PALOS
INVESTMENT FUNDS

Palos Weekly Commentary

February 16, 2017

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■Portfolio Management & Advisors

Charles Marleau, CIM
President & Senior Portfolio Manager

Hubert Marleau
Economist & Co-Founder

Robert Boisjoli, FCPA, FCA
Chair of the Board

Wakeham Pilot
Director – Wealth Management

Bechara Haddad
Portfolio Manager

Joany Pagé
Financial Analyst

Hugo Maurice
Financial Analyst

■Contacts

Tracey Bishop
Administrative Assistant

Palos Management Inc.
1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

■ Palos Income Fund

By Charles Marleau

A New Best Friend

Pembina Pipeline Corporation (TSX:PPL) announced that it has entered into a 20-year infrastructure development and service agreement with Chevron (NYSE: CVX). The magnitude and the opportunity of this agreement is incredible for PPL. The agreement includes over 230,000 acres in the liquid-rich Kaybob region. The agreement allows CVX to call upon PPL to construct, own and operate gas gathering pipelines and processing facilities in the area. The infrastructure agreement could represent multibillion dollars of growth for PPL. The agreement further solidifies PPL growth opportunities for the next 20 years. This agreement makes PPL the best-positioned midstream company among its peers for high-quality growth. Furthermore, this reiterates why PPL should trade at a higher multiple to its peers. For example, PPL trades at 13.1x P/CF, 13.1x P/AFFO, and 14.3x EV/EBITDA for 2018 while its peers trade at an average of 10.8x, 11.8x, and 11.9x respectively. High-quality names, with good growth visibility and a history of executing on growth, deserve to trade at a premium.

■ What is New on the Macro Level?

By Hubert Marleau

U.S. Economic Outlook

On Wednesday, our market algorithm calculated that the fair value for the S&P 500 was 2155. That is, if the following assumptions are correct:

- The US economy will grow in nominal terms at an annual rate of 4.0% in 2017.
- Yields on ten year treasuries could soon trade as high as 3.00%.
- Market prices for oil could eventually equal its marginal cost of $60 a barrel.

The S&P 500 index closed at 2350 on Wednesday. As much as 200 points is the direct result of the market sentiment of speculators. While the difference is of concern, market fluff is not abnormal when the animal spirit reigns, recession risks are low, and the inflation rate runs much faster than wage rates, suggesting that profit margins are rising.

One should take note that recent data published by the BLS, shows that the pace of inflation is clearly

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns)*

	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL 100	$10.01	2.58%
Palos Equity Income Fund - RRSP	PAL 101	$6.55	2.71%
Palos Merchant Fund L.P. (Dec 31, 2016)	PAL 500	$4.33	-16.73%
Palos IOU High Yield Fund (Jan 31, 2017)	PAL 701	US $7.45	-0.06%
S&P TSX Composite			4.03%
S&P 500			5.14%
S&P TSX Venture			10.63%
Bloomberg USD High Yield Corporate Bond Index 1 to 3 Year			2.02%

Chart 2: Market Data*

	Value
US Government 10-Year	2.45%
Canadian Government 10-Year	1.75%
Crude Oil Spot	US $53.44
Gold Spot	US $1,240.00
US Gov't10-Year/Moody BAA Corp. Spread	221 bps
USD/CAD Exchange Rate Spot	US $0.7651

* Period ending Feb 16, 2017

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Palos Management Inc.
1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada
T. +1 (514) 397-0188 F. +1 (514) 397-0199
www.palos.ca

above the Fed's target rate of 2.0%. The probability of a March rate hike by the Fed significantly increased yesterday. Retail sales are rising because consumers are borrowing more than they should, yet industrial production has stalled. Inventories are rising fast. The prospects of stagflation may be low, but real. Caution is recommended as such an occurrence could negatively turn market sentiment.

If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at info@palos.ca