predicting no U.S. interest rate hikes until after February 2017. Subsequent to quarter end, the U.S. 10-year Treasury bond yield hit an all-time low, falling below the level seen at the depths of the European sovereign debt crisis in 2012 when the solvency of many large Western economies was in question. The odds of a U.S. rate hike in 2016 are now only ~15% while the odds of an interest rate cut are ~5%. Canadian bond yields have behaved similarly with the 10-year Government of Canada bond yield and 30-year Government of Canada bond yield at ~1% and ~1.65% respectively.

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 fully 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 15, 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.

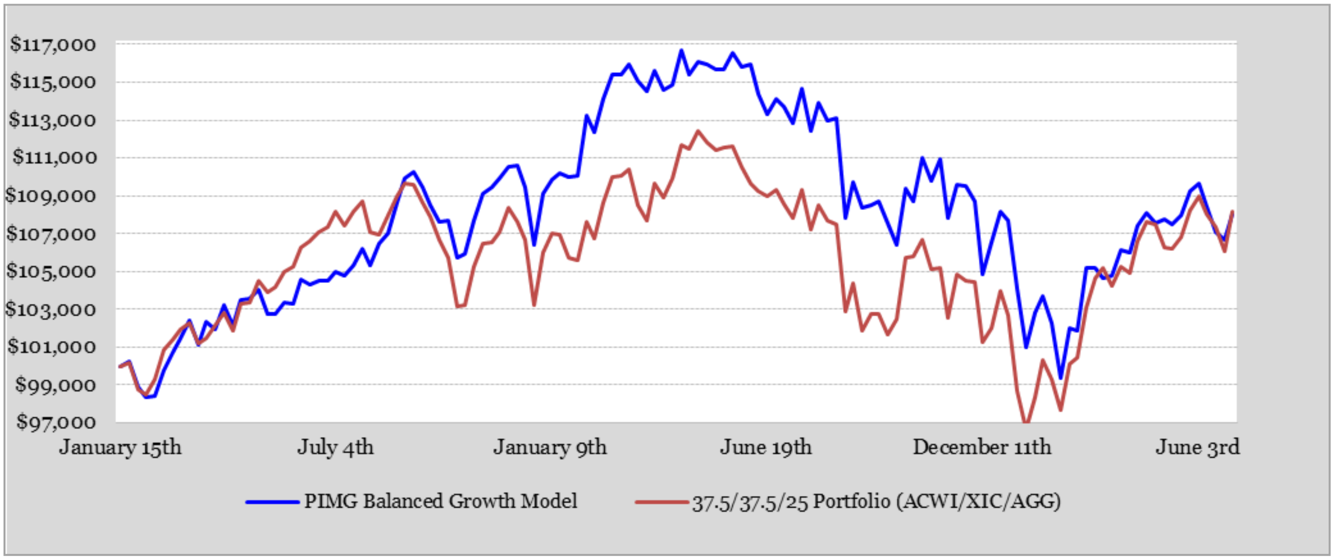
- As a result of the model changes outlined above, we also changed our benchmarks to reflect the new asset allocations and exposures. Benchmark information is detailed in the disclosures at the bottom of the following two pages.

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

vs

The PIMG Balanced Growth (BG) Model

January 15, 2014 (Inception of BG Model) to June 30, 2016



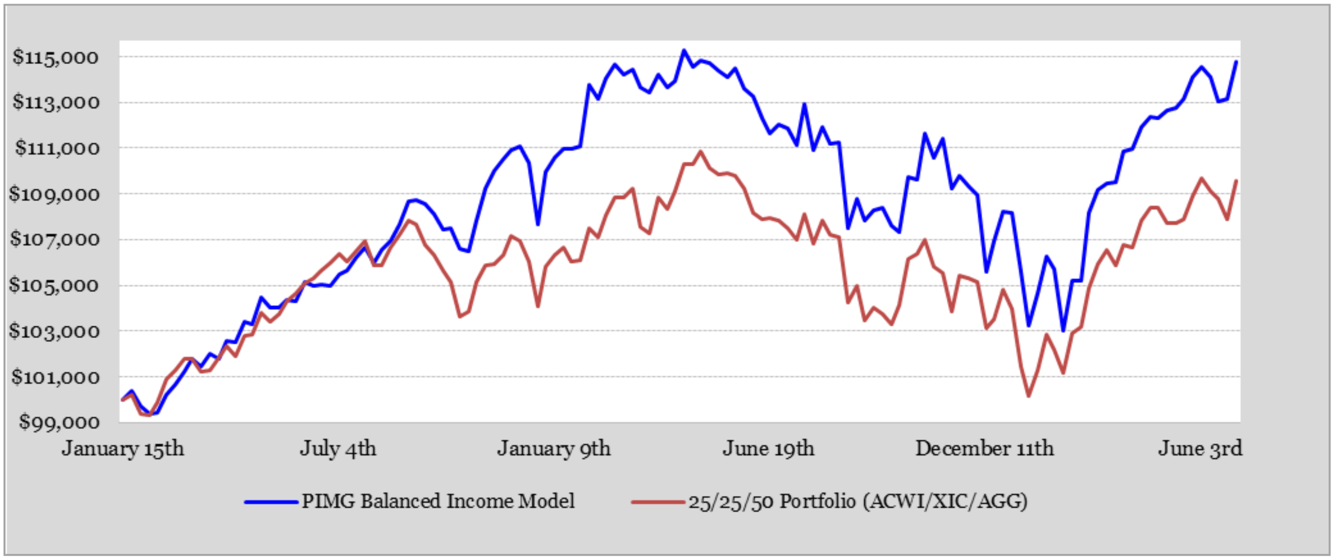
01/15/2014 – 06/30/2016	PIMG Balanced Growth Model	37.5% XIC / 37.5% ACWI / 25% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	8.02%	8.14%	9.73%	2.63%	11.45%
Compound Annual Return	3.18%	3.23%	3.84%	1.06%	4.50%
Standard Deviation	9.39%	9.38%	13.24%	13.83%	3.15%
Sharpe Ratio	0.02	0.02	0.06	-0.14	0.48
Largest Monthly Gain	4.16%	5.04%	5.45%	7.66%	2.22%
Largest Monthly Loss	-3.99%	-4.25%	-4.31%	-6.81%	-1.07%
Number of Up Months	17	17	16	15	18
Number of Down Months	13	13	14	15	12
Correlation with Balanced Growth	--	0.90	0.88	0.83	-0.34

PIMG Balanced Growth Model	3 month	6 month	9 month	12 month	3 year	5 year	10 year	Inception
	1.87%	0.28%	1.28%	-4.38%	n/a	n/a	n/a	3.18%

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. All return numbers beyond 12 months are annualized numbers.

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

January 15, 2014 (Inception of BI Model) to June 30, 2016



01/15/2014 – 06/30/2016	PIMG Balanced Income Model	25% XIC / 25% ACWI / 50% AGG	iShares XIC	iShares ACWI	iShares AGG
Cumulative Return Since Inception	14.77%	9.57%	9.73%	2.63%	11.45%
Compound Annual Return	5.75%	3.78%	3.84%	1.06%	4.50%
Standard Deviation	7.14%	6.09%	13.24%	13.83%	3.15%
Sharpe Ratio	0.39	0.13	0.06	-0.14	0.48
Largest Monthly Gain	4.87%	3.65%	5.45%	7.66%	2.22%
Largest Monthly Loss	-3.06%	-2.95%	-4.31%	-6.81%	-1.07%
Number of Up Months	18	18	16	15	18
Number of Down Months	12	12	14	15	12
Correlation with Balanced Income	--	0.87	0.88	0.81	-0.25

PIMG Balanced Income Model	3 month	6 month	9 month	12 month	3 year	5 year	10 year	Inception
	3.54%	6.11%	6.91%	3.11%	n/a	n/a	n/a	5.75%

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. All return numbers beyond 12 months are annualized numbers.

PIMG Balanced Growth Model

Gained 1.87% during the quarter (from April 1 to June 30).

The model's asset allocation as of June 30 was 8.4% cash, 19.0% bonds, 8.9% preferred equity, 3.3% alternatives and 60.4% common equity.

Top five outperformers in Q2 were:

- Black Diamond Group (Industrials/Remote Workforce Accommodation) at +28.89%
- Corus Entertainment (Telecom/Media) at +15.69%
- Open Text Corp (IT/Enterprise Information Management Software) at +14.45%
- Crescent Point Energy (Energy/Light Oil) at +14.02%
- Russel Metals (Industrials/Metals Distribution) at +11.64%

Top five underperformers in Q2 were:

- Performance Sports Group (Consumer Discretionary/Branded Sports Goods) at -12.50%
- Apple Inc. (IT/Consumer Electronics) at -11.29%
- Algoma Central (Industrials/Great Lakes Shipping) at -8.49%
- Empire Company (Consumer Staples/Grocery Retailing) at -7.42%
- AMC Networks (Consumer Discretionary/Media) at -6.61%

During Q2, we bought:

- Empire Company (EMP.A): We purchased a full position in Empire. Empire was down 38% since early 2015, while its peers L and MRU are up over 10%. Empire traded at 11.2x our analyst's downgraded forecast EPS for the upcoming year compared to Loblaw at 18x and Metro at 17x. While Empire has more western Canadian exposure, the negatives related to this exposure are already baked into our analyst's forecasts. We believe the longer term effects will be minimal due to the nature of the business and expect that Empire should experience full margin recovery within one to three years. We see a 10%-20% discount as reasonable and rational, at least temporarily, but a 33% discount as excessive. We think Empire provides plenty of value and should rebound as Empire continues to execute on its cost cutting plan following the acquisition of Safeway Canada and as investor sentiment improves.

- Power Corp Preferred D (POW.PR.D): We purchased a full position in POW.PR.D with the proceeds of sale from TD.PF.D. We thought it was prudent to reduce fixed reset preferred share exposure and add perpetual preferred share exposure at a time when fixed reset preferred shares were trading well above their all-time lows and interest rates were back near their all-time lows. The yields offered by perpetual preferred shares are attractive and many perpetual preferred shares and POW.PR.D in particular have plenty of capital gains upside should the Canadian preferred share market normalize.

- National Bank Consensus International Equity Fund (NBC491): We purchased a full position in NBC491 with the proceeds of sale from iShares XFH. We were unsatisfied with our international equity exposure via iShares XFH and saw NBC491's strong track record and low management cost as being advantageous. We believe that a portfolio manager can add plenty of value in the international equity space as managing country risk is of utmost importance, much more so than security and/or sector selection. The manager of the NBC491 has a solid track record of managing country risk, is value-oriented like us and has been with the fund since its inception in 2007. The fund charges an all-in MER of 2.15%, which is the lowest of any actively managed international equity mutual fund we have come across.

- iShares 1-3 Year Treasury Bond ETF (SHY): We purchased a position in iShares SHY with the proceeds of sale from J.P. Morgan. We purchased iShares SHY as a placeholder for U.S. dollar cash as we did not wish to convert to Canadian dollars at the time. iShares SHY has exhibited volatility of less than 1% annually and provides a yield and yield-to-maturity of ~0.7%.

- Sun Life Financial Preferred C (SLF.PR.C): We purchased a full position in SLF.PR.C with the proceeds of sale from RY.PR.J and FFH.PR.C. We thought it was prudent to reduce fixed reset preferred share exposure and add perpetual preferred share exposure at a time when fixed reset preferred shares were trading well above their all-time lows and interest rates were back near their all-time lows. The drive to reduce fixed reset preferred share exposure was particularly acute as the odds of a Brexit vote were rising at the time and a vote to Brexit would have drastically reduced interest rate expectations. Interest rate expectations did fall following the Brexit vote wherein the 'Leave' camp was successful.

<u>During Q2, we sold:</u>

- Russel Metals (RUS): We sold our position in Russel in two tranches as it appeared increasingly expensive relative to the rest of the market and the rest of the industrials space in particular. Russel was trading off the positive sentiment of the energy and materials sectors as oil and steel prices rose rapidly from their lows in February. While rebounding oil and steel prices is certainly good for Russel in the short-term and likely allows Russel to avoid the worst case scenario, we believe prices will remain depressed for an extended period of time and that Russel's revenues and earnings will not rebound materially. We saw the rally in RUS shares as excessive and that the shares will weaken when earnings reports show minimal improvement or when oil and steel prices come back down to earth.

- TD Bank Preferred D (TD.PF.D): We sold our position in TD.PF.D. We thought it was prudent to reduce fixed reset preferred share exposure and add perpetual preferred share exposure at a time when fixed reset preferred shares were trading well above their all-time lows and interest rates were back near their all-time lows.

- Progressive Waste Solutions (BIN): We sold half of our position in Progressive Waste. BIN's valuation was stretched and was pricing in near perfect execution in achieving the cost and revenues synergies that are expected from its merger with Waste Connections. We wished to maintain some exposure as the waste sector remains attractive relative to most other sectors given its below average volatility and above average dividend yield. BIN does not trade at an excessive valuation relative to its peers Waste Management and Republic Services assuming the expected synergies can be achieved.

- Open Text Corp (OTC): We sold half of our position in Open Text. OTC was trading at an all-time high despite two consecutive earnings misses and in our opinion, a high probability of future disappointment and stock price volatility. While OTC still trades at a material discount to peers assuming a normalization in earnings, it is unclear when and if OTC's earnings will normalize. We've been waiting a long time for this normalization and nothing has surfaced as of yet. We believed it was prudent to lower our exposure to the stock but to maintain a position despite its high valuation given its potential for upside due to acquisitions.

- iShares Core MSCI EAFI ETF (XFH): We sold our position in iShares XFH. After much consideration and by analyzing the performance of XFH over the past two years, we believe passive management is the wrong way to play international equity markets. When we discovered a low cost alternative that has had strong performance and is value oriented (i.e. NBC491), we opted to switch to active management.

- J.P. Morgan Chase (JPM): We sold our position in J.P. Morgan in the lead up to the Brexit referendum vote. We saw the odds of a Brexit vote as much higher than the bookmakers and the equity and bond markets and deemed JPM at risk should the UK populace vote to leave the European Union. JPM was only down ~5% from its recent high and we thought there was potential for at least another 10% downside.

- Royal Bank Preferred J (RY.PR.J): We sold part of our position in RY.PR.J. We wished to sell the entire position but we unable to do so at a price that we deemed appropriate. We thought it was prudent to reduce fixed reset preferred share exposure and add perpetual preferred share exposure at a time when fixed reset preferred shares were trading well above their all-time lows and interest rates were back near their all-time lows.

- Fairfax Financial Preferred C (FFH.PR.C): We sold our position in Fairfax Financial Preferred C after having difficulty selling our position in RY.PR.J. We thought it was prudent to reduce fixed reset preferred share exposure and add perpetual preferred share exposure at a time when fixed reset preferred shares were trading well above their all-time lows and interest rates were back near their all-time lows. The drive to reduce fixed reset preferred share exposure was particularly acute as the odds of a Brexit vote were rising at the time and a vote to Brexit would have drastically reduced interest rate expectations. Interest rate expectations did fall following the Brexit vote wherein the 'Leave' camp was successful.

- Bank of Nova Scotia (BNS): We sold our position in Bank of Nova Scotia following the Brexit vote. The Brexit vote materially shifted global interest rate expectations lower which will hurt BNS's long run net interest margins and overall profitability. The vote also raises the risk of European bank stress and the potential for financial contagion from European banks. We chose to sell BNS over Royal Bank of Canada and TD Bank due BNS's international exposure and the weakness that this exposure is likely to experience in a world with greater financial sector risk and a rising U.S. dollar.

- Performance Sports Group (PSG): We sold our position in Performance Sports Group following the Brexit vote as we predict that the cost of capital could rise materially over the coming months and years, particularly for high yield issuers. As PSG is highly indebted and requires orderly credit markets to refinance and service its debts, we are concerned about PSG's long-term solvency in a low growth or recessionary economic environment. Add the increasing weakness of the sporting goods sector and a potential resumption of U.S. dollar strength versus the Canadian dollar following the Brexit vote and PSG's outlook is dire.

PIMG Balanced Income Model

Gained 3.54% during the quarter (from April 1 to June 30).

The model's asset allocation as of June 30 was 4.6% cash, 24.4% bonds, 6.6% convertible debentures, 13.4% preferred equity, 3.3% alternatives and 47.7% common equity.

Top five outperformers in Q2 were:
- Black Diamond Group (Industrials/Remote Workforce Accommodation) at +28.89%
- Corus Entertainment (Telecom/Media) at +15.69%
- Crescent Point Energy (Energy/Light Oil) at +14.02%
- Smart REIT (Financials/REIT) at +13.80%
- Progressive Waste Solutions (Industrials/Waste Management) at +11.92%

Top five underperformers in Q2 were:
- Manulife Financial (Financials/Life Insurance) at -9.76%
- Fairfax Financial Preferred C (Preferred Shares/Fixed Reset) at -3.41%
- Enbridge Preferred E (Preferred Shares/Fixed Reset) at -3.29%
- National Bank Consensus International Equity (Mutual Fund/International Equity) at -2.48%
- AIMIA Preferred C (Preferred Shares/Fixed Reset) at -1.63%

<u>During Q2, we bought:</u>

- Power Corp Preferred D (POW.PR.D): Same reasoning as the Balanced Growth Model.

- Manulife Financial (MFC): We purchased a full position in Manulife with the proceeds of sale from Sun Life. Sun Life's valuation looked excessive relative to Manulife given the interest rate and equity market outlook. At the time of purchase, Manulife traded at ~10x trailing earnings and ~1x book value versus peers at ~13x trailing earnings and ~1.7x book value. The fading energy market downturn was likely to have a positive effect on Manulife's significant energy investments and provide higher than average earnings growth going forward.

- National Bank Consensus International Equity Fund (NBC491): Same reasoning as the Balanced Growth Model.

- Sun Life Financial Preferred C (SLF.PR.C): Same reasoning as the Balanced Growth Model.

<u>During Q2, we sold:</u>

- TD Bank Preferred D (TD.PF.D): Same reasoning as the Balanced Growth Model.

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

- Sun Life Financial (SLF): We sold half of our position in Sun Life and used the proceeds to buy Manulife whose valuation looked more attractive.

- iShares Core MSCI EAFI ETF (XFH): Same reasoning as the Balanced Growth Model.

- Royal Bank Preferred J (RY.PR.J): Same reasoning as the Balanced Growth Model.

- Fairfax Financial Preferred C (FFH.PR.C): Same reasoning as the Balanced Growth Model.

Going Forward:

For the second quarter in a row, the **Balanced Growth** model underperformed its benchmark as falling interest rate expectations resulted in outsized price gains for commodity producing companies, long-term government bonds and interest rate sensitive equities, of which the Balanced Growth has very little, as well as opposite, exposures. While we expect interest rate expectations to remain depressed for some time, we believe the long-term effects of a Brexit will eventually result in general weakness for equity markets, particularly stocks in the materials (ex-gold) and energy sectors. We remain highly underweight the materials and energy sectors and are more confident in this call following the Brexit vote. We have sold off some of our more vulnerable and richly valued securities and now have ~10% in cash and cash like securities, our highest cash level since our models were established. It is likely that we will continue to hold this cash balance until market valuations improve. As we are concerned about the possibility of eternally low interest rates, we have been reducing our negative interest rate exposure by selling fixed reset preferred shares and buying perpetual preferred shares. Doing so allows us to increase our current income while removing much of the inverted sensitivity to interest rates. Currently, perpetual preferred shares offer similar upside to fixed reset preferred shares but with limited interest rate related downside.

For the second quarter in a row, the **Balanced Income** model outperformed its benchmark due to its exposure to high yielding, value-oriented and interest rate sensitive securities.

Our interest rate stance has shifted since our last commentary and is now in line with market expectations. It is difficult to see how interest rates will go higher from here, consider the deflationary effects of a Brexit. Firstly, the rapid appreciation of the British pound will result in near-term inflation in the UK and deflation everywhere else. Secondly, capital flight will likely cause economic contraction in Europe and push down prices. Lastly, a Brexit could depress prices of European real estate and other assets which could have materially negative effects on Europe's banks which could cause them to cut back on lending, further adding to deflationary pressure. These newfound deflationary risks are responsible for the rapidly falling interest rates worldwide.

We expect European central bankers to cut interest rates and North American central bankers to remain on hold until there is more clarity about just how much deflation is coming down the pipeline. We believe this clarity may not arrive for quite some time. As a result, we have become more defensive in our stance toward common equities and believe that holding some cash and value-oriented, dividend paying stocks has never been more important. We also think it is prudent to be underweight financials at the current time due to the effects of falling interest rates and the heightened risk of financial contagion from European banks.

Our U.S. dollar exposure was fairly constant throughout the quarter. We expect the U.S. dollar to strengthen in the coming quarters and we continue to look for opportunities in U.S. stocks.

As at the end of Q2, the models yield 2.7% (Balanced Growth) and 3.6% (Balanced Income) from 3.3% and 4.0% at the end of Q1. The decrease is due to higher cash exposure at the end of Q2.

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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