Ninepoint Enhanced Equity Strategy

April 2018 Commentary

Investment Team

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Q1 earnings season is now effectively completed for S&P 500 and U.S. companies have been able to deliver some of the best revenue and EPS growth of the current cycle as benefits from the tax reform package begin to take hold. Sales and EPS growth has averaged 8.5% and 24% respectively this quarter with companies beating EPS by the largest margin in over 2 years. Despite this, equity markets have largely shrugged off the earnings upside, choosing instead to treat tax gains as a one-time event and focusing instead on a 10yr treasury bond that is flirting with 3%. We also saw a large portion of companies in cyclical sectors such as industrials beat earnings and yet trade lower on concerns over future operating margin expansion and forward organic growth. We had expected these concerns might come into play as we moved into the back half, but the forward-looking nature of the equity market has begun discounting them already.

The above dynamic has lead the FWD PE multiple on the S&P to decline from 18X forward earnings before tax reform to what looks to be ~15.5XFWD post this earnings season on a one year forward basis. We highlighted that the primary risk to equity valuations would likely be a rise in rate expectations which seems to have manifested it-self in the current de-rate in PE multiples. The 2.5X turns of forward multiple compression we have witnessed is roughly in-line with what typically occurs over a full fed tightening cycle. We also think markets have struggled due to a deceleration in economic momentum. We note though that economic surprises tend to be seasonal and we would typically see a bottom and reacceleration in data upside surprises sometime in June (Chart 1). A reacceleration in economic data could be a positive catalyst for markets as investors would gain confidence in organic growth estimates potentially continuing beyond 2018. We will be monitoring the data closely for an inflection point in the coming months.

Chart 1: Economic Surprise Seasonality

Source: Bloomberg

Portfolio
In the Enhanced funds our holdings have reported very strong first quarter performances so far, with EPS growth of ~30% and revenue growth of over 8%. Some of our key positions and notable changes to the portfolio are as follows:

Energy: Recent attention in the energy space has focused on the impact of the U.S. decision to withdraw from the Iran deal, potentially leading to further sanctions and less Iranian oil supply on the global market. As we have been highlighting for the past several months, global crude inventories have been in steady decline and are supporting consistently higher crude oil prices. With WTI now holding about US$70 barrel and Brent above US$75, we continue to believe the domestic crude oil producers and their related service companies remain severely undervalued. We continue to hold positions in Suncor, Crescent Point and Precision Drilling in Canada along with Parex Resources in Columbia. In addition, we have monetized upside calls on an energy producer ETF and rolled up to new strike prices.

Facebook: We added a position in Facebook following its collapse on privacy concerns last month and ahead of their stellar first quarter earnings which saw revenue growth of 49% and GAAP EPS growth of 62%. Prior to the quarter, we estimate Facebook was trading at an ~18 PE multiple with an ~8% 2020 free cash flow yield while being set to grow EPS above 20%. We still own the equity at these levels and feel near-term we are compensated for the regulatory headline risks that are unlikely to unfold anytime soon.

Microsoft: We increased our position in Microsoft during the quarter in anticipation of acceleration in cloud spending and upside to forward revenue estimates. We think the combination of a stable enterprise business with accelerating cloud growth will allow the company to maintain 10%+ revenue growth with relatively low cyclicality for several years to come.

Roots: Rallied >13% in the days following earnings on upbeat mgmt. guidance and strong comp store sales. With the company still trading at <14 2020 EPS we think the stock continues to screen well for value and is being penalized too greatly for being in an unloved industry such as retail.

Visa: The equity has rallied >8% since reporting 26% and 13% EPS and revenue growth respectively. Cross-border transaction volume, which is considerably more profitable that domestic transactions, continue to drive momentum in the business.

Alimentation Couche-Tard: We held ATD/B in the funds into earnings season given our belief that very strong earnings growth expectations were now more achievable, and valuation compensated us for possible small misses in organic growth. The company traded lower after reporting much worse than expected earnings, leading us to considerably trim our position (at much higher prices). We no longer see a path to improving organic growth or higher valuations. It's been a great core holding the past several years given the >100% move in the equity, and we have nothing but respect for the management team. Unfortunately, we think the current operating environment from an organic growth perspective is more challenging than even we expected (and we were substantially below the street), and we no longer see upside that compensates us for the elevated risk. Several large cap staples traded 5-15% lower season on lackluster revenue guidance confirming the trend continues for weak organic growth for the sector.

Hedging: We believe that economic momentum is likely to surprise to the upside against recently lowered street expectations and, given the contraction in the market multiple, this should allow for a reasonable rally higher in equities. That said, the generally higher level of volatility has allowed us to more cost effectively manage our hedge book as we have been able to opportunistically add and monetize parts of our hedging portfolio. As a result, we are currently annualizing a below historical average cost year to date on our hedging and still have a tighter than historical average loss curve. In addition, we have added upside call exposure on the S&P 500, reflecting our general optimism as highlighted earlier.

Until next month,

The Enhanced Team

NINEPOINT ENHANCED EQUITY CLASS - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F NPP435)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	6.5%	-6.1%	-6.1%	-0.2%	-6.7%	-2.7%	-1.3%	2.9%
Index	10.5%	-7.4%	-9.1%	-3.1%	-1.7%	5.6%	7.5%	11.8%

NINEPOINT ENHANCED US EQUITY CLASS - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F $USD NPP391)

	1M	YTD	3M	6M	1YR	3YR	INCEPTION
Fund	7.9%	-5.7%	-5.6%	-1.7%	-1.3%	2.3%	1.0%
Index	12.8%	-9.3%	-9.3%	-3.2%	0.9%	9.0%	9.3%

NINEPOINT ENHANCED BALANCED FUND - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F NPP245)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	3.9%	-1.8%	-2.6%	0.2%	-2.2%	-0.9%	0.2%	3.0%

[1] All returns and fund details are a) based on Class/Series F shares/units; b) net of fees; c) annualized if period is greater than one year; d) as at April 30, 2018; e) inception date for Ninepoint Enhanced Equity Class is 04/16/12. The index for the Ninepoint Enhanced Equity Class; Ninepoint Enhanced Long Short; and Ninepoint Enhanced Long Short RSP is 50% TSX & 50% S&P 500 (CAD) Blended Index and is computed by Ninepoint Partners LP based on publicly available index information. The index for the Ninepoint Enhanced US Equity Class is S&P 500 TR USD and is computed by Ninepoint Partners LP based on publicly available index information.

The risks associated with investing in a Fund depend on the securities and assets in which the Fund invests, based upon the Fund's particular objectives. There is no assurance that any Fund will achieve its investment objective, and its net asset value, yield and investment return will fluctuate from time to time with market conditions. There is no guarantee that the full amount of your original investment in a Fund will be returned to you. The Funds are not insured by the Canada Deposit Insurance Corporation or any other government deposit insurer. Please read a Fund's prospectus or offering memorandum before investing.

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