INVESTORS' JOURNAL

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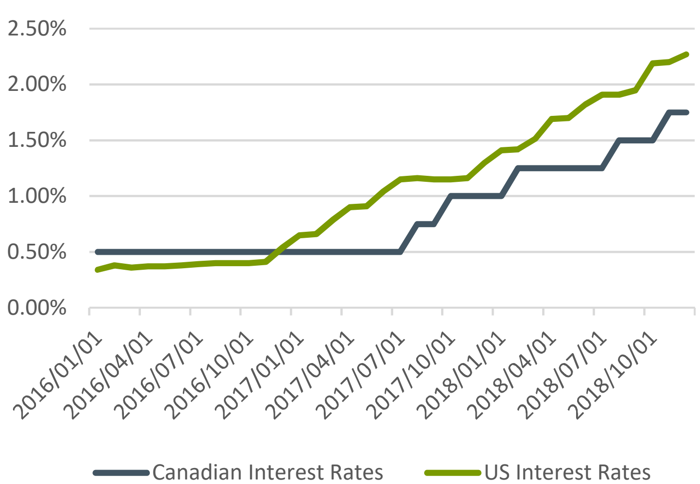
CAPSTONE ASSET MANAGEMENT™

2018 ECONOMIC REVIEW

As 2018 drew to a close, investors were subjected to a dramatic drop in the North American stock markets. The Canadian S&P/TSX Composite Index fell to -8.89% and the U.S. S&P 500 Index to -4.38% for the year. While many factors contributed to this volatility, the most prominent issues were rising interest rates, Canadian oil price declines, trade tensions, and concerns about slowing global growth.

Within this last quarter, the U.S. once again raised its interest rates to 2.25-2.50%. This is the fourth time within the year that rates increased, and Canada followed suit on October 24 with an increase to 1.75%. While rates are still very low, each increase draws them closer to the historical norm.

CANADIAN vs. U.S. INTEREST RATES



In response to rising interest rate activity, Canada's bond market returned 1.0% (represented by the XBB iShares Canadian Universe Bond ETF). Average bond returns did not keep pace with inflationary activity which averaged between 1.7%-3.0% on a monthly basis through 2018.

Throughout the year, both the Bank of Canada and the Federal Reserve were steadfast in their mandate to move interest rates away from emergency territory and into a more normal range. While economic data has mostly supported these moves, the market volatility in the fourth quarter has incited criticism and calls for policy makers to be more patient. While we still expect data indicators to prompt at least one additional rate increase in 2019, the basis for a decision to increase rates seems to be less about statistics than about the feelings of cautious policy makers. It is our opinion that key policy makers will pay more attention to market sentiment and how they 'sense' things are going. Additionally, with an election looming for Canadians, there is likely to be more political pressure to keep the economy humming along at stable rates.

In Canada, oil prices have been another major issue affecting GDP growth and stock market volatility. We are still a country heavily dependent on energy production. 2018 delivered more than a 20% drop in U.S. energy prices (based on WTI) and the impact was definitely felt. To make matters worse, the political climate surrounding pipelines and energy transportation has exacerbated the spread between U.S. and Canadian oil prices.

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A new year means new opportunities to contribute to your registered accounts. If you would like to contribute to your TFSA, RRSP or RESP, please email us at wealthmanagement@capstoneassets.ca.

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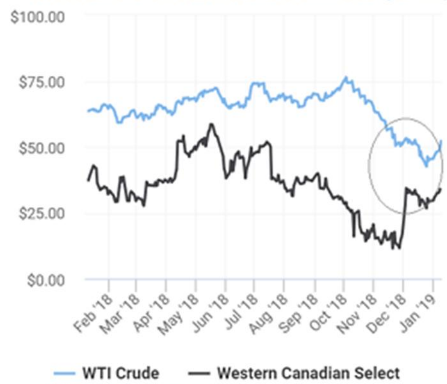
Towards the end of the year we saw the price disparity narrow as the market positively responded to Rachel Notley's plan to buy railway tank cars. The plan was to improve transportation of product to market, and to lessen supply by mandating oil production cuts. While the move helped narrow the gap, there is still no easy solution to Canada's pipeline infrastructure issues and this will continue to weigh heavily on the Canadian market.

WEST TEXAS INTERMEDIATE (WTI) vs. WESTERN CANADIAN SELECT (WCS)



Source: https://oilprice.com/oil-price-charts/45

On the Canadian housing front, 2018 was not much of a surprise as the market was already beginning to shift to a slower pace at the end of 2017. We expected rising interest rates and were aware of the implementation of stricter borrowing regulations, all of which resulted in a slowing of home sales and price increases compared to previous years. In our opinion, the current market trends are healthier than we have seen for a while, but we are closely watching unemployment rates in various regions as these can be early indicators of housing market strength or vulnerability.

Global trade tensions have marked much of the past year and remain a large factor in the Canadian economy. The uncertainty created by the renegotiation of NAFTA, now called USMCA, was heavily felt until a deal was struck at the end of the third quarter. Additionally, the Brexit situation continued throughout the year to create tensions in Europe, and China's stressed trading relationship with the U.S. was highlighted regularly in media headlines. All of these issues intensified investors' negative sentiment and uncertainty in these regions. Interestingly, a point to note in these struggling relationships is the focus that each country is placing on protecting their own people and economy, rather than more open borders and trade agreements. From an economic perspective, these isolationist trends tend to increase investor uncertainty and stifle global growth expectations.

For traditional equity exposure, Capstone will be focusing more heavily on finding value outside of Canada. At present, there is still a higher than typical cash allocation in this part of the portfolio and additional buys will be triggered over time when the market hits various targets. On the fixed income side of the traditional portfolio, we are generally still seeing downside volatility in bond prices as we remain in a rising interest rate environment. While rates are low and capital losses are common in this arena, value can still be found when evaluating the spreads between various opportunities.

For non-traditional equity exposure, we continue to search out and invest in opportunities that are not correlated to traditional market activity. Within the mortgage side of the portfolio, we spent much of 2018 funding projects with healthy metrics, but sacrificed slightly on the return to ensure a solid foundation that would buffer against further declines in the housing market. As the year progressed, investments were made into new projects with higher rates more in line with long term averages.

As always, we are encouraging investors to address economic uncertainties by ensuring that their portfolios are appropriately diversified. It is important to act on the information we have while protecting against the variables that cannot be anticipated. With this in mind, we continue to promote both our traditional investment options, as well as the non-traditional opportunities to ensure true portfolio diversification and risk mitigation.

The Government of Canada has increased the yearly TFSA maximum to $6,000 for 2019. This means that the cumulative TFSA room for 2019 is $63,500 for all Canadians aged 18 and over in 2009.

CAPSTONE TRADITIONAL EQUITY POOL: A GLOBAL FUND

Market disruptions can often lead to tremendous opportunities. Given the economic backdrop, it is no wonder that stock market volatility is, and has been, in the air for quite some time now. At the beginning of 2018, the Dow Jones Industrial Average broke above 25,000 – a milestone that was just the beginning of a tumultuous year. In recent months, we have seen a pullback across several global markets, leading investors to question if the tides are turning. A "risk off" sentiment currently prevails. At Capstone, we take a long-term approach. As Warren Buffett once said, "Be fearful when others are greedy and greedy when others are fearful."

Managing several funds with dissimilar mandates is one of the ways that we practice diversification. Capstone's Funds are also internally diversified to prevent over-saturation within each asset class. Generally speaking, many equity funds born and bred in Canada have a natural "home bias," meaning that Fund Managers gravitate towards large-cap Canadian equities. Similarly, the Capstone Traditional Equity Pool has historically been more North American focused, although we have always invested across varying market capitalizations. Lately, we have also been drawn to some outstanding value opportunities outside of Canada and the U.S.

Amidst uncertainties that exist within our national economy, we felt it was the right time to venture down the path of further globalizing our mandate. In so doing, we reduced our Canadian equity positions and were able to take some risk off the table while capitalizing on some gains.

As of the end of 2018, we are well on our way to having a portfolio with concentrated equities across Europe, Japan and Asia. In fact, for the first time, our large cap Canadian stock exposure has dropped below our global exposure. While we still hold Canadian assets in the small/mid cap sector, the shift away from Canadian large cap equities is a significant change. Additionally, the first hedge fund has been introduced to this portfolio in the past quarter. This position is North American centric, and the managers seek to invest in companies where they believe they have identified fundamental value, or hidden value, plus an associated catalyst or event that will unlock that value.

With these allocation shifts over the past 3-6 months, the cash position in this portfolio has increased substantially. Capstone's Investment Committee will strategically trigger additional buys over time, or when the market hits various targets. As we move into 2019, we continue to seek out and diligently evaluate opportunities with the goal of maximizing investor return for the risk taken.

As tax season quickly approaches, our clients can expect to receive tax reporting and T-slips via mail and online. Make sure to save these documents for your 2018 tax filing, due April 30, 2019.

CAPSTONE'S POOLED FUNDS SUMMARY

Performance figures are those of Class I units as of December 31, 2018

Capstone Mortgage Pool

Diversified pool of construction and development mortgages (Launched April 30, 2012)

3 Month:	2.08%
1 Year:	6.21%
Inception:	9.02%

Capstone Fixed Income Pool

Conservative, traditional, and non-traditional income (Launched November 1, 2013)

3 Month:	0.94%
1 Year:	4.15%
Inception:	4.24%

MarshallZehr Mortgage Opportunities Fund

Diversified pool of construction and development mortgages (Launched July 31, 2014)

3 Month:	1.90%
1 Year:	5.58%
Inception:	8.44%

Capstone Non-Traditional Equity Pool

Diversified portfolio of non-traditional equity investment opportunities (Launched May 2, 2014)

3 Month:	0.27%
1 Year:	2.77%
Inception:	6.02%

Capstone Traditional Equity Pool

Value-based approach to investing in traditional markets (Launched November 14, 2014)

3 Month:	-8.17%
1 Year:	-3.38%
Inception:	2.80%

MarshallZehr First Mortgage Fund

Diversified pool of construction and development mortgages (Launched August 31, 2016)

3 Month:	1.48%
1 Year:	6.09%
Inception:	5.74%

Class I units are only available to Capstone's managed account clients and certain institutional investors.
Performance is annualized for periods longer than one year.

EVERLASTING WEALTH

As we enter a new year, our hope at Capstone is that you will experience great riches in 2019. Of course, that may not be surprising, given that it is our business to preserve and grow wealth for our clients. To be sure, being in a financially secure position can be a blessing and undoubtedly allow for the blessing of others. However, we also desire for our clients to have rich lives and to cultivate an everlasting wealth, a sort of wealth not dictated by our wallets or our possessions. May you have a rich year ahead!

Then he said to them, "Watch out! Be on your guard against all kinds of greed; life does not consist in an abundance of possessions." ~ Luke 12:15

Command those who are rich in this present world not to be arrogant nor to put their hope in wealth, which is so uncertain, but to put their hope in God, who richly provides us with everything for our enjoyment. Command them to do good, to be rich in good deeds, and to be generous and willing to share.
~ 1 Timothy 6:17

One person gives freely, yet gains even more; another withholds unduly, but comes to poverty.
A generous person will prosper; whoever refreshes others will be refreshed. ~ Proverbs 11:24-25