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SECOND QUARTER 2016 - NEWSLETTER

Dear Partner,

I am pleased to send you this portfolio review and commentary for the second quarter of 2016.

PERFOMANCE REVIEW

During the second quarter of 2016, the Tonus Partners Fund increased **5.35%**. Over the same period, the performance of our benchmark (defined as 50% S&P/TSX Total Return and 50% S&P 500 Total Return in Canadian dollars) was **4.05%**.

Year to date, the Tonus Partners Fund is up **10.38%** against **3.40%** for the benchmark.

Since the inception of the Tonus Composite[1] in October 2007, it has achieved a compound rate of return of **11.64%**, compared with **6.33%** for the benchmark.

Underexposed to the resource sectors, we still beat the return of the Canadian market

After a volatile beginning to the year, the second quarter - up to the Brexit vote in late June - saw most global indices posting increases. Although the vote significantly impacted European markets, both Canadian and American stocks quickly rebounded after the selloff of June 24th, and Canadian and American indices finished the quarter up 5.1% and 2.9%, respectively. The Canadian market's outperformance this quarter and year to date is entirely driven by a rebound in commodities. The 9.8% return generated by the TSX this year was driven by a 29% return in resource sectors while non-resource sectors remained flat (0.1%). Gold has been the biggest winner; while the price of yellow metal is up 25% this year, stocks have exploded, with the gold sector sub index increasing a walloping 94%. Gold alone contributed 4% to the return of the index. In this context, and given our non-exposure to gold, we are quite pleased with our return of 5.4% during the quarter and overall return of 10.4% year to date.

Concerning Brexit, the vote was another reminder that we do not live in a risk free world, and that some unforeseen events can and will disrupt the market. Again, we responded to this drop in the markets by deploying some of our liquidity to increase our weight in several of our holdings. For most stocks in our portfolio, the financial impact of Brexit is insignificant. We have two holdings that have a meaningful exposure to the U.K. market, namely **Penske Automotive Group (PAG - $31.46)** (33% of revenues) and **Jacobs Engineering (JEC - $49.81)** (10% of revenues). We believe the decrease in their share price outweighs the potentially negative impact on their future profitability caused by economic uncertainty and the weakening of the pound.

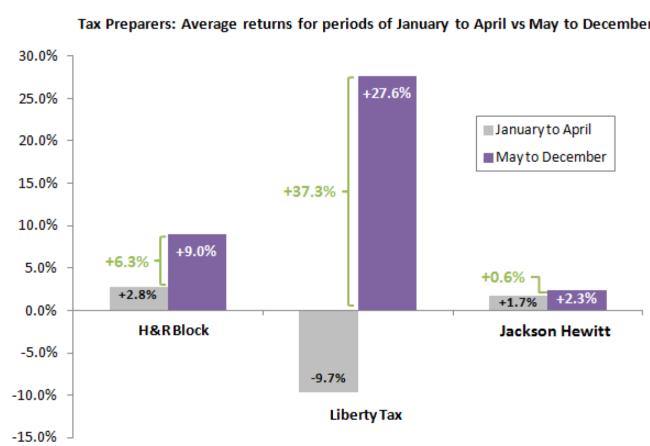
[1] Please see page 4 for a description of the Composite

Market valuations, while not extreme, remains high

We remain concerned with market valuations again approaching historical highs. Indices were up in Q2 despite the fact that analysts' profit estimates were again reduced by 3% during the quarter. The rising market puts the focus squarely on companies about to report their results for the second quarter, which should indicate whether profit growth can support the market's gains. We feel confident about the financial performance of the limited number of investments we hold in our portfolio and continue to search for those companies that will see positive revisions in the future, and whose current valuation is not reflective of their earning power. Meanwhile, our flexible investment policy allows us to maintain our buy and sell discipline. We will continue to sell stocks that reach their full value and wait for the right price to initiate new positions. We were less active on trading during Q2, but still managed to find new stocks that met our criteria.

Second run on the same horse

One stock making its way back into the portfolio is **Liberty Tax (TAX - $13.32)**, the second largest tax preparer in the United States. You might recall that we owned this stock following its IPO in 2012 and generated a hefty return of **185%** over our two year holding period (see our 2012Q4 letter for our investment thesis at the time). As you know, we spend a lot of time conducting our research prior to buying new positions. After liquidating a position, we do not always try to "reinvent the wheel" by finding new stocks to research, but instead, we also usually continue to follow the company's developments and buy more again if the right opportunity returns. Liberty Tax is a case in point. We sold the stock in November 2014, when we believed it was fully valued at $37 per share. The market had gotten very optimistic in anticipation of the potentially positive impact on tax preparers of the *Affordable Care Act* and the proposed *Immigration Reform*. As it turned out, neither has yet to be a catalyst and, combined with disappointing store count growth and the industry's flat return count this year, drove impatient investors to dump the stock. But the reality is not that harsh. Looking at their financial results, they have actually been stable. When we sold the stock, trailing earnings were $1.45 per share. Liberty generated $1.41 in the recently completed year. Although growth expectations have been slightly reduced, their balance sheet remains strong, the number of shares outstanding has decreased, and we bought shares at $11, a 70% discount to its peak value of November 2014.



Our timing is also interesting. The following graph depicts the stock performance of the 3 public companies in the sector during the tax season (January to April) and the off-season (May to December). Historically, May has been the right time to be buying as these stocks tend to produce strong returns during the offseason. Although no financial results of importance are released during that period, investors tend to focus on the positive steps taken by management to position their company for the upcoming tax season. We expect the same to happen this year with the focus turning to Liberty's growing store count, financial product innovations, and pricing power. Our purchase at a price-to-earnings multiple of 8x is extremely attractive and we plan to reap great profits from this stock... a second time around!

Summer reading

As summer months might mean you are vacationing with more time to read, we would like to direct your attention to an article that was written about Philippe Hynes and Tonus Capital by the *Montreal CFA® chapter*. We wish you a very enjoyable summer while our research team stays busy continuing to find great additions to our holdings.

Sincerely,

Philippe Hynes, CFA
July 11, 2016

Tonus Composite Performance
As of June 30, 2016

Date	Tonus Composite	Benchmark
3 Month	5.35%	4.05%
6 Month	10.38%	3.40%
Year-to-Date	10.38%	3.40%
1 Year	9.48%	4.17%
2 Years	5.75%	7.90%
3 Years	12.60%	14.01%
5 Years	17.26%	11.51%
Since Inception (Oct. 31, 2007)	11.64%	6.33%

Source: FactSet Research Systems, Inc.
All returns are gross of fees.
Please note that all returns greater than one year are annualized.
Benchmark: 50% S&P/TSX & 50% S&P 500 (in $CAD)

Please note that the historical returns shown are for the Tonus Partners Fund. Prior to January 2016, the returns are from the Tonus Select Fund from October 2007 to October 2011 and from the weighted average of all managed accounts (including those accounts no longer with the firm), using the same strategy implemented in the actual Tonus Partners Fund, from November 2011 to December 2015. Although the structure and the name of the investment product changed, it had for the entire period the same investment mandate, objectives, strategy and benchmark. Past returns are not necessarily indicative of future performance. At any moment, the portfolio composition may vary widely from a 50/50 CAD/USD split as it is for the benchmark. Returns are gross of fees and in Canadian dollars. This document is not to be construed as a public offering of securities in any jurisdiction in Canada and is for informational purposes only. While the information and material in this document are believed to be accurate at the time they are prepared, Tonus Capital Inc. cannot give any assurance that they are accurate, complete or current at all times. The Tonus Composite was created October 31st, 2007 and the Tonus Partners' Funds was created January 4th 2016. The firm maintains a complete list and description of composites, which is available upon request.