Mackenzie Cundill US Class – Series F

Q4 -2018 COMMENTARY

Performance Summary

- During Q4 2018, the Fund returned -26.4% vs. the S&P 500 which returned -8.7%.
- The Fund underperformed the index due to overweighting and security selection in the Energy and Industrials sectors.
- We would draw attention to the extreme attractiveness of the Cundill US Class' valuation which currently trades at an 80% discount to the overall market (S&P 500 index) on a price to book value of 0.6x vs. S&P 500 at 2.8x. We do not believe that the Q4 sell-off in Cundill US Class was fundamental in nature. We did not have a material, adverse shift in individual company fundamentals that reduced our estimate of intrinsic values. Nor was there a material change in our risk management practices or portfolio construction. In fact, at the end of Q3 all the risk metrics looked normal. In short, we see a clear disconnect between what the CEO's of our portfolio companies are telling us what the markets are indicating.

Market Review, Outlook and Strategy

- Mackenzie Cundill US Class experienced a significant decline in reported NAV during Q4/2018 along with a severe market downdraft. In November-December we experienced a period of heightened volatility concurrent with reduced liquidity, which we believe to be (at least partly) structural in nature. We saw high negative flows from systematic strategies such as CTAs, volatility targeting, option hedging, passive rebalances, CPPI structures, etc. which represented a large part of overall flows. We believe there were not enough fundamental, long only buyers to counter these outflows, which created unrelenting downward pressure on many of our names.
- Secondarily, many of our holdings, particularly in the energy complex, have publicly traded debt. High yield bond holders have looked to hedge their downside via shorting the underlying equity, rather than using credit default swaps because of their illiquidity or unavailability altogether. This also put downward pressure on our names.
- A severe global market sell-off engulfed Q4/2018 and Cundill funds did not escape as investors fled any kind of 'risk on' investments. Risk appetite 'disappeared' in the quarter. Even the mighty FAAMG stocks were hammered. Safe haven stocks like utilities and consumer staples stocks fared better, but there really was 'no place to hide' except in cash. Under such a scenario, stocks that Cundill team buys don't do well. By its very nature as a value manager, Cundill buys re-rating stories. Regardless of sector, these re-rating stories take time and execution. When risk appetite disappears, it is very challenging for Cundill to outperform. We believe that markets experienced a global growth scare and overreacted to worries over the potential to go from a ~3% GDP US economy (~4% global growth GDP) to a recession as characterized by two successive negative quarters of GDP Growth. We view the past year as a temporary setback and believe the markets will shake off the fears of 2018, driven mainly by two overriding concerns: 1) US Fed raising rates to quickly and 2) China-US trade wars and tariffs. As evident from positive market behavior in the first week of January 2019 after Fed Chairman Powell convinced the market that the Fed is going to be patient with further hikes.
- 2018 was tumultuous year of performance in the US markets, with volatility dominating the first & fourth quarters. The year started with concerns over Trump's tariffs on aluminum and steel imports, U.S. - North Korea tensions and rising worries over China-U.S. trade as well the possibility of a Federal Reserve policy mistake. That culminated in panic out of risk-on assets in the fourth quarter.
- In the energy markets, global inventories steadily dropped to below five-year average levels by second quarter. That was due to robust demand, coupled with likely declines in Venezuela and Iran production, and pipeline bottle-necks in the Permian, to be supportive of crude prices despite increased production from Saudi Arabia and Russia in the near term. WTI responded positively and was trading in the low 70s and Brent was in the high 70s. During the fourth quarter oil prices collapsed on rising inventories due primarily to: regular seasonal refinery shutdowns, Saudi excess supply and the surprise excess of oil as Trump gave waivers to many countries buying from Iran.

Cundill View

- We view the fourth quarter as a temporary setback and believe the markets will shake off the fears of 2018, driven mainly by two overriding concerns: 1) US Fed raising rates too quickly, and 2) China-US trade wars and tariffs, as evident from positive market behavior in the first week of January 2019 after Fed Chairman Powell convinced the market that the Fed is going to be patient with further hikes.

MACKENZIE Investments

- Our view is that although global growth is slowing, there is no sign of recession on the horizon. Employment numbers and wage gains are pointing to continued healthy labour market and consumers. The parts of the yield curve that are meaningful indicators are still upward sloping and not indicative of impending recession. The current US Fed has indicated that it pays attention to signals from the equity markets. We find it difficult to see a Fed that will blindly hike rates to potentially cause a recession in the foreseeable future.
- In summary, we believe what we saw in Q4 was a "global growth scare". Although global growth is slowing down, recession risks remain low. As the costs of the trade war increase on both sides, we believe the US and China are incented to reach a deal where both sides can claim victory and provide businesses and consumers with more confidence. Such a deal should bring relief to the markets.

Catalysts for 2019

1. US-China trade negotiations - deadline March 1st, 2019
    a. Base case is that we see resolution that will provide certainty to the market
    b. Delay - will push certainty into future and add to volatility
2. Energy
    a. OPEC cut 1.2m boe/day
    b. OPEC+ March 1st meeting
    c. Expiry of Iran sanction waivers to eight countries - early May
3. Sentiment change
    a. Chinese government stimulus and further rate cuts
    b. Continued strong labour markets and strong banking sector earnings dismiss fear of recession
    c. Depressed valuations in our holdings getting re-rated to reflect underlying fundamentals

Bullish on Energy and Financials

- **Energy** stocks got hammered when oil prices cratered at the beginning of October 2018 from $75 per barrel for WTI to $45 by December 31st and Brent fell from $85 per barrel to $50 by December 28, both down around 40% in 3 months. Why? We believe Trump 'browbeat' the Saudis into pumping more oil into the market with the quid pro quo that he would increase sanctions on Iranian oil, preventing output. However, Trump provided enough waivers to buyers of Iranian oil that the markets ended in oversupply. This added to global growth scares but is entirely uncorrelated in our view to any growth concerns. OPEC has agreed to cut production by a substantial 1.2 million barrels per day and we have seen the market recognize this with WTI jumping up to $52 and Brent up to $61 by January 10, 2019. We evaluated every energy name in the portfolio, talked with management and went to Oslo, Houston … to talk with suppliers/customers and all indicated that business was looking good if not better in 2019 than 2018, completely not reflected in stock prices.
- Small cap stocks were disproportionately impacted in the fourth quarter and the fund's three largest security detractors are energy small caps. Bristow Group, Nordic American Offshore and TransOcean were the largest detractors. These companies provide services to the oil and gas industry and have more torque on financial performance than large integrated energy companies such as Exxon or BP Energy. Stocks sold off dramatically and went well below our estimated intrinsic value on a complete risk-off trade. We have had extensive conversations with management and customers and are confident the fundamentals of the business are doing quite well, which is divorced from stock price movements due to extreme market sentiment.
- In **Financials**, after the sell-off in December, our major US bank holdings were trading at near 'recessionary' book value levels and we are not even in a recession, nor are we heading into a recession in the foreseeable future. This was a big disconnect we can only attribute to panic/fear. Our banks are in better financial condition than they were even before the 2008 financial crisis with great balance sheets that are over-capitalized which allow the banks to ramp up dividend payouts and buy back shares. As we write, the market is coming to its senses. Year to date (January 16th), shares of Bank of America are up 15.5%, Citigroup up 19.5%, and Wells Fargo is up 6.2%.
- In the last few days, our bank holdings have reported earnings that have largely exceeded expectations and erased market fears of impending doom.

- Bank of America's Q4 Net Income is up 40% vs. year ago. Return on Equity is up 380 bps. Efficiency improved by 700 bps. Credit quality is stable. They see in the US strong indications of continued growth. During 2018, the company returned $25.5 bil in dividends and share buybacks to shareholders.
- Citigroup results showed continued momentum in 2018. EPS grew 25% vs. 2017. The bank returned $18.4 bil of capital to shareholders and bought back more than 200 mil shares during the year. Returns on Tangible Equity improved 286 bps to 10.9%. The company sees strong underlying fundamentals in the economy.
- We expect the US banks to continue to return substantial capital to shareholders via higher dividends and share buybacks. Notably, their expense base is shrinking, and they are seeing positive momentum in many parts of their businesses. That should improve their positive operating leverage going forward. They commentary during this earnings season confirms our view that the fundamentals of the economy are sound.

PORTFOLIO MANAGEMENT TEAM:

Jonathan Norwood, Vice President, Investment Management, Mackenzie Investments

Effective March 24, 2016 Jonathan Norwood was named lead manager of the Fund

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Fund and Benchmark Performance as at: December 31, 2018	1 year	3 years	5 years	10 years
Mackenzie Cundill US Class Series F	-23.3%	-1.4%	3.4%	10.8%
S&P 500 Index TR (CAD)	3.8%	8.8%	14.1%	14.4%