TETREM

QUARTERLY REVIEW

"TREMENDOUS" SHIFT IN THE MARKET

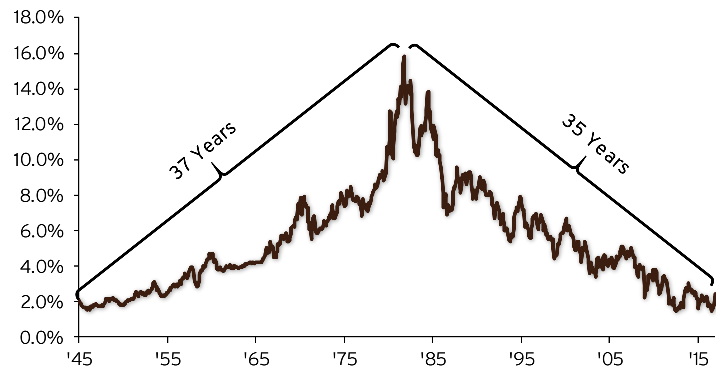
After starting the year on rocky footing, 2016 turned out to be a good year for North American equity investors. Both the S&P 500 and the S&P/TSX benchmark indices posted double digit total returns of 12% and 21%, respectively.

Since the onset of the financial crisis, the subtext of the market narrative has been the ongoing tug-of-war between reflation and deflation. Over the past few years deflation has dominated and, in the aftermath of the Brexit vote in the summer of 2016, markets priced deflationary risks to an extreme level. Negative interest rates, particularly given the magnitude of $13 trillion of negative yielding sovereign debt, were simply not sustainable. However, since the summer of 2016, equity markets have taken on reflationary characteristics, with the US Presidential election acting as an accelerant. This shift looks like it is going to extend well into 2017, fueled by fiscal stimulus and stronger economic growth. The shift is bad for bonds and good for the stock market, particularly companies that benefit from an improving economic outlook. Rather than pricing assets on simple yield, earnings are back in vogue, favouring active management and fundamental stock picking in particular.

That said, many market observers believe the equity bull market is getting long in the tooth. We are approaching the eight-year mark of the 2009 trough in equity prices and investors are wondering where we go from here. Early in the bull market, equities rallied in anticipation of an earnings recovery, but over the past few years the upward trajectory of equity prices has increasingly been driven by the thirst for yield. We've often used the US 10-Year Treasury Bond to illustrate both the duration and magnitude of the fall in global interest rates (Figure 1). This time we've extended the chart back to 1945 so as to capture the period of rising rates coming out of World War II. The last secular rise in long-term interest rates lasted 37 years. The subsequent secular drop in interest rates has lasted 35 years and there are indications that yields hit secular lows this past summer. Since bottoming at 1.32% in July of 2016 the yield on the 10-Year Treasury has risen 113 basis points to 2.44%, handing significant losses to bond investors. During this time, the S&P 500 rallied 6.6% to new all-time highs. It appears that the bull market is intact but its character is now changing to one that is earnings driven, a situation that will bring on new market leadership, as we started to see in the second half of 2016.

One of the many problems with negative interest rates is that they distort the pricing mechanism in asset markets. How does an investor value a cash flow stream when the benchmark risk-free rate is negative? The answer is "with great difficulty and caution." Declining rates have pushed up the valuation that investors have been willing to pay for pretty much any asset that offers a steady

Figure 1 US 10-Year Treasury Bond Yield



Source: Strategas. As of December 31, 2016.

and persistent cash flow. This dynamic is now at risk with the rise in rates. Instead of investing with the "greater fool theory" that accepts expanding overvaluation on the expectation that another investor will pay a higher price, investors need to look for earnings growth and rising profitability as drivers of capital appreciation. Fortunately, it appears that, as we enter 2017, earnings are set to expand in a number of important sectors.

Since Donald Trump was elected President of the United States, Energy and Financials have been market leaders after having been market laggards for much of the eight-year bull market. Despite what he may think, Mr. Trump doesn't get all of the credit. Both areas were doing well coming out of the summer, benefitting from a pick-up in global growth and rising interest rates. Energy stocks received a post-election boost from OPEC when it announced plans to limit production, with Russia joining in. The Trump Administration appears to be pro-domestic energy production, to the benefit of all industry participants, particularly energy service and infrastructure companies in both the US and Canada. We have written in the past about the deep undervaluation of our portfolios' energy services companies, such as Precision Drilling. Service stocks performed strongly in the fourth quarter and yet remain historically cheap on book value, which suggests there is upside as profits normalize, thanks to a friendlier oil drilling environment.

Without question financial service companies, and in particular banks, appear to be the big winners from the Republican sweep. The list of reasons is quite long. Pre-election, few investors cared about American banks. They were dramatically under-owned after years of lagging the market with low valuations that matched investor apathy. Like everyone else, investors expected a Clinton Presidency and a continuation of Obama's policies of

(Continued on page 4)

MARKET OVERVIEW

- The S&P/TSX Composite rose 4.5% in the fourth quarter. For the full year, the index produced a total return of 21.1%, the best result among global developed markets.
- Financials and Energy led the market during the quarter. Insurance companies and Banks were up in the context of higher bond yields and good business fundamentals.
- Materials were down as mining stocks gave back some of their earlier gains. Over the full year, mining stocks were among the top performing areas of the market.

S&P/TSX SECTOR PERFORMANCE

Sector	Quarterly Total Return (%)
Financials	11.5
Energy	7.0
Industrials	5.3
S&P TSX	4.5
Consumer Discretionary	1.5
Real Estate	0.1
Utilities	-0.4
Information Technology	-0.5
Consumer Staples	-1.5
Telecommunication Services	-2.8
Materials	-6.2
Health Care	-28.6

TETREM'S TOP TEN CANADIAN POSITIONS

Security	Weight (%)
Royal Bank Of Canada	8.6
Toronto-Dominion Bank	7.6
Bank Of Nova Scotia	6.6
CCL Industries Inc	5.0
Manulife Financial Corp	4.0
Canadian National Railway Co	3.8
Suncor Energy Inc	3.7
Keyera Corp	3.3
Air Canada	3.2
Tourmaline Oil Corporation	3.1
	48.8

NOTEWORTHY PORTFOLIO CHANGES

▲ Enbridge Inc	▼ Alimentation Couche-Tard
▲ Exchange Income Corp	▼ Canadian Imperial Bank
▲ Manulife Financial Corp	▼ Crescent Point Energy

TETREM'S QUARTERLY RESULTS

- Tetrem's Canadian Equity Portfolio advanced 7.8% during the quarter, outpacing the benchmark by 324 basis points. For the full year Tetrem's portfolio rose 20.6%, lagging the TSX by 50 basis points.
- Stock selection within Energy, Industrials and Materials drove performance.
- Positioning within Consumer Discretionary detracted from relative results.
- Notable positive contributors: Air Canada, Canyon Services Group, Manulife Financial.
- Notable detractors: Detour Gold, Keyera, Quebecor.

MANAGER COMMENTARY

Few would have predicted such a standout year for Canadian equities at the start of 2016, when oil was trading below $30 per barrel and pessimism was widespread. For us, the year reinforced the benefits of being contrarian and of sticking to our value process. By July's end, the TSX was up by 14% year-to-date and we were 7% behind, largely because we were significantly underweight gold stocks. We stuck to our guns and by year end the portfolio made up the shortfall as our value stocks started to get noticed – a gratifying development. Strong performance came from a diversity of companies within industries such as Energy Services, Airlines and Banks. The unexpected victory of President-elect Trump further accelerated sector rotation out of "bond proxy" stocks into economically-sensitive equities.

We believe the outlook has improved for portfolio holding Manulife Financial, whose share price jumped 29% during the fourth quarter. The company reported better than expected third quarter results, driven by strong product sales and a positive inflection on its return on equity. Additionally, the stock tends to go up in tandem with the US 10-Year Treasury yield, which rose 85 basis points over the quarter from a low starting yield of 1.59%. A continuation of higher bond yields would turn a persistent headwind for the company into a long-term tailwind. We believe that these improved fundamentals will enable Manulife to achieve a higher return on equity over time, leading to a higher multiple. We remain "long and strong" after the recent rally as valuation remains modest at 11x forward earnings and 1.2x book value.

Label maker CCL Industries continued to execute on its M&A strategy in 2016. Earlier in the year, CCL acquired CheckPoint Systems, a security-focused label provider. CCL was already on pace to exceed its original synergy targets when, on December 19, it announced another major acquisition, its biggest ever at $1.1 billion. The acquired company, Innovia, will facilitate CCL's expansion into new categories that leverage its capabilities and expertise, thereby generating higher growth. The shares, which remain the portfolio's largest active position, jumped on the news. We look forward to further value creation by CCL's top-notch management team.

Energy markets appear to be rebalancing and we believe the portfolio will continue to benefit. Supply and demand dynamics have improved significantly compared to two years ago. Furthermore, Trump's energy-friendly policies bode well for the industry. Our view is that, while oil price volatility is unavoidable, an oil price collapse is unlikely and the more probable scenario is further upside.

Alec MacIsaac, CFA *Principal & Portfolio Manager*

TETREM'S CANADIAN EQUITY PORTFOLIOS - HISTORICAL PERFORMANCE (% return denominated in CDN$ - see performance disclosures at end of page 4)

		Annualized Returns to December 31, 2016										
	Q4 2016	1 year	3 year	5 year	10 year	15 year	Since Inception	2012	2013	2014	2015	2016
TETREM CANADIAN EQUITY COMPOSITE												
Gross of Fees	7.8	20.6	5.1	9.7	4.8	9.1	10.0	8.8	25.7	5.7	-8.8	20.6
Net of Fees	7.6	19.8	4.4	9.0	4.2	8.4	9.3	8.1	24.9	5.0	-9.4	19.8
S&P / TSX Total Return Index	4.5	21.1	7.1	8.2	4.7	7.4	7.3	7.2	13.0	10.6	-8.3	21.1
TETREM CANADIAN EQUITY DIVIDEND COMPOSITE												
Gross of Fees	2.9	16.2	4.8	-	-	-	9.9	-	23.4	4.8	-5.5	16.2
Net of Fees	2.7	15.5	4.1	-	-	-	9.2	-	22.6	4.2	-6.1	15.5
S&P / TSX Total Return Index	4.5	21.1	7.1	-	-	-	8.8	-	13.0	10.6	-8.3	21.1

MARKET OVERVIEW

- The S&P 500 advanced 3.8% in the fourth quarter, capping a 12.0% total return for the year.
- The Financials sector increased 21.1% in the fourth quarter, helped by a steeper yield curve and expectations for higher interest rates post the US election.
- Funds flowed into equities at the expense of fixed income, pushing up the 10-Year Treasury yield by 85 basis points to 2.44%.

S&P 500 SECTOR PERFORMANCE

Sector	Quarterly Total Return (%)
Financials	21.1
Energy	7.3
Industrials	7.2
Telecommunication Services	4.8
Materials	4.7
S&P 500	3.8
Consumer Discretionary	2.3
Information Technology	1.2
Utilities	0.1
Consumer Staples	-2.0
Health Care	-4.0
Real Estate	-4.4

TETREM'S TOP TEN US POSITIONS

Security	Weight (%)
Microsoft Corporation	5.1
Alphabet Inc	5.0
Union Pacific Corp	4.3
EOG Resources Inc	4.1
Wells Fargo & Company	3.9
Dow Chemical	3.8
Johnson & Johnson	3.8
Schlumberger Ltd	3.8
JP Morgan Chase & Co	3.7
United Parcel Service	3.4
	40.9

NOTEWORTHY PORTFOLIO CHANGES

▲	Kinder Morgan Inc	▼	Medtronic Plc
▲	Goodyear Tire & Rubber Co	▼	FNF Group
▲	Zions Bancorporation	▼	Hewlett Packard Ent.

TETREM'S QUARTERLY RESULTS

- Tetrem's US Equity Portfolio gained 4.0% during the quarter, leading the index by 18 basis points. More importantly, the portfolio returned a healthy 13.3% for the full year, outperforming the benchmark by 132 basis points.
- Stock selection within Consumer Discretionary, Materials and Information Technology contributed positively to relative performance.
- Portfolio performance was negatively impacted by Industrial sector investments.
- Notable positive contributors: Citigroup, Halliburton, Dow Chemical.
- Notable detractors: Nielsen Holdings, Thermo Fisher, Crown Castle International.

MANAGER COMMENTARY

US equities continued their rally following the unexpected election of the 45th President of the United States, Donald J. Trump. His proposed policies, namely corporate tax reform, fiscal stimulus and deregulation, should benefit sectors that are sensitive to higher inflation and improving economic activity. Because these sectors offer better value, the portfolio was well positioned heading into the election, with significant holdings in Financials and Energy, and light exposure to defensive sectors such as Consumer Staples and Utilities.

Our financial holdings carry many characteristics we routinely look for within our investment framework. Valuations are reasonable, and there are several opportunities to cut costs and improve the quality of the companies' revenues by adding fee-based services. Our already high conviction is stronger as a result of the new political backdrop. US banks stand to benefit from a steeper yield curve, rising interest rates, lower corporate tax rates, and less regulation. Additionally, there is upside optionality from higher GDP growth arising from fiscal stimulus and infrastructure spending.

Another potential outcome from the Trump Administration is a friendlier stance toward energy infrastructure projects. Currently there are 24 stalled projects in the United States with a total value of over $48 billion of private spending that could immediately stimulate the economy. One company poised to benefit is new portfolio holding, Kinder Morgan. Kinder Morgan owns and operates energy pipelines and storage facilities. An increase in project approvals would mean more opportunities for the company to deploy capital on accretive projects. Our positive view is reinforced by the relative value opportunity we see in the shares. Kinder Morgan cut its dividend in late 2015 to free up capital and now trades at a discount to higher-yielding midstream energy peers. We believe that the company's healthier model, which is now less reliant on capital markets, coupled with consistent execution, should narrow the discount.

During the quarter we initiated a position in Goodyear Tire & Rubber. Goodyear is a global tire manufacturer, servicing a wide range of vehicles from Mini Coopers to Boeing 787 Dreamliners. The tire business has changed significantly over the last 20 years, evolving from standardized round rubber wheels to more complex products known as "high-value-added" tires. These tires offer improved fuel efficiency, durability and handling for the customer. In turn, Goodyear benefits from higher profitability per tire, a less volatile sales cycle and greater customer brand loyalty. The shares trade at an undemanding valuation of 7.5x 2017 earnings – and those earnings are growing faster than the market – making Goodyear a rare value opportunity.

Ben Ellis, CFA *Portfolio Manager*

TETREM'S US EQUITY PORTFOLIOS - HISTORICAL PERFORMANCE (% return denominated in US$ - see performance disclosures at end of page 4)

		Annualized Returns to December 31, 2016										
	Q4 2016	1 year	3 year	5 year	10 year	15 year	Since Inception	2012	2013	2014	2015	2016
TETREM US EQUITY COMPOSITE												
Gross of Fees	4.0	13.3	6.2	12.7	6.1	8.6	10.2	10.3	37.9	9.9	-3.9	13.3
Net of Fees	3.8	12.6	5.5	12.0	5.4	7.9	9.5	9.6	37.0	9.2	-4.6	12.6
S&P 500 Total Return Index	3.8	12.0	8.9	14.7	6.9	6.7	7.7	16.0	32.4	13.7	1.4	12.0
TETREM US EQUITY DIVIDEND COMPOSITE												
Gross of Fees	5.2	16.7	10.3	-	-	-	15.4	-	34.3	14.8	0.1	16.7
Net of Fees	5.0	16.0	9.6	-	-	-	14.7	-	33.4	14.1	-0.6	16.0
S&P 500 Total Return Index	3.8	12.0	8.9	-	-	-	14.3	-	32.4	13.7	1.4	12.0

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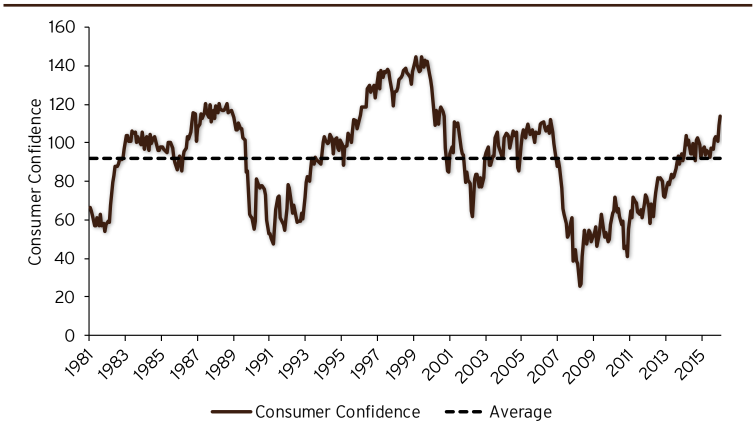
bureaucratic bank oversight. After November 8th, this changed and banks simply had to rally as they were cheap and under-owned. The liftoff in bank shares was further fueled as news came into the market of reduced regulatory burden, lower taxes and pro-growth economic policies. Most importantly, banks benefit from a rise in interest rates. There is a huge latency of earnings power within the sector to higher interest rates and a steeper yield curve, both of which are occurring. This was beneficial to both our US and Canadian portfolios, where bank holdings such as JP Morgan and TD Bank were up 23% and 9%, respectively, from the election to year end.

Yes, there are reasons for caution. Everyone seems focused on an errant Presidential Tweet, but thus far the market (and voters) has largely ignored them, so this may not be the obvious area of risk. Valuations are not particularly cheap and expectations are high. Therefore, if earnings growth does not deliver, equity markets will have to correct. A longer-term risk is that pro-growth policies come with debt, something that all former over-leveraged casino owners, such as Donald Trump, are aware of. Sentiment has picked up but it is a long way from being frothy. Even with the rally in equity prices investors continued to sell in the aggregate - hardly a sign of excessive enthusiasm. Protectionist trade policies will be a clear negative if they are enacted, but there is a difference between pro-domestic growth policies and anti-trade policies, something that the market is sniffing out thanks in part to trade-oriented cabinet appointees.

What we haven't seen since the financial crisis is the activation of "animal spirits" that ultimately are required for an economy to achieve escape velocity and grow without the artificial stimulation of central bank money printing. Even though The Donald was elected President without a majority of the popular vote, his election has not had a dampening effect on consumer or business confidence; in fact the opposite has occurred. The December reading for consumer confidence increased 6.6 points, adding on to November's massive jump of 8.5 points and pushing the survey to a level not seen since the 1990s (Figure 2). Business confidence indicators are moving up in a similar fashion. The spirits are starting to stir. We think that 2017 is setting up to be a "terrific" year for value investing.

Daniel A. Bubis, CFA *President & Chief Investment Officer*

Figure 2 Conference Board Consumer Confidence Index



Source: Strategas. As of December 31, 2016.

ABOUT TETREM

Tetrem Capital Management offers money management services to institutional and private clients. Our investment portfolios are focused on Canadian and US equities, rooted in our long-standing contrarian value style and tailored to the specific needs of our clients.

Investing is our profession and we are committed to doing it well. Our experienced team's primary focus is seeking out and investing in undervalued companies. For each of our investment portfolios, we employ fundamental and quantitative analysis in our rigorous stock selection process, with a focus on preserving and growing our clients' assets.

For more information about Tetrem Capital Management please visit our website, www.tetrem.com, or call and ask to speak with us about our investment services.

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Performance Disclosure

Tetrem Capital Management Ltd., an independent investment management firm, claims compliance with the global investment performance standards (GIPS®). To receive a complete list of composite descriptions please contact us at the above phone number.

To receive a presentation that adheres to the GIPS standards, please contact us at the above phone number or see the "performance" section of our website at www.tetrem.com.

Composite Descriptions:

Tetrem Canadian Equity Composite
Contains fully discretionary Canadian equity accounts following a value investment strategy. Inception date: January 1, 1997.

Tetrem US Equity Composite
Contains fully discretionary US equity accounts following a value investment strategy. Inception date: January 1, 1997.

Tetrem Canadian Equity Dividend Composite
Contains fully discretionary Canadian equity accounts following a value investment strategy with stocks that pay a dividend or are expected to pay a dividend. Inception date is November 30, 2012.

Tetrem US Equity Dividend Composite
Contains fully discretionary US equity accounts following a value investment strategy with stocks that pay a dividend or are expected to pay a dividend. Inception date is November 30, 2012.

Returns represent past performance. Returns stated within this newsletter are gross of fees unless otherwise indicated. Past performance does not guarantee future results. Different types of investments involve varying degrees of risk.

The S&P/TSX Composite Total Return Index comprises approximately 71% of the market capitalization for Canadian-based, Toronto Stock Exchange listed companies and provides broad economic sector coverage of the Canadian markets.

The S&P 500 Total Return Index consists of 500 stocks chosen for market size, liquidity, and industry group representation.

Tetrem's mandates are available to institutional investors such as pension plans, group retirement plans and foundations and certain individual investors who meet specified investment criteria. The mandates' performances are not guaranteed, the values change frequently and past performance may not be repeated.

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