FRONT STREET

Canadian Energy Resource Fund

COMMENTARY Q4 2016

PORTFOLIO MANAGER
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MARKET OVERVIEW

December capped what has been an exceptional year in the resource world. It's difficult to imagine that the global economy was seemingly coming undone at the seams only 10 months ago. The fallout from the free-falling commodity prices became quite contagious. Beyond its impact on resource companies specifically, with a record number of bankruptcies, commodity price weakness dragged down emerging economies dependent on oil, the banking sector exposed to the sector, high-yield debt markets as well as the broader global capital markets.

We were pleasantly surprised by OPEC's decision to curtail its own oil production in order to prop up prices. While the proof is always in the pudding (as OPEC has a long history of cheating), early rhetoric from the group seems to be positive. Oil prices did rally 18% into the year end from the announcement.

OPEC's curtailment of production will only accentuate what was already in progress, that is, falling global oil inventories.

IN THE PORTFOLIO

In the fourth quarter, the S&P/TSX Composite Index was up 3.8%. Within the Index, the energy sub-index advanced 6.2% while the materials group declined 6.5% and golds dropped 16.5%. The Front Street Canadian Energy Resource Fund was up 11.8% for the same period and up 130% for the calendar year.

The year 2016 proved to be another solid oil demand growth year, while oil production outside of OPEC, was in decline.

However, as we've been postulating for many years, the North American energy shale players should continue to win market share as a result of improving cost structures relative to their global non-shale peers. While much of OPEC (and some non-OPEC) producers are currently busy curtailing production, the bulk of the Fund's energy company holdings are busy ramping up capital spending, drilling activity and production outlooks. The Fund's growing exposure in the energy services stocks in the latter half of the year proved quite fruitful. For the three-month period, the energy services positions contributed the bulk of the returns, up 8.9%, with oil producers adding approximately 2.1%. The Fund's gold position detracted over 3% from performance, while base metals and natural holdings provided a slight drag on the portfolio.

At year end, the Fund's portfolio breakdown included an overweight exposure to the energy sector, at 75%, with base metals at 20%. We have been adding to the Fund's gold weighting during the period.

While the beginning of this energy year is seemingly on better supply and demand footing compared to last year at this time, we continue to expect curveballs thrown at us from environmentalists and politicians this year. The new Trump administration in particular, brings tremendous uncertainties to all of America's trading partners. We continue to like the supply/demand fundamentals for energy in 2017; the political and geopolitical machinations, however, will likely give us heartburn.

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