Ninepoint International Small Cap Fund

Q3 2021 Commentary

Dear Clients and Colleagues,

In many ways, the 3rd quarter was a continuation of the themes and topics we discussed in the second quarter: inflation, supply chain issues, US-China, and return to normal. Oh, and did we mention inflation?

During the quarter, the OECD raised its inflation forecast for the G20 country, citing a mix of higher shipping costs and rising energy prices. The average annual inflation rate for the group is now expected to be 3.7% this year and 3.9% in 2022. The US annual inflation rate stood at 5.3% in August, driven among other things from the price of used cars, while the UK inflation rate surged from 2% to 3.2% on the back of a jump in the cost of eating out. It makes sense that central bankers around the world are starting to shift their language in a way that suggest the time to taper their pandemic fiscal and monetary stimulus is fast approaching. That is all it took for markets to react and start betting that rates will be tightened far sooner and at a much quicker pace than rate-setters are signaling. This belief appears to have some credence so far: both Norway and New Zealand have already lifted their rates.

Energy prices and shortages appear to be the new face of supply chain problems and inflation, in a way that is reminiscent of the 1970s. Natural gas prices rose sharply during the quarter in Asia and Europe from a mix of tight inventory and booming Asian demand. The International Energy Agency (IEA) also pointed to Russia's reduced exports to Europe as a factor. In China more than 20 provinces experienced some form of power outage, including many industrial areas. Both the high price of coal and strict environmental limits on energy consumption are to blame.

Much like we discussed for the US in last quarter's commentary, China is also having its fight with the Chinese big tech names. The government proposed strong antitrust regulations for its tech firms which would ban activities that regulators feel will stifle competition and harm its users in whichever way they deem inappropriate. Chinese regulators have intervened in multiple high profile corporate events recently, such as the blocking of Ant Group IPO and Tencent attempt to merge its two biggest video game streaming sites.

Much noise has also been made of the Evergrande debt default and its impact on China's economy, but it is our view that the impact should be limited abroad and that the government has the capacity to intervene. This is not another Lehman moment and the risk of a contagion effect is unlikely. Nonetheless, the Chinese economy is showing some signs of weakness. August retail sales rose only 2.5%, much below the 7% forecast. Factory output and investment activity were also both well below analysts' expectations.

Back To International Small Cap

During the third quarter of 2021, the MSCI EAFE Small Cap Index outperformed both the MSCI EAFE Large Cap Index and the MSCI Emerging Markets Index.

In the MSCI EAFE Small Cap Index, Energy, which represents 1.6% of the index, was the strongest performing sector, delivering a positive return of 8.4%. At the opposite end of the spectrum, Consumer Discretionary was the worst performing sector, returning -0.3% for the quarter, with an index weight of 13.2%.

Performance Highlights

For the third quarter, our International Small Cap composite delivered a return of 2.8% gross, underperforming the MSCI EAFE Small Cap Index by 0.4% gross.

Our top contributor this last quarter was Raffles Medical Group (BSL SI). It is a leading integrated healthcare group in Asia with three main segments: primary care, inpatient care and specialist care. With over 100 clinics across 13 cities in five countries, Raffles employs over 370 physicians, 850 nurses and serves more than 2million patients.

The company ticks many boxes of the secular themes we like to invest in: it benefits from an aging global population, the growing Asian middle-class, and finally an increasing demand for health care. The co-founder, Dr. Loo Choon Yong owns more than 60% of the shares.

What drove the stock up?

In the first six months of 2021, Raffles Medical delivered strong results, revenue grew by 42% year over year, and profit grew by 138% year over year. This was driven by two main factors. First, although medical tourist volume declined due to border restrictions, local patient traffic has exceeded pre- COVID levels, and was higher than management's expectations. Second, Raffles Medical has been supporting the government's COVID-19 initiatives to provide testing, vaccination, and air-border screening services. It is required by the Singapore government that all the inbound travelers must receive the COVID-19 testing upon arrival at the Changi Airport, and Raffles Medical is the exclusive provider of such testing. With the introduction of the Vaccinated Travel Lane in Singapore, Raffles Medical is well positioned to capture the increasing testing demand at the airport. Raffles Medical's China operations are also on track. Raffles Hospital Shanghai opened on July 26, 2021. It is a 400 bed hospital with comprehensive medical services including inpatient and outpatient services.

Another top contributor this last quarter was Savills (SVS LN), a real estate service provider which includes: transactional, consultancy, property and facilities management, funds management and financial services. With 19,000 staff in 200 offices across 36 countries, it boasts a dominant position in many of the markets it operates in.

So what drove the stock up?

The main driver of outperformance was the release of H1/21 earnings. All divisions saw positive growth compared to the same period last year. Residential markets, particularly in the UK, continued to be strong. Transactional markets also improved with the completion of many delayed transactions, although travel restrictions were still an obstacle to cross-border capital deployment. Assuming no further meaningful disruption from COVID-19, Savills expects performance to be meaningfully ahead of previous expectations.

Our top detractor for the quarter was FlatexDEGIRO AG Corp (FTK DE), FlatexDEGIRO is one of the leading and fastest growing online brokerage businesses in Europe. The firm operates more than 12.5 million transactions annually and serves the B2C segment through a wide range of independent products and competitive pricing.

What drove the stock down?

The quarter started with a private placement at a discount from the founders of DEGIRO after the lock-up period post acquisition expired. Shareholders of FlatexDEGIRO also participated. Part of the rationale was to increase the free float with a view to listing on the MDAX by year end. However, the largest negative impact on share price occurred with the release of preliminary H1/2021 results. After increasing guidance twice in 2021, the last figures showed a slight slowdown in the number of customers added during the second quarter.

However, the company confirmed guidance for 2021 and mentioned the slowdown is more to seasonal patterns. Customer growth and trading activity is usually strong in the first quarter but slows in the second quarter due to more banking holidays, and the start of summer vacations, before picking up in the second half of the year. Overall H2 activity is higher than H1.

New Position

During the quarter, we did not initiate on any position. Although new names were added to our approved list, we are currently well diversified among the multiple countries and currencies included in the benchmark.

Other New Buys and Sells

Over the quarter, we exited Royal Unibrew as it reached the upper threshold of our market cap range and Tarkett as it was privatized.

What is our ear-to-the-ground approach telling us?

Global Alpha remained busy attending conferences and company meetings from all around the globe. As countries around the world are slowly reopening and travel picks up, it is likely that the team will resume travelling and meeting company managements in person in a not-so-distant future.

As we mentioned earlier, not much has changed from last quarter. Inflation remains at the forefront of our discussions with companies and it is becoming clearer that it is unlikely to be transitory. Many continue to blame supply chain issues resulting from the COVID-19 hangover, but it will be wage growth, real estate and commodity prices that are likely to keep inflation more sustained.

M&A also continues to be a driving force in the market. High liquidity, low rates and a valuation mismatch between industries are making managements turn to acquisitions to sustain their growth. Many of our holdings have already made acquisition in this environment and others are attractive targets themselves.

Our process remains unchanged: we focus on holding companies with defensible business models and stronger balance sheets that are trading at a large discount to their intrinsic value. Our portfolios remain diversified across the many countries, currencies and industries that compose our benchmarks.

Have a good day.

The Global Alpha Team
Sub-Advisor to the Ninepoint International Small Cap Fund

NINEPOINT INTERNATIONAL SMALL CAP FUND - COMPOUNDED RETURNS[1] AS OF SEPTEMBER 30, 2021 (SERIES F NPP371) | INCEPTION DATE: MARCH 15, 2018

	1M	YTD	3M	6M	1YR	3YR	INCEPTION
Fund	-2.1%	11.4%	2.1%	8.1%	24.9%	7.9%	6.7%
MSCI EAFE Small Cap NR USD (CAD)	-3.3%	9.4%	3.2%	6.1%	22.4%	8.3%	6.5%

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2021; e) annual returns are from 03/15/2018. The index is 100% MSCI EAFE Small Cap NR USD (CAD) and is computed by Ninepoint Partners LP based on publicly available index information.

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