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Introduction

Hello everyone,

What's great about financial markets is that they always manage to surprise us. While this bull market is now one of the longest in modern history, the best performing stocks continue to deliver extraordinary returns. While it was perhaps a little too early, we took conservative positions in our clients' portfolios to avoid a sharp decline in markets. This positioning, combined with our under-representation in the resource sector, resulted in a neutral performance for our customers, though the TSX continued to climb. In addition, a low Canadian dollar early this year meant that, for the first time in several years, we will not beat the benchmark in 2016. While this is common reality for financial market participants like us, it is never a pleasant situation. We put enormous emphasis on capital protection for our investors, and it is often when the bull market is coming to an end that the gap between our performance and that of the index is the largest.

On a happier note, the Rivemont Absolute Return Fund was nominated as a finalist for the Canadian Hedge Fund Awards, making it one of the top ten hedge funds (stocks) in Canada in terms of performance for the period of June 2015 to June 2016. Although the third quarter was very average for the fund, its average annual return since January 2013 is close to 14%. It is definitely better to have this fund in a portfolio than not to have it.

I will begin this newsletter with a review of our performance during the quarter and look at our hits and misses. I will then discuss the use of new transactional technologies in financial markets, and my colleague Jean Lamontagne will address the importance of non-correlated assets in a portfolio. As usual, I will conclude with our outlook on markets and an overview of our most important positions.

Happy reading!

The third quarter of 2016

Conventional strategies

We had partially returned to the resources sector, we quickly pulled back out due to its weakness.

While traditional accounts had an average yield of about 1%, indexes posted a rate of 3 to 4% this quarter. Aqua America (WTR) and Bell (BCE) shares are primarily responsible for this underperformance.

We conducted two major transactions. While we had partially returned to the resources sector, we quickly pulled back out due to its weakness. First, we sold Silver Wheaton for just over $37, which resulted in a slight gain. The stock is now trading at less than $30, so this turned out to be a very good transaction.

We also sold Torc Oil and Gas shares for close to $7.50, and it is currently nearing $8.25; so this was a less successful move.

The acquisition of Parkland Fuel was a good move !

To replace these stocks, we turned to a Canadian company, Parkland Fuel, which owns service stations. We purchased the stock for less than $25 and it was on an uptrend. A very interesting agreement with Couche-Tard was concluded shortly after our purchase, and the stock shot up over $30. That was a good move.

For the second major purchase, we selected Canadian National stock, in the railway sector. This is trading slightly over our purchase price and, as such, we cannot yet draw conclusions on this transaction.

<u>The Rivemont Absolute Return Fund</u>

For the fund, the short positions did not yield the expected returns during the third quarter.

The fund had a negative return of 3.7% in the third quarter. This performance is due to short positions that did not yield expected returns. We quickly stopped the losses on these positions, but the damage was done. We were too negative, expecting a market decline that did not materialize. In this type of situation, one has to be humble and make adjustments right away, which is what we did. We were also long in several gold securities, and these have been greatly hindered by the sudden falling prices of raw materials.

The Rivemont Absolute Return Fund's performance stands at 14% annually since its launch in January 2013, nearly double the performance of the S&P/TSX Composite Index. It is inevitable that there will be other lackluster quarters… but there will also be very good ones. At least, we hope so. ☺

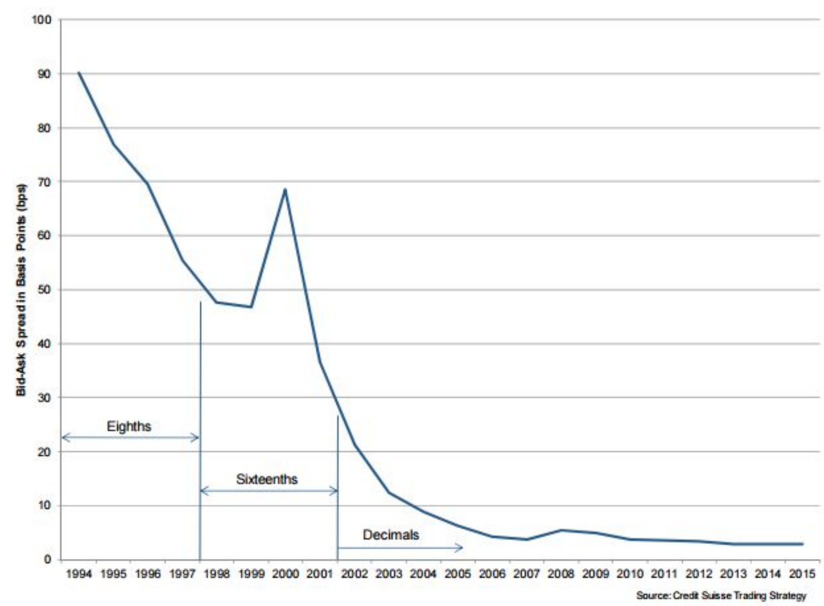
New Transactional Technologies

The new technologies have reduced significantly the spread between the "bid" price and the "ask" price.

For most of the North American financial markets' history, the price gap between buyers and sellers was at least 1/8 of a dollar, or a minimum of 12.5 cents. Thus, for a $5 share, there was a difference of 2.5% between the price at which the share was purchased and the price at which it sold. This difference, called the "spread", is a cost that must be accounted-for in market transactions. During this period, the bid-ask spread equaled the profit potential of the market maker, who was responsible for authorizing transactions on securities under its responsibility while minimizing the impact on prices or, in other words, reducing the short-term volatility caused by buyers and sellers.

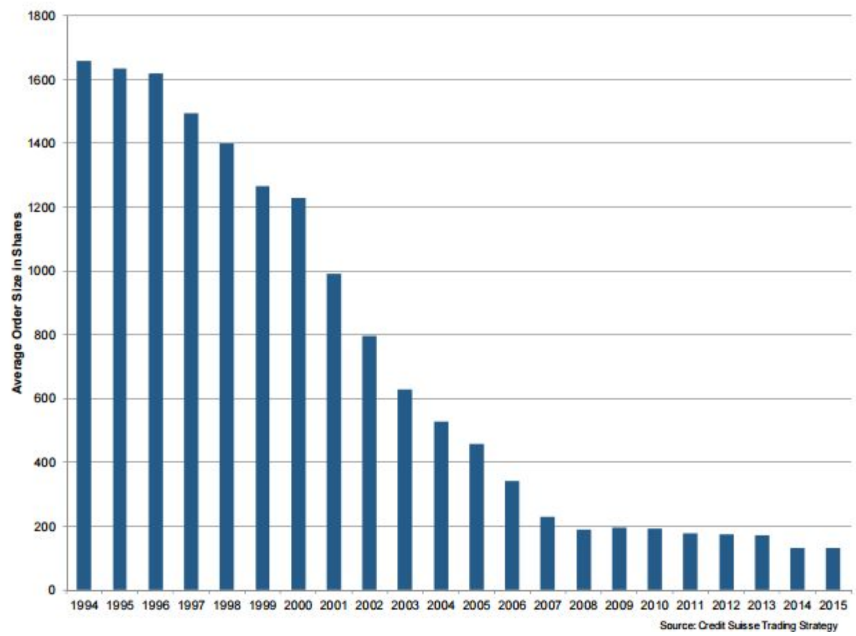
This relatively easy profit era for financial intermediaries ended in 1996 in Canada when the gap was first reduced to 5 cents and then to 1 cent in 2001. In the chart below (Figure 2), we see equivalent changes in U.S. markets.

Figure 2: Consolidated U.S. Average Bid/Ask Spread



Alongside the reduction in the gap, we have seen a significant decrease in the number of shares per order, from over 1,600 to less than 200 shares over the same period (Figure 1).

Figure 1: Historical U.S. Order Size



A same company stock can now trade on multiple markets at the same time.

In addition, a third element eventually contributed to this revolution: the fragmentation of markets. Whereas before the stock of a Canadian company was only traded on the TSX, several competing markets developed so that, currently, the shares of a company change hands simultaneously on multiple platforms. Here is the graphic representation of this concept drawn from an analysis by RBC Capital Markets.

At Rivemont, we use, when necessary, leading transactional technologies (algorithms).

It is therefore easy to understand that this new model of exchanging fewer shares more often and on many platforms is more compatible with computer systems than with humans. Everything was in place so that High Frequency Trading and algorithms would form the new transactional system of choice.

At Rivemont, we do use, when necessary, leading transactional technologies (algorithms) to ensure the quality of execution on the orders we place with our brokers.

Hedge Funds

By Jean Lamontagne

I recently attended a AIMA (Alternative Investment Management Association) conference and several speakers made the same observation: stock and bond markets are historically expensive, and it is anticipated that the economic environment of the future will be almost perfect (e.g. sustained economic growth as well as rising incomes and corporate profits). However, reality may be disappointing for many.

It is important to integrate within a portfolio assets that behave differently from traditional asset classes.

While we at Rivemont do not believe that we are on the verge of a recession or a major stock market correction, the fact remains that some risks associated to the financial system could tip the current balance. Think, for example, of the high level of debt globally, of the intentional devaluation of certain currencies or even of the precariousness of certain European banks. It is therefore important in a diversified portfolio to incorporate assets that behave differently from traditional asset classes such as equities and bonds. In this sense, hedge funds can provide an attractive absolute return when yields on conventional assets are not delivering. That is why we believe it is important to commit a portion of privately-managed traditional portfolios to the Rivemont Absolute Return Fund.

In the current economic context, we believe that institutional investors (such as pension funds and foundations) would do well to incorporate hedge funds into their portfolios. This appears to be a current trend in the United States. According to Preqin, the number of U.S. public pension funds that hold hedge funds has grown from 234 in 2010 to 282 in 2016. However, some major U.S. institutional investors (including the California Public Employees' Retirement System and the New York City Employees Retirement System) have made the opposite choice in recent years, by withdrawing completely from hedge funds. They blame high management

In the current context where few assets offer an interesting real yield, the addition of a hedge fund should be considered.

fees. Although hedge funds have underperformed traditional asset classes in recent years, it could be different in the ones to come.

In the current context, few assets offer a positive real yield (i.e. the performance after the effect of inflation). Today, government bonds offer negative real returns while average stock dividend rates barely cover inflation. As such, a hedge fund with a return history of 7% per year is very interesting (or a real return of about 5% if we consider that inflation hovers around 2%). That is why we believe that Canadian investors should also turn more to hedge funds.

Market Prospects

Rivemont Investments			
Subject	**Question**	**Recommendation**	**Comments**
Allocation between equities and fixed income securities	Which are most interesting, stocks or bonds?	Neutral weighting of the two major asset classes.	We recommend adding alternative investments to portfolios.
Distribution between Canadian, U.S. and international securities	Which securities are most interesting: Canadian, U.S. or international?	Preference for Canadian stocks.	The resource sector may continue on an uptrend.
Distribution between corporate and government bonds	Which are more interesting, corporate or government bonds?	Recommend corporate bonds and high yield bonds.	We recommend short- and medium-term corporate bonds as well as high-yield corporate bonds.
Investments in Canadian dollars or in foreign currency	Do investments in other currencies increase or decrease the total yield?	American securities remain essential in portfolios.	An increase of the Canadian dollar would be surprising.

Favorite Securities

You will find below a list of the individual securities with the largest weight in our "growth" portfolio. These stocks were selected based on their respective potential to outperform the stock market. You will find a short description of their activities, the annual dividend, if any, and the total return since their first inclusion in our portfolio.

As of October 28, 2016

1) Symbol: AGT
Name: AGT Food and Ingredient
Description: Lentil and pea splitting company.
Dividend Yield: 1.6%
Total Return: 118.1%

2) Symbol: TD
Name: TD Bank
Description: Financial services.
Dividend Yield: 3.6%
Total Return: 5.0%

3) Symbol: PKI
Name: Parkland Fuel
Description: Gas stations network.
Dividend Yield: 3.7%
Total Return: 25.6%

4) Symbol: GD
Name: General Dynamics
Description: Production of military equipment.
Dividend Yield: 2.0%
Total Return: -2.2%

5) Symbol: BCE
Name: BCE
Description: Telecommunications.
Dividend Yield: 4.5%
Total Return: 2.6%

6) Symbol: SLF
Name: Sun Life Financial
Description: Insurance.
Dividend Yield: 3.6%
Total Return: 17.9%

7) Symbol: CNR
Name: Canadian National Railway
Description: Railroads.
Dividend Yield: 1.8%
Total Return: -1.6%

8) Symbol: CL
Name: Colgate Palmolive
Description: Hygiene products.
Dividend Yield: 2.2%
Total Return: -1.8%

Conclusion

In closing, it is my pleasure to invite you to listen to our new financial talk show on FM 104.7. Every Tuesday, at around 2:40pm, in the company of the inimitable Roch Cholette, I discuss various topics related to personal finance. All the shows can be found here:

http://www.fm1047.ca/in/martin-lalonde-1651.html

Sincerely,

Martin Lalonde, MBA, CFA
President

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