Ninepoint Enhanced Equity Strategy

September 2018 Commentary

Investment Team

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The U.S. equity market continued to hold in through September with the S&P 500 managing a 0.6% (USD) gain while the Canadian market continued to languish, falling a further 0.9%. The resolution of the NAFTA dispute with the U.S. drove a 1.2% rally in the Canadian dollar which dropped the Canadian dollar return in the S&P 500 over the month to a decline of 0.4%. Crude oil continued to reflect supply shortages and continued solid demand as WTI crude rallied over 6% (USD) while Brent crude rallied over 7% (USD). Despite the strong showing in crude elsewhere, the discount realized by Canadian heavy crude continued to widen, reflecting the prolonged pipeline shortage to move heavy oil out of Alberta. Canadian Energy names continued to decline through September as the XEG dropped 3%. Oddly, the decline continues to include even Canadian energy names with little or no exposure to the Canadian heavy crude discount. Finally, markets continued to be disinterested in gold (down 1% (USD)) and even less interested in Bitcoin (down over 8% (USD) last month).

As we discussed last month, we have expected, and continue to expect, crude oil prices to hold near current levels with much more risk of a meaningful move to the upside than the downside. We have been well aware of the lack of pipeline capacity to transport of heavy crude out of Alberta and so while we think the sharp move higher in the Canadian price discount is overdone, it is also not that surprising. What is surprising, disappointing, frustrating and inexplicable is the continued selloff in energy names with no exposure whatsoever to that discount. As an example, we own energy names with no domestic operations and whose realized prices are based on Brent, yet these names sold off as Brent prices rose and then selloff again when Brent prices fall. At current Brent prices, these names now trade at 2.5x debt adjusted cash flow, which is ridiculously cheap. We have a meaningful allocation to energy given our views but that allocation contributed materially to our negative underperformance last month.

Also contributing to our poor performance last month was our allocation to utilities and Altagas in particular. Altagas has been selling “non-core” assets in order to deleverage following the closing of its purchase of WGL and the street has been unconvinced they can realize sufficient proceeds to reach its leverage targets and keep the current dividend sustainable and growing. The decline in the Altagas share price last month reflected those concerns. That said, Altagas is actually slightly ahead of its targeted deleveraging plan and the current dividend yields over 10%. We believe that dividend is sustainable, making the position very attractive. Altagas is actually slightly ahead of its targeted deleveraging plan and the current dividend yields over 10%. We believe that dividend is sustainable, making the position very attractive given sustained low yields elsewhere.

The final negative contributor to our performance in September was financials, U.S. money-center banks in particular. We own one Canadian bank, one life insurer, two U.S. money-center banks and an exchange/clearing house. None of those were helpful to our performance last month but our life

insurer, Manulife, came under particular pressure after a short seller issued a report calling attention to an outstanding lawsuit facing the company. We are well aware of the lawsuit and believe the odds of an adverse ruling for Manulife are exceedingly low. Additionally, U.S. banks (including ours: Bank of America and Citibank) have continued to decline even as both short and long term rates have risen. We Believe these banks are cheap (~1.1x book value) and we received solid earnings growth from both of our banks this earnings season. Despite this, the sector has continued to sell off. Similar to our views on energy and utilities, we believe we will eventually be right and we are sticking with our discipline.

Finally, we continue to manage cost very well across our hedge book. Rapid moves in both the underlying index and volatility have necessitated more rapid changes in positioning across our downside hedges in order to both ensure downside market protection and monetize gains/limit costs. Last month we rolled our market hedging out into November and we hold a series of strike prices from 2850 down through 2620 on the S&P 500.

The story of our strategy this year has been the poor performance of our long stock positions. While the market has not meaningfully rewarded our discipline in stock picking over the past three years, this year has been particularly difficult. As tempting as it might be to chase momentum, our discipline and strategy does not allow that without sufficient downside hedging to manage a negative turn in that momentum. Chasing momentum is very difficult for us to achieve in the low volatility rising market we experienced most of this year, but sharp downdrafts and rising volatility offer us the opportunity to package some of those positions with option hedges in a way that allows us to participate in their rebound, at least somewhat.

Overall, we believe the positions that have caused the most pain for us this year now offer tremendous risk/reward for our portfolio. Our discipline is to continue hedging downside and wait for the reward part of that equation to play out.

Until next month,

The Enhanced Team

[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 September 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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