2014 OUTLOOK

Managing risk,
nurturing wealth.
YORKVILLE
ASSET MANAGEMENT INC

Last month, Yorkville was the host of two Investment Forecasts, the first in Toronto and then three weeks later in Ottawa. Speakers at both included Yorkville President & CEO Hussein Amad, Deputy Chief Investment Strategist Raphael Aronowicz, and Southbridge Capital Inc. President Mike Petersen.

Read below as Mr. Aronowicz addresses and summarizes the core themes dicussed at these forecasts and outlines Yorkville's investment strategies for 2014.

"History does not repeat itself, but it does rhyme"
- Mark Twain

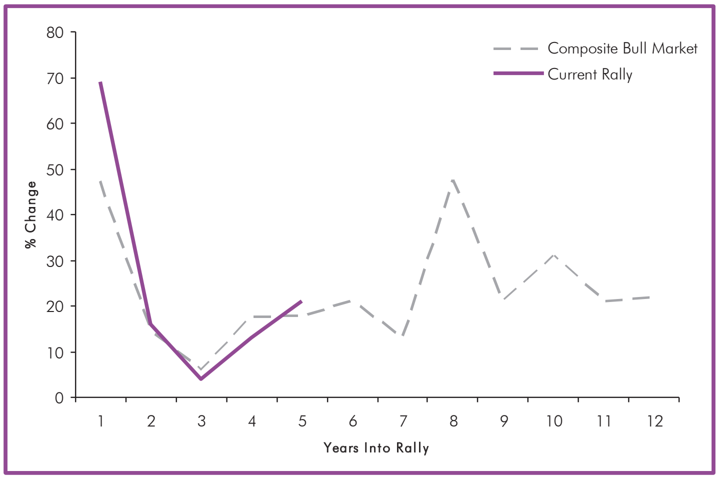
The Yorkville Enhanced Protection Strategy delivered 25.49% return to investors in 2013, which marks the 5th consecutive year of positive market returns of the S&P 500 Index after the 2008 crash.

As we enter the 6th year of this equity market rally, we are asked with increasing frequency: "How long can this last?" While we realize that nobody can answer this question with any certainty, there are a number of frameworks we can use to assist in a theoretical exercise.

Using history as our guide, we find that the path and performance of the current rally is surprisingly typical of the average of market rallies following significant crashes dating back over 100 years.

You can see the similarities in the chart that follows, which shows the annual performance of the current rally closely mirroring the performance of a composite of all other bull market rallies.

The 5th year of this rally delivered a 21% return, which is very close to the 18% return delivered by the average 5th year return of other market rallies. In addition, while today's 5-year rally may seem long in the tooth, the rally leading up to the Dot Com crash of 2000 was 12 years long compared to today's five.



Therefore, as far as history is concerned, today's market rally is really quite ordinary from both a performance and duration perspective. Historically, we have seen rallies stronger and longer than the one we are living through today. Many analysts and strategists have been pointing to this as a reason why we can and should expect the rally to continue.

However, while the rally may seem ordinary from a historical perspective, the investing environment in which it is taking place is anything but. In fact, certain factors shaping our investing landscape are unprecedented, including:

- Record low interest rates (0%) in developed markets
- Record high levels of sovereign debt
- Record levels of cash on balance sheets and stock buybacks
- Experimental monetary policies - Quantitative Easing

As a result, we are hesitant to draw any meaningful conclusions from this analysis.

A Brave New World

These unprecedented factors mentioned above have encouraged increased risk taking and sparked an indiscriminate hunt for yield by investors, as rates are held at zero and liquidity is pumped into the market. Furthermore, the excessive amounts of cash on balance sheets of corporations and record low interest rates and credit spreads have allowed companies to issue extremely cheap debt to buyback their shares. This has ultimately led to an increase in earnings per share for these companies, driving a large proportion of earnings growth in recent history. These factors, in our view, are a significant contributor to the market rally we experienced in 2013, and the chart below highlights how these numbers breakdown:

S&P 500 March 12, 2013 to March 12, 2014	
Returns	20.18%
Earnings Per Share Growth	7.72% (1/3 of Returns)
Price to Earnings Multiple Expansion	12.64% (2/3 of Returns)
Revenue Growth	1.90%

Looking at the numbers, you can see that roughly two thirds of the 20.18% market performance is as a result of multiple expansion, while only one third is from earnings growth. What multiple expansion means, simply put, is that investors are willing to pay a higher price for stocks relative to the earnings they produce, either because they expect higher future growth of earnings, or because they have no better alternative to invest in with yields as low as they are.

However, earnings grew by 7.7% while revenue grew by only 1.9%, highlighting that earnings growth is less tied to actual economic expansion and more tied to other factors that executives are able to manage internally, such as buybacks and cost cutting. We would obviously like to see these ratios shift, but note that these developments are still positive for equity investors and can continue to push earnings higher.

We titled this section, "A Brave New World" because, as the numbers suggest, fundamentals have taken a backseat to other market forces which continue to push equities and other risk assets higher. To invest in a market solely based on these forces certainly requires an element of bravery, however the line between bravery and foolishness is very fine indeed.

This concept of bravery ties in nicely to the concept of investing versus speculating.

Benjamin Graham, the father of value investing, proposed that the difference between investing and speculating is as follows:

"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

To invest based on expectations of market multiple expansion is to speculate. To invest based on a view on Quantitative Easing and liquidity flows is to speculate. These factors which have been driving market returns offer no promise of safety of principal, nor an adequate return.

However, we take comfort in knowing that Yorkville's Quality, Valuation, and Risk (QVR) investment process eliminates any need for bravery, imposing on us a discipline where the investments we make require both safety and adequate return. This is because we do not overpay for businesses, we look for business with sustainable competitive advantages, and we do not chase returns.

With that said, in lieu of all the challenges facing value investors in today's highly valued market, we are excited about a number of opportunities we believe will be rewarding for our investors not only for 2014, but for many years to come.

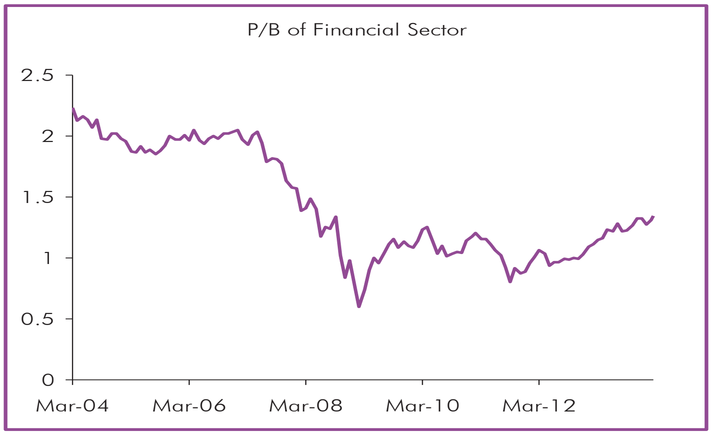
OPPORTUNITIES

We would like to take this opportunity to highlight 4 investment themes we are positioning to take advantage of, being:

1. US Banks
2. The US Consumer
3. Luxury Goods
4. Health Care

US Banks

We have liked US Banks since they emerged from the financial crisis, and continue to like them for a number of reasons. First, US Banks remained undervalued relative to historical multiples. While that discount has narrowed as a result of their strong performance, there is still substantial upside in the sector if it were to trade near its ten year average multiple. The chart below highlights the discount of the US Financial sector's price-to-book value relative to history.

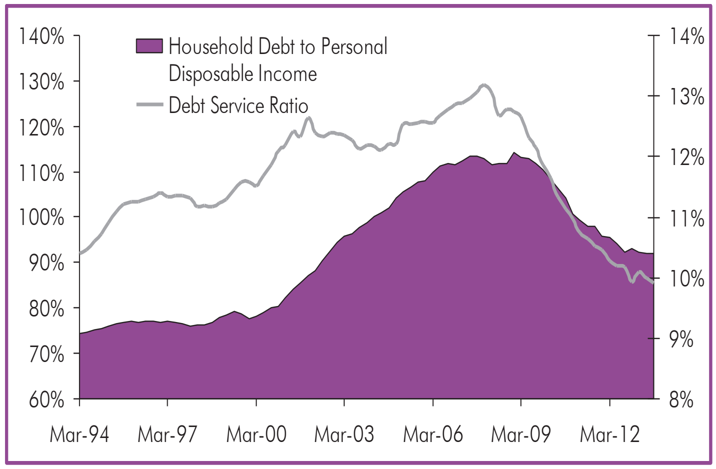


But valuation isnt the only reason we like US Banks. After years of expensive regulatory overhaul, Banks are finally in a position where they can shift their efforts from recovery and compliance towards growth, not to mention they have significant excess reserves waiting to be deployed in this event.

Lastly, Banks are some of the only companies that actually benefit from a rising interest rate environment. As investors fear the impacts of rising rates, Banks' profitability increases as the spread they make on loans- their net interest margin- rises as well. Therefore, Banks could act as a hedge against the negative effects of a rising interest rate environment.

The US Consumer

The US Consumer has struggled since the financial crisis and has typically held back spending on big ticket items. With a recovery in both the housing market and stock market, combined with low interest rates, the average American looks a lot healthier as their household debt to personal disposable income and their Debt Service Ratio (the amount of their income spent on servicing their debt) have both declined meaningfully.



The consumer is now not only faced with the need to replace those durable goods that are approaching their life expectancy, but finally has the ability to replace them as well.

We expect this pent up demand to materialize into spending on big-ticket items such as cars, appliances, and other home improvements.

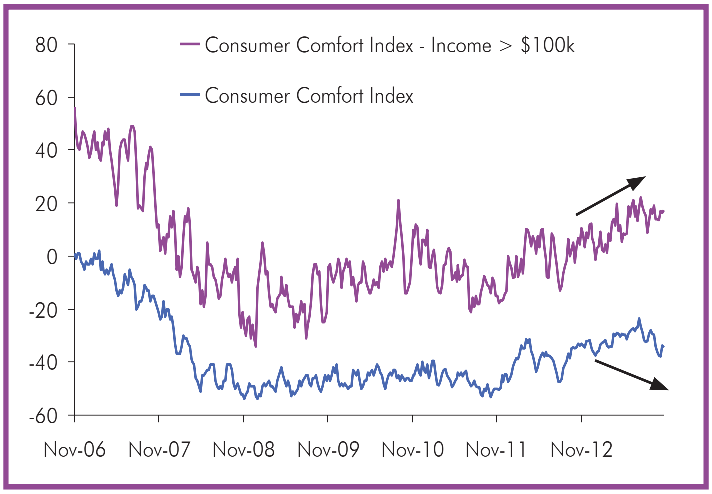
We are positioned to benefit from this upgrade cycle through our investments in Ford, Home Depot, and Whirlpool.

Luxury Goods

Income inequality has never been greater and this trend does not show any signs of slowing down. Today's reality is the rich are getting richer and the middle class is getting squeezed.

We believe this reality, as harsh as it may be, presents an opportunity for investors to benefit from the increase in demand of luxury goods as wealth continues to be created globally.

You can see how this divergence manifests itself by comparing consumer confidence of the average consumer versus the consumer earning $100k+.



Health Care

The last opportunity we like is in the Health Care space. Of the four opportunities discussed, Health Care has the longest timeline with the investment thesis being primarily based on the long-term shift of demographics in developed markets.

Populations are aging and birthrates are declining, meaning a disproportionately large population will require an increased amount of spending on health care goods and services than ever before.

In the short-term however, demand for these goods and services is poised to increase dramatically as well, in the US specifically, as "Obamacare" comes into effect. With the uninsured population beginning to receive insurance, the total addressable market will vastly increase.

One such opportunity in health care is the ***Southbridge Health Care Fund*** ("the Fund"). Developed in partnership with Yorkville and the Petersen Family (formerly Versa-Care), the Fund's objective is to distribute a stable yield to investors.

Priced at a lower multiple of earnings than public market comparables, the Fund is considered an alternative asset class that is not exposed to traditional volatilities that stock markets are exposed to.

In addition, the tax efficient distribution provides investors with quarterly cash flows that far surpass that of current earnings on bonds.

With successfully and experienced management, the Fund focuses on the acquisition and redevelopment of licensed long term care homes in Ontario. The Fund delivered an 11% return to investors in 2013 and projects to deliver similar returns in 2014. Chronic shortages in supply and positive demographics will fuel expansion of this business for the next 20 years and Yorkville clients have benefited from the results of the Fund.

In closing, while the investing landscape is set to change with drastic shifts in global monetary policy, our goal of delivering steady returns while protecting our clients' principles from downside risk has not.

As the margin of safety provided by lower valuations continues to decrease while volatility is expected to increase, we continue to exercise caution on the market as a whole by hedging our positions. Although our conservative strategy may not be ideal for an environment where the market rises indiscriminately as it has for the past year, our tactical approach and use of options for hedging should help us deliver on our promise if the market behaves as we expect it to.

For more information on Yorkville's approach to wealth management, as well as for up to date information on our funds and their performance, please visit www.yorkvilleasset.com

---