F&A Managed Accounts

Quarterly Report

Fourth Quarter Report 2018

While all markets tumbled into negative territory we still outperformed our Benchmark for 2018.

What is different today is that the bond market is also down in 2018.

Something very different happened in 2018 which turns portfolio theory on its head.

We are all aware of the value destruction that took place in stock markets around the world. Now, traditionally, when there is selling in equity markets, the ‘flight to safety’ puts a premium on low risk bonds, which improve in value – although, not to the same degree. So, the traditional thinking for investment managers of balanced portfolios is to expect the bond portion of their holdings to rise in value when their equity investments are falling. What that really means is, we expect the bonds in our portfolio to protect our stocks during bad times.

So far, the best stock market in the world (notwithstanding its punishing sell off since the summer) is the NASDAQ – up just over 0.1% year to date. The worst, Shanghai (China) - down over 21%. As points of comparison in between, Germany – down 16%, Canada – down 10% and Dow – down almost 1%. The MSCI (a global stock market index) is down almost 8%.

What’s different today, is the bond market is also down in 2018. Using the XBB (an ETF of high quality government bonds) as a proxy, the market is down 2% so far.

To measure how we are managing your money, we use a comparative index, our Benchmark, composed of an average of three elements: the Canadian stock market (S&P/TSX), the global stock market (MSCI) (converted to $CAD); and the XBB for the bond market. To date, in calendar 2018, this index is down 5%.

Surprisingly, all components of our Benchmark are down in 2018, which is not the case for any other year in the past decade. This means that the bond allocation has not protected the equity allocation in bad times, as would traditionally be expected.

	2018 Q4	12 Month Returns
Benchmark	-6.1%	-5.4%
S&P/TSX*	-10.9%	-11.6%
XBB	1.5%	-1.9%
MSCI (CAD)	-8.9%	-2.7%

*The S&P/TSX is a capitalization-weighted index of Canadian equities; the IShares Core Canadian Universe Bond ETF (XBB) is an open-ended mutual fund trust; the MSCI World Index is a free-float weighted equity index. Neither the S&P/TSX nor the MSCI are investable indices and as such are not a direct comparison to an investment in the Foster Managed Account program, and should therefore be considered hypothetical in nature and for illustrative purposes only.

Yes, 2018 was the worst year in the past decade and 2011 was a close second, down 3.7%; but these are the only negative years. Both 2009 and 2013 had strong double digit returns, with the remaining years having modest single digit returns.

Beginning in calendar 2009, for 10 years, our comparative index has averaged up 5.3% per year. As active portfolio managers, our objective is to beat that benchmark by 2% after your management fees are paid. So in simple terms, we are trying to make 6 or 7% on your money

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annually, over the long term, using what we consider a 100% medium risk portfolio.

The good news in all of this is:

- The systemic problems that created the crisis in banking around the world are not in play – we've been buying both Royal and TD Bank for accounts that don't own them.
- Oil is trading at $50 a barrel – we've been buying Suncor and Parkland Fuel for accounts that don't own them.
- Canada continues to be a great place to live with a good rule of law, education and access to resources, food and water in particular – we've been buying an innovation ETF focused on artificial intelligence and robotics; and we've also been buying a Mackenzie Environmental Equity Fund, managed by Greenchip Financial, a mutual fund focused on solar power, water and responsible investing.

We are expecting double digit returns out of these core holdings over the medium-term. To be sure, it is hard to absorb these 'corrections' in the short term, however, it is prudent to use this kind of negative action to improve the quality of balanced portfolios as a whole. Using gardening as an analogy, we have been 'trimming the weeds and planting seeds.'

When this happened before (in 1994 equity and bond markets both sold off in a rising interest rate environment), it was followed by a 38% bull market run. We could all use that again!

Ron Riley, December 17, 2018

TOP TWENTY MANAGED ACCOUNT HOLDINGS

This list of securities is derived by amalgamating all the households in the F&A Managed Account Program (MAP). Households previously run by Frank Florio and FIQ are included in the MAP program. The current universe of securities in the program exceeds 100 names. As a result, your particular portfolio may not hold all of these securities.

IShares Floating Rate Index ETF	Telus
TD Bank Series 12 Preferred Shares	Suncor
Toronto Dominion Bank	Manulife Financial
Enbridge	Coca Cola
Royal Bank	Thompson Reuters
Johnson & Johnson	Atco
Mackenzie Global Environmental Energy Fund	Allied Properties REIT
Horizons Robotics and Automation ETF	Brookfield Renewable Energy
Parkland Fuel	Intel
BMO Floating Rate High Yield ETF	Trans-Canada Pipeline

What's Next?

Briar Foster

is the founder and former CEO/Chairman of Foster & Associates Financial Services Inc (Foster), and remains a Board Member of FAFS Holding Corporation, the parent company of Foster.

The financial markets are clearly in a transition phase. To be frank, there is a lot not to like about the way financial markets have been behaving. However, enumerating the reasons is pointless because there are too many, and there will be a fresh set of concerns next week. And maybe some different ones again next month.

So what should investors do? First, it is important to realize that the structure of the markets has undergone a gradual and fundamental shift over the past sixty years. The millions of individual investors who trade their own portfolios of stocks and bonds no longer dominate trading. That role has been taken over by the thousands of large corporations and institutions who for practical reasons engage in large transactions that cause large price swings. They like high-priced stocks because they are not competing against retail investors. Usually their trading decisions are made by individuals but increasingly their trades are triggered by algorithms.

Of course, their remuneration is based on the aggregate of assets under their administration. In other words, unlike individual investors, these institutions are committed to the financial markets for their living. They have a collective vested interest in not frightening their customers to the point of panic. Their reputations are sacred to them: medium risk, medium returns and oodles of diversity. Diversity sometimes stifles performance, but when managing a $600 million equity portfolio, diversity is inevitable. Financial institutions crave reliability. High levels of volatility are bad for business.

The point is, financial institutions have a strong bias for stable markets. The last thing they want to occur is an avalanche of selling. Given the institutional dominance of the major markets, Individual investors have good reason to remain calm. The economy is growing, albeit at a slower pace. Interest rates remain relatively low, and both Presidents Xi and Trump really want a trade deal.

While geopolitical and some economic uncertainty cloud the period immediately ahead, there are some trends investors should keep in mind. The social network companies will face some overdue regulation, especially in protecting the privacy of their customers. In a growing number of jurisdictions, they also will face taxation on revenues, reducing the benefits of moving their profits to tax havens. An OECD commission has proposed a 3% levy on services and sales.

The Global economy isn't working as smoothly as it used to. Part of the reason is that the issue of inequality has yet to be addressed by most governments. The unresolved inequality issue is "blamed" for a variety of situations including: getting Trump elected, fueling the recent Paris protests, the rise from obscurity of a right-wing party in Spain. Inequality is an extremely complex problem. Until it is addressed, investors can expect a counter wave of nationalism, protectionist policies, attacks on capitalism and a deepening division between left and right-wing politics. In other words, international company profits are at greater risk, domestic companies less so.

On a more cheerful note, the digital age briskly marches forward. Facial recognition has finally arrived. It will make homes and office building more secure. Merchants will have less risk when accepting large purchases by phone. Children will be able to access their home any time. AI has provided an added impetus to further developments in robotics. In a recent technology report, The Economist describes how hydrogen, with the help of clean electricity, will decarbonize the global economy. For example, the diesel engines for heavy-duty trucks will be replaced by fuel cells powered by hydrogen, the hydrogen being produced by electrolysis or steam methane reforming (SMR) powered by clean electricity.

The global economy is going through a transitional phase: new technologies, discarding old models. It is most likely that the applications of the new technologies will lead the financial markets out of their current malaise.

Briar Foster, December 15, 2018

The views as articulated in this article are those of Briar Foster alone and do not necessarily reflect the opinion of Foster, and do not constitute a solicitation to engage in any specific investment or strategy.

Our core beliefs

As your fiduciary, we have a deep sense of responsibility, act with good faith and loyalty and provide full and fair disclosure of all material facts.

Relationship First

Your portfolio begins with the professional relationship we have with you. To construct a portfolio consistent with your values, goals and objectives, we need to understand what makes your relationship with us unique. To do that, we specialize in thoughtful discussion with you; we are available to answer questions, provide input and discuss options. Our job is to guide you through the investment planning process as often as you need.

As your fiduciary, we have a deep sense of responsibility, act with good faith and loyalty and provide full and fair disclosure of all material facts. You will hear from us regularly, on an ongoing basis, to help you understand what is going on in your portfolio, and why, so that you feel comfortable with it. As your situation changes over time, your portfolio may also need to change – so we periodically reassess your needs.

Portfolio Engineering

Using a top-down asset allocation model first, with economic, political and sentiment drivers, tailored to your personal objectives, we dynamically adjust your asset allocation based on our forward-looking market views. We believe the vast majority of long-term portfolio returns are attributable to allocating between the Foster Four asset classes and when to shift between them.

Canadian Stocks Canada makes up less than 5% of the global stock market and is not very well diversified – that said, we are asked to measure the performance of your portfolio in $CAD, so when considering individual companies for your portfolio will always look to Canada first to eliminate currency risk.

US Stocks The largest, best diversified stock market in the world with great liquidity and the largest companies in the world with global diversification. To get appropriate sector diversification we include US stocks in your portfolio.

Fixed Income Traditionally the lower risk asset class that provides predictable fixed dollar returns and protection in the event of market selloffs.

Alternative Products Particularly in low risk interest environments, these generate stable, non-correlated returns for your portfolio similar to large scale, institutional investment management firms.

For both Canadian and US stocks, we use a proprietary, largely quantitative, multi-factor selection model to screen for stocks that are likely to outperform in your portfolio. This provides a disciplined system to avoid common behavioural pitfalls and help identify successful companies. For Fixed Income and Alternatives we use both exchange traded funds and outside managers to get appropriate diversification and thematic overlays to dampen the overall volatility of your portfolio and enhance real returns in excess of inflation.

At the core, we believe an active, disciplined, balanced approach built on a professional relationship will deliver long-term out-performance.

F&A MANAGED ACCOUNTS

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