Perron & Partners
WEALTH MANAGEMENT

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Feb. 2018 **Issue No. 11**

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2017 is in the record books.

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PERRON ASSET MANAGEMENT – Managed Account Program

NAFTA Potential Investment Implications

Preparing the Next Generation: How We Can Help You and Your Family

"We'll take a look back at 2017, and at the year ahead, including tax reform, the marijuana market and what the NAFTA negotiations could mean for the Canadian economy."

2017 is in the record books.

Gary Perron, CFA, Portfolio Manager, Founder

Below details our performance in our Kipling funds for 2017 and since inception.

We are proud of our performance relative to our "Investment Styles", which entail purchasing investments (stocks) in commercial businesses at reasonable prices, with growth potential in dividends and earnings.

KIPLING PRIVATE FUNDS

PERRON ASSET MANAGEMENT

PERRON ASSET MANAGEMENT FUND RETURNS

PRICING	NAV	1mth	3mth	6mth	2yr	3yr	2015	2016	2017	Inception
Kipling Strategic Income Fund										
M Series	$10.13	0.11%	1.33%	2.05%					4.76%	5.44% CAD (Aug 16')
Kipling Monthly Income Fund										
M Series	$11.81	0.3%	1.4%	3.4%	8.6%		8.6%	16.2%	1.5%	9.8% CAD (May 15')
Kipling Global Enhanced Dividend Fund										
M Series	$11.57	-1.0%	2.8%	4.4%	6.5%	7.8%	10.5%	2.7%	10.5%	8.6% CAD (Oct 14')
Kipling Global Enhanced Growth Fund										
M Series CAD	$12.68	-1.6%	4.7%	5.6%	5.3%	7.6%	12.4	2.9%	7.8%	9.6% CAD (Sept 14')
M Series USD	$10.02	1.3%	4.5%	9.5%	11.0%	5.4%	-5.1%	7.0%	15.2%	5.5% USD (Oct 14')
Kipling Canadian Enhanced Dividend Fund										
M Series	$ 11.87	2.1%	5.2%	9.2%	10.9%			11.2%	10.7%	10.8% CAD (Oct 15')
US Growth Strategy										
Segregated	USD	1.3%	6.8%	11.8%	13.0%			4.0%	22.8%	11.9% USD (Apr 15')

*As of December 29th, 2017

2017 is in the record books. *Cont'd*

Periodic Table of Canadian and Global Market Returns

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Barclays Core Aggregate US 32%	TSX Small Cap Index 61%	TSX Small Cap Index 34%	Barclays Core Aggregate US 10%	MSCI Emerging Markets Index 16%	Russell 2000 48%	S&P 500 24%	S&P 500 21%	TSX Small Cap Index 38%	MSCI Emerging Markets Index 28%
TMX Bond Universe 6%	MSCI Emerging Markets Index 55%	Russell 2000 19%	TMX Bond Universe 9%	MSCI EAFE Index 15%	S&P 500 41%	Barclays Core Aggregate US 16%	Barclays Core Aggregate US 19%	TSX Composite 21%	MSCI EAFE Index 17%
Russell 2000 -19%	TSX Composite 34%	TSX Composite 17%	S&P 500 4%	Russell 2000 14%	MSCI EAFE Index 31%	Russell 2000 15%	MSCI EAFE Index 19%	Russell 2000 18%	S&P 500 13%
S&P 500 -22%	Russell 2000 34%	MSCI Emerging Markets Index 12%	Russell 2000 -2%	S&P 500 13%	TSX Composite 13%	TSX Composite 11%	Russell 2000 14%	S&P 500 9%	TSX Composite 9%
MSCI EAFE Index -29%	MSCI EAFE Index 14%	S&P 500 8%	TSX Composite -9%	TSX Composite 7%	TSX Small Cap Index 7%	TMX Bond Universe 8%	TMX Bond Universe 3%	MSCI Emerging Markets Index 9%	Russell 2000 7%
TSX Composite -32%	S&P 500 9%	TMX Bond Universe 6%	MSCI EAFE Index -9%	TMX Bond Universe 3%	Barclays Core Aggregate US 5%	MSCI Emerging Markets Index 7%	MSCI Emerging Markets Index 2%	TMX Bond Universe 1%	TSX Small Cap Index 3%
MSCI Emerging Markets Index -42%	TMX Bond Universe 5%	MSCI EAFE Index 2%	MSCI Emerging Markets Index -16%	Barclays Core Aggregate US 2%	MSCI Emerging Markets Index 4%	MSCI EAFE Index 5%	TSX Composite -8%	Barclays Core Aggregate US 0%	TMX Bond Universe 2%
TSX Small Cap Index -44%	Barclays Core Aggregate US -10%	Barclays Core Aggregate US 0%	TSX Small Cap Index -16%	TSX Small Cap Index -2%	TMX Bond Universe -1%	TSX Small Cap Index -2%	TSX Small Cap Index -13%	MSCI EAFE Index -1%	Barclays Core Aggregate US -4%

Source: Bloomberg (chart created by Perron & Partners)

What about 2018?

There are currently some caution flags in the marketplace. Rising interest rates, speculation in Canadian marijuana stocks and crypto-currencies (Bitcoin) is overwhelming. Rising rates, with Canadian household debt at all-time highs, will curtail personal consumption. We have addressed a Canadian macro-industry view of the potential marijuana industry in this newsletter. Bitcoin has attracted a speculative fever of many multiple increases in 2017 with no underlying backing or guarantee of the currency. History has shown that speculative bubbles don't end well, but can continue for unrealistic time frames. This is making us a little concerned and has led us to spend more time ensuring the asset mix in our clients' portfolios is appropriate.

We will have another economic slowdown and/or recession; we just don't know the timing.

Our enhanced portfolio structures (130-30) in three of our funds should outperform in this environment.

2018 will see the benefits of the US tax changes for corporations and personal tax payers and we are focused on the companies who will benefit the most from these changes.

2017 is in the record books. *Cont'd*

Select Canadian companies should be among them, but Canada has the black NAFTA cloud hanging over the markets. Macro changes in geopolitical policies will make for a volatile ride in 2018. The S&P 500 has earnings growth forecasted for 18/17 of 26.6%, while the TSX is forecasted at 21.78%. This will be more of a stock picker's year and execution will be very important in identifying opportunities. To be clear, at this point in time we are not bearish, as the market fundamentals in our businesses forecast continued growth in underlying business fundamentals (revenues and earnings, etc.), but we remain alert and cautious as fundamental forecasts can change quickly.

We have addressed in this newsletter the importance of asset allocation at this stage of the economic cycle and we recommend that you always stick to the investment discipline that has created consistent investment returns.

Asset allocation is the most important choice every investor has to make and we strive to ensure that each household understands the expected returns and risks of their asset mix. (See asset returns chart on the previous page.)

In the last few years, we have emphasized that a Canadian household should overweight Global and US allocations, which have performed very well, but at some time we may want to allocate more of our asset mix back to Canada, due to Canadian exposure to commodities.

We are currently spending a lot of resources understanding what stage we are at in the commodities cycle. While the chart on page five shows how commodities have performed over the last 10 years, we are thinking it may be time to increase our portfolio weights in commodities. Not all commodities are alike, but the supply/demand situation on a world basis is changing for some particular commodities.

We could have a situation of rising commodity prices and underperforming stock markets.

Again, asset allocation is important in order to participate with the companies (stocks) who will benefit.

The chart on page 3, similar to the commodity-based one on page 5, shows the returns of Canadian and Global Market asset classes over the last 10 years. You can see by looking at the colours that there is no obvious trend in what asset class will perform the best given a certain time frame.

Quite often the area that performs the best in one year will be one of the worst performers the following year.

However, as seen with Canadian small cap in 2009-2010, sometimes the momentum continues on for more than a single year. This thought process makes it evident to us that we need exposure to all markets and asset classes to have an effective portfolio. Our team's collective experience of 100+ years has taught us that we are never as right as we think

2017 is in the record books. *Cont'd*

Periodic Table of Commodity Returns, 2017

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Coal 13%	Copper 141%	Palladium 97%	Gold 10%	Wheat 19%	Gas 26%	Palladium 11%	Lead -3%	Coal 104%	Palladium 56%
Gold 6%	Lead 137%	Silver 83%	Oil 8%	Lead 15%	Oil 7%	Nickel 7%	Corn -10%	Zinc 61%	Aluminum 32%
Corn -11%	Palladium 118%	Corn 52%	Coal 6%	Zinc 12%	Palladium 2%	Zinc 4%	Gold -10%	Gas 59%	Coal 31%
Silver -23%	Zinc 114%	Wheat 47%	Corn 3%	Gas 12%	Zinc 0%	Aluminum 4%	Coal -11%	Oil 45%	Copper 30%
Gas -25%	Oil 78%	Nickel 34%	Silver -10%	Platinum 10%	Coal -1%	Gold -2%	Silver -12%	Palladium 21%	Zinc 30%
Wheat -31%	Nickel 59%	Copper 31%	Wheat -18%	Silver 9%	Lead -5%	Wheat -2%	Aluminum -18%	Copper 17%	Nickel 28%
Aluminum -36%	Platinum 57%	Coal 31%	Palladium -18%	Corn 8%	Copper -7%	Corn -6%	Gas -19%	Silver 15%	Lead 24%
Platinum -39%	Silver 48%	Gold 30%	Aluminum -19%	Palladium 8%	Platinum -11%	Platinum -12%	Wheat -20%	Aluminum 14%	Gold 13%
Palladium -49%	Aluminum 46%	Platinum 21%	Platinum -21%	Gold 7%	Aluminum -14%	Copper -14%	Platinum -26%	Nickel 13%	Oil 12%
Zinc -50%	Gold 24%	Oil 15%	Copper -21%	Copper 4%	Nickel -19%	Coal -16%	Copper -26%	Lead 11%	Silver 6%
Oil -54%	Corn 2%	Aluminum 12%	Lead -22%	Aluminum 2%	Wheat -22%	Lead -16%	Zinc -27%	Gold 9%	Wheat 5%
Copper -54%	Gas -1%	Lead 7%	Nickel -24%	Oil -7%	Gold -28%	Silver -19%	Palladium -29%	Platinum 1%	Platinum 3%
Nickel -55%	Wheat -11%	Zinc -3%	Zinc -25%	Nickel -9%	Silver -36%	Gas -31%	Oil -30%	Corn -2%	Corn 0%
Lead -60%	Coal -13%	Gas -21%	Gas -32%	Coal -17%	Corn -40%	Oil -45%	Nickel -42%	Wheat -13%	Gas -21%

Source: Data from The Periodic Table of Commodity Returns 2017, US Global Investors

we are. By having selective exposure to the market, our portfolios are able to experience a positive return in an area that may otherwise have been overlooked.

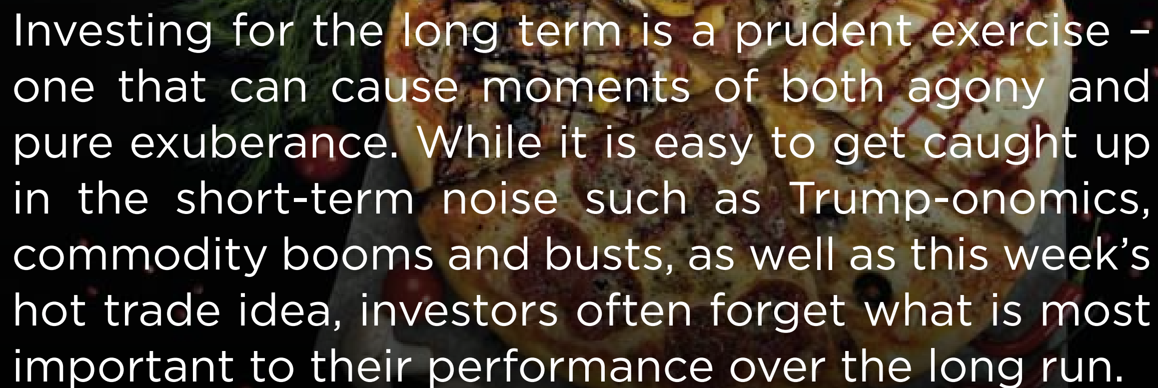
In this newsletter, we continue to expand our wealth management services with an article on preparing the next generation. We also address US tax reform, asset allocation, NAFTA issues, marijuana business economics, and the expansion of our managed account program.

Wishing our clients and friends a healthy and prosperous 2018.

Gary Perron, CFA
Portfolio Manager, Founder

Back to the Basics: Asset Allocation

James Nickerson, CFA, Investment Advisor



Investing for the long term is a prudent exercise – one that can cause moments of both agony and pure exuberance. While it is easy to get caught up in the short-term noise such as Trump-onomics, commodity booms and busts, as well as this week's hot trade idea, investors often forget what is most important to their performance over the long run.

It is widely agreed upon by both industry professionals and academics that the most important aspect of long-term performance is not stock picking or market timing, but rather the investor's long-term asset allocation.

It has been suggested that 90% of portfolio performance is purely based on an investor's asset allocation.

The process of determining an investor's asset mix is a critical piece of the investment process and is one aspect we spend a large amount of time on at Perron & Partners. The asset mix that is optimal for any individual or corporation at a given time will largely depend on the time period the investment will be made, as well as the ability both financially and psychologically for that investor to tolerate risk. More specifically, factors that affect the asset mix decision include:

- **Time Horizon** – The time horizon is the expected number of months, years, or decades that the funds will be invested to achieve a particular financial goal. Normally, a longer investment horizon affords that ability to withstand exposure to riskier (more volatile) securities in hopes of achieving higher returns due to the fact that slow economic cycles and the inevitable ups and downs of the markets can be 'waited out'. On the other hand, the closer to term the financial goal is, the less risky the investment strategy should be, because there is very little time to recover from a negative financial event.

- **Risk Tolerance** – Risk tolerance should not only consider the ability to withstand bad markets, but also the willingness to accept bad markets. Risk tolerance is the acceptance that, over any given time frame, some or all of the original investment capital may lose value in exchange for the potential of ultimately

Back to the Basics: Asset Allocation *Cont'd*

realizing greater returns. The most important concept to remember is that an aggressive investor (one with a high risk tolerance) is more likely to achieve better investment results than a conservative investor (one with a low risk tolerance) over a sufficiently longer period of time (i.e. five years).

From a basic approach there are three asset classes commonly used; their traits are as follows:

- **Equities** (high risk / high growth) – Historically equities have had the greatest risk and highest returns among the three major asset categories. As an asset class, equities are a portfolio's "big guns", offering the greatest potential for growth. There is no secret that some stocks can turn into homeruns, but some stocks also strike out. The volatility of equities makes them a very poor choice for short-term investment strategies (i.e. anything less than two years). Consider the fact that equities as a group have lost money on average about one out of every four years and sometimes these losses have been quite significant. However, on the flip side, equity investments typically gain in value seven out of 10 years with some of these gains being very dramatic. So for investors that are willing and able to ride out the volatile ride that equities take will likely be rewarded with strong positive returns.
- **Fixed Income** (low risk / low growth) – Bonds and GICs are less volatile than stocks and offer more modest returns. A common strategy for investors approaching a financial milestone is to increase the amount of fixed income exposure relative to equity in order to reduce the overall risk to the portfolio. Additionally, increased fixed income weightings would be highly attractive to any investor that is unwilling to accept swings in the value of the portfolio under any circumstance. In this case capital protection is more important than capital growth.
- **Cash** (zero volatility / zero growth) – Cash and cash equivalents, such as savings accounts, Certificate of Deposits, T-bills and money market funds are easily the safest investments around. The catch is they provide the lowest return of the three major asset classes. The chances of losing money on an investment in this asset category, while not impossible, are generally extremely low. What is important is that the chief concern for investors utilizing cash is inflation risk.

Other asset classes (ex. real estate, private equity, commodities, precious metals, market-neutral strategies, etc.) also exist and will be included in some investors' portfolios. These types of assets will typically offer a level of diversification to a client's portfolio, but ultimately will be subject to very category-specific risk.

The main goal of an asset allocation should be made in effort to maximize an investor's risk-adjusted returns.

That is to say that, while the upside potential is an important factor with one's portfolio, downside protection must also be in the forefront.

Back to the Basics: Asset Allocation *Cont'd*

Remember, that if a portfolio is down X% one year, a return of 1/(1-X%) must be achieved the next year for the portfolio to regain what it has lost. For example, if you lose half (50%) of an investment, you then need to double the holding to get back to even. By including different types of asset classes that respond differently under different market conditions, the portfolio should be protected from significant losses - the idea being that not all the asset classes will move up together nor will they move down together.

Economic conditions that cause one asset class to preform well typically are the same conditions that cause another asset class to perform poorly.

Ultimately, this effect will dampen volatility and provide the investor with smoother returns.

One final thing to note is that while a portfolio should be diversified between asset classes, it is important to also diversify within asset classes. In addition to allocating your portfolio between equities, fixed income and cash, your PPWM Portfolio Managers will also spend a large amount of time determining the optimal allocation towards Canadian, US and international equities as well as the appropriate grouping of government, corporate, high-yield and emerging market debt within the fixed income component.

While it may be tempting to allocate all of your capital to one sector or to trade on news headlines, more often than not we find that to be an ill-advised strategy.

A proven approach comes from investing over the long term, and your asset allocation should be at the forefront of the conversation.

US Tax Reform

Darrin Erickson, MBA, CFA, Portfolio Manager, Perron Asset Management

The US stock market was strong in 2017, posting a return of almost 22% in US dollar terms. A significant part of this move was driven by the expectation for tax reform, which was passed by Congress at the end of the year.

Corporate tax rates were reduced from 35% to 21%, while repatriated earnings will be subject to a 15.5% tax on liquid assets and 8% on other earnings with an 8-year payment window. Net interest deduction is limited to 30% of adjusted taxable income, and net operating loss (NOL) deductions are capped at 80% of taxable income and may now be carried forward indefinitely (previously limited to 20 years). Lookback for NOLs is no longer allowed. Capital expenditures see full depreciation and are 100% deductible for five years. For small businesses, the capital investment deduction limit is increased from $500,000 to $1 million.

The corporate alternative minimum tax (AMT) was eliminated.

The tax bill also reduced individual tax rates for most Americans. The standard deduction for individuals was increased from $6,350 to $12,000 and for couples from $9,350 to $24,000. Changes to individual tax brackets are shown in the table below.

Other significant changes to individual taxation include:

Pass-through businesses (often used by professionals running a law or medical

Provision	Current Law		Conference Bill	
	7 Brackets 10% - 39.6% (top rate starts at $470,700 for joint filer – for 2017)		7 Brackets - 10% - 37% (top rates starts at $600,000 for joint filer)	
	Single	Married	Single	Married
Income Brackets	10% - <$9,325	10% - <$18,650	10% - <$9,525	10% - <$19,050
	15% - $9,325	15% - $18,650	12% - $9,525	12% - $19,050
	25% - $37,950	25% - $75,900	22% - $38,700	22% - $77,450
	28% - $91,900	28% - $153,100	24% - $82,500	24% - $165,000
	33% - $191,650	33% - $233,350	32% - $157,500	32% - $315,000
	35% - $416,700	35% - $416,700	35% - $200,000	35% - $400,000
	39.6% - $418,400	39.6% - $470,700	37% - $500,000	37% - $600,000

Source: "Done Deal – Tax Reform Passes Congress." Raymond James Equity Research, 2017.

US Tax Reform *Cont'd*

practice), which had been subject to the individual marginal rate, have been changed to allow most pass-throughs to deduct 20% of business income. The deduction for joint filers in service businesses is limited to $315,000.

The State and Local Taxes (SALT) deduction (where up to $10,000 in taxes paid to states and local governments were deductible) was repealed.

Mortgage Interest Deduction (MID) was also impacted. Previously, mortgage interest paid was deductible for a principal residence and one other residence up to $1 million. Deductions for up to $100,000 on interest paid on home equity loans were also allowed.

Under the new tax bill, MID is capped at $750,000 from 2018-2025, but it retains the $1 million cap for acquisitions made before December 15, 2017.

The ability to deduct interest on home equity loans was removed.

The base exclusion for estate taxes was increased from $5 million to $11.2 million and will be indexed for inflation going forward.

As you can see, the tax reform passed in the US has far-reaching implications for US businesses and should give a small boost to overall economic growth.

Goldman Sachs currently expects a 0.25% increase in GDP growth in 2018 and another 0.25% increase in 2019 as a result of tax reform. In the short-term these tax cuts should help support both the US economy and equity market.

As of January 24, 2018, 45 of the companies in the S&P 500 had provided updated guidance regarding their expected tax rate. On average, tax rates are expected to fall from 28.5% to 22% for those companies, with the biggest impact seen in Industrials, where tax rates in the Capital Goods and Transportation sub-industries are expected to drop by roughly 10%. However, not all sub-industries will benefit, as Business Services companies are expected to experience an 8% increase in their tax rate. Financials and Telecom are also expected to see large (~8%) decreases in their tax rates. Although tax rates for Healthcare companies are expected to improve only modestly, they remain among the lowest of any sector in the S&P 500.

An Update on the Fund

As you are aware, in responding to the needs of our clients to increase exposure to global equity markets, we expanded the investable universe of the Kipling US Enhanced Equity Fund to include global equities. To reflect this adjustment accurately, the name of the fund was changed to the Kipling Global Enhanced Growth Fund and will be benchmarked against the MSCI World Index. The MSCI World Index is approximately 40% invested outside of North America. The fund continues to invest in high-quality growth companies and the quarterly distribution of the fund remains unchanged.

The End of Prohibition: Round 2

Derek VanGenderen, Equity Analyst
James Nickerson, CFA, Investment Advisor

Ever since the kick-start of cannabis legalization led by Colorado and Washington in January 2014, there has been a growing fervor around medical marijuana companies. Canada has joined many US states with the planned legalization and sale of the products country wide.

Cannabis users are not the only ones getting “high”, as investors in names like Canopy Growth, Aurora Cannabis and Aphria, to name a few, have seen their investments triple, quadruple and in some cases, quintuple in value over the last three months. While the majority of companies do not generate positive earnings or cashflow, the move has been primarily due to the July 1, 2018 planned legalization, leading to speculation on the potential of future revenue and earnings within the sector (sound familiar?).

As of this writing, the combined market capitalization for the marijuana space is over $30 billion on all Canadian exchanges.

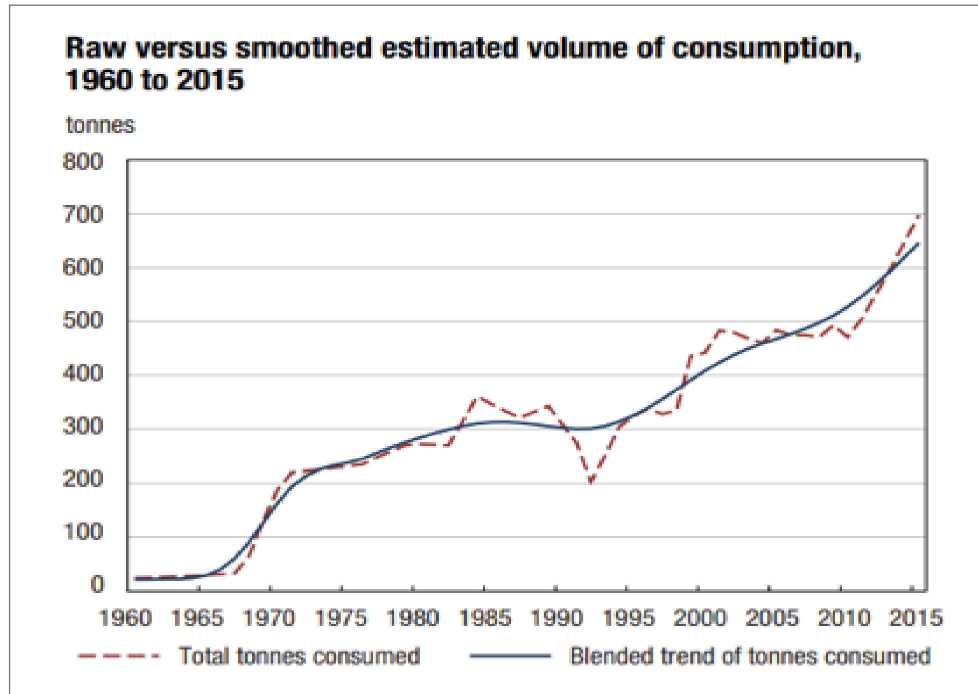
We beg to ask the question: just what is the potential for this industry and how much of that is currently priced in?

To try and see what could happen with this market, we look to Colorado, which legalized marijuana in January of 2014. The growth of the market has surprised many spectators with the speed of sales growth and overall size of the market. In 2017, Colorado recorded about $1.5 billion of sales. This is with an approximate adult population of 4.5 million adults on a base of 5.6 million total people. Tourism has provided an additional boost to the sales with 8% of the 77.7 million annual tourists saying they visited a dispensary (no reference was made on whether or not they made an actual purchase).

Given the sales figure and the average retail price of $6.61 per gram (since 2014 retail prices have fallen 25% while wholesale prices declined 48%) has a roughly implied annual consumption of 226.9 million grams.

This has an implied average consumption of

The End of Prohibition: Round 2 *Cont'd*



50.5 grams per year per adult in Colorado. Some will use none and some will use more, but the implied average basically means that once a week the average Colorado adult is using cannabis.

Transitioning over to Canada, legalization has been planned to occur around July 1, 2018. The ground roots are already in place with the federal and provincial governments working with producers and retailers in preparation for the coming changes. Canada has a population of approximately 36.7 million people with an adult population of ~29.5 million. Statistics Canada estimated that in 2015 the Canadian marijuana market (illegally) was $6.2 billion (average prices hovering in the $8/gram range), consumed by 4.9 million people, totalling 698 metric tons.

This means current consumption for the active user population is 2.7 grams per week or 0.5 grams per week if spread across all Canadian adults.

This compares to a current $9 billion beer market and $7 billion wine market.

The important question is how big can the market become in Canada? For simple math let's take Colorado's roughly one gram per week number (doubling the current consumption in Canada) and multiply it across the 29.5 million Canadians. This creates a market in the 1,500 metric ton range. Retail sales prices have fallen in Colorado significantly, making it so that the old $8 range per gram in Canada could possibly reach $6 or lower. This creates a market with roughly $9.2 billion in sales, adding nearly $3 billion on top of the current estimated size.

The End of Prohibition: Round 2 *Cont'd*

Population by sex and age group

	2017					
	Canada	**Male**	**Female**	**Canada**	**Male**	**Female**
	Persons (millions)			% of total of each group		
Age group						
Total	**36.7**	**18.2**	**18.5**	**100**	**100**	**100**
0 to 4	**2.0**	1.0	1.0	**5.3**	5.5	5.1
5 to 9	**2.0**	1.0	1.0	**5.5**	5.6	5.3
10 to 14	**1.9**	0.9	0.9	**5.2**	5.4	5.1
15 to 19	**2.0**	1.1	1.0	**5.6**	5.8	5.4
20 to 24	**2.5**	1.3	1.2	**6.7**	7	6.5
25 to 29	**2.6**	1.3	1.3	**7**	7.1	6.9
30 to 34	**2.6**	1.3	1.3	**7**	7	6.9
35 to 39	**2.5**	1.2	1.3	**6.8**	6.9	6.8
40 to 44	**2.4**	1.1	1.2	**6.4**	6.5	6.4
45 to 49	**2.4**	1.2	1.2	**6.6**	6.6	6.5
50 to 54	**2.6**	1.3	1.3	**7.2**	7.3	7.1
55 to 59	**2.7**	1.3	1.3	**7.3**	7.3	7.3
60 to 64	**2.4**	1.1	1.2	**6.5**	6.4	6.5
65 to 69	**2.0**	1.0	1.0	**5.4**	5.4	5.5
70 to 74	**1.5**	0.7	0.8	**4.2**	4.1	4.4
75 to 79	**1.1**	0.5	0.6	**2.9**	2.7	3.2

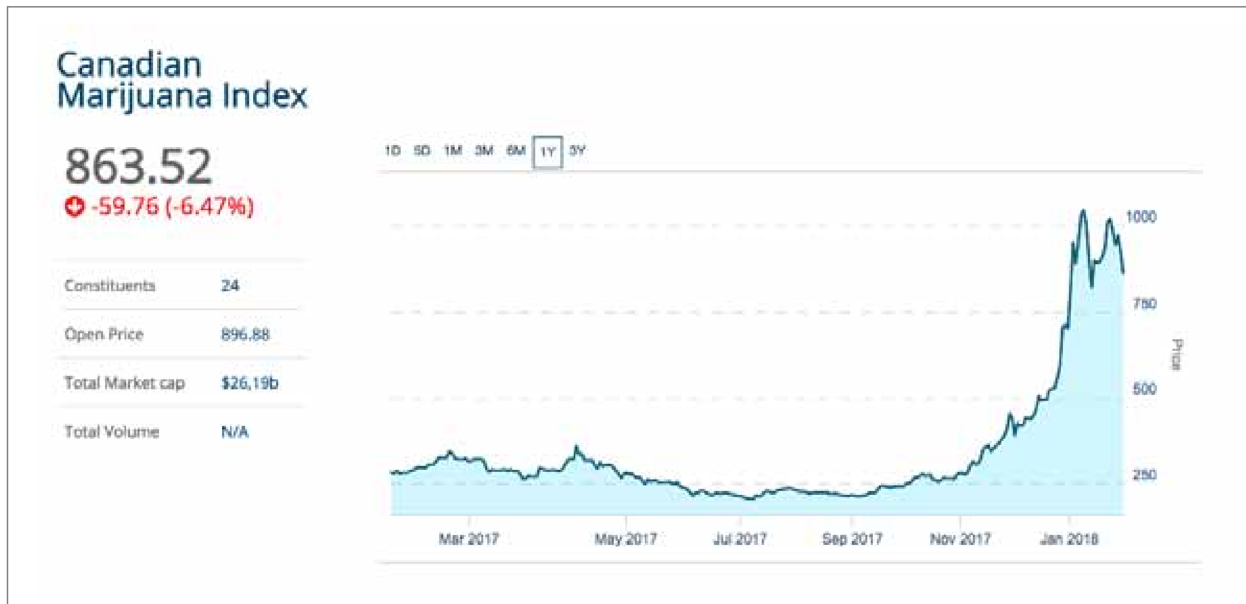
Source: Statistics Canada, CANSIM, table 051-0001.

The cannabis industry could in the very near term be matching beer sales dollar for dollar.

Now that we know the end market retail sales, we can make some assumptions and back into the potential profits of producers. Liquor store retailers generally earn about a 30% gross margin on products sold, so collectively the stores are purchasing $6.45 billion of product from growers. Most top-tier spirit and beer producers sport after-tax margins in the low 20s. Let's say marijuana producers earn 30% after tax on sales; this would create a Canadian cannabis profit pool of $1.9 billion dollars annually. Collectively today, the current market cap on the Canadian marijuana index is $30.8 billion. This means at today's stock prices and our market estimates, you are paying ~16x times fully penetrated earnings for the entire industry. That is on the back of some generous consumption forecasts more than doubling, margins being 50% higher than the most profitable alcohol producers, and average sale prices falling only 25%.

The potential for expansion into the US market could be an interesting scenario where there is growth that we have not accounted for, but to us that seems to be a scenario that is a

The End of Prohibition: Round 2 *Cont'd*



Source: The Canadian Marijuana Index

long way away from being a realization, and fraught with competition.

One thing to note is that even though recreational marijuana is legal in eight states, it is still federally illegal.

One of the biggest obstacles that stands in the way of these companies being able to grow (pun intended) in the United States is due to this fact. As marijuana is still considered a Schedule One substance, categorized to be as harmful as heroin, banks risk losing their federal charter if they work with cannabis companies. Financial institutions need to go on record with the US Treasury Department's Financial Crimes Enforcement Network (FinCen) to establish a relationship with a known marijuana-related business. As a result, in 2017 it was estimated that 70% of Colorado-based cannabis companies still had no basic bank accounts and operated solely in cash. Keep in mind estimates have recreational marijuana in California as a $5.2 billion revenue-generating industry – that's a lot of cash which could lead to a lot of unforeseen problems. For these cannabis companies to be viewed as legitimate, they will need access to basic banking.

For this to happen, something needs to be done with the federal legality of marijuana and we do not see that changing with the current administration.

On an international basis, the only currently viable market is in the medical space. Currently the Canadian companies have two distinct advantages. The first advantage is Health Canada's stamp of approval. Health

The End of Prohibition: Round 2 *Cont'd*

Canada is widely regarded as one of the most well-respected medical organizations and approval with Health Canada carries a lot of weight across the globe. Due to this, approval in other parts of the world should be easier for Canadian-backed companies and their products, relatively speaking. The second advantage is due to the fact that legalization in Canada has created a feeling that these companies are legitimate businesses, and as so they have access to capital.

Whether it be through bank lending or equity financings, access to capital for Canadian cannabis companies allows them to act as financiers for local medicinal marijuana companies in other countries.

Through equity stakes or joint ventures, money raised in Canada can be spread globally. A lot of this would require flawless execution from management, though, and is a difficult investment thesis to bank on.

While our calculations could be wrong every step of the way, we believe the total market size we have calculated is not out of line either pessimistically or optimistically. So what does this mean? Whether you are buying individual Canadian cannabis stocks or the industry collectively, you are already paying for complete market penetration in Canada - the only caveats being the unknown factor of how big the US market could potentially become, as well as how Canadian management teams will execute on global growth.

If consumption, prices or margins miss the expectations embedded in any of these companies, there is significant risk to current stock prices.

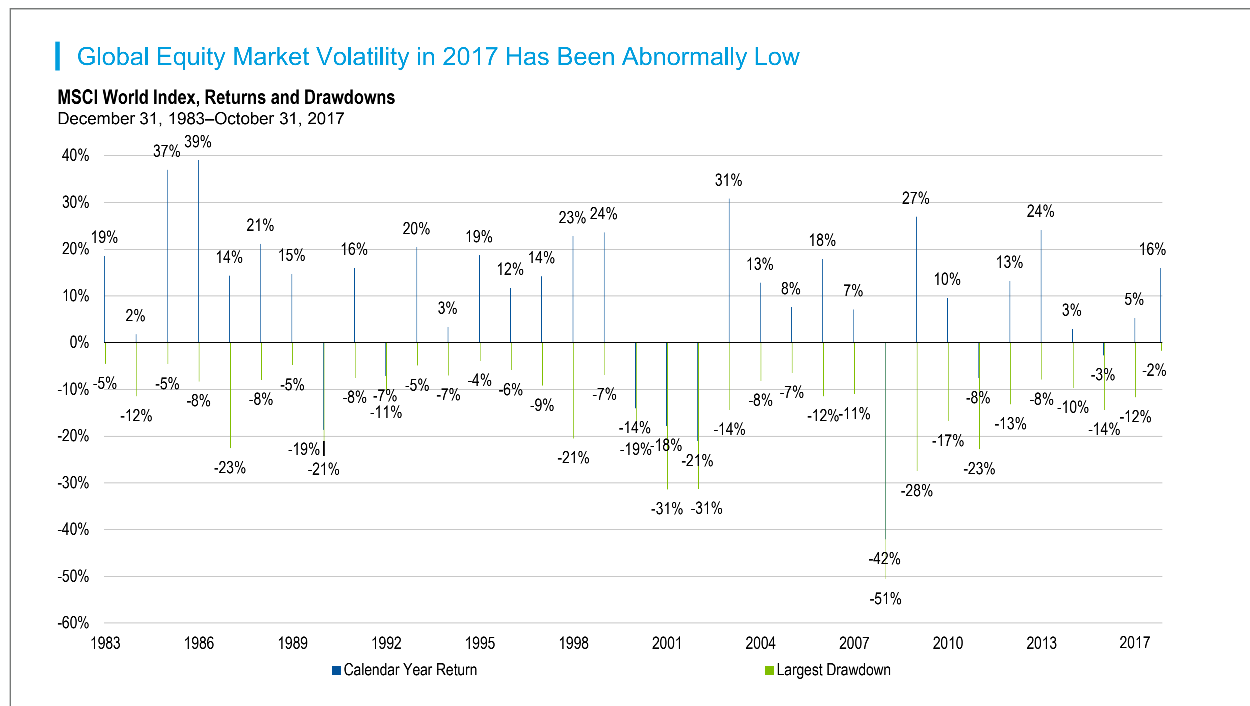
It is this risk that makes us think the better way to invest would be to look for some industries that could see an uptick in sales due to the legalization of marijuana, such as....snacks.

PERRON ASSET MANAGEMENT – Managed Account Program

Jason Isaac, CFA, CAIA, Portfolio Manager, Perron Asset Management

The challenge for investors in the coming year will be to prepare their portfolio for the possibility that the the traditional diversifying relationship of stocks and bonds may not hold in 2018.

While traditional portfolio management is based on the idea that stocks and bonds move in opposite directions, there could be a switch in 2018. Specifically, we must consider the possibility that bond yields rise (and consequently bond values fall), and that equities could decline in value as well. From a purely financial mathematics point of view, the value of any financial asset is determined by the present value of the expected cash flows from that asset. Markets have become overly reliant upon exceptionally low discount rates on which these expected cash flows are valued and a strong and messy shift higher



Source: Franklin Templeton 2018 Global Investment Outlook "Optimism and Selectivity in 2018", Ed Perks EVP, Portfolio Manager.

PERRON ASSET MANAGEMENT – Managed Account Program *Cont'd*

in rates could/will detrimentally impact the valuations of all risky assets. As a result, given that there will be less monetary support as 2018 unfolds and we expect an increase in overall global equity volatility (in 2017 it was abnormally low – see chart on previous page.), the PAM Managed Solutions are positioned heading into 2018 towards lower-risk equity solutions, non-traditional alternative assets, and lower-duration fixed income with the primary objective of dampening the expected volatility over the coming year.

Why Perron Asset Management's Managed Account Program?

- Team collaboration – best ideas of the entire Perron & Partners team
- Exposure to the world's largest, most diverse and liquid equity markets
- Global in-house investment management by Kipling Funds
- Geographic and sector diversification beyond the domestic market (Technology, Health Care and Industrials)
- Focus on companies with stable, strong cash-flow-generative businesses
- Active and passive investment strategies
- Managed portfolios to suit every investor

Active vs. Passive: The Debate

An active portfolio manager can add value in one of two ways:

1. Security selection (individual security analysis)
2. Factor tilt (value/quality/momentum/volatility/size/themes/sector/geographic allocations)

Active Share is the percentage of the holdings in the portfolio that differ from the benchmark. It is a reasonable proxy for security selection.

Tracking Error indicates risk exposure of the portfolio above and beyond what affects the benchmark. It is a reasonable proxy for the aggregate level of factor tilts that differ from the benchmark. Each metric emphasizes a different aspect of the active portfolio management process.

✓ Higher Active Share has shown to be a good indicator of persistent positive performance without assuming additional risks.

✓ Higher Tracking Error entails increased risks without any evidence of consistently improving performance.

All things equal, preference should be for portfolios that exhibit high active share and low tracking error.

Managed Account Mandates

- Income – Lower-risk investor looking for income, stability, and capital preservation
- Income with Growth – Moderate-risk investor looking for income, capital preservation, and moderate growth
- Balanced – Moderate- to high-risk investor looking for a balance of fixed income and equities
- Growth – Higher-risk investor looking for the potential of long-term growth
- Maximum Growth – Higher-risk investor with no need for income looking to maximize long-term growth

PERRON ASSET MANAGEMENT – Managed Account Program *Cont'd*

December 29, 2017

Balanced – Managed Investment Solution

Portfolio Commentary:

Cash (underweight) Modest allocation which is earmarked for opportunities in the large cap developed market equities & alternative assets to provide volatility dampening advantages to the portfolio. **Fixed Income (underweight)** Direction of 2yr yields is one of the more accurate predictors of forward GDP & with the current trajectory, it's hard to argue against future strength. As a result, the fixed income strategy remains cautious regarding government bonds, & has a tilt toward shorter duration, which lowers the bond's portfolio price sensitivity to changes in interest rates. Improving growth, favorable fiscal policies, plus higher yields, provides opportunity in emerging-market debt. Corporate credit conditions appear healthy right now, but with tight spreads currently, any rate increases could cause pressure for bonds that are more susceptible to price declines or defaults should credit conditions turn, thus, PAM will be reducing exposure to High Yield bonds. **Equities (overweight)** Global economic growth outlook remains solid & equities are still the favored asset class, however, PAM is expecting greater volatility in general relative to the past 24-36 months. The equity strategy will continue to employ broad diversification to dampen this anticipated uptick in volatility with specific areas of opportunity being the Eurozone (positive earnings cycle & persistence of ultra-low rates), Japan (attractive valuations, loose monetary policy, & expected corporate buybacks) & Emerging Markets (strong economic growth, expanding middle class & FX tailwinds). That being said, PAM recognizes heading into 2018, valuations are stretched in certain pockets of global equities & we're looking to trim exposures in Global Infrastructure & Small-Cap equites. As is consistent with our over-arching investment philosophy we view corporate earnings, CF & DVD growth will matter most for the performance potential of global equities going forward. **Alternatives (overweight)** Alternatives typically receive an income stream while exhibiting low correlation to standard asset classes, which makes them suitable for portfolio diversification. Because of this, many large institutional funds such as pensions & private endowments have begun to allocate a small portion of their portfolios, typically < 10%.

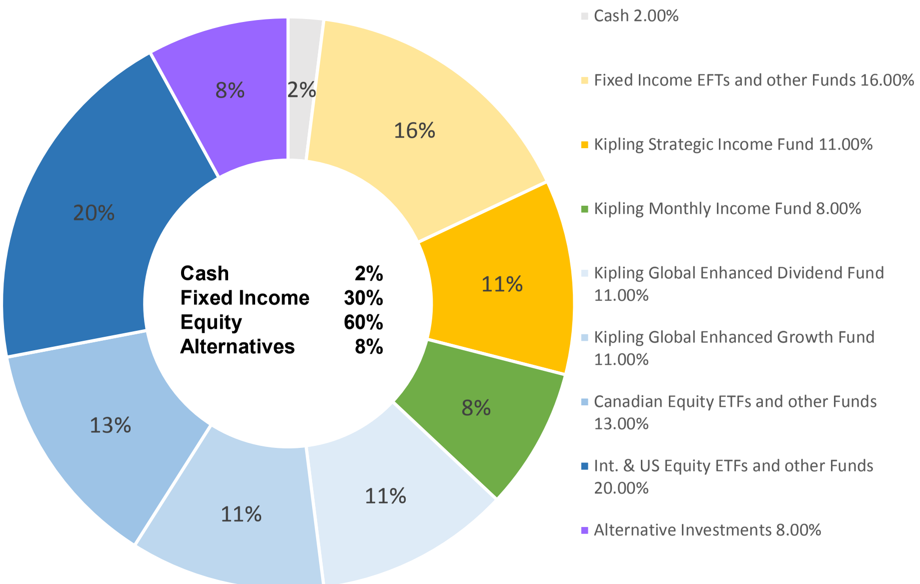
Key Benefits

- Diversified, low-cost portfolio of actively managed pooled funds, mutual funds and top-tier exchange-traded funds (ETFs).
- Actively managed asset allocation.
- Portfolio targets a maximum return for a given level of risk.
- Income stream with capital appreciation upside potential.
- Active & passive investment products.
- Geographic and sector diversification beyond domestic market.
- International currency exposure dynamically hedged to the Canadian dollar.

Asset Allocation Discretionary Ranges

Asset Class	Current	Neutral	Range
Cash	2%	5%	0-20%
Fixed Income	30%	40%	+/- 10%
Equity	60%	50%	+/- 10%
Alternatives	8%	5%	0-10%

Asset Allocation



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NAFTA Potential Investment Implications

Chris Bolton, CFA, Portfolio Manager

The sixth round of North American Free Trade Agreement (NAFTA) negotiations took place from January 23-28, 2018 in Montreal. While almost unthinkable two years ago, the termination of NAFTA is now being viewed as possible or even probable. Here were my thoughts leading up to the meeting.

Key US demands appear to include a sunset clause that would effectively require countries to ratify the treaty every five years, an ending to the current dispute settlement mechanisms and significant changes to government procurement rules. Several trade experts think that these demands are unacceptable to the governments of both Canada and Mexico. Consequently, the risk of NAFTA being terminated is increasing.

Is trade with Canada a problem for the US?

To quote the Office of the United States Trade Representative (an Executive Office of the President of the United States) website, "The US goods and services trade surplus with Canada was $12.5 billion in 2016." Canada is the largest export market for 32 US states and the number two export market for the majority of the remaining 18 US states.

The facts seem clear that the US has a trade surplus with Canada and that Canada remains a very important market for the vast majority of US states.

However, ideology can frequently override facts, particularly in a political arena.

What could take the place of NAFTA?

One of the biggest unknowns is what might replace NAFTA. Alternatives could include reverting to the Canada-US Free Trade Agreement, or to World Trade Organization (WTO)-level tariffs. We believe if NAFTA is terminated, there may not be the political will to revive the 1989 Canada-US Free Trade Agreement. Therefore we think a reversion to WTO-level tariffs is the most likely scenario.

Implications for the Canadian Economy

Canadian banks estimate the termination of NAFTA and the reversion to WTO-level tariffs would reduce Canadian GDP by 1-2% (in aggregate) over the next decade.

The Bank of Montreal estimates the Canadian dollar would decline by approximately 5%. The lower exchange rate would act as a potential buffer to exporters.

We also believe the Bank of Canada may be more accommodative in terms of monetary policy (either reducing short-term interest rates or being slower to increase short-term interest rates). Arguably,

NAFTA Potential Investment Implications *Cont'd*

consumers would be one of the bigger losers in a NAFTA termination. For example, the Bank of Montreal estimates that a weaker exchange rate and modestly higher tariffs would raise consumer prices by roughly 0.8%.

Sectors That May Benefit From a NAFTA Termination

As noted above, the Bank of Montreal estimates the termination of NAFTA to result in the Canadian dollar declining by approximately 5%.

In that scenario, we believe the sectors where companies sell their products in US dollars and pay little or no tariffs under WTO are most likely to outperform.

These would include sectors such as oil and gas producers and metals and mining.

We caution that the US administration could seek to enact other restrictions, regulations and/or costs on any company looking to export product to the US. We would also note that these companies may face higher capital costs for capital equipment priced in USD.

Finally, if the termination of NAFTA results in lower growth in North America, this could also lead to less demand for commodities and therefore lower prices.

We note that President Trump approved the Keystone XL pipeline on March 24, 2017. We believe this signals that the current US administration would like to encourage oil imports from Canada.

Sectors That May Be Vulnerable

In the first five rounds of negotiations, two of the sectors that the US appears focused on are auto parts and dairy products.

The US made a proposal related to auto parts in October 2017. First, the proposal would require all cars to include 85% North American content to avoid a tariff, an increase from the current 62.5%. Second, 50% of a car's content would have to come from the US. Third, it would update the way content is calculated, with a list upgraded to include parts that didn't exist in 1994 when NAFTA was originally implemented.

If accepted, we believe this proposal would be negative for Canadian auto part makers.

The supply chain of auto parts in North America is very integrated, with some parts crossing borders 5-7 times before the final product is delivered to the customer. While the WTO most-favoured nation tariff is only 2-4% on most auto parts, if it is charged each time the part crosses a border it will radically change the North American supply chain.

In addition, we believe the US Federal Reserve and the Bank of Canada are likely to increase interest rates in 2018 and it appears that auto sales are nearing their peak for this cycle in North America.

Despite all of these factors, auto part stocks have been strong performers. The S&P/TSX Composite Index Auto Parts and Equipment Sub Industry Total Return Index increased by over 64% from June 30, 2016 until the end of 2017. We believe investors should avoid Canadian auto part suppliers in 2018.

NAFTA Potential Investment Implications *Cont'd*

Canada has high tariffs on imported dairy products. This has long been an irritant for many of our trading partners, including the US.

While it is difficult to determine if Canada will change its policy, it seems to us that the best case for Canadian dairy producers is the status quo.

If Canada is willing to liberalize trade in dairy products as part of a broader NAFTA renegotiation, it would likely be negative for Canadian dairy producers. Consequently, we would also avoid this sector.

Finally, under WTO tariffs are relatively high on products such as trucks greater than 20 tons (~25%), clothing products (~12%), and food and beverage (up to 20%).

Positioning of the Kipling Monthly Income Fund

The potential renegotiation or termination of NAFTA is one of many factors we take into consideration when choosing where to allocate our clients' capital. We are overweight Energy as we believe that sector will be a modest beneficiary of NAFTA collapsing. We also hold approximately 14% of the fund's assets in US dollars. If NAFTA were to be terminated we believe the US dollar will appreciate relative to the Canadian dollar. In addition, we have avoided allocating our clients' capital to sectors we think are more vulnerable. These include auto parts, dairy products, clothing, and food and beverage makers.

Conclusion

In summary, predicting the outcome of ongoing trade negotiations is difficult.

We do not believe it is prudent to make a large "bet" with the capital of our clients based on a particular outcome.

Nevertheless we need to be prepared for all outcomes. Furthermore, our analysis indicates there are clearly sectors that have the risk of a meaningful decline under certain scenarios.

Preparing the Next Generation: How We Can Help You and Your Family

Shawnalynn Perron, MBA, CIM, FEA, Portfolio Manager

Preparation initiates from the first generation business or wealth creators. You cannot expect the next generation to mature and understand the significance of what they will be managing or inheriting if they are unaware of what exactly it is they are inheriting.

It's like gifting a child a bicycle and expecting them to know how to sit on it, balance on it and ride it all at once. You need to start with a tricycle.

This article aims to outline some steps to help your families start preparing for a wealth transition event.

1. Stop keeping it all a secret.

We need to stop keeping family wealth a secret. The next generation may not know all the details, but when they reach a certain age they already know the family has money. They can understand discrepancies between their lifestyle and friends at school or the communities around them. Now, I am not suggesting you tell a 14-year-old everything about the family's wealth, but they need to start learning that money comes with responsibilities. Keeping the family wealth a secret creates a sense of distrust and that can be destructive when it comes to preparing the next generation and for your succession or estate planning.

Come talk to us about how you can best start this conversation.

2. Call a family meeting.

When you start treating your family wealth like a business and creating new formalities and structure, it can help all members start learning and preparing for what is to come.

Learning to listen and work together on topics such as fiscal responsibility, educational requirements, and prenuptial agreements can help the family align its values so everyone has a common understanding of intentions and expectations.

Preparing the Next Generation: How We Can Help You and Your Family *Cont'd*

In addition, trusting your family members with financial information goes a long way. Knowing that the first generation is trusting and providing the next generation with confidential information can create maturity, a sense of responsibility and engagement that might surprise you.

Together, we can design your first family meeting agenda.

3. Develop an education roadmap.

Through collaboration and discussion, you can learn about where skills may be lacking or where family members might excel. Identifying the gaps will help you develop a list of where education will be required. Depending on the nature of the family's assets, different skills may needed — so it doesn't mean buy the latest financial book for dummies and mandate everyone read it. Education is for everyone, including the first generation. Topics can include:

- Understanding personality types
- Conflict resolution
- Budgeting
- Investment management
- Leadership
- Strategic management
- Industry-specific research

Engage our firm as your stop for learning financial literacy and investing 101.

To prepare is to make something ready ahead of time for an activity, use or purpose. When you start your estate planning process, you are doing just that. Traditionally, we think this is complete when we sign the will. I disagree. When you decide to draft a will, you are committing to preparing all the members involved and impacted by the will for the eventual outcome, whatever that is. It is everyone's responsibility to make sure the wealth transition is successful.

More importantly, having the family involved in the process can help strengthen and develop a more appropriate plan so unintended consequences do not result.

Through thoughtful conversation and planning, we can help you and your family navigate this process to help achieve a successful wealth transition.

PERRON & PARTNERS
WEALTH MANAGEMENT

> "Our services reward families who expect wealth management that is both custom and independent."
>
> **Gary Perron,** CFA
> Portfolio Manager, Founder

- **Truly Independent:** As an independent practice, we have no restrictions, directives or corporate incentives. We are in this business with one agenda: to preserve and enhance our clients' wealth.
- **Flexibility and Tailored Service:** With an open architecture, we have the flexibility to find the lowest costs, best platforms, and latest innovative ideas to meet your specific needs for risk, preservation and growth.
- **100+ Years:** Our core team is guided by over 100 years of combined industry experience.
- **Superior Due Diligence:** Our independence provides us the freedom to explore a variety of resources before selecting the appropriate investments and strategies for you.
- **Risk-Adjusted Investing:** We are experts in generating risk-adjusted returns. We also work to maximize results by controlling tax and identifying low-cost investment options.
- **Business Expertise:** We work with business owners to develop succession strategies, identify taxation opportunities and implement complex investment plans.
- **Family Wealth Guidance:** Through simplified guidance and a personalized approach, we work with families to grow, preserve, plan and transfer wealth.

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