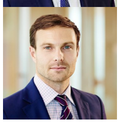
Ninepoint Enhanced Equity Strategy

November 2018 Commentary

Investor anxiety of the potential for a global growth slowdown began back in October, kicked up a notch in November and accelerated into a minor panic in early December. Global economic growth has remained modest for much of the past year with only the U.S. seeing a meaningful acceleration in 2018, largely due to the tax cut package introduced early this year. Now, a slowing forward outlook, rising short term rates from the Fed and increased rhetoric over tariffs from Trump have led financial markets to begin discounting a coming recession. We do not believe the global economy is on the precipice of a recession, nor do we believe either the U.S. or North America generally is about to enter one. The U.S. economy experienced eight years of modest growth following the GFC, sometimes above the 2% trend for a few quarters, sometimes below. This year the U.S. has enjoyed solidly above trend growth as tax cuts and a strong consumer more than offset weak business investment and a slowing housing market. We expect a return to trend growth next year and, eventually at some point though not necessarily next year, another recession. The question is, how much of this has the equity market now discounted?

Investment Team

John Wilson, MBA
Co-CEO, Managing Partner, Senior Portfolio Manager



Colin Watson,
Vice President, Associate Portfolio Manager

Although we did believe forward earnings estimates were too high for 2019 this is generally always the case and consensus estimates have come down materially over the past month (now forecasting ~5% earnings growth in 2019 as compared to almost 10% earlier in the year). The S&P 500 has de-rated from a high of 18X forward earnings down to less than 15X forward (Chart 1) the new, lower estimate as investors question forward earnings estimates on tariffs concerns as well as general "angst" about future revenue growth and margins. The last time the S&P 500 traded at this valuation was early 2016, a period when high-yield spreads reached almost 6% (Markit CDX Index), Nominal GDP growth in the U.S. had decelerated from 4.5% to 2.5%, PMI's globally touched 50 and earnings growth in the U.S. went flat to negative for several quarters.

While we have been more cautious on earnings revisions post Q2 given the strong correlation between estimate revisions and US. PMI momentum (Chart 2), which suggests a peak, we feel the market narrative has quickly moved from concerns over earnings "beats" declining to fears of outright negative growth in 2019 estimates. While 2019 will see more risk to earnings growth given we are lapping significant tax reform tailwinds, our sense is that the recent cut to 2019 S&P earnings (now 4-5% growth vs 9-10%) is achievable. In fact, we believe this new, lower EPS growth rate generally implies a nominal GDP growth environment even lower than we envision, something more akin to the 2016 slowdown (Chart 3) and therefore would lead us now to be generally less negative than the consensus on 2019 estimates. Without question, a negative swing factor to growth would clearly be a significant tariff escalation although we continue to believe this will take a lot of time to play out and probabilities still point to cooler heads prevailing. If we are right and growth only slows to trend, then current earnings estimates are indeed achievable and we think the top end of the range is likely ~16X forward earnings or 2800 on the S&P.

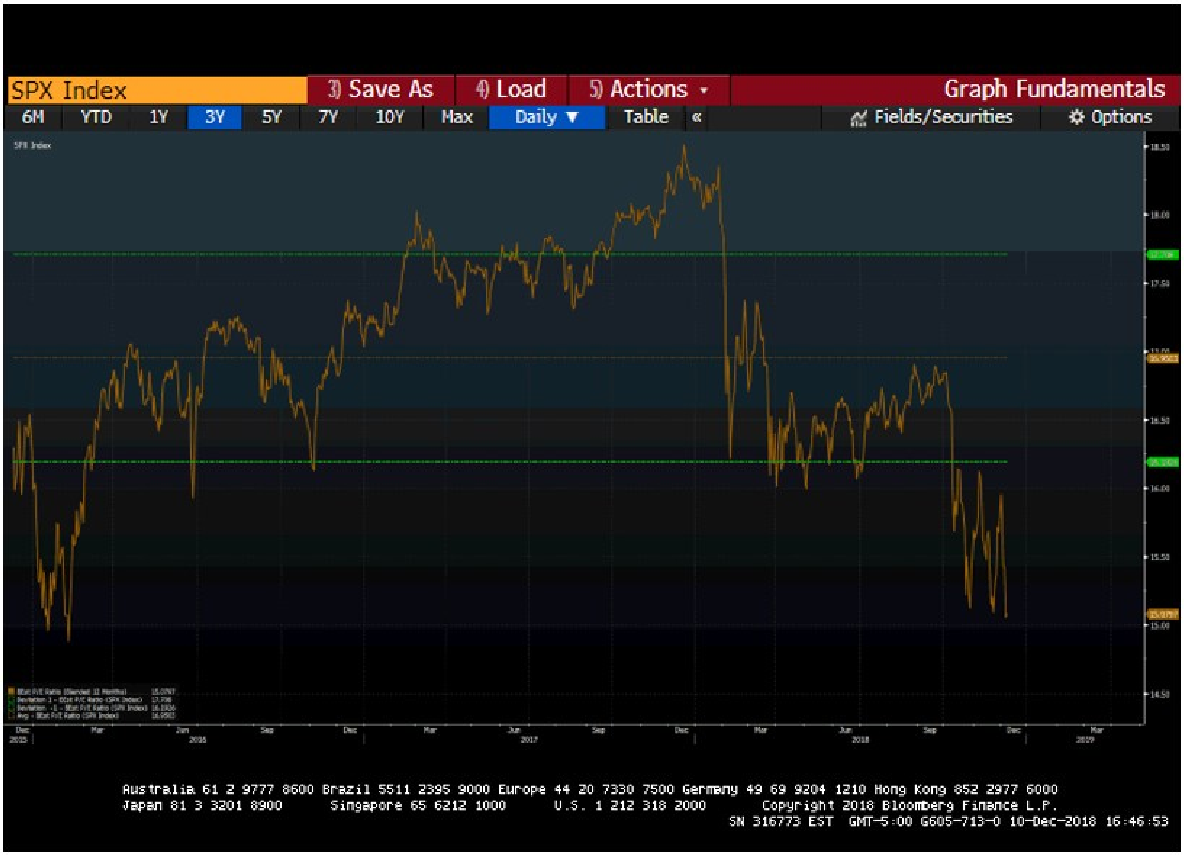
Challenges with the performance of our equity book has more than offset the positive contribution from our hedge book through the recent decline as traditional correlations have broken down and rapid sector rotation has removed much of the safety we have historically found in more defensive oriented stocks. The continued negative performance of our “value” orientation to stock picking has been both painful and frustrating. Cash flow, cash flow yield, price to book and earnings have offered virtually no valuation support. Incredibly, given the current state of the economy (which we would remind everyone is still pretty good), there are both mid and large cap companies which have traded to multiples matching levels reached during the 2008 crash. We know that those levels were an excellent buying opportunity in 2008 and we expect they will prove to be again once we look back from some unknown point in the future. Value investing was crushed by technology stocks through the late 1990’s only to reward investors as technology stocks gave back all their gains through the early 2000’s. In the meantime, we have increased our downside hedging exposure and we own significant S&P put exposure at the 2600 level and below. Market reaction has appeared largely disconnected from fundamentals over the past few months so predicting its future path feels uncertain at best. As a result, even though we believe the current selloff is overdone, maintaining a significant hedge book is in our view warranted. That said, should markets come to their senses, they are likely to move quickly back above the 2700 level on the S&P. Given that possibility, we have been adding upside call exposure on the S&P in order to help offset declines in the value of our hedge book should the equity market move sharply higher.

Without question, the last three years (and the last three months in particular) have been the most difficult and challenging in my career. Managing our portfolio through the financial crisis of 2008 felt like a walk in the park in comparison since at least markets were reacting to deteriorating fundamentals then as opposed to imagined ones today. Unfortunately we do not get to choose the market environment, it is our job to analyze, decipher and, maintain discipline. We are doing just that.

Until next month,

The Enhanced Team.

Chart 1: FWD PE Back to the early 2016 Lows

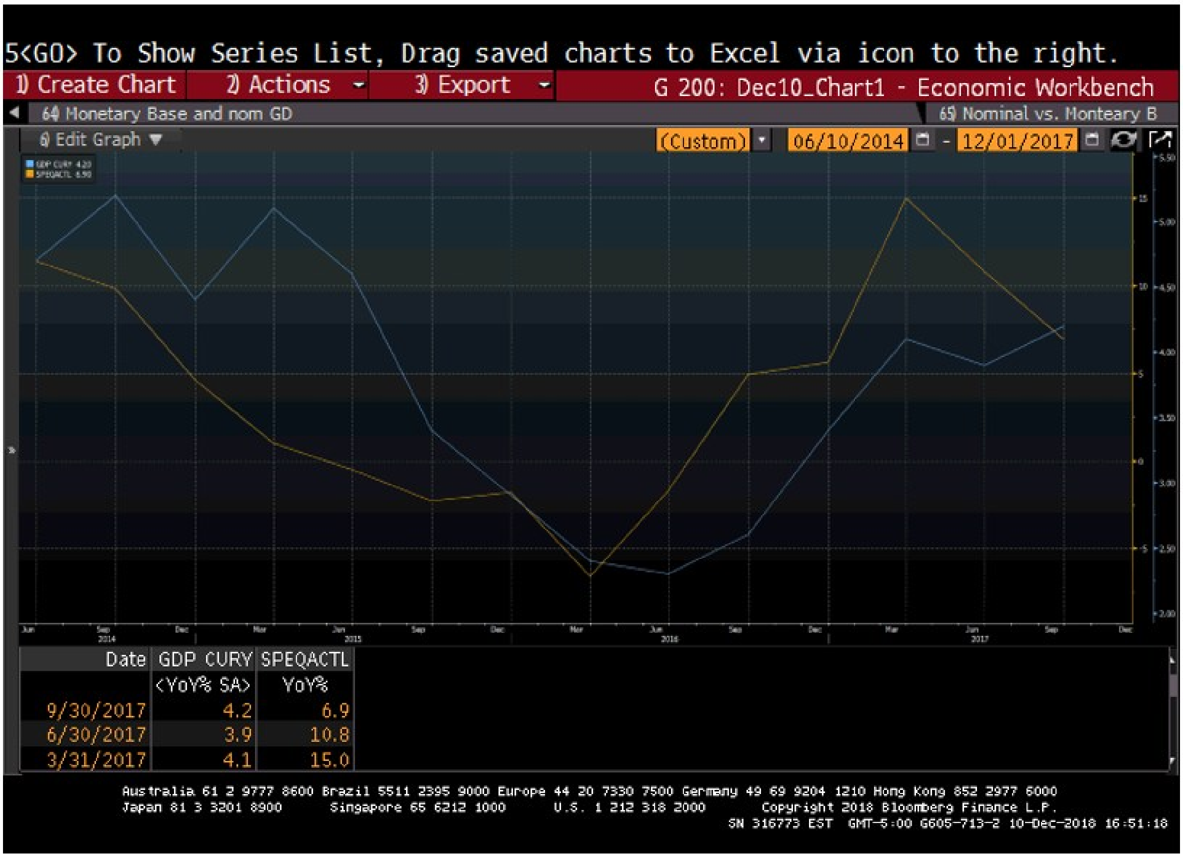


Source: Bloomberg

Chart 2: EPS Revisions follow PMI (purchasing managers index) momentum

Source: Bloomberg

Chart 3: 2016 Nominal GDP Growth fell to 2.5% YoY when EPS growth went negative



Source: Bloomberg

COMPOUNDED RETURNS[1]

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	7.1%	7.1%	-2.7%	-11.0%	-12.3%	-0.5%	1.2%	3.7%
Index	6.3%	6.3%	2.4%	-2.9%	2.7%	10.8%	10.3%	12.9%

[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 November 30, 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.

Ninepoint Partners LP is the investment manager to the Ninepoint Funds (collectively, the "Funds"). Commissions, trailing commissions, management fees, performance fees (if any), other charges and expenses all may be associated with mutual fund investments. Please read the prospectus carefully before investing. The indicated rate of return for series F units of the Fund for the period ended November 30, 2018 is based on the historical annual compounded total return including changes in unit value and reinvestment of all distributions and does not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The information contained herein does not constitute an offer or solicitation by anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada should contact their financial advisor to determine whether securities of the Fund may be lawfully sold in their jurisdiction.

The opinions, estimates and projections (“information”) contained within this report are solely those of Ninepoint Partners LP and are subject to change without notice. Ninepoint Partners makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, Ninepoint Partners assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. Ninepoint Partners is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by Ninepoint Partners LP. Any reference to a particular company is for illustrative purposes only and should not to be considered as investment advice or a recommendation to buy or sell nor should it be considered as an indication of how the portfolio of any investment fund managed by Ninepoint Partners LP is or will be invested. Ninepoint Partners LP and/or its affiliates may collectively beneficially own/control 1% or more of any class of the equity securities of the issuers mentioned in this report. Ninepoint Partners LP and/or its affiliates may hold short position in any class of the equity securities of the issuers mentioned in this report. During the preceding 12 months, Ninepoint Partners LP and/or its affiliates may have received remuneration other than normal course investment advisory or trade execution services from the issuers mentioned in this report.

Ninepoint Partners LP: Toll Free: 1.866.299.9906. DEALER SERVICES: RBC Investor & Treasury Services: Tel: 416.955.5885; Toll Free: 1.877.874.0899