Ninepoint Enhanced Equity Strategy

June 2018 Commentary

Investment Team

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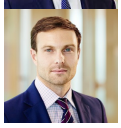

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Market leadership swung quietly back to technology in May and June with the S&P Info tech sub index up >7%, after experiencing a momentum meltdown in April. We used the sell-off as an opportunity to add to Microsoft and Facebook as discussed in our April commentary.

Energy equities experienced a pullback in late May on risks of OPEC production increases only to rally back in June. We remain bullish on energy equities and believe that current already well anticipated production increases only shift supply forward and don't much change the aggregate tightness the market is likely to experience in the coming years (barring a global recession).

Financials, an area of the market we believe offers good value at current levels, underperformed this month on rising concerns over the growth impact of recent trade spats, deposit beta's and broad risk off sentiment. We believe the recent CCAR results are quite positive as they offer banks the ability to release substantial capital back to shareholders. While we acknowledge that positive earnings revisions for 2019 for financials are less likely at this juncture, we see double-digit earnings growth, sustainable capital returns and low relative valuation offering an attractive risk reward.

The last several months have seen an acceleration in political turmoil in Europe as well global trade concerns. With the formation of a government last month in Italy, markets have de-risked some of the European monetary Union concerns near-term. We think headline risks remain elevated but an exit of Italy from the EU is a very low probability tail risk anytime soon. On the other hand it is becoming clearer that trade conflict is likely to continue escalating as the first round of U.S. tariffs on Chinese goods hit the first week of July, prompting an immediate response from China. Trump has already looked to initiate an additional $200B worth of import tariffs in a tit-for-tat response to China's tariffs.

Increased trade tension has lead to a considerable sell-off in industrials given their global supply chains along with other cyclical sectors such as financials. We had already lowered our weight in industrials in March/April largely due to our concerns over peaking near-term PMI's and stretched valuations, with the trade risks an additional negative dynamic that we knew was certainly brewing in the background yet difficult to price. However, coming into this quarter we have increased our exposure to industrials again using call options as stock replacements, viewing the risk as more balanced on the recent decline in share prices. This position offers us similar upside to a plain long position on a 4-6% move but with downside limited to just the premium invested.

If a trade war continues to evolve ahead of expectations the sector likely has considerable downside and we will only lose the moderate premium we have added coming into the quarter. However, if no escalation in trade rhetoric occurs we suspect that a sharp re-rate is possible near-term.

We also see broad market equity options currently priced at a level where upside optionality on the SPY ETF appears much more attractive to us relative to several months ago with upside implied volatility near the lows of the last several years (chart 1).

Chart 1

Source: Bloomberg

We re-initiated this position in early July as trade concerns set-in and the market sold off. We can effectively replace and add some of our upside market exposure cheaply with call options, with only our premium at risk. If the wall of worry we are climbing leads to some further equity upside as economic data could potentially continue to improve vs. expectations in the coming months, the move could be quicker than many imagine. As discussed this still manages the risk of a larger correction given only our premium is on the table.

The Enhanced Strategy Team

COMPOUNDED RETURNS[1]

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.2%	-0.4%	1.0%	-1.5%	6.8%	0.9%	4.3%	6.0%
Index	1.9%	6.7%	7.2%	5.7%	16.5%	10.0%	13.8%	14.5%

[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 June 29, 2018; e) inception date for Ninepoint Enhanced Equity Class is 04/16/12.[2] 50% of S&P/TSX Composite TRI; 50% of S&P 500 TRI CAD and is computed by Ninepoint Partners LP based on available index information.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these

risks: capital depletion risk (series T and series FT securities only); capital gains risk; class risk; commodity risk; concentration risk; credit risk; currency risk; cybersecurity risk; derivatives risk; exchange traded funds risk; foreign investment risk; inflation risk; interest rate risk; market risk; regulatory risk; securities lending, repurchase and reverse repurchase transactions risk; series risk; short selling risk; tax risk.

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