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# Palos Weekly Commentary

## ■ Palos Income Fund

By Charles Marleau

### Secure Energy Makes a Roaring Comeback

On March 1, 2017, Secure Energy Services Inc (TSX:SES) announced its fourth quarter results. We were pleased with SES' results. The company reported an EBITDA of \$34 mil which was above the street's estimates of \$31.8 mil. The processing, recovery and disposal (PRD) segment of SES was the highlight as its revenue improved by 22% QoQ, with better margins. The PRD business includes:

- Processing oil and gas by-products
- Maximizing the recycling of oil
- Recycling and disposal of waste fluids
- Crude oil treatment with pipeline and rail access

The Drilling & Production Services (DPS) did not do as well because of the weather, which led to the deferral of some projects. Those projects will be pushed back into the first half of this year.

The DPS business includes:

- Drilling and completion fluids
- Fluids and solids control equipment
- Innovation products and systems
- Production chemicals and chemical EOR products

With its niche services and the location of its facilities, we believe that SES is well-positioned for the future and to take advantage of the increased activity in the oil patch. The company has a strong management team and a conservative culture. SES continues to be one of our favorite energy services name with great growth visibility.

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

	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL 100	\$9.88	1.29%
Palos Equity Income Fund - RRSP	PAL 101	\$6.46	1.37%
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%
Palos WP Growth Fund - RRSP (Feb 28, 2017)	PAL200	US \$9.78	-2.20%
S&P TSX Composite			2.02%
S&P 500			6.79%
S&P TSX Venture			6.26%
Bloomberg USD High Yield Corporate Bond Index 1 to 3 Year			2.57%

**Chart 2: Market Data\***

	Value
US Government 10-Year	2.48%
Canadian Government 10-Year	1.70%
Crude Oil Spot	US \$52.56
Gold Spot	US \$1,234.40
US Gov't 10-Year/Moody BAA Corp. Spread	219 bps
USD/CAD Exchange Rate Spot	US \$0.7468

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## ■ What is New on the Macro Level?

By Hubert Marleau

### “The Case for a Rate Hike is Compelling” Said the President of N.Y. Fed.

While the focus for investors is currently on US fiscal policy, personal and corporate tax cuts, infrastructure spending and easing business regulations, they should keep in mind that monetary policy is still a potent force. The Federal Reserve gets plenty of criticism for making wrong bets and very little praise for good ones. This observation explains why monetary authorities are sending multiple signals suggesting that they will seriously consider a rate hike at the next FOMC meeting on March 14-15. They are testing market reactions.

As far as we are concerned, probabilities of a hike are very high. Our constructed proprietary indicators, like the inflationary content of the Misery Index, the representation of interest rate sensitive expenditure to GDP and the Palos Monetary Policy Index (please see below for details), are shouting for another up-notch in the Fed's policy rate. In our opinion, the risk of a policy mistake is low for three reasons. Firstly, economic and monetary indices, that track the current conditions of the banking sector and financial markets, show hardly any stress. Secondly, the markets are not nervous. Stock prices and bond prices are up. Thirdly, there is little chance of a harmful and disruptive effect on the bond market. There is a push toward lower bond yields stemming from relatively low German and Japanese bond yields, which is creating a global search for yield. Furthermore, the Fed may have ended its easing cycle, but the road to significantly higher bond yields will be long. Our model of the ten-year bond market reveals that yields are not likely to go any higher than 3.00% over the next 12 months. If this rise is accompanied with rising economic activity, the stock market bull run may ease but remain intact.

### The Palos Monetary Policy Index

The index indicates what the Fed's monetary stance ought to be by measuring the relative importance of inflation, growth, employment and international trade on policy decisions. When the index is near 100, the monetary stance should be even keel, tight when above 100 and easy when below 100. It currently stands at 150.

*If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at [info@palos.ca](mailto:info@palos.ca)*