Third Quarter 2018

"NAFTA in Focus While US-China Trade War Escalates"

All Eyes Are On NAFTA Negotiations as a December 1 Deadline Approaches

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Quarterly Summary and Musings on Quarterly Happenings

Commodity prices and stocks of commodity producers fizzled in the third quarter as the US-China trade war escalated, hurting investor sentiment toward basic materials. China consumes an outsized share of commodities, so anything that impacts Chinese economic growth expectations will impact commodity prices. Other trade disputes like the US-Turkey trade war and ongoing NAFTA negotiations also impacted economic growth expectations for the latter part of the 2018.

Weakness in the commodity complex resulted in Canadian equity market (S&P/TSX composite index) underperformance relative to the US and global equity markets. The S&P/TSX composite index finished the quarter down 0.6% versus the US (S&P 500) and global (MSCI World Index) markets which were up 7.7% and 4.5% respectively.

The telecom, financials, health care, industrials, technology and real estate sectors led the S&P/TSX composite index, while the energy, materials, utilities, consumer staples and consumer discretionary sectors trailed.

US-China Trade War

After implementing steel and aluminum tariffs and threatening to hike auto tariffs on numerous trading partners in the first half of the year, the Trump administration has since honed in on China.

In July, the US imposed a 25% tariff on $34 billion in Chinese imports and China responded in kind. In August, another $16 billion in Chinese imports were hit with a 25% tariff and China responded in kind. In September, the US announced a 10% tariff on $200 billion in Chinese imports and signaled that the tariff would increase to 25% by the end of 2018. China has since responded with a 10% tariff on $110 billion in US imports. Total value of US imports of Chinese goods: $506 billion in 2017. Total value of Chinese imports of US goods: $130 billion in 2017. Virtually all Chinese imports of US goods (roughly $170 billion in 2018) now attract tariffs. The Trump administration has threatened tariffs on the remaining ~$267 billion in Chinese imports if China responds in kind to its most recent tariff.

How China defends itself from the Trump administration's trade aggression is still up in the air. Now that there are tariffs on virtually all US imports, if it wishes to continue to directly confront the US, China could resort to more aggressive currency management/depreciation or other trade war tools to make US products less attractive to Chinese consumers. As an indirect and more political attack on the US, China announced that it is lowering tariffs on various non-US products in an effort to develop closer ties with other major trading partners, Japan and the European Union, and to encourage allies to speak out against US trade aggression. At the very least, lowering tariffs for these two trading partners may persuade them from joining the US in this particular dispute.

We remain fairly optimistic that the Trump administration does not want to be single handedly responsible for a global economic downturn. As a result, we believe the administration is nearing the end of its tariff escalation campaign on its allies and will stop short of imposing significant, economy-halting tariffs on Chinese imports as well.

NAFTA Negotiations

NAFTA negotiations appeared to be going nowhere for much of the last year, but in late August the US and Mexico reached a bilateral trade deal wherein Mexico made some significant concessions that benefitted both the US and Canada. After sealing a deal with Mexico, US negotiators pivoted to Canada, using the concessions earned from Mexico as a bargaining chip in negotiations. The centerpiece of Mexican concessions relates to the automotive sector wherein auto companies can evade tariffs if they use more North American product than before (75% North American content versus 62.5% now), use more North American steel and aluminum and a certain portion of vehicles must use labour earning at least US$16 per hour. This is a positive for employment in the US and Canadian auto sectors as it should result in more autos and auto parts being made in North America and more auto production in Canada and the US where wages are higher.

In the final hours of September, the US and Canada agreed to new NAFTA terms. Early indications show that Canada has gotten its way on most NAFTA discussion points and had to budge only slightly with respect to its highly protectionist dairy industry and e-commerce rules. Negotiations continue to work out the finer points of the deal so nothing is set in stone just yet.

NAFTA negotiations had an unofficial deadline of October 1 given that the incoming Mexican President Andres Manuel Lopez Obrador, along with his administration, takes office on December 1. As per congressional rules, the text of the bill/deal must be provided to the US Congress 60 days before it can be signed by the US president. If a new NAFTA deal, currently dubbed the United States-Mexico-Canada Agreement (USMCA), is not finalized by December 1, the incoming Mexican administration may have different motives or viewpoints when it comes to NAFTA terms. US midterm elections could also complicate the picture if a new NAFTA deal is not signed by January when newly elected politicians take office. Democrats are widely expected to win seats in the upcoming midterm election on November 6, 2018, and could win enough seats to block or request changes to the agreed upon NAFTA terms.

NAFTA related uncertainty, weak energy and materials sectors and a murky picture for housing put the Bank of Canada on pause and interest rates have been fairly stable this year. On the other hand, US rates rose steadily throughout the year largely as a result of above average economic growth driven by a US budget deficit of nearly $1 trillion, which is unprecedented outside of wartime and recession on a deficit/GDP basis. While interest rate expectations have risen largely by a Republican controlled government unexpectedly running a massive deficit, this deficit can’t be sustained at this level and future years will likely see meaningfully less fiscal support than in 2018.

Oil Price Summary and Outlook

The price of oil was virtually flat quarter-over-quarter, finishing the third quarter at ~US$73 (WTI) versus ~US$74 (WTI) at the end of the second quarter. The price of oil was US$70 for much of the third quarter as a slowdown in the global economic growth rate, relative to a very strong second quarter, resulted in lower than expected oil demand.

The oil supply picture continues to appear uncertain. Libyan oil production rose significantly quarter-over-quarter, rising to over one million barrels of oil per day in September from less than 700,000 in July and as low as 200,000 at one point in late June. The temporary trough in oil production was due to attacks on two port facilities but the security situation improved rapidly and these facilities were fully operational within weeks. While Libyan production is the highest it has

been in five years, reliability of supply remains in doubt and any future supply issues could catalyze a boost in global oil prices in the future.

Throughout the summer, Saudi Arabia produced roughly 11 million barrels of oil per day. Saudi officials noted that Saudi production can likely hit 12.5 million barrels per day if need be using current infrastructure, but getting much beyond that level will require significant investment. Oil prices rallied in reaction to this pronouncement as Saudi Arabia may not be able to offset enough of the future production shortfalls faced by OPEC's less reliable members to stop oil prices from rising significantly.

In May, the Trump administration pulled the US from the Iran nuclear deal and stated that it would penalize any nations that deal in Iranian oil. The cancellation of the Iran nuclear deal puts one million barrels per day of Iranian oil production at risk and could further worsen the oil market deficit. While Iranian oil production has yet to decline meaningfully, Iran's oil exports have fallen by roughly 800,000 barrels per day between April and September 2018, indicating that Iranian production will eventually have to follow suit.

The oil price spread between Canadian Western Select (CWS) and WTI widened to a historic level, finishing the quarter at ~US$36 per barrel relative to ~US$27 per barrel at the end of June. Subsequent to quarter end, this spread spiked to over US$50 per barrel, an unfathomable number when the price of WTI is only ~US$70. Oil-by-rail capacity and new pipeline capacity is well short of Canadian oil production. Eventually oil-by-rail capacity should catch up with Canadian oil production and force a narrowing of this spread. We continue to favour US oil producers and Canadian producers with global presence over Canada-centric producers as oil-by-rail capacity may take a long time to catch up with demand.

We remain constructive on energy prices and energy stocks as the oil supply picture remains uncertain and there is plenty of opportunity for oil supply shocks.

Manufacturing

The JP Morgan Global Manufacturing PMI slowed to a two year low in September. This level of activity is still robust and is roughly in line with the historical average during economic expansions. New export orders contracted for the first time in several years in September, highlighting the effect that tariffs are having on country-to-country trade. The contraction in new export orders is the key factor that dragged down the overall JP Morgan Global Manufacturing PMI to a two year low.

Eurozone Sovereign Risk Reemerging

Fears of another European sovereign debt crisis have subsided somewhat, although Italian bond yields remain at their highest level in almost five years and European bank share prices remain near multi-year lows. Towards the end of the third quarter, Italian policymakers defied European Union (EU) policy by setting a 2019+ budget deficit target of 2.4%, far above its 2018 deficit of 0.8% and above the EU's strict limit of 2%. In doing so, the Italian coalition government fulfilled an election promise to defy EU budget rules. This is a simple reminder to European investors that Italian lawmakers are anti-EU and unfriendly to EU bureaucracy and oversight.

PIMG Balanced Growth Model

The model gained 1.0% during the quarter. Performance figures for other periods are in the Appendix.

During the quarter, we bought new positions in Linamar (LNR), Embraer (ERJ) and added to our position Vermilion Energy (VET). Please see the reasoning for our purchases below.

Linamar Corp (LNR)
Linamar is the second largest auto parts manufacturer in Canada behind Magna International. We purchased a full position in Linamar in two stages.

We initially purchased Linamar based on valuation and our belief that the auto sector would mostly skirt any major changes in a new NAFTA agreement. Linamar currently trades at ~4x trailing EV/EBITDA compared to Magna at ~6x, the biggest valuation discount to Magna in recent memory and lowest valuation for Linamar shares since mid-2016. Linamar typically trades within 0.5x-1.0x of Magna and the pair typically trades in the 5x-6x EV/EBITDA range. Linamar has been picked on relative to Magna due to its Canada-centric exposure and the seemingly worsening trade relationship between Canada and the US. We believe enacting tariffs on auto parts and finished vehicles would be damaging for all automakers and auto parts manufacturers, would result in equal job losses in both in Canada and the US, and makes no logical sense. As a result, we see no good reason for Linamar's significant valuation discount and believe the current valuation is entirely due to headline related selling and fear.

In late August we learned the terms that US and Mexico already agreed to for the 'new NAFTA'. Shortly after learning of these terms, we added to our position in Linamar. These terms declare that auto companies can evade tariffs if they use more North American product than before (75% North American content versus 62.5% now), use more North American steel and aluminum and a certain portion of vehicles must use labour earning at least US$16 per hour. This is a positive for Linamar as a North America focused parts maker and could result in more parts being made by Linamar in North America rather than made in Europe and shipped to North America. Linamar also has the vast majority of its facilities in places where its workers earn more than US$16 per hour. Further, this deal would allow Trump and potentially Canada and Mexico to apply higher tariffs to non-NAFTA countries which could further boost auto/parts production within North America. We think the market will eventually see Linamar as the foremost winner of the new agreement if these auto terms are maintained.

Embraer (ERJ)
Embraer is a Brazilian aerospace company that produces commercial, military, executive and agricultural aircraft. Embraer is the third largest producer of civil aircraft after Airbus and Boeing.

We purchased a half position in Embraer and will look to make this a full position when the outcome of the Boeing-Embraer deal is solidified. Embraer currently trades at ~7x trailing EV/EBITDA and ~4x 2020 EV/EBITDA based on consensus estimates. Embraer is currently in the midst of a ramp up cycle that should result in above average growth over the next two years. Embraer trades at a 50%-70% discount to peers Boeing, Airbus and Bombardier based on current and future EV/EBITDA multiples. This discount is unusual considering Embraer is the least leveraged company in the sector, it is the market leader in the narrow-body plane segment with

~70% market share and its market leadership is defendable due to meaningful switching costs for airlines and labour/production cost advantages not available to its competitors. Embraer recently signed a non-binding joint venture agreement with Boeing that would monetize a large part of its commercial aircraft business at a much higher valuation while providing global reach and improving earnings consistency. Embraer shares should appreciate considerably if the joint venture agreement is finalized and approved.

Vermilion Energy (VET)

We added to our position in Vermilion after its shares declined almost 20% in a short period of time, despite only a mild decline in oil prices. Vermilion is one of the better capitalized mid-cap Canadian oil companies and as a result should be able to self-fund its production capex and make highly accretive acquisitions in most oil price environments. Vermilion is one of the lower cost operators in Canada and also has a meaningful oil and gas business in the North Sea. We think Vermilion's meaningful exposure to Brent crude oil prices as well as premium European natural gas prices set it apart from Canadian peers. Its very low debt load also means its shares will be less sensitive to oil and gas prices over time and it has historically been much less volatile than other Canadian pure play energy producers. We believe energy producers offer the most value in the energy sector currently as many pipeline and integrated energy companies trade near cycle highs.

During the quarter, we sold our positions in SNC-Lavalin Group (SNC) and Rogers Communications (RCI.B). Please see the reasoning for our sales below.

SNC-Lavalin Group (SNC)

SNC traded at ~12x forward EV/EBITDA (based on consensus estimates). We assume that the market was providing SNC's engineering & construction (E&C) business a valuation multiple of 7.5x forward EV/EBITDA, which is liberal given this is the industry average, above SNC's E&C multiple of the last five years and the performance of its E&C business has been weak and well below expectations**.** Even with this liberal assumption, SNC's current valuation means that SNC's infrastructure business was valued at well over 30x EV/EBIT. This is roughly double the valuation of most infrastructure, utility, pipeline and royalty peers and ~40% above its second highest publicly traded peer. It appears the market has continued to provide SNC's 407 ETR business, and other smaller concessions, with a very high multiple despite decidedly turning on all other comparable stocks due to concerns about rising interest rates.

Rogers Communications (RCI.B)

We sold our position in Rogers Communications after it rallied almost 25% in under four months. Rogers traded at a ~10% premium to both Telus and BCE at the time. We think Rogers should trade at a discount to Telus due to its negative growth media and home phone businesses. We think Rogers trading at close to 9x EV/EBITDA, a historical premium, is not appropriate given that many media stocks trade at 3-5x EV/EBITDA.

Previous to the RCI.B sale, we had double the market weight to the telecom sector. Having such an overweight position in the telecom sector exposed us to significant regulatory and new entrant risk. We think it is possible that Verizon may look at acquisitions in the Canadian market again, given its stated unwillingness to make transformative acquisitions in the US, 20%+ Canadian dollar depreciation since they explored buying Wind Mobile in 2013 and the fact that Shaw/Freedom Mobile in particular would provide a more competition-ready competitor than Wind in 2013. The big three telecom operators all fell ~20% when Verizon announced it was exploring the purchase of Wind Mobile in 2013.

PIMG Balanced Income Model

The model gained 1.4% during the quarter. Performance figures for other periods are in the Appendix.

In line with trades in the Balanced Growth model, we bought new positions in Linamar (LNR), Embraer (ERJ) and added to our position Vermilion Energy (VET).

In line with trades in the Balanced Growth model, we sold our positions in SNC-Lavalin Group (SNC) and Rogers Communications (RCI.B).

In order rebalance the risk of the Balanced Income model, we sold our positions in BMO Covered Call Banks ETF (ZWB) and SmartCentres REIT (SRU.UN). The primary reason for these sales was to reduce equity market exposure and bring the model's equity allocation below the 50% target. Both ZWB and SRU.UN were near multi-month highs and we believed upside to be limited at the time of sale.

Our View Going Forward

The asset allocation of the Balanced Growth model is currently 7% cash, 17% fixed income, 6% preferred equity and 70% common equity and the Balanced Income model is currently 12% cash, 33% fixed income, 7% preferred equity and 48% common equity. We added to common equities during the third quarter as compelling opportunities arose. We believe it makes sense to be highly selective when deploying cash at this point in the economic/market cycle. We think focusing on unique opportunities in the industrials and energy sectors is ideal at the present time as it appears a recession is unlikely in the near future and stable economic growth and rising interest rates tend to benefit these two sectors. We remain somewhat concerned about the risk of contagion from the European financial sector. While rising interest rates are also positive for financials, this European overhang makes financials less attractive than other cyclical sectors and as a result we remain slightly underweight financials relative to our benchmarks.

Global economic activity remains robust, unemployment rates are stuck at cycle lows and corporate credit standards appear to be loosening further so the medium-term economic and equity market outlook remains positive. Corporate credit standards, as per the US Federal Reserve's Senior Loan Officer Survey data, indicates that large US firms are experiencing the least amount of funding stress in five years and have little to no reason to cut back spending plans or employment. This indicator provides us with more confidence than any other that the US economy and in turn the Canadian economy will experience steady, positive growth for the foreseeable future.

With the purchase of Linamar shares, we have officially made a bet that a new NAFTA deal will be finalized and Canada will be included in the deal. While this bet does come with some binary risk, we see the upside associated with deal completion as overwhelming any downside associated with a delayed deal or no deal at all.

At the current time, utility stocks appear to provide better portfolio diversification and a higher yield than credit sensitive fixed income securities like preferred equities, convertible debentures and corporate bonds. Given many utility stocks are already down 10%-20% from their cycle highs, we see utility stocks as having less downside than credit sensitive fixed income while having greater upside in a sideways and/or rising equity market. We currently have a full position in Fortis (pure utility) and Enbridge (quasi-utility) but may look to add more utility exposure in future.

We have been gradually adding to our energy sector exposure throughout the year and may look to add more if specific opportunities arise. The energy sector appears to exhibit even more value than in previous quarters. Investors remain hesitant to toward Canadian energy stocks, and rightfully so given the historic spread between the price of Canadian Western Select and West Texas Intermediate. We think investors are better served by investing in energy companies that have little to no exposure to Canadian oil prices.

We remain positive on the Canadian market mostly due to our optimism with respect to NAFTA. We think the Canadian equity market will outperform if a trilateral NAFTA deal is finalized.

As in the second quarter, CVS Health and DAVIDsTEA shares were the most interesting stocks in the third quarter.

CVS shares rallied consistently throughout the third quarter as the "Amazon threat" appears to have subsided, as we expected, and it was rumoured that the merger between CVS and Aetna is set to

receive all necessary approvals. The CVS-Aetna deal is expected to close in early-to-mid Q4. We believe investors will begin to more accurately value CVS following its merger with Aetna.

While DAVIDsTEA continues to struggle operationally, its stock is now fully caught up in the cannabis craze. DAVIDsTEA's CEO stated in an interview that six cannabis companies approached DAVIDsTEA in the summer presumably to discuss cannabis retail and product innovation opportunities. For anyone who has been in a DAVIDsTEA store, it would not be difficult to convert DAVIDsTEA locations, which are effectively tea dispensaries, into cannabis dispensaries. Such a move is not unprecedented as Second Cup announced last year that it intended to convert some of its stores to dispensaries. Further, most of DAVIDsTEA locations are in urban areas with high foot traffic and fall within the regulatory requirements set by the Ontario government. On the product front, cannabis tea is already sold in US states where cannabis is legal so pivoting to cannabis-infused beverages is not a stretch for a company that has roughly 20% market share in the Canadian tea market. While the DAVIDsTEA story now involves a lot of what-ifs, its valuation is a fraction of many cannabis product and retail companies and its shares could experience material upside if DAVIDsTEA management embraced a pivot to cannabis.

We cut our exposure to the telecom sector as valuations were above average while other interest rate sensitive sectors are generally below their historical valuations. We would be happy to add to our telecom holdings if the sector experiences a correction. We added to the energy and industrials sectors throughout the quarter. We continue to actively look for new opportunities in the industrials and energy sectors.

Sincerely,

Steele Wealth Management

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Appendix

Model	3-mos	6-mos	1-yr	3-yr	Since Inception
Balanced Growth	1.0%	3.6%	3.8%	5.9%	5.2%
Balanced Income	1.4%	3.2%	4.0%	6.5%	5.7%

The above performance data is current as of September 30, 2018. The returns above incorporate 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. Inception date for the Balanced Growth model and Balanced Income model is January 15, 2014. Performance figures for periods greater than 1-year are annualized.