Mackenzie Global Equity & Income Team

Q3 2018 COMMENTARY

Market Review

- During Q3 2018, Mackenzie Global Dividend Fund (Series F) returned 1.5%, and has now returned 12.8%, annualized, since portfolio manager change. This compares with the MSCI World Net Return Index ($CDN) Q3 return of 3.2%, and 12.6%, annualized, since portfolio manager change. Stock selection in Materials contributed positively to relative performance during Q3, while stock selection in Health Care detracted from relative performance. Exposure to Chinese equities also dragged down relative performance throughout the quarter.

- Mackenzie US Dividend Fund returned 0.3% during Q3 2018 and has now returned 14.1% annualized, since inception. This compares with the S&P 500 Total Return Index ($CDN) Q3 return of 5.8% and 16.8%, annualized, since inception of the Fund. Stock selection in the Energy sector contributed positively to relative performance, while stock selection in the Information Technology sector detracted from quarterly relative performance.

- Virtually all returns for the year and the quarter have come from the U.S. Why did this happen? At the end of the day, and this is oversimplifying things for sure, but markets discount earnings expectations and earnings growth estimates for regions outside the U.S. started to decouple, particularly in Emerging Markets. This started in Q2 and began to accelerate in Q3. Up until now, U.S. estimates have surprised positively, which has certainly been helped by the tax cuts.

- The themes that have dominated the global and economic market backdrop YTD have remained relatively consistent and Q3 proved no exception. Trade remains top of mind globally, with much focus on the U.S. and its major trade partners. With a reworked NAFTA out of the way in the form of USMCA, China is now front and center. A reasonable question one might ask: how is the portfolio positioned to deal with a trade war? From a broad overview, a shrinking of global trade or a reduction in efficiencies as it relates to comparative advantages between countries is a net negative. We run a global equity portfolio and any friction that might make it more expensive to operate is ultimately not a good thing. And while we have no crystal ball as to how or when a deal with China will ultimately be made, odds are it will eventually happen. Why? Because trade protectionism is bad for the both sides. The opening up of China to foreign investment has allowed the likes of Nike, Apple, 3M and BMW, etc. to earn enormous profits and has given consumers access to more affordable products. Trade wars will ultimately result in lower consumer spending, lower profits, and job losses in both countries. And even though exports to the U.S. totalled just over 4% of GDP ($500 billion, or under 20% of the country's total exports) and thus far only half are subject to tariffs between 10% of 25%, sentiment has clearly been hit. We have already seen tax cuts for individuals and businesses worth 1% of GDP announced, and if these frictions result in increased unemployment we will likely see further Chinese policy relaxations.

- Against this backdrop the U.S. Fed raised its benchmark rate 25bp to a range of 1.75%-2.00%, continuing its divergence among major global central banks (and also publicly drawing the ire of President Trump). Our sense is that if other central banks could raise rates, they would. The Bank of England, which faces heightened domestic uncertainty surrounding the country's impending exit from the EU, as well as the ECB, where economies are still growing albeit at a less robust level, have thus far signaled they will remain as accommodative as necessary to avoid unduly pressuring their markets or economies. The Bank of Japan, much to the chagrin of the IMF's managing director Christine Lagarde, has shown no indication it will later its exceedingly accommodative stance anytime soon. The Bank of Canada recently raised its overnight benchmark a quarter point to 1.75% and also dropped any reference it would be taking a "gradual approach" to future hikes.

- The UK was notably weak as Brexit negotiations have proven challenging, rattling nerves about the likelihood the country successfully maintains trade agreements with the European continent. We'd like to remind investors that of the six UK-domiciled companies we own, only one (London Stock Exchange) earns more than 10% of its profits within the UK. We would look to take advantage to own Dream Team companies as a result of any political fallout. As an aside, we maintain a 20% hedge in our positions priced in pound sterling.

MACKENZIE Investments

- When building a portfolio we want diversity in geography, industries and the type of investments that we are making. We also want to own a collection of businesses whose implied return – including both capital appreciation and dividends - is above average, or at least greater than the long term real return of global equities of just over 5%. We don't seek out "hot" areas of the market but we also don't avoid them if valuations are reasonable. We also don't avoid areas that face temporary uncertainty, which creates low expectations and good value. Given that we are over nine years into a bull market, the portfolio currently leans towards the latter.

- We have no intention of deviating from our approach, which despite having underperformed over the most recent period has generated above average returns over the course of time we have been managing funds for Mackenzie. And while we have little control over short term movements in our companies' stock prices, the portfolio has been built to reasonably withstand global stressors by being balanced across sectors and geographies, and by concentrating in companies that we believe can deliver durable free cash flow and dividends.

- We take a long-term approach to investing and typically expect to hold our investments in companies for many years. Most of the companies that we invest in operate in several countries, and often benefit from natural or financial hedges that alleviate policy, country and currency risk. The geographic exposure is based on where we find the highest quality at the best valuation. As long as we are right about the cash flow potential and the quality of the businesses we own, purchased at a sensible price, we feel confident about the future outcome.

- As for making calls on what direction the stock market might head in the coming months, we can unambiguously say we have no idea. We read all the same headlines that you do and understand what the concerns are. To name just a few: signs that global growth may have peaked; rising sovereign debt levels; slowing trade growth/rising trade tensions; heightened policy uncertainty; geopolitical tensions; challenging developed world demographics; emerging market stress; mid-term election concerns; the fear of inverted yield curves. These have been front and center and have clearly been on the mind of investors as stock markets have weakened in recent weeks. What could go right? Earnings could continue to advance at a healthy rate and inflation could stay within a normal 2% range. Interest rates, while higher than two years ago, are still well below their long-term averages. Corporate profits could remain intact and unemployment near 50-year lows. Bull markets end when either the economy turns down and earnings decline or when interest rates rise to a level where bonds provide significant competition for stocks. Today, 10-year government bonds yields from around the world range from 3.1% in the U.S. (equivalent to 32x earnings), to 2.45% in Canada (40x) to under 1.5% in the UK (67x) to under 0.15% (667x) in Japan. Today's rates, while higher than they were recently, are still among the lowest in history. While we would never rule out a stock market correction – we are aware it's been almost 10 years since the GFC - we also feel that the best thing we can do for our unitholders is continually seek to upgrade the portfolio and take advantage of market volatility.

What contributed positively to performance?

- Starbucks bounced back after it was announced a well-known activist (Bill Ackman's Pershing Square) had acquired a $700m+ stake in the company. We were able to acquire shares the previous quarter after weak results indicated some challenges they were having in their two key markets, the US and China. This is on the back of having already lowered their long-term EPS growth targets at the end of FY 2017 from 15-20% to 12%+. We believe the issues in China will be remedied, as the slowdown there was largely a function of their not being able to do beverage and food delivery well. Consumers in China have quickly adopted a desire for coffee delivery, and Starbucks will now partner with Alibaba in a comprehensive way to not only accomplish delivery, but to do it in a sustainable and profitable way. Starbucks still plans to double its units in China over the next four years, a market it has been in since 1999. The US issues are a bit more complicated but not insurmountable. Our biggest concern was cannibalization in this mature market, but this does not seem to be the case. With strong positive traffic in the morning, but weakness in the afternoon, cannibalization is not likely the issue, as it would impact the entire day, not just the afternoon. The company's data also indicates that cannibalization rates across the US have not changed over time when new stores move close by. This is another indicator that the issues are more likely due to the company's afternoon's offerings and/or changing consumer preferences. We think it is a combination of both that will take time for Starbucks to work through, but the company has a history of excellent product and experience innovation that we believe will return the company to better growth in 2019 and beyond. Despite its leading brand in a secularly attractive category and best-in-class per unit economics, we were able to purchase the company at a substantial discount to its historical average valuation and a 2.7% dividend yield.

- Apple was one of the outperformers last quarter as the company reached the $1 trillion market capitalization milestone. The company has been working on growing its recurring revenue base by growing its services revenues. Services revenues grew 27% and are now on $40 billion run rate. While still only 18% of sales services like Apple Care and iCloud Storage, are a very important part of Apple's future's growth story. The iPhone, which makes up nearly 60% of Apple sales, continues to expand its reach as well as ASP (average sales price). To alleviate the sticker shock in the U.S. the company has shifted carriers to a rental model where for $40 a month the consumer gets the newest iPhone. This not only increases the predictability for the company it accelerates the frequency in which phones are upgraded. The market reacted positively to these developments which outshined a temporary slowdown in growth of the company's China sales as a result of the ongoing trade war. We believe that Apple is one of the highest quality consumer discretionary businesses in our universe and we continue to hold shares in the company.

What detracted from performance?

- When a stock underperforms, we review the thesis for holding it. Most of the time, it is simply a function of the investment case taking longer than expected. We have expectations on what the company will produce in terms of sales, profits and cash flow over the coming 3+ years and beyond and track its progress against these metrics. We aren't too fussed one way or another if a company "misses" or "beats" in any given quarter as long as the underlying trends are roughly in line with our longer-term views. But while the businesses may perform within expectations, the stock price might not necessarily follow in lock step. Furthermore, we are fallible and can make mistakes in our analysis or events take place that changes the structural nature of the underlying business case. Take for example two of our holdings that contributed to underperformance this quarter: Bayer AG and Atlantia. The former name's underperformance is quite straight forward: in September Bayer declined after a California jury awarded a cancer patient almost $300m after he claimed glyphosate (the chemical found in Roundup) caused his Non-Hodgkin's Lymphoma, which flies in the face of almost forty years of scientific evidence that suggests there is no link to this chemical and cancer. A judge called for a new trial on the punitive damages, citing lack of evidence. Shares have regained some of its lost since the quarter end and while the timing of arriving at a final resolution is uncertain, we feel that at 10x earnings and approximately 8% FCF yield, we are being paid to wait as these issues will ultimately prove manageable.

- On the other hand, Atlantia presented us with a more complicated – and unprecedented - scenario. Atlantia, one of the largest publicly-traded infrastructure players, declined following the collapse of a bridge on a tolled road in Genoa. The bridge that collapsed was a tolled section of the A10 motorway that was operated under a concession contract by Autostrade per L'Italia, an 88% owned subsidiary of Atlantia. The newly formed left-right populist Italian government blamed the company for being derelict in its duties to maintain the bridge. The government appears to have commenced a process that could lead to it revoking the single concession that governs Autostrade's toll-road network in Italy. Following internal analysis and listening to Italian legal and political experts, we acknowledge the range of potential outcomes is wide. As a result we did not take the decline in share price as an opportunity to add to our position and will continue to monitor the situation.

What changes have we made to the Mackenzie Global Dividend Fund?

New Positions

- We initiated a new position in the largest retail pharmacy in the world, Walgreens. The company was taken-over by the management of Alliance Boots through a reverse takeover in 2015. Alliance Boots has been one of the best managed companies in Europe and its CEO and founder, Stefano Pessina, one of the best capital allocators in the industry. In the last year there have been two obstacles to overcome: first, the pending of acquisition of Ride Aid which was recently completed and second, the entry of Amazon into pharmacy. Both put pressure on the shares sending them down nearly 40%, where we were able to initiate a position. While margins in the pharmacy are capped do to regulatory standards, the front of store is where great pharmacies differentiate themselves. Boots in the UK has always had the best front of store profitability and management is trying to apply the same concepts to their U.S. stores, where Walgreens has historically lagged their peers. Front of store sales at Walgreens represent nearly 40% of sales with two-thirds being general merchandise and one-third being very profitable non-prescription drugs. Store margins at Walgreens have significant room to increase as the company optimizes its footprint of 14,000 stores. While we view Amazon as long-term threat, we believe Walgreens will have time to react and Amazon will be slow to pick up market share. We were able to purchase shares at a 10% free cash yield to enterprise value with a 3% yield, making it one of the least expensive businesses in our universe. At that valuation, this relatively non-cyclical business provided a unique opportunity.

Sales

- We sold our shares in Epiroc AB, which was spun out from long-term Swedish holding Atlas Copco. Epiroc is pretty much a pure play on global mining capex and was spun at valuations we felt did not warrant holding on to. That being said, Epiroc has been added to our Dividend Dream Team list and we would be happy to revisit at more appropriate valuations.

- We also sold our position in Goldman Sachs for a switch into another financial services company that we believe provided better risk-adjusted upside going forward. We will comment on that company in next quarter's statement

PORTFOLIO MANAGEMENT TEAM:

Darren McKiernan, Head of Team, Senior Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

Eugene Profis, Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

Ome Saidi, Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

---

MACKENZIE Investments

The investors in Mackenzie US Dividend Registered Fund are restricted to certain registered plans whose planholders are residents of Canada or the U.S. for tax purposes, as more fully described in the Fund's simplified prospectus.

The rate of return is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual fund or returns on investment in the mutual fund.

Fund and Benchmark Performance (%) as at: September 30, 2018	**1 year**	**3 years**	**Since PM change***	**5 years**	**10 years**
Mackenzie Global Dividend Fund F	7.9	11.3	12.8	13.5	11.0
MSCI World Index NR (CAD)	15.0	12.2	12.6	14.4	10.7
*PM fully implemented new strategy February 1, 2014. Inception on July 12, 2007					
	1 year	**3 years**	**Since inception****		
Mackenzie US Dividend Fund F	8.1	15.9	14.1		
Mackenzie US Dividend Registered Fund F	7.7	15.5	13.8		
S&P 500 Index (CAD)	21.9	15.9	16.8		
**Inception on April 24, 2014					