INVESTORS' JOURNAL

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CAPSTONE
ASSET MANAGEMENT™

ECONOMIC UPDATE

Steady and stable progress has been the theme throughout the latest quarter in both Canada and the United States.

The most anticipated news item was the preliminary agreement on NAFTA. A new trade deal, named the "USMCA," short for United States-Mexico-Canada Agreement, was reached at the end of September. The fact that a deal has finally been struck is huge progress and should help to remove some of the uncertainty investors have felt about the Canadian economy over the past year. This positive sentiment will likely translate to a stronger loonie and more stability in the stock market.

Primary take-aways from the USMCA agreement as of September 30 include:

- Canada will give access to 3.5% of their $16 billion-dollar dairy industry
- If the U.S. imposes a 25% tariff on car imports, both Canada and Mexico will be permitted 2.6 million units in vehicle exports
- No resolution was reached regarding tariffs on Canadian steel and aluminum exports
- Trade dispute settlement mechanism will remain intact
- The deal still needs to be submitted to U.S. Congress for approval, which is estimated to occur in 2019

Significant changes to big agreements, such as NAFTA, will have far reaching impacts. On a portfolio level, this leaves room for opportunities to arise. For example, Capstone's Traditional Equity Pool purchased shares of Linamar, which operates in the automobile manufacturing space. It was

purchased on September 18 and was up 9.0% by October 1. While this illustrates an example of how we seek out specific securities that can be affected by current events, we have also been monitoring trends at a macro level.

Since the majority of mortgages in our portfolios are located in Ontario, we have been closely watching this market on a macro level. Generally speaking, we are pleased to see that the USMCA agreement has provided some protection within the auto industry, as well as maintained the current trade dispute settlement mechanisms. Since Ontario has a heavy auto manufacturing and export industry, these provisions should bode well in managing employment risks.

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If you would like to discuss your investments with a Portfolio Manager, please contact the Wealth Management Team to set up an appointment (wealthmanagement@capstoneassets.ca).

ECONOMIC UPDATE

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The Ontario real estate market has remained stable and healthy. While sales and price hikes have not burned as hot as previous years, stability is preferable from an investment perspective. At Capstone, we continue to partner with builders who see great development opportunities in the Greater Toronto Area and sales of existing projects have been exceptionally strong. We continue to have more demand for funding than we can fill, which is a good problem to have! Excellent project supply means that we can afford to be selective to ensure the pools are well diversified with good quality mortgages.

Steady economic growth, primarily led by strong consumption and labour markets, has prompted the U.S. to once again raise interest rates over this past quarter to 2.25%. The Federal Reserve (Fed) has remained committed to a tightening agenda and additional hikes in the future are expected. The next meeting of the Fed is scheduled for November 8.

The Bank of Canada (BOC) also increased interest rates in the early summer to 1.5%. Additional rate increases this year appear very likely, given the recent progress on trade agreements and that inflation is hitting BOC targets. However, Canadian interest rate changes remain very data dependent, meaning the consensus on a rate increase could change at any point. The next BOC meeting is scheduled for October 24.

Changes in interest rates continue to cause many traditional fixed income investments to underperform for Canadians. The XBB (iShares Canadian Universe Bond Index ETF), a good proxy for the Canadian traditional bond market, only returned 1.58% over the past year. Investors exposed to a lower risk, traditional fixed income portfolio also have not been able to protect their investments from inflation, which has been hovering around 3% over the summer. The underperformance of traditional fixed income is likely to persist if interest rates continue to move up. We have addressed this problem by supplementing our Capstone Fixed Income Pool with non-traditional fixed income options, such as: low-risk (bank grade) construction mortgages, private debt instruments, factoring, infrastructure investments and a global real estate fund. These non-traditional investments are uncorrelated to interest rates, which has provided a stable return of 4.04% over the past year.

North American stock markets have trended positive so far in 2018. By September 30 the Canadian market was up 1.4% YTD, while the U.S. had rallied 10.6% YTD. Many risks still persist in the traditional equity arena. On the Canadian side, this includes the lack of recovery in the oil market, which we do not expect to turn around until the pipeline disputes in Canada are resolved. In addition, higher interest rates and uncertainty between global trading partners is putting pressure on Canadian market sentiment and growth expectations.

In the U.S., rapid increases in interest rates, renegotiation of trade agreements and the implementation of tariffs, particularly with China, has created uncertainty in global markets. Historical analysis has shown that in midterm election years, a specific market cycle emerges in the U.S., namely, a stock market sell-off in September to October and then a rally up in November to March.

At Capstone, we know that investors who intentionally diversify their portfolios using various types of assets, both traditional and non-traditional, will better protect themselves against future uncertainties. If you are interested in learning more about how you can be better diversified, or how to mitigate risk factors in other ways, please feel free to contact one of our Portfolio Managers.

Trust in the Lord with all your heart, and do not lean on your own understanding.
In all your ways acknowledge him, and he will make straight your paths. ~ Proverbs 3:5-6 ESV

THE BALANCING ACT

You may already have a good idea about our investment philosophy and values and you may even know what types of investments currently form our pooled funds. But do you know how those investments were chosen? This quarter we would like to uncover what goes on behind the scenes and shed a bit of light on how an investment goes from concept to final approval.

The Investment Management Team (IMT) is effectively our core research council. In any given day, they could be doing a variety of tasks, such as: evaluating a potential mortgage for inclusion into one of our funds, number crunching performance data or speaking to other investment management companies.

The concept for a potential investment is born within the IMT and they are responsible for the preliminary research that goes into any potential investment vehicle. As they gather the relevant information, they begin to formulate an opinion through the initial stages on whether such an opportunity is suitable for our funds. If it does not pass their initial 'smell test' it goes no further. However, if they believe they have uncovered a compelling investment opportunity, this will be presented to the Investment Committee (IC) for consideration.

Every investment is valued on its own merit, but in addition to its valuation from an absolute sense, its correlation and relationship to the other existing investments within our funds is of paramount importance.

At the IC table, there are both voting members and non-voting members present. Full-fledged Portfolio Managers are voting members. There are currently five voting members on the IC. Although the majority rules, if there is discomfort by any voting member, this may supersede the voting majority if the other members cannot assuage the dissentient's unease.

Once an investment has been approved by the IC, it is the job of the Chief Compliance Officer to comb through the offering documents in painful detail to ensure that the fine print is sound. This is the final stage in the approval process and not merely a formality. Things can, and have, been halted at this stage should the compliance review find cause for concern. If an investment does receive the final stamp of approval, its timing and amount to be allocated goes back to the IC for a closing discussion.

A great deal of thought goes into each investment within our pooled funds. In this regard, one could say that each investment that eventually makes it into our funds has undergone three separate layers of evaluation. Although we cannot guarantee the outcome, we can confidently stand by the decisions, knowing a rigorous process was undertaken from start to finish.

Whoever walks in integrity walks securely, but he who makes his ways crooked will be found out.
~ Proverbs 10:9 ESV

CAPSTONE'S POOLED FUNDS SUMMARY

Performance figures are those of Class I units as of September 30, 2018

Capstone Mortgage Pool
Diversified portfolio of construction and development mortgages (Launched April 30, 2012)

3 Month:	2.25%
1 Year:	6.36%
Inception:	9.04%

Capstone Fixed Income Pool
Conservative, traditional, and non-traditional fixed income (Launched November 1, 2013)

3 Month:	0.71%
1 Year:	4.04%
Inception:	4.28%

MarshallZehr Mortgage Opportunities Fund
Diversified portfolio of construction and development mortgages (Launched July 31, 2014)

3 Month:	2.07%
1 Year:	5.79%
Inception:	8.48%

Capstone Non-Traditional Equity Pool
Diversified portfolio of non-traditional equity investment opportunities (Launched May 2, 2014)

3 Month:	0.13%
1 Year:	4.90%
Inception:	6.31%

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

3 Month:	-0.24%
1 Year:	9.66%
Inception:	5.27%

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

3 Month:	1.53%
1 Year:	6.03%
Inception:	5.70%

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.

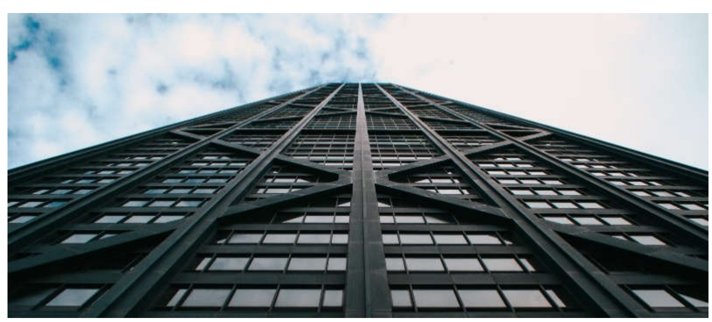
YEAR-END PLANNING

As the fourth quarter begins, it is time to consider how to end 2018 strong. Here are some thoughts that may help you to plan your year-end:

RESP Contributions
Each year, $2,500 is eligible per child for government grant top ups of 20%. This means that for every $2,500 contributed yearly to a RESP, the government will add a $500 grant to that account. This can be repeated for each child on the account.

Giving & Foundations
If you are interested in donating through a foundation, please contact your Portfolio Manager for more information about how to do so.

Mailing Dates & Office Closure
In preparation for the holiday season, we ask that any contribution cheques be mailed to our office by December 18. This will allow enough time for deposit before our holiday closure.



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