FÉRIQUE
PRIVATE WEALTH

FINANCIAL LETTER

Market Review

By Louis Lizotte, CFA, FRM, Vice President, Investments, FÉRIQUE Fund Management

First Quarter of 2018

SUMMARY

The year began much like 2017: it was very positive for foreign equities, less so for bonds and even less so for Canadian equities.

At the end of 2017, despite the sunny economic context, investors seemed a tad jittery. How much longer would the markets continue to rise with very little volatility? Now we know: 26 days.

	Variation Q1-2018	Variation YTD
Indexes (%)		
Canadian equities		
MSCI Canada	-4.5	-4.5
U.S. equities (CA$)		
MSCI USA	2.3	2.3
Global equities (CA$)		
MSCI Asia Pacific (all countries)	2.9	2.9
MSCI Europe	1.0	1.0
MSCI World (ex. Canada)	5.1	5.1
MSCI Emerging Markets	4.3	4.3

Source: MSCI

	Closing 18-03-29	Variation Q1-2018	Variation YTD
Interest rates (%)			
Canada			
Key rate	1.25	0.25	0.25
3 months	1.09	0.04	0.04
2 years	1.80	0.14	0.14
5 years	2.00	0.18	0.18
10 years	2.11	0.13	0.13
30 years	2.25	0.05	0.05
Commodities (US$)			
Oil (WTI)	$64.87	7.3%	7.3%
Gold	$1,323.85	2.5%	2.5%
Currencies			
EUR / CAD	0.63	-5.1%	-5.1%
JPY / CAD	82.51	-8.1%	-8.1%
USD / CAD	0.78	-2.7%	-2.7%

Sources : Bank of Canada, St.Louis Fed, U.S. Energy Information Administration

In our previous Financial Letter and during our conferences held earlier in the year, we cited some risks that could cause the stock markets to decline:

- Wage increases leading to a rise in inflation: check;
- Trade disputes caused by the United States: check;
- Scrutiny of the data management practices of dominant global companies, such as Facebook: sorry, not that one.

These three factors drove the markets and brought their volatility back up to the historical mean. The result was a quarter when diversified strategies generated slightly negative returns for the first time in two years.

	Returns as of March 31, 2018 (%)				
	Q1-2018	1 year	3 years	5 years	10 years
FÉRIQUE Portfolios					
Conservative	n/a	n/a	n/a	n/a	n/a
Moderate	-0.9	1.4	2.0	3.9	n/a
Balanced	-0.9	4.0	3.9	7.0	5.2
Growth	-0.4	5.6	4.5	n/a	n/a
Aggressive Growth	-0.6	n/a	n/a	n/a	n/a
FÉRIQUE Funds					
Short-Term Income	0.3	1.0	0.8	0.9	1.0
Bond	0.0	1.0	0.9	2.2	3.6
Diversified Income	-1.7	0.6	n/a	n/a	n/a
Dividend	-4.4	-0.1	3.5	6.6	n/a
Equity	-4.8	-0.8	2.4	5.2	4.0
American	-0.6	4.2	8.4	16.3	9.6
European	1.0	11.8	4.7	10.5	4.6
Asian	2.9	17.4	8.9	12.5	6.9
Emerging Markets	3.3	22.2	n/a	n/a	n/a
World Dividend	1.7	7.9	7.9	13.9	7.3

Source: Gestion FÉRIQUE
Note: Conservative and Aggressive Growth Portfolios don't have a year.

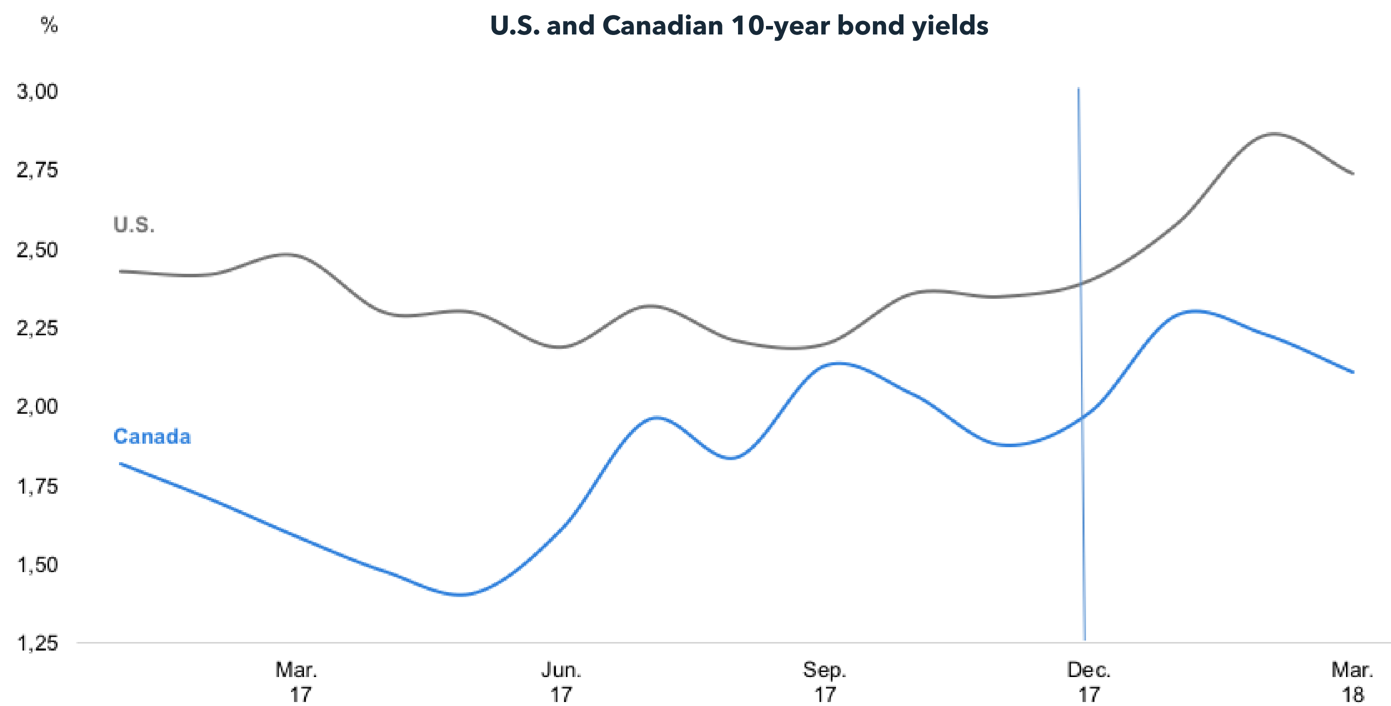
T 514 840-9204 I Toll free 1 855 337-4783 I gestionprivee@ferique.com

FIXED INCOME

RESULTS AND EXPLANATIONS

Global economic growth is still positive and synchronized. Inflation is rising (very) slowly, so central banks will keep normalizing their key interest rates, causing longer-term bond yields to rise.

Simple! This probably should have happened in a more pronounced fashion in 2017, but instead it started at the beginning of the year. The following graph shows U.S. and Canadian 10-year bond yields.



Souces: Bank of Canada and St.Louis Fed

It can be seen clearly that yields rose slowly in the United States in 2017 but accelerated significantly at the start of 2018, until a headline about steel and aluminum tariffs slowed their rise. It was the same on our side of the border, although the two increases in the key rate and prevarications over the impact of the NAFTA renegotiations on Canada's economy caused a degree of volatility in 2017. Even so, the increase was pronounced at the start of 2018.

The origin of the stock market correction early in February, namely U.S. wage increases that were slightly higher than expected, simply emphasized the obvious. The bond and stock markets adjusted sharply to this reality. But, apart from this event, there was no change in the positive economic environment or in the corporate earnings outlook.

T 514 840-9204 I Toll free 1 855 337-4783 I gestionprivee@ferique.com

FIXED INCOME

RESULTS AND EXPLANATIONS (continued)

In this context, the FERIQUE Bond Fund returned 0.0% on the quarter. As for the Diversified Income Fund, it had a return of -1.7% because of the weak performance of foreign bonds and the fact that it is hedged against currency fluctuations.

OUTLOOK AND ISSUES

For interest rates to continue rising, the current economic environment will have to continue.

President Trump has made a great deal of effort to ensure that outcome, first, with the tax cuts announced in 2017 and then an array of expenditures in the recently approved budget. The U.S. engine of growth should continue on its way, which means that the Federal Reserve will stick to its plans for at least three interest rate hikes, which are now priced into the market. Some people think the Fed could even opt for a fourth rate hike.

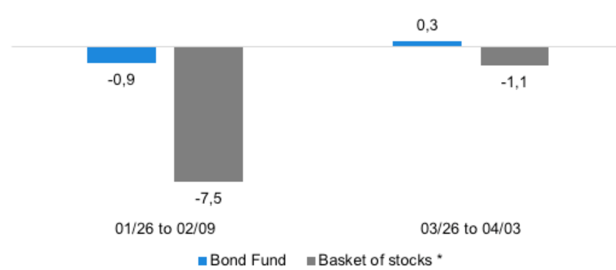
Longer-term rates should also gradually increase. Of course, that will have a negative impact on bond returns and, ultimately, on equity returns as well. It is no secret that higher interest rates increase financing costs for individuals and businesses alike, and will potentially detract from corporate earnings.

Also, equity valuations represent the present value of future earnings. Accordingly, a higher discount rate means a lower present value. There is no clear level beyond which we see a real adjustment of stock market valuations. However, the risk of a market repricing is rising considerably as the nominal yield on U.S. 10-year bonds approaches 3%, on its way to 4%.

OUTLOOK AND ISSUES (continued)

The outlook for bond returns is weak over the short and medium terms, but this asset class can play a stabilizing role in a diversified strategy, even though when equities were down in February, bonds also posted negative returns. We must, however, distinguish that situation from what happened in March. In February, the stock market weakness was caused by so-called good news, whereas the March decline stemmed from the trade dispute. This context may detract from growth and even slow, if not reverse, the interest rate hikes. The following chart shows stock and bond returns during these two periods.

FERIQUE Bond Fund's return vs a basket of stocks' return



Source: Gestion FÉRIQUE
** : Fictive basket of stocks for presentation purposes*
Percentages were calculated from the equity allocation of the Aggressive Growth Portfolio

CANADIAN EQUITIES

RESULTS AND EXPLANATIONS

The Canadian stock market, as measured by the MSCI Canada Index, returned -4.5% in the first quarter. The economic indicators are still flashing green and the job market is practically saturated. This context should give rise to higher wages, which would be positive for consumer spending and, one hopes, would lower household debt levels, a factor that is still weighing on the long-term outlook.

Even so, only the tiny information technology sector (11.3%) had a positive return on the quarter. The dominant sectors, namely finance (-3.4%) and energy (9.6%), posted negative returns.

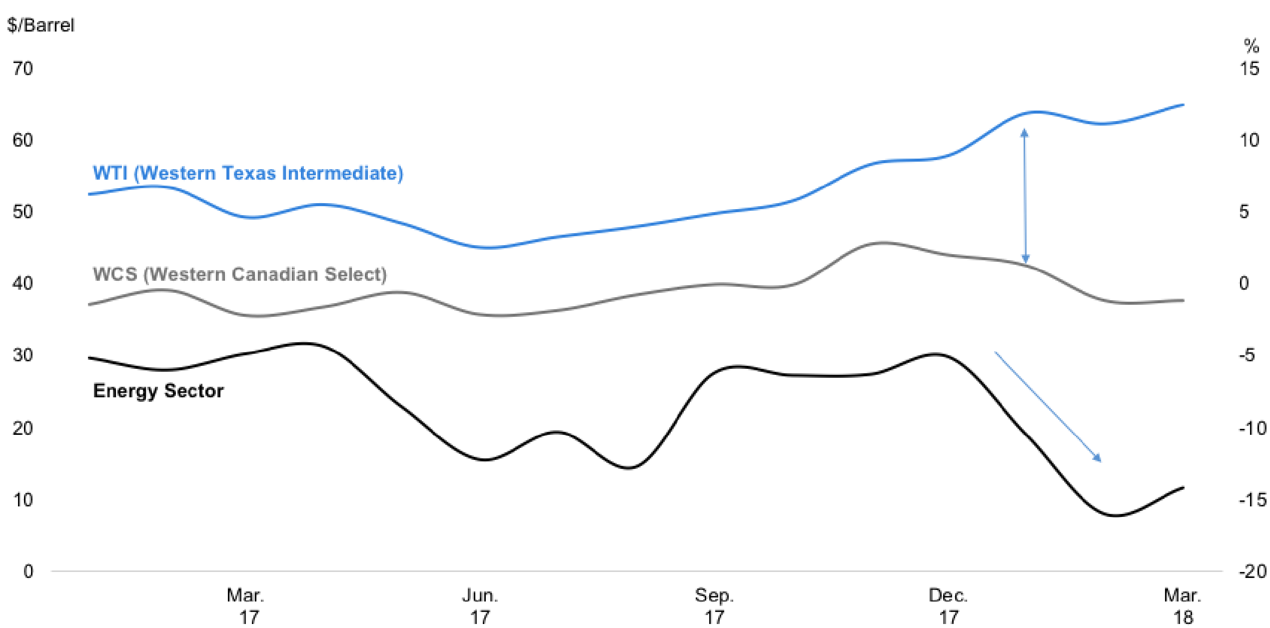
OUTLOOK AND ISSUES

The Bank of Canada kept its key rate at 1.25% during the quarter. Even though economic growth justified an increase, the Bank cited the same reasons for its patience as it did last year: debt levels, house prices and NAFTA.

The energy sector again dragged our stock market down. The U.S. oil price (WTI) has been rising since 2017. OPEC members' compliance with their output agreement and continuing strong demand are the main reasons. The problem in Canada is that the Canadian oil price, whose benchmark is Western Canadian Select (WCS), is not rising at the same pace. Our oil is cheaper, notably because of the cost of transporting it to refineries.

The following chart shows changes in crude oil prices.

Price per barrel of WCS and WTI in US dollars compared to energy sector's cumulative return in CAD dollars (MSCI Canada)



Sources: Government of Alberta, Alberta Energy Regulator, MSCI

T 514 840-9204 I Toll free 1 855 337-4783 I gestionprivee@ferique.com

CANADIAN EQUITIES

OUTLOOK AND ISSUES (continued)

With the cancellation of Energy East, the Keystone oil spill at the end of 2017 and the obstacles to shipping oil by train, inventories are building at storage hubs and the price gap is rising. At the end of March it was almost $25, although historically it has been $15.

The companies most affected are small and medium-sized Canadian producers. Integrated companies, such as Suncor, are faring better.

Everything seems to indicate that the price of WTI will continue to rise in 2018. Moreover, even if the price gap continues to exceed its historical level, it should narrow. The pipeline systems' capacity should stabilize this spring and shipping contracts with railways should be signed.

Finally, the recent budgets adopted by Ontario and Québec feature spending increases that in principle will boost Canada's economy. With a positive NAFTA outcome, could Canadian equities become the best asset class? We shall see.

U.S. EQUITIES

RESULTS AND EXPLANATIONS

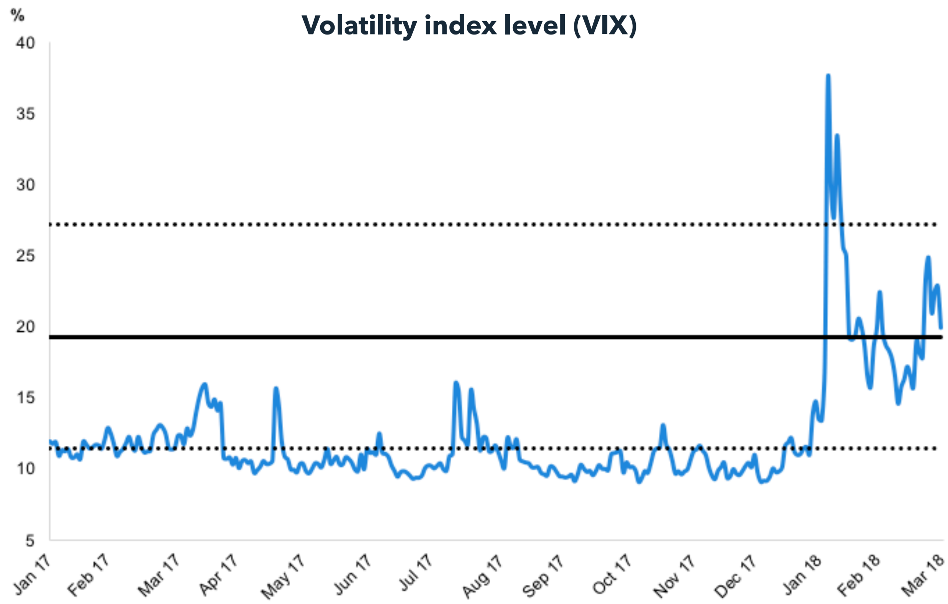
After its longest streak of consecutive months with positive returns, the U.S. market turned negative in February and March, in local currency.

As measured by the MSCI USA Index, the U.S. stock market returned 2.3% in Canadian currency. The Canadian dollar's weakness against the U.S. dollar boosted the return by almost 2.9%.

OUTLOOK AND ISSUES

As already stated, the increase in wages was higher than expected, with a gain of 2.9%, the largest since 2009. This context prompted many portfolio managers to review their positioning in the context of unexpectedly rapid rate hikes by the Federal Reserve. The markets' sudden decline caused the VIX (volatility index) to spike, taking many investors by surprise, especially those who borrow to invest, thereby aggravating the situation.

U.S. EQUITIES



Source : BCA Research inc.

OUTLOOK AND ISSUES (continued)

It is undeniable that high-frequency trading played a role in the decline and the equally sharp recovery in the following days. Its influence remains to be assessed, however.

Then, early in March, the markets were shaken by the announcement of steel and aluminum tariffs, and then at the end of the month, by the decision to target Chinese imports directly.

As if that was not enough, the information technology sector as a whole could not escape the consequences of revelations about Facebook's fast and loose practices with user information. As the saying goes about social media and apps in general " If something is free, you are the product ". *Caveat emptor!*

The situation will work itself out, no doubt. Even though the Facebooks and Twitters of this world are part of our daily lives and their growth outlook seems infinite, their shares are definitely priced for exactly that: limitless growth. To be continued!

T 514 840-9204 | Toll free 1 855 337-4783 | gestionprivee@ferique.com

WORLD EQUITIES

RESULTS AND EXPLANATIONS

Once again, the weak loonie boosted the returns of our foreign funds.

The MSCI Europe, the MSCI Asia Pacific (all countries) and the MSCI Emerging Markets returned 1.0%, 2.9% and 4.2% in Canadian currency, respectively, during the quarter, while their returns in local currency were -4.2%, -2.1% and 0.8%.

OUTLOOK AND ISSUES

The strength of the euro is cause for concern because the European Central Bank is still in expansionary mode and normally the currency would be depreciating. The impact on exports has still not been felt, but the risk is definitely present. The situation is the same in Japan, where the yen's strength could become problematic. The good news in Japan is that business activity has ticked up, with the bonus of a bit of inflation.

After having roiled the markets earlier in March with the announcement of tariffs on steel and aluminum imports, President Trump was at it again with a set of tariffs targeting China. What we can deduce from his announcement is that, of the $500 billion of Chinese goods imported into the United States each year, $50 billion or more, depending on his mood, could be subject to a 25% tariff.

OUTLOOK AND ISSUES (continued)

The Americans are asking the Chinese leaders to introduce reforms to reduce or eliminate discriminatory trade practices (access to the Chinese market, technology theft, etc.). The recent nationalistic speech by President Xi Jinping implied that he would instead take a tit-for-tat approach. And that is just what he did when he announced equivalent tariffs on U.S. goods sold in China, in particular soybeans.

The start of a trade war is bad news for the global economy. The various actors are only getting into position for negotiations, and President Trump has already made several 180-degree turns. A tariff escalation would be negative in several respects.

Theoretically, the Americans are in a position of strength: they import from China the equivalent of 2.7% of U.S GDP, whereas their exports to China represent barely 1.0% of the country's GDP. But the matter is not that simple, and ultimately the consumers in both nations will see price increases.

Some people think China could decide to liquidate its U.S. holdings, such as its Treasury bonds, to damage the United States. Such a move would drive the U.S. dollar down, making U.S. exports cheaper and imports more costly. Clearly, such an outcome would not be advantageous for China.

CONCLUSION

Rising interest rates in an expanding economy is a normal phenomenon. If the hikes are gradual, asset prices in general (bonds, stocks, etc.) will also adjust gradually.

At present, the risk stems more from the trade negotiations, and the markets could fluctuate in response to the daily headlines. The fact remains that the positive ***momentum*** generated by expansionary fiscal measures in the United States will not be stopped easily.

In conclusion, according to game theory, the trade situation of long standing was perhaps an example of Nash equilibrium. In other words, each party, China like the United States, was in the better situation, provided that the other party doesn't change its position. Obviously, the assumption is that both would make rational decisions!

Cheers!

TO JOIN US

To discuss the markets and your investment strategy, contact your Financial Planner and Mutual Fund Representative of FÉRIQUE Investment Services.

Private Wealth
T 514-840-9204
Toll free 1-855-337-4783
gestionprivee@ferique.com

Advisory Services
FÉRIQUE Investment Services
Open from 8:00 a.m. to 8:00 p.m.
From Monday to Friday
T 514-788-6485
Toll free 1-800-291-0337
client@ferique.com