$$\left(\frac{\boldsymbol{Analyst\ intrinsic * (1 - MOS) * (1 + 9.5\%)^3}}{\boldsymbol{Current\ price}}\right)^{\boldsymbol{1/3}}$$

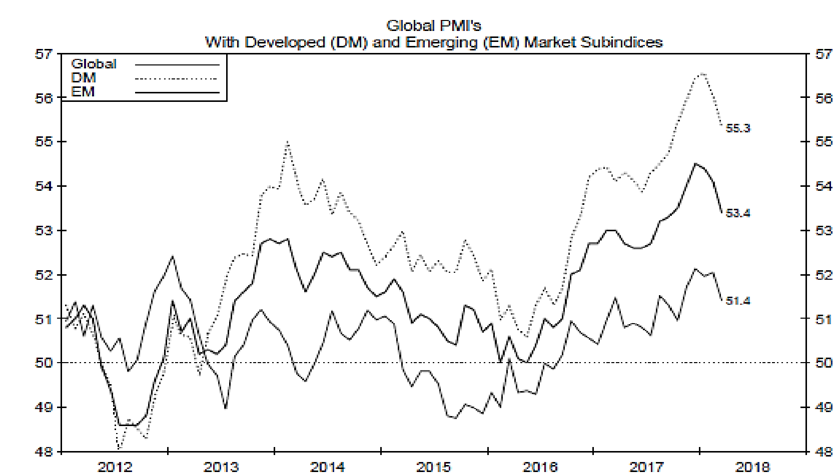
The recent passing of Stephen Hawking was marked by an algorithm in his obituary that captured his immense knowledge of astrophysics and inspired the title of this quarterly commentary. The algorithm above is central to how Manitou derives “expected risk-adjusted returns” for each of our investee companies. With this calculation we are able to make a fair comparison of the relative attractiveness of each eligible investment within our diverse universe of investable companies. In an effort to fully explain our research and ranking methodology we will return to a more complete explanation of this algorithm later.

Capital markets

While complacency and tranquility characterized 2017, volatility was everywhere in the first quarter of 2018. The value of currencies, commodities and equity markets saw wide swings on an intraday basis, and for the quarter the S&P/TSX Composite declined 4.6%, the Dow Jones declined 2.5%, the Stoxx Europe 600 declined 4.7% and the Nikkei 225 declined 5.8%, all in local currencies according to the Wall Street Journal. Subsequent to the quarter end, volatility has continued as the very real threat of a trade war escalates. In addition, bond returns were mildly negative as the Federal Reserve followed through with a widely expected increase in administered rates.

Macro-Economic Outlook

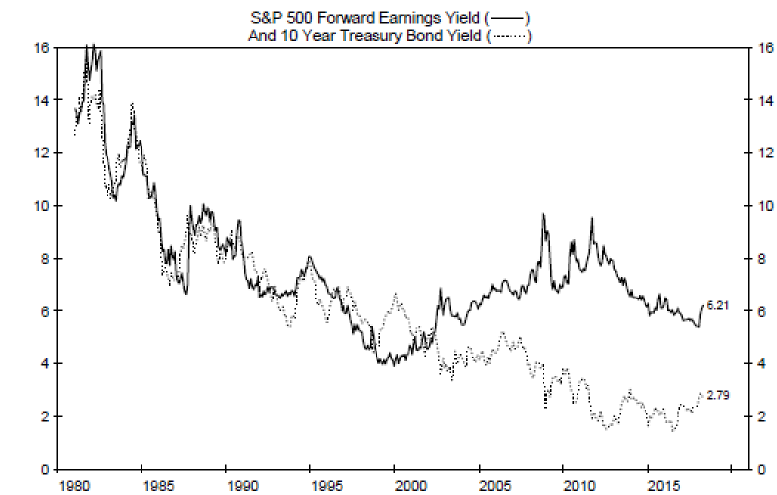
Volatility returned to all equity markets during the first quarter and index returns everywhere were negative for the first time in over two years. It is most important to recognize that overall equity prices are driven by two distinct forces, namely fundamental value and sentiment. The former can be derived by careful analysis, and in the Trumpian era, the latter is being regularly jolted back and forth by tweets and utterances at campaign style rallies. Markets do not like uncertainty. Nor do they appreciate deliberate attempts to manage the world’s largest economy and its relationships with both friend and foe by chaos theory; all of which exacerbate an already delicate balance between continued global growth and stagflation.



Courtesy of TD Securities - March 2018

It is evident from the Purchasing Manager's Indices in the chart above, that business continues to grow in both developed and emerging markets. Combined with healthy business confidence this might suggest more of the same going into 2018. The wild card, which is impossible to analyze, is the likely imposition of import tariffs by both the US and China, as well as other smaller reactions by American allies. Our conclusion, confirmed by a recent Bloomberg poll, is that growth will continue at about 2.5% per annum for the developed countries and about 5.4% in emerging economies. This is quite a remarkable achievement.

There has been an enormous word count directed at determining whether the equity market is cheap, expensive or fairly valued. A simplistic determination of this question is to compare an owner's share of corporate earnings to the 10-year Treasury bond alternative. The chart to the right, demonstrates that the market as a whole, based on estimated 2018 earnings, still provides an adequate "risk premium" in relation to conventional fixed income alternatives.



Courtesy of TD Securities - April 2018

Conflicting dynamics are at play in this broad brush commentary. The first is the real risk that government policies will upset the earnings momentum set in place by lower taxes and the repatriation of offshore funds. This is a distinctly negative scenario. The second is the prospect of significant earnings increases, anticipated to be announced beginning in mid-April. It is interesting to note that according to FactSet, analysts' estimates of first quarter earnings have steadily increased for the first the time in many years. We conclude, there are segments of the market (read high tech) that have inflated valuations and are now regressing to more normal levels. Further, there are other sectors that more realistically reflect their underlying positive fundamentals.

Manitou Methodology

At the core of Manitou is the belief, supported by empirical evidence, that carefully selected equities, combined in diversified concentrated portfolios can provide added return (alpha). In order to construct such portfolios, it is essential to have a ranking system that compares "expected risk-adjusted returns" amongst a diverse range of potential investee companies. The algorithm that heads this quarter's report is not intended to make securities analysts of our clients, but rather to inform them by breaking down the algorithm into its component parts.

Analyst's Intrinsic Value: After performing a deep dive into the workings of each investee company, focusing on factors such as key performance indicators, quality of management, sustainability of competitive advantage, record of profitability, and potential growth opportunities, we build financial models for each company. These models incorporate our projections of the future free cash flows of the business discounted back to the present based on historical data and sound assumptions. From this work we establish an *estimated* intrinsic value. This estimate is regularly updated, but unlike the company's stock price, does not tend to materially vary in the short-term.

Margin of Safety: A margin of safety is assigned to each investable idea as a cushion against variances in our calculation of intrinsic value. The more stable the industry and higher the quality of the business, the more predictable the cash flow stream. Accordingly, we assign a lower discount when we have higher confidence (and therefore higher probability) of reaching our intrinsic value. This is expressed in percentage terms and factored into the equation.

Discount Rate: We use a 3-year discount rate of 9.5%, which is the rate at which we 'discount back' a company's future cash flows. The lower the discount rate used, the higher the expected return (for example, using an 8.0% discount rate will result in a higher stock price than a 9.5% rate). In theory, a stock trading at its intrinsic value will generate an expected return of 9.5%. As an added layer of conservatism, we desire a stock price trading 'at least' 15% below our estimate of its intrinsic value in order to hold a full position.

Current Price: Only after extensive research has been done and an estimated intrinsic value has been determined do we give serious consideration to the current market price of the potential investee company. With our intrinsic value in hand, we assess the current price of the stock in relation to its historical market multiples (examples of which are price-to-earnings, price-to-book, debt-to-equity, etc.) as well as those of its key comparators.

After performing this valuation exercise on a company by company basis, we rank each stock in our investable universe against each other. This list becomes our Master Control Sheet, which is our method of dispassionately ranking our best risk-adjusted return opportunities. Each of our investment mandates are subject to a pre-set series of protocols (such as diversification by industry, limits on individual company weightings, etc.). By allocating capital to our best ideas while abiding by our risk protocols, we form the framework for each mandate. All final decisions are a function of our collective judgment. We find this process fundamental to constructing sensibly diversified portfolios, with attractive potential upside return while also preserving capital on the downside.

Manitou Mandates

For Q1 2018, all Manitou Mandates achieved satisfactory relative results in spite of extremely volatile markets. This was principally due to stock selection and cash weightings. Manitou Global Equity (formerly known as Manitou Equity) returned (+0.31%), Manitou Equity (formerly known as Dividend Growth) (-1.24%), Canadian Equity (-3.06%), US Equity (+1.10%) in Canadian dollar terms, which is (-1.63%) in US dollar terms and Focus 5+ (-0.43%). All mandates with the exception of US Equity outperformed their respective relative (index) benchmarks.

The principal contributors to this quarter's returns in Manitou Global Equity were Edwards Lifesciences Corporation (+27.23%), Shopify Inc. (+26.13%), MasterCard Incorporated (+19.10%), Airbus SE, ADR (+18.97%) and Constellation Software Inc. (+14.88%).

Edwards achieved good full-year results with positive comments made regarding mass adoption of its TAVR cardio vascular product.

Shopify's stock price increased during the year on continued sales increases and higher penetration of its software platform.

MasterCard's share price increased on the back of strong full year results, continued consumer spending and momentum in online payment and IT penetration.

Airbus outperformed due to a longer order book which is the result of the industry's replacement cycle. In addition, disruptions regarding parts were unwound, which positively impacted the stock price as well.

Constellation Software announced continued strong results as well as the acquisition of Acceo for $250 million CDN. Acceo specializes in the design and implementation of management software, e-business and payment services. The purchase was the second largest in the firm's history. Several smaller acquisitions were also announced during the quarter.

The detractors affecting the Manitou Global Equity mandate were Uni-Select Inc. (-29.33%), Dentsply-Sirona Inc. (-21.33%), Alimentation Couche-Tard Inc. (-11.91%), Wells Fargo and Company (-10.76%) and Canadian Natural Resources Limited (-9.05%).

Uni-Select recently announced full-year results that were not as robust as expected due to continued issues with its Finish Master division in the US.

Dentsply-Sirona announced disappointing results due to the slow integration of Sirona; a company it merged with in 2016. The combined entity has subsequently made several key management changes designed to accelerate the integration.

Couche-Tard's results were negatively impacted by one-time issues pertaining to weather patterns and a volatile fuel price in the US.

Wells Fargo continues to suffer from the fallout surrounding the investigation of its activities in opening spurious customer accounts. To date, significant corrective actions, including the replacement of the CEO and other senior officers, as well as the forfeiture of current and long-term incentives, have taken place. Manitou believes the market reaction is overdone.

Finally, CNQ announced lower than expected returns due to fluctuations in oil prices throughout the quarter.

We continue to hold all names in various mandates.

Manitou Equity (North America) achieved similar results to Manitou Global Equity. In addition to MasterCard Incorporated, Airbus SE ADR and Constellation Software Inc., Manitou Equity's top performers also included CME Group Inc. and Microsoft Corporation.

CME achieved good results due in part to an increasing interest rate environment and heightened trading activity.

Microsoft also achieved good results due to ongoing sales of its Office 365 software, improvements in its LinkedIn social media site and continued growth in the Azure cloud platform. This last segment is growing market share through increased spending on AI capabilities, core infrastructure services and distribution channels. These investments are anticipated to lead to long-term growth.

The detractors in Manitou Equity (North America) were the same as those in Manitou Global Equity.

The Manitou Income Fund outperformed the index by utilizing its basket clause that allows up to 10% exposure to unrated or less than investment grade securities. These included Constellation Debentures (that are now rated) and Easylegal financial debentures. We are comfortable with both of these credits, which contributed nicely to our outperformance over the quarter.

Additions to the Manitou International Equity Fund during Q1, 2018 included Vopak and Jardine Strategic.

Vopak (Netherlands) Vopak is a Dutch independent tank storage company founded in 1616. The company is a global leader with terminals across 25 countries offering 36 million cubic meters of outsourced storage infrastructure to companies in the oil, gas and chemical industries. It was a first mover in critical trading, refining and production hubs such as Rotterdam and Singapore where its terminals are integrated directly into customer facilities via pipeline. Competitive advantages include the superior location of existing terminals, economies of scale and its reputation for quality operations. Vopak's experienced management team, balance sheet strength and its exposure to growth regions such as Asia, position the company favourably going forward.

Jardine Strategic (Hong Kong) Jardine Strategic was founded in 1832 as a trading company in China and has evolved over time to become a diversified business group. The company describes these activities as comprising "a combination of cash generating activities and long-term property assets". The conglomerate takes strategic interests in various multi-national companies and sectors including retail, auto sales and distribution, hotel development and management, property development, insurance brokerage, engineering, construction, transport, IT, mining, agriculture, etc. The common thread amongst them all is that they are largely geared toward Asia and are well-positioned to benefit from rising standards of living that will result in increasing consumption of goods and services. The company was floated as a public company in 1961.

Conclusions

1. Market volatility will continue, driven in part by Trumpian eruptions and a genuine concern about a looming trade war on the one hand and the announcement of very good earnings on the other. Volatility offers the opportunity to acquire ownership positions in top quality companies at reasonable prices. We will be alert to these opportunities.

2. With the Federal Reserve and to a lesser extent the European Central Bank, pulling back on bond purchases and moving steadily to higher administered rates, the general investment environment has shifted from expansionary to mildly contractionary. Interest rates inevitably will increase to more normal levels.

3. The massive flow of funds into index-related vehicles has tended to move stocks either up or down in a highly correlated manner. The opportunity to generate added returns using more narrowly constructed portfolios has seldom been better.