



LEON FRAZER QUARTERLY REVIEW

Equity Market Commentary: Strong Dividend Growth in 2017

LET'S START THE NEW YEAR WITH A RECAP OF PORTFOLIO HIGHLIGHTS AND A SNAPSHOT VIEW OF 2018.

Our portfolios demonstrated very strong dividend growth in 2017, with almost 70% of our names increasing their dividends by a weighted average of 6.5%, well outpacing the rate of inflation and increasing our clients' standard of living. With three companies already announcing 2018 dividend increases, we are already off to a good start and look forward to another strong year.

CONFIDENCE IN OUR VIEW

Heading into 2018, we remain confident in our view and will continue to look for opportunities to position ourselves more defensively ahead of slowing growth. We have limited to no exposure in the areas of the markets we view as outright risky and/or expensive, including Cannabis, Technology or Consumer Discretionary. A correction in these overvalued sectors would be welcome as we believe their valuations are not sustainable, yet the momentum is encouraging more and more investors to buy in at prices which expose them to a significant probability of loss.

REAR VIEW MIRROR: 2017

2017 proved to be an interesting year. While the equity market in both the US and Canada moved ahead with an appearance of calm tranquility, the year was filled with a combustible combination of geopolitical risk, natural disasters and progressive social movements. For the first time in several years, emerging market equities outperformed the developed markets with the MSCI Emerging Markets Index returning an impressive 25.6% year-over-year in Canadian Dollars. In North America, the S&P 500 once again outperformed the S&P/TSX, advancing 13.9% in CAD versus a more modest 9.1% in Canada after underperforming in 2016. With the global economy showing continued signs of strength, 2018 equity markets appear poised for another year of greatness.

Healthcare, representing only 1.0% of the market, was the top performing sector in Canada this year, returning 34.2%. Included in the sector are Cannabis stocks, which were some of the top performers on the TSX and dominated headlines as Canada moves closer

LFA Top 5 Dividend Growers <i>(YOY as at December 31, 2017)</i>		LFA Top 5 Dividend Yielders <i>(as at December 31, 2017)</i>	
Freehold Royalties	25.0%	Altagas	7.5%
Enbridge Inc	15.1%	Vermilion Energy	5.4%
Pembina Pipeline Corp	12.5%	Enbridge Inc	5.3%
Northland Power Inc	11.1%	Russel Metals	5.2%
Manulife Financial	10.8%	Enercare Inc	4.8%

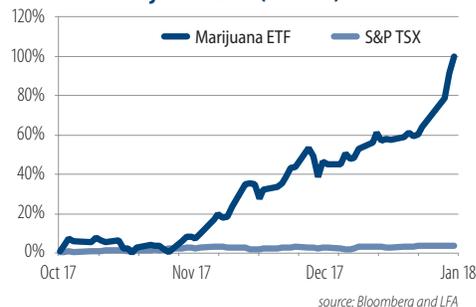
source: Bloomberg and LFA

to recreational legalization. While the market may continue to push these names higher, we believe this type of euphoria is dangerous as the sector trades at a premium valuation with little to no earnings.

Energy gave back much of its outperformance from 2016. The Energy sector in Canada was down 7.0% in 2017, with Energy Producers down 13.6% in the same period. Interestingly enough, WTI Oil prices were up over 12%, reflecting a 20%

"With three companies already announcing 2018 dividend increases, we are already off to a good start and look forward to another strong year"

Performance of S&P TSX and Marijuana ETF (HMMJ)



drop in inventories and steadily increasing demand. This begs the question; why was there such a large disconnect between oil stocks and oil prices? Investors have seemingly lost interest in the sector and have shifted toward

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“Despite the ongoing exuberance, we remain cautious of certain risk factors and overvalued sectors that have pushed the overall market to potentially unsustainable highs”

Strong Dividend Growth in 2017

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“trendier” investments like US Technology, Canadian Cannabis or even Cryptocurrencies.

CAUTION GOING FORWARD

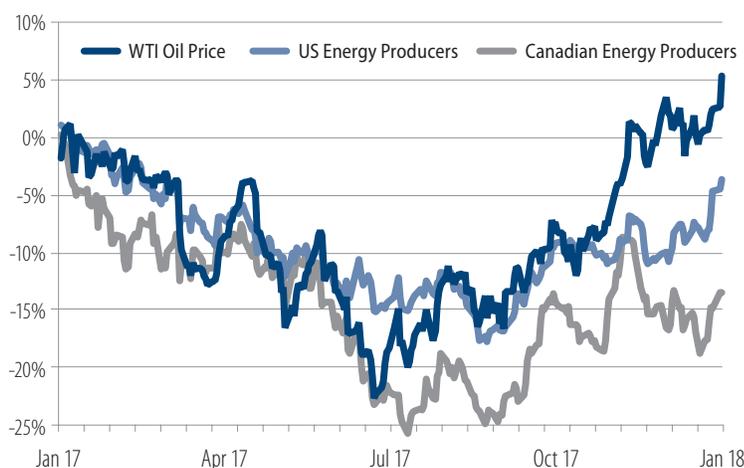
The global economy should remain relatively strong, continuing the currently prolonged, subpar economic expansion from 2009–present. In the US, the unemployment rate hit 17 year lows last year at approximately 4%, whereas Canadian unemployment fell

below 6% for the first time since 2008. Confidence indices continue to climb on both sides of the border, while GDP growth remains firmly in expansionary territory. The speed and magnitude of the Federal Reserve’s monetary tightening program and the extent to which it is followed by the Bank of Canada, combined with the impact of tax reform and trade negotiations, are key uncertainties for the year ahead.

Potential positive catalysts would include further improvement in oil prices, increased government infrastructure spending and ongoing manufacturing recoveries in Eastern Canada.

Despite the ongoing exuberance, we remain cautious of certain risk factors and overvalued sectors that have pushed the overall market to potentially unsustainable highs. We feel additional prudence is warranted going into 2018. ●

Performance of US and Canadian Energy Producers vs. Oil Price



source: Bloomberg and LFA

“We continue to see value for taxable investors going forward into 2018”

Fixed Income Commentary

The JOV Leon Frazer Bond Fund was up 1.37% in 2017, outperforming our benchmark (50% FTSE TMX Short-Term Bond Index and 50% FTSE TMX Mid-Term Bond Index) by 0.89%. Our shorter duration benefited performance and should continue to do so as interest rates rise. The JOV Leon Frazer Preferred Equity Fund posted a solid 16.22% return for the year, outperforming the S&P/TSX Preferred Share Total Return Index by 2.60%. The Canadian preferred market plummeted at the beginning of 2016 when interest rates fell unexpectedly, but made a nice comeback in 2017. We continue to see value for taxable investors going forward into 2018.

We expect some volatility in the bond markets in 2018 as inflation and interest rates are expected to pick up along with the growth of the global economy. Should the spread between the 2-year and 10-year notes begin to widen, we will take advantage of the opportunity by increasing the yield and duration of the portfolio.

SHORT RATES UP, CURVE FLATTENS

The US yield curve flattened slightly as the Federal Reserve raised the fund rate three times in 2017, moving the short end of the yield curve upwards to over 1%, while the longer end notes remained closer to 3%. The spread between the two-year and ten-year notes dropped to 0.55% at the end of 2017, compared to more than double at the beginning of the year, representing the flattest level in over a decade. While an inverted yield curve is often a predictor of an economic recession, we have yet to see an inversion when long rates are at such low levels. The Federal Reserve is forecasting three additional increases in 2018.

Canada’s yield curve is slightly flatter than the US with the spread between the 2-year and 10-year notes settling at less than 0.40% at the end of 2017. Following two unexpected rate hikes in July and September, the market is now anticipating three additional increases by the Bank of Canada in 2018. ●



Spotlight: Hunger in Canada – A Persistent Issue

At Leon Frazer, we believe access to food is a basic human right, not a privilege, and that no one should go hungry. Yet, despite an improved economy, the need for food banks is higher now than ever before. Every month, food banks in Canada assist 860,000 people, the highest annual number since 2010, when the aftermath of the 2008 recession hit with full force.

HUNDREDS OF THOUSANDS ACCESS FOOD BANKS FOR HELP

No discussion of hunger is complete without acknowledging its root cause: low income. The simple truth is that the number of people living in Canada on low income has not dropped below 2.7 million in any year in the current era. Each month, hundreds of thousands of Canadians access food banks to make ends meet. In addition, people are accessing food banks twice as long as they needed to in the past, from an average of one year in 2010 to two years in 2017. According to Food Banks Canada, over half of Canadians know someone who has visited a food bank, and this figure climbs by more than 10% in Atlantic Canada.

“Again this year, Leon Frazer & Associates chose not to send holiday cards to our clients and instead donated the money we would normally direct to this activity”

FOOD BANK RECIPIENTS

Food banks aid a diverse range of people. More than one-third of individuals helped are children and youth and more than 40% of households receiving food are families with children. Single people living alone, who face a very high risk of living in poverty, have also grown as a proportion of households helped. Many households accessing food banks are on some form of government assistance, including pension, disability-related income supports and welfare. Almost 50% of Canadians mistakenly think food banks are used exclusively by the homeless and unemployed, yet close to 20% of those assisted by a food bank are employed or recently employed.

CHALLENGES FOR FOOD BANKS

Food banks in Toronto do not receive government funding and rely mostly on private donations. As affordable space in Toronto becomes

more challenging to find, many food banks are in an increasingly vulnerable position to maintain their operations, despite persistent need. According to the Daily Bread Food Bank, in the past year, 77% of food banks distributed less food than usual because they were running out of food to give; 13% had to close early or not open due to lack of food; and about one fifth had to turn people away because there was no food left to give out.

EACH MONTH

860,000

PEOPLE TURN TO CANADIAN
FOOD BANKS FOR HELP

Managing inventory can be a difficult task for any organization. For a food bank, it can be especially challenging, since they can't always count on a steady inventory of food received, nor can they always anticipate client demand. Many food banks experience unpredictable surges in need from week to week.

OUR ONGOING COMMITMENT

In our Spotlight article last December, we reflected on this same topic. We feel a strong sense of giving to this persistent cause. We realize that all contributions, whether big or small, can make a difference. Again this year, we chose not to send holiday cards to our clients and instead donated the money we would normally direct to this activity. Through these and other measures, we increased our food bank monetary donations not only in Toronto, but in Vancouver, Calgary and in various communities throughout southwestern Ontario.

THERE ARE MANY WAYS TO GIVE

You, too, can help support the network of more than 550 food banks and 3,000 food agencies across Canada. There are many ways to be involved, from making a financial donation, a food donation or even volunteering time at your local food bank. As Food Banks Canada notes, awareness is the first step towards alleviating this problem. Action is the second. ●

A FAREWELL

It is with sadness we inform you that Ryan Bushell has left Leon Frazer. Ryan has been with the company for 12 years, starting as a junior trader and finishing as Vice President & Portfolio Manager. We appreciate Ryan's contributions to the firm.

Rebecca Teltscher, Portfolio Manager, has assumed many of Ryan's duties, having worked closely with Ryan for over five years. Our intention is to add an additional member to the investment team early in 2018.

Leon Frazer & Associates has endured the test of almost 80 years of change, both internally and externally. Our disciplined investment process is the one constant throughout this change. Our steadfast commitment to the Leon Frazer decision-making process outlives any one individual and outlasts any extreme market dislocation. From 1939 to today, the firm has honoured that process and the entire LFA team is grateful for our clients, and in some cases, generations of clients, who entrust us with their investment portfolios. ●



Leon Frazer Timeline: A History of Canadian Currency

- 1939 ○ A new silver dollar is issued to commemorate the Royal Visit of His Majesty King George VI and Her Majesty Queen Elizabeth II
- 1943 ○ The Royal Bank of Canada releases the last banknotes issued by any of the chartered banks
- 1949 ○ A new silver dollar commemorates the entry of Newfoundland into the Dominion of Canada
- 1953 ○ An effigy of Her Majesty Queen Elizabeth II appears on Canadian coinage for the first time
- 1954 ○ The third series of banknotes causes controversy when highlighted areas of the Queen's hair give the illusion of a grinning demon
- 1958 ○ A new silver dollar is issued to commemorate the centennial of British Columbia
- 1965 ○ The effigy of Queen Elizabeth II is updated to feature a more mature Queen wearing a tiara
- 1967 ○ Canadian artist and sculptor Alex Colville creates six new coin designs to commemorate Canada's centennial
- 1970 ○ The fourth series of Canadian banknotes is introduced featuring the use of multicoloured tints
- 1976 ○ Five and ten dollar coins are launched to celebrate the Summer Olympics in Montreal
- 1980 ○ A one-hundred dollar gold coin is issued to commemorate the adoption of "O Canada" as the country's national anthem
- 1986 ○ The Birds of Canada banknote series is released, designed with enhanced security features to protect from counterfeiting
- 1987 ○ The loonie \$1 coin is released as a cost-cutting measure
- 1989 ○ The Bank of Canada retires the \$1 note from circulation
- 1992 ○ To celebrate Canada's 125th anniversary, 12 different quarters are put into circulation, representing each of the provinces and territories
- 1996 ○ A two-dollar coin is introduced to replace the two-dollar banknote
- 1999 ○ A toonie featuring an Inuit drummer is issued to celebrate the creation of Nunavut
- 2001 ○ The Canadian Journey banknote series is released, featuring enhanced security, world-class designs and a tactile feature to help the blind and visually impaired
- 2004 ○ The first lucky loonie is released to serve as a good luck charm for the Canadian Olympic athletes competing at the Summer Olympics
- 2011 ○ The first banknotes of the Frontier Series are released into circulation
- 2012 ○ After more than 150 years in circulation, the Royal Canadian Mint stops producing the penny
- 2018 ○ Civil rights activist Viola Desmond will replace the face of Sir John A. Macdonald on a new \$10 banknote

Source: en.wikipedia.org



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