



# Ninepoint Enhanced Equity Strategy

## March 2019 Commentary

Worries over a global slow down continued to fade last month allowing equity markets to extend their 2019 rally in March with the S&P 500 up 1.8% and the S&P/TSX 60 up a more modest 0.6%. The Canadian dollar fell 1.4% for the month, pushing the US\$ return of the unhedged S&P 500 to 3.2% in March. Prices for crude oil continued to recover from their swoon during the fourth quarter of last year and prices for WTI gained 4.5%. Despite the substantial gain for crude oil from its lows (up over 33%) equity prices for energy related companies continue to lag. Although up roughly 20% from their lows, share performance for energy companies was largely negative in March with the XEG sector ETF down almost 2% despite the 4.5% gain in crude prices. Finally, gold gave back some of its gains from earlier in the year, falling 1.9% in March as worries over future inflation (which were already low) fell further.

We were not in the recession camp during the selloff late last year, and we are still not in the recession camp as we have moved through the first quarter. Yes, economic data, particularly sentiment data, softened meaningfully exiting 2018 and for the first part of 2019; however, there were also several headwinds that played a role. Anxiety of the China/US trade dispute, fears over the Fed over tightening, worries the US government could shut down (which it did) and typical weak first quarter seasonality all played a role. Add to those factors tough year over year earnings growth comparisons as last year's tax cuts are lapped and the outlook looked risky. Yet here we stand, entering the second quarter, with the China trade spat increasingly looking resolved (if only superficially), The Fed on hold and sounding dovish, the shutdown over and largely forgotten, vastly improved seasonality and a labour market that has continued to meet or beat expectations so far this year.

In our view, we think the wind can remain at our backs for some time to come. With improving growth, steady (or softening) inflation (which is keeping central bank policy on a dovish path), reduced trade tensions (as Trump pauses his tariff campaign in light of the 2020 election) all that is left to really worry about is whether earnings can actually grow this year and, if so, how much should we pay for that growth?

Earnings estimates for the S&P 500 have been steadily moving lower for weeks and now stand at \$166 (bottom-up)/\$171 (top-down) for 2019 and \$184.65 (bottom-up)/~\$180-181 (top-down) for 2020. Most investors seem to be penciling in ~\$180-182 for 2020 and based on that range the S&P is presently trading at ~16x exactly. We believe the earnings bar is now set low enough to allow the "meet and beat" cycle to resume again and, if we are right, the first quarter earnings season could provide the fuel to continue to push equity markets higher. Our two largest sector allocations, Financials and Energy, remain substantially undervalued in our view and are both poised to beat very low investor expectations and deliver excellent earnings and cash flow, especially relative to their very low current valuations. With WTI now over US\$60 and Brent crude approaching US\$70, we

### Investment Team

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Co-CEO, Managing Partner,  
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believe our energy holdings can deliver exceptional cash flow yields (20% or more) and return capital to shareholders through increasing share buybacks. Likewise, investors have been too focused on net interest margins (NIMs) for our bank holdings and are ignoring their tremendous earnings power as they enjoy strong balance sheets (including their capital buffers), continued loan growth, low credit losses and excellent cost control. Elsewhere in the portfolio we effectively reduced our weighting in U.S. healthcare related stocks to a toehold position (roughly 1%) as we entered March over concerns the Democratic presidential campaign would introduce increasing rhetoric surrounding “healthcare for all” – a clear negative for healthcare insurers and providers. We kept our hedging book relatively short dated during the year to date rally in order to minimize the hedge burn as indices moved consistently higher but we have started to extend out our expiry dates at current levels (at or above 2800 on the S&P).

Looking forward, the top five most important macro events for equity markets over the next few months are likely to be as follows:

1. First quarter earnings season - The key will be management commentary around linearity and guidance and whether that can allow earnings estimates to bottom out and begin to move higher again;
2. US/China trade deal - This could occur soon (perhaps within the next two weeks) with a Trump-Xi summit possibly happening by May (investors will tolerate this process extending into the opening weeks of May but not much longer). A deal is widely assumed and it would take the immediate removal of all current tariffs to surprise on the upside;
3. Trump’s decision on Iranian sanctions waivers (expected in early May) – it seems like some of the waivers will be dialed back but the White House will be careful about materially disrupting crude markets (so it’s likely some countries will still be permitted to buy Iranian oil);
4. Trump’s decision on auto tariffs - Trump was given the authority to impose auto tariffs and needs to make a decision on this front by May 18th (although this date can probably be moved). It seems unfathomable the White House would actually impose these tariffs given the economic consequences of such a move (likely more than the China tariffs and at least with those there was some support. Literally nobody, outside of the small circle around Trump, is in favor of auto tariffs). If these tariffs are actually implemented, it would be an enormous downside risk for stocks;
5. Fed inflation conference (June 4-5 in Chicago) - Fed anxiety about undershooting the inflation target has been a growing theme and this will be a key topic of discussion at this conference. However, while presentations/papers at this event may alter expectations one way or another, investors shouldn’t expect a formal policy announcement (the Fed has said its review of the inflation target won’t arrive until the first half of next year.

It is tempting to look at the strong year to date gains for equity markets and assume there isn’t any more room for gains this year. In our view, that would be wrong. In effect, the strong rally from the market lows hit last Christmas have just back filled the hole created by the sharp decline in equity values late last year. While we don’t expect another double digit gain in the second quarter, it is not unreasonable to expect high single digit gains over the remainder of this year. We believe our current portfolio is more than capable of delivering that sort of performance and, as always, we will continue actively hedging in case we are wrong.

## **The Enhanced Team**

<sup>1</sup> 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 March 31, 2019; 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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