MARKET REVIEW AND MANAGERS' COMMENTARY

GLOBAL EXPRESS

Markets continue to rally, and nothing seems to be standing in the way of continuing global expansion. President Trump's twitter rages against North Korea, which undermine his own Secretary of State, are shrugged off. Throwing the Iran nuclear deal under the bus has no effect. The Administration's failure to repeal Obamacare or pass any significant legislation at a time where the Republicans control all three levels of the U.S. Government – no impact. Ridiculous demands and threats to kill NAFTA – Canadian GDP and equity markets are at the highest levels in years.

Mind you, President Trump did get the National Football League to capitulate on the issue of kneeling during the National Anthem. Perhaps business does trump – sorry for the pun – free speech. But that's an issue for another day.

Despite these and other justifiable concerns, global equity markets seem immune to any issues, including the possibility of higher rates. Institutional investor complacency is at an all time high – meaning volatility is at historic lows - while individual investors are, for the most part, on the sidelines, with as much as USD $5 trillion in liquid capital that could come into play under the right conditions.

The bottom line is we believe the global bull market in equities remains alive and well. Certainly, a correction is possible, but with a quick glimpse of figure 1, one could argue that we have experienced a rolling correction in the S&P 500 index for the past 12 months.

We can have a correction with a sharp sell off in stocks or we could see a period of sector rotation where one sector after another self corrects but the market remains strong, with overall S&P 500 earnings rising 11% year-over-year. Both scenarios yield the same result: a broad-based decline in price-to-earnings multiples which is the purest definition of a correction.

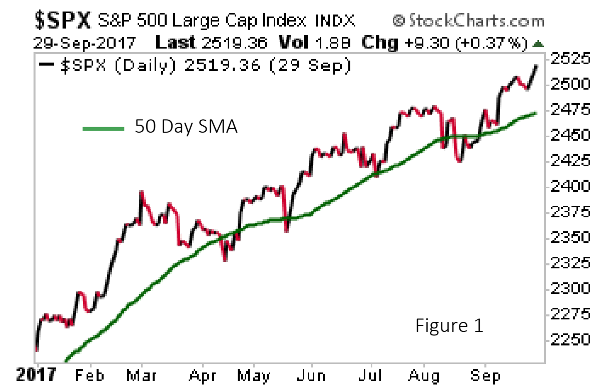


Figure 1

Overall, we suspect earnings will continue their upward trajectory as virtually all global economies are posting solid growth. That's beneficial for the S&P companies which compete internationally (see *Sector Returns* below). Profits in that space will also get a boost from currency translation because of a weaker U.S. dollar.

We don't think the U.S. Federal Reserve will derail the rally even if they raise rates by a quarter point in December. In fact, one could argue that a rate increase would be good for stocks as it would signal the economy is on a solid footing. If they leave rates alone – we see this as a 50-50 call – it is because Fed Chair Janet Yellen may simply want to leave the status quo for the new appointee. If we are correct, we could see the market rally through the remainder of the fourth quarter.

CROFT FINANCIAL GROUP

MARKET REVIEW AND MANAGERS' COMMENTARY

As we move into 2018, there is another potential catalyst… tax reform. If President Trump can muster enough support to pass corporate tax cuts, that would have a significant benefit for bank stocks which tend to pay higher rates.

As for the multi-nationals, the impact will be more muted because they have subsidiaries in many tax jurisdictions and they are not currently paying anywhere near the top tax rate as it currently exists. Lowering the corporate tax rate would take away the incentive to employ such elaborate strategies and might end up being revenue neutral.

The main benefit of tax reform for U.S. equity valuations would be the repatriation of capital that is currently held in lower tax jurisdictions offshore. That number is pegged by some analysts to be as high as USD $3 trillion. If the U.S. government allows that to come back at a lower rate it would stimulate economic growth and encourage companies to engage in more aggressive stock buy-back programs.

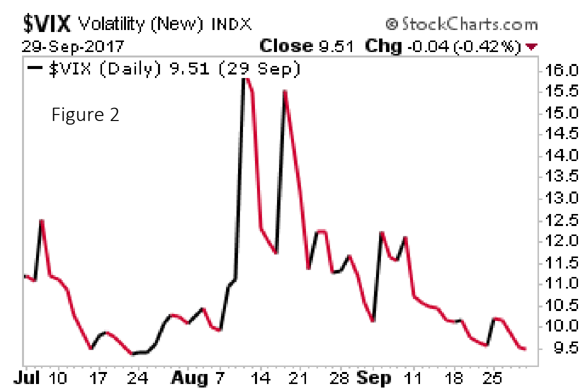
One would think such a move would be something that should play well given President Trump's psyche. The challenge will come in the line item negotiations that will occur in the U.S. Congress and Senate. We suspect that as tax reform moves through Washington's political elite, the line separating a "sure thing" from "doubt" will begin to blur. As the process grinds on we suspect that the market will assign a lower probability to any package that looks remotely close to the initial proposal from the Trump administration.

One final point about the impact tax reform has on equity valuations – historically markets rally in anticipation of tax reform, and sells off on news of the event. The trick is to ascertain how much of the current growth in equity valuations is tied to tax reform versus stronger earnings, and calculating that is more art than science.

Dealing with Investor Complacency

The other issue that raises concern is volatility as measured by the CBOE Volatility Index (see figure 2). Volatility is at historic lows and has been, save for minor blips, for the past twelve months. Low volatility translates into reduced option premiums making it more difficult to earn money from covered-call strategies.

In dealing with low premiums we have engaged in more short-term option writing strategies. That combined with the bull market and superior stock selection has allowed us to write and roll up covered calls. As a result, we have been able to engage in profitable option writing strategies as a component of our Income pool as well as generate double-digit returns in our option writing pool, both of which made major dividend and capital gain distributions at the end of September.



MARKET REVIEW AND MANAGERS' COMMENTARY

Black Mondays and Swans

As we pass the 30th anniversary of the record 1987 Black Monday global equity markets crash, we do well to remember that at a basic level, all financial markets are driven by greed and fear – especially fear of that rare, unpredictable event that event could trigger a major sell-off. The objective is to be mindful of potential, and as yet unknown, risks that could dramatically upset equity valuations and then hedge against widespread catastrophe – a strategy that is much easier to say than do!

One risk that is on our radar came from French President Macron. He floated an idea in a speech that the European Union should pile all the debt created by quantitative easing onto the balance sheet of the European Central Bank.

When you understand the implications, what President Macron was suggesting is that the European Union simply forgive the indebtedness of its member States so that countries like Greece, Portugal and Spain could start with a fresh balance sheet.

You may recall that Europe and Japan have both experienced a period of negative interest rates. When their Central Banks 'print money' to buy government bonds that have a negative yield it is the practical equivalent of debt forgiveness. Surprisingly, they did this without triggering inflation. Is it such a big step to simply assume and forgive EU member countries' debt that can never realistically be repaid?

One potential unintended consequence that might follow extending such a massive debt forgiveness program is the 'moral hazard' if inflation fails to materialize. Inflation is the only protection society has in limiting government excesses within industrialized economies. Without fear of price increases that result from a weakening in the value of sovereign currency, what prevents governments in all jurisdictions from spending without any fear of consequences?

U.S. Puerta Rico, as an example, has $70 billion of debt and only 3.5 million people who live on the island State. That's $20,000 of debt for every man, woman and child on an island that has just been decimated by Hurricane Irma. There is no way for that government to repay its debt, which is why it currently trades at pennies on the dollar. There is no solution to this catastrophe without some form of debt forgiveness.

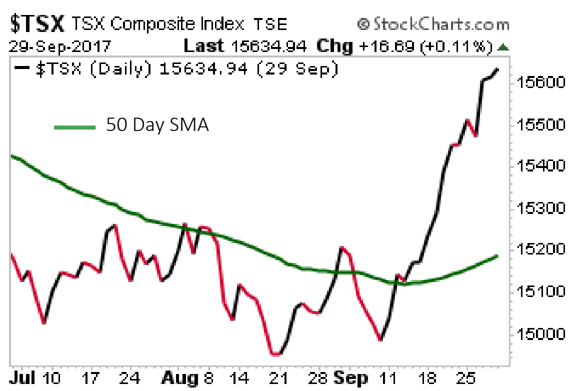
If Puerto Rico is bailed out, why should the U.S. not apply the same standards to other U.S. States in a similar situation such as California, New York State and Michigan? And if those States are bailed out why shouldn't states such as New Hampshire and Wisconsin, where budgets are balanced, engage in deficit spending for programs that are popular politically and simply upload their debt to the Federal Reserve?

Now take that principal and apply it to society's middle class. If governments can simply write off bad debt, why should ordinary citizens not take on more debt than they can afford and simply walk away from any responsibility? Such are the potential 'moral hazard' consequences.

On the other hand, we suspect the risk of triggering long-term inflation is why gold continues to trade at relatively constant levels. Given low interest rates and strength across all global economies, gold prices should be in free fall, but we think 'gold bugs' believe there is a real chance that we will see a major devaluation of major global currencies and unintended inflation. Certainly, Macron's proposal would be a catalyst for such an event. Should we see this idea gain momentum we suspect gold would rally to new highs.

Obviously, we will continue to watch the U.S., Europe and Japan for any hint of this or any other potential 'Black Swan' strategy becoming reality.

Canada



The S&P/TSX Composite ended the third quarter up 3.0%. The Industrials and Consumer Discretionary sectors gave the index its biggest boost while the Energy and Health Care sectors lagged. The dividend yield on the S&P/TSX Composite retreated to 2.8% over the quarter but continues to outpace the Canada 10-year bond, which ended the quarter at 2.10%. In terms of our currency, the Canadian dollar continued its charge forward to end the quarter at $0.799 USD/CAD.

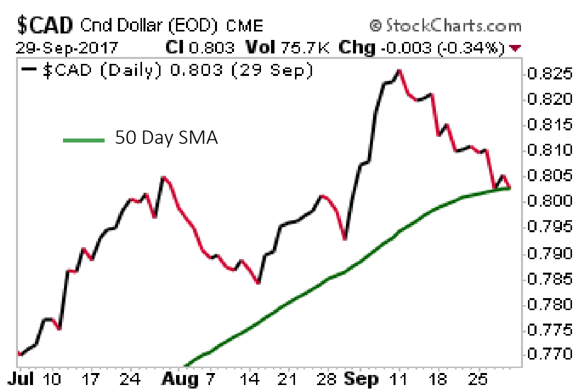
The Canadian economy continues to exhibit strength. Following a strong first half of the year we did see things come down a bit from unsustainable levels – the best trailing four-quarter growth since 2006 – but slower and steadier often wins the race. On the current trajectory, expectations are that Canadian GDP growth will come in near 3.0% for the year. This will be the best performance in six years and there are many supporting factors that indicate this will be the case.

Going back to Q2, we recall that the Bank of Canada (BoC) shifted its tone from a dovish stance to a more hawkish one. We now see that Governor Poloz was correct in removing the low interest rate insurance he took out on the economy in the wake of the oil crash of 2015 because capacity utilization has returned to pre-recession levels and there is now little slack left in the Canadian economy. While this ratio of actual output to potential output hasn't reached levels where inflation warnings signals start to go off, taking some pre-emptive action to keep inflation in check was prudent on the part of the BoC. Nonetheless, a reduction in economic slack bodes well for business investment and corporate profits.

Another reason to be optimistic is that the labor market continues to show resilience. Over the last 12 months 375,000 jobs have been created and the trend continues in a positive direction. Average jobs created monthly is now 31,000 vs. 26,000 three months ago. Amid this tighter labor market, it is not surprising to see that wages are growing as well. Adding an element of quality to those job gains is that more than half have been full-time and in the private sector. While Ontario, Quebec and British Columbia lead the nation in job creation, Alberta's employment is also on the rise. This uptick is important because it demonstrates that Alberta is indeed recovering from the oil shock and adds further evidence that the BoC was correct in removing the insurance it took out during that period.

Despite interest rates rising over the quarter, income gains coupled with historically low interest rates have contributed to this year's price rise in the Canadian housing market. Admittedly, we did see a cooling of the housing market over the quarter as the government imposed tighter measures to keep prices in check. However, homes sales have appeared to bounce back in August as new listing returned to normal levels after a rush for the doors. If the market continues to remain balanced and risks to financial stability recede, the BoC may not need to increase rates as quickly, or at all.

The biggest reason, we think, that interest rates will not rise quickly is that monetary tightening has caused the Canadian dollar to rise 8% against the U.S. dollar since June, and continued strength in the Canadian dollar will hurt non-energy exports.



Getting back to business investment and capacity utilization, increasing Canada's productivity gives the economy room to grow in a non-inflationary way. Without inflation there may not be the impetus for significant rate rises in the future. Also considering uncertainties around NAFTA and protectionist sentiment, the inflation outlook is less clear and it wouldn't be surprising to see Governor Poloz using more cautious language toward interest rate normalization.

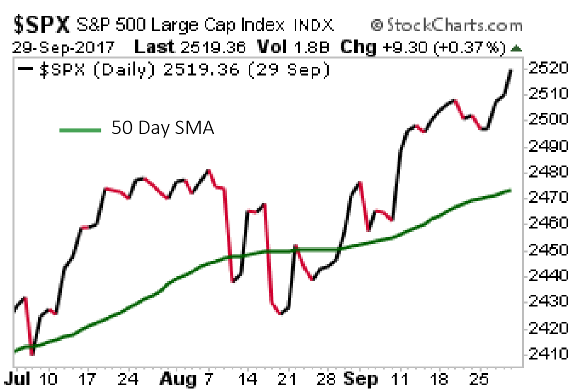
Turning our attention to markets, investors must be starting to recognize the opportunity the TSX offers. While the S&P/TSX had its best quarter of the year, Canada's index remains undervalued relative to the S&P 500 to the south. Relative to its own performance, valuations have risen for the TSX over the quarter, but they remain low relative to history. This leaves room for the possibility of further 'mean reversion' as investors pour money into the undervalued index.

Further justifying the rise in valuations is that the return on equity for the S&P/TSX index has also risen. Earnings growth along with actual earnings of the TSX composite have been increasing for the last few quarters, and stocks on average have been beating earnings estimates.

Looking forward we expect the fourth quarter of this year (absent any economic shocks) to be a good for investors. Over the 1957 – 2016 period, the fourth quarter has registered positive performance 78% of the time with an average return of 3.8%. While we never know what tomorrow will bring, we hope this is a case where history will repeat itself.

United States

Driven by the familiar features of expanding price-to-earnings ratios, falling interest rates across all maturities of U.S. government debt, and low volatility, U.S. equity markets delivered another quarter of solid performance, with three bellwether indices (Dow Jones, S&P 500, and Nasdaq) all fetching record highs. Equally familiar are the themes of intractably low unemployment and inflation, along with mediocre GDP growth rates that characterize the underlying U.S. economy.



For better or worse, this market has also learned to tune out the sensational news stories making headlines on a regular basis. Whether this is the 'Efficient Market Hypothesis' at its best is open for debate, but if current events can be categorized as either short- or long-term, and as either bad or good, then it is clear investors don't believe there is any short-term bad news. As pointed out in our theme article, however, events that would imply a 'down' or at best 'unclear' direction for capital markets are on the horizon, even if they are being ignored today.

Starting with the Trump Administration's promised tax reform package revealed on September 27th, for markets not to fizzle if such a bill gets passed (a big uncertainty in itself) there must be real, long-term benefits to the economy, not just the transfer of cash held abroad by U.S. multinationals into the hands of their shareholders. A preliminary review of the details, however, leaves room for doubt that: a) the middle class would experience a real reduction in tax rates and b) there would be any reduction in Federal government debt. Fortunately, even in a Republican-controlled House and Senate, checks and balances exist such that the chances of both scenarios remaining on the table after a bill is passed are slim, and there could be a compromise to either stimulate the economy, reversing scenario a), or to reduce the debt, reversing scenario b).

Of course, that means the U.S. Government will continue to run budget deficits into the foreseeable future, causing Federal indebtedness to climb. Exacerbating this long-term problem are the diminished chances that the costs of Medicare and Medicaid will be shared at the Municipal or State level, given that the last Bill to repeal or change Obamacare expired on September 30th. That is not to say efforts to repeal the program will cease, but the political unpopularity of a U.S. Senator voting against the program only slightly exceeds the unpopularity of voting to assume responsibility for administering and sharing the cost of the scheme at the State level, a feature of all Republican alternatives to Obamacare so far.

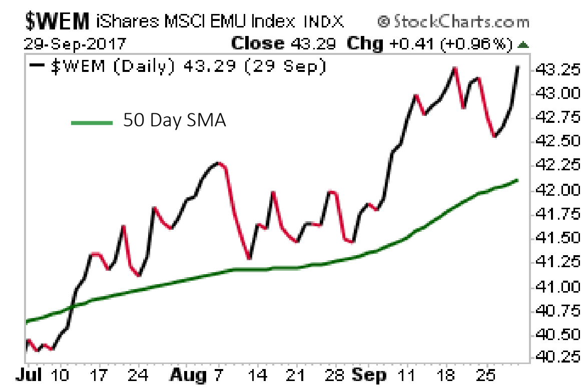
On the other hand, it is a much easier political sell to take issue with America's free trade agreements, the most obvious example being NAFTA, so there is a real chance that talks to renegotiate it will fail. The consequence to Mexico and Canada in such a scenario would be obvious, but protectionism carries unintended consequences for America. The best very recent example is Bombardier's creative response to a 320% tariff levied by the U.S. Department of Commerce on its CS100 Series Jets that Delta Airlines was about to take possession of. A week later Bombardier strikes a deal with Airbus to build these planes in the U.S., allowing it to avoid the tariff and likely further impediments by the U.S. Government.

So, there is room to hope for the best – that America's decision makers will deal with the challenges that lie ahead constructively, and that this market rally is sustainable – so long, of course, as we do not ignore preparing for the worst.

Europe, Asia & Emerging Markets

Europe

The MSCI EMU index returned 4.3% driven by strong economic data. GDP for the 2nd quarter was 0.6% and 0.4% for the first quarter. Economic settlement remains at its highest level since July 2007 at 111.9. Unemployment for the region was stable at 9.1%. The euro continued to gain against the USD with year-to-date returns of approximately 15%. The appreciation of the euro resulted in the central bank lowering its inflation forecasts as the price of imports decreased. The ECB is struggling to achieve its 2% inflation target with current inflation rates of 1.5% and a projected rate of 1.2% for 2018. The EU regional economic growth forecast was increased to 2.2%.



With regards to Quantitative Easing and negative interest rate environment, the ECB has indicated that they are comfortable with the current level of economic stimulus. While relatively stable economic growth has not resulted in material increase in wages and inflation, unwinding of the ECB Quantitative Easing program must be accomplished strategically to avoid stagflation. Positive pro-EU election results from the Dutch and French elections provided some reassurance to the markets, but there continues to be some concerns regarding populist politics in the upcoming Italian elections.

Despite dire predictions, political and economic intransience and uncertainty concerning Brexit have had little effect on UK or major EU equity markets so far.

Japan

The Japanese market was up 4.7% for the quarter. Returns were led by the oil and mining sectors, with a weaker yen also enabling auto manufacturing to outperform. Economic data continued to post positive figures. September industrial production beat expectations and inflation surprised the market at 0.7%.

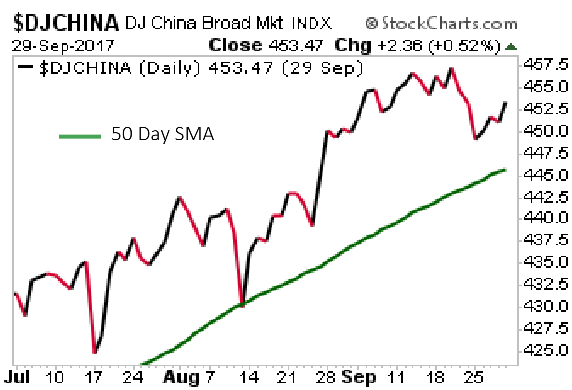
Mr. Abe called a snap election for October and, capitalizing on his recent surge in popularity, won handily, assuring markets of another four years of Abenomics. The ten-year government bond yields are still within the central bank's target of zero percent, and with the win there will be no pressure on the BoJ to raise them any time soon.

With an aging population and restrictive immigration policies, the Japanese economy is now considered to be at full employment with a shortage of labour and capacity. This has resulted in increased capital expenditures to try to create additional efficiency. Most corporate earnings beat expectations and thus resulted in raising expectations for the final quarter of 2017. There remains the ongoing threat from North Korea adding a layer of uncertainly.

China & Emerging Markets

China

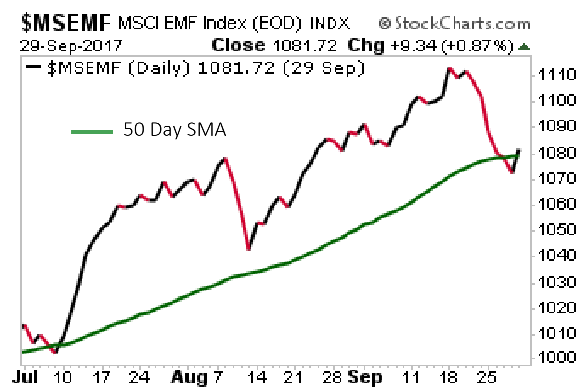
GDP growth rebounded back to 7% supported by government stimulus that pushed up commodity prices and industrial profits. The Chinese President Xi Jinping is entering his second 5-year term and it is expected that he will continue to pursue his key initiatives to reduce the excess capacity in state-owned companies and minimizing the countries reliance on debt to fuel growth. The Chinese government's attempts to rain in excessive leverage is gaining traction with bank and credit lending slowing down.



There is risk of increased trade tensions with the U.S. because of the geopolitical risk in North Korea. Construction was subdued by regulatory reforms newly-implemented to cool the overheated housing market. The Chinese economy has stabilised over the past year which is promising as the government is gradually withdrawing some stimulus measures.

Emerging Markets

Emerging Markets indexes posted impressive Q2 returns, which were driven by a combination of strong developed-economy demand on the back of reflation and growth, as well as a pause from the decline in commodity prices, and a weaker U.S. dollar. Compelling valuations combined with local economic reforms tempted investors to ease back into emerging market stocks.



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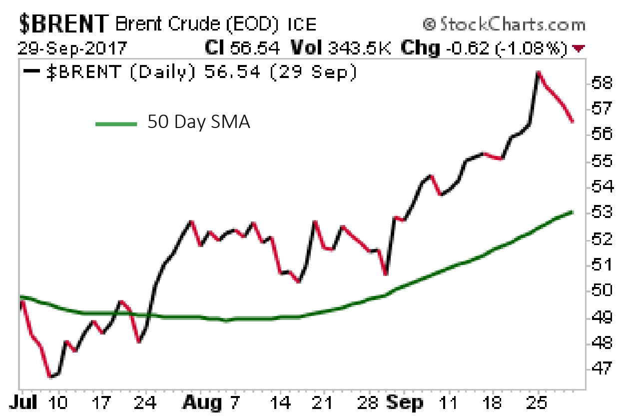
Locally, there continue to be some risks in the emerging market countries, including shifts in currency policies and possible trade conflicts. In Latin America, Brazil's chaotic political environment renewed threats of a possible second recession. In contrast, Mexico's outlook has improved as the peso rebounded from the 15% drop that followed uncertainties surrounding last year's U.S. election and threats of NAFTA cancellation.

Sector Report

S&P Sector (In USD)	Q3 Returns
Consumer Discretionary	0.80%
Consumer Staples	-1.30%
Energy	6.80%
Financials	5.20%
Health Care	3.70%
Industrials	4.20%
Materials	6.00%
Technology	8.60%
Utilities	2.90%
Telcom Services	6.80%

Energy

Energy was the second top performing sector, up 6.8% for the 3rd quarter. The strong returns can be attributed to oil production being temporary hampered by several hurricanes in the oil-producing regions. Oil producers are becoming more diligent, reigning in supplies of crude in attempts to increase the price. The U.S. rig count finally stabilizing after several months of increases. The September 22nd OPEC meeting echoed the same settlement to continue production cuts to beyond March 2018. Historically, desired production cuts have not materialized as planned with a compliance rate of OPEC and the non-OPEC members at 86%.



As governments and automotive companies continue to push towards an "all-electric future" the effects on the Oil industry could be severe. About 30% of crude is used for transportation, and with the real possible of that demand evaporating the Oil sector must change to adapt to the new environment.

Healthcare Sector

The healthcare sector returned 3.7% for the 3rd quarter. Overall, the sector is attractive with solid balance sheets, stable dividends and improvements in cost structure. Valuations are below historical averages and with an aging population increasing future demand for health care products and services. However, the inability of Republicans to "repeal and replace" Obama care and President Trump's attempts to suffocate funds for the sector continue to cause significant uncertainly with select healthcare companies. This political volatility is expected to continue for the next several months.

Real Estate Sector

The real estate sector experiences a wide divergence between the apartments and mall REITs subsectors. Multifamily (apartment) rents increased 3.8% year over year as the U.S. national vacancy rate rose slightly in the quarter to 4.5% from 4.4%. Mall REITs are experiencing difficulties as consumers shop online while warehousing REITs benefit from e-commerce. In contrast, vacancy rates for retail are currently 12.1% as department store sales experienced a 3.3% decline while online experienced a 10.5% growth. With interest rates expected to increase there should be some modest downward pressure on real estate investment trusts (REITs). Yield curves are flatting out, helping this sector as it is traditionally highly leveraged with longer-term debt.

Market Summary

	31-Dec-17	30-Jun-17	30-Sep-17	Q3 2017	YTD 2017
S&P/TSX Index Composite	15287.59	15182.19	15634.94	2.98%	2.27%
S&P 500 Composite	2238.83	2423.41	2519.36	3.96%	12.53%
Nasdaq Composite	5383.12	6140.42	6495.96	5.79%	20.67%
MSCI EAFE	1684.00	1883.19	1973.81	4.81%	17.21%
MSCI Emerging Markets	862.28	1010.80	1081.72	7.02%	25.45%
MSCI World	1751.22	1961.10	2000.55	2.01%	14.24%
CBOE Volatility Index	14.04	11.18	9.51	-14.94%	-32.26%
FTSE TMX Bond Universe	1011.41	1035.30	1016.30	-1.84%	0.48%
Gold	1145.90	1242.25	1283.10	3.29%	11.97%
WTI Crude Oil Spot Price	53.75	46.31	51.67	11.57%	-3.87%
CAD:USD FX	0.75	0.75	0.81	8.26%	8.52%
RWI Income	3078.16	3106.25	3078.93	-0.88%	0.03%
RWI Balanced	3192.41	3264.76	3250.79	-0.43%	1.83%
RWI Growth	3256.39	3335.07	3362.73	0.83%	3.27%

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