INVESTORS' JOURNAL

March 2019

CAPSTONE
ASSET MANAGEMENT™

ECONOMIC UPDATE

Growing trade tensions, Brexit negotiations, Germany's slowing economy, inverted bond yields and a stalling housing market—these are just some of the factors that created a noisy first quarter to 2019. The global economy has been marked by weakness and uncertainty. While we're not seeing clear signs of impending doom, any one of these factors have the potential to disrupt enough to tip equity markets toward instability.

Trade tensions dominated headlines this quarter as China and the US continue negotiating tariffs and other barriers to market. Conflicts between Canada and China also ramped up as China began restricting Canadian Canola, in what many believe to be retaliation for Canada's detention of Huawei's CFO, Meng Wanzhou. There appears to be some motivation on all sides of these issues for resolution and ideally this will occur early in Q2, possibly when President Trump meets the Chinese in April for further discussion. Successful resolution could mean added stability in the Asian economies, while lack of progress could spell further downside volatility in that region. The Canadian government is considering whether to send a high-level canola delegation to China to smooth over tensions. Meanwhile, farmers remain frustrated as they try to decide which crops they should be planting this spring.

On March 19, Finance Minister Bill Morneau tabled the new federal budget. While there are some new provisions for First Time Home Buyers, we did not see any serious economic drivers in either fiscal or monetary policies. What we did see was a forecasted higher deficit of over $19 billion for the next two years, before reducing to $9.8 billion by 2023. This news prompted Fitch Ratings Inc., a major credit rating agency, to warn Canada that their AAA credit rating may be at risk with such high debt levels. A change in credit rating could be a serious blow to the positive economic sentiment that Canada has enjoyed for many years. This, in turn, could negatively impact both our fixed income, equity and currency markets.

For a while now, we have been saying that it takes time for monetary and fiscal policy changes to be absorbed into the economy. Over the past few years there have been so many new changes thrown at Canadians, many of which have focused on the housing market. These changes, combined with the rapid increase in interest rates, are finally beginning to have impacts as growth

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Has it been a while since your last portfolio review? We like to touch base with our clients regularly to ensure that their portfolio allocation is appropriate for their current circumstances. Call us at 604.546.1500 or email wealthmanagement@capstoneassets.ca to set up an appointment.

ECONOMIC UPDATE

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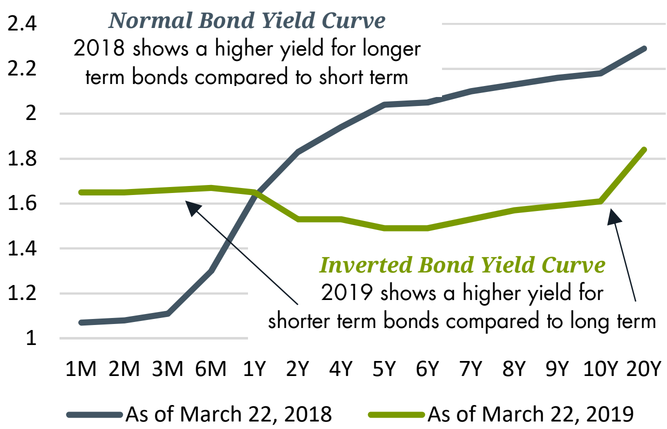
appears to be slowing in many areas of the Canadian economy. For this reason, we believe the Bank of Canada is likely to hold steady on interest rates in 2019 and there may even be a rate cut if things continue to worsen.

One of the most notable economic events of this past quarter was the inversion of the bond yield curve. In a typical bond environment, longer term bonds will have a higher yield than shorter term bonds. This makes sense, as investors expect to be paid more to lock money up for a longer period of time. However, when the bond yield curve inverts, it indicates that investors are pessimistic about the future state of the economy. This causes the yields for long term bonds to come down while simultaneously pushing short term yields up.



Data Source: FactSet

When long term yields, usually denoted by 10-year bonds, are below those of the short term (3 month) bond yields, the curve is inverted. This event signals that investors are acting cautiously and are less willing to take long term risks.

Investors and economists pay close attention to yield curve inversions because they have historically been indicators of impending recession. It's important to note that there have been false positives in the past, and in many cases, markets have continued strong for another year or more after the yield curve inverts. This means that investors will usually have time to observe other signs to confirm recessionary trends – such as increasing household debt ratios, credit delinquencies, weakness in employment, wages, and a slow down in the housing market.

Signs of economic downturn have left many investors concerned. At Capstone, we have responded in our non-traditional investment options by moving towards assets with a longer lifecycle that are not as affected by short term market noise. While these investments have a stronger disconnect from short term economic events, they do contain other risks, such as limited liquidity due to longer lock-up periods.

Farming is a great example of an investment with a long lifecycle that we are planning to add into our non-traditional portfolio. Within the farming arena, investors are usually required to lock up their funds for long periods of time (8-10 years), for which they look to earn a liquidity premium. Over time, returns can come from improved farming efficiencies, raw land conversions, and land appreciation. Done right, this type of investment can provide a solid return and be a fantastic diversifier for a long term portfolio.

On the traditional equity side of the portfolio, we have moved further away from our Canadian home biases to investing in a more globally diverse strategy. While the US is certainly not without its risks, this strategy also includes increasing our exposure south of the border.

In normal markets, problems tend to be isolated to specific regions, meaning that a well diversified portfolio should have investments that are less affected by market disruptions. In periods of extreme downside volatility, markets tend to move together and correlations get closer. In such market circumstances, the diversifying effect of geography is not as effective. Investors who recognize these different market realities will better understand their risk factors and how their portfolios will function under various economic conditions. This knowledge allows the smart investor to assess their overall traditional equity exposure to determine whether or not it is suitable for them.

Therefore, do not be anxious about tomorrow, for tomorrow will be anxious for itself.
Sufficient for the day is its own trouble. ~ Matthew 6:34 (ESV)

WHAT SHOULD I DO IF THE MARKET DECLINES?

There is no doubt about it—investors are cautious these days. Perhaps they should be, since many are holding arguably higher equity positions than is suitable for them. It is tempting for investors to overconcentrate in equity when fixed income markets are so low and they are searching for yield and growth from wherever they can find it.

But what if the market declines significantly? What if March's inverted yield curve proves to be the first sign that we're about to enter a period of recession? The answer to these questions can be simple…do nothing different. At least, that's the right answer for those already practicing sound financial principles.

The first thing to consider is your lifestyle and if you are practicing the principle of living below your means. Stop spending money you have not earned. Your priorities should be to provide for your family, to give, pay taxes and pay off debt. All this should be done *before* you decide to increase your standard of living. Ask yourself if your lifestyle spending truly aligns with your values and goals. If it doesn't, maybe some changes are needed.

Remember that lifestyle expenditures will be your biggest hurdle to achieving financial freedom.

A principle often neglected in low interest rate environments is reducing your use of debt and ensuring you have a sound repayment plan for current debt. While interest rates have gone up a bit in Canada during the last year, many have not yet felt the pinch of higher mortgages, business loans and consumer debts. If this part of your life is not kept under control, it can unravel quickly with one small change to interest rates or your personal situation.

Additionally, investors need to really understand and manage the risks that they are exposing their hard-earned savings to. Risks such as sustained volatility, liquidity lockups, general market exposure (such as the housing market or the Canadian oil and gas industry), fiscal policy changes…these can all affect different investments in dramatic ways. Take the time to understand what your portfolio is vulnerable to at both the individual investment level, as well as the holistic portfolio level. This will help you determine if you are taking more risk than your financial situation, or emotional capacity, can handle.

Just because you want a high return, doesn't mean you need a high return.

Exposing your portfolio to excessive risk can often prove to be wasteful and even unnecessary when proper financial planning is done.

And lastly, implementing sound portfolio management principles can both improve your investment's performance and give you peace of mind. Knowing and reducing investment costs sounds obvious, but many have no idea what they are paying for the investments and services they are accessing. Including investments that provide cashflow into the portfolio helps to smooth out periods of volatility and provides a return when capital gains are negligible. Diversifying your investments in a variety of ways (sector, geography, type, term, liquidity, etc.) will help to insulate against periods of uncertainty and decline. All of these portfolio principles can help to avoid permanent losses, smooth out returns, and make your portfolio more efficient.

They say "time is money," but we believe that taking the time to reflect on your financial habits will pay off in the long run. Contentment in our financial situation is achievable when we work hard to manage our savings, debt, giving and lifestyle. While we should strive for contentment *regardless* of our material possessions, it's important to recognize and change our bad financial habits today—even if they're difficult; they will prove fruitful in the long-term.

The plans of the diligent lead surely to abundance, but everyone who is hasty comes only to poverty. ~ Proverbs 21:5 (ESV)

CAPSTONE'S POOLED FUNDS SUMMARY

Performance figures are those of Class F units as of March 31st, 2019

Capstone Mortgage Pool
Diversified pool of construction and development mortgages (Launched November 30, 2012)

3 Month:	1.88%
1 Year:	7.74%
Inception:	7.96%*

Capstone Fixed Income Pool
Conservative, traditional and non-traditional income (Launched December 6, 2013)

3 Month:	1.03%
1 Year:	2.94%
Inception:	3.30%*

MarshallZehr Mortgage Opportunities Fund
Diversified pool of construction and development mortgages (Launched July 15, 2014)

3 Month:	1.96%
1 Year:	7.92%
Inception:	8.18%*

Capstone Non-Traditional Equity Pool
Diversified portfolio of non-traditional equity investment opportunities (Launched June 6, 2014)

3 Month:	0.66%
1 Year:	-0.05%
Inception:	4.88%*

Capstone Traditional Equity Pool
Value-based approach to investing in traditional markets (Launched December 12, 2014)

3 Month:	3.03%
1 Year:	-1.91%
Inception:	2.63%*

MarshallZehr First Mortgage Fund
Diversified pool of construction and development mortgages (Launched July 31, 2016)

3 Month:	1.39%
1 Year:	5.79%
Inception:	5.41%*

*Performance is annualized for periods longer than one year.

INTRODUCING JOHN PRITCHARD

Capstone is pleased to welcome John Pritchard to our team as Sr. Vice President, National Sales. John brings with him a wealth of knowledge from his 15+ years of working in the industry. His exuberance and quick wit make him a wonderful addition to the team. We look forward to having him re-focus our business as we grow together as a firm. Join us in welcoming John!

CLIENT LOGIN

Have you signed up yet for access to your online account? Our online portal allows you to view and download historical statements, tax documents, check the current value of your accounts, and access news and announcements. Your online portal will also provide you with a breakdown of how your funds are invested to keep you informed between portfolio review meetings. If you'd like to learn more about the funds that make up your portfolio, we publish Quarterly Fund Commentaries that provide updates on progress and the underlying assets within each of our funds. These can be found on our website, www.capstoneassets.ca. If you would like more information or require a link to sign up for your online access, please email our Wealth Management Team at wealthmanagement@capstoneassets.ca.