



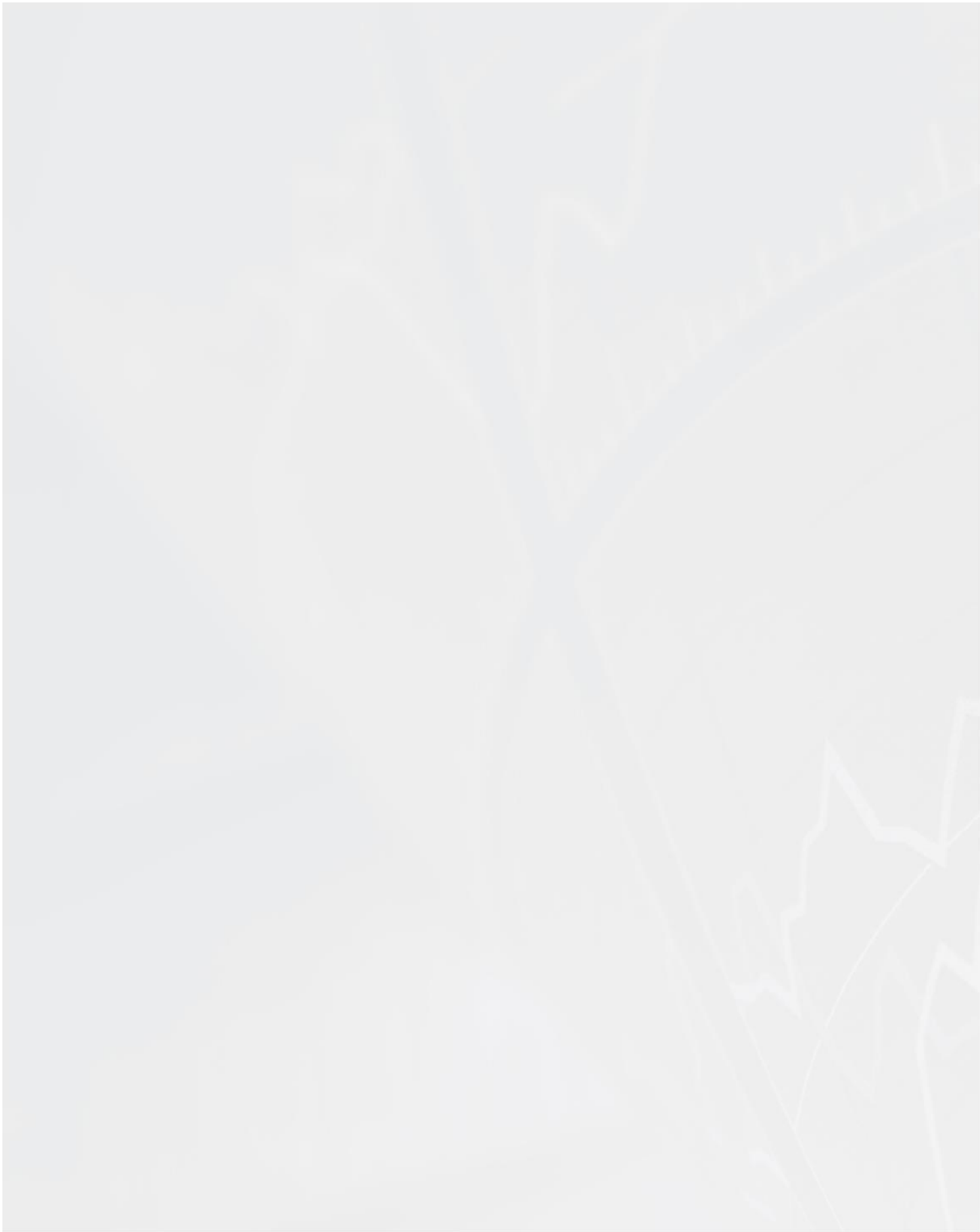
**N O R T H**  
GROWTH MANAGEMENT LTD.

**DECEMBER 2016**

**Month and Year in Review  
Outlook for 2017**

January 16, 2017





# Fund Performance Update

## U.S. Equity Fund

2016 was a challenging year for active managers of U.S. equities. Amid much volatility, general market unease prevailed as continual worries over global economic growth, the cantankerous tone of the U.S. presidential campaign, and last but not least the shocking, unexpected events of Brexit on June 23<sup>rd</sup> and the victory of President-elect Donald Trump on November 8<sup>th</sup> contributed to a high degree of uncertainty for investors. Despite a rough beginning to the year—the S&P 500 Index fell 10% during the first six weeks to February 11<sup>th</sup>—U.S. equity indices ended 2016 at record highs, aided by a post-election rally in the final two months.

The S&P 500 Index gained 2.0% in December, while the S&P 400 MidCap and S&P 600 SmallCap were up 2.2% and 3.4% respectively. The NASDAQ Composite advanced the least with its return of 1.2% for the month. During December, the North Growth U.S. Equity Fund appreciated 1.9%, performing relatively in-line with the broad S&P 500 and above the NASDAQ while falling behind the smaller capitalization indices.

For the majority of the year, up until the end of September, the North Growth U.S. Equity Fund maintained relative outperformance against the S&P 500. However, the Fund's laggard returns during October and November ultimately resulted in its underperformance versus the major indices we track for the year.

In 2016, the North Growth U.S. Equity Fund gained 7.0% whereas the S&P 500 was up 12.0%. The smaller cap indices, the S&P 400 MidCap and S&P 600 SmallCap, delivered strong annual returns of 20.7% and 26.6% respectively, while the NASDAQ Composite appreciated 9.0%. After three years of significant weakness against the U.S. dollar, the Canadian currency strengthened over 3% last

year; the Fund's annual return in Canadian dollars was 3.8% versus the S&P 500 which rose 8.6% in Canadian dollars in 2016.

Entering its eighth year of moderate expansion, the U.S. economy is in solid form and is poised to continue its growth trajectory. Yet with stock valuations pushing the upper end of historical averages and the additional uncertainty and risks of Donald Trump's incoming presidency, we expect increased market volatility in 2017. Our outlook for U.S. equities in the new year is tilted toward caution.

## Canadian Equity Fund

During December, the North Growth Canadian Equity Fund declined 0.9% whereas the S&P/TSX Composite Index gained 1.7%.

In 2016, Canadian equities rallied the most out of all developed world stock markets. Advancing 21.1% on a total return basis, the S&P/TSX Composite Index ended the year just shy of its record reached in September 2014. The Canadian market was propelled predominantly by materials stocks and energy shares which gained 41% and 35% respectively in 2016. Financials, namely the big banks, also performed well with an annual total return of 24%.

Having no exposure to the heavily-weighted financial and commodity sectors of the market, the North Growth Canadian Equity Fund underperformed the S&P/TSX significantly. The Fund gained 3.1% for the year.

Although the performance of the Canadian Fund has struggled in the most recent couple of years, 2015 and 2016, the Fund dramatically outperformed the S&P/TSX in the preceding two years. Over the past four years for which we have published returns since filing a prospectus on June 15, 2012, the Canadian

Fund's annualized gain of 11.8% compares favourably against the S&P/TSX Composite's annualized return of 8.5%. We continue to believe the Canadian Fund provides interesting diversification from mainstream Canadian equity portfolios.

### **Economic Commentary**

The ongoing gradual U.S. economic expansion that is currently beginning its eighth year continues to be the most positive story in the global macro picture. Based on the final estimates released by the U.S. Department of Commerce, U.S. gross domestic product or GDP grew at an annualized rate of 1.1% in the first quarter of 2016, 1.4% in the second quarter, and 3.5% in the third quarter. In a pattern consistent over past years, U.S. GDP growth was weaker during the first three months of 2016 and accelerated thereafter. Last year, researchers at the Federal Reserve Bank of San Francisco found that a "statistical quirk" likely explained why from 2000 to 2015 first-quarter GDP averaged 2.3% lower than the remaining quarters.

The Commerce Department's preliminary estimate of fourth quarter GDP will be announced on January 27, 2017. According to Bloomberg data, most economists forecast a deceleration in the rate of growth from the better-than-expected pace of the third quarter; nonetheless, with the average estimate for fourth quarter GDP to rise 2.2%, there is clearly no change to the view that the U.S. economy remains in a sustained, durable, moderate expansion.

On balance, the economic fundamentals of the United States continue to be positive. Most importantly, in 2016 the labour market strengthened further and was again the bright spot in the overall macroeconomic backdrop. The unemployment rate ended the year at 4.7%, a nine-year low, while the addition of jobs each month throughout the year continued to extend the longest streak of growth on record. Over 2016, average hourly earnings rose by 2.9%

and signs of wage gains solidified toward the end of the year.

The healthy employment situation buoyed U.S. consumer spending and boosted consumer net worth which has been on a steep climb since 2009. The U.S. housing market remained solid during 2016 while motor vehicle sales reached a new record high on top of the previous record set in 2015, demonstrating the strength of the consumer amid ongoing improving financial conditions.

### **Monetary Policy**

Given the continued strengthening in the labour market and pickup in economic growth throughout 2016, it was widely anticipated that the U.S. Federal Reserve would continue raising interest rates following its first hike in almost a decade in December 2015. However, due to concerns over global economic and financial developments during the year, along with political uncertainty and with inflation rather subdued, the Fed proceeded cautiously in raising rates. The pause in the interest rate hiking cycle during 2016 led to recurrent speculation by market participants on the trajectory of monetary policy.

Finally, following its December 13<sup>th</sup> – 14<sup>th</sup> meeting, the Fed raised the target range for the federal funds rate by  $\frac{1}{4}\%$  to  $\frac{1}{2}\%$  to  $\frac{3}{4}\%$ . In light of the fact that inflation, although on the rise, is still below the Fed's 2% longer-run objective, the Federal Open Market Committee (FOMC) reiterated its expectation of "gradual increases in the federal funds rate" in its recent December 14<sup>th</sup> statement.

Monetary conditions in the U.S. and around the globe remain accommodative. We continue to view the gradual removal of monetary stimulus by the Fed as confirmation the U.S. economy is in solid shape.

## U.S. Companies and Stocks

In 2016, while reported U.S. corporate earnings mostly exceeded analysts' expectations every quarter, earnings for the S&P 500 companies declined during the first half of the year. The drop in profits for the S&P 500 Index during the first and second quarters of 2016 was led by the energy, materials and financials sectors. According to FactSet, full-year 2016 earnings for the S&P 500 are projected to grow a mere 0.2% on revenue growth of 2.2% after a rebound in earnings growth during the latter half of the year.

With regards to the North Growth U.S. Equity Fund, we were pleased with the results of virtually all the companies in the portfolio throughout 2016. Profits for the Fund's holdings on a weighted-average basis grew 13.7% year-over-year (excluding the anomalous 318% gain in the earnings of First Solar) in the first quarter, 12.0% year-over-year in the second quarter, and 15.4% over a year ago in the third quarter of 2016. The U.S. Fund's companies consistently delivered earnings above expectations every quarter, and clearly, the profit growth rate for the Fund compared much favourably to that of the S&P 500 Index. For the final quarter of 2016, we expect that the Fund's track record of beating analysts' estimates and reporting solid earnings growth will continue.

By and large, corporate fundamentals remain strong. U.S. companies continue to generate healthy levels of cash flow and maintain strong balance sheets; corporate cash reached a record high of \$2.1 trillion in the third quarter of last year. With the exception of energy and commodity-related companies, many U.S. corporations continue to report record-high, growing earnings while increasing their

dividend payouts and share repurchases. Such companies comprise the U.S. Fund.

## Outlook for 2017

Heading into 2017 with a continued favourable macroeconomic backdrop and generally solid company fundamentals, U.S. equities are trading near the high end of their historical valuations. At a forward 12-month price/earnings (P/E) ratio of 17.5, the current valuation of the S&P 500 Index is above its 5-year average multiple of 15.1, 10-year average multiple of 14.4 and its average multiple since 1937 of around 15.

The North Growth U.S. Equity Fund is currently trading at a below-market multiple of 15.2 times forward 12-month earnings with a superior profit growth profile.

Nevertheless, the U.S. stock market overall offers fewer opportunities of high caliber companies with attractive growth prospects trading at compelling valuations. Coupled with more fairly-priced stock valuations, equities face additional uncertainty in the coming year with the advent of Trump's presidency. We believe there are serious risks to the U.S. economy from the president-elect's various proposals and policy positions; our views were highlighted in the previous October and November monthly reports. Certainly, we anticipate increased volatility in global financial markets in 2017.

Accordingly, we enter the new year with a more tempered outlook than in past recent years. We continue to believe stock selection is the key to outperformance, and will focus, as always, on the analysis of individual stocks that adhere to our long term "growth at a reasonable price" investment philosophy.

# Annual Performance Results

This data gives you insight into the typical annual variations in investment results. Annual results explain how long results come about and will reveal whether a record is dependent largely on earlier results, more recent results, or more ideally a balance of both. This data also shows that our outstanding long term results were not achieved by having stellar results in every single year. In equity investing, it should be noted that performance results will periodically fall below expected or desired

levels and this is why we emphasize these of longer term results in the evaluation of performance. Furthermore, a year or more of exceptionally strong performance should not give rise to unreasonably high long term expectations. A superior long term record does not mean every year was (or will be) exceptional but it does mean that despite some years of low returns we have delivered on our mandate to provide superior long term results.

## North Growth (NGM) Equity Funds and Market Indices Annual Rates of Return (%) for Calendar Years

U.S. Equities	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
<b>NGM U.S. Equity Fund \$CDN</b>	3.8	20.8	21.7	44.2	6.6	1.7	11.6	28.2	-26.7	-10.9	12.7
S&P 500 \$CDN	8.6	21.0	24.0	41.5	13.5	4.4	8.9	9.1	-22.6	-10.3	16.0
<b>NGM U.S. Equity Fund \$U.S.</b>	7.0	1.2	11.6	34.9	8.9	-0.5	17.9	48.5	-40.4	4.7	12.5
S&P 500 \$U.S.	12.0	1.4	13.7	32.4	16.0	2.1	15.1	26.5	-37.0	5.5	15.8
S&P 400 MidCap \$U.S.	20.7	-2.2	9.8	33.5	17.9	-1.7	26.6	37.4	-36.2	8.0	10.3
S&P 600 SmallCap \$U.S.	26.6	-2.0	5.8	41.3	16.3	1.0	26.3	25.6	-31.1	-0.3	15.1
NASDAQ Composite \$U.S.	9.0	7.1	14.8	40.2	17.7	-0.8	18.2	45.4	-40.0	10.7	10.4
Canadian Equities	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
<b>NGM CDN Equity Fund \$CDN</b>	3.1	-12.2	19.4	44.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A
S&P/TSX \$CDN	21.1	-8.4	10.6	13.0	7.2	-8.7	17.6	35.1	-33.0	9.8	17.3

Source: Bloomberg "Total Return Analysis"

# North Growth U.S. Equity Fund

## Short Term Rates of Return (%) for the Period Ended December 31, 2016

	1 Month	3 Months	6 Months	YTD
<b>NGM U.S. Equity Fund in \$CDN</b>	1.88	1.37	9.43	3.78
S&P 500 in \$CDN	1.96	6.28	12.08	8.62
<b>NGM U.S. Equity Fund \$U.S.</b>	1.89	-0.97	5.27	6.98
S&P 500 \$U.S.	1.98	3.82	7.82	11.96
S&P 400 MidCap \$U.S.	2.19	7.42	11.87	20.74
S&P 600 SmallCap \$U.S.	3.37	11.13	19.14	26.56
NASDAQ Composite \$U.S.	1.20	1.69	11.88	8.95

## Annualized Rates of Return (%) for the Period Ended December 31, 2016

	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	Since Inception
<b>NGM U.S. Equity Fund \$CDN</b>	3.78	15.10	18.56	8.32	8.49	11.02	12.67
S&P 500 \$CDN	8.62	17.67	21.21	8.47	5.49	7.57	9.78
<b>NGM U.S. Equity Fund \$U.S.</b>	6.98	6.50	12.16	6.80	9.73	11.13	12.32
S&P 500 \$U.S.	11.96	8.87	14.66	6.95	6.69	7.68	9.44
S&P 400 MidCap \$U.S.	20.74	9.04	15.33	9.16	9.73	11.29	12.28
S&P 600 SmallCap \$U.S.	26.56	9.47	16.62	9.03	10.17	10.30	11.78
NASDAQ Composite \$U.S.	8.95	10.24	17.17	9.59	8.14	8.34	9.67*

Source: Bloomberg "Total Return Analysis" as of Jan 3, 2017.

\*These returns are a simple price appreciation because total return data is not available on Bloomberg.

Unit Price: \$ 48.75 CDN  
\$ 35.17 USD

Total Assets in Fund \$ 486.9 Million CDN

# North Growth Canadian Equity Fund

## Short Term Rates of Return (%) for the Period Ended December 31, 2016

	1 Month	3 Months	6 Months	YTD
<b>NGM Canadian Equity Fund</b>	-0.92	2.97	7.31	3.09
S&P / TSX \$CDN	1.66	4.54	10.24	21.08

## Annualized Rates of Return (%) for the Period Ended December 31, 2016

	1 Year	2 Years	3 Years	4 Years	5 Years	Since Inception
<b>NGM Canadian Equity Fund</b>	3.09	-4.83	2.63	11.75	N/A	N/A
S&P / TSX \$CDN	21.08	5.33	7.06	8.52	N/A	N/A

*\*The Canadian Equity Fund became a reporting issuer on June 15, 2012. It is not permitted to publish performance data prior to the date it became a reporting issuer.*

Unit Price: \$ 17.01 CDN

Total Assets in Fund \$ 36.6 Million CDN



# North Growth Canadian Money Market Fund

## Annualized Rates of Return (%) for the Period Ended December 31, 2016

	*Current Yield	1 Year	3 Years	5 Years
<b>NGM Canadian Money Market Fund</b>	0.52	0.51	0.65	0.74
30 Day Treasury Bill	N/A	0.48	0.65	0.76

*\* The **Current Yield** for the Money Market Fund is the average of the annualized daily yield for the most recent seven day period. This measure is no longer available for the 30 day T-Bill Index.*

We take a very simple approach to managing the North Growth Canadian Money Market Fund. We invest in a portfolio of high quality short term bonds. The average maturity of the portfolio is most often less than 30 days. Historically the Fund has generated very competitive yields with this simple approach because the management fee is, and always has been, 0.25%. In today's low rate environment most other money market funds in Canada have cut their management fees and extended their maturities in order to improve yields, as a result the North Growth Canadian Money Market Fund's yields are now below the industry average.

We manage the portfolio to ensure high liquidity and have no intention to extend

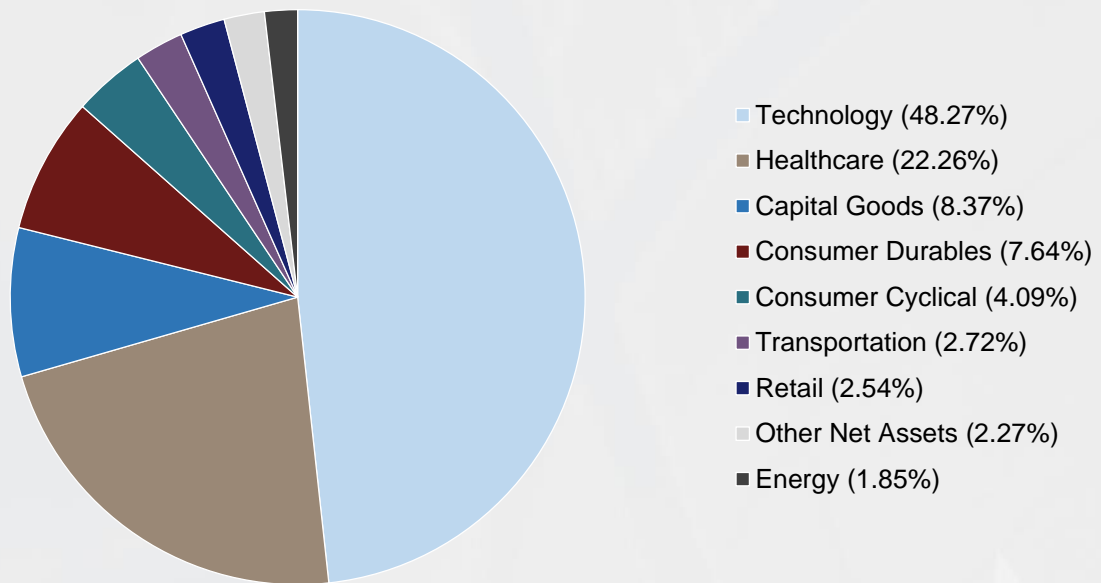
maturities in order to chase a few basis points and we do not have any room to reduce our management fees because we already take a loss on the product. We still believe our money market fund has superior liquidity characteristics due to its very low average maturity but our current yield is 0.52% which is lower than many other mainstream money market funds and even short term GICs at top tier Canadian banks.

The North Growth Canadian Money Market Fund's yield will quickly rise in response to any future increase in the Bank of Canada's overnight rate but its yield will not become competitive again unless other money market funds begin to increase their management fees back to their historic levels.



## U.S. Equity Fund – Sector Mix as at December 31, 2016

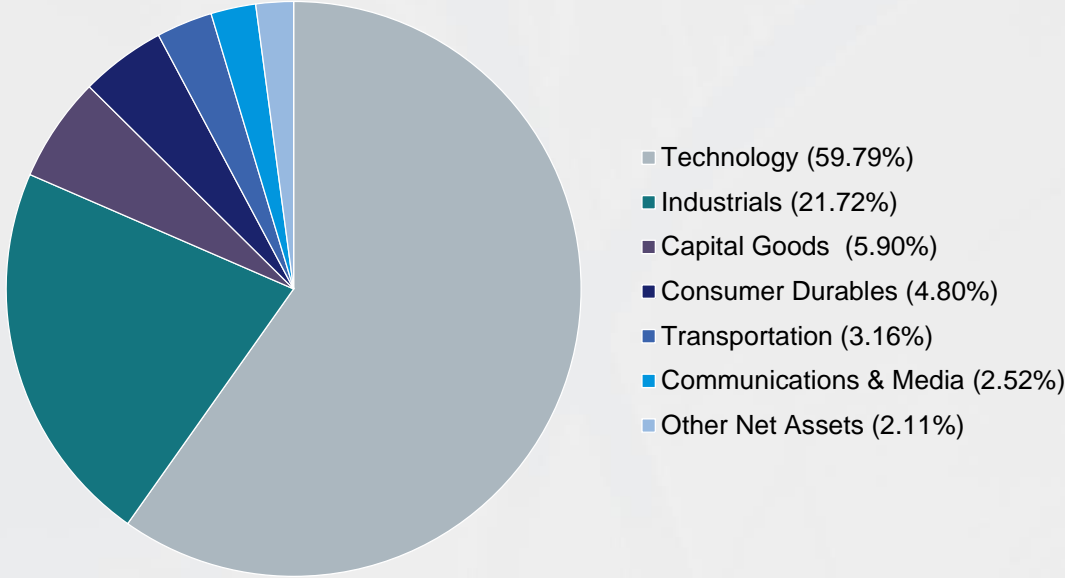
### Sector Mix





Canadian Equity Fund –Sector Mix at December 31, 2016

Sector Mix



# Investing With Us

## Investing With North Growth Management

North Growth Management is a focused firm. We are Canada's U.S. Equity Specialist. Our objective is consistent, superior, long term returns on our equity funds based on our "growth at a reasonable price" investment philosophy.

## Conducting Transactions

The cut-off time for same-day transactions is 3 p.m. Eastern Time or 12 p.m. (noon) Pacific Time. Orders received after that time will be processed on the next business day. Cheques must be made payable to RBC Investor Services Trust. For security reasons, instructions can only be accepted by mail or by fax to:

North Growth Management Ltd.  
Suite 830, One Bentall Centre  
505 Burrard Street, Box 56  
Vancouver, BC V7X 1M4

Fax: 604-688-5402

## Where to Find NGM Fund Prices

Please visit [www.northgrowth.com](http://www.northgrowth.com) to view the Fund's daily prices or to be added to our e-mail list to receive daily notification of the Fund's prices. Alternatively, the Globe & Mail reports prices on [www.globefund.com](http://www.globefund.com) at the following links:

North Growth U.S. Equity Fund

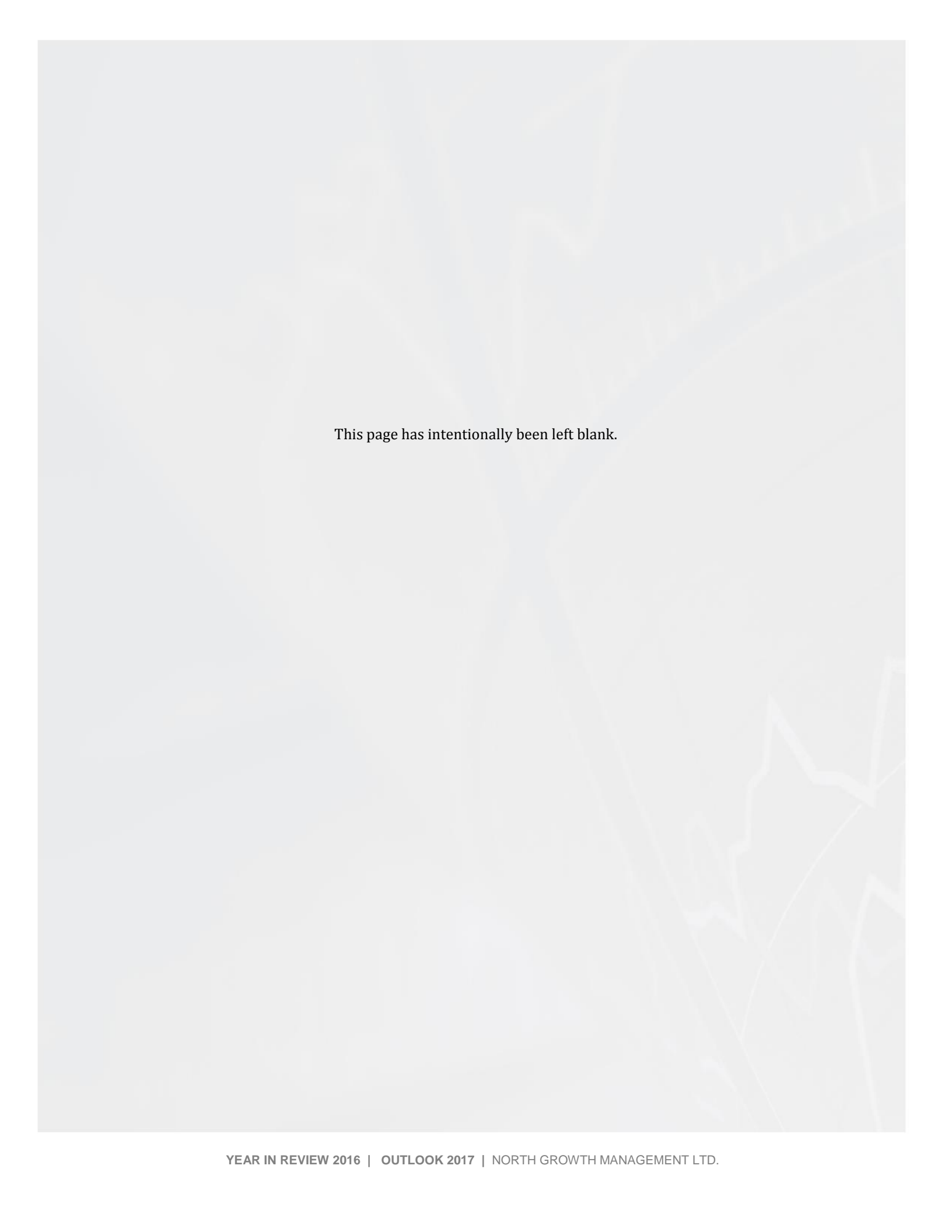
<http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/summary/?id=52033&cid=4008>

North Growth Canadian Equity Fund

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North Growth Canadian Money Market Fund

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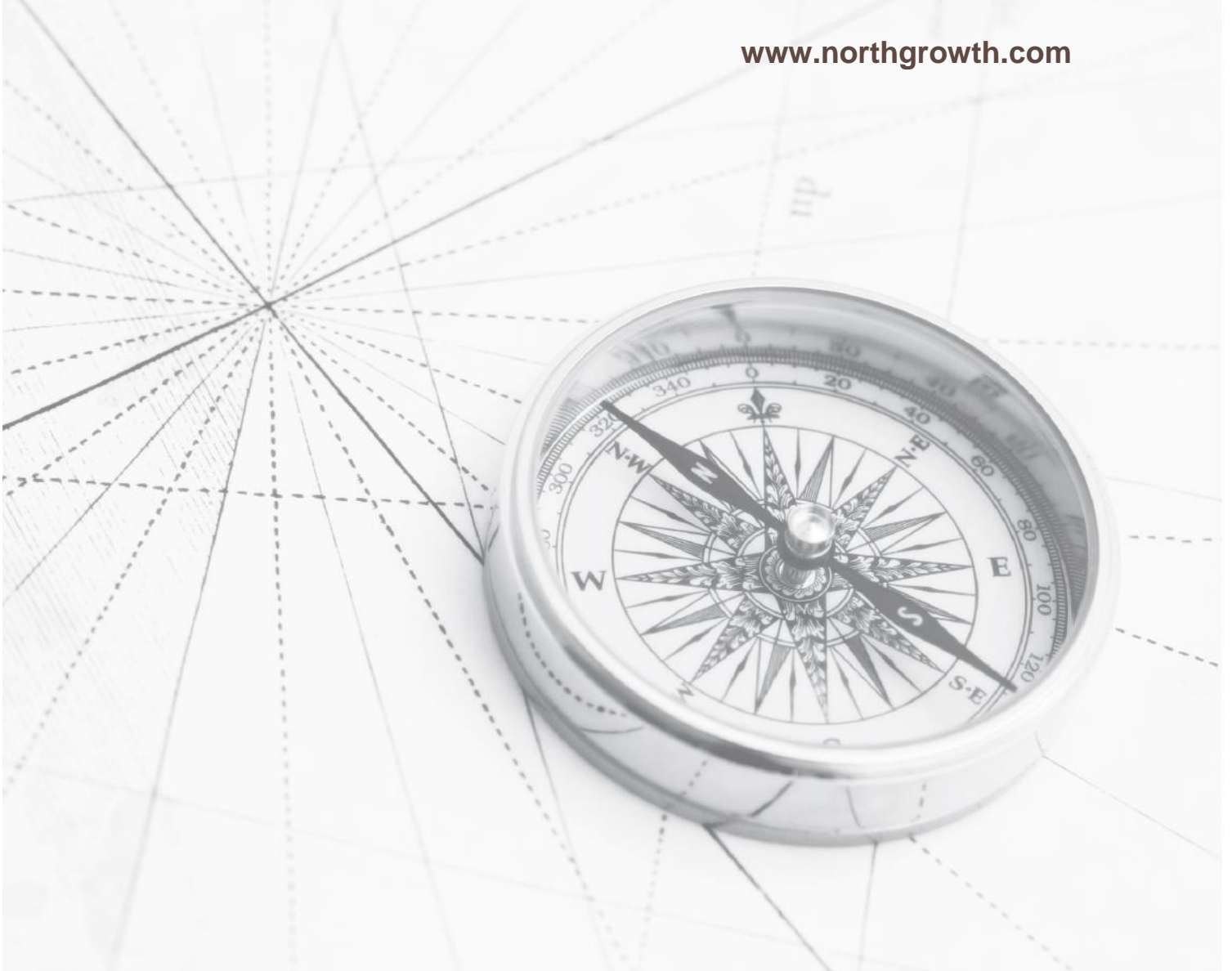
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