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FIRST QUARTER 2017 - NEWSLETTER

Dear Partner,

I am pleased to send you this portfolio review and commentary for the first quarter of 2017.

Performance Review

During 1Q17, the Tonus Partners Fund was up **1.54%**. 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 **3.94%**.

Since the inception of the Tonus Composite in October 2007, it has achieved a compound rate of return of **12.31%**, compared with **7.24%** for the benchmark

Solid Foundation

The Tonus Partners Fund was up 1.5% in the first quarter. Its cumulative return since inception 15 months ago now exceeds 25%. Our investment strategy based on fundamental analysis has yielded great results for almost ten years now and, combined with the simple structure of the fund, has led to significant growth as the number of fund partners increased more than 50% in 1Q. We have now exceeded all regulatory requirements, completed the fund's first year of operation, and concluded its audit. The fund's optimal structure was confirmed by the fact that it simplifies tax reporting for our partners and enables us to spend more time on research.

The market is as calm as it has been in 50 years

As busy as our back office was on the operational front, it was a different story for transactions in the portfolio. The market was extremely quiet in the first three months of 2017 owing to conflicting indicators. On the one hand, we observed economic data that exceeded expectations, a low unemployment rate, and consumer sentiment at its highest level in a decade. On the other hand, the stock market lumbered toward its ninth year of expansion, valuations were lofty, and geopolitical risk was elevated. In the midst of such a conundrum, the S&P 500 lacked direction and posted an average daily swing of only 0.3172%, making 1Q the quietest quarter since 3Q 1967! The CBOE Volatility Index (Chicago Board Options Exchange), commonly referred to as Wall Street's "fear gauge," posted its second-lowest quarterly average on record. In light of this, and given the relatively high average earnings multiple of the market, it was a frustrating quarter for us as few opportunities arose. Our strategy to hunt for bargains usually serves us well in times of panic and irrational behaviour. There was no such climate in 1Q. However, at some point, the calm will end and bigger variations (positive and negative) will be observed.

We believe these future swings could be exasperated by the growing proportion of shares being transacted by computer programs and by passive funds that trade shares on no fundamental basis whatsoever. Over the past five years, investors have rapidly funnelled billions of dollars into passively managed exchange-traded funds (ETFs). These strategies worked fine in the recent bull market where returns stemmed from an expansion of the market's multiple. However, as we enter a period where returns should be driven by earnings growth, the correlation between stocks should decrease and active stock pickers should thrive. Moreover, investors were quick to pour money into ETFs and could conceivably bail out just as quickly in times of uncertainty, thus feeding volatility even further. Mispriced stocks should then be plentiful to the delight of long-term value-oriented stock pickers like us.

Portfolio Transactions

Despite a dearth of opportunities in 1Q, we still managed to initiate a new position. **Tempur Sealy International Inc. (TPX - $46.46)** is a manufacturer of bedding products, including its leading brand, Tempur Pedic. As you may recall, we bought shares in bedding retailer **SleepCountry Canada (ZZZ - $32.41)** last year and have been analyzing the different players in this sector ever since. In January, Tempur's stock plunged 40% from $70 to $42 after the company scrapped its contract with its biggest customer, Mattress Firm. Clearly, both parties had a lot to lose and it was a bold decision by management not to bend in order to protect the long-term economics of the business. We believe that Tempur will ultimately win back the lost business as consumers seek out its brand. Mattress Firm will need to give in or it will likely lose market share. Investors punished Tempur severely for the likely short-term impact on earnings this decision will have. Over the long term, however, the brand remains very strong and the company's earnings potential, unaltered. We will monitor developments this year and adjust our portfolio's weight accordingly.

We also transacted another stock during the quarter. **PHI Inc. (PHIIK - $11.98)**, a provider of helicopter transportation services, was our worst performer in 1Q, declining 35% as it continued to face a challenging environment flying workers to oil and gas platforms in the Gulf of Mexico. Though we acknowledge that conditions are difficult in this portion of its business, we nevertheless took advantage of the low share price to add to our position. We believe the market is overlooking three key elements.

First, PHI's air medical segment is a highly successful and profitable business generating approximately $60 million in EBITDA annually. A competitor, Air Methods, was recently acquired by a private equity fund. If we apply the same multiple paid in this deal, PHI's business would be worth $500 million or $30 per share. Second, the company's operations related to the oil and gas industry are not getting worse and management has taken steps to boost profits. Namely, they are cutting costs and moving some of their aircraft to international locations like Israel, Ghana and Australia. Third, its fleet is comprised of large helicopters that tend to retain their value. Even if we apply all the debt against these assets and trim their fair value 30%, these helicopters would still net PHI $270 million or $17 per share. Clearly, there is inherent value in the two segments, and we trust that CEO Al Gonsoulin, who holds 3.1 million shares or 20% of all shares outstanding, will do what needs to be done to create long-term value for all shareholders.

Similarly, we are also focussed on creating enduring value for all our partners. Rest assured that our unusually low level of activity in the first quarter was due not to a lack of effort, but rather to a lack of exceptionally priced opportunities. We simply remained committed to our approach.

Please feel free to contact us if you have any questions. We are always here for you.

Sincerely,

Philippe Hynes, CFA
April 11, 2017

Tonus Composite Performance Report
As of March 31, 2017

	Tonus Composite Gross Return	Benchmark Return
YTD	1.54%	3.94%
1 Year	21.12%	19.69%
2 Years	13.60%	8.64%
3 Years	9.70%	11.56%
5 years	16.69%	13.75%
Inception	12.31%	7.24%

Source: FactSet Research Systems, Inc.
Returns are gross of fees and are calculated using a time-weighted rate of return.
Past performance is not indicative of future results.
Returns greater than 1 year are annualized.
Benchmark consists of 50% S&P/TSX TR Performance ($CAD) + 50% S&P500 TR Performance ($CAD)
S&P500 TR ($CAD) is adjusted for US dividend withholding taxes