Ninepoint Focused US Dividend Class

October 2018 Commentary

Investment Team

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Year-to-date to October 31, the Ninepoint Focused US Dividend Class generated a total return of 1.22% compared to the S&P 500 Index, which generated a total return of 7.99% (CAD).

Returns in the month of October were disappointing on an absolute and relative basis, with the Fund generating a total return of -6.88% while the benchmark generated a total return of -5.09%. In October, the US 10-year bond yield rallied from 3.06% to 3.16%, remaining above the key psychological level of 3.0%, which acted as a headwind for the equity markets. Our investments in the Communication Services and Utilities sectors performed well and but could not offset weakness in the Energy, Information Technology, Industrials and Consumer Discretionary sectors. Finally, currency hedging detracted from performance in October as the CAD weakened despite the successful negotiation of the USMCA trade deal.

October 2018 will be remembered for the dramatic correction in the equity markets, with the S&P 500 falling 10.6% to an intraday low on October 29, before rebounding. The list of potential factors or causes of the correction have been well documented (including a more-hawkish than expected FED tone that led to higher rate expectations, a deteriorating US-China relationship that led to the enactment of trade tariffs, wage and materials cost inflation that led to margin compression in various earnings reports and the looming US midterm elections that led to political uncertainty) but, in realty, no single factor can be blamed.

Whatever the trigger, aggressive positioning in crowded high-growth and high-multiple stocks was unwound and the entire market de-rated. Broadly speaking, rising rates and uncertainty imply lower P/E multiples but consider the following scenarios for the S&P 500 based on forward earnings estimates: 15x $178 = 2,670 (seems unlikely since earnings growth remains positive in 2019), 16x $178 = 2,850 (very reasonable), 17x $178 = 3,025 (quite possible) or 18x $178 = 3,200 (seems unlikely without an improvement in either the FED's tone or US-China trade rhetoric).

Therefore, we believe that it is too early to position for an outright downturn and expect markets to end the year higher than today. Positive seasonality for the markets should kick in (gains in November and December occur 75% of the time based on data from the past twenty years), the midterm elections proved to be benign (on average markets rally 7% from August 31 to year-end around midterms based on history) and earnings expectations and market valuations have been reset to reasonable levels.

Our modelling indicates that the Canadian dollar is roughly fairly-valued. However, the equity market selloff has introduced a new level of complexity to our FX analysis as prior correlations become less statistically significant. We have therefore maintained hedges on half of our USD/CAD exposure to reduce volatility in the Fund.

Top contributors to the year-to-date performance of the Ninepoint Focused US Dividend Class included Apple (+130 bps), Mastercard (+129 bps) and Microsoft (+124 bps). Top detractors year-to-date included Chevron (-55 bps), Canadian Natural Resources (-54 bps) and Facebook (-43 bps).

The Ninepoint Focused US Dividend Class was concentrated in 26 positions as at October 31, 2018 with the top 10 holdings accounting for approximately 44.4% of the fund. Over the prior fiscal year, 20 out of our 26 holdings have announced a dividend increase, with an average hike of 10.7%. We will continue to apply a disciplined investment process, balancing various quality and valuation metrics, in an effort to generate solid risk-adjusted returns.

Jeffrey Sayer, CFA