FIRST ASSET
A CI Financial Company

FIRST ASSET CAMBRIDGE CORE U.S. EQUITY ETF
MANAGER COMMENTARY
Fourth Quarter 2016
TSX: FCY

Capital Appreciation

Equity markets slumped as the quarter began, as uncertainty set in ahead of the U.S. election. The surprise over Donald Trump's unexpected victory and the renewal of the Republican congressional majorities ignited a rally that lasted through the end of the year. The prospects for pro-business policy measures from the incoming administration provided the catalyst necessary to drive up global interest rates, as well as energy and equity prices. However, the election result was only part of the reason for the rebound, as markets were also buoyed by signs of improvement in economic indicators in the Eurozone, as well as in the United States and Canada.

Interest rates moved dramatically higher during the period, gaining roughly 80 and 70 basis points in the United States and Canada, respectively. The price of crude oil rose 16% amid the prospects for greater economic activity and promised production cuts by OPEC. Natural-gas and base-metal prices also recovered during the quarter, while gold prices fell 12% due to higher real interest rates (which include the impact of inflation). Despite the increase in oil prices and the strong performance of the S&P/TSX Composite TR Index, the Canadian dollar fell 2.3% against its U.S. counterpart, as the latter strengthened because of enthusiasm over U.S. economic growth prospects.

The increase in optimism caused bond prices to fall significantly during the quarter, driving down U.S. bond prices more than 2%, while pushing up the S&P 500 TR Index 3.8% (5.4% in Canadian-dollar terms), led by the strong performance of the financials sector. Small-cap stocks outperformed, given their more domestic focus, as the Russell 2000 Index rose 8.4% (11.4% in Canadian-dollar terms).

A significant weight in financials, consumer staples and industrials contributed significantly to performance. Weights in Bank of America, Marriot, and Allison Transmission also contributed to performance.

Manager Outlook

While the Republican election victory has continued to fuel developed equity markets, it remains to be seen whether the Trump administration's planned implementation of tax cuts and infrastructure spending ultimately will boost investment fundamentals in the coming months. Interest rates could rise due to these pro-growth initiatives, as well as the improving global economy, rising inflation expectations and the unwinding of very dovish central bank policies.

This optimism is tempered by the negative trade and inflationary implications of the new government's platform. Indeed, U.S. earnings forecasts – which anticipate a 12% increase during 2017 – are relatively unchanged from pre-election expectations, which imply recent gains have been driven predominately by price-earnings expansion. In addition to worries over U.S. economic policy, we believe it is possible that rising inflation – and with it higher interest rates – could lead to a contraction of price-earnings multiples.

Other potential negative factors include continuing fallout from Brexit and the effect on European trade with the United States, as well as concern about China's liquidity, trade barriers and capital flows. We will maintain a conservative stance until there is greater clarity on these issues or until more attractive bottom-up opportunities are found.

Given the considerable political and macroeconomic uncertainty, market participants remain keenly focused on developments in these areas. As bottom-up fundamental investors, we welcome any opportunities that are created by market participants' excess focus on top-down factors. We continue to employ a bottom-up strategy, identifying the most attractive portfolio candidates from a return/risk perspective.

Brandon Snow
Principal & Chief Investment Officer
Cambridge Global Asset Management

Each pillar of Cambridge's investment philosophy was conceived to help compound client wealth over the long term. It dictates how the team operates, what it stands for and what differentiates Cambridge from the competition.

The three pillars of investment management at Cambridge are:

- True Active Management
- Focus on Absolute Returns
- Manager Alignment

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First Asset - **Smart Solutions™**

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