Mackenzie Cundill Team

Q3-2018 COMMENTARY

Market Review, Outlook & Strategy

- This past quarter was headlined by a number of market concerns: eleventh hour NAFTA negotiations, the new Italian government's budget, on-going Brexit negotiations, and more trade war tensions between China and the U.S. There has been increased volatility in stock prices. We believe that in terms of price regime in the equity markets, we are near an inflection point. Globally we have seen wage pressures build up. Yield curves have been steepening since mid-August and long bond yields are now rising. Energy prices have improved significantly. Shares in momentum technology leaders have struggled with regulatory headwinds and privacy concerns. We believe these are signs pointing to the resurgence of value style leadership in the market place going forward.
- Canada's Crystia Freeland took center stage in a hard-fought NAFTA negotiation, which inevitably resulted in some concessions made to the US. Net-net, our portfolio constituents will not be materially impacted. The Canadian energy sector continued to be dogged in Q3 as the Federal Court of Appeal delayed the approval of the TMX project by overturning the pipeline's construction permits. While just a delay, it exasperated an already bleak WCSB picture, and sent Canadian heavy oil prices tumbling. Offsetting this to some extent was the positive final investment decision from LNG Canada, which will see it proceed with a massive, $40 billion infrastructure investment in BC and Alberta.
- US GDP growth, capital expenditure, earnings improvement and consumer confidence have been leading the rest of the world, thanks to the corporate tax cut and accelerated depreciation of capital investments. Unemployment rate continues to drop and we believe wage pressures are building. We do not see a significant risk of recession in the near term. In fact, it's likely that the current expansion could keep extending.
- Energy prices have improved, reflecting growing demand and tight supply. The price of Brent is up over 25% year-to-date. Globally crude inventory is now well below 5-year average. Shrinkage of supply from Venezuela, sanctions against Iran, and lack of energy capex investments in recent years have all contributed to the current environment. We see upside risk to energy prices. We have traveled to Oslo and Houston recently and met with many energy industry executives. We believe we are in the early days of recovery in offshore energy drilling and services. The portfolio is well positioned to benefit from that.
- The coalition government in Italy between the Five Star movement and the Northern League have proposed a budget that exceeds EU rules in terms of deficit/GDP. Italian bond spreads have spiked as a result. Italy has a current account surplus and we do not believe the risk of an Italian exit from the Eurozone to be high. There will likely be prolonged negotiations between Brussels and Rome as the Italian government wants some degree of freedom to honour their election pledges to the public. Having said that, our portfolio has no direct exposure to Italian banks.
- At the time of writing, there are some indications that the UK may be close to having a Brexit deal agreed with the EU. We have always held the position that it is in the interest of both the UK and EU to provide businesses a level of certainty in managing the transition. We believe a deal to allow for a form of "soft Brexit" is likely. However, these negotiations could drag on and the UK prime minister Theresa May still has to sell the proposal to her government and her country. Her minority government position and recent departures from her cabinet have put tremendous pressure on her during these negotiations. Meanwhile, the UK economy is actually holding up fairly well. Our UK holdings are global companies and we do not expect changes in the valuation of the GBP to affect our performance meaningfully.
- Over in China, ongoing trade war with the US is putting pressure on the technology hardware sector there and consumer confidence has started to weaken. In addition, prior tightening by the central bank has slowed down shadow financing and the housing sector. In the long run, China has tremendous growth even if the pace of growth is slower than the past decade. Our Chinese holdings are not directly affected by trade flows as they are not exporters.
- In Japan, there are signs that the corporate sector has improved its focus on shareholder returns in the last couple of years due to reforms initiated by the Abe government. We have added to our Japanese holdings this year as we found compelling value ideas.
- Our portfolio is fully invested and the recent pull back in the market has given us opportunities to initiate new positions in value ideas with strong re-rating potential. We feel that we are now seeing the beginning of the end of growth style leadership in the market, and our value strategy has significant upside in the coming years.

MACKENZIE Investments

PORTFOLIO MANAGEMENT TEAM:

Richard Wong, Senior Vice President, Portfolio Manager, Investment Management, Mackenzie Investments
Jonathan Norwood, Senior Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

Fund and Benchmark Performance as at: September 30, 2018	1 year	3 years	5 years	10 years
Mackenzie Cundill Value Fund Series F	7.6%	9.0%	6.1%	6.6%
MSCI World Total Return Index (net CAD)	15.2%	12.3%	14.4%	10.7%
Mackenzie Cundill Canadian Security Fund Series F	6.6%	8.8%	5.7%	8.2%
60% S&P/TSX Composite Index, 30% S&P 500 Index and 10% MSCI EAFE (Net) Index	10.7%	11.5%	11.4%	8.9%
Mackenzie Cundill US Class F	11.8%	10.7%	12.4%	10.2%
S&P 500 Index (CAD)	22.1%	16.1%	19.2%	14.2%
Mackenzie Cundill Canadian Balanced Fund Series F	5.2%	7.1%	4.9%	7.1%
Blended Index (62.5% S&P/TSX Composite Total Return Index and 37.5% FTSE TMX Canada Universe Bond Index)	4.3%	6.7%	6.2%	5.8%

*Blended benchmark: 60% S&P/TSX Composite Index, 30% S&P 500 Index and 10% MSCI EAFE Index.

MACKENZIE Investments