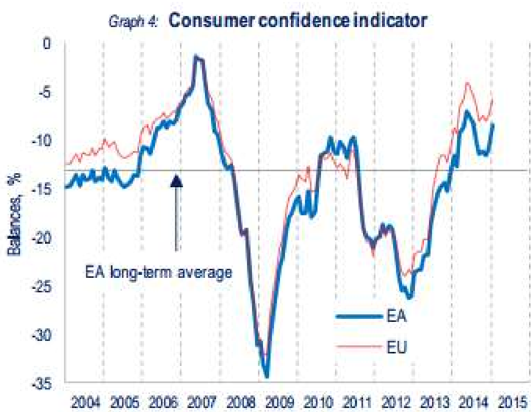
COMMENTARY

February 13, 2015

Dear clients and colleagues,

Despite geopolitical tensions in Europe, recent economic data was surprisingly positive. Sentiment in the EU and euro-area has improved since the beginning of 2015, driven by increases in consumer and retail trade confidence. Consumers, perhaps as a result of the European Central Bank's quantitative easing program or lower oil prices or both, have regained confidence in the European economy and the prospects for unemployment to come down. Falling oil prices have boosted household spending, as people are enjoying the extra disposable income. Surging retail sales should help to counter fears of deflation for the EU.



Source: European Commission

We remain slightly overweight Europe in our portfolios. While aware of the negatives, we remain optimistic about the region. An accommodative monetary policy from the ECB, a weaker euro, and more favorable input costs create a definitive case for the attractiveness of investing in European equity markets.

Here is an update on some of the latest market trends:

Reporting season:

Nearly half-way through the fourth quarter reporting season, we have seen impressive "beat" ratios, especially for smaller companies: 68% of smaller companies in the Stoxx 600 Index have exceeded the top line consensus and 65% of these companies have reported better than expected earnings.

	Market Cap Reported	Sales Beat Proportion	Sales Beat Surprise	EPS Beat Proportion	EPS Surprise
Stoxx 600	44%	55%	-1%	51%	+1%
Stoxx 600 Large	47%	49%	-2%	46%	-1%
Stoxx 600 Mid	25%	57%	+9%	50%	+8%
Stoxx 600 Small	**31%**	**68%**	**+3%**	**65%**	**+74%**

Sources: IBES, Deutsche Bank

In general, we have found that downward revisions for earnings are becoming less frequent. Forward-earnings revisions for the Technology, Financial services, Automotive, and Travel industries seem to be trending up. On the other hand, earnings expectations for Energy, Materials, Health Care, and Food & Beverage are being reduced.

Our European holdings have reported fourth quarter results that are broadly in-line with the Stoxx 600 Index. Of our 35 holdings, 16 have reported quarterly numbers or trading updates. On average, 75% of those companies have beaten revenue expectations and only 17% have underachieved. In addition, 63% of our firms have delivered clear, positive messages for the beginning of 2015.

Flow of funds:

Sources: Deutsche Bank

Looking at the flow of funds year-to-date, European equities are gaining traction versus other equity regions. Despite geopolitical tensions, Europe continues to outpace US inflows for the 5th consecutive week. Japanese equity funds remain very strong thus far this year, but have lost some momentum in the past few days. When looking at flows by asset class, bond funds have seen positive inflows over the past number of weeks (driven by the US, Europe, and Emerging Markets). Money market funds have also experienced inflows, while outflows from EM equity funds continue.

Performance:

Evident in the table showcasing regional benchmark returns, Europe has delivered a solid performance year-to-date as compared to the other regions. Within Europe, all sub-regions have contributed to returns, with Continental Europe leading the way.

Benchmarks	Returns (as of Feb 12)
MSCI EMU Small (CAD)	**13.9%**
MSCI Europe ex UK Small (CAD)	**12.7%**
MSCI Europe Small (CAD)	**12.1%**
MSCI Nordic Small (CAD)	11.9%
MSCI UK Small (CAD)	11.2%
MSCI Pacific Small (CAD)	10.8%
MSCI North America Small (CAD)	9.8%

Source: MSCI, GACM

The outperformance of small cap companies has yet to really take off, but we remain confident in the higher growth profile of smaller firms. In fact, the MSCI Europe Small returned 12.1% year-to-date, beating its larger counterpart by approximately 90 basis points. We continue to believe that in this low growth environment, smaller companies should outperform.

As a final thought, the European region has been hampered by sluggish growth, the threat of deflation, exhaustive talk of a Greek exit, and the ongoing crisis in Ukraine. However, the leaders of Russia, Ukraine, France, and Germany have managed to reach a ceasefire deal on the Ukrainian conflict. Germany saw its fourth quarter growth more than double forecasts and this was driven largely by domestic demand. The January Purchasing Managers Survey had its best showing for Eurozone firms since mid-2014. So as economic data out of Europe improves, confidence in the region should ramp up at a faster pace with changes to the geopolitical situations in Greece and Ukraine. Our portfolios are well positioned to reap the benefits.

Have a nice weekend.

The Global Alpha Team