TETREM
QUARTERLY REVIEW

STRIKING THE RIGHT BALANCE

The market environment remains complicated. In the aftermath of June's Brexit vote there were widespread expectations that equity markets would be volatile throughout the summer. They weren't. Rather, equity volatility was far below average and, for the most part, stock prices were up over the summer. From July 14 to September 8, the S&P 500 traded within a range of 1.54%, the tightest band ever for this duration of time (43 consecutive trading days). By the end of August, the S&P 500 and the S&P/TSX Composite had returned 7.8% and 14.4% year to date, respectively. Not bad in a period defined by lackluster economic and earnings growth. Volatility resurfaced in September, but it was nothing unusual for a month that tends to be seasonally weak and has historically experienced more than its fair share of market swoons.

At the end of the third quarter I had the pleasure of attending the annual investment forum hosted by Strategas Investment Partners, a firm whose research Tetrem has been following for nearly a decade. The firm specializes in macro-oriented research with a focus on the United States' economy, markets and political environment. The forum is unique in that it is comprised of the partners of the firm and a small group of approximately twenty clients, allowing for open dialogue. We heard presentations from the Strategas partners and outside speakers. Additionally, all client attendees were given 15 minutes to pitch an investment idea, a process that contributed to the ongoing market narrative at the forum.

Among investors present, a clear consensus emerged that this is a complicated period that is unlikely to change anytime soon. Numerous participants expressed their belief that we are in a prolonged period of sub-par economic growth. An evolving concern that central bankers may be doing more harm than good with negative interest rates was an underlying theme, though no one expected that this was about to change in a dramatic fashion. Notably, both bullish and bearish investors voiced concerns that an artificial rate structure imposed by the world's central bankers is creating asset price distortions globally. Unsurprisingly, some participants shared their view that equities were due for a correction "sometime soon," a prediction that always finds voice within any group of investors. It likely didn't help that news of a $14 billion fine on Deutsche Bank was announced, which raised short-lived concerns about a Lehman-style credit contagion. However, no one rang the alarm bell to signal a US recession, and therefore there were no calls for an outright bear market. Strategas' Don Rissmiller summed up his economic outlook by stating "it's hard to find anything wrong with the US economy."

One participant argued we are in the midst of a multi-year bull market. He went through his bear market checklist, honed over many decades on Wall Street, and found none of the conditions are present. In his opinion, behavioural, economic and fundamental factors point to a continuation of the current bull market over the next few years. His behavioural argument was particularly convincing. He pointed out that bull markets typically end during periods of excessive investor exuberance, something that is sorely lacking today.

It was striking that many of the discussions focused on what could go wrong, as opposed to what could go right. Evidently, the psychological scars of the previous decade's technology stock bubble implosion and financial crisis are slow to heal. It seems that everyone is laser-focused on finding the next "black swan" risk to the downside, or maybe they are just looking for the next big short. In a fitting summary, the bullish presenter pointed out that the next bear market is likely to be triggered by something we can't predict or even analyze. Instead, he asked, why not contemplate a white swan event such as a change to the tax code that would allow for the repatriation of foreign profits that, in turn, would fund infrastructure and capital investments? Such an event would shock investors out of expensive bonds and into relatively cheap equities, a reversal of capital flows of the past few years.

Given that we were just entering "playoff season" for the US Presidential election, everyone was eager to handicap the outcome and its potential market and economic effects. From an economic perspective, no one voiced a concern that either candidate would alter the current trajectory of US economic growth. A Trump victory would likely trigger a market correction, but ultimately prove to be a buying opportunity. Many expressed the view that Trump is not ideological and would appoint capable people, thereby settling the markets. Over cocktails many lamented the poor choice Americans were facing at the polls, with neither candidate viewed as suitable. Clinton is seen as risky for a number of industries, in particular Financials and Energy, with Health Care a question mark. While there is clearly a populist push for pharmaceutical price controls, a few presenters opined that, thanks to recent share price weakness, many of the stocks in the sector are showing good value and a buying opportunity is setting up as the political rhetoric ultimately abates. As the group's lone non-American resident, I was struck by the lack of political vitriol from the attendees and it was difficult to ascertain where individuals stood politically. The group was focused on the investment implications of the Presidential election, not ideology, which was refreshing in an election campaign defined by anger.

Professor Robert Gordon of Northwestern University gave a sobering and impartial presentation on the outlook for US growth, particularly as it relates to the link between productivity and

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MARKET OVERVIEW

- The S&P/TSX Composite rose 5.5%, its third consecutive quarterly increase. Results were broad-based, with nine of eleven sectors producing a positive return.
- In general, cyclicals such as the Auto Parts and Transportation sectors were up strongly, while defensives such as Utilities and Real Estate lagged. The Gold sector reversed course from the previous quarter, declining 9.0%.
- Bond yields remained historically low, a headwind for rate-sensitive industries such as life insurance.

S&P/TSX SECTOR PERFORMANCE

Sector	Quarterly Total Return (%)
Information Technology	12.1
Industrials	10.8
Health Care	9.0
Consumer Discretionary	8.9
Consumer Staples	6.3
Energy	6.2
Financials	5.9
S&P TSX	5.5
Telecommunication Services	2.8
Utilities	0.7
Materials	-1.1
Real Estate	-1.5

TETREM'S TOP TEN CANADIAN POSITIONS

Security	Weight (%)
Royal Bank Of Canada	8.2
Toronto-Dominion Bank	7.1
Bank Of Nova Scotia	6.6
CCL Industries Inc	4.2
Canadian National Railway Co	3.9
Canadian Imperial Bank Of Commerce	3.9
Keyera Corp	3.7
Manulife Financial Corp	3.1
Agrium Inc	3.1
Suncor Energy Inc	3.0
	46.8

NOTEWORTHY PORTFOLIO CHANGES

▲	Killam Apartment REIT	▼	Whistler Blackcomb Hldg
▲	Premium Brands Holdings	▼	BRP Inc
▲	H&R REIT	▼	iShares S&P/TSX Gold

TETREM'S QUARTERLY RESULTS

- Tetrem's Canadian Equity Portfolio advanced 7.0% during the quarter, outpacing the benchmark by 153 basis points.
- Positioning within the Materials and Consumer Discretionary sectors contributed positively to performance.
- Stock selection in the Energy sector detracted from relative results.
- Notable positive contributors: Whistler Blackcomb Holdings, Vermillion Energy, Element Financial.
- Notable detractors: Crescent Point Energy, Precision Drilling, Killam Properties.

MANAGER COMMENTARY

The portfolio's good performance was broad-based. Relative results were strongest in the Materials sector thanks to the "one-two punch" of owning a large active position in CCL Industries (up over 12%) and simultaneously being substantially underweight the Gold subsector which gave back some of its first-half 2016 gains. The Canadian Bank holdings were solid, posting continued earnings strength and dividend increases from Royal Bank and Bank of Nova Scotia. The Energy holdings were mixed, with Vermillion Energy a positive standout, partially offset by Crescent Point Energy which disappointed the market – and us – with an equity raise.

We have good news to report on two holdings that we wrote about earlier in 2016, Whistler Blackcomb Holdings and Air Canada. Whistler received a takeover offer from Vail Resorts in August. We had purchased the shares in early 2015 on the premise they were undervalued following a poor snow season, an example of the market getting stuck in short-term thinking and missing the longer-term narrative. Whistler is a world-class resort with several growth avenues and significant value in the long-term lease of the mountain itself. Vail's offer helped unlock this value, causing the shares to jump over 40% on what had already been a good investment.

Air Canada continues to execute on its strategy and the shares have recently started to climb. Although the company is profitable and growing, investors have remained anchored to old views about the airline industry and Air Canada's valuation has remained stubbornly low. The company is engaged in a two-pronged international growth strategy. The low-cost Rouge brand is stimulating demand and gaining share in the leisure market; meanwhile, new efficient aircraft are allowing Air Canada to expand into international markets, for example Montreal to Shanghai direct. At a recent meeting with management, we were excited to hear about the cash flow outlook, which is set to inflect upward as capital expenditures for new airplanes abate.

We initiated a position in Killam Apartment REIT, which owns a portfolio of apartments, with a dominant market share in Atlantic Canada. Apartment leasing is a stable business, and we were intrigued that there is a growth element to the story. The company has a development pipeline of ten projects that will increase its long-term asset value. Of note, five of these are in Halifax where the job market is attracting workers who need accommodations, which Killam is well positioned to provide. The REIT offers a yield of 5.0% (at September 30, 2016) – compelling in the current low-rate environment – and its valuation is modest relative to peers.

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 September 30, 2016										
	Q3 2016	YTD	1 year	3 year	5 year	10 year	15 year	Since Inception	2011	2012	2013	2014	2015
TETREM CANADIAN EQUITY COMPOSITE													
Gross of Fees	7.0	11.9	10.9	5.5	8.7	4.8	9.1	9.7	-11.9	8.8	25.7	5.7	-8.8
Net of Fees	6.8	11.3	10.2	4.8	8.0	4.1	8.4	9.0	-12.5	8.1	24.9	5.0	-9.4
S&P / TSX Total Return Index	5.5	15.8	14.2	8.0	8.1	5.3	8.0	7.2	-8.7	7.2	13.0	10.6	-8.3
TETREM CANADIAN EQUITY DIVIDEND COMPOSITE													
Gross of Fees	4.0	13.0	12.1	7.2	-	-	-	9.8	-	-	23.4	4.8	-5.5
Net of Fees	3.8	12.5	11.4	6.5	-	-	-	9.0	-	-	22.6	4.2	-6.1
S&P / TSX Total Return Index	5.5	15.8	14.2	8.0	-	-	-	8.2	-	-	13.0	10.6	-8.3

MARKET OVERVIEW

- The S&P 500 finished the third quarter up 3.9%. Through the first three quarters of 2016 the S&P 500 has returned 7.8%.
- Defensive sectors such as Consumer Staples, Telecommunication Services and Utilities underperformed the broader market, a partial reversal of first-half 2016 trends.
- Global monetary policy remains accommodative, which has led to $13 trillion of negative yielding sovereign debt. We believe this has contributed to higher equity market valuations.

TETREM'S QUARTERLY RESULTS

- Tetrem's US Equity Portfolio increased 6.8% during the quarter, leading the S&P 500 by 290 basis points. Results have now surpassed the index by 108 basis points year to date.
- Stock selection within Energy, Information Technology and Industrials contributed positively to performance.
- Stock selection within Financials detracted from relative performance.
- Notable positive contributors: Spectra Energy, EOG Resources, Alphabet Inc.
- Notable detractors: Wells Fargo & Co, Pfizer Inc., Halliburton Co.

S&P 500 SECTOR PERFORMANCE

Sector	Quarterly Total Return (%)
Information Technology	12.9
Financials	4.6
Industrials	4.1
S&P 500	3.9
Materials	3.7
Consumer Discretionary	2.9
Energy	2.3
Health Care	0.9
Real Estate	-2.1
Consumer Staples	-2.6
Telecommunication Services	-5.6
Utilities	-5.9

TETREM'S TOP TEN US POSITIONS

Security	Weight (%)
Alphabet Inc	6.3
Microsoft Corp	4.9
Johnson & Johnson	4.4
EOG Resources Inc	4.2
Cash	3.9
Spectra Energy Corp	3.6
Union Pacific Corp	3.4
Schlumberger Ltd	3.4
Pfizer Inc	3.2
American International Group	3.2
	40.7

NOTEWORTHY PORTFOLIO CHANGES

▲ Gilead Sciences Inc	▼ Teva Pharmaceutical
▲ Eaton Corp	▼ United Rentals Inc
▲ Crown Castle International	▼ McKesson Corp

MANAGER COMMENTARY

In the third quarter of 2016 the US equity market continued to appreciate from February's lows, reaching all-time highs by mid-August. The portfolio was rewarded when our companies reported some of the best quarterly results in recent memory. Specifically, more than 70% of portfolio holdings beat consensus revenue expectations and nearly 60% beat earnings estimates. This compares to 55% and 54%, respectively, for the S&P 500, providing evidence that there is reasonably priced earnings growth to be found in the market.

One of our larger holdings, Spectra Energy, was the top contributor to performance. Spectra is a North American energy company primarily focused on natural gas infrastructure. Its operations stretch across the natural gas value chain, including gas plants, pipelines and processing facilities. We identified a mispricing early in the energy downturn and started to build a position. The market was overestimating the company's direct commodity exposure, when in fact greater than 90% of its profits are independent of energy prices and offer utility-like stability. The shares rebounded from a depressed level and Spectra was one of the top portfolio contributors through the first half of 2016. Nevertheless, we continued to hold a large position as our analysis indicated that the assets remained undervalued. We were rewarded in the third quarter when Enbridge Inc. announced they would acquire Spectra at an 11% premium.

We were active within the portfolio's Health Care holdings during the quarter. For example, we exited our position in Teva Pharmaceuticals. We were concerned that industry competition was heating up and the company's position was not as strong as initially thought. Teva is facing increased competition from Indian companies that do not prioritize shareholder returns. Additionally, the US Food and Drug Administration continues to approve generic drugs at a record pace, which increases the competition for Teva's products. We believe these two dynamics will play into a weak pricing environment for the foreseeable future. We also exited our position in drug distributor McKesson, as our thesis played out faster than expected and the risk/reward no longer warranted a position. Proceeds from the sale were used to initiate a position in Gilead Sciences, a large biotech company. Gilead is a classic value stock, trading at 6.5x forward earnings. The market questions the company's ability to grow longer term, a view we do not share. Based on our assessment of management, their research success and the company's strong financial position, we believe the valuation is too low and does not account for any possibility of positive developments in its drug pipeline.

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

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

			Annualized Returns to September 30, 2016										
	Q3 2016	YTD	1 year	3 year	5 year	10 year	15 year	Since Inception	2011	2012	2013	2014	2015
TETREM US EQUITY COMPOSITE													
Gross of Fees	6.8	8.9	15.1	8.0	14.4	6.3	8.9	10.1	-7.1	10.3	37.9	9.9	-3.9
Net of Fees	6.6	8.4	14.3	7.3	13.6	5.6	8.2	9.4	-7.8	9.6	37.0	9.2	-4.6
S&P 500 Total Return Index	3.9	7.8	15.4	11.2	16.4	7.2	7.1	7.6	2.1	16.0	32.4	13.7	1.4
TETREM US EQUITY DIVIDEND COMPOSITE													
Gross of Fees	0.5	11.0	18.4	11.8	-	-	-	15.0	-	-	34.3	14.8	0.1
Net of Fees	0.3	10.4	17.7	11.1	-	-	-	14.2	-	-	33.4	14.1	-0.6
S&P 500 Total Return Index	3.9	7.8	15.4	11.2	-	-	-	14.1	-	-	32.4	13.7	1.4

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rising standards of living. The title of his recently published book, *The Rise and Fall of American Growth*, sums up his outlook for secular economic stagnation. Professor Gordon provided evidence that secular drivers of productivity have dramatically slowed since the 1970s. From the end of the US Civil War through to the 1970s, revolutionary advances such as electricity, indoor plumbing and the internal combustion engine changed both the workplace and home, leading to a dramatic increase in life expectancy and productivity. Since then, productivity has slowed. Technological innovation continues to advance but the changes are now more evolutionary than revolutionary. This slowing advancement along with various headwinds such as an aging population, high debt and stagnating education have combined to make real growth more challenging.

Given the low-growth tone of the forum, it was fitting that Tetrem presented the investment case for Johnson & Johnson (JNJ), a conservative choice that we believe will provide investors with reasonable returns, regardless of the economic backdrop. The company has a highly persistent earnings stream that is growing, enabling it to pay a dividend that has increased every year since 1963. JNJ's debt is rated AAA and the balance sheet is endowed with $22 billion of cash net of debt, providing significant firepower for the company to invest, acquire, and repurchase shares. The stock has done well over the past few years but its valuation remains at a discount to Consumer Staples companies — even while providing superior growth prospects, in our view. JNJ's fundamentals are relatively isolated from emergent political pressures and its valuation is likely to re-rate higher post the US election. In an era defined by negative yielding sovereign bonds with dubious credit ratings, JNJ offers an attractive risk/reward profile.

A point often made at the forum was the need to invest in "self-help" stories. The idea is to find companies whose earnings drivers are within management's control and not reliant on the winds of economic change. More specifically, self-help most often relates to a combination of cost cutting, industry consolidation and smart capital allocation. For instance, we have been building out a position in Dow Chemical as the market appears to be underestimating the cost and market synergies from the coming merger with DuPont. Our view is that the merger will create a stronger industry structure and higher returns on capital for the merged entity. In a low-growth world, good management teams will do what they can to create shareholder value. The recently proposed merger between Potash Corp and portfolio holding Agrium is another example.

At Tetrem we focus our research on opportunities that strike a balance between upside potential and capital preservation, an approach that was validated at the Strategas Investment Forum. The investment and economic climate will remain confusing over the foreseeable future; therefore, the best way to achieve conviction is to find companies with attractive valuations, strong economic moats and management teams that are actively working to drive higher returns on capital. It's a simple recipe that works.

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

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

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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.

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