Ninepoint International Small Cap Fund

Q4/2021 Commentary

Dear Clients and Colleagues,

The second year of the COVID-19 pandemic was as much a rollercoaster as the first. The year started with the hope that the soon to be made available vaccines would allow us to return to something closer to a normal life. Reopening names were viewed more positively by institutional investors, although the meme stocks (GameStop, AMC, and others) were still at the heart of retail trading. As the various vaccines started being distributed however, the deadlier Delta variant started spreading globally after being first detected in India in late 2020. Supply chains did not yet recover from their 2020 hangover and inventories were still lagging the exploding consumer demand resulting from massive fiscal spending and reduced costs of working from home. The big question on everyone's mind was whether this increased inflation was to be sustained or just transitory. Still, all these factors did little to dampen investors' enthusiasm.

With the reopening well underway and a significant portion of the world at least partially vaccinated, the Omicron name started appearing in the news as the new variant of concern. Markets, used to dealing with COVID-19 at this point, continued rising. Political responses to the new wave were initially wide ranging. China reacted by continuing its zero- tolerance policy and locking down cities that saw spikes in cases. The US continued its message of asking its citizens to get vaccinated, seeing how harsher measures such as Biden's vaccine mandate for the workplace was eventually blocked by the Supreme Court. Europe's response went from lockdowns in Austria to simply closing restaurants after 8 pm in Ireland.

At the same time, it started to become more commonly agreed in the second half of the year that the inflation experienced across the world was unlikely to subdue on its own and Central Banks, Fed included, shifted their language to make it clearer that 2022 will be the year of raising rates and balance sheet lightening.

The microchip shortage continues across the world, affecting virtually all industries but none as hard as the automotive industry. Car sales in Europe hit a record low in Q4, as new passenger car registrations dropped by more than 30%. Meanwhile in North America used vehicle prices surged 37% YoY as inventories dried and demand soared.

UK market return was positive over the quarter, primarily on the back of defensive names such as consumer staples with international exposure, despite the uncertainty around Omicron and supply chain disruptions. Its Central Bank was one of the first to raise rates in December from 0.1% to 0.25%. The rest of Europe also saw positive returns over the period, as corporate profits and economic resilience reassured investors. The Eurozone inflation rate for November stood at 4.9%

Most of Asia's equity markets suffered small losses in the fourth quarter. Its worst performers were China and Hong Kong. Both faced a significant resurgence of COVID-19 and the fear that authorities might impose more lockdown restrictions. Many observers started worrying about the impact that Omicron could have on the global economy, and how it would disproportionately affect the export-dependent Asian economies.

Although the US equity market had solid gains during the quarter, concerns around inflation are still on the minds of most investors. Consumer spending fell sharply in December, likely as the impact of rising prices started to be felt.

BACK TO INTERNATIONAL SMALL CAP

During the fourth quarter of 2021, the MSCI EAFE Small Cap Index underperformed the MSCI EAFE Large Cap Index while outperforming the MSCI Emerging Markets Index.

In the MSCI EAFE Small Cap Index, Real Estate, which represents 12.2% of the index, was the strongest performing sector, delivering a positive return of 5.1%. At the opposite end of the spectrum, Consumer Staples was the worst performing sector, returning -7.5% for the quarter, with an index weight of 5.2%.

PERFORMANCE HIGHLIGHTS

For the fourth quarter, our International Small Cap composite delivered a return of -0.8%% gross, underperforming the MSCI EAFE Small Cap Index by 0.6% gross.

Our top contributor this last quarter was L'Occitane International S.A. (0973 HK). A French company listed in Hong Kong, L'Occitane is a manufacturer, marketer and retailer of natural and organic skincare and beauty products. The company has over 3,400 retail locations in 90 countries. Its main brand, l'Occitane en Provence, represents 80% of its sales and is well-known for its quality at an affordable price.

The global beauty market is estimated at USD $240 billion and growing between 3 and 5% per year, driven by demand in Asia. L'Occitane benefits disproportionately from this trend as its brand recognition in China outshines most of its occidental peers.

What drove the stock up?

The company was a top performer in Q4, due to two reasons. First, the company delivered stronger than expected first half results ending in September 2021. Like-for-like sales were up 19% YoY, and up 7% vs pre-pandemic, profit was up by more than 260% over last year. The company also revised up its full year revenue and profit guidance. Second, the company announced the acquisition of Sol de Janeiro, an innovative leader in the global premium body care market, inspired by the authentic Brazilian philosophy of self-love and joy. 83% of its revenue comes from North America, 65% of sales are from online, and about two thirds of purchases are made by Gen Z and Millennials. There is a lot of room for synergies including sharing distribution channels and product development know-hows.

Another highlight this last quarter was Internet Initiative Japan (3774 JP). Founded in 1992, IIJ is Japan's leading internet infrastructure provider, offering Internet connections, hosting, outsourcing, and wide-area-network (WAN) services along with system integration services. More than 80% of its revenues are recurring. IIJ has the largest market share in public cloud services and is the number one player in the mobile virtual network operator (MVNO) market in Japan. Today, the company serves more than 10,000 corporate clients, mostly blue chips, and operates in Japan, the US, Europe, China, Hong Kong and Southeast Asia. It employs more than 3,000 staff worldwide, over 70% of which are technical engineers.

The company's competitive advantage is derived from its unique position as the first full-scale internet service provider in Japan with a solid track record of reliability. It is also the largest internet backbone network in the country, with over 20 network operation centers. With a global trend among companies worldwide to move their IT infrastructure to the cloud, IIJ is uniquely positioned to benefit from the increased capital expenditure companies will be making in IT over the next decade.

So what drove the stock up?

It's most recent earnings results beat analysts' estimates by a significant amount, with operating profit up 77% and net profit up 149% on the back of its IP and security & WAN services. In addition, the company increased its full year profit guidance by more than 50% along with its dividend forecast. Scale benefits are starting to show for the company and, in addition to the lower connectivity charges from telecom carriers, this should continue to help the company grow over the next few years.

Our top detractor for the quarter was Autogrill SPA (AGL IT). Autogrill is the world's largest food and beverage company serving travelers across the globe. Since World Duty Free spun out from Autogrill in 2014, the new Autogrill has generated half of its revenue and two-thirds of its profit in the US. Fifty percent of its global revenue comes from airport locations and forty percent from motorway locations. You may have driven the New York State Thruway to Albany or the Illinois Turnpike to Des Plaines, or perhaps instead you have taken a plane from LAX to Tampa. If you bought food or beverage in any of these places, you were a client of Autogrill or, to be more precise, of its US subsidiary HMS Host.

Autogrill's market is growing and mainly captive due to the concession nature of the company's locations. Before the COVID-19 crisis, air traffic was growing faster than global GDP, and lower oil prices should continue to lead to an increase in road traffic, creating a positive trend for the company. The company's concessions last from five to fifty years, with the average duration exceeding seven years. Once the company wins a concession, it becomes the sole operator and makes all the food and beverage decisions for that location, including available brands. In addition to having its own brands, Autogrill is the largest franchisee of Starbucks and Burger King.

What drove the stock down?

Nothing changed fundamentally for Autogrill during the quarter, as it even upgraded its guidance in December. Instead, the stock merely underperformed along with other European travel and leisure names as countries imposed new lockdown measures even before the Omicron variant became dominant and the new Omicron wave led to more travel restrictions. Of note is that the stock is still up triple digits since November 2020. It is one of our better performers, and we remain confident in the management.

NEW POSITION

During the quarter, we initiated a new position in DFDS A/S (DFDS DC). Headquartered in Copenhagen, the company is an integrated shipping and logistics service provider. It operates a network of 23 routes that include 8 port terminals with 57 freight and passenger ships. The company offers a one-stop-shop offering to its clients including custom clearance, warehouse logistics, clerk service and more that helps it maintain its strong market share in some of its more important routes: the Mediterranean, Baltic and North Seas.

DFDS growth strategy is focused on optimizing its existing network, but is also willing to add new routes to meet its existing client needs. It has been ranked among the best ferry operators and is recognized for its best-in-class customer service.

The company has a transition plan in which it targets a reduction of 45% in its CO_2 emissions by 2030. All this made DFDS an easy addition to both our international and global portfolios.

OTHER NEW BUYS AND SELLS

Over the quarter, we also initiated positions in Seiren Co, Thk, Als and Dometic Group. We will profile these names in future commentaries.

During the quarter we exited the following names: SBBB, Seria Co, and S.O.I.T.E.C.

WHAT IS OUR EAR-TO-THE-GROUND APPROACH TELLING US?

Global Alpha is starting another busy year attending conferences and meeting companies from all around the globe. As the response to Omicron and the subsequent rules regarding travel varies wildly between countries, these meetings are still mostly taking place remotely.

We expect inflation and Central Bank rates to remain at the forefront of discussions in 2022 which would favour names in the financials, consumer discretionary, and industrials at the expense of Utilities and Telecom. M&A could slow down from a record year in 2021 as a result of increased borrowing cost and lead Private equity firms to shift their focus to quality companies trading at a reasonable valuation.

As a bottom-up fundamental manager however, we do not make material sector or country adjustments to the portfolio as a result of these expectations and maintain a diversified list of holding companies with defensible business models and strong balance sheets that are trading at a discount to their intrinsic value. Our portfolio remains well diversified across the many countries, currencies and industries that compose our benchmarks.

The Global Alpha Team
Sub-Advisor to the Ninepoint International Small Cap Fund

NINEPOINT INTERNATIONAL SMALL CAP FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2021 (SERIES F NPP371) | INCEPTION DATE: MARCH 15, 2018

	1M	YTD	3M	6M	1YR	3YR	INCEPTION
Fund	2.2%	10.0%	-1.2%	0.9%	10.0%	11.0%	5.9%
MSCI EAFE Small Cap NR USD (CAD)	2.7%	9.2%	-0.2%	3.0%	9.2%	12.6%	5.9%

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at December 31, 2021; e) annual returns are from 03/15/2018. The index is 100% MSCI EAFE Small Cap NR USD (CAD) and is computed by Ninepoint Partners LP based on publicly available index information.

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