Issue 2

PALOS
INVESTMENT FUNDS

January 12, 2017

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Palos Weekly Commentary

■ Palos Income Fund

By Charles Marleau

A Secondary Offering That Did Not Go According to Plan

On November 11, 2016 Savaria Corporation (TSX: SIS) announced that the Bourassa family was selling 1.75 million shares at $11.34 per share via a secondary offering. Unfortunately, the market was not pleased with the announcement that the founders were selling 12% of their position. The lead on the offering was not able to place the whole deal. This created an overhang on the stock and caused it to trade below the deal price for the remaining of 2016 and early 2017. However, we heard from the bank that the overhang was finally sold on January 11, 2017.

With the overhang gone, we see an opportunity in SIS. The fact remains that the Bourassa family will still own 36% of the company or 13.1 million shares. We believe the family still has a significant stake in the game and the overhang of the family selling will be short lived. This has created an interesting entry level for an investment in SIS.

SIS designs, manufactures, and distributes equipment that facilitates the mobility of people with special needs. The company's products include vertical lifts, incline lifts and stair lifts. With the aging population, the demand for SIS products is growing rapidly. We believe the demand for SIS legacy and new products will continue to grow organically in the double digits in the coming years. Furthermore, our view on SIS was reinforced when the company announced its 2017 guidance on November 21, 2016. The company is also well capitalized with $45.5 million of cash and $10 million in unused credit line. With the expected cash flow and strong balance sheet, the company is well positioned to develop new products and perform tuck-in acquisitions. The company has a history of increasing its guidance during the year and 2017 should be no different.

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

	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL 100	$9.80	0.44%
Palos Equity Income Fund - RRSP	PAL 101	$6.40	0.33%
Palos Merchant Fund L.P. (Sep 30, 2016)	PAL 500	$4.60	-13.07%
Palos IOU High Yield Fund (Nov 30, 2016)	PAL 701	US $7.69	0.42%
Majestic Global Diversified Fund (Jan 5, 2017)	MAJ 100	$0.00	-4.03%
S&P TSX Composite			0.92%
S&P 500			1.48%
S&P TSX Venture			3.58%
Bloomberg USD High Yield Corporate Bond Index 1 to 3 Year			0.88%

Chart 2: Market Data*

	Value
US Government 10-Year	2.36%
Canadian Government 10-Year	1.66%
Crude Oil Spot	US $53.03
Gold Spot	US $1,198.10
US Gov't10-Year/Moody BAA Corp. Spread	223 bps
USD/CAD Exchange Rate Spot	US $0.7608

* Period ending Jan 12, 2017

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■ What is New on the Macro Level?

By Hubert Marleau

The Canadian Dollar

As a given rule, the Bank of Canada generally refrains from intervening directly in the foreign exchange markets. However, the Canadian monetary authorities will, from time to time, adjust their interest-rate policies to fit an exchange-rate objective. It makes sense because Canada is an export-oriented economy and, in turn, has recurring worries about being overvalued in the global trade market. The precipitous fall in commodity and energy prices explains why the Bank of Canada has allowed the Loonie to fall below its purchasing power parity rate of 80 U.S. cents. Fortunately, this apparent action on the part of the central bank did not cause a crisis of confidence in 2015 and 2016. As a matter of fact, net capital inflows were recorded.

In geopolitical terms, English speaking countries attract foreign capital. Capital tends to migrate to economies where capital flows are unrestricted, transactional costs are low, utility is present, safety is assured as a store of value and a relatively decent rate of return is offered. Canada is such a country. For example, foreigners have purchased a lot more Canadian securities than Canadians have bought from foreign countries in the past year. This situation has helped the Bank of Canada adopt a looser monetary stance than the U.S. in addressing the negative financial effects of deteriorating terms of trade, caused by low energy prices and decreasing business confidence in the economic growth. Recently, there are reasons for some optimism in Canada's economy. Statistics Canada reported a surprise trade surplus and an unexpectedly large increase in job creations in November. Two signs that suggest that the big economic downturn may have ended and, in turn, may move the Bank of Canada to a more neutral stance. The exchange value of the Loonie reacted favorably to these data points and rose from a low of 73 to 76 U.S. cents.

Unfortunately, many more surprises on the trade and employment fronts will be needed over the coming months to turn the path of the dollar into a sustainable upward trend beyond 80 U.S. cents. There are also more factors to consider. Firstly, the price of oil is still below its marginal cost of production, limiting capital investments in the energy sector. Secondly, the Bank of Canada might have received some solace from recent economic reports. Yet, it remains that monetary policy divergence with the U.S. is very much over.

The Palos Monetary Policy Index for Canada stands at 60 points compared to an elevated 140 points for the USA. The crossover point is 100. A number below 100 suggests that the monetary stance should be loose and tight when it is above. The Palos Monetary Policy Index considers price stability, economic growth, viability of the balance of payment and unemployment to assess what ought to be the central bank monetary policy stance. Put simply, the exchange value of the Canadian dollar may stabilize near the current level, but it's way too soon to expect a major breakout above 80 U.S. cents.

Furthermore, Moody's Analytics, which has a good forecasting record, believes that the Loonie could trade as high as 85 U.S. cents in 2018. They do not seem to believe that the incoming Trump administration has heightened the risks of stunted trade and seem confident that reflation will take place.

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