



Ninepoint Enhanced Equity Strategy

December 2018 Commentary

Global equity markets exhibited considerable downside in December with the S&P 500 almost 15% lower only to rally back in the post-Christmas sessions to down just over 9% on the month. In our view, financial markets quickly moved from fears over slowing global growth (and therefore earnings growth) to starting to discount a pending recession as fears over a growing trade war and slowing economy in China took hold. Confidence in equity valuations was further undermined by Federal Reserve member statements that initially seemed to be less concerned about negative market price action than many had initially hoped (the removal of the Fed “put”). Early January saw a considerable rally on the reversal of central bank hike “angst” as several fed officials offered more dovish comments on forward rate hikes leading the market to regain much of the December decline. As we noted last month, our general sense has been that 2019 earnings estimates for the S&P 500 are starting to look much more achievable at ~5% growth given our expectations for the broader economic environment. We still expect a bit of caution during quarterly conference calls for 2019 guidance as companies manage a stronger US dollar and weakness in emerging market growth, however we think markets are much more appropriately priced to absorb these risks. Several factors suggest to us that near-term upside resistance on the S&P 500 at 2800 or 16x 2019 earnings is likely until either trade negotiations or global economic data show signs of improvement.

December capped an extremely frustrating year for our strategy. While our hedge book had a meaningful positive contribution during the sell-off, our equities performed considerably worse than we had forecast would be the case during a downdraft, especially in the Enhanced Equity fund. Energy and Financials have been our largest weights given their compelling value and strong underlying business fundamentals. Although they continued to report solid results over the course of the year, overarching fears of a global recession and momentum seeking trading programs continued to sell these sectors despite their low valuations. As the market decline accelerated into Christmas, our financial and energy positions bottomed out first, allowing our curve to flatten out and enabling a much more limited downside capture. During the period from December 17th-24th, the worst of the equity sell off, when the S&P 500 traded down 8%, we were able to manage to only an ~1.3% loss, with several days of positive performance when the market was deeply in the red. During this sell off, we were able to take some profits on a portion of our hedge book by rolling our downside protection to lower strikes. This allowed us to maintain a similar projected downside curve and still lock in some gains. After this most recent rally into earnings season, we have increased our hedges somewhat.

Since the lows, many of our financial and energy stocks have rallied back, improving some of the downdraft we experienced relative to the market’s performance and what we projected our downside curve to be. In terms of several of our financials, news that Value Act, a value oriented activist asset manager, was putting activist pressure on Citi’s management team pushed Citigroup’s

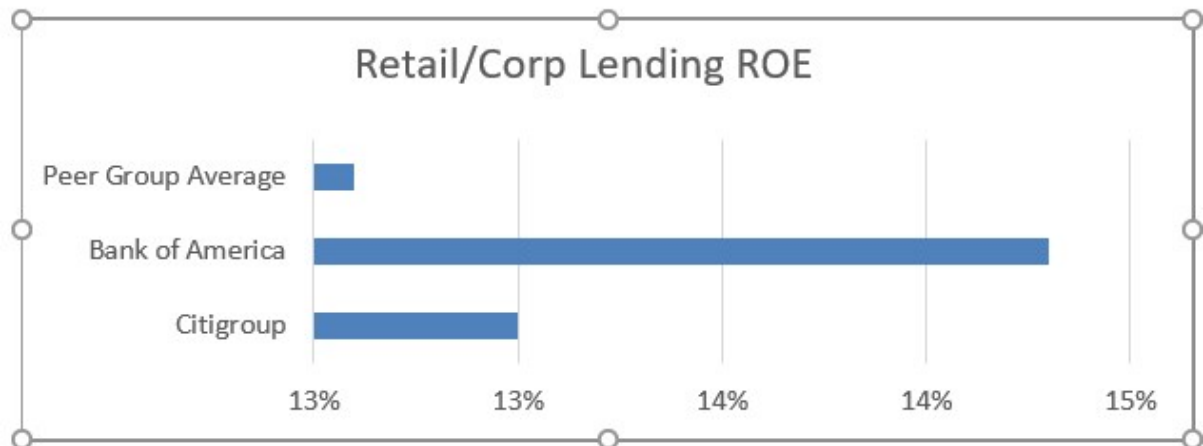
Investment Team

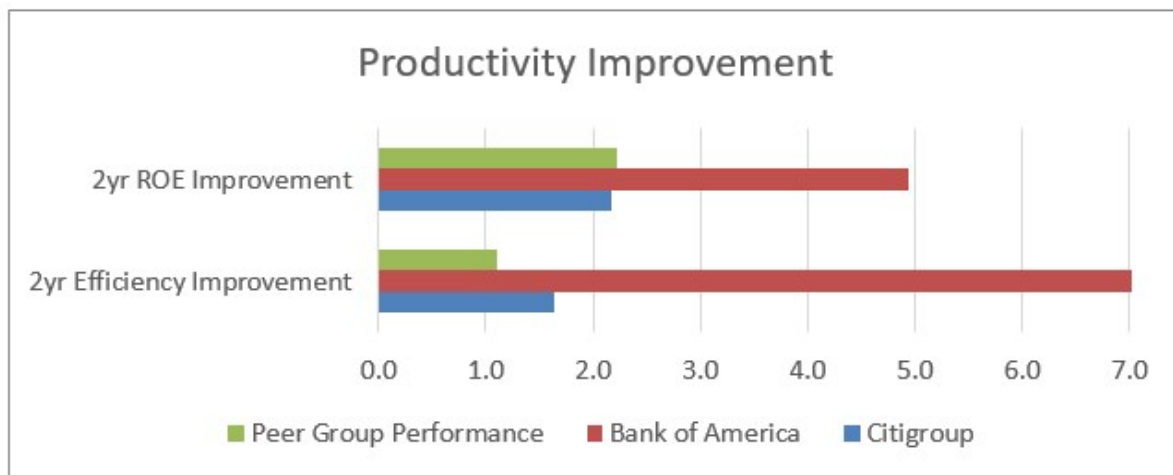


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equity value higher. We noted in a recent webcast the considerable discount that Citigroup and Bank of America, two of our largest holdings are trading at relative to regional bank peers despite in-line to considerably better cost improvement and “core” retail return metrics (Graph 1). Both have recovered meaningfully so far in January but remain extraordinarily good value. Manulife during the lows of December, traded down to ~6X FWD earnings. This price implied investors were getting most of the North American business for very little to nothing once you adjust for the value we believe exists in the Asian business.

Graph 1: Citi Group and Bank of America Relative Operating Performance vs. Peers (Dec 3rd 2018)





Source: Bloomberg, BMO Capital Markets, Ninepoint Partners

Parex Resources, our top energy holding, has rallied back ~40% from the lows reached in late December as the company announced strong production growth and the initiation of a stock buyback program for 10% of its outstanding shares. Parex continues to grow production at over 20% YoY and we expect reserves to continue to increase even faster. The company sells into the Brent market (over \$60/barrel), funds its capex out of cash flow and produces free cash flow on top of capex of over \$300M at current crude prices. Despite all of this, the company continues to trade at a substantial discount to its already cheap energy peer group.

In summary, although growth is definitely slowing back toward trend, we do not see either a U.S., Canadian or global recession on the horizon. The Fed will likely remain on “pause” until it sees further evidence of accelerating growth or inflation and is unlikely to hike rates further until then. Absent a severe misstep on either US/China trade or Brexit, both of which are of course possible, it is hard to see what would derail a decent year in equity markets. As much as the much better performance for our strategy so far in January has been welcome, we remain focused on achieving long term performance more in line with our historical rate, which is considerably higher than what has occurred over the past three years. We don't see any reason why we can't achieve that and 2019 (so far) has been a good start.

Until next month,

The Enhanced Team

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 December 31, 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.

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