Special Market Commentary

Clearly any investor who has sold micro/small cap Canadian equities over the past few weeks is not abiding by the axiom "Buy low, Sell high".

We have been asked many times this past year why we do not buy large cap stocks which have clearly been working well for investors in recent years. The simple answer to this question is that it is not in our mandate to do so. However, the inherent reason is that we do not offer any competitive advantage by investing in large cap stocks which are covered relentlessly by BUY side and SELL side analysts. The majority of large cap managers rarely outperform their respective indices over the long term. AlphaNorth presents investors with an increased risk reward profile versus large cap managers and we generate significant excess returns versus most other asset classes. This competitive advantage is a result of our proprietary deal flow in private placements and our ability to research and identify investments that offer significant potential that our competitors cannot offer investors.

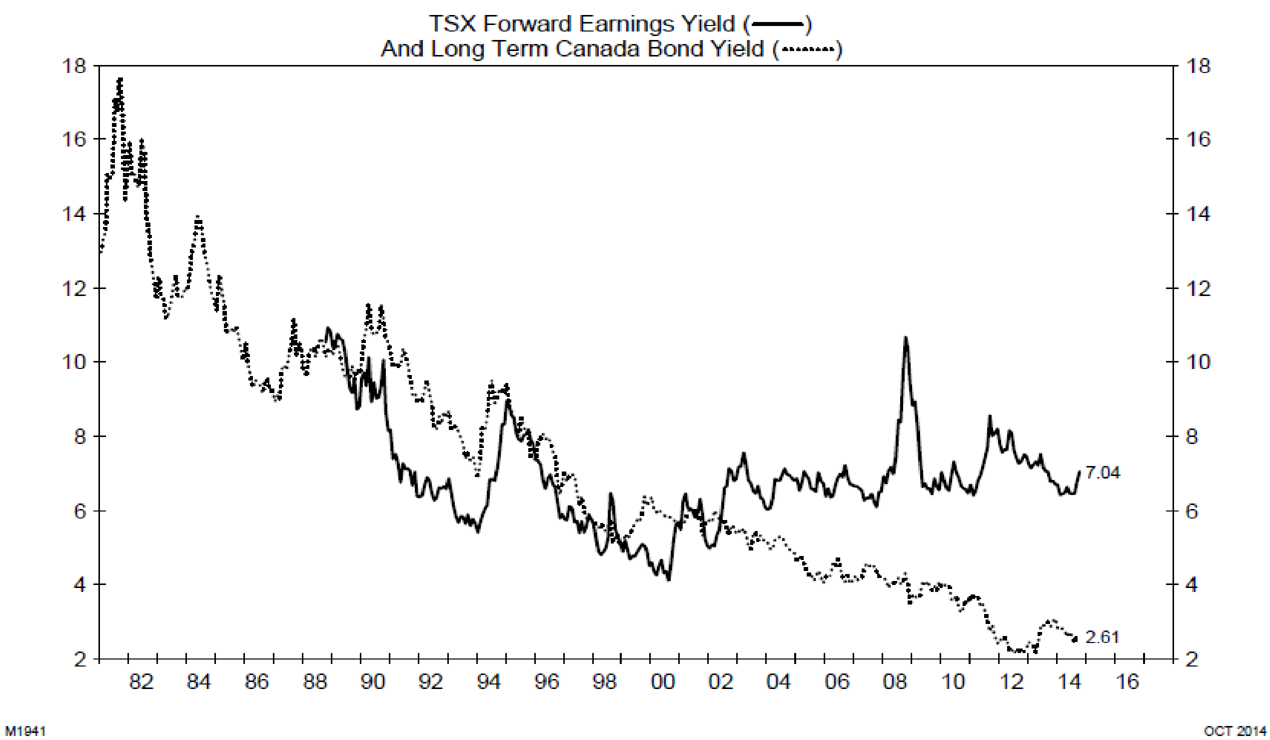
Investing entails some calculation of the odds of various potential outcomes of a company: will it meet earnings projections, will management execute on plan, will the product sell or will investors embrace the potential. In any market cycle, the odds are typically not in an investor's favour, but when they are, it pays to bet big. We have been investing in small cap equities for over 27 years now and it has proven to be highly successful over the long term. Periods of poor performance are followed by strong returns. The best time to buy is after these poor periods of performance.

In the current market backdrop, we believe that the odds are in our favour as evidenced by the following points which support our conviction that micro/small-cap Canadian equities are poised for a significant move higher.

The time is now to Bet Big!

Valuations relative to fixed income market are extremely attractive.

Many market commentators have referred to the P/E multiple in the context of the long term average. We have consistently argued that this is not the appropriate frame of reference. The current P/E multiple should be looked at in the context of the fixed income yield environment. In this context, equities are extremely cheap. For example, an investor can buy a bond which returns/earns 2% annually. The implied P/E of this is 50x (100/2). Comparatively, equities, as measured by the TSX Composite, earn 7.3% which translates to a P/E multiple of 13.7x based on 2015 consensus estimates. In addition to this, equity earnings are expected to grow at 7-9% whereas bond return's currently have no growth prospects.



TD Securities - John Aitkens

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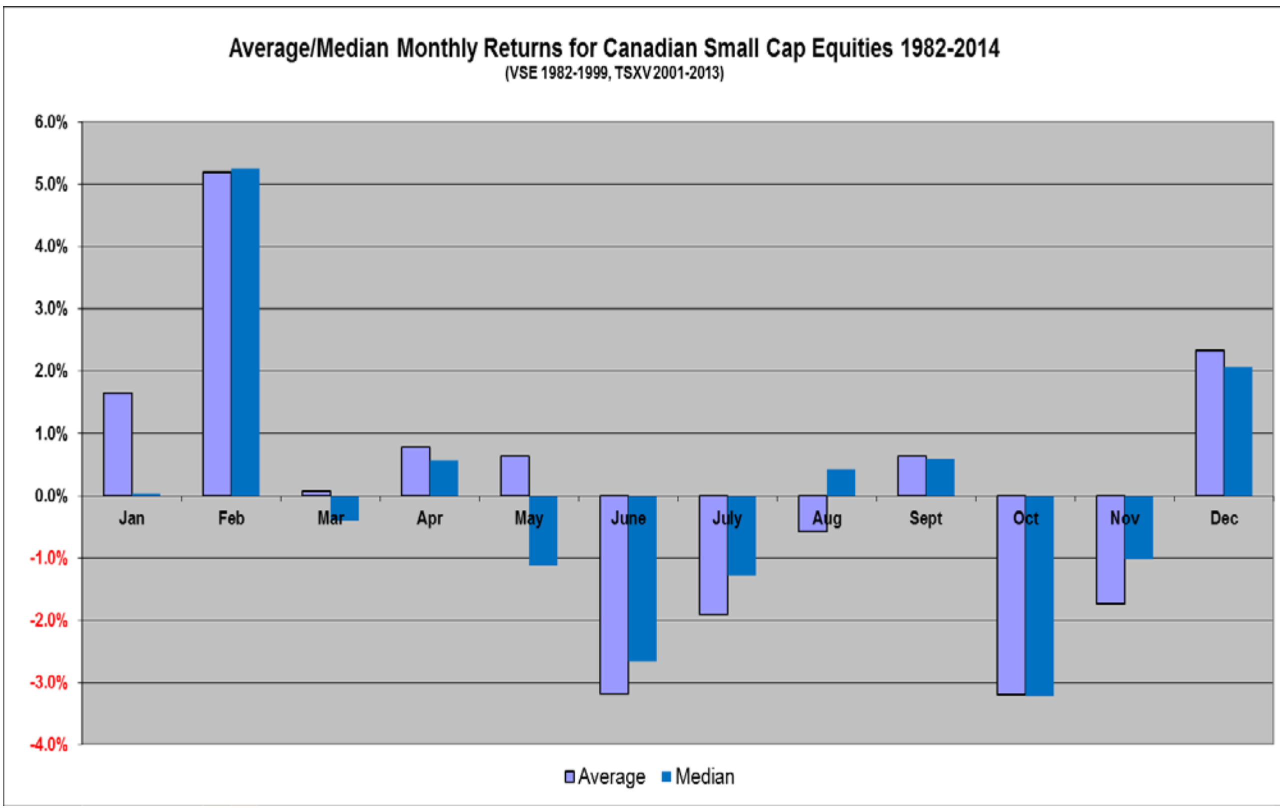
Special Market Commentary

Seasonality for micro/small-cap equities is very favourable now



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How we are positioned

The global economy is forecast to grow faster in 2015

The data below is from the IMF website. The only major countries expected to have slower growth in 2015 are China and the UK. The U.S., Europe and India are forecast to have materially higher growth in 2015 resulting in total worldwide growth of 4.0% in 2015 as compared to 3.4% in 2014.

Table 1. Overview of the *World Economic Outlook* Projections 1/
(Percent change unless noted otherwise)

	Year over Year						Q4 over Q4		
			Projections		Difference from April 2014 WEO Projections 2/		Estimates	Projections	
	2012	2013	2014	2015	2014	2015	2013	2014	2015
World Output	**3.5**	**3.2**	**3.4**	**4.0**	**–0.3**	**0.0**	**3.6**	**3.3**	**3.8**
Advanced Economies	**1.4**	**1.3**	**1.8**	**2.4**	**–0.4**	**0.1**	**2.0**	**1.8**	**2.4**
United States	2.8	1.9	1.7	3.0	–1.1	0.1	2.6	1.7	3.0
Euro Area	–0.7	–0.4	1.1	1.5	0.0	0.1	0.5	1.4	1.6
Germany	0.9	0.5	1.9	1.7	0.2	0.1	1.4	1.8	1.8
France	0.3	0.3	0.7	1.4	–0.3	–0.1	0.8	1.0	1.6
Italy	–2.4	–1.9	0.3	1.1	–0.3	0.0	–0.9	0.8	1.2
Spain	–1.6	–1.2	1.2	1.6	0.3	0.6	–0.2	1.7	1.5
Japan	1.4	1.5	1.6	1.1	0.3	0.1	2.4	1.4	0.6
United Kingdom	0.3	1.7	3.2	2.7	0.4	0.2	2.7	3.4	2.2
Canada	1.7	2.0	2.2	2.4	–0.1	0.0	2.7	2.0	2.4
Other Advanced Economies	2.0	2.3	3.0	3.2	0.0	0.0	2.8	2.7	3.7
Emerging Market and Developing Economies	**5.1**	**4.7**	**4.6**	**5.2**	**–0.2**	**–0.1**	**5.1**	**4.8**	**5.0**
Commonwealth of Independent States	3.4	2.2	0.9	2.1	–1.0	–1.1	2.1	–0.4	0.9
Russia	3.4	1.3	0.2	1.0	–1.1	–1.3	2.0	–0.1	0.4
Excluding Russia	3.6	4.2	2.4	4.4	–0.6	–0.6	. . .	. . .	. . .
Emerging and Developing Asia	6.7	6.6	6.4	6.7	–0.2	–0.1	6.7	6.6	6.4
China	7.7	7.7	7.4	7.1	–0.2	–0.2	7.7	7.7	6.8
India 3/	4.7	5.0	5.4	6.4	0.0	0.0	6.1	5.6	6.6
ASEAN-5 4/	6.2	5.2	4.6	5.6	–0.4	0.2	. . .	. . .	. . .
Emerging and Developing Europe	1.4	2.8	2.8	2.9	0.4	0.0	3.4	3.0	3.5
Latin America and the Caribbean	2.9	2.6	2.0	2.6	–0.5	–0.3	1.9	1.9	2.6
Brazil	1.0	2.5	1.3	2.0	–0.6	–0.6	2.2	1.3	2.2
Mexico	4.0	1.1	2.4	3.5	–0.6	0.0	0.6	3.0	3.4
Middle East, North Africa, Afghanistan, and Pakistan	4.9	2.5	3.1	4.8	–0.2	0.2	. . .	. . .	. . .
Sub-Saharan Africa	5.1	5.4	5.4	5.8	0.0	0.2	. . .	. . .	. . .
South Africa	2.5	1.9	1.7	2.7	–0.6	0.0	2.1	1.7	2.7
Memorandum									
Low-Income Developing Countries	5.8	6.3	6.2	6.5	0.0	0.0	. . .	. . .	. . .
World Growth Based on Market Exchange Rates	2.6	2.4	2.7	3.3	–0.3	0.0	2.9	2.7	3.1
World Trade Volume (goods and services)	**2.8**	**3.1**	**4.0**	**5.3**	**–0.3**	**0.0**	. . .	. . .	. . .
Imports (goods and services)									
Advanced Economies	1.1	1.4	3.5	4.6	0.0	0.1	. . .	. . .	. . .
Emerging Market and Developing Economies	5.7	5.7	4.7	6.4	–0.3	0.1	. . .	. . .	. . .
Commodity Prices (U.S. dollars)									
Oil 5/	1.0	–0.9	0.1	–4.3	0.0	1.7	2.6	–0.9	–5.7
Nonfuel (average based on world commodity export weights)	–10.0	–1.2	–1.7	–3.6	1.8	0.4	–2.9	–1.4	–2.7
Consumer Prices									
Advanced Economies	2.0	1.4	1.6	1.7	0.1	0.1	1.2	1.7	1.8
Emerging Market and Developing Economies	6.1	5.9	5.4	5.3	–0.2	–0.1	5.5	5.0	4.8
London Interbank Offered Rate (percent)									
On U.S. Dollar Deposits (six month)	0.7	0.4	0.3	0.8	0.0	0.0	. . .	. . .	. . .
On Euro Deposits (three month)	0.6	0.2	0.2	0.2	0.0	–0.1	. . .	. . .	. . .
On Japanese Yen Deposits (six month)	0.3	0.2	0.2	0.2	0.0	0.0	. . .	. . .	. . .

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during May 5–June 2, 2014. Economies are listed on the basis of economic size.
1/ Global and regional growth figures are based on new purchasing power parity (PPP) weights derived from the recently released 2011 International Comparison Program survey (see box) and are not comparable to the figures reported in the April 2014 WEO. The quarterly estimates and projections account for 90 percent of the world PPP weights.
2/ The comparisons are based on April 2014 country forecasts aggregated with the revised PPP weights. The projections for Ukraine are included in the July 2014 *WEO Update*, but are excluded in the columns comparing the current forecasts with those in the April 2014 WEO since they were excluded at the time.
3/ For India, data and forecasts are presented on a fiscal year basis and output growth is based on GDP at market prices. Corresponding growth rates for GDP at factor cost are 4.5, 4.7, 5.4, and 6.4 percent for 2012/13, 2013/14, 2014/15, and 2015/16, respectively.
4/ Indonesia, Malaysia, Philippines, Thailand, and Vietnam.
5/ Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil. The average price of oil in U.S. dollars a barrel was $104.07 in 2013; the assumed price based on futures markets is $104.14 in 2014 and $99.62 in 2015.

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Volatility index (VIX) has signaled a buy for equities

A quick comparison of the VIX and the TSX displays that, every time the VIX has gone above 20, it has presented a buying opportunity.

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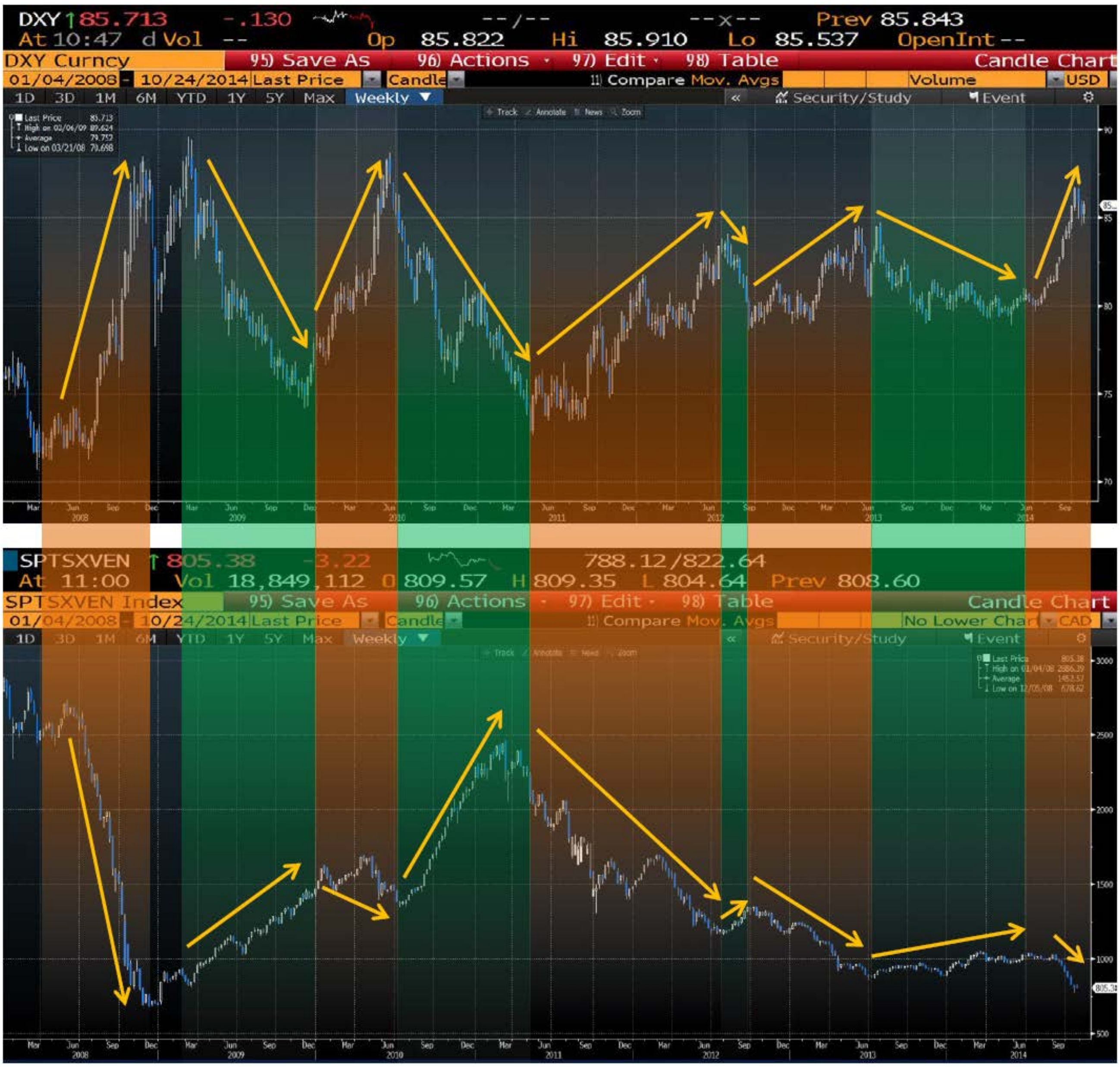
The TSXV index is negatively correlated to a strong USD.

Our technical analysis work suggest that the USD has recently peaked.



Conclusion

We believe Canadian small cap equities are long overdue for a material move higher.

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