NCM MARKET NEUTRAL INCOME FUND YEAR END REPORT

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The second half of 2018 was very weak in the Canadian equity markets with most of the damage coming in the fourth quarter. After a third quarter that returned -0.6%, the S&P/TSX Total Return Index (TRI) struggled in the fourth quarter generating a return of -10.1%. For calendar 2018, the S&P/TSX TRI returned -8.9%, posting negative returns in seven of the twelve months. The S&P/TSX Completion TRI (or mid cap index) and the S&P/TSX Small Cap TRI returned -12.9% and -18.2% respectively for calendar 2018. The FTSE TMX Universe Bond Index performed much better but still only delivered a return of 0.8% in the second half of 2018 and 1.4% for the calendar year.

After a reasonable but boring first half of 2018 where the NCM Market Neutral Income Fund (MNI) generated a return of 1.1%, the Fund faltered in the back half of the year by returning -5.8% leading to a calendar year return of -4.8%. The MNI Fund only posted five negative return months but was affected by two bad months (October and December) which combined to deliver more than all the yearly deficit.

What made 2018 disappointing was that historically, this fund has been able to post positive returns in years in which the S&P/TSX was negative (2011 and 2015). We need to remember that the goal of most market neutral strategies is to have NO correlation to the market; meaning that it does not matter whether the market goes up or down. If a Fund always goes up when the market goes down, then it would likely have a negative correlation. Given that the MNI has a correlation since inception of essentially zero, it is not surprising that it did not go up with the S&P/TSX being down. A small win is that the fund did protect better than any Canadian equity index and the returns, as is the norm, fell somewhere between stocks and bonds showing the diversification benefits of the strategy. Unfortunately, that does not make it any less disappointing for you as an investor or for me as a Portfolio Manager.

Over the next few pages, we will walk you through what worked and what did not in 2018, show you a few examples of trades that did not work out as planned, give an in-depth analysis of the attributes of the Fund, and discuss our outlook for the strategy in general and the Fund specifically.

Bond Performance

Breaking down performance; let's start by reviewing the bond portfolio. At the end of December, bonds made up 93% of the portfolio through 11 positions. As a whole, they currently have a yield to maturity of 3.4% and a modified duration of 1.3 years. All the bonds were investment grade at the time of purchase, except a 12% weight in NCM Short Term Income Fund (which includes some senior loans). The estimated return on the bond portfolio was 2.6% for calendar 2018. The bond portfolio performed as expected.

We want to remind our investors of why we hold a bond portfolio. Simply put, the proceeds from the short equity positions are used to buy the long equity positions, which means we still have the initial investment left. We can choose to do nothing with that money and earn 0% or we can invest that money in a short duration, investment grade bond portfolio that should cover the fees of the Fund.

Given that all the bonds are bought with the intention of holding them to maturity, what we continually monitor is whether we believe that the underlying company has a chance of going bankrupt before the maturity date from an equity point of view. Given that bonds are typically more secure than equity, if we believe that the company is a going concern from an equity standpoint, we are happy owning the bond.

Equity performance

On December 31, 2018, the NCM Market Neutral Income Fund held 40 long equity positions totaling 96% of the portfolio, and 58 short equity positions totaling 96% of the portfolio with 0% net exposure to all 11 S&P/TSX sectors. The Fund was 50% invested in sub-sector neutral pairs and 50% invested in sector neutral pairs. The long positions were 26% small cap, 36% mid cap and 33% large cap while the short positons were 26% small cap, 38% mid cap and 31% large cap.

In 2018, we had many successful trades and unfortunately many that did not work out as planned. In general, we attempt to close out trades that have not worked quickly and let the winners run by increasing their target weights. Having said that, we are very active in trading around core positions and will move quickly to reduce our target weight if a long position's reported numbers start to slow down or if their valuation gets excessive. We typically close out short positions if there is a significant price drop, if they start generating stronger numbers or if their momentum gets stronger.

Top Longs	Bottom Longs
Alimentation Couche-Tard	BRP
Brookfield Real Estate	Conifex Timber
Great Canadian Gaming	Hardwoods Distribution
TFI International	Maxar Technologies
West Fraser Timber	Trevali Mining

Top Shorts	Bottom Shorts
Acadian Timber	Aritzia
Freshii	Canada Goose Holdings
Richelieu Hardware	Canfor Pulp
Shawcor	MTY Food Group
WestJet Airlines	Ritchie Bros Auctions

Top Pairs
Enerplus / Advantage & Tourmaline
Fortis / Hydro One
Kirkland Lake / NovaGold & Goldcorp
Parex Resources / Prairie Sky & Arc Resources
Quebecor / Shaw

Bottom Pairs
AGF Management / Fiera Capital
H&R REIT / Dream Unlimited
Lundin / First Quantum
New Flyer / Student Transportation
Whitecap / Freehold & Peyto

In 2018, we were very pleased with how the exact pairs (or sub-sector neutral) portion of the portfolio performed. Unfortunately, we were let down by the performance of the non-exact pairs (or sector neutral) portion of the portfolio.

Sector Analysis

The Fund was very successful when pairing up energy, materials, consumer discretionary, communication services, utilities, and real estate stocks but not as successful with industrials, health care, and financials stocks. The sector neutral (non-exact) pairs were strong in the consumer staples and real estate sectors but very weak in the materials, industrials, consumer discretionary, and technology sectors.

Overall, the Fund provided its best performance in the energy, consumer staples, and real estate sectors and its worst performance in the materials, industrials, consumer discretionary, financials and technology sectors. The most surprising issues came in the materials sector, which had delivered positive returns in every year since the Fund's inception. However, in 2018, the materials sector was the cause of the majority of the negative performance.

Examples

We thought it might be useful to take you through a pair trade that did not work in the fourth quarter to show you what we saw at the beginning of the quarter. Then, we thought we would also show you two long positions that went against us in the fourth quarter again, to show you the opportunity we saw beforehand. Two thing to keep in mind when looking at these companies is that we use median analyst estimates (rather than a simple average to eliminate the impact of an outlier) as our expected growth rates and that we assume that analysts change their estimates to reflect the current market conditions. For example, if the expectation is that car sales will decrease then the estimates of companies that make car parts will have been reduced to reflect that expectation.

Example #1

One pair that the Fund has is long Hardwoods Distribution and short Richelieu Hardware. While not a perfect pair, both companies should be impacted by housing starts/ renovations and both have operations in Canada and the Unites States.

September 30, 2018	Hardwoods Distribution (HDI)	Richelieu Hardware (RCH)
Trailing P/E	10.5x	24.7x
Expected P/E	9.1x	21.4x
Trailing ROE	14.2%	16.0%
QEM	1.9%	1.1%
Expected 2019 Growth Rate	13.9%	14.8%
Expected 2020 Growth Rate	5.3%	3.6%
Yield	1.9%	0.8%
3 Year Beta	0.64	0.73

On September 30, 2018, Hardwoods traded at a significant discount to Richelieu despite similar ROEs, similar growth and expected growth rates, a higher yield and similar Betas. In the fourth quarter, Hardwoods was down 35.3% and

Richelieu was down 23.9% resulting in a three month loss on this pair of 11.4%. Hardwoods ended the quarter with an expected P/E multiple of 6.5x versus 16.6x for Richelieu despite all the other attributes looking similar. We expect this anomaly to reverse over the next quarter or two. While the other characteristics remained similar, the 3 Year Beta skyrocketed for both of these stocks. Hardwoods now has a 3 Year Beta of 1.79 versus Richelieu's at 1.34. Dramatic shifts in Beta like this is one of the reasons we have had a difficult time matching the Betas of the longs and the shorts.

Example #2

Bombardier Recreational Products (or BRP) designs, develops, manufactures, distributes, and markets snowmobiles, all-terrain vehicles, and personal watercraft among other items. Below are the characteristics of the stock on both September 30, 2018 and December 31, 2018:

	BRP (DOO) Sept 30, 2018	BRP (DOO) Dec 31, 2018
Trailing P/E	23.4x	11.1x
Expected P/E	19.8x	9.8x
Expected 2019 growth rate	18.1%	20.1%
Expected 2020 growth rate	16.7%	18.8%
Yield	0.6%	1.0%

Despite the company reporting another strong quarter and raising their guidance leading to higher expected growth rates, BRP's stock price declined 41.5% in the fourth quarter making it one of the worst performing stocks. It now trades at a significant multiple discount to the market at only 9.8x expected earnings from 19.8x at the beginning of the quarter. We expect this to reverse over the coming quarters.

Example #3

Goeasy provides financial services to own furniture, electronics, computers, and appliances through leasing agreements. Below are the characteristics of the stock on both September 30, 2018 and December 31, 2018:

	goeasy (GSY) Sept 30, 2018	goeasy (GSY) Dec 31, 2018
Trailing P/E	15.1x	10.0x
Expected P/E	8.7x	6.7x
Expected 2019 growth rate	51.0%	39.4%
Expected 2020 growth rate	21.2%	22.6%
Yield	1.8%	2.5%
3 Year Beta	-0.05	1.00

Much like BRP, goeasy reported another strong quarter and yet the stock surprisingly returned -29.6% in the fourth quarter. Goeasy went from being an inexpensive stock with huge expected growth rates to an extremely inexpensive stock with huge expected growth rates. Interestingly, in the quarter, the 3 Year Beta went from -0.05 to 1.00. Hard to believe that one quarter can move a 3 year number that much. We expect goeasy to rebound over the coming months.

Current Fund Attributes

Now, let's take an in-depth look at the characteristics of the longs, the shorts and the overall market. The purpose of this section is to show investors the significant advantage our longs have over our shorts on every mathematical characteristic we follow. We encourage you to take some time to review and understand this section as it is why we are so excited about the prospects for the Fund. In almost all cases, our long attributes look better than the market and our short attributes look worse than the market so we will limit this analysis to a comparison of the longs and the shorts.

Profitability & Growth

	Long Positions	Short Positions	**Advantage**	S&P/TSX
Trailing ROE	16.1%	8.5%	**7.6%**	14.0%
QEM	9.8%	0.8%	**9.0%**	3.6%
Expected QEM	5.3%	-0.7%	**6.0%**	2.3%

The long positions in the Fund, on average, have nearly twice the return on equity of the shorts. Return on equity is generally considered an excellent measure of profitability. Quarterly Earnings Momentum (QEM) is essentially current earnings growth and expected QEM is the expected earnings growth. The longs are growing 9% faster on a trailing basis and are expected to outgrow the shorts by 6%. In fact, the shorts are expected to have a negative growth. Bottom line is that the longs are significantly more profitable, have better trailing growth, and are expected to grow faster than the shorts. These are all very positive factors for the long positions.

Earnings Momentum

	Long Positions	Short Positions	**Advantage**	S&P/TSX
Earnings Surprise	2.9%	-0.7%	**3.6%**	1.0%
Estimate Revisions	-0.7%	-7.4%	**6.7%**	-1.0%

The long positions are posting better than expected results as shown by the positive earnings surprise versus the average short position has been missing earnings expectations. The analyst expectations are generally holding steady on the long positions versus big negative estimate revisions on the short positions. There is a significant earnings momentum advantage by the long positions.

Other Characteristics

	Long Positions	Short Positions	**Advantage**	S&P/TSX
Yield	3.3%	3.1%	**0.2%**	3.4%
Cash Flow / Debt	0.25	0.21	**0.04**	0.31
3 Year Beta	0.95	0.84	**-0.11**	1.00

The long positions have a small yield advantage as well as a small advantage in the ability to service their debt as measured by the cash flow/debt ratio. While we do our best to match the Beta (Beta is essentially variability as compared to the market) of our longs and shorts, the Betas have been changing rapidly over the past few months so we currently have a Beta mismatch. This is something that we are working on eliminating and it perhaps explains some of the correlation to the market during the fourth quarter market pull back. One thing to note is that we began the fourth quarter with no Beta mismatch and this mismatch came from unexpected increased volatility in our long positions rather than one created by additions or subtractions to the portfolio.

Outside of Beta, all of the above attributes are ones that a company has at least some control over. What is outside of a company's control is the valuations that they trade at. Given that the long positions have better earnings momentum, better profitability, better growth and expected growth rates, pay a greater dividend and service their debt better, they should logically trade at higher valuations. In other words, an investor should be willing to pay more the above advantages.

Valuation

	Long Positions	Short Positions	**Advantage**	S&P/TSX
Trailing P/E	12.1x	21.7x	**9.6x**	13.9x
Forward P/E	9.5x	17.4x	**7.9x**	12.3x
Trailing P/CF	6.1x	9.4x	**3.3x**	7.0x

Unfortunetly, the long positions trade at significant P/E and P/CF discounts to the shorts on both a trailing and expected basis. We cannot stress enough how illogical this is not just because they trade at a discount but the magnitude of this discount is mind boggling in our opinion. To put numbers to this, our longs trade at a 45% discount to our shorts on trailing and forward earnings multiples. These discounts unexplainably have existed, and have grown in many cases, for about three years now. Clearly, this explains the recent underperformance of market neutral strategies in general. In order to be successful, we would have to go long expensive stocks with poor growth prospects and go short undervalued stocks with strong growth prospects. We continue to believe that markets are rational and will eventually get things right.

Changes or Modifications

We made a few changes to gross sector weightings in the second half of 2018. We increased our gross sector weights in the energy, consumer staples, and utilities sectors. On the flip side, we reduced our gross exposure in the materials, industrials, health care, financials, and communication services sectors. Of course, our net exposure to each sector is always 0%.

Outlook

The characteristics of the Fund look as good as they ever have. First, let's look at the attributes that a company can control or influence such as ROE, earnings surprise, estimate revisions, quarterly earnings momentum (QEM), and yield. The long positions are more profitable, are growing faster, have better yields, are posting better than expected results, and have better estimate revisions than both the short positions and the S&P/TSX. The short positions also look worse than the S&P/TSX on all attributes. This type of numerical advantage is a hallmark of the Fund and has remained consistent since the Fund's inception. Now, let's look at the things that the company cannot control, namely valuation. Historically, the difference in forward earnings multiples between our long and short positions has been about 5x. Today, that difference is 7.9x. For the Fund to revert to what we believe is the norm, the shorts will have to go down more than the longs or the longs will have to go up more than the shorts. Either way would provide solid returns in the fund. This phenomena had existed for a few years now which likely explains why market neutral strategies have lagged in performance. This is also what has us excited about the fund's prospects going forward. We believe that reported numbers eventually matter and that multiples will normalize.

Going forward, we will stick to the methodology that has worked since the Fund's inception. We will not chase returns through sector exposure nor through a long bias. We will continue to exact pair as many trades as we can and rebalance the Fund on a daily basis to ensure there is no market or sector exposure. The Fund remains well diversified as it has holdings in ten of eleven sectors but no net exposure to any one sector. We will not take on the added risk of having sector exposure, nor will we concentrate the portfolio into a few sectors.

Conclusion

While we are not content with the results in 2018, periods of extreme volatility like we saw late last year can create excellent buying opportunities and return potential. Early in 2019, we are already witnessing the beginning of a return to normalcy as companies are being rewarded for their numbers and valuations are starting to matter again. We remain confident in our methodology and believe that good times are ahead.

	6 month	1 year	3 year	5 year	Inception
NCM Market Neutral Income Fund	-5.8%	-4.8%	-2.3%	-0.4%	3.2%