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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well-informed of changes affecting local business decisions and our investment recommendations. We believe Knowledge Pays and we want our knowledge to help pay for you.

GLOBAL EQUITIES MARKETS IN TURMOIL MARKETS FALL THE MOST IN 4 YEARS

In the four trading days starting August 19, global equities markets declined rapidly, with the S&P 500 falling as much as 13%. Markets have since recovered about half of this decline as Chinese authorities unleashed a large, unexpected monetary stimulus package and global interest rate expectations declined considerably.

The rapid market decline is likely due to **four major factors**:

- **Slowing growth in China.** Underscored by the lowest reading on the Caixin Flash PMI since 2009 in August and 50%+ growth in non-performing loan balances.

While slowing growth in China is negative for global growth and inflation expectations, the Chinese slowdown has been taking place gradually since 2010 and the Chinese authorities likely have the tools to prevent a major calamity.

- **Ongoing currency wars.** To fight their respective spells of economic malaise, Europe, Japan and Russia have all deeply devalued their currencies in the years following the 2008 crash. China recently devalued its currency against the U.S. dollar for the first time in years, as its currency and exports have grown increasingly uncompetitive versus peers.

Currency wars can change where economic growth occurs but have little long-term effect on global economic growth so as it doesn't evolve into full out protectionism; we do not see this type of "war" as being an issue.

- **High market valuations.** Global equity markets, and the U.S. market in particular, remain slightly overvalued (5-30% depending on time frame) as measured by price-to-earnings multiples relative to historical levels. U.S. corporate profits currently sit ~67% above historical levels mostly due to historically low labour, interest and tax costs. Most western countries have similarly inflated corporate profits.

High market valuations are a concern, but we believe the unwinding of inflated corporate profit margins will occur gradually, and that investors should expect historically lower equity market returns over the long-term.

- **An exhausted bull market in a seasonally weak period.** The S&P 500 is currently in the third longest bull market in history, has gone 4 years without a correction, market volume and internals have been weak for an extended period, and equity markets are typically weak in the May to October period.

Equity market weakness is inevitable when a bull market is long-winded and is plagued by low volume and participation. It is fitting that the weakness occurred in a seasonally weak period.

Current Rates & Data

Govt of Canada

90 day	0.36%
1 year	0.45%
2 year	0.45%
5 year	0.75%
10 year	1.45%
30 year	2.22%

U.S. Treasury

90 day	0.03%
1 year	0.37%
2 year	0.70%
5 year	1.49%
10 year	2.17%
30 year	2.93%

Canada Prime Rate

2.70%

U.S. Prime Rate

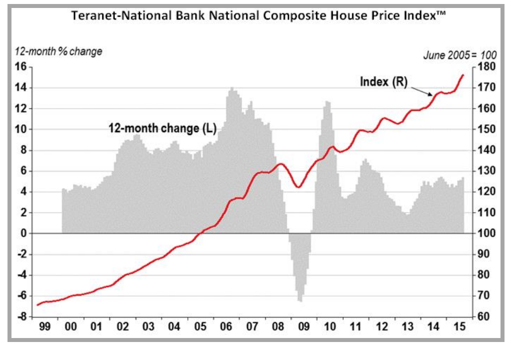
3.25%

Exchange Rates

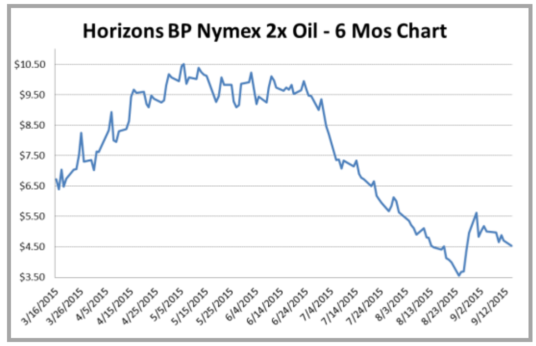
CAD/USD	0.754
USD/EUR	1.132
JPY/USD	120.1

ECONOMIC TIDBITS CANADIAN HOUSE PRICES KEEP ON RISING AND OIL BOUNCES THEN FADES

• Canadian house prices are **up 5.4% year-over-year in August, and are at an all-time high** as measured by the Teranet-National Bank National Composite House Price Index. The national gains have been driven mostly by gains in Vancouver, Toronto and Hamilton. Rising non-energy sector employment and record low mortgage rates have made housing more attractive in many areas.



• Oil prices fell as low as US$38/bbl (WTI) during the recent market turmoil, and subsequently rallied 29% in just five trading days as high as US$49/bbl, as traders reacted to rumours that **Venezuela was pushing for an emergency OPEC meeting**. Oil prices have since declined to the mid-$40s as the reality of the oil surplus has begun to erode the positive investor sentiment.



LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

Highly Depressed Stocks With Plenty of Inherent Value

- **Black Diamond (BDI)** and **Sandvine (SVC)** are two investment ideas related to this theme.
- **Black Diamond** provides remote workforce accommodations and modular space solutions in Canada, the U.S. and Australia. Black Diamond has been dragged down by the energy sector slowdown and reduced demand for oilfield accommodations. Black Diamond shares trade at a trailing EV/EBITDA multiple of 6x (versus 7-10x in boom times) on depressed earnings that are 20-30% below previous year levels. A rebound in oil sector activity or the approval of a West Coast LNG project could result in meaningful upside for Black Diamond shares. Black Diamond should be able to weather a prolonged period of low oil prices as it has exposure to some major late stage oil sands projects that are likely to keep producing.
- **Sandvine** develops and markets network policy control solutions for internet service providers. Sandvine shares fell sharply in June when management warned quarterly revenues would be well below previous quarters. Management expected revenues to recover in future months as new customer orders were secured. The shares came under pressure again in early September when management warned of quarterly revenues slightly lower than the previous, already disappointing quarter. Sandvine shares and enterprise value (excluding cash) are down over 45% and 60%, respectively, since June. As Sandvine's revenues and earnings have historically been volatile we believe the company's revenue run rate is closer to last year's average of $30.5 million per quarter rather than the recent depressed level of $27-$29 million. At this average revenue level, Sandvine shares are very attractive trading at a P/E of 4-5x ex-cash.
- Feel free to ask a member of our team for more information on these securities.

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