



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?

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.

Investment Team



John Wilson, MBA
Co-CEO, Managing Partner,
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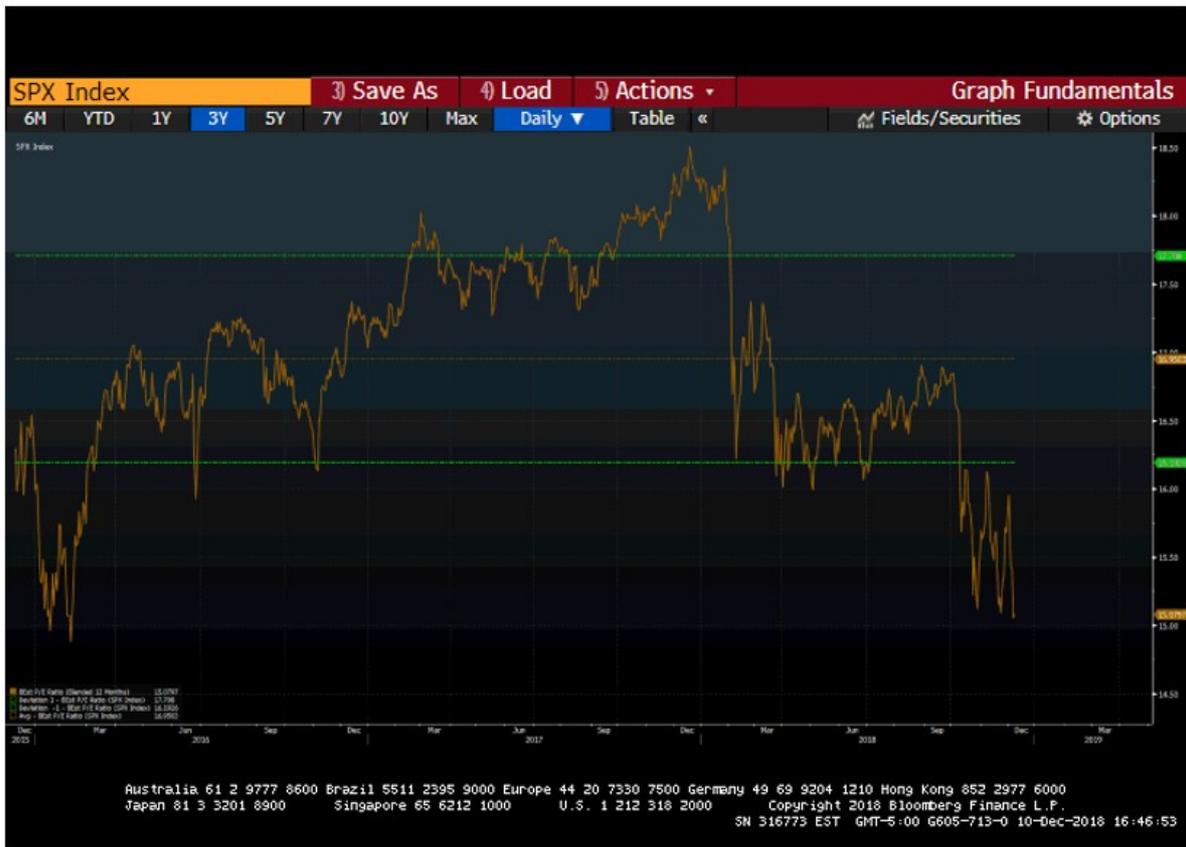
Challenges with the performance of our equity book has more than offset the positive contribution from our hedge book through the recent decline as traditional correlations have broken down and rapid sector rotation has removed much of the safety we have historically found in more defensive oriented 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



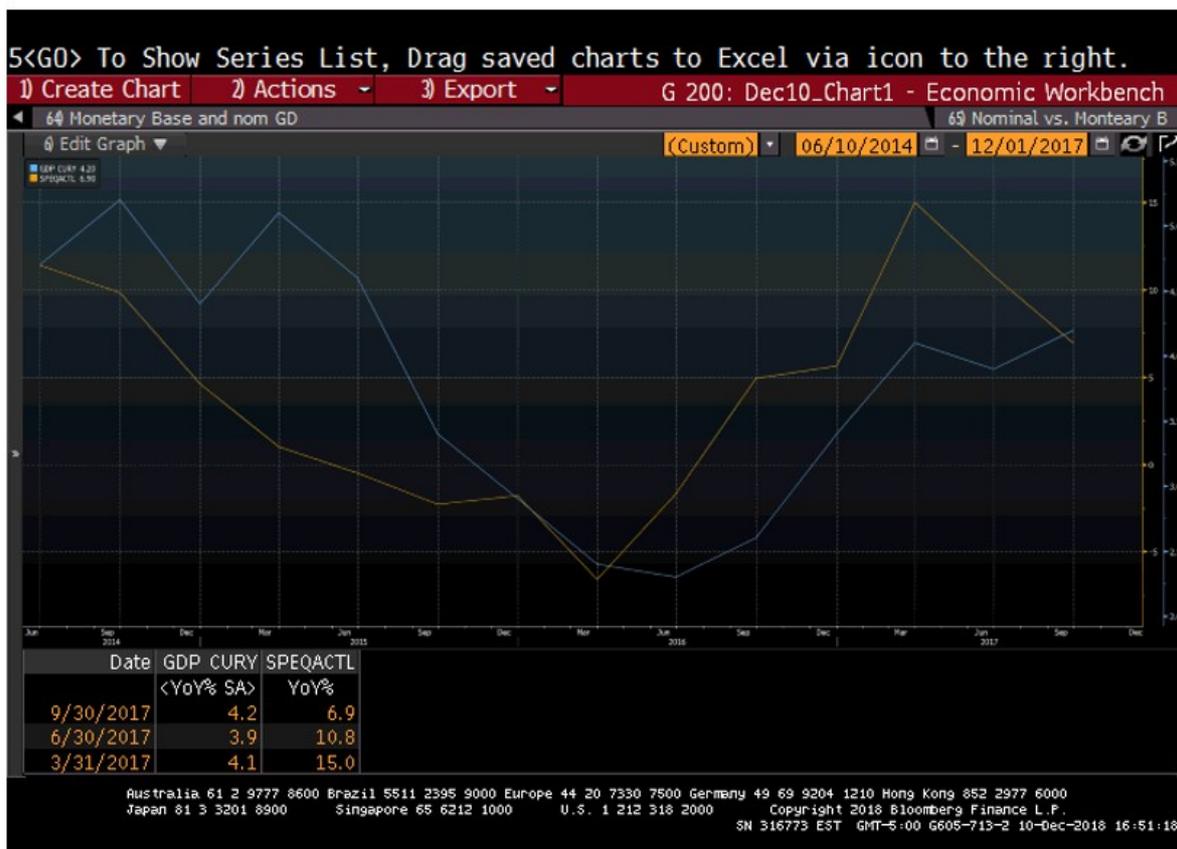
Source: Bloomberg

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

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. 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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