STONE
ASSET MANAGEMENT LIMITED

MARCH
MARKET COMMENTARY & FORECAST

MARKET PERFORMANCE

Market	Return (%)*
Canada (S&P/TSX)	(0.2)
US (S&P)	(2.1)
MSCI (World)	(2.1)
Best (Portugal)	1.8
Worst (Argentina)	(5.5)

**In Canadian dollar terms as at March 31 , 2018*

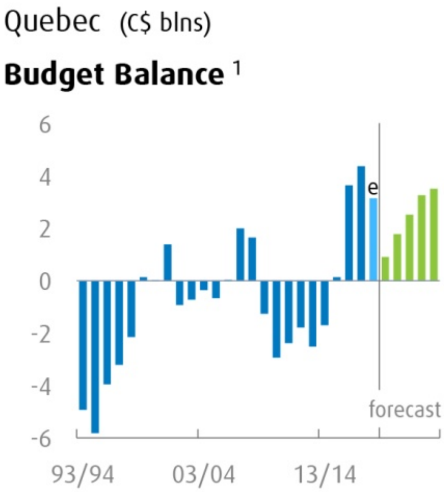
The first quarter of 2018 was one of the most turbulent in the history of financial markets offering investors few places to hide. After what followed to be a year of low volatility in 2017, investors have had a myriad of issues to deal with so far in 2018. The melt up in early January (with MSCI up 8% in January) has quickly evaporated as last year's champion technology shares wobbled into quarter end. Investors now have the threat of higher interest rates, escalating tensions over global trade, increasing volatility, geopolitical tensions, upcoming corporate earnings announcements and concerns about stretched equity valuations to deal with. Markets were down right across the board in March with the MSCI down 2.2%. The Dow and S&P were down 3.6% and 2.5% respectively. The TSX continued its losing ways down another 0.2% bringing the YTD loss at a miserable 4.5%. Industrials, Information Technology and Financials lead Canadian equities lower in March. There continues to be a tug of war between the bulls looking at the solid global earnings and economic backdrop compared to the bears that are looking at the risk of a pickup in inflation and higher interest rates, as well as listening to all the noise.

The topic of budgets was front and centre in the Canadian news in March. Not only has the Federal government made the clear cut decision to spend last year's revenue windfall but Provincial governments are also seeing their spending jump by more than 5% this year. We will highlight the country's two largest provinces' divergent budget plans below as they have taken sharply different paths compared to history.

In a reversal of long-standing form, Québec has become the epitome of fiscal management while Ontario has taken to spending like the drunken sailor. Québec's budget calls for a surplus of $2.8B for 2018-19, which is the fiscally appropriate thing to do at the top of an economic cycle. This will be its fifth consecutive surplus (see **chart 1**) while also delivering a large serving of spending plans ahead of an October election. This is even after drawing $1.6B from its reserve account in order to meet its Generations Fund contribution requirements. The Generations Fund is Québec's provincial savings account with Revenue from Hydro Québec's water royalty fees, taxes from alcohol and specific provincial accounts.

After one year of surplus, the Ontario government has decided it prefers to be in deficit again (see **chart 2**). Ontario is budgeting a $6.7B deficit in 2018-19 as it heads into a June election. It is also showing very little interest in balancing the books any time soon (2024-25). These budget deficits come even after receiving a massive $10B windfall from a stronger

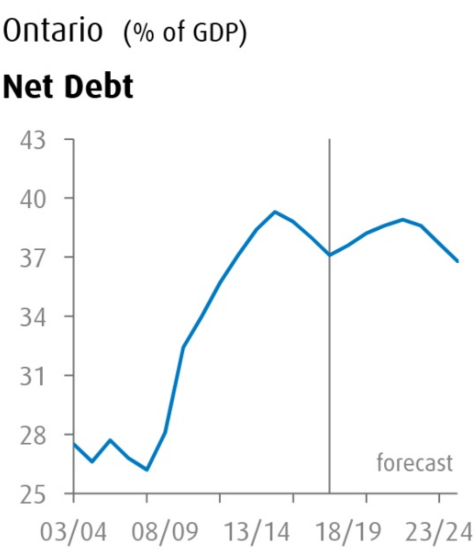
Chart 1



[1] before transfers to the Generations Fund
Source: Provincial Budget e = estimate

economy and lower interest rates than was originally projected. These windfalls have been cycled back into higher spending programs. This may be the best decision for seniors – at the expense of their children and grandchildren. Time will tell. In our opinion, the provincial government would do better for the economy by operating with balanced budgets and reducing its debt where possible to protect from the increased future costs as a result of higher interest rates.

Chart 2



Source: Provincial Budget

Based on the above, Québec is being praised as Canada's new fiscal darling even though it has been that way for several years now. The markets have taken notice as the cost to borrow for Ontario is now higher than Québec. Ontario is the highest-indebted sub-national government in the world, even greater than California which ranks number two.

As mentioned above, technology shares have been a big contributor to the current selloff. The five major FAANG stocks have been "deFAANG'ed" shedding a combined $397B in market value since Nasdaq's March 12 peak. Fears are mounting that cracks may be appearing in one of the most enduring trades of the past several years. There are many reasons for the technology selloff including concerns about increased regulatory scrutiny over this growing dominant sector, President Trump tweeting about certain companies' business practices and the general stretched valuation in this hot investment area.

Midway through the month of March it was certain that the technology topic most worthy of commentary discussion would be Facebook's (do not own) security concerns and potential user backlash but by month-end the focus shifted strongly to Amazon (do own). This isn't the first time that President Trump gave his Twitter-finger to the company or its founder Jeff Bezos who lost an estimated $16B in net worth following the latest Amazon-directed Tweet. Nor is it atypical for Trump to pounce first and gather evidence later, a tactic he has admitted to undertaking in recent NAFTA talks. In this case his claims that Amazon's deal with the United States Postal Service is directly costing taxpayers billions or that the company does not pay its fair share of state taxes are misleading, at best. Regardless of the trigger that set these Tweets loose, the path from rhetoric to support to any policy that will penalize Amazon is a lengthy one and all the while Amazon is continuing to gain share of IT budgets and retail purchases. It's difficult being the president's punching bag and will likely add to the volatility of the stock until this blows over and Facebook or another tech giant is back in the headline news.

We remain invested and are committed to companies that provide revenue growth, improving free cash flow and the higher EPS. Our investment process and implementation of various risk management tools have improved our funds' performance over the short term. The Stone Growth Fund is 2nd quartile ranking for 1 year while the Stone Dividend Growth Class, Stone Global Balanced Fund and Stone Global Growth Fund are 1st quartile over that same period.

CANADIAN FACTS

Kathleen Willis Watkins ("Kit") Coleman was a relentless innovator and pioneer, who in 1889 began penning her regular column "Woman's Kingdom" in the Toronto Mail. She was the first woman to be a page editor of a newspaper, the first accredited woman war correspondent when she covered the 1898 Spanish-American War in Cuba, first president of the Canadian Women's Press Club, and, with her internationally read "Kit's Column," the first syndicated journalist in the world.

*Adapted from *Ingenious - How Canadian Innovators Made the World Smarter, Smaller, Kinder, Safer, Healthier, Wealthier, and Happier,* by David Johnston & Tom Jenkins

Sleep well

Knowing you'll have the financial resources to live well.

STONE
ASSET MANAGEMENT LIMITED

40 University Ave, Suite 901
Toronto, Ontario M5J 1T1

Toll free. 800 336 9528
Fax. 416 364 8456
www.stoneco.com
info@stoneco.com