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CROFT
FINANCIAL GROUP

Commentary & Outlook

Uncertainty Reigns

November appeared to begin with a strong start in both Canadian and U.S. equities as the TSX, S&P 500, Dow and Nasdaq all rebounded from their respective late-October 2018 market lows.

This relief was short lived, as stocks fell back to retest their 2018 lows once again towards the end of the month, reflecting ongoing investor uncertainty. While stocks finished November off these lows, there was and continues to be, a clear lack of commitment to the upside.

Much of the relief came from Fed Chairman Powell hinting at the Central Bank easing off on interest rate hikes. Regardless, ongoing uncertainty around U.S./China trade relations and the anticipation of some sort of resolution at the G20 summit towards month's end fostered ongoing market instability as buyers continued to waiver in their commitment to equities at current prices.

The Canadian equity market mirrored the U.S. in its uncertainty and trading behavior. While the TSX finished modestly higher due to gains in more defensive sectors such as consumers staples, telecom and utilities, weakness in financials and energy continued to weigh heavily. With the OPEC meeting set for December 6th, many investors and money managers closed out November on the sidelines, anxiously awaiting a decision on production cuts. Which we now know had little impact on the price of oil.

To summarize, November, as with the entire year, has been a battle between investor uncertainty fueled by headlines concerning interest rates and trade, along with algorithms programmed to sell the market at the slightest hiccup, versus a North American economic environment that is not all that bad in the grand scheme of things. And so far, uncertainty seems to be winning to the detriment of most investors.

Fund Performance

TCG 531 Equity

For the month of November, the Equity Fund finished up 0.11% while its benchmark, the TSX Total Return Index regained 1.39%

At the end of November, year-to-date, the Equity Fund is down -2.66% with the TSX Total Return benchmark trailing at -3.68%.

Lead Manager Alex Brandolini confirms that given the heightened volatility in equity markets, the IRC took the opportunity to add to some high conviction names on weakness. Valuations on tech stocks are attractive and growth rates for these companies still outpace the broader markets. While our income fund has been positioned more defensively, the equity fund is setting up to take advantage of a trader's market, through a higher cash position and more active add/trim decisions at market peaks and troughs to take advantage of current trading ranges. Several put writes on new and existing names were initiated to maintain exposure in a risk managed way.

TCG 534 Income Fund

The Income Fund finished the month of November up 0.25% compared to the Financial Post Index - Income benchmark, which was up 1.70%.

Year-to-date the fund sits positive at 1.64% compared to its benchmark, which is up 0.29%.

The IRC's focus has been to reduce the overall risk exposure within the fund. Last month's repositioning of the fund to an increase in the fixed income allocation and a reduction in overall equity exposure remains in place. Within the equity sleeve of the pool, lead manager Mark McAdam confirms that exposure to consumer staples has been added and an increased exposure to healthcare is planned. Both sectors tend to outperform in a recessionary environment.

Exposure to the gold mining sector was increased by using a covered call strategy. This strategy helps generate cash flow and reduce the impact of significant price swings on a sector that tends to do better in uncertain markets.

We also continued to reduce exposure to financials and technology and added a hedge through the purchase of put options on the Nasdaq. If the Nasdaq continues to sell off, the put will increase in value, helping to offset risk in the pool.

TCG 539 Option Writing Fund

The Option Writing Fund finished November down 2.56% while its benchmark, the Montreal Exchange Covered Call Writers Index (MX-CWI), regained 2.04%.

Year-to-date the fund is down -6.03% compared to its benchmark, which still sits positive at 2.66%

Lead manager Richard Croft confirms that preferred share exposure and weakness in Canadian Banks acted as the most significant drags on pool performance for the month of November.

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Over the course of November and into December, the preferred share position and overall equity exposure, particularly in tech, has been reduced, leaving the pool 65% invested at present, with just under 50% exposure to equities.

The overall objectives are to reduce the impact of market noise on the pool and to offset broad market risk. The intention is to accomplish this by investing in equities that have demonstrated less sensitivity to the day to day headlines and related market swings and through the tactical application of option strategies. Option strategies currently being implemented include longer-dated covered calls on several Canadian, dividend paying companies as well as credit spread strategies with expiration dates 2 to 4 months out.

Outlook & Expectations

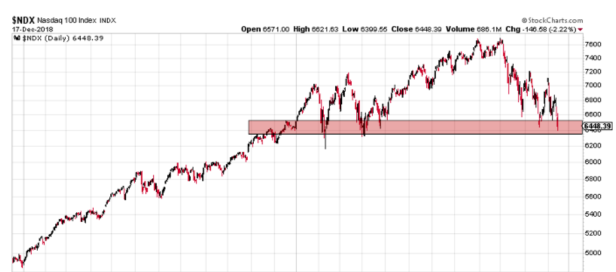
Despite the ongoing noise, the economy remains in expansionary or "growth" mode with low unemployment. Overall, cyclical earnings growth forecasts for the next 12 months continue to outpace defensive earnings growth forecasts. What does this mean? There still is a positive outlook for the companies that have been leading this market higher, compared to that of defensive stocks that tend to be favoured in less optimistic conditions.

That said, the major U.S. equity indices are now testing the lows from February as selling has accelerated into mid-December. Driven by headlines, algorithms, continued uncertainty and tax loss selling into the year end, the Dow, the Nasdaq and the S&P 500 indices are currently at the February lows.

DOW, Weekly – December 17th, 2018

S&P 500, Weekly – December 17th, 2018

NASDAQ, Weekly – December 17th, 2018



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On the Canadian side, the TSX is now testing the lows from September of 2016, with oil and financials and general market uncertainty weighing heavy.

TSX, Weekly – December 17th, 2018

We will be watching to see how these levels hold and adjusting accordingly as macro risks such as the U.S./China trade negotiations, Brexit and global oil markets continue to work their way through the system.

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