



Financial Letter Volume 9 Number 1



By Martin Lalonde, MBA, CFA, Jean Lamontagne, CFA, FICA et Recherche MicroCaps.

Introduction

Hello everyone,

The year 2017 turned out to be a pretty exciting one for us here at Rivemont, and 2018 is already off to a flying start. I would be remiss to begin this newsletter without first thanking our faithful clients. We work extremely hard to deliver a consistently high level of client service and we are rewarded by a substantial increase in new investors recommended by our existing partners. From the bottom of my heart, thank you.

Over the year, assets under management rose by more than 30% and totalled \$42 million at the end of 2017, through a combination of returns and an inflow of new assets. In Q4, for the most adventurous among you, we launched the Rivemont Crypto Fund, the first Quebec cryptocurrency fund. And in the first quarter of 2018, we're launching the Rivemont MicroCap Fund, in collaboration with Recherche MicroCaps Canada, which will act as an independent consultant/analyst to generate investment ideas.

It is important to remember, however, that we are and will remain primarily a private wealth management firm whose goal is to maximize its investors' returns in line with their risk profile. In the first part of this newsletter, I will present how our portfolios performed in 2017 with a look back at our good, and not so good, moments. I'll then hand things over to our new partners at Recherche MicroCaps Canada, who will present the strategy underlying our new product. As usual, we'll wrap up with our market outlook and an outline of our most important positions.

Happy reading!

February 1st, 2018

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“The stock market continues its uptrend. However, we need to pay attention to any change in direction.”

We didn't fare too badly either as far as equities are concerned, despite a decidedly unfavourable exchange rate. Indeed, over 2017, the U.S. dollar dropped from 1.3433 to 1.2576, which automatically caused our U.S. equities to fall by the same proportion. Luckily, they produced strong returns. For example, we took our profits on Micron Technologies (MU) after a gain of close to 70%. Likewise, General Dynamics has been trending upwards for several years now. We also added Philipps 66 (PSX) to the portfolio recently, and it is already at an all-time high. The U.S. market continues to surprise us. The arrow indicates the beginning of 2017.



Philipps 66 (PSX)

“Despite a disappointing 2017, the strategy still posts an annualized return of more than 8%.”

Rivemont Absolute Return Fund

After the first three months of 2017, the Rivemont Absolute Return Fund was down 7%, and it hasn't really moved since then. As you know, the fund can take long and short positions to benefit from short-term market movements. Many funds in this asset class experienced challenges this year, including our competitor, the Fiera Long/Short Fund, which fell 10% in 2017. The reason is quite simple. No one really thought the “Trump effect” would last. At Rivemont, we shorted a number of securities that we considered very weak at the beginning of the year, and they rose, contrary to our expectations. Nonetheless, with an average return of more than 8% over the past five years, we're not all that worried. What's more, the fund has already recovered more than the 2017 loss with an 8% gain over the first three weeks of 2018. We're all for that!

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Rivemont MicroCap Fund

What is a “microcap”?

In Canada, a “microcap” is a company with a very small market capitalization, i.e. \$300 million or less. Microcaps are generally the smallest corporations that can be found on the stock market.

There are currently more than 2,400 companies in Canada that meet this definition. In North America, these 11,000+ companies employ more than 2.8 million people and contribute significantly to economic growth. Some of the most successful companies made their stock market debut as microcaps, the most notable of which include Wal-Mart, Netflix and Apple. The famous Warren Buffett, with his company Berkshire Hathaway, started his career investing in microcaps.

“The market inefficiency and the low liquidity of the microcaps provide high potential returns.”

Why is it advantageous to invest in the Rivemont MicroCap Fund?

While past performance does not guarantee future results, several studies have shown that microcaps outperform large caps over the long term. The table below shows the returns of U.S. stock exchange-listed companies from 1927 to 2016, segmented into 10 deciles based on their market capitalization.

Decile	1 small	2	3	4	5	6	7	8	9	10 large
2016 avg market cap	114 million	499	941	1557	2295	3384	5157	9092	18412	88945
Avg return 1927-2016	25.86%	18.66	16.88	16.12	15.05	15.23	14.33	13.52	12.91	11.11
Std dev	49.67%	41.44	32.7	31.65	27.65	26.55	26.33	23.76	22.15	19.64
Compounded return	17.45%	12.54	12.43	11.95	11.53	12.01	11.16	10.90	10.48	9.21

Source: The Excessive History of Microcaps, Mark Vonderwell

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The first decile with an average market capitalization of \$114 million largely outperformed all the other deciles in terms of compounded annual return. The two main reasons explaining this outperformance are the following:

- 1) Market inefficiency: Because of their small size, microcaps are structurally inaccessible to professional investors with large sums of money to invest. The market is therefore composed primarily of retail investors and small investment funds, where the competition is obviously much less aggressive than among large caps.
- 2) Low liquidity: Liquidity is the ability to buy or sell financial assets quickly, at a low cost and without causing drastic change in the assets' price. Since this is relatively absent from microcaps, investors who know how to navigate this environment generally benefit from higher returns.

The two characteristics mentioned above help our analysts identify outstanding opportunities well before other market players.

"A detailed fundamental value analysis is performed for every security of the Rivemont MicroCap Fund."

Analysts' expertise

To analyze the fund's securities, Rivemont has retained the services of Recherche MicroCaps Canada, an expert duo working in the microcaps sector. Philippe Bergeron-Bélanger and Mathieu Martin, the two analysts at Recherche MicroCaps Canada, have been immersed in this field for many years.

Over the years, the duo has built a vast North American network composed of successful investors, industry experts, analysts, brokers and company officers. This network provides them with a constant flow of investment opportunities and, combined with their own research methodology, helps them discover the most promising companies well before the rest of the pack.

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Philosophy of the Rivemont MicroCap Fund

The fund's objective is to target the most promising companies early on in their development cycle in order to maximize the potential for long-term returns. Securities are analyzed using a fundamental value approach. Research and due diligence are carried out directly in the field, that is, by visiting the company's head office and talking with management, clients, suppliers, etc. Knowing better than anyone else about the companies we're investing in is core to the Rivemont MicroCap Fund management philosophy. This knowledge helps us accurately determine the real risks of mere market turmoil.

As the microcaps market is an extremely volatile asset class, the fund is suited for investors with a long-term investment horizon and strong risk tolerance. The somewhat unconventional nature of the fund's strategy makes it a unique investment product with strong return potential and an excellent diversification tool owing to its low correlation to traditional asset classes.

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Market Prospects

Rivemont Investments			
Subject	Question	Recommendation	Comments
Allocation between equities and fixed income securities	Which are most interesting, stocks or bonds?	Underweight in bonds.	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?	Canadian equities, except for financial companies, are relatively unattractive.	The technology and health care sectors are particularly interesting.
Distribution between corporate and government bonds	Which are more interesting, corporate or government bonds?	Government bonds have little attraction.	We recommend corporate bonds with short and medium-term maturities.
Investments in Canadian dollars or in foreign currency	Do investments in other currencies increase or decrease the total yield?	U.S. assets are still just as essential to portfolios.	We do not anticipate any sharp movement in currencies.

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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 January 26, 2018

1) Symbol: GD

Name: **General Dynamics**

Description: Production of military equipment.

Dividend Yield: 1.5%

Total Return: 48.8%

2) Symbol: ETSY

Name: **Etsy**

Description: Online retail website.

Dividend Yield: N/A

Total Return: 5.7%

3) Symbol: SLF

Name: **SunLife Financial**

Description: Insurance and financial services.

Dividend Yield: 3.4%

Total Return: 45.6%

4) Symbol: RY

Name: **Royal Bank of Canada**

Description: Financial services.

Dividend Yield: 3.4%

Total Return: 36.9%

5) Symbol: CAE

Name: **CAE**

Description: Flight simulators.

Dividend Yield: 1.6%

Total Return: 18.4%

6) Symbol: CNR

Name: **Canadian National Railway**

Description: Railroads.

Dividend Yield: 1.9%

Total Return: 15.4%

7) Symbol: T

Name: **Telus**

Description: Telecommunications.

Dividend Yield: 4.4%

Total Return: 4.7%

8) Symbol: IFC

Name: **Intact Financial**

Description: Casualty insurance.

Dividend Yield: 2.5%

Total Return: 7.6%

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Conclusion

It is difficult to predict the future, but in our view, we are approaching a period of market euphoria, where many speculative assets will present interesting short-term opportunities. You can be sure that our team will stay glued to their computers to find you the best hidden gems on the markets.

On that note, we wish you all a happy, healthy and prosperous 2018.

Sincerely,

Martin Lalonde, MBA, CFA
President

RIVEMONT

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