Laurus INVESTMENT COUNSEL

Enterprise Fund Quarterly

June 2016

"Too large a proportion of recent 'mathematical' economics are mere concoctions, as imprecise as the initial assumptions they rest on, which allow the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols." ...John Maynard Keynes

Laurus Enterprise Small Cap Fund
Total Time Weighted Rates of Return
Measured to June 30, 2016

	2nd Quarter 2016 (%)	One Year (%)	Two Years (%)	Three Years (%)	Four Years (%)	Five Years (%)
Enterprise Fund	**5.57**	**-4.49**	**-2.41**	**9.84**	**11.05**	**10.28**
Quality Peer Group	4.57	-5.51	-4.98	8.19	11.89	9.20
S&P/TSX Composite Index	5.07	-0.20	-0.68	8.27	8.18	-0.02
S&P/TSX Small Cap Index	17.93	10.17	-4.03	7.86	5.57	4.21

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REVIEW AND OUTLOOK OF CANADIAN SMALL-CAP STOCKS

For most of its existence, the investment business was driven by information. Those who had it hoarded and guarded it. They tended to dominate the markets too, because good information could be so very hard to come by. But the inexorable march of time, as well as the growth and development of information technology, has changed the nature of the investment "game" dramatically. Success in the markets today is driven by analysis – of data, predominately – in the search for a "leg up" against the competition (market).

In today's world, with more and more information available faster and faster, it's easy to postulate that market advantages will be harder to come by and more difficult to maintain. But an alternate idea is that the ongoing growth and glut of data will make the useful interpretation of that data more difficult and more valuable.

With data so readily available, so too the varied comments – both hue and cry. Extrapolation of short term events into long term "themes" becomes the very foundation on which information media bases its convictions.

Over the past few months, three specific themes have weighed heavily on investors, each with considerable – and, we suggest, controversial – data points. First, the continued posturing on interest rates and potential movements by the US Federal Reserve ("Fed"). Next, the increasing contention that corporate earnings throughout the world are in recession. And finally, the ongoing debate surrounding "Brexit" (the exit of Britain from the European Union) and its impact on the global economy up to the eventual "leave" decision.

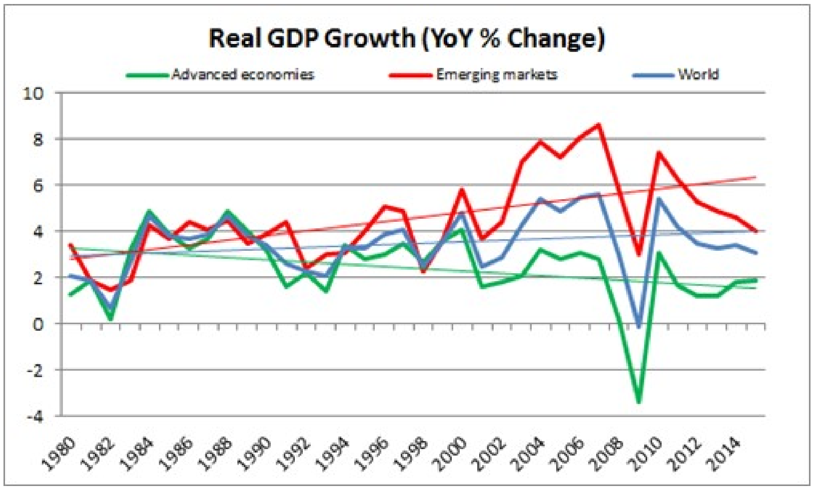
After a positive, and obviously overly-zealous, surge in markets on June 23rd as incorrect information from pollsters rolled across markets, traders awakened the following morning to considerably downward pressure which continued June 26th. Despite the quick snap-back in the week that followed, we expect to see plenty of volatility as events unfold throughout Europe.

In perspective, the UK is just 4% of global GDP. Even in a worst case scenario, while a significant decline in GDP will be harmful to the country it likely cannot derail the global economy. China, a country four times larger than England (currently at 16.3% of global GDP), has gone through their own economic slowdown with little global impact. Next, the actual removal process of the UK from the European Union will take years to negotiate which means the long term negative effect will be muted. Finally, in our opinion the vote in the UK is part of a wider, more global, backlash against the establishment, rising inequality and globalization. Several reports note the populace already regret it, either because they didn't really expect to prevail and merely wanted to register a protest vote, or because of the sharp sell-off in financial markets and the mushrooming forecasts of recession.

While we do own companies with global exposure, the Brexit vote does not change their long term intrinsic value. This value is measure over long periods in normalized markets, and though there may be some short term implications, over the long term these are mostly muted. We continue to believe these businesses provide our investors with the best long term opportunity.

Another theme building momentum: the fascination with "Fed Watching" has almost reached hysteria. In fact, watchers will argue that Federal Reserve ("Fed") rate changes, or lack thereof, are directly associated with economic growth. Keeping interest rates low, they say, mutes consumer spending (savers and retired people not receiving enough interest on their capital and are forced to take additional risk for return), and limits the ability for corporations to borrow money.

In fact, economic stimulus through what has been an aggressive monetary policy has been a dismal failure over the past five years. Despite continued stimulus from the Fed, the US economy has had trouble transitioning from the Balance Sheet Recession period of 2008-2012 to a more sustainable growth trajectory. As the chart from the IMF at right illustrates, GDP growth throughout the world has been in decline, though the trend line for emerging market economies has been on the rise since 1980 whereas advanced economies (which were responsible for 64% of global growth in 1980) have been on the decline. So the US isn't alone in their economic doldrums.



While true the Fed requires increases to interest rates to create "dry powder" for the next recession (where interest rates can again be reduced to "stimulate" the economy again), how far off is the recession itself? Historically, recessions don't occur at times of low economic growth – recessions are formed when asset prices are historically high and greed at excess. In short, one needs a boom to have a bust. Certainly none of that exists today, and likely not for the foreseeable future with forecast economic growth rates in the 2.0-2.5% range. And in the face of Brexit, the Fed no longer has the impetus to raise rates given the unknown consequences. This has a positive side as the US dollar will likely come down, making exports more palatable throughout the globe.

Finally, and likely more prevalent, what is generally causing consternation with investors is the widely-reported shrinkage of earnings in the MSCI all-country world index by 7% for the year ending March 31st. Corporate earnings rarely shrink outside of an economic contraction therefore investors worry a global recession is forthcoming.

In a recent report by BCA Research, their research explains how this recent period has been unusual. There have only been three periods with profit contractions outside a recessionary period (like the period we just experienced) since 1980: 1987, 1999, and a very brief period in 2012 and all involved a mid-cycle slowdown in nominal GDP growth. BCA contends that these contractions have been the result of commodity price decreases – oil, most importantly.

We expect earnings will begin to grow as we move into the second half of 2016 and, as such, are more positive on the prospects for the North American stock market for the following reasons:

1. While certain economic events (like Brexit) cause volatility, there is greater likelihood of stabilizing oil prices in the next few quarters. Collapsing oil prices have been a major drag on markets, pulling down overall profits. As oil surplus disappears, the oil price will improve – so too, the energy balance sheets and profitability resulting in the sector becoming a tailwind rather than headwind to the overall market.

2. We expect the Fed will remain on the sidelines through the remainder of the year, which will likely cause the US dollar to ease. Consequently, profit growth will improve for businesses with international earnings.

3. There are clear signs the US economy continues to improve, particularly the labour market is showing strength. However, inflation in wages and consumer prices will likely remain moderate which means the impact on corporate profits remains low.

Though there are plenty of economic data points being posted daily, our preference resides solely in that information underlining the strength in our invested businesses. We remain vigilant of forces that may, or may not, impact their economic vitality but, in the main, tend to look through event-driven volatility, preferring to see short term volatility as an opportunity and not as a threat.

Yours truly,

THE LAURUS INVESTMENT TEAM