BARRANTAGH
Investment Management

BIM REVIEW

1Q21 | RECOVERY NOW FIRMLY IN PROGRESS

INVESTMENT ENVIRONMENT

- A global recovery is underway, and regions with more advanced vaccination rates provide optimism of brighter times ahead for the economy.

EQUITY MARKETS

- Equity markets are well positioned to benefit from continued improvement in earnings growth.

FIXED INCOME MARKETS

- A strong economic recovery leads to record rising interest rates which is managed by reducing duration and investing in preferred shares.

INVESTMENT ENVIRONMENT | CONSUMER AND CORPORATE SENTIMENT IMPROVE WITH VACCINATION RATES

Global GDP forecasts continue to rise with economic growth underpinned by an accelerating vaccine rollout, and continued monetary and fiscal support (Figure 1). A third COVID wave remains a potential risk, though it is unlikely to derail the recovery. Businesses have become more nimble in adapting to operating restrictions, vaccine rollouts have prioritized the most vulnerable, and we expect any lockdowns, required to deal with regional flare-ups, will be shorter and less draconian than those of a year ago.

Growth will not be evenly distributed and will partly be a function of the pace of local vaccination efforts. Regions such as the U.S. are benefitting from an expedited rollout, while the E.U. and many emerging market economies are experiencing a more gradual process. Despite these regional disparities, there is growing optimism for the global economic outlook aided in part by expectations for some of the largest contributors such as the U.S. and China. Goods and manufacturing industries continue to show rapid growth, while the service industries remain in the early stages of recovery and are expected to accelerate as vaccination rates increase.

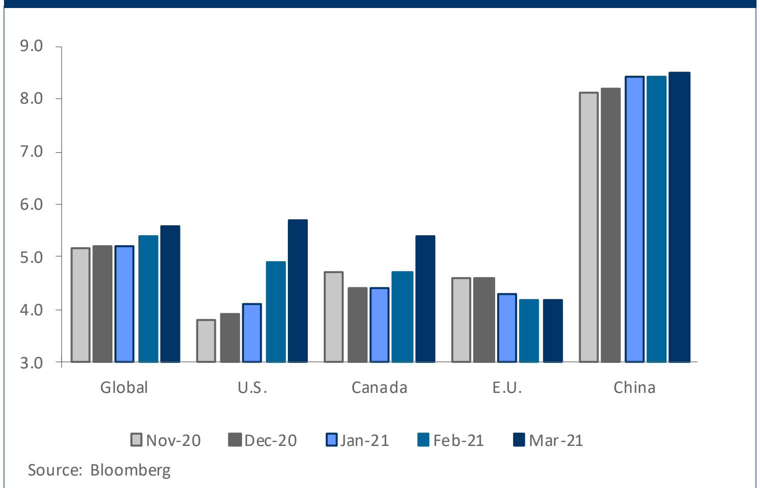
Elevated consumer savings support the potential release of pent-up demand akin to the “roaring twenties” that followed the conclusion of the 1918 flu pandemic just over a century ago. Drawing upon an analogue from so far back may have its limitations, though analysis of regions with more well advanced vaccine programs supports the view that consumers desperately wish to renew their normal routines after greater than a year of varying restrictions. This effect will be magnified by the substantial government spending programs that have either launched, or remain in their early stages, resulting in a very favourable backdrop for consumer spending.

Supply chain constraints have become more prominent as economies reopen, with particular shortages in semiconductors, freight capacity, and various raw materials. Although these constraints should be transitory in nature, they may linger for a few quarters before supply catches up, thereby placing modest upward pressure on inflation given the relatively small percentage of the overall economy impacted by these dynamics. Other factors influencing inflation forecasts include rising commodity prices and expectations of continued fiscal stimulus. **Notwithstanding the recent increase in the yield curve, real rates (nominal rates less breakeven inflation), remain in negative territory and continue to aid the recovery by supporting economic activity and asset prices (Figure 2).**

In addition to a stronger consumer spending backdrop, corporate sentiment also continues to improve. Mergers and acquisitions activity further accelerated in the quarter reaching levels not seen for decades indicating a growing desire to transact on strategic opportunities. Canadian listed companies were involved in some of the highest profile announcements including Rogers Communications bid for Shaw, Canadian Pacific Railway’s offer for Kansas City Southern, and Brookfield’s hostile proposal for Inter Pipeline.

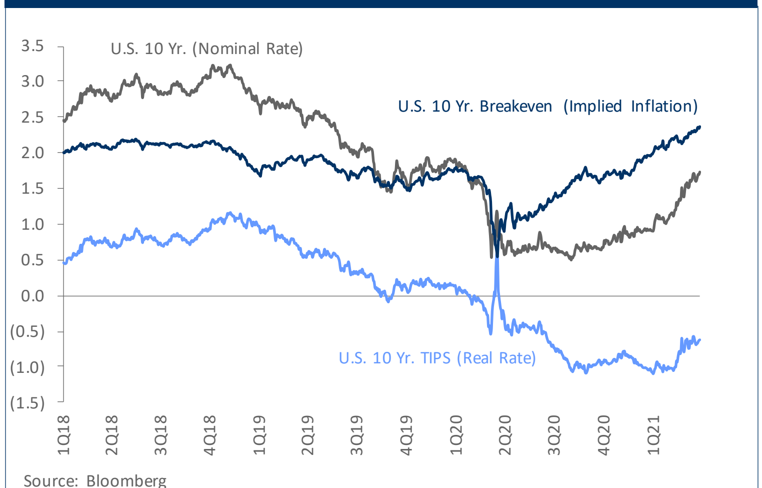
Although near term COVID related uncertainties remain, consumer and corporate sentiment continue to support a strong outlook for growth. Furthermore, we remain early in the economic cycle as we have yet to fully emerge from the pandemic.

FIGURE 1: 2021 GLOBAL GDP FORECASTS MOVING HIGHER (%)



Source: Bloomberg

FIGURE 2: REAL RATES REMAIN NEGATIVE (%)



Source: Bloomberg

EQUITY MARKETS | CONTINUED ROTATION AS LAST YEAR'S LAGGARDS ARE THIS YEAR'S LEADERS

Equity Index Returns		
	1Q21 (CAD)	1Q21 (USD)
Canadian	+8.1%	
Global (Net)	+3.5%	+4.9%

The sector rotation that began last year following positive COVID vaccine announcements continued in the quarter led by the positive earnings revisions of companies that had been most impacted by the pandemic. The improving growth outlook linked to an acceleration of the vaccine rollout put upward pressure on rates, commodities and inflation more generally, though none of these indicators are at levels that raise alarm bells for the broader equity markets.

BIM EQUITY FRAMEWORK

Equity markets often pay up for growth when it is scarce, and reward value stocks when the global economy is either improving or on more solid footing. Though many companies aligned with the ongoing recovery have performed well in recent quarters and now offer less compelling risk/reward, we continue to find select opportunities in names with underappreciated exposure to the reopening of the economy. We also maintain a bias towards businesses that were able to strengthen their competitive positioning during the pandemic and emerge as stronger entities. We are not overly concerned with inflation, though are mindful of a company's ability to pass through rising input costs and focus on businesses with pricing power.

GLOBAL MARKETS

Earnings growth outlook for this year continues to strengthen, with pent up demand, supportive monetary and fiscal policy and improving sentiment being the key drivers. Although supply chain constraints may cause some pressure to profit margins in the next few quarters, the higher quality companies should be able to navigate this risk given the cost actions they have taken during the past year.

The U.S. consumer in particular is well positioned for an imminent reopening due to the country's accelerated vaccination rollout, and we continue to look for opportunity there. However, given the sharp rise in stock prices of companies with U.S. consumer exposure, valuations have become much more challenging. Our focus remains on companies that have long term structural drivers that are also positioned to benefit from the strong consumer spending trends near term, yet still trade at reasonable valuations. We added to our Dollar General position for this reason.

Government spending around the world has been focused mainly on filling in the economic slack that was created by COVID-19. The focus is starting to shift towards stimulus spending with the U.S. leading the way (Figure 3). President Biden recently unveiled his American Jobs Plan which, if approved, hopes to spend over $2 trillion on transportation, social, digital, and environmental initiatives in order to stimulate job growth and improve competitive positioning for US companies. Our holding in Quanta Services, as highlighted below, has benefitted from growth in electric grid investments driven by wind and solar deployments, and is well positioned to gain from this stimulus plan should it receive approval. We continue to look for companies in the industrials and materials sectors that could also benefit from this stimulus plan as long as the market has not already priced this opportunity into valuations.

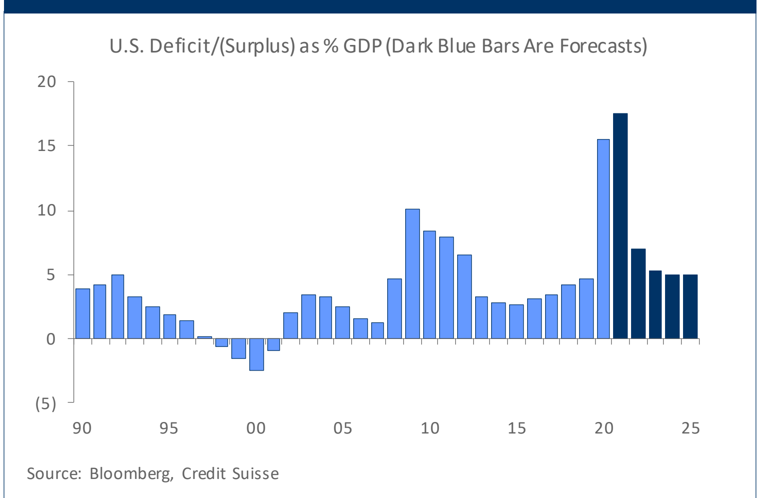
CANADIAN MARKET

While growth and momentum stocks have experienced some angst from rising rates, the financial and resource sectors generally benefit from reflation and make the Canadian market a good place to invest in the current environment.

We increased our exposure to financials based on attractive valuations and still as yet unrecognized growth potential. An already favourable backdrop for banks strengthened during the quarter when forward-looking earnings estimates gapped higher on forecasts of lower credit losses and an improving outlook for margins due to the steepening of the yield curve. The lifting of restrictions related to buybacks and dividend increases imposed at the onset of the pandemic would offer banks additional capital return options should Canadian regulators follow the lead of their U.S. counterparts.

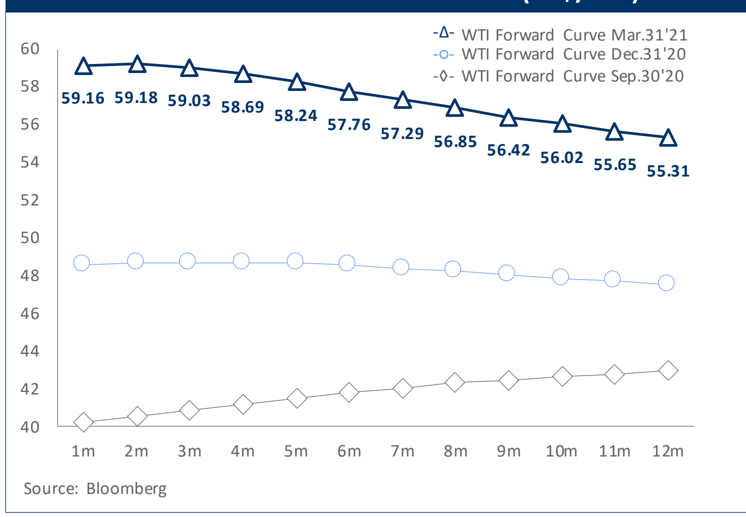
Within resources, diminishing pandemic related travel headwinds linked to positive vaccine updates rapidly improved the outlook for crude oil (Figure 4). Coordinated OPEC+ policy has been important in managing production which is likely to continue until demand more fully recovers and so long as there is not a meaningful supply response from non-OPEC sources. U.S. shale has acted as the swing producer in recent years, and investor pressure on public energy companies to prioritize profits over growth has been key to the capital discipline exhibited to date. Free cash flow generation remains critical to a sustainable operating model and Canadian Natural Resources' long lived assets and relentless focus on efficiencies position the company very well in this regard.

FIGURE 3: OUTSIZED STIMULUS CONTINUES



Source: Bloomberg, Credit Suisse

FIGURE 4: OIL PRICES ON FIRMER FOOTING (US$/BBL)



Source: Bloomberg

BIM EQUITY THESIS SPOTLIGHT

Quanta Services is the largest engineering and construction company focusing on the electric power grid, telecom fiber network, and oil/gas pipeline installation opportunity in North America and Puerto Rico.

As alternative energy sources such as wind and solar become a larger percentage of power generation, a more robust and flexible grid is needed. This has resulted in a sustained increase in grid capex that should persist for years to come. Furthermore, grid vulnerability to storms and wildfires is also driving increased spending towards grid hardening projects at utilities most exposed to this risk.

Another interesting area of growth for the company is in telecom fiber installation services where a multi-year opportunity exists, driven by increased broadband penetration and 5G deployment in North America.

Quanta has a strong track record of execution in the industry driven by a prudent approach to risk management and an emphasis on training and retaining skilled labour. The latter point is relevant to the industry given skills shortages, and should position the company for market share gains in the future. Furthermore, their ability to generate free cash flow has allowed them to invest for growth, make acquisitions, and buy back a material amount of their share base, while also trading at an attractive valuation.

FIXED INCOME MARKETS | STRONG ECONOMIC RECOVERY LEADS TO RECORD RISE IN INTEREST RATES

Fixed Income Index Returns	
	1Q21
Canadian	-5.0%

A near 90 bps uptick in the Canada 10-year was the largest quarterly increase since the 1990s, a datapoint made even more remarkable considering that prevailing rates were above 5.0% at that time. The recent rise to just over 1.5% has resulted in a more than doubling of the 10-year rate in just the past three months (Figure 5).

Strong economic growth and continued optimism contributed to the rising yield curve. The Canadian economy was much less impacted by lockdown conditions than initially forecasted, and GDP estimates for Canada and other regions have been on the rise (Figure 1). The market is also pricing in expectations for the U.S. and Canadian central banks to taper their purchases of Treasury bonds. As the central banks reduce their purchases of Treasury bonds, interest rates go up to attract new buyers. We are anticipating interest rates continuing to rise, although at a more moderate pace, and are positioned accordingly.

Rising interest rates decrease the value of existing bonds since they must be priced lower to provide the new yield to maturity. This explains the -5% return for the bond index which is the lowest quarterly result dating back to 1996 per our records. The index has seen numerous quarterly gains of +5% or more as recently as 2Q20 at +5.9%. On a trailing twelve month basis, the index return remains positive at +1.6% as of the end of March.

BIM FIXED INCOME FRAMEWORK

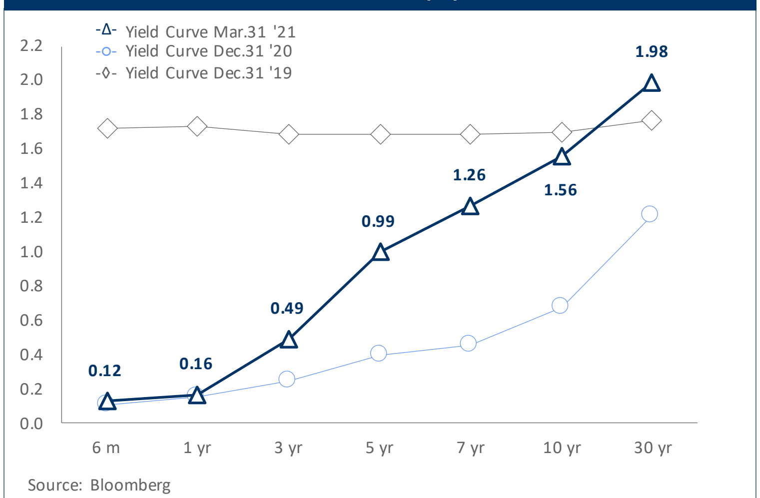
At quarter end we are well underweight duration and at our lowest level in many years. We have also increased our exposure to preferred shares and corporate bonds.

Preferred shares are likely to outperform most other fixed income instruments during periods of solid economic growth and increasing inflation expectations. Preferred shares offer attractive yields and less sensitivity to rising interest rates, and in the current environment are most sensitive to credit spreads which have been contracting over the past twelve months (Figure 6). We expect to achieve modest positive returns from the recently purchased preferred shares many of which will be redeemed in 2021 at the issuers option. At that time we will look to reinvest proceeds into bonds at higher rates.

We decreased duration by selling the Canada 2030 and halving the CMB 2024 holding. Purchases that increased the corporate credit weight included buys of the A- rated utility Enbridge Gas 2020 and the A+ rated Manulife Bank 2025, which is a subsidiary of Manulife Insurance.

Finally, near the end of March we sold Province of Newfoundland 2029 and invested the proceeds into Province of Ontario 2029. Newfoundland's credit spread has tightened -35 bps towards Ontario and provided a good opportunity to switch into a fiscally stronger province.

FIGURE 5: CANADIAN YIELD CURVE (%)



Source: Bloomberg

FIGURE 6: CREDIT RISK (bps)

Source: Bloomberg

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