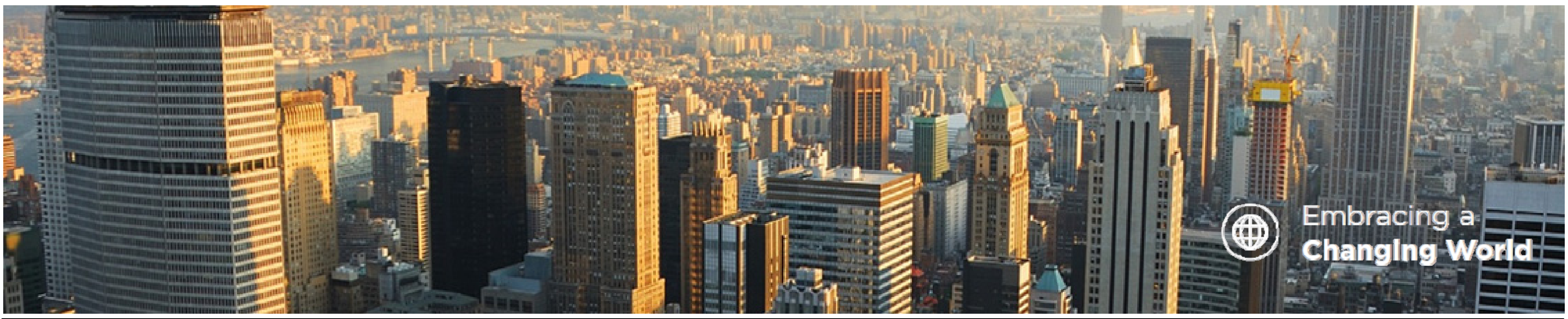
GENUS

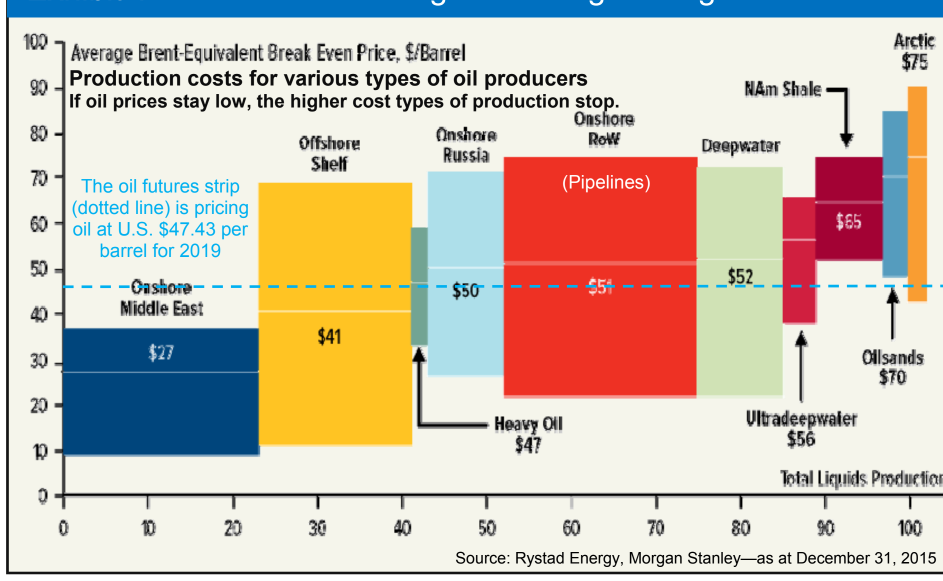


The Long Unwinding Road

The adjustments to the global economy and the challenges that financial markets faced in 2015 made for a rollercoaster of a year. The outlook for 2016 is for more of the same—but with a little less certainty if the first three weeks of the new year are any yardstick—primarily because of reaction related to the following issues:

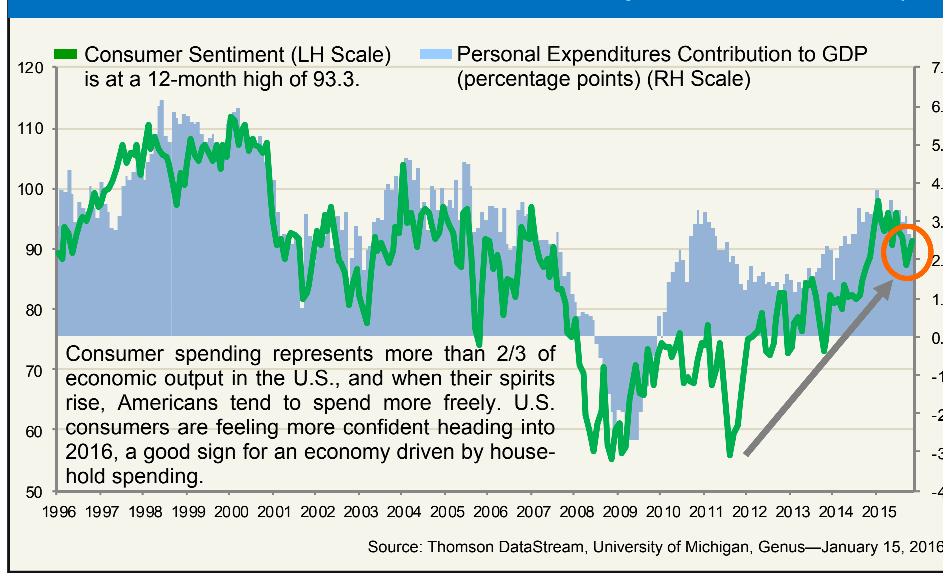
- The U.S. Federal Reserve starting the gradual unwinding of the stimulus it poured into the U.S. economy to counter the financial crisis, beginning with the long and slow process of raising short-term interest rates from zero, which will continue to support the stronger U.S. dollar.
- China grappling with the unwinding of its historic debt-fueled investment boom in a decelerating economy that is being buffeted by both stock and currency market gyrations, and policy zig-zags and blunders.
- The staggering collapse in the price of oil continuing to wreak havoc in the stock, currency and commodity markets while creating severe financial pressure for some producers and petro-states like Saudi Arabia and Russia.

Exhibit 1 Low Prices Forcing Unwinding Among Oil Producers



Source: Rystad Energy, Morgan Stanley—as at December 31, 2015

Exhibit 2 Confident Consumers a Good Sign for U.S. Economy



Source: Thomson DataStream, University of Michigan, Genus—January 15, 2016

As these three "great unwindings" continue to play out in 2016 they will no doubt bring adjustments to the global economy and financial markets. To be sure, the market's attitudes can change quickly from calm to fear on each of these issues. This is why it's important to keep in mind the large number of factors that are positives for the global economy and the financial markets:

First, central bankers and money supply remain very supportive of global growth and the markets. Second, despite the upheaval in its stock market, China continues to avoid a hard economic landing and its rate of economic growth (6.9%) is by far the strongest in the world. Third, the U.S. economy has a number of bright spots (employment & wages) and the Fed's 0.25% interest rate hike (from zero) in December reinforces the positive outlook for the U.S.

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So far, the Fed has done a great job to not spook the global markets by clearly communicating its intentions; China, not so much with its verbal-jujitsu, muddled policies and mixed signals. As far as oil is concerned, Saudi Arabia has confirmed its intention of remaining the world's lead crude oil producer by not cutting production to shore up prices – a move largely aimed at annihilating U.S. shale oil producers that emerged with the advancement of fracking technology. The sell-off in oil has slashed by two thirds (1,028) the number of drilling rigs in the U.S. from a year ago. Those that are left are driving down costs to survive rock-bottom prices and hang on, albeit by their finger-nails. The Saudis are also wary of cutting production for fear other OPEC members will not follow their lead and simply increase production to fill the gap, especially as the cartel braces for the return of Iranian oil to the market after the lifting of Western sanctions. Another reason behind Saudi Arabia's decision to ramp up production and also put its oil industry (Aramco) on sale is the threat to its 266 billion barrels of in-the-ground reserves posed by renewable energy sources prompted by climate change concerns. These reserves could be left "stranded" (unburnable) which is why the Saudis want to monetize the oil in the ground while they still have customers for it. Against this backdrop, the outlook for oil prices in 2016 remains quite bleak. Some analysts believe that prices as low as U.S.$20/bbl might be necessary to push enough higher-cost production out of business and allow a rebalancing of the market (Exhibit 1). Some predictions are for prices to fall to between $25 and $10/bbl in 2016 before a recovery takes hold in 2017. Current U.S. oil futures contracts assume a price of U.S.$47.43/bbl in 2019.

The Fed Awakens

The first U.S. rate increase since the financial crisis (zero to 0.25%) was probably the least surprising rate hike in living memory and only the first step in a long and cautious return to normalcy. The Fed has been careful to emphasize that future increases will be gradual and dependent on economic data. Rate rises, however, are not the only hot issue on the Fed's agenda. Behind the scenes, a second debate is under way about how the Fed will unwind the mountain of debt it has accumulated since 2008—without upsetting the bond markets or steam-rolling the U.S. economic recovery in the process. Until the onset of the 2008 financial crisis, assets on the Fed's balance sheet totalled about $1-trillion, mostly in the form of government bonds. The balance sheet has since ballooned to more than $4.5-trillion as a result of the Fed's Quantitative Easing programs. The Fed has indicated that it plans to shrink that to a more normal size within a decade. How it plans to go about this is still up for debate. Almost all estimates suggest that QE (printing money to inject it into the economy) works in boosting both economic growth and inflation. But if QE works on the way in, what happens on the way out, when central banks stop buying bonds, and instead start selling down their holdings? Fed Chair Janet Yellen has acknowledged that the phasing out and unwinding of QE is "uncharted territory" for the Fed and can pose potential threats to the stability of the financial system and the economy. There are, however, positive indications that the Fed will take the necessary steps to ensure an optimal outcome. They include the fact that Ms. Yellen is a strong proponent of using Forward Guidance to maintain well-anchored public expectations about what the Fed intends to do, what conditions will cause it to stay the course and what will cause it to change its approach.

China's Acrobatics

Chinese authorities on the other hand have made quite a hash of the past six months in terms of muddled market policies and sending signals. They have appeared to backtrack on pledges to make the management of the Chinese currency (yuan) more market driven; and created uncertainty over their willingness to remove stock price supports imposed during a $5 trillion sell-off last summer.

Amid the confusion, the benchmark CSI 300 Index, down 14% in the first two weeks of 2016, has revisited the lows of last year's rout and pressure on the Chinese currency continues. These policy zig-zags have created confusion over just how wedded China is to financial sector reform and to shifting its $10 trillion-plus economy from one powered by exports and investment to one more focused on consumption and services.

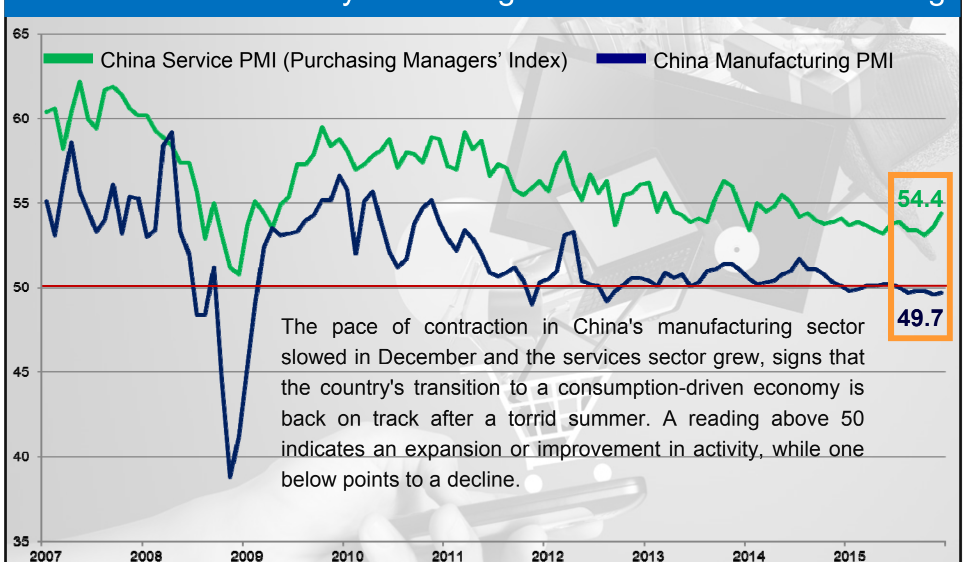
There's also been no real progress in chipping away at China's towering debt burden, super-charged by spending on housing and infrastructure in the wake of the 2008 financial crisis. /Page 2▶

►**From Page 1:** This spending was the driver of average economic growth of 10% over the past 30 years. Government, corporate, and household debt totaled $28 trillion in mid-2014, or about 282% of China's GDP. The reliance on credit-fueled growth has produced one of the biggest debt expansions in history, and today's hangover. Officials now face the high-wire act of trying to keep the economy growing rapidly enough to repay past obligations, without resorting to a fresh pick-up in debt to fund more stimulus. In 2015 the overall economy grew 6.9%, its slowest since 1990. While weak foreign demand is weighing on China's manufacturing sector, the rest of the economy appears to be holding up reasonably well (Exhibit 3) with evidence indicating consumers are spending, house prices are steadying and export demand is recovering, albeit it slowly.

Insulated From China

The U.S. economy has proved to be fairly insulated from China so far, and some industries that operate in China, such as fast food and retail, are expected to remain so as consumer demand there picks up. In looking at the geography of U.S. exports, it is evident why the U.S., which may have triggered 2008, has not suffered as much as other countries: U.S. exports are only 13.5% of GDP and only about 8.0% is attributed to countries outside of Canada and Mexico. Only 0.5% of GDP consists of exports to China. Limited exposure to China is also why Japan, as economically hard-pressed as it may be, has not destabilized. Only 16% of Japan's GDP is attributable to exports. Of that, 3.0% goes to China. Against this backdrop, the outlook for the continuation of relatively slow but steady economic growth in the U.S., Japan and the Eurozone remains intact, even as the latter two continue their painfully slow emergence from long periods of financial crisis and economic stagnation. On the other hand, countries that thrived on China's decade-long insatiable demand for natural resources (Brazil, Peru, Venezuela, Russia, Saudi Arabia) are being hardest hit by the end of China's investment boom. Included among them are Australia, which is facing fears of recession, and Canada, which has seen its oil and commodities exports decline dramatically, along with its near-term economic growth prospects.

Exhibit 3 China Slowly Unwinding its Reliance on Manufacturing



Source: Thomson DataStream, Genus—December 31, 2015

Under Pressure

China's economic deceleration will apply a handbrake to growth in Asia, pushing other central banks to enact looser monetary policies with interest rate cuts expected in China, South Korea, Thailand, Turkey, Indonesia, and possibly India. Any significant under-shooting of China's 6.5% growth target for 2016 will put additional pressure on the global economy, as well as oil and commodity prices, and the currencies of China and the emerging markets.

Deteriorating conditions in the emerging markets, coupled with the anticipation of an increase in U.S. interest rates and the strengthening U.S. economy, has caused the U.S. dollar to appreciate in recent months. This has led investors and "yield tourists" to pull an estimated U.S. $540 billion out of the emerging markets and back toward the U.S. in anticipation of higher returns. This is the first outflow of capital from these economies since 1988 and most of that was from China where some estimates put the outflow at $1 trillion. China has to date sold around $500 billion in foreign exchange reserves to counter the flows and control the pace of the yuan's depreciation.

Since mid-2014, the U.S. dollar index is up by nearly 30%. The greenback's safe-haven status in a world of renewed geopolitical tensions and the economic weakness spreading from China explains some of this appreciation. The rest can be explained by what might be the financial 'Word of the Year' in 2016: Divergence. Interest rates are not only likely to rise in the U.S. during 2016, drawing in more capital, but for the Eurozone, Japan, China and the emerging markets, lower rates and more monetary stimulus, rather than less, is likely.

Looking Ahead

We continue to hold a constructive view on global economic growth, which is being bolstered by low inflation and supportive central bank monetary policies in most regions. From an asset mix perspective, equities are almost at benchmark weight (65%) in our Balanced portfolios. Overall, we still favour equities versus bonds in our Balanced portfolios (see table, right) with a strong focus on market segments that offer good value and potential downside protection should a difficult environment unfold. We are maintaining our reduced exposure to Canadian stocks (energy, oil and metal) and emerging market equities because of their weaker prospects at this time. This may change when prospects improve. Our allocation to fixed income continues to favour shorter-term investment grade corporate issues and select commercial mortgages. Our bond portfolios are structured to pare bond (interest rate) risk by remaining anchored in shorter and intermediate durations, where the impact of rising interest rates is limited. □

Genus Pooled Fund Performance

Returns are shown Gross of Fees

As at December 31, 2015	Compound Annual Returns				
	3 months	1 year	3 years	5 years	10 years
BALANCED FUND	2.5	5.5	10.4	7.7	4.9
EQUITIES					
Canadian Alpha[1]	-2.2	-7.1	4.6	1.3	3.1
Dividend Equity	3.8	8.2	15.1	11.0	
Global Alpha[2]	7.3	11.4	20.7	16.0	6.7
CanGlobe Equity	3.7	7.2	15.3	9.1	
Emerging Markets	6.9	4.7	4.4		
FIXED INCOME					
Government Bond	1.2	3.7			
Short-Term Corporate Bond	0.5	2.6	2.8	3.2	3.9
Strategic Bond	0.5	3.6	4.6	6.1	
Commercial Mortgage	0.5	3.0	3.8		
FOSSIL FREE					
Fossil Free Dividend Equity[3]	5.1	11.0			
Fossil Free CanGlobe Equity [4]	6.8	11.4			
Fossil Free Corporate Bond	0.6	3.9			
Fossil Free Impact Equity	10.7	25.1			
INDEX RETURNS	3 months	1 year	3 years	5 years	10 years
S&P/TSX Composite	-1.4	-8.3	4.6	2.3	4.4
S&P 500 Index (C$)	10.9	21.6	28.6	20.4	9.2
MSCI Emerging Mkt (C$)	4.4	2.4	4.6	2.1	5.8
MSCI World Index (C$)	9.4	19.5	23.2	15.7	7.4
DEX Universe Bond Index	1.0	3.5	3.6	4.8	5.0

Past performance is no guarantee of future results.

1 **Mandate change:** Genus U.S. Equity mandate changed to Global Equity (Sept 14, 2012) and Global Alpha (June 30, 2014).
2 **Mandate change:** Genus Canadian Equity changed to Canadian Alpha on June 30, 2014.
3 **Mandate change:** Biosphere Canadian Equity (100%TSX) changed to Biosphere Dividend Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE) as at April 1, 2013. Name change to Fossil Free Dividend Equity on March 31, 2015.
4 **Mandate change:** Biosphere Global Equity (50% S&P 500 / 50% MSCI EAFE) changed to Biosphere CanGlobe Equity (40% TSX, 30% S&P 500, 30% MSCI EAFE). Name change to Fossil Free CanGlobe Equity on March 31, 2015.

A rollercoaster year for global equities in 2015

Global equities delivered positive returns for the fourth quarter to post a gain of 5.6% in U.S. dollar terms. For the year, however, global equities as measured by the MSCI World Index returned -0.32% in U.S. dollar terms. Much of the blame for 2015's under-whelming performance can be laid at the feet of crude oil prices, which lost a third of their value and weighed heavily on the global Energy sector. Government bond markets reflected the policy trajectories of the world's major central banks.

In the U.S., the S&P 500 index recorded a total return of 7.0% over the quarter in U.S. dollar terms (10.4% CAD) to eke out a small gain of 1.4% for the year, including dividend income. It was led higher by a recovery in large cap companies. Healthcare was one of the top performers, along with Technology where the "fangs" (Facebook, Amazon, Netflix and Google) led the way.

The Canadian S&P/TSX closed out one of its more tumultuous years with a total return of -8.3% for the year and -1.4% for the quarter. Energy (-25.7%), Materials (-22.8%) and Industrials (-14.5%) dragged down the overall index. Eurozone equities delivered positive returns for the quarter (+6.5%) and finished the year up 10.1% in euro terms. Emerging market stocks returned 4.4% (CAD) for the fourth quarter to finish the year up 2.4% in Canadian dollar terms. The EM continues to struggle with an appreciating U.S. dollar, falling commodity prices and flagging exports, which only add to their challenges of dwindling corporate profits, sluggish productivity and a dispirited investor base. □

Genus Balanced Fund Asset Allocation

(As at December 31, 2015)

Asset Class	Percent of
Government Bond	4.9%
Strategic Bond	17.2%
Commercial Mortgage	12.1%
Total Fixed Income	**34.2%**
Canadian Alpha	**1.9%**
Canadian Equity	*1.8%*
Cash	*0.1%*
Dividend Equity	**24.2%**
Canadian Equity	*8.4%*
U.S. Equity	*9.6%*
International Equity	*5.6%*
Cash	*0.6%*
CanGlobe Equity	**32.4%**
Canadian Equity	*10.5%*
U.S. Equity	*13.1%*
International Equity	*8.0%*
Cash	*0.8%*
Global Alpha	**5.7%**
Canadian Equity	*0.1%*
U.S. Equity	*3.5%*
International Equity	*1.9%*
Cash	*0.2%*
Emerging Markets	**1.9%**
Total Equity	**64.4%**
Total Cash	**1.4%**
Total Portfolio	**100.0%**
Portfolio Equity Exposure	
Canada	32.3%
United States	40.6%
International	24.2%
Emerging Markets	3.0%
Total Equity	**100.0%**