Mackenzie Cundill Canadian Balanced Fund – Series F

Q1-2019 COMMENTARY

Performance Summary

- For Q1 2019, the Fund returned 9.6% compared to the return for the blended benchmark of 9.7% which is comprised of 62.5% S&P/TSX Composite Total Return Index and 37.5% FTSE TMX Canada Universe Bond Index.
- The Fund slightly underperformed the benchmark over the quarter due to security selection in the Health Care and Information Technology.

Contributors to Performance

- Some outperforming stocks during the quarter were **Transalta Corp. and General Electric.**
- **TransAlta** shares performed well during the quarter as Brookfield Renewable Partners LP plan to invest $750 mil in TransAlta that could be convertible into an equity ownership in TA's Alberta hydro assets in 2025. The transaction highlights the value of the hydro assets and improves the company's financial flexibility. In addition, activist investors are pushing the management to surface more value from the company's asset base. We are monitoring closely developments on this front.
- Cundill holding **General Electric Co.** (GE) saw its shares jump during the quarter after agreeing to sell its bio-pharma business to Danaher Corp. for $21.4 billion. The biopharma business provides tools for medical research and the development of advanced therapies. It accounts for roughly two-thirds of the total sales of the life sciences operations. GE is retaining its other life sciences business, pharmaceutical diagnostics, which it sees as a better fit with its medical equipment business. The announcement in March supports one of the key points behind our GE thesis; namely, that bears were underestimating the amount of assets that GE could monetize. No shareholder vote is required for this transaction, which is expected to close later this year. We believe that it will meaningfully accelerate GE's deleveraging plan. GE shares were another contributor to performance during the quarter and we continue to see upside as the company executes on cutting its debt and restructuring under new CEO Larry Culp.

Detractors from Performance

- **UBS Group** is the undisputed global leader in wealth management. Its client base is ultra-high-net-worth individuals and it has a meaningful exposure to emerging markets' growing population of billionaires and multi-millionaires. The company has decreased its investment banking exposure over the last few years to about a quarter of total revenues. Thus, earnings going forward should be much less volatile than the past. We like the company's wealth management franchise, which is difficult to replicate due to history, market share and reputation. Shares have underperformed this quarter due to client redemptions related to market volatility and weaker investment banking results. In the long run, the UBS franchise is extremely valuable as the premier global wealth manager. Currently stock trades at an undemanding P/E of 9.9X, P/Book of 0.9X with a dividend yield of 5.5%.

Portfolio Activity

- Cundill initiated a new position in **Hang Lung Properties Ltd.** in 2H last year. The position is up for the quarter. Despite the negative headlines about trade war and macro-economic concerns around China, Hang Lung is bucking the trend and showing good growth. High end luxury brands continue to do well in China and Hang Lung's malls continue to benefit. Its Hong Kong rental and operating income reported steady growth a few weeks ago. In the China mainland malls, tenant retail sales continue to trend positively. The company's key high end malls are all showing continued positive progress after management's turnaround efforts. 2019 will be a busy year for new and renovated assets to enter into operations. We are monitoring key milestones including new openings of properties and completion of renovations, which should add to their revenue and earnings base.
- We exited our position in **iA Financial Corporation Inc**. during this quarter.

Market Review, Outlook and Strategy

- Equity markets rebounded meaningfully in the first quarter from depressed levels in December. The sell-off in November and December was excessive due to a global growth scare. During this quarter, a more dovish sounding US Fed and some positive indications of progress being made in trade talks improved investor sentiment.

- China remains the number one global economic driver, but its economy has slowed down over the last year due to credit tightening and trade war concerns affecting investment and spending intentions. We believe we are likely to see the Chinese central bank cut rates to support the economy. Housing prices have improved of late, and construction of living floor space is up year-over-year as of February (latest data). High-end consumer spending especially continues to be strong. Retail sales growth is running at about 8% (February data). Credit growth improved as well in March. Overall, we believe there are signs of improvement in China.
- Although there are indications of progress, a comprehensive China-US trade deal does not seem imminent. Both economies are slowing due to trade concerns. Both sides are looking for wins for the domestic audience. Thus, the deal that will emerge will likely allow both sides to claim victory. Difficult issues outstanding include intellectual property protection and technology transfer requirements.
- In the U.K., the Brexit deadline of March 29th has come and gone, without a deal and without an actual exit at the moment. That deadline was extended after the UK Parliament rejected the divorce agreement Theresa May negotiated with the EU. Meanwhile, UK's economy has slowed down, possibly partly due to the uncertainty created by the Brexit debate. UK's service sector PMI fell below 50 for the first time since 2016. At the time of writing, Theresa May is working on a compromise with her domestic political enemies on a post-Brexit customs alliance with the EU. May secured an extension of Brexit to Oct 31st at a European Council meeting in Brussels on April 10th, which she now has to sell it to her Parliament.
- In the most recent meeting, the ECB kept its benchmark refinancing rate at zero and its deposit rate at minus 0.4%. The council said it expected to keep official borrowing costs for the region on hold "at least through the end of 2019". The ECB is concerned with economic weakness but saw the chance of a recession as low. In fact, the most recent data out of the Eurozone is painting a more positive picture of economic stabilization. Industrial production in France and Italy increased unexpectedly in February. Retail sales in the Eurozone also rose faster than expected in February.
- In Japan, the first three months of 2019 saw companies' lower capital spending plans. This is not surprising due to Japan's proximity to China and its role as a provider of components and equipment to the Chinese manufacturing sector. Consumer sentiment in Japan has dropped as well to the lowest level since 2016. The service sector, however, held up in March, with the services purchasing managers' index still showing growth. The Japanese economy should do better as a China-US trade deal gets done and sentiment improves. The Japanese stock market has lagged other developed markets year-to-date and presents interesting value opportunities in our opinion.
- As for Canada, despite NAFTA headwinds, slowing housing sales, and a continued soft commodity environment; the Canadian economy has managed to post modest GDP growth thus far this year. The yield curve temporarily inverted in March, however, and the jobs market recently posted its first decline in seven months. The SNC Lavalin case has created significant discord in the Liberal administration and more uncertainty could arise from the federal election later this fall. We are less optimistic about Canada than other regions of the globe for these reasons.
- **Fixed Income Team Outlook:** The equity and credit market volatility of Q4 2018 made a complete 180 degree turn in the first quarter of the new year. While a fair amount of the blame for the sell-off that ended 2018 lays at the feet of the Federal Reserve and its hawkish monetary policy stance at the time, the ensuing bounce this year is mainly thanks to the Fed's "dovish" pivot. Starting early in January, the Fed successfully calmed the markets' collective nerves with soothing statements and followed this up with actions. At the March FOMC meeting, the official statement and press conference effectively communicated that future rate hikes in 2019 are unlikely, and accompanying this was a slight downgrade to the Fed's GDP growth estimate for the year, and a pronouncement of an end to the balance sheet reductions ("quantitative tightening") in September 2019.

- Much attention has been paid to the flattening of the yield curve over the past year. In prior economic cycles, an inverted government bond yield curve (short term yields greater than longer term yields) that appeared after years of economic expansion and many quarters of the Fed raising the policy rate, has seemed to presage a downturn in the economy and equity markets. The Fed's recent dovishness has encouraged the bond market to not only completely eliminate (price-out) additional rate hikes, but to also go so far as to "price-in" a high probability for a 0.25% rate cut over the next twelve months. This has induced an end-of-the-quarter inversion of the curve between the Fed Funds rate and the 5-year bond yield.

- Recent weakness in the global economy emanating from many regions is also a significant contributor to the bond market's Fed outlook. Equity and credit markets are not currently reflecting nervousness about the end of this economic expansion, having rebounded throughout the quarter. So, does the stock market have it right, or is the bond market's view of a needed rate reduction the correct call? What the two markets have in common is a positive reaction to the Fed's pause, and in the case of the bond market, there may be some technical components that have caused an inversion in recent weeks.

- The next set of market reactions may hinge more on how certain geopolitical risks are dealt with, as well as continuing stimulus from fiscal sources. Brexit, US bi-lateral trade disputes with various countries, and China's attempts to target stimulus are issues that, if mitigated sufficiently in the near term, could be enough to provide a path to a soft landing and reinvigorate business spending in the second half of the year. This soft landing could occur without the need for Fed rate cuts. Any resumption of rate hikes is now likely to occur only after the economy has shown renewed strength, and an above target inflation rate has persisted for a short period of time, in our opinion.

- Corporate credit markets look poised to generate reasonable, coupon-like returns for the rest of the year, on-balance, after a tremendous start, provided that none of the geopolitics get in the way. It is likely some companies have delayed capital investments due to uncertainties surrounding supply chain management given the trade tariff escalations of the past year. Non-financial corporate debt has increased this cycle, however even with moderate economic growth most companies will continue to have little trouble servicing their debts.

- For the global economy, total debt has increased markedly during this cycle. The debt outstanding may create a drag on potential growth, and any material increases in bond market yields could push debt-service costs beyond tolerable. As the slowing global growth rate and volatile markets have shown us over the past few quarters, rising bond yields and policy rates can quickly produce headwinds even from what are historically considered low prevailing yield levels.

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Fund and Benchmark Performance as at: March 31, 2019	1 year	3 years	5 years	10 years
Mackenzie Cundill Canadian Balanced Fund Series F	-8.9%	2.8%	1.4%	7.2%

Blended Index (62.5% S&P/TSX Composite Total Return Index and 37.5% FTSE TMX Canada Universe Bond Index)	-5.0	4.7%	4.0%	6.7%