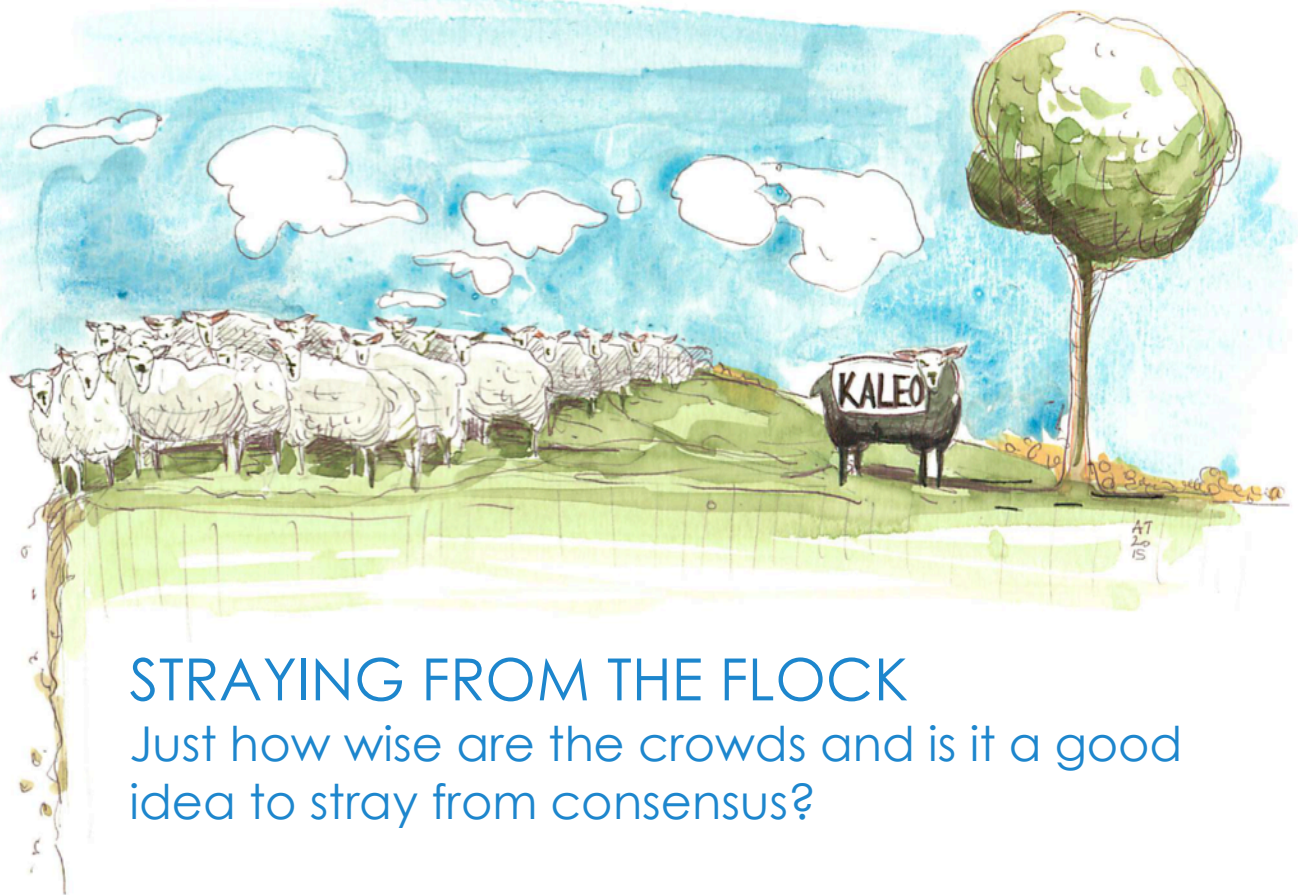




Qube Quarterly

2015: Q1



STRAYING FROM THE FLOCK

Just how wise are the crowds and is it a good idea to stray from consensus?

In this issue

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Qube Investment Management

Free of influence from bank, brokerage, and securities dealers, Qube is one of the few truly independent investment management firms in Western Canada. Our only agenda is to take care of you and your investments.

Clients place their trust in portfolio managers and deserve transparency. By publishing our quarterly activity report and engaging in personalized account reviews, we want to give you insight into how we think about investing.

Proper stewardship of your investments also means managing portfolio risk by incorporating responsible investing principles in all aspects of our work. We are also happy to model the taxation of your portfolio and retirement as part of our management plan.

You work hard for your money - so we do, too.

Ian Quigley, MBA

Qube Investment Management Inc. is a registered portfolio management firm in the provinces of Alberta and British Columbia.

We are proud to serve you from our offices headquartered in Edmonton!



New year, new look, new clients, and a new team member - a lot of new things happened here at Qube over the last quarter.

Having recently joined the team in February, I've had the pleasure of meeting several of you (our clients) already and look forward to getting to know all of our clients as I help manage the Kaleo portfolio and Qube operations.

As the editor for the Qube quarterly report, I'd like to reassure you that our plan is to keep putting out the same great research content you've come to expect from the equity research group.

In addition to showing you what's happening in the portfolio, we'll continue to write timely and relevant articles on things we see happening in the economy.

I hope you enjoy reading this quarter's update as much as I enjoyed putting it together!



Arden Tse, MBA



Contributing Writers:

Ian Quigley, MBA



Patrick Choi, B.Com



Colin Seto



Greetings from the Editor

Arden comes to the team with a background in data analysis, real estate investment, and responsible investing.

Prior to Qube, he worked as an investment analyst at the Alberta Investment Management Corporation (AIMCO) and completed an MBA in Finance at the University of Alberta in 2013.



Kaleo: to call, summon, or invite...

Our invitation to you, to invest with us

At Mar 31, 2015

	6-Month	2014	2013	2012	Since Inception (Jan 2011)
KALEO A	16.8%	20.7%	33.7%	12.2%	18.3%
KALEO B	16.7%	17.9%	33.4%	9.3%	15.6%
KALEO FULL	17.0%	22.0%	35.0%	12.6%	17.2%
S&P 500 (US Benchmark)	19.8%	24.0%	41.5%	13.5%	21.4%
S&P TSX (Canadian Benchmark)	1.1%	10.9%	12.7%	7.2%	5.5%
50% TSX / 50% S&P 500 (KALEO BENCHMARK)	10.4%	17.5%	27.1%	10.3%	13.4%

Kaleo is Qube's stock model, which is offered as follows:

Kaleo Full – currently a 43 stock + 2 index ETF model offered to clients with \$1M+ positions

For clients with positions between \$250,000 to \$1M, we offer two subsets of the Kaleo Full model:

Kaleo A – currently a 24 stock + 2 index ETF model

Kaleo B – currently a 24 stock + 2 index ETF model

Our model portfolios were launched in January of 2011. They continue to report a lower risk metric (beta) and generate a superior return when compared to our performance benchmark of 50% of the TSX (CAN) & 50% of

We currently aim to hold a stock for 3-5 years in our Kaleo models. This means we have an average portfolio turnover of 25%. In other words, a quarter of our positions change each year on average. One goal with Kaleo is to generate income through dividends. An investor entering Kaleo at inception would have a dividend yield today of over 3.5%. Many of the companies in our portfolio increase their dividends each year, so an investor can therefore grow his or her dividend over time. An investor entering Kaleo today would see a starting dividend yield of about 2.0%.

In the management of our Kaleo model, we use both company specific / fundamental analysis and macroeconomics to determine our positions (what to buy/sell).

Our research universe refreshes each year and we currently track between 150 and 200 companies. To learn more about our investment philosophy, please see our investing brochure at www.qubeconsulting.ca.

Also please read our disclaimers on the back page of this newsletter!

Kaleo at a Glance

Patrick Choi
Ian Quigley, MBA



The Wisdom of Crowds?

Ian Quigley, MBA

In the summer of 1906, Dr. Francis Galton attended a country fair in rural England. Galton worried about the future of mankind, and believed its destiny hinged on being able to find and promote the most exceptional individuals in society. According to Galton, if we listened to the few with the highest intelligence and capability (while ignoring the many average and incompetent), humanity had a chance to survive.

While at the fair, Dr. Galton happened by an ox raffle. It was a simple wager; people would guess its weight and the closest bid would win meat for the year (the ox). When the raffle was over, Galton asked for the 787 wager slips. He analyzed them and published his groundbreaking review in the journal *Nature*. To everyone's surprise, the average bid on the raffle was closer to the real weight of the ox than the actual winning bid. In other words, the consensus of the crowd was more accurate than the single opinion of any particular person. The average bid placed the ox at 1,197 pounds, while the actual weight came in at 1,198. In essence, the crowd knew collectively the true weight of the ox. Galton re-ran his experiment (as have many since), causing him to seriously consider changing his mind about the solution to mankind's problems.

This story, along with many other excellent ones on crowd dynamics, were chronicled in the 2004 book by James Surowiecki, *The Wisdom of Crowds*. Surowiecki proposed that, under the right circumstances, groups are remarkably intelligent and do not need to be dominated by especially well-informed

or intelligent leaders in order to accomplish great things. His ideas have inspired and motivated me to vigorously review our investment management practices and perspectives.

In the late 19th century, the driving force behind academics like Galton was the fear that democracy would fall short when compared to the competing autocratic systems. That perhaps democracy would falter over time thanks to the collective results of each person: one vote mathematics. Would the sum total of an average population lead to mediocre results?

When is the Crowd Wise?

The proven success of democracy goes hand in hand with the 200-year endurance of the financial markets (leading to my special interest in crowd behaviour research). The financial market is, essentially, a large crowd arguing over the correct price of a bond or stock. The consensus of the crowd determines the price of the security and, despite the failures in 1929, 1987, 2002 and 2008, we have a system that corrects itself over time and endures as an efficient and accurate mechanism for the storage of wealth. Endurance has proven that both democracy and the financial markets are at least wise enough, or at least wiser than the alternatives. What particularly interests me is when it all fails. What causes the crowd to misbehave when it does? What underpins the success?

This is what Surowiecki tries to answer in his book. He states that there are a number of key elements that are required to protect collective consensus and prevent mass delusion. For example, each member of a group, in theory,

A NEW YORK TIMES BUSINESS BESTSELLER
"As entertaining and thought-provoking as *The Tipping Point* by Malcolm Gladwell... *The Wisdom of Crowds* ranges far and wide."
—The Boston Globe

**THE WISDOM
OF CROWDS**
**JAMES
SUROWIECKI**
WITH A NEW AFTERWORD BY THE AUTHOR



should be able to contribute at least a small amount of intelligence (often combined with a large amount of error). The trick is to aggregate the good information, while eliminating the bad. Ideas from the membership have to be independent, enabling the group to draw on a decentralized and/or localized knowledge. It sounds strange, but under this perspective consensus and compromise are not winning elements in a crowd! We need diversity and disagreement for a winning collective. Let me take a moment here to shamelessly plug the independence of Qube Investment Management (one of the few investment managers in Canada not owned or influenced by a bank or brokerage).

The stock market is an amazing crowd. The best example of this is in the aftermath of the 1986 Challenger disaster. Within minutes of the shuttle explosion, while the world was paralyzed with shock, the stock market began to react. There were four major contractors involved in the construction of the shuttle and within 21 minutes of the explosion all four saw share values drop. Trading became so severe that the New York Stock Exchange had to halt trading in these particular stocks in an effort to calm what appeared to be an irrational response. Trading was allowed to resume within hours, and by the end of the day, one of the contractors was left with a 12% decline in share value while the other three ended at only minus 3%. Keep in mind, nobody knew what caused the explosion and it took a six month Presidential Commission to uncover who was at fault. In the end, the contractor Thiokol, who made the engine O-rings, was held liable while the other three were exonerated. And yes, if you were wondering, this was the very company damned by the stock market within hours of the explosion. The accuracy of the stock market in this event, along with many

others, has confounded academics. It has been studied by many and explained by none. The crowd, yet again, was smarter and faster than a Presidential Commission.

Implications for Investing in Leadership

There is no question about the importance the investment community places on the position of the President/CEO at a company. This particular corporate employee is watched and evaluated closely by the investment community in a never-ending quest for "talent". In fact, the recent decade has been dubbed the "talent war" by many observers.

It goes without saying that Harry Warner, founder of Warner Brothers Pictures, had talent; however, he was quoted in 1927 as saying, "Who the hell would want to hear an actor talk?" The infamous Thomas Watson of IBM commented in 1943, "I think there is a world market for maybe five computers."

Surowiecki believes that a good leader has the ability to facilitate an environment where employees work with independence and where they can express a diversity of opinion. Further, an exceptional leader creates structure in order to aggregate these opinions into collective wisdom.

At Qube, we believe that while strategy comes from the top, innovation comes from the ranks. Our research team agrees that a good CEO matters less than an organization with a good business model, an enduring competitive advantage, secular demand for its products and shares that are trading at a good price (at least when we are wanting to buy). If we were to highlight a CEO who exemplifies the leadership we seek, it would be Bob Iger

*...strategy comes from the
top, innovation comes from
the ranks.*



from Disney. Iger has transformed his predecessor's centrally planned company, hacking away at the bureaucracy and unshackling his veteran executives. Iger is known for listening more than talking. He is a proven leader, not because of his unique intelligence and insight, but his ability to aggregate the talent of Disney employees.

Implications for Portfolio Management

In 1973, Dr. Burton Malkiel published *Random Walk Down Wall Street*, which exposed for the first time how many mutual fund managers failed to beat the various indexes and benchmarks. What if Surowiecki is right and the financial markets represent the cumulative wisdom of investors within it?

If the crowd truly is smarter than any one manager, what lessons can be learned and what adaptations might be necessary? Surowiecki offers six:

Overconfidence – Surveys will show that the majority of professionals, including physicians, nurses, lawyers, engineers and entrepreneurs, suffer from overconfidence. A study of foreign exchange traders found that 70% of the time they had overestimated the accuracy of their exchange-rate predictions. The lesson learned? One should poll a number of perspectives and aggregate the opinions before coming to conclusions, especially on forecasted data.

Groupthink – When a crowd becomes homogenous and cohesive, they gain confidence, thinking that they are invincible. During the peak of the technology bubble (1999-2002), professional money managers across the globe became comfortable as a crowd, investing in companies that had no proven earnings and no history of profitability. A key lesson to be learned here is to be mindful in watching for excessive consensus indicating groupthink.

Social Proof – In 1968, three social scientists ran an experiment where they had a single person stand on the street and look up into

the sky. In the minute to follow, nobody looked up to see what he was looking at as they passed him. The scientists then put five people on the street looking up into the sky, and then a few of those who passed by looked up in the minute that followed. When the scientists placed 15 people on the street all looking up, they counted almost half of all the bystanders also glancing skyward! This is called a social proof, and we are wired to answer its siren call: it can save our lives (especially if something is about to fall on our heads!) In the investing world, this can be one of the most dangerous trends and needs to be avoided. Just because everyone was buying Nortel did not mean it was a good investment!

Herding - Similar to social proof is the herding risk. Herding is all about safety in numbers; rather than trying to innovate, many will decide to stick close to the crowd. Herding in the investment world is called "closet indexing" and happens when an investment manager puts his portfolio into a near match to the general market itself. It's agnostic, or soul-less investing.

The Random Fool – If enough people make predictions, it would only be logical and expected that some of them would stand out. Over longer periods of time, fewer and fewer will remain noteworthy, thanks to basic statistics. In a period as long as 50 years, you may whittle your candidates down to just one. I believe that in the financial world, it is Warren Buffet, a man true to his investment style (taught initially by Dr. Benjamin Graham, and used by university trained portfolio managers since 1928). Is Buffet an "oracle of investing", or simply the last man standing? It's a question worth asking, as one needs to be very careful not to confuse a random result from a real result.

Conventions - Conventions are a normal part of our social order. It is our local convention to line up at the theatre, or to get on and off planes. In the corporate world, companies



will lay off workers before cutting wages by convention. Which is actually irrational and inefficient, if examined more closely.

Investors have their conventions too. A famous behavioural experiment called the “ultimatum game” pairs people together and gives \$10 to the first of the pair. This person is then asked to make a “take it or leave it offer to the other,” sharing the \$10 in whatever proportion he or she decides. If the second person accepts the offer, they both get to keep the money; otherwise it is lost to both. If they were rational, the first would offer \$1 to the second, a lowball offer. The second would accept because \$1 is better than \$0. However, when the second sees the lowball offer, he or she most often decides to punish the first with a rejection. In this game, the most common result is an irrational offer to split the \$10. One cannot expect behaviour in the investing world to be entirely rational and predictable either!

People, often by convention, want some form of social contract in business, but this is changing in the financial markets. For example, Europeans reject far more executive pay packages than the Americans. New investors from Asia also do not work under the same social conventions as those in North America. Being aware of the changing context and rules of “fair play” are more important in the investing world today than ever before.

Conclusions

Simply put, we need to change our perceptions that we can only trust a few “exceptional experts” to have all the investment and economic insight. That diverse opinion actually empowers and strengthens the stock market. That looking to the consensus can indeed offer insight and wisdom, but we need to remain cognitive of conditions where groupthink or herding are prevalent. Finally, we should remain proud about our independence, as that is key in adding to and understanding the collective wisdom within the markets for the benefit of our clients.





IBM

TRADES UNDER REVIEW

Buy BBM
Sell IBM

Most people are familiar with Steve Jobs' famous turnaround of Apple, where he transformed it from a \$3B company on the verge of bankruptcy to \$350B in a span of 14 years. However, that hasn't been the only successful turnaround in Silicon Valley. Those in the enterprise technology sector will also be familiar with the story of John Chen. In 1998, he became CEO, President & Chairman of Sybase, an enterprise software company. The stock price had fallen 90% prior to him taking the reins, with a market capitalization of approximately \$360M. In the 12 years that Chen ran Sybase, he rebuilt the company to become the largest enterprise software provider in wireless technology, and eventually sold it to SAP SE for \$5.8B in 2010. In November 2013, John Chen was appointed Chairman and CEO of BlackBerry and is once again working his turnaround magic.

In the coming few weeks, the equity research team will be performing additional due diligence on both IBM & BlackBerry with the intention of selling one for the other. Our reasoning for this trade is as follows:

VALUE UPSIDE: Thanks to the 80% drop since Feb 2011, BlackBerry is currently trading at a valuation based upon the worth of its assets rather than on future earnings. On a fully diluted basis, BlackBerry has a current market capitalization of approximately \$4.8B comprised of:

- \$1.8B in liquid assets plus property, plant and equipment (net liability)
- \$3B market implied value for BlackBerry's patents and future earnings

(continued)

One Man Can Make a Difference

Patrick Choi
Arden Tse

"...we are financially under control. Now I need to stabilize the revenue and then I am going to start growing that."

John Chen

(on Q4 2014 earnings – CNBC,
March 27, 2015)



With 44,000 patents, analysts have estimated the worth of the portfolio to be in-between \$1B-\$3B¹.

We believe the worth of the portfolio to be on the higher end of that range due to its average patent age, the value of previous patent liquidations, and on Fairfax Financial Holding's tentative offer in 2013 to purchase BlackBerry in its entirety for \$4.7B. This leaves a negligible amount of value attributed to BlackBerry's future earnings potential when compared to IBM.

ABILITY TO EXECUTE: Since his tenure in late 2013, Mr. Chen has made transparent his game plan priorities for turning around the fortunes of BlackBerry, which had year-over-year declines in revenues, earnings and free cash flows:

1. Generating positive free cash flows
2. Stabilizing revenues
3. Growth

Having spent a little over a year as the CEO of BlackBerry, he has managed to not only stop the bleed in cash, but also managed to grow both free cash flows and earnings. At this stage, we do not believe there is any question as to BlackBerry's financial viability.

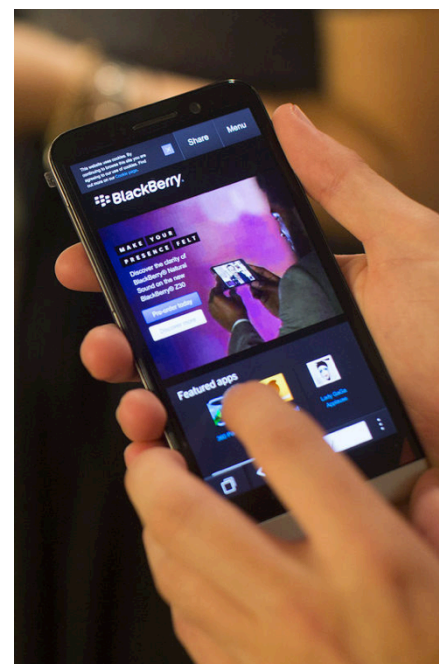
FOCUSED PLAN FOR GROWTH: John Chen has stated that the goals going forward for this fiscal year is to stabilize the falling revenues and to eventually grow it. In order to achieve this, his plan of attack is to focus his attention on the following: mobile security through enterprise software and services, and, to a lesser degree, Internet of Things through greater adoption of its QNX operating system. In December 2014, Ford Motor announced the adoption of QNX into their cars, adding another customer to a list that already includes General Motors and Apple.

IBM, by comparison, has a more murky future. With the mass adoption of cloud technology from enterprises, we believe

IBM's future revenues, earnings and margins to be in jeopardy. Where once companies would pay huge sums of money for IBM hardware, software, middleware and support, they can now leverage the cloud to outsource much of their internal IT to other companies, substantially saving on cost at the expense of IBM. In addition, Cloud is currently a highly competitive market where price decreases year-over-year is the norm. IBM's competitors in this space (Amazon, Google and Microsoft) are able and willing to compete over price because, unlike IBM, none of their core operations are being cannibalized with the

adoption of Cloud. Every single customer these competitors add on will not only increase their scale and decrease their cost, but will also be accretive to their underlying earnings, even with the decline in price. At the present moment, it is unclear to us how IBM will satisfactorily manage these factors going forward.

In summary, on both a valuation and business viability standpoint, we believe that BlackBerry offers greater potential for outsized risk adjusted returns when compared with IBM. BlackBerry has room to grow and is priced reasonably – qualities that should bode well for the portfolio.



Photographer:
Simon Dawson / Bloomberg

¹<http://www.bloomberg.com/news/articles/2013-10-21/blackberry-search-for-bidders-depends-on-patent-stockpile>





TRADES UNDER REVIEW

Identity Crisis

Buy CHD
Sell MCD

Patrick Choi
Arden Tse

Following our write-up of Church & Dwight from the previous quarter, we now turn our attention to McDonald's as a possible sell.

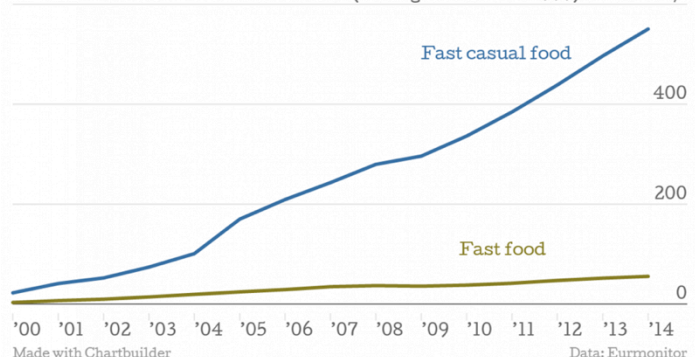
When it comes to restaurants, there is perhaps no name more recognizable than McDonald's. From its humble beginnings as a hamburger stand in 1948, it has now grown to be the world's largest fast food chain by global sales, with 36,000 restaurants spread across 120 countries.

Despite the recognizable brand name and scale of its operations, we believe that there are several headwinds that could materially impact McDonald's going forward.

INCREASING COMPETITION: McDonald's operates in a highly competitive industry with low barriers to entry. One can easily setup a hotdog joint down the street, and for every hotdog eaten, it would mean one less customer for a MCD's restaurant (a person can only eat so much). With increased globalization and the demand from customers for variety, we can now choose for a meal Korean food, Vietnamese food, Mongolian food, Indian food, Greek food, Ukrainian food, Italian food, Japanese food, Lebanese food, or... hamburgers. As the world continues to become further globalized, this headwind will only become more pronounced.

CHANGING CONSUMER TASTES: The demand for "fast food" in general has been flat over the past decade when compared to the faster growing "fast casual". The appeal of "fast casual" is in its farm-to-table operation: fresh, sustainable, local ingredients, which are perceived (rightly or wrongly) to be healthier, tastier and more nutritious. While a market for cheap fast food fare will continue to exist, we believe that global future demand will continue to stagnate going forward.

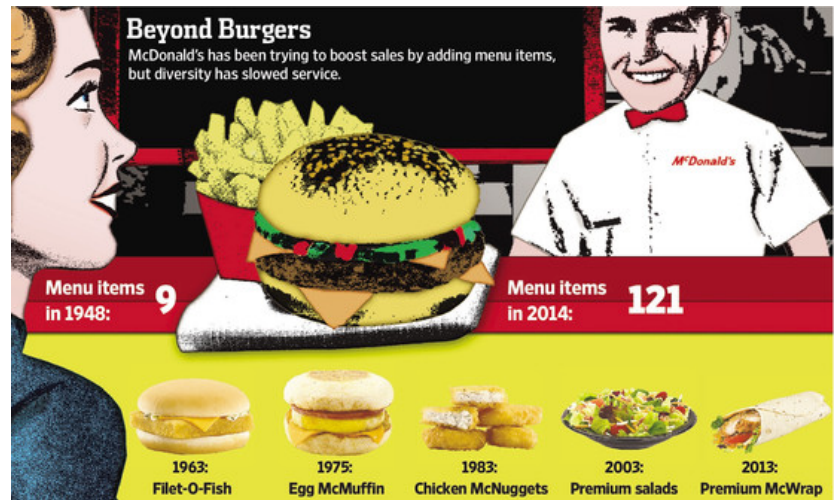
The American fast casual food craze (sales growth since 1999)



(continued)



IDENTITY CRISIS: Since the opening of its first restaurant, McDonald's had been defined by their burgers, shakes and fries; however, over the past 10 years, the menu expanded from 69 items in 2004 to 121 in 2014 in order to cater to both the fast casual and fast food segment of the market. This bifurcated strategy has resulted in poorer customer service through longer wait times and increased order errors. The problem we see for McDonald's is how they will identify themselves going forward, and specifically, what their product mix will be. Will they decrease complexity in their menu by focusing on only one segment, or will they continue to pursue both using a different approach? Either way, given the breadth of their franchise, the shift in product mix is almost guaranteed to be long and complex, with many bumps along the way, as they continue to experiment with their menu offerings and try to figure out what their focus is.



Data source: the company; Illustration: Pierre-Paul Pariseau (www.wsj.com)

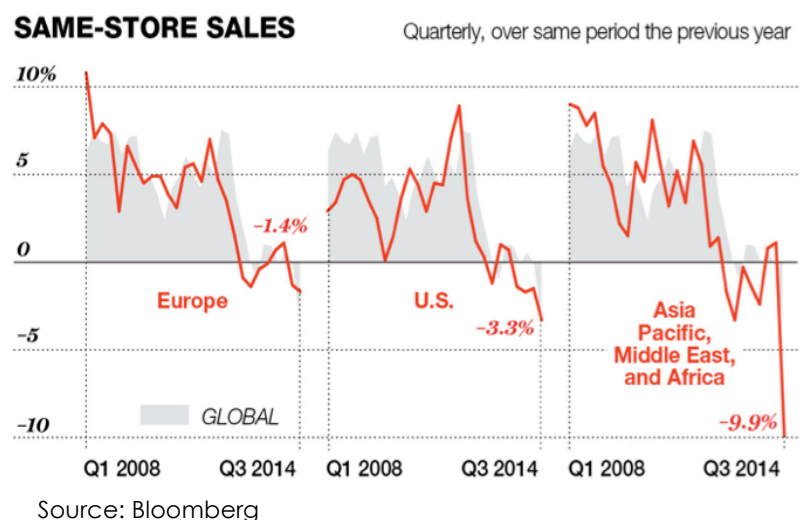
'Our kitchen comes to a halt when we get an order for a McWrap'

—A McDonald's franchise owner

<http://www.wsj.com/articles/mcdonalds-menu-problem-its-supersized-1417631056>

There are 2 metrics that are of particular relevance when measuring the performance of restaurant companies: Comparable Sales & Comparable Guest Count. From McDonald's latest 2013 annual report and 2014 quarterlies, comparable sales and guest counts have both fallen on a global basis and within each region. Same store sales have been on a declining trend since 2008. (Bloomberg)

Given the many headwinds facing McDonalds and our prediction for a long turn-around execution, we feel that it is worthy to consider its sale for Church & Dwight. With CHD, investors are able to achieve a similar volatility profile as MCD, while at the same time investing for future growth. In the coming weeks, the equity research team will be performing the last of our due diligence before finalizing the approval and making the actual trade in your portfolios.





TRADES UNDER REVIEW



Buy TSO
Sell RDSA

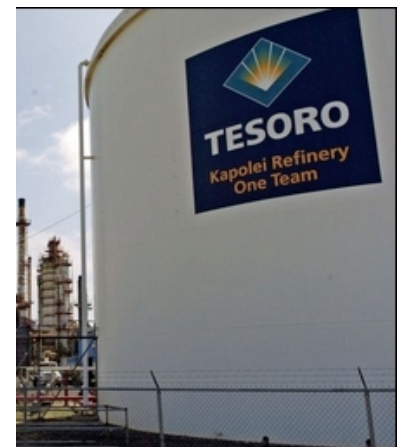
Refining our Energy Exposure

Colin Seto
Arden Tse

Oil prices have been on everyone's mind for the past six months, plummeting from a high of \$114.77 USD/bbl to its current pricing levels in the low to mid \$50s USD/bbl¹. Are low oil prices here to stay or is this merely a correction? The answer remains uncertain as a number of economic and political factors are at play.

What is certain, though, is that few companies in the energy sector have escaped the effects of low oil prices. From large fully integrated companies like Exxon and BP to energy services like Precision Drilling and Halliburton, everyone seems to have felt the sting of the sharp price decline. Or have they?

Interestingly, our research team noticed that refinery operations have come out pretty much unscathed and are making record profits, helping companies that have integrated energy businesses like Exxon offset slumping commodity prices. Why is that? The refining business benefits from low oil prices through creating products that are largely insulated from oil price fluctuations (e.g. asphalt), they can export to higher paying foreign markets, and of course, lower gasoline prices can encourage more driving. We dug deeper into this side of the industry and found a well-managed and growing company called Tesoro, a leading independent petroleum refiner focused on the West-Coast and Mid-Continent.



After much analysis, we have decided to sell our position in Shell (which is currently underperforming its peers), and buy Tesoro, a stock that we feel is much better positioned to handle an environment of lower oil prices².

Cost advantages and offsetting revenue segments. Tesoro has three different business segments: the refining segment refines crude oil and other feedstocks; the logistics segment operates a network of pipelines that transport the products, and the retail segment sells gasoline and diesel fuel through retail stations.

As a refiner, Tesoro uses oil as an input (feedstock) to produce outputs such as distillates and gasoline. The “crack spread” is the profit margin between the two. While product

(continued)



prices have fallen sharply since last summer, refiners are still at a strong advantage due to the shale-oil boom. Most U.S. crude oil cannot be exported due to an export ban, so domestic producers must sell their oil to U.S. refiners. Couple this with the fact that U.S. oil output has skyrocketed in recent years, and producers become compelled to discount their crude in order to compete with global prices.

This allows Tesoro to have a cost advantage over international peers, allowing them to buy for less and sell for essentially the same cost as everyone else. While low product prices (e.g. gasoline) can hurt Tesoro's business margins, the increased volume in its retail segment (e.g. convenience store items at their stations) helps offset those margin declines, giving Tesoro a two-pronged approach to growth.

Shell doesn't share the same cost advantage; in contrast, producers need high oil prices in order to drive earnings growth. (Upstream segment contributed 20% and 83% of revenues and earnings, respectively).³



New projects are also not economically feasible at current oil prices. Shell's primary areas of growth are in Deep-Water and Liquefied Natural Gas (LNG) projects, both of which require oil prices to be above \$70USD per barrel. Management has already indicated that its \$20 billion+ LNG

project in Queensland, Australia, will be shelved while other ventures will be deferred or abandoned. Spending is also expected to be curtailed by \$15 billion over the next three years due.

Market Leader. Tesoro's integrated refining, logistics and marketing business model allows them to deliver strong performance with exceptional margins (\$2.66 greater than West Coast Peers' Valero and Phillips 66). This is quite surprising given that 62% of its refining capacity is located in California, a state known for its harsh regulatory environment and lack of cheap crudes. Currently, their refineries in California are accepting foreign crude, which is priced anywhere from \$2-\$8 above Bakken crude. This is expected to change when Tesoro receives approval for the Port of Vancouver project, a 360k bpd rail-to-marine terminal located in Washington that will receive Bakken crude by rail, and then be transported by tankers to California⁴.

Shell, on the other hand, is struggling to find meaningful assets to replenish their reserves. Most of their assets are aging past their economic life, with notable projects not in operation until the beginning of 2017. For the year, Shell reported a replacement ratio of 26%, which is scant when compared to 104% for Exxon Mobil, another big oil company.

Considering the changes in the energy market over the last year, it makes sense to maintain specific exposure to the sector through a non-extractive segment that stands to benefit from an environment of lower oil prices. We're keen on Tesoro's potential for returns and will be finalizing our due diligence shortly before making the approval to replace Shell.

¹As of March 31st, 2015

²<http://blogs.wsj.com/moneybeat/2014/09/12/refiners-still-enjoying-the-crack-spread-even-as-gas-prices-fall/>

³Shell's 2014 Annual Report

⁴Tesoro's Investor Day Presentation



Every quarter we're going to highlight some of the portfolio holdings and share with you our investment thesis (why we hold the stock) and examples of news / activities we're seeing in the market that support or contradict that thesis. We'd like to give you some insight into our thought processes so you can understand why we hold or want to sell these companies.



Kaleo Full, A, B

BCE – Largest telecommunications and media company in Canada. While traditional cable television and landline phones are in a secular decline, we expect this to be offset with higher future fees on both mobility and Internet due to the oligopolistic nature of the industry. In addition, an investment in BCE allows us exposure in both the telecom sector and in the Canadian stock market.

"Wireless bills among the country's big three service providers, Rogers, Bell and Telus, are poised to continue their nearly uninterrupted march higher in 2015..."

(Jamie Sturgeon, Global News, January 6, 2015)

<http://globalnews.ca/news/1757364/heres-how-much-canadian-wireless-bills-will-climb-in-2015/>



Kaleo Full, A, B

NATIONAL BANK – Sixth largest commercial bank in Canada. An investment here gives us diversification into a broad swath of the Canadian economy, without needing to invest in the cyclical primary sector such as logging, mining and oil.

"Its first quarter, ending in January 2015, shows its revenue source is mainly diversified across three core business segments: personal and commercial (about 47% of revenue), financial markets (26%), and wealth management (24%)"

(Kay Ng, The Motley Fool, April 15, 2015)

<http://www.fool.ca/2015/04/15/how-does-national-bank-of-canadas-performance-compare-with-the-big-5->



Kaleo Full, B

3M – At its heart, 3M is a technology company whose competitive advantage is constant innovation. In fact, 1/3 of the company's product line didn't even exist 5 years ago. As long as 3M continues to innovate and churn out useful products, we believe they can continue to generate premium margins and return on invested capital.

"Today that's around 32 to 33 percent of products that did not exist five years ago, and we call that 'new product fatality index,' which is an important element for us." – Inge Thule, CEO 3M

(Ritesh Anan, Benzinga, March 24, 2015)

<http://www.benzinga.com/media/cnbc/15/03/5352196/why-has-3m-been-consistently-successful-ceo-explains>

(continued)





Kaleo Full, B

Colgate Palmolive - Best known for their toothpaste products, which currently command almost **45%** of the global market share. This is impressive considering the fact that other blue chip staple stocks like Coca Cola (soft drinks) or Altria (cigarettes) don't share similar bragging rights for their brands. Despite what many would consider to be a boring, staple-like operation, the company has been able to outperform the market through constant innovation. Examples include the world's first and only anti-cavity toothpaste that directly fights sugar acids, and the world's first and only weight management food for cats and dogs. As long as Colgate continues their innovation track record, we believe they can continue to maintain and grow their global market share leading to outsized returns for shareholders.

"Colgate-Palmolive has a number of new products lined up for 2015, which aim at providing specific essential care benefits. For instance, the company is attempting to build a so-called "whitening mega brand". Colgate-Palmolive claims that whitening is the second biggest toothpaste segment globally, next only to anti-cavity toothpaste."

(Trefis Team, Trefis, April 6, 2015)

<http://www.trefis.com/stock/cl/articles/288266/here%E2%80%99s-what-will-drive-colgate-palmolive%E2%80%99s-oral-care-business-in-2015/2015-04-06>



Kaleo Full, A

VISA – The Company facilitates electronic funds transfers throughout the world. 85% of the world's transactions are still made with cash according to Mastercard. We believe there are 2 secular trends that will move the world towards a more cashless economy: 1) the continued growth in e-commerce (you can't perform online transactions with cash), and 2) continued innovation on security and convenience (e.g. mobile payments).

"After the secondary factor authentication, more customers are now comfortable using their plastic (cards) for online transactions... Visa India spend data showed 43% growth in e-commerce payment volume in 2014. It also reflects a 53% growth in the number of e-commerce transactions." - TR Ramachandran, group country manager, India & Southeast Asia, Visa

(Saikat Das, The Economic Times, March 27, 2015)

http://articles.economictimes.indiatimes.com/2015-03-27/news/60553938_1_debit-e-commerce-transactions-ramachandran



QUBE INSIGHTS: Equity Research Snapshots

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Our equity research is guided by a proven value-based approach pioneered by Benjamin Graham. Balancing traditional research techniques with modern portfolio science allows our team to find companies that demonstrate and maintain solid investing fundamentals. We look for less volatile and proven earnings combined with long-standing stable dividend policies. Share prices need to be justified on a combination of current earnings and reasonable earnings

growth possibilities. Quality financial statements, coherent management and an operational business plan need to be in place before we rank a company "green".



Do not hold

Considering a decision

Hold











	INDUSTRY	Prior	Current	Snapshot
Apache Corp.	Energy			Apache Corporation is an upstream oil and gas company that has production wells around the world. Recently, Apache's stock has taken a beating due to the plunge in oil prices. In addition to laying off 5% of their workforce, their Chairman, President and CEO Steve Farris is retiring, effective immediately. With a change of leadership coming up, we will hold off on pursuing Apache for now.
Occidental Petroleum	Energy			Occidental Petro posted a Q4 earnings loss, thanks to big write-downs totaling ~4 billion as a result of lower oil prices. Capital spending is expected to be cut by one-third as the firm focuses on cutting costs and shedding non-core assets. Given Occidental Petroleum's core-assets, strong growth prospects and healthy yield, we think it would be a great company to ride out the current storm. We will perform a more in-depth analysis to see if Occidental Petroleum fits all our criteria.
Canadian Oil Sands Ltd.	Energy			Canadian Oil Sands, also known as Syncrude, has taken a significant plunge in the last few months due to the drop in oil prices. Management is already wary of this and has already slashed spending for this year in addition to cutting dividends. We like that Syncrude is a pure-play on the Oil Sands, but we will need to see improvements in the price of oil before we even start to consider buying stock in this company.

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	INDUSTRY	Prior	Current	Snapshot
Imperial Oil	Energy			The Canadian producer majority-owned by Exxon Mobil has largely been unaffected by the recent plunge in oil prices. While other energy companies have seen their stock drop 30%, Imperial Oil is only down 18% since September. The firm has excellent exposure to the Alberta Oil Sands, a strong balance sheet and a superior management team. In addition, there has been speculation that they would be acquisitive given the low oil price environment. More due diligence needs to be done before we decide if we want to initiate a position in Imperial Oil.
Suncor Energy	Energy			Suncor has recently announced that it is cutting \$1 billion from its 2015 capital budget, in addition to cutting 1,000 jobs in response to plummeting oil prices. On their latest quarterly result, Suncor reported an 81% drop in earnings from last year. Despite all this, management is expected to move forward with its planned Fort Hills oil sands project. We feel that this is a bit risky given the current economic trends, and, as such, will hold off pursuing Suncor this quarter.
Chevron Corp.	Energy			In an effort to curb spending, Chevron has suspended their share buybacks for a year. The company's dividend, which is currently \$1.07 per quarter, remains the "highest priority," according to CEO John Watson. Given the current changes to Chevron, we will hold off for now and review again next quarter.
Exxon Mobil	Energy			Exxon Mobil, one of the largest oil producers in the world, said they wouldn't reveal their 2015 capital spending plans until March during their Q4 earnings conference call. While this makes us a bit wary, management did mention they are committed to growing Exxon's dividends. With that being said, we will hold off on adding to our Exxon position, given that many of the big oil companies are finding it difficult to grow reserves and production.
Marathon Oil	Energy			Marathon broke even in their latest Q4 earnings, and their capital budget for 2015 was also decreased by 20%. Despite this, management expects a 20% Y/Y production growth in 2015. Marathon has one of the strongest balance sheets of the energy companies in our universe, but we will hold off for now until we see the price of oil stabilizing.

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	INDUSTRY	Prior	Current	Snapshot
Penn West Petroleum	Energy			Similar to other energy companies, the management team has slashed capital spending for the upcoming years and cut dividends to maintain a healthy balance sheet. We think that this is the right way to go, but we will hold off on Penn West - we feel that it is too risky investing in a stock that has already lost 80% of its value.
Arc Resources Ltd.	Energy			Arc Resources is the latest Canadian oil producer to cut its 2015 capital budget to cope with plunging oil prices. Looking through the balance sheet, we feel that there are better energy companies in our universe with stronger balance sheets and cash flow. On that note, we have no interest in pursuing Arc Resources at this moment.
Cenovus Energy	Energy			Cenovus Energy recently announced that it will cut 15% of its workforce, freeze wages and reduce spending. Cenovus reported a huge Q4 loss of -\$0.78 cents per share, stemming from the extra charges to its Pelican Lake project that has slowed down as a result of the drop in oil prices. In addition, Cenovus recently sold 67.5M shares at \$22.25 each in order to strengthen their balance sheets. Again, we will hold off on them for now until there is a clearing price for oil.
Enbridge	Energy			Despite the significant drop in oil prices, Enbridge hasn't been battered like the other energy companies in our universe. While Q4 earnings fell short of expectations, management has remained confident that they can deliver low double-digit EPS growth over the next four years. We also like that the pipeline projects for 2015 seem to be on track, with over \$9B in orders. In summary, there's nothing pressing that would make us sell Enbridge at the moment.
Royal Dutch Shell	Energy			Shell has held steady even as the price of crude oil has plummeted 50% from its summer highs. This is probably due to the fact that Shell has a very strong balance sheet. However, we expect Shell to slash spending in order to maintain their dividend, which is the highest in their peer group. Given their current spending budget and dividend payments, Shell will be cash flow negative this year, which is a concern to us. Note this quarter's trade recommendation discussed previously.

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	INDUSTRY	Prior	Current	Snapshot
SCHLUMBERGER LTD.	Energy			Schlumberger profits plunged 82% Y/Y as it wrote down over \$1.7B in assets, but adjusted earnings were ahead of investor expectations due to strong operational results. We suspect that the land drillers will be in the best positions for the oil recovery, as demand is expected to pickup in the latter half of 2015. We will review again next quarter to see if operational results continue to exceed investor expectations.
National Oilwell Varco	Energy			Given current macroeconomic situations, we will be holding off on pursuing National Oilwell Varco for now. The backlog for their rig division has dropped significantly and more weakness could come as the price of oil continues to decline. Until oil prices rebound substantially and rig counts begin to recover, we have no interest in National Oilwell Varco.
Public Storage Inc.	Financials			Public Storage is the only real estate investment trust in our stock universe. Upon further examination, we have no interest in the sector at the moment, given that interest rates will likely begin to increase soon, hampering the firm's profits. In addition, Public Storage trades at a 40x multiple, more than 2x the S&P 500 average. While we were impressed by the 35% return the stock provided in 2014, we will hold off any action for now.
The Western Union Company	Financials			At the moment, we are not interested in Western Union, as we believe that their current business operations and strategy are inferior to other payment services such as PayPal. We believe that PayPal's superior interface and ease of use will cause competitors like Western Union and MoneyGram to face significant pressures.
Ace Ltd.	Financials			Ace operates as an insurance and reinsurance company, offering commercial insurance products and services. Ace had a strong run in the last few years, producing double digit returns Y/Y. Given the current record low-interest rate environment, we are interested in adding to our position but not until we are more certain with where interest rates are headed. Until then, we will continue to hold onto Ace and enjoy its healthy stock performance and yield.

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	INDUSTRY	Prior	Current	Snapshot
Lincoln National Corp.	Financials			Financials stocks had a terrible start to the new year, as investors hoped for higher interest rates, but they got the opposite. However, the continued strength of the U.S economy has made skeptics believe that a June rate hike may be coming, which would provide a boost to insurers such as Lincoln National Corp. Until such a rate hike arrives, we will hold off on adding additional insurers into our portfolio, despite Lincoln's performance.
Hartford Financial Services	Financials			We feel that there are better buying opportunities in our stock universe. As we already own one insurance investment (Ace), we feel that we are appropriately represented in the insurance industry and have no need to include another one. However, we will continue to monitor Hartford and see if our sentiment changes next quarter.
Travelers Companies	Financials			Travelers had an outstanding quarter with revenues of \$5.84B (+3.7% Y/Y) and EPS of \$3.07, which beat expectations by \$0.54. It has consistently been one of the few insurance companies in our universe that continues to impress us with their execution. We like them, but we don't like where the industry is heading to at the moment - we will continue monitoring.
MetLife	Financials			The strong U.S. dollar and record low interest rates have taken a toll on MetLife's financial performance. Revenues are down -0.5% from last year while operating earnings and EPS are only up 2% and 1%, respectively.
Chubb Corp.	Financials			As a property and casualty insurer, Chubb derives most of its income through the policies it writes and investment income. We like that the management team is very shareholder friendly, having increased its dividend every year since 1987. Also, the company authorized a \$1.5B share repurchase program as of January 2014. We think that there is potential for Chubb to go even higher, but given the outlook of the insurance industry and the low-interest rate environment, we will hold off for now.
Sun Life Financial	Financials			Sun Life took a dive after weak Q4 results; operating income was \$511m vs. \$624M one year ago, return on equity fell from 17.7% to 12.2%. It has been a challenging year for the insurance industry due to low interest rates. Our best course of action is to stay out of them until rates move up.

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	INDUSTRY	Prior	Current	Snapshot
Aflac Inc.	Financials			Aflac's primary business is in supplemental health and life insurance, an industry that is quite stable in the long run. What we don't like is that they operate only in the U.S. and Japan, with 75% of revenues coming from the latter. As the dollar has been appreciating over the last few months, we expect this will hurt Aflac's bottom line next quarter. Given the immense concentration in Japan, we feel that there are better insurance companies in our universe. As such, we have no interest in Aflac at the present time.
Marsh & McLennan	Financials			Marsh & McLennan is a holding company with four different subsidiaries that cater to different areas of risk-management. The company has been able to deliver double-digit EPS growth in recent years, and management is committed to maintaining this as a long-term goal. Given their business model and strategy, we have taken a liking to Marsh & McLennan. Further research will be conducted to see if this is a good fit for KALEO.
T. Rowe Price	Financials			Given the current conditions of the financial sector, we are not interested in pursuing additional investment in this asset management firm at this time. Although they do pass our quantitative tests, we feel that there are better opportunities in our stock universe.
Charles Schwab	Financials			Charles Schwab does not meet our initial quantitative testing; it has failed to meet our required returns on both a dividend and free cash flow basis. Continued interest margin pressure and modest organic growth seems to be the trend for the online broker. No further research is required.
IGM Financial	Financials			IGM Financial's high dividend payout has led us to believe that this is unsustainable. Revenues and earnings have been flat for the last few years. As a result, IGM Financial's stock returns have been quite dismal. We will examine this company more closely to see if IGM warrants selling in order to acquire something with better performance.

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	INDUSTRY	Prior	Current	Snapshot
Franklin Resources	Financials			Out of the four asset management firms in our universe, Franklin Resources seems to be the one that would represent our KALEO model quite well. It easily passed our initial tests and continues to provide value for shareholders through dividends, share repurchases and strong returns. Their multiples are at the lowest when compared to the other three firms, although Franklin Resources is not growing as fast as the others. We might be onto something here with Franklin, but we'll need to do additional research and due diligence.
Bank of Nova Scotia	Financials			Given the prolonged oil slump, we expect that Canadian lenders would see a decrease in revenue due to spending cuts by the oil and gas clients. Bank of Nova Scotia is no exception; the stock is already down 8.2% YTD. Despite of this, we think Scotiabank is a very well managed Canadian bank and we expect to see the stock rebound when oil prices begin to climb.
National Bank of Canada	Financials			Low interest rates, weak oil prices and a slowing domestic economy will make it difficult for National Bank of Canada to beat investor expectations as they release earnings in the coming weeks. We are not the only ones reflecting this sentiment as the bank is already down 6% YTD. Based on the long-term implications, we still think National is one of the best Canadian banks to hold, given their strong cash flow and hefty dividend yield.
Canadian Imperial Bank of Commerce	Financials			CIBC has seen their stock pummeled since the beginning of the year, down more than 16%. While many might think this presents a great buying opportunity, we think that CIBC was already overpriced due to their slowing earnings growth. We will hold off for now and wait until the earnings release to see management's commentary on the outlook for the upcoming year.

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	INDUSTRY	Prior	Current	Snapshot
Royal Bank of Canada	Financials			Royal Bank of Canada, Canada's largest bank, has had a strong run in the past few years; their sound business model and well rounded management team has rewarded investors who managed to stay for the long run. After looking through their financial statements, we feel that Royal Bank is very well positioned for the upcoming year, despite a slowing Canadian economy and slumping oil prices, as evidenced by their 17% increase in quarterly profit Y/Y and a dividend increase of 3%. We will conduct a more in-depth analysis to see if Royal Bank is worth adding to our portfolio.
American Express	Financials			American Express, a major credit company, has impressed us with their strong earnings growth and stock returns; in their latest quarter, earnings were up 21% and the stock delivered an impressive 25% return! We especially like that the company operates its own network, and has been heavily expanding internationally. As we already own another credit card company (Visa), we will hold off on any position in American Express at this time.
MasterCard	Financials			Credit cards have practically become necessities for everyday life and MasterCard is no exception. They had a tremendous year in 2014; sales and earnings are at record highs and continue to grow in double-digits. Alongside a 45% boost in its dividend, they approved a \$3.75B share repurchase program to replace the current plan when it is completed. All in all, MasterCard is an extraordinary company. However, since we already own Visa, we don't see the need to buy another credit card company at the present time.
Visa	Financials			One of our past picks from last year, Visa has been firing on all cylinders; latest quarterly results shows that earnings are up 8.8% Y/Y and the consensus for next year is 10.2% growth. Dividends continue to increase and the firm authorized a new \$5B buyback program. We are tremendously pleased with Visa's performance and see no reason to cut it short.

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QUBE INSIGHTS: Equity Research Snapshots

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	INDUSTRY	Prior	Current	Snapshot
McGraw Hill	Financials			McGraw Hill, a financial intelligence company that provides information to capital and commodity markets, has had a strong year. We really like that the firm has a very high sustainable growth rate, which has been averaging 36% in the past five years. It's a great company, but we have no interest in the financial sector right now as we feel that there are better macro opportunities out there.
Thomson Reuters Corp.	Financials			Thomson Reuters, similar to McGraw Hill, provides intelligent information for businesses and professionals worldwide. After doing our quantitative testing, our findings have shown that Thomson Reuters does not meet our initial criteria. Simply put, Thomson Reuters has not been able to grow their earnings as quickly as the market expects it to, making it overvalued.
Moody's	Financials			Moody's is one of three bond rating agencies that provide credit ratings for various bonds. As with McGraw Hill and Thomson Reuters, we have no interest in the financial sector at the present time as we feel that there are better alternatives in our stock universe. With that being said, Moody's is still an exceptional company; they increased their dividends and continue to perform share repurchases in addition to increasing their revenues by 16% Y/Y based on last quarterly results. They deserve a second look at a later time.
Intercontinental Exchange	Financials			Intercontinental Exchange operates a network of regulated exchanges and clearing houses for financial and commodity markets. After conducting our initial quantitative tests, we have decided not to pursue this company any longer, given that their sustainable growth rate has plunged to low single digits in the past two years. In addition, we think it is very overvalued right now given that the firm trades at a 44x multiple.



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At any one point in time, the composition of the Kaleo model may change. Currently, the focus for our models (Kaleo A, B and Full) is to invest in a globally diversified portfolio of liquid stocks with a minimum market capitalization of \$1 billion. Our diversification strategy is to have similar industry weightings between our Kaleo models A, B and Full, which in turn will have similar weightings to the S&P 500. Our investment

mandate is to not have any one industry sector or sub-group exceed 2.0 times the percentage weighting assigned to that group by the S&P 500 index unless the sector or sub-group composes less than 5% of the total index. Please refer to your Investment Policy Statement (IPS) for more details.

Index comparisons are based on the total return index provided by Standard & Poor's for both the S&P/TSX and the S&P 500. All index returns are inclusive of dividends, adjusted to the Canadian currency, and, similar to the modeled portfolio, determined via the IRR method. Please note that, as total return indices are not actual portfolios, these returns do not include the cost of management and/or trading fees.

Past performance is not indicative of future results and there is no assurance that our model portfolio will achieve its objectives or avoid significant losses





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