BARRANTAGH Investment Management | 1995 2020 | 25 Years

BIM REVIEW

2Q20 | CENTRAL BANK POLICIES COMBINED WITH FISCAL STIMULUS SUPPORT RECOVERY

INVESTMENT ENVIRONMENT

- Real-time data points to a quicker than expected recovery. The COVID-19 shock accelerated a number of technology trends that were already in place.

EQUITY MARKETS

- Central bank stimulus provided macro policy clarity for equities and valuation support by anchoring interest rates at historic lows.

FIXED INCOME MARKETS

- Bond buying programs offered liquidity to the market and helped to absorb an increase in new issue supply.

INVESTMENT ENVIRONMENT | QUICKER RECOVERY TO DATE THAN EXPECTED

The second quarter began with a severe and rapid reduction in economic activity as a result of widespread government imposed lockdown measures taken around the world. Announced monetary and fiscal policy measures were in the early stages of filtering into the economy, and interest rates were at all-time lows. With the liquidity crisis behind us, markets quickly shifted towards assessing the eventual path to recovery. The month of April was likely the low in activity since much of the economy was effectively shut down due to shelter in place orders, which resulted in a spike in unemployment.

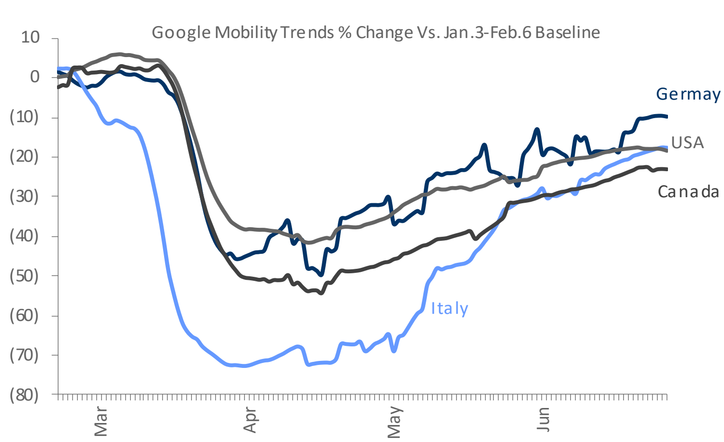
How the economy evolves from this extremely low level of activity will be crucial in determining growth prospects at a broad level. **To help our understanding of the global economic situation, we have supplemented our analysis by monitoring real-time alternative data along with the usual key aggregate indicators.** During the month of May, indicators such as credit card spending, rail freight movement, and general mobility information began pointing towards improvement in economic activity off of an April bottom. This development can be linked to the easing of containment measures in certain regions (Figure 1), along with the monetary and fiscal stimulus measures implemented to support the labour market and broader economy (Figure 2).

While we are confident that the worst of the economic fallout is behind us and that a bottom in GDP has been reached in the second quarter, uncertainty regarding what shape the recovery will take still remains. Potential challenges to the recovery include a resurgence in COVID-19 cases, permanent job losses, high government debt levels, and the U.S. election in November. **However, lessons learned since the emergence of the virus should reduce the severity of a potential second wave aided by improved standards of care, increased testing and contact tracing, and populations more accustomed to safe behavior.** Government fiscal policy measures should also help with the recovery as the creation of a EUR 750Bn Recovery Fund in Europe and a potential $1 Tn infrastructure bill being discussed in the U.S. point to the scale of what could be possible. Furthermore, central banks appear committed to ongoing monetary policy support in an effort to maintain bond yields lower for longer.

Exogenous shocks impact not only the near-term but can also serve to accelerate trends that were already in place. We expanded on these sentiments in a recently published strategy update and the most meaningful takeaway is an expectation of structurally higher adoption of e-commerce and digital communication technology. Shelter in place requirements compelled more consumers to discover the benefits of online shopping and forced companies to rapidly deploy expanded work from home capabilities that are unlikely to be entirely rolled back as offices reopen. These permanent shifts in behaviour will result in a persistent divergence between sectors that will be beneficiaries and those that will experience headwinds during the economic recovery.

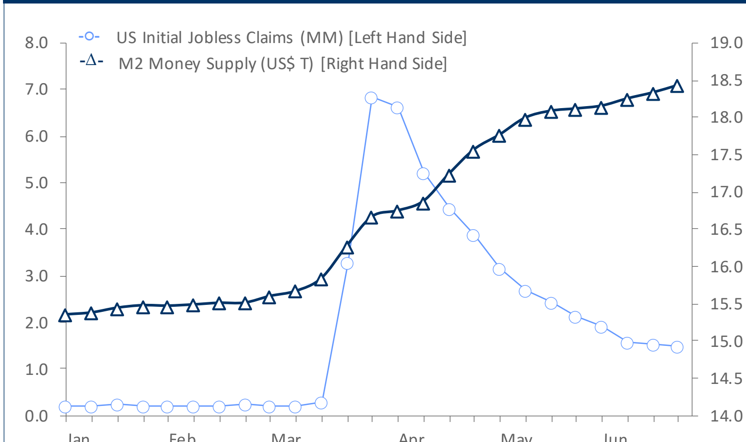
Although there exists significant uncertainty in the near-term, our view remains that the combination of the rapid monetary and fiscal response (particularly when compared to 2008/09 period) provide reassurance that policy makers can bridge the gap to a full recovery, with the main uncertainty being timing.

FIGURE 1: MOBILITY IMPROVING



Source: Google | Index of Retail, Grocery, Transit, Workplace Mobility Trends
7 Day Moving Average (Data Set From Feb.15 To Jun.27)

FIGURE 2: FED SUPPORTING THE LABOUR MARKET



Source: Bloomberg

EQUITY MARKETS | STIMULUS AND LOW RATES SPARK MARKET REBOUND

Equity Index Returns	2Q20 (CAD)	2Q20 (USD)	YTD20 (CAD)	YTD20 (USD)
Canadian	+17.0%		-7.5%	
Global (Net)	+14.2%	+19.4%	-1.0%	-5.8%

In the second quarter, equity markets responded very favourably to the monetary and fiscal measures put in place by policy makers which provided capital markets with much needed liquidity and the unemployed with income support. Strength in equity markets was broad based, though companies positioned as long-term beneficiaries of trends accelerated by COVID-19 (i.e. those exposed to e-commerce and digital communication) performed particularly well.

Due to the uncertainty in the outlook at the beginning of April, many companies pulled their guidance and analysts revised EPS sharply lower for the quarter and the year. **However, optimism regarding a quick recovery started to build as economic indicators began to improve more quickly than expected which fueled a growing belief that downward EPS revisions should be largely contained to the second quarter.** Central Banks' clear plans for further stimulus (if required) also helped stocks by providing confidence in a lower for longer rate outlook, a boost to the economy, and valuation support for equities.

BIM EQUITY FRAMEWORK

The rally in equities has resulted in greater difficulty finding companies which trade at a discount to their historical ranges, though this is offset by the ultra-low interest rate environment that compresses discount rates and supports higher multiples (Figures 3 and 4). This is particularly notable as market concentration has continued to increase, with a larger percentage of returns being driven by fewer stocks whose valuations are increasingly expensive. For instance, the top 10 companies on the S&P 500 make up 25% of its weight, with technology representing a substantial and growing portion. In Canada, banks remain a source of concentration, though technology and gold stocks have now become much larger weights where we struggle to justify valuations.

We continue to emphasize a balanced approach to portfolio construction, seeking companies in various categories and sectors including long-term structural growers, well managed yet cyclically exposed, and attractively valued defensives. **Our bottom up focus aims to uncover unique aspects about each company that will be reflected in the share price over time, and we prefer to avoid fundamentally challenged businesses.**

GLOBAL MARKETS

A heightened level of economic uncertainty in the second quarter has crowded investors into stocks with greater near term visibility and higher long-term growth (particularly as growth has become more scarce). This is mainly evident in sectors such as Technology where the shift towards e-commerce, cloud computing, and work from home are most pronounced. Although many of these stocks have become expensive, we continue to see value in the payment processors which are benefiting from the trend towards more e-commerce and the shift towards cashless transactions. Similarly, our holding in Microsoft has been a strong performer due to the accelerated shift towards work from home, yet trades at a valuation not fully reflective of its durable growth prospects.

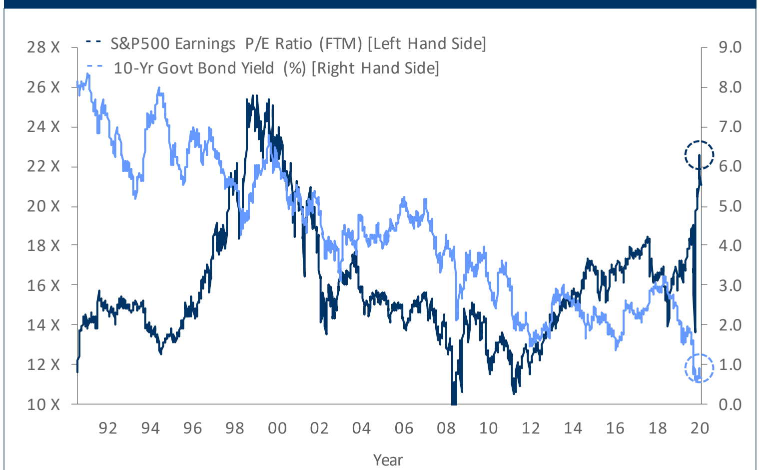
Companies that have become more attractive to us during the quarter include some well managed industry leaders with strong track records which have experienced near-term pressures due to lock down measures in place. As such, we took the opportunity to initiate a new position in two of these "high quality laggards", and also added to a few of our existing positions of this nature. Despite facing some near term headwinds, these companies have strong balance sheets, robust product innovation pipelines, and a successful track record of acquisitions which we expect will allow them to gain market share during the recovery and beyond.

CANADIAN MARKET

A select group of our high-quality Canadian holdings with solid investing track records acted on their ability to raise equity during the quarter to accelerate a pre-defined consolidation strategy. The current environment could provide generational acquisition opportunities and a strengthened balance sheet increases the chance of completing a successful deal.

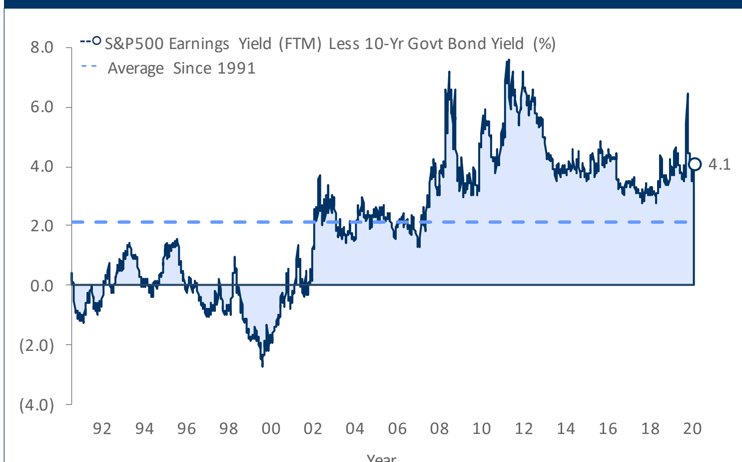
Notwithstanding recent on-site due diligence challenges, Granite REIT which is focussed on growing exposure to e-commerce related distribution centers did announce a previously well-advanced transaction resulting in increased scale in key markets. Other companies in service or consumer sectors including WSP Global have yet to reveal a use of proceeds, though targets have certainly been identified and further normalization of the economy is likely to facilitate more serious discussions with updates expected in due course.

FIGURE 3: BOND YIELD COLLAPSE AND P/E EXPANSION



Source: Bloomberg - Weekly Data Ending Jun.26/2020

FIGURE 4: EARNINGS YIELD SPREAD



Source: Bloomberg - Weekly Data Ending Jun.26/2020

BIM EQUITY THESIS SPOTLIGHT

T-Mobile is a core holding in our global portfolios. After a lengthy regulatory process, the T-Mobile/Sprint merger finally closed in 2020 to combine the #3 and #4 wireless players in the U.S. The deal provided "New T-Mobile" with the deepest spectrum position in the industry, significant scale from the combined subscriber base, and opened up substantial cost saving opportunities. The lucrative mid-band spectrum acquired from Sprint is particularly advantageous for 5G deployment, since an efficient 5G network requires a "spectrum layer cake" of low, mid, and high band.

Prior to the merger, T-Mobile had a history of disrupting the wireless industry with competitive low prices for consumers and a creative marketing strategy. This has resulted in share gains and industry leading subscriber growth over the years, which led to strong financial growth metrics and robust free cash flow generation. The transformative merger puts T-Mobile in a position to accelerate its footprint expansion story and further gain share. Looking out longer-term, T-Mobile will be among the first carriers to have built a reliable nationwide 5G network with abundant capacity, which will drive substantial margin expansion and FCF as it scales its new and improved national network.

FIXED INCOME MARKETS | CENTRAL BANK BOND PURCHASES RAMP

Fixed Income Index Returns	2Q20	YTD20
Canadian	+5.9%	+7.5%

The second quarter of 2020 was all about recovering from the COVID-19 shock. Credit spreads tightened 50 bps in Q2 retracing two thirds of the spread widening experienced in Q1 (Figure 5). The large and quick response from the Federal government and Central Bank gave investors confidence that the stimulus could bridge the gap as the economy and consumer recovers.

The Bank of Canada has begun purchasing bonds in the secondary market for the first time ever. It is actively buying Canada bonds, Federal agency CMB, Provincial debt up to 10 years to maturity, and even investment grade corporate debt up to 5 years to maturity. The objective of these bond buying programs is to be the buyer of last resort and add needed liquidity to the market. It also has the impact of raising bond prices by reducing interest rates and credit spreads.

The size of the Canada, CMB, and Provincial bond buying programs was designed to roughly equal the amount of additional bonds that needed to be issued. **Without these programs the deluge of new supply could have overwhelmed the market and led to higher debt costs for the issuers when they could least afford it.** The demand for lower risk assets such as bonds has also decreased interest rates to all time lows. At the end of the quarter the Canada 30-year rate was just 1%, compared to the 2-year rate of 1.7% at the start of the year (Figure 6).

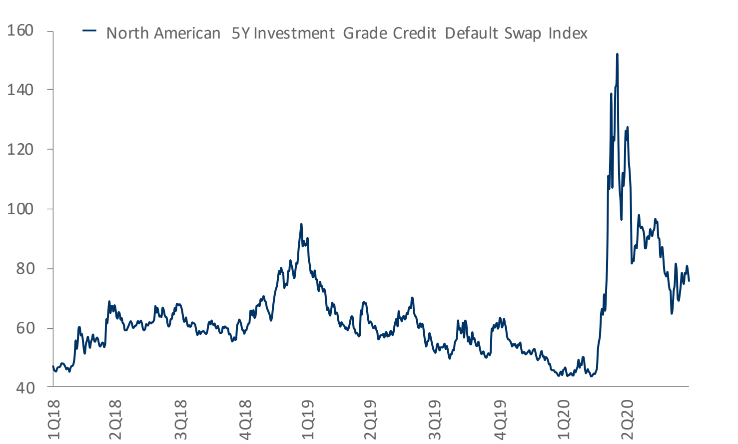
BIM FIXED INCOME FRAMEWORK

There were two strategic changes to the portfolio this quarter. **In early April, we sold the Laurentian Bank 2021 deposit note and switched into Suncor 2021.** At the time, Suncor offered a very attractive yield with a higher credit rating of BBB+. It raised $1.25 bln in additional liquidity and has one of the best cash flows and balance sheets among integrated oil companies. Laurentian has been gradually shifting its loan book towards higher risk commercial loans since the deposit note was purchased in 2017. Subsequently, Laurentian lost its CEO and continues a long period of transition. At the time of the portfolio change Suncor yielded 100 bps more than Laurentian and by quarter end its credit spread had outperformed by 120 bps resulting in substantial outperformance by Suncor.

In early June we trimmed our Canada 2026 holding and added to the Ontario 2027 holding and entered a new position in Canada Pension Plan Investment Board (CPPIB) Capital 2028. CPPIB is the Federal pension plan that Canadian workers pay into for retirement. It is a Federal crown agency with a AAA credit rating and issues bonds in multiple countries and currencies. Interest rates at the time were at an attractive level and it was a good opportunity to increase duration from a 2026 maturity to 2027 and 2028. In addition, buying Ontario and CPPIB bonds increased the yield on the portfolio.

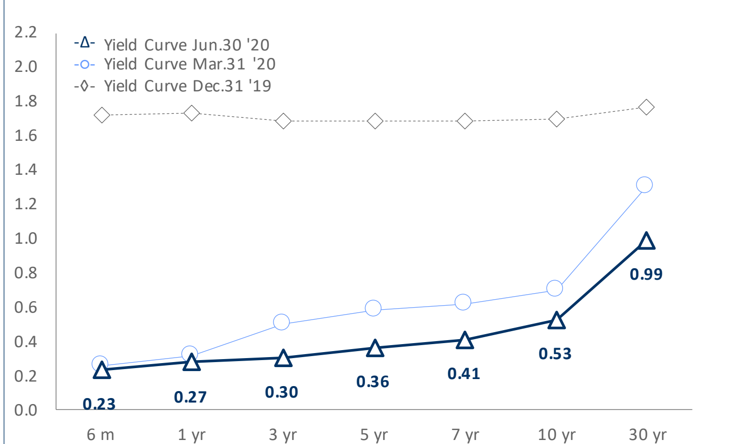
During the quarter we also selectively increased the holdings of Canada 2030, Canada 2045, and Ontario 2046 by small amounts from cash when they offered an attractive yield. Portfolio duration ended the quarter at 8.3 years, slightly below the benchmark.

FIGURE 5: CREDIT RISK (bps)



Source: Bloomberg

FIGURE 6: CANADIAN YIELD CURVE (%)



Source: Bloomberg

Barrantagh Investment Management

100 Yonge Street, Suite 1700
Toronto, Ontario M5C 2W1
(416) 868-6295
www.barrantagh.com

Barrantagh Investment Management Inc. provides disciplined portfolio management to institutional and individual investors. The firm is committed to a high level of client service provided directly by its experienced partners. We are dedicated to preserving our clients' capital while generating growth through consistent application of our value-based fundamental investment philosophy. We manage portfolios on a segregated basis to meet our clients' investment objectives. Because the firm is owned by our professional staff we maintain a completely independent and objective perspective.

For more information contact: Barrantagh Investment Management Inc. (416) 868-6295