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FOURTH QUARTER 2015 - NEWSLETTER

Dear Partner,

We are pleased to send you this portfolio review and commentary for the fourth quarter of 2015.

PERFOMANCE REVIEW

During the fourth quarter of 2015, the Tonus Composite increased **4.08%**. Over the same period, the performance of the S&P/TSX Total Return was **-1.40%** and that of the S&P 500 Total Return in Canadian dollars was **10.91%**.

For the full year, the Tonus Composite is up **5.65%** against **-8.32%** and **21.59%** for the S&P/TSX TR and the S&P 500 TR $CAD, respectively.

Since the inception of the Tonus Composite in October 2007, it has achieved a compound rate of return of **10.78%**, compared with **1.54%** for the S&P/TSX TR and **10.77%** for the S&P 500 TR $CAD.

PORTFOLIO REVIEW

The year just completed was a very interesting one on the stock market. Volatility is back and certain sectors and indices were down materially. We are satisfied with the returns generated during the year as we were up 5.7%. By no means is this a spectacular performance and we strive for higher levels in the years to come, but given the hand we were dealt, we think we have played our cards well. Analyzing our performance this year and using a hockey analogy, it felt like we played short-handed all year with, at times, two players in the penalty box! Why? First, small capitalisation companies lagged materially. Second, value significantly underperformed growth. Nonetheless, we finish the year with returns comparable to that of the presented yardstick. As we made few transactions during the past quarter, we will use this letter for a general review of 2015.

The 50/50 benchmark we present combines the most widely used index on each side of the border: the S&P/TSX and the S&P 500. They are broad representations of their respective markets, but clearly have a tilt towards larger capitalisation companies, as both indices are constructed using the largest companies traded on their respective markets. As a matter of a fact, the median capitalisation of the Canadian and American indices is $7 billion and $37 billion, respectively. The mandate we have with you allows us to invest in both large and small capitalisation companies: we go where we find value. By comparison, the median market capitalisation in our portfolio currently stands at $2 billion. Our approach of doing our own research and thriving to find uncovered gems bodes well for small companies and thus, we have always had a certain allocation towards that category. Over the long term, small caps tend to outperform, but there will be periods where the opposite is true, as in 2015:

Performance of indices in 2015 Small cap compared to large cap		
Canada	Large cap (S&P/TSX)	-8.27%
	Small cap (S&P/TSX SC)	-13.30%
United States	Large cap (S&P500)	1.38%
	Small cap (Russell 2000)	-4.39%

For the year, the small capitalisation index underperformed by 5% and by 6% in Canada and the United States, respectively. The valuation premium on the small cap stocks has shrunk and both indices are now trading at similar multiples, the first time since 2009. Although smaller, the percentage of the portfolio invested in the category represented a third of our assets at year end.

The second headwind we faced last year came from the relative underperformance of value compared to growth stocks. Based on three factors (sales growth, the ratio of earnings change to price, and momentum), the 504 companies in the S&P 500 are split between growth and value. The historical performance of each is presented :

	2010	2011	2012	2013	2014	2015
S&P 500 Total Return	15.1%	2.1%	16.0%	32.4%	13.7%	1.4%
S&P 500 TR Growth	15.1%	4.7%	14.6%	32.8%	14.9%	5.5%
S&P 500 TR Value	15.1%	-0.5%	17.7%	32.0%	12.4%	-3.1%
Growth vs Value	0.1%	-5.1%	3.1%	-0.8%	-2.5%	-8.7%

In most years since the recession, the performance of both indices has been fairly similar, with the exception of 2011 when major banks incurred losses tied to European credit foes. This year however, the gap is huge, a more than 8% delta between the two. What is behind the disparity? It is largely related to the performance of the technology sector which, as you might imagine, is concentrated in the growth sub index. Particularly interesting is the contribution from the newly nicknamed group of the *FANGs*, namely Facebook, Amazon, Netflix, and Google. Their performance last year averaged +80% and their contribution to the S&P 500 was +3.3%. Said another way, these 4 stocks pulled the index up by 3.3% last year, while the other 500 companies in the index averaged -2.1%. Clearly, any portfolio that did not contain the FANGs had difficulty matching the return of the benchmark. Without a doubt, these are great companies with strong business models. But their valuations, with an average P/E above 100x, is hard to justify from a value standpoint.

Be assured that we will stick to our style, and not deviate because short-term it is out of favor. To the opposite, the point of presenting these statistics was to reinforce our view that more opportunities will be found where we like to hunt.

As we analyze our portfolio at the end of calendar 2015 compared to the end of the previous year, we make the following observations. We added some new names in the portfolio this year and they have had a decent performance. The exception to this is **Penske Automotive Group (PAG - $42.34)**, which came down hard along with other auto dealerships towards the end of the year. We believe the market is overlooking their diversification as well as their ability to generate profit from their maintenance and services operations. At current levels, we could generate strong returns and to this end, we bought more of it in 2016. We had two big winners this year, **Uni-Sélect (UNS - $68.51)** and **Lojack Corporation (LOJN - $5.56)**, which demonstrate that in a year of flat-to-negative performance of the markets, it is still possible to make money (although admittedly it is definitely harder!). On the negative side, although we have reduced our exposure to the energy sector to less than 10% of the portfolio, we lost money in the sector during the year as we had not foreseen such a collapse in the oil barrel. We estimate that our exposure to the sector cost us 6% of performance during the year. As violent as the fall was, we believe the upswing could be as spectacular and, given our view that sub $30 per barrel is not a sustainable long-term price because very few producers can generate positive returns at such levels, we are confident that our companies will face better times in the future. Finally, our cash position ended the year in the high-teens, down from where we started, but still an enviable position given the brutal start of 2016 for the markets.

We have a major milestone to share with you as January 2016 marks the launch of our pooled fund: The Tonus Partners' Fund. As our assets under management have reached a level where we can justify the effort and expenses in creating this product, we are delighted to announce that it was officially launched at the beginning of this year. Our investment philosophy remains intact, but allows us to simplify our structure and free up more of our time to focus on doing research and making you money. With the markets in free fall as we are writing these lines, we look for these tumultuous times to offer great buying opportunities.

Should you have any concerns regarding your portfolio or questions related to your year-end taxes, capital gains, or anything else, please don't hesitate to contact our team.

Sincerely,

Philippe Hynes, CFA
January 18, 2016

Tonus Composite Performance Report
As of December 31, 2015

Date	Tonus Composite Gross Return	S&P/TSX Total Return	S&P 500 Total Return ($CAD)
3 Month	4.08%	-1.40%	10.91%
6 Month	-0.82%	-9.14%	11.43%
Year-to-Date	5.65%	-8.32%	21.59%
1 Year	5.65%	-8.32%	21.59%
2 Years	5.09%	0.68%	22.76%
3 Years	15.61%	4.62%	28.64%
5 Years	14.22%	2.30%	20.35%
Since Inception (Oct. 31, 2007)	10.78%	1.54%	10.77%

Source: FactSet Research Systems, Inc.
All returns are gross of fees.

Please note that all returns greater than one year are annualized.

The Tonus Composite was created October 31, 2007. The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow of at least 25% of portfolio assets.

Investors should carefully consider the firm's investment objectives, risks, and expenses before investing.

Portfolio composition is subject to change at any time and reference in this letter to specific securities, industries, and sectors should not be construed as a recommendation to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. The Composite return is not guaranteed; its value changes frequently and past performance may not be repeated.