NEXUS

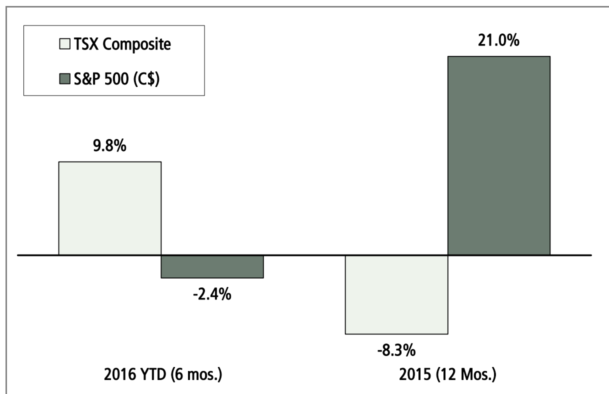
Portfolio Management & Financial Counsel

THE NEXUS REPORT
Second Quarter, 2016

A World Turned Upside Down

In the first six months of 2016 Canada's stock market surged higher, generating a total return of 9.8%. It gives the impression that all is well in the world and economies everywhere are stable and prospering. Reality is considerably different, particularly in Canada. The last six months was a period of political and economic upheaval that has frayed investor emotions.

Canada, in fact, is a bit of an outlier. Returns in the U.S. and many foreign markets have moderated dramatically after a decent 2015. Canada was one of the worst major stock markets in the world in 2015, and its surge this year has positioned it as the best. Currency movements have exaggerated this shift as the Canadian dollar regained a bit of the ground it lost in 2015. It's unlikely that Canada's recent outperformance will be sustained.



North American Stock Market Returns[1]

The other perplexing change in 2016 has been the shifting role for bonds and stocks. According to conventional wisdom, investors look to bonds for income and stability, and stocks for capital gains. Recently, however, the dividend yield on stocks exceeds the interest on high-quality bonds in many countries. Moreover, the biggest source of capital gains in recent months has been in bonds. For example, the S&P 500 stock index in the U.S. has generated a total return of 3.8% over the first half of 2016, while the 10-year U.S. Treasury has returned 8.0% and the 30-year returned 16.9%.[2] This phenomenon has continued into July as the 10-year Treasury hit another all-time low yield, thereby adding to the considerable gains for the year. Conventional wisdom has been turned on its head.

[1] Total returns for each asset class expressed in C$.
[2] These are total returns in US$.

Unsettling Politics

Much of what has the financial markets topsy turvy is rooted in political turmoil. The most dramatic of these, of course, is the so-called "Brexit" – the UK referendum on June 23 whereby the country voted to leave the European Union.

The "Leave" victory in the referendum stunned observers in all walks of life – from stock market investors, to London bookmakers, to politicians of all stripes. That Prime Minister, David Cameron, immediately announced his resignation was expected, but the plot quickly took on all sorts of Shakespearean twists shortly thereafter. Former London Mayor, Boris Johnson, the central figure of the "Leave" campaign, was the man everyone expected to succeed Cameron. However, several days after the victory he announced he would step aside. Some believe Johnson never actually wanted to leave the EU, but was using the "Leave" pulpit solely to advance his own political profile. He never thought "Leave" would win, so when the bluff was called he ran for cover. Just as ironic is the fact that the quickly anointed successor to Cameron is Home Secretary, Theresa May, someone who campaigned openly for the "Remain" team. Now some speculate whether she always really wanted to leave! In any event, the process by which the UK actually would leave the EU will be long and tortured and, despite the vote, it is far from clear when, or even if, it will happen.

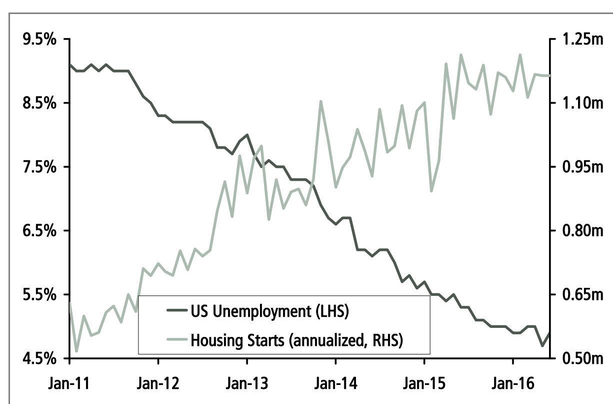
Regardless of what happens, we doubt it will have a profound long-term economic impact on the UK. What is more worrying is the contagion that could spread to other countries in the EU. Both the French and the Dutch reportedly have higher levels of popular support for "leave" than the UK ever did. Could this be the beginning of the end for the EU?

The other great political unknown facing investors is the U.S. presidential election. Will it be Hillary or will it be The Donald? Both elicit powerful negative emotions from the majority of the U.S. population. We express no opinion as to which candidate is preferred, but observe that neither is likely to be good for Canada. Trump has been most outspoken about protectionist trade policies, but Hillary has expressed many of the same views. Our hope is that some combination of greater pragmatism once in office, and the moderating influence of Congress (a.k.a. gridlock) will mitigate actions limiting trade. Free trade is important for U.S. economic growth, and critical to the health of the Canadian economy.

U.S. Economic Recovery Intact

While political turmoil continues to unsettle investors in the short term, it is the fundamental forces of economic growth that are most important over the long term. In this regard, we continue to be encouraged by the ongoing strength in the U.S. economy. For some time, the U.S. recovery has been underpinned by a strong and steady improvement in labour market conditions. A month ago, this was thrown into doubt by a surprisingly weak non-farm payroll report for May. However, the June report was equally surprising on the positive side. A total of 287,000 new jobs were created, easily surpassing consensus expectations for a 180,000 gain. While the unemployment rate increased to 4.9% from 4.7%, this was largely as a result of more people entering the workforce – a good sign as it reflects optimism about employment prospects.

The sound labour market is also reflected in other positive measures such as housing starts and light vehicle sales, which remain at high levels. House and vehicle purchases both reflect the confidence of American consumers to make big financial commitments, but strength in those industries also has the positive effect of providing well-paying jobs to many auto and house construction workers, as well as stimulating demand for many supporting industries.



U.S. Labour and Housing

Canada, unfortunately, continues to struggle with what Bank of Canada Governor Poloz first described last year as "serial disappointment". While oil prices have recovered significantly from their lows, they remain lower than required to encourage renewed investment. Of course, the wild fires around Fort McMurray have only added to the challenges in that region.

Moreover, our expectation that a weak Canadian dollar would enhance the competitiveness of our export-oriented economy has not yet come to pass. In May Canada recorded a $3.28 billion trade deficit, its second largest in history. The largest was in April. In fact, we have recorded three of the four largest trade deficits in history in the last three months. To be sure, the depressed energy sector weighs heavily on the trade deficit. What's more confounding is that non-energy export volumes also have been surprisingly weak.

We expect economic growth in Canada to be positive over the balance of the year, but it is likely to remain anemic. A stronger U.S. economy and a weak loonie are both desperately needed to support Canadian economic activity.

Investment Outlook

Uncertainty is a constant in the investment world. Today it seems a bit more acute than normal because there is so much attention on transformative issues: Brexit, the U.S. presidential race, and investment conditions that have not previously existed in any current investor's experience.

As mentioned previously, interest rates have plunged to levels never seen before. Of the $35.1 trillion of sovereign debt outstanding around the world, 36% – or $12.7 trillion – yields less than zero.[3] In other words, lenders are paying sovereign borrowers to take their money rather than the historic relationship of borrowers paying lenders for the use of their capital. Only 6% of all sovereign debt yields more than 2%, a level that would have been considered absurdly low just a few years ago.

Typically, interest rates at this level would be indicative of economic conditions that are dire. However, stock markets seem to be dancing to another tune. In early July, for example, the principal U.S. stock market index, the S&P 500, hit an all-time high. The actions of bond investors reflect fear, the actions of stock investors reflect greed. Who is right? Perhaps the traditional relationships no longer hold?

We have no crystal ball. However, we do believe that economic laws have not been repealed. If we can invest in a collection of companies that grow their earnings over time, and we pay a fair price for the earnings stream, stock prices will go up. They will go up regardless of whether the UK is in or out, and they will go up regardless of who inhabits the big house on Pennsylvania Avenue in Washington. Today it is more important than ever to block out the noise and focus on fundamentals.

---

[3] *Barron's*, July 2, 2016.

Asset Class Investment Review

Fixed Income

Interest rates remain at historically low levels and actually fell slightly from where they were at the end of the second quarter. Most of the decline was in bonds of longer maturity. The yield to maturity of Canada 30-year bonds dropped 0.30%, from (2.01% to 1.71%) while 5-year bonds declined 0.11% (from 0.68% to 0.57%). Our portfolio remains predominantly invested in maturities between 3 and 9 years and so we captured some, but not all, of the benefit of the capital gain that comes from falling yields and higher bond prices.

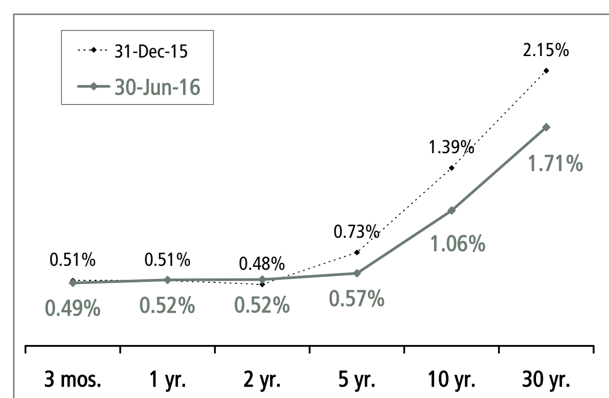
The prevailing narrative these days is that the unprecedented demand for bonds arises from a "flight to safety" bid, premised on an assumption that investors would rather have the certainty of exceedingly small or even negative returns, instead of the risk of more extreme capital loss from other asset classes. This line of reasoning is abetted by ultra-stimulative monetary policies pursued by virtually every national central bank in the world. By keeping administered rates, such as Canada's overnight rate, low central banks encourage investors to "reach for yield", either by extending term or by adding more credit exposure. However, in addition to keeping policy rates low, central banks have also been buying longer-maturity bonds. In this regard, they are not acting like traditional participants in capital markets, because their primary motive is not to generate a fair return, but rather to drive down interest rates.

Canada's bond market is heavily influenced by these policies. Firstly, our own central bank has set the overnight rate at 0.50%, which is below the rate of inflation. Secondly, Canada is an attractive destination for foreign capital because it is one of only 8 sovereign AAA credits left in the world.[4] In particular, bonds of AAA credits are widely used by foreign central banks in their foreign exchange assets. Simplistically, these central banks sell their own currencies (thereby lowering their exchange rate and increasing export competitiveness) and purchase Canadian dollar bonds for their foreign currency reserves. Because Canadian rates are higher, and the market is more liquid than most of the remaining sovereign AAA credits, Canada has become a magnet for foreign capital.

To the surprise of many, including Nexus, these policies have moved rates much lower, and they have stayed low longer than we would ever have imagined. But it will not last forever. Eventually the traditional economic forces of supply and demand will return interest rates to more sensible levels. In our opinion, it is fine to miss out on the "opportunity" to earn returns that are below the rate of inflation, are typically taxable, and could suffer from significant price erosion when these central banks reverse policy.

While the policies described above are designed to stimulate investment and consumption, of late their primary impact has been to inflate asset prices and encourage governments and consumers alike to build up debts to worrisome levels. In fact, before the Brexit crisis, we had sensed a broadening consideration amongst economists and government policy makers that these policies might be doing more harm than good.

But for now, with anxiety high and investor demand for safety extreme, we have a portfolio that has generated solid returns, but which has lagged the benchmark. In the second quarter, the FTSE TMX Canada Bond Universe Index (the Bond Index) returned 2.6%, and the trailing 12 month return was 5.2%. Our return, using the bonds in the Income Fund as a proxy, trailed the Bond Index over the quarter, and the last 12 months. For the quarter, our return was 1.6% and for the last 12 months it was 3.7%.



Government of Canada Yield Curve

[4] The 8 sovereign AAA credits are; Australia, Canada, Denmark, Germany, Holland, Luxembourg, Norway and Singapore.

Equities

The second quarter continued the rollercoaster from the first. As an indicator, the Equity Fund was up 2.1% in the quarter and up 1.6% over the past 12 months.[5] There were puts and takes in the quarter. Our Canadian equities and Emerging Markets holdings shone, while our U.S. equity portfolio and our EQIT holding moved sideways.[6]

Part of the background story continues to be the Canadian dollar. The 3 and 12 month changes in the Canadian dollar, weaker by 0.3% in the quarter and by 4.3% over 12 months, mask much greater swings within these time periods. Year-to-date, the currency is stronger by 6.0% and has strengthened a full 11.4% from its January low against the US dollar. As a reminder, strength in the Canadian dollar has the effect of reducing the returns from our U.S. and international investments (and vice versa). Also, although currency swings can have big short-term effects, their impact over the long term for a diversified equity investor is not material.

Canadian Equities

Continuing from a very strong first quarter, Nexus's Canadian stocks were up 5.2% in the most recent quarter and up 8.3% over the past 12 months. This was in line with the TSX Composite's 5.1% return for the quarter and substantially better than its 0.2% loss for the year.

For the quarter, broad-based strength across our Canadian portfolio was enough to offset a huge 26% recovery in the Materials sector, where we have no exposure, and a good recovery in the Energy sector, where we are underweight. Our most significant contributors to returns were our real estate investment trust holdings, Allied Properties and H&R, and our pipeline and utility stocks, ATCO, TransCanada and Enbridge.

During the quarter, we sold our holding of Progressive Waste after it had traded up on the announcement of its merger with Waste Connections. Waste Connections has a strong management team, but trades at a substantial premium to its peers. We decided to avoid the deal risk and valuation risk and sold Progressive Waste before the merger closed.

U.S. Equities

Nexus's U.S. equities moved sideways, up 0.4% in the second quarter and down 0.5% for the 12 months. Our performance has trailed the S&P 500 index (by 9.0 percentage points for the 12 months). Despite this, our longer-term U.S. equity returns remain very strong on an absolute basis and ahead of the S&P 500 over the past 10 years.

Recall that we do not aim to have a broad-based U.S. equity portfolio on its own, just a well-diversified North American portfolio. The three best performing sectors in the U.S., Energy, Telecom and Utilities are sectors where we are entirely absent. Rather, in these sectors, we have Canadian holdings, in part because these are dividend-rich sectors and dividends from a Canadian company receive substantially better tax treatment than a comparable U.S. investment. The funds retain substantial holdings in the U.S. Technology and Financial sectors. These have produced good long-term returns, but are not currently in favour. Our Technology holdings are substantially more attractively valued than the S&P 500 overall, so patience should be rewarded. Our U.S. banks, JPMorgan, Citigroup and M&T Bank, have strong balance sheets and attractive valuations. All three passed the recent regulatory capital adequacy tests and are increasing the pace at which they return capital to shareholders (dividends and buybacks).

There were no substantial trades in the U.S. portfolio in the quarter.

Other Equity Investments

We continue to hold two non-North American equity investments within our Balanced and Equity Funds. These are externally-managed pooled funds called EQIT (international developed market equities) and EMEC (emerging market equities).[7]

EQIT was down 0.4% in the second quarter and down 9.3% for the 12 months. EMEC was up 4.1% in the quarter and down 0.1% for the 12 months. We believe they will add value to the portfolio over the long-term. Both have better dividend yields and substantially lower valuations than the S&P 500 and TSX Composite. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

[5] All the return data in the Equities section are total returns for the Equity Fund. Equity returns within the Balanced Fund were similar. For more specific performance, please refer to the Fund reports in this document or your client-specific report.

[6] Except where indicated, all U.S. and international returns are measured in Canadian dollars.

[7] Both funds are managed by teams from JPMorgan Asset Management in London, England.

Pooled Fund Reports

Nexus North American Equity Fund

On the back of a strong month of May, the second quarter generated a positive return for the Nexus North American Equity Fund. Over the quarter, the fund gained 2.1%, an amount that lagged our benchmark, which rose 3.9% for the quarter. In the last 12 months, the Fund returned 1.6%, which also lagged the benchmark return of 3.9%. Our returns for 2, 5 and 10 year periods remain at or above the benchmark and are very attractive on an outright basis. More detail on the Fund's performance is laid out in the table below.

Equity market returns continued to differ widely between domestic and international markets and be heavily influenced by currency fluctuation. Beginning with Canada, the TSX Composite continues to be surprisingly strong. Much of the year-to-date return of the TSX Index stems from a sharp recovery of commodity stocks, which rebounded strongly from levels at the beginning of the year that incorporated the possibility of insolvency for some, as well as increased "safe haven" demand for gold shares. Thankfully, good stock selection elsewhere in our Canadian holdings more than made up for our under-representation in the commodity sector. In the second quarter our Canadian holdings generated a 5.2% return, just ahead of the TSX Index which rose 5.1%.

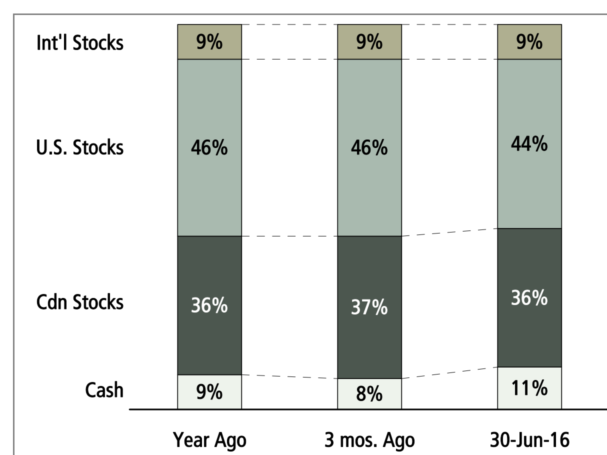
However, our holdings outside Canada continued to fare less well. In the U.S., our exposure to financial services stocks at a time of low interest rates remains a headwind to better performance. The prevailing opinion is that with interest rates kept at artificially low levels, net interest margins will continue to grind lower, eroding the overall profitability of the banks. However, at current valuation levels, we think our bank holdings discount this concern. Each of M&T Bank, Citigroup and JPMorgan trade at low Price / Earning and Price / Book valuations. In addition, they have each come through the latest round of Federal Reserve capital adequacy testing with a green light to return capital to shareholders, either by dividend increases or share buybacks. Despite their sluggish recent returns, we think they have very attractive long-term attributes. In the second quarter, our portfolio of U.S. securities gained 0.4% in Canadian dollar terms, while the S&P 500 gained 2.8% in the same period.

Our holding of the EQIT fund, which invests in developed markets outside North America, returned -0.4% and outperformed its benchmark, the EAFE Index, which fell 1.2%. EMEC, which invests in emerging markets, rose 4.1% which also topped its benchmark return of 1.0%. We have maintained an allocation of approximately 10% of the Fund's equity exposure to markets outside North America and remain confident that this will provide important diversification to our North American investments. A more detailed explanation of developments in equity markets appears earlier in the Asset Class Review section of this report.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	2.1%	5.2%	0.4%	1.2%
Benchmark	*3.9%*	*5.1%*	*2.8%*	
One Year				
Fund	1.6%	8.3%	-0.5%	-6.1%
Benchmark	*3.9%*	*-0.2%*	*8.5%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 91 Day TBill, 50% TSX, and 45% S&P 500 (in C$) (rebalanced monthly); (b) for Cdn Stocks: TSX; and (c) for U.S. Stocks: S&P 500 (in C$).

Investment Returns – As at June 30, 2016



Equity Fund Asset Mix

Nexus North American Balanced Fund

In the second quarter the Nexus North American Balanced Fund recovered from a difficult start to the year, generating a 2.0% return. Its benchmark advanced 3.6%. In the last 12 months, the Fund has returned 2.7%, which also has lagged the benchmark return of 3.8%. Despite this recent lag in relative performance, the returns for 2, 5 and 10 year periods remain higher than the benchmark and are very attractive on an outright basis. More detail on the Fund's performance is shown in the table below.

Beginning with bonds, interest rates fell again this quarter, with much of the decline concentrated in the longer end of the bond market. With a strategy of emphasizing higher-quality bonds of a shorter-maturity profile than the Bond Index, our bond performance lagged this quarter. While the Bond Index generated a 2.6% return, and the bond component of the Fund returned 1.6%. The Canadian economy has been subdued, with obvious economic softness in the energy patch (accentuated by the Fort McMurray fires) and a disappointing recovery in export activity in Ontario and Quebec (likely owing to the surprising rebound in the loonie). While each of these factors may justify some of the recent decline in interest rates, what has been more impactful has been the easy money policies pursued by global central banks. These policies have turned Canada into a destination for foreign capital and driven interest rates to historic low levels. A more detailed explanation of developments in bond markets appears earlier in the Asset Class Review section of this report.

As was the case in the first quarter, equity returns differed widely between domestic and international markets. In the latest quarter, the TSX Composite continued to generate good returns. Much of the year-to-date return has come from a sharp recovery in commodity stocks, which rebounded sharply from end of year levels that incorporated the possibility of insolvency for some companies and prolonged unprofitability for many others. Despite the Fund's lack of representation in the commodity sector, including gold stocks, the returns from our Canadian holdings only slightly lagged the benchmark. In the second quarter, the Fund's Canadian equities returned 4.7%, slightly behind the TSX Index which rose 5.1%.

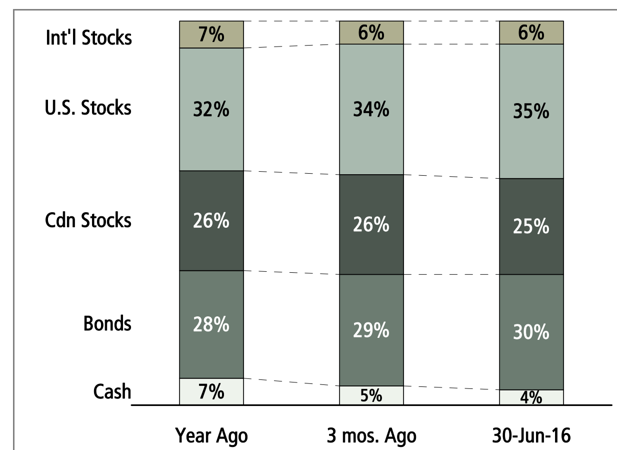
Our holdings outside Canada continued to fare less well. In the U.S., exposure to financial services stocks at a time of low interest rates remains a headwind to better performance. The prevailing opinion is that with interest rates kept at artificially low levels, net interest margins will continue to grind lower, eroding the overall profitability of the banks. However, at current valuation levels, we think our bank holdings discount this concern. In addition, they have each come through the latest round of Federal Reserve capital adequacy testing with a green light to return capital to shareholders, either by dividend increases or share buybacks. Despite their sluggish recent returns, we think they have very attractive long-term attributes. In the second quarter, our portfolio of U.S. securities gained 0.7% in Canadian dollar terms, while the S&P 500 gained 2.8% in the same period.

Each of the EQIT and EMEC funds, which together give us exposure to stock markets outside North America, outperformed its benchmark in the quarter. A more detailed explanation of developments in equity markets appears earlier in the Asset Class Review section of this report.

	Balanced Fund	Bonds	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter					
Fund	2.0%	1.6%	4.7%	0.7%	1.1%
Benchmark	*3.6%*	*2.6%*	*5.1%*	*2.8%*	
One Year					
Fund	2.7%	3.6%	7.8%	0.9%	-6.2%
Benchmark	*3.8%*	*5.2%*	*-0.2%*	*8.5%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 91 Day TBill, 30% FTSE TMX Universe Bond, 40% TSX, and 25% S&P 500 (in C$) (rebalanced monthly); (b) for Bonds: FTSE TMX Universe Bond; (c) for Cdn Stocks: TSX; and (d) for U.S. Stocks: S&P 500 (in C$).

Investment Returns – As at June 30, 2016



Balanced Fund Asset Mix

Nexus North American Income Fund

Once again, Canadian interest rates fell over the quarter and, as was the case in the first quarter, the decline in yields was most pronounced in longer-dated bonds. Yields of 10-year bonds declined 17 basis points (from 1.23% to 1.06%) while bonds of less than 5 years in maturity were essentially unchanged. Looking at conventional factors that affect interest rates, such as inflation and economic growth, the case for record low yields is difficult to make. Inflation in Canada has recovered, but the Canadian economy is performing poorly. In western Canada, growth has been slow (accentuated by the fires around Fort McMurray) and the recovery is less than robust in central Canada. In the west, despite some rebound, the recovery in energy prices has been insufficient to remove the cloud of uncertainty that overhangs the energy sector. In Ontario and Quebec, there has been a less-than-expected pickup in export activity due to the surprising rebound of the loonie. But as much as these factors might argue for lower rates, global factors and specifically the monetary and quantitative easing policies of global central banks, are far more impactful. A more detailed explanation of developments in bond markets appears earlier in the Asset Class Review section of this report.

The Nexus North American Income Fund had another surprisingly strong showing, increasing 2.3% this quarter, and returning 5.1% over the past year. The Fund has performed just slightly behind its benchmark, the Bond Index, which increased 2.6% over the quarter and has returned 5.2% in the last 12 months. More detail of the Fund's performance is set out in the table below.

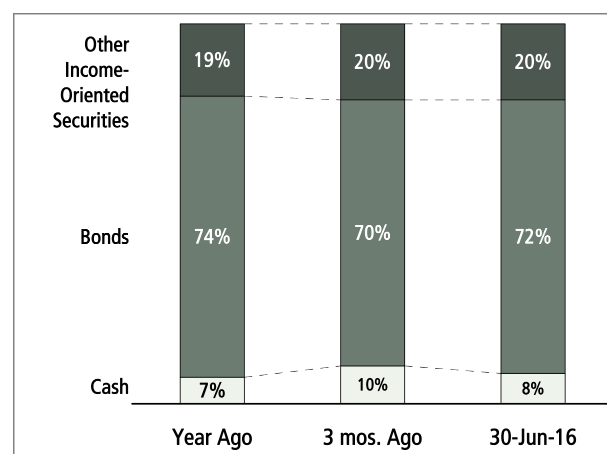
Our benchmark, the Bond Index, now has a duration of 7.7 years. This is an extension of almost half a year from last quarter and reflects the desire of borrowers to raise as much financing as possible in longer-dated maturities to lock-in historically cheap funding. Although this seems sensible to borrowers, it does not seem attractive to us as investors. Our strategy remains to own a portfolio of shorter-dated, higher-quality bonds. The duration of our portfolio is 5.2 years. Over the quarter, we did execute some switch trades, swapping out Canada Housing Trust bonds for stable utility bonds at higher yields, and selling a small holding of Manitoba bonds to buy a new holding of BMW Canada bonds, also at an increase in the yield to maturity.

Where we are comfortable investing for the long-term is with our allocation to "Other Income-Oriented Securities". In effect, high-quality, dividend growth stocks are our Fund's long duration instruments. But unlike long-dated corporate or provincial bonds that have a fixed coupon, these holdings have a growing return from rising dividends. With an allocation of 19.7% to this portion of the portfolio, we remain near the maximum allowed allocation of 20%. We remain committed to using high-quality income-producing equities as a method of augmenting the Fund's returns in an ultra-low interest rate environment. It is a strategy we remain fully confident in.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	2.3%	1.6%	6.5%	4.1%
Benchmark	*2.6%*	*2.6%*		
One Year				
Fund	5.1%	3.7%	10.8%	15.8%
Benchmark	*5.2%*	*5.2%*		

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: FTSE TMX Universe Bond; (b) for Bonds: FTSE TMX Universe Bond. In addition to bonds, up to 20% of the Fund's portfolio may be invested in equities.

Investment Returns – As at June 30, 2016



Income Fund Asset Mix

Nexus International Equity Fund

The Nexus International Equity Fund ("NIEF") was launched in September 2015. It is a pooled fund invested in international developed markets ("EAFE") and emerging markets ("EM").[8]

NIEF holds two underlying funds – EQIT (invested in international developed market equities) and EMEC (invested in emerging market equities) – both of which are managed by JPMorgan Asset Management in the United Kingdom. Currently, NIEF's holdings are approximately two-thirds EQIT and one-third EMEC. EQIT and EMEC complement Nexus's North American equity exposure and offer additional diversification. The Nexus Balanced and Equity Funds continue to hold EQIT and EMEC directly.

In the second quarter, NIEF had a small positive return of 1.2%, ahead of the 0.6% loss of its blended benchmark. This was comprised of a small loss of 0.4% for EQIT and a gain of 4.1% for EMEC. Over the past year, EQIT is down 9.3% and EMEC down 0.1%. Longer-term returns are good: EQIT is up 8.3% per year and EMEC is up 6.8% per year over the past three years.

The June Brexit vote dominated headlines and screens in the most recent quarter, but its aftermath will be felt for years. It will take time to see how the U.K.-EU relationship evolves. Anything seems possible, from a complete backtracking by the U.K. from its exit plans to a successful two-way trade relationship. The geographical make-up of the U.K. and EU may change, with Scotland wanting in and other EU countries wanting out. We should celebrate diversity of opinion! This ongoing uncertainty will not be good for investment or consumer spending in the U.K or more broadly across Europe. At the very least, investors fear that Brexit will marginalize the U.K.-based banks, which have traded down heavily. Separately, pre-existing concerns have heightened over the strength of the Italian banks, in turn raising concerns about possible financial "contagion".

By contrast, emerging market countries and companies, which have commodity and geopolitical issues of their own, continue to outgrow the developed world. EM equities are attractively valued relative to EAFE, and EAFE is attractively valued relative to North America. Put together, the 4.6 times valuation multiple discount of EM relative to the S&P 500, makes EM particularly appealing.

We continue to like the longer-term prospects for EQIT and EMEC. History demonstrates the resiliency of economies, companies and equity markets. With all the concerns that Eurozone and other EAFE countries face, we take comfort in this. Looking several years ahead, whatever happens with the U.K. will likely not be of fundamental long-term harm. Sentiment and markets can swing wildly in the short term, but corporate adaptability and attractive valuations are powerful forces over the long term. While the short-term "headline" and ongoing geopolitical issues will continue, longer-term investors should look through this.

	Price / NTM Earnings(1)	Price / Book	Dividend Yield
Int'l Developed Markets (EAFE)	14.2x	1.5x	3.5%
Emerging Markets (EM)	12.0x	1.4x	2.8%
S&P 500 (U.S.)	16.6x	2.7x	2.2%

(1) Price to next 12 months earnings

Comparative Index Statistics – As at June 30, 2016

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	1.2%	-0.4%	4.1%
Benchmark	*-0.6%*	*-1.2%*	*1.0%*
One Year			
Fund	n.a.	-9.3%	-0.1%
Benchmark	*n.a.*	*-6.3%*	*-8.3%*

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: 75% MSCI EAFE (in C$) and 25% MSCI Emerging Mkts (in C$) (rebalanced monthly); (b) for EQIT: MSCI EAFE (in C$); and (c) for EMEC: MSCI Emerging Mkts (in C$).

Investment Returns – As at June 30, 2016

[8] "International developed markets", also referred to as EAFE includes all developed markets outside of North America (that is, Europe, Australasia and the Far East). "Emerging markets" include 23 developing countries, such as India, China, South Africa, Brazil, Taiwan, and South Korea.