NCM Core Canadian

2018 Year End Review

Keith Leslie, CFA
Portfolio Manager

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 posting a return of -10.1%. For calendar 2018, the S&P/TSX TRI returned -8.9%, delivering negative returns in seven of the twelve months. The S&P/TSX Completion (mid cap) TRI returned -12.9% and the S&P/TSX Small Cap TRI returned -18.2%.

We see this as an excellent buying opportunity rather than something to be too concerned over. We believe market pullbacks are healthy and necessary for the market to get to the next level.

Prospects for the Canadian market

Our experience has been that the S&P/TSX usually trades in the 16x–20x trailing price/earnings range. Typically, the S&P/TSX trades at the lower end of that range when its earnings are expected to be less than average, and at the higher end of that range when its earnings are expected to be greater than average. In a normal year, we expect earnings growth between 6% - 8%. Finally, the S&P/TSX usually yields around 3%.

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The S&P/TSX is currently trading at 13.9x trailing earnings or below the low end of its typical range. The S&P/TSX has expected EPS growth of 9.7% which is above the high end of its normal range. The S&P/TSX currently has a yield of 3.4%. Finally, the S&P/TSX is trading at 12.3x expected earnings which is extremely low.

In our opinion, the above factors could lead to a strong 2019 for the S&P/TSX.

NCM Core Canadian

We believe that the NCM Core Canadian is set up for a strong year from both a sector exposure and attributes point of view. The market did not seem to care about company characteristics and reported numbers in 2018 but we believe that company results will always matter, eventually. We have mostly avoided volatile sectors and stocks, but believe that our MARP (momentum at a reasonable price) style of investing could be in for a prosperous year. Below, you can see our year end sector exposures compared to the market, as well as the Fund attributes as compared to the market. We do not replicate the market but instead use our knowledge and experience to make active management count.

Sector Weights

December 31, 2018	Core Canadian	S&P/TSX
Energy	6.0%	17.8%
Materials	1.8%	11.3%
Industrials	10.6%	10.8%
Consumer Discretionary	4.4%	4.3%
Consumer Staples	7.7%	4.0%
Health Care	0.0%	1.6%
Financials	24.8%	32.9%
Information Technology	9.6%	4.0%
Communication Services	6.1%	6.0%
Utilities	6.0%	4.1%
Real Estate	8.4%	3.2%

Source: CPMS

Fund Attributes

December 31, 2018	Long Positions	S&P/TSX	Short Positions
Trailing P/E	13.3x	13.9x	20.0x
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Trailing ROE	16.9%	14.0%	11.0%
Earnings Surprise	1.8%	1.0%	-0.9%
Estimate Revisions	1.8%	-1.0%	-0.8%
QEM	6.3%	3.6%	-1.6%
Expected QEM	5.2%	1.8%	-4.3%
Yield	3.6%	3.4%	4.5%
3 Year Beta	0.63	1.00	0.62

Source: CPMS

	Core Canadian	S&P/TSX
Large Cap (> $5 billion)	63.6%	85.6%
Mid Cap ($1 billion to $5 billion)	14.2%	13.2%
Small Cap (< $1 billion)	17.4%	1.2%
Active share	71.2%	-

Source: CPMS

A portfolio that has better earnings momentum is less expensive, is growing faster, has a higher yield and owns stocks that have historically been less volatile is a hallmark of this Fund. You will also note that our active share (a measure of how different a fund looks from its index) is very high for a large cap Canadian equity fund.

Differentiating Factors

There are more than 270 large cap Canadian equity funds as well as many ETFs. One of the challenges facing Canadian equity managers is differentiating themselves. NCM Core Canadian differentiates itself from other large cap Canadian equity funds in 7 different ways, making it a good substitute or complement to other Canadian equity holdings.

1. Canadian only
2. Typically, the Fund will have no exposure to energy producers or mining companies
3. The Fund will normally have a Beta of less than 0.70
4. Uses shorting selling as a means to increase net cash positions or control net sector weights

   - *Will usually have between 10 and 25 short positions at a 0.5% weight each*
5. Actively managed rather than monthly or quarterly rebalancing
6. High active share
7. Low fee including flat fee Z series pricing

Conclusion

We are glad to see 2018 behind us and are excited for what lies ahead in 2019. We believe that the markets may be strong but choppy and we have tried to mitigate that by running a low Beta portfolio that avoids the sub-sectors and stocks that tend to add volatility. As we approach our three year number, we have never felt better about the future prospects for the Fund.