

# NCM Small Cap Update

## 2018 Year End Review



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**Well we must admit, we are happy to say good-bye to 2018 as it was a long and tough year for Canadian investors, particularly for small cap stocks. The BMO Small Cap Total Return index was down 18.2% for the year, underperforming the S&P/TSX Total Return, which was down 8.9%.**

While Canadian investors were not alone in their angst, with almost every major global index in negative territory for the year, once again Canada underperformed the U.S., with the S&P 500 Total Return Index declining a more modest 4.4% for the year.

**We continue to focus on investing in and uncovering high quality, cash flow generative companies that are trading at attractive valuations.**

Similar to 2018, concerns over the health of the Canadian housing market, trade uncertainties and the weakness in the energy markets, once again weighed on the Canadian equity markets. On top of these concerns, the small cap sector was hit with a continued reduction in liquidity levels as investors migrated up cap and the growth in ETFs pulled additional liquidity out of the sector.

While it is difficult to say when these headwinds will fully dissipate, we believe that valuation levels in the Canadian equity markets have become increasingly attractive. At the end of 2018, the S&P/TSX index was trading at 12.7x forward

earnings, down from 17.5x in 2017 and below its long-term average of 14.6x. Valuation levels in the small cap segment are also very attractive, with numerous companies across the NCM small cap funds trading at or below 10x forward earnings despite strong balance sheets and the expectation for solid earnings growth in 2019.

Throughout 2018 the cash levels across the NCM small cap funds increased given the increased volatility levels and concerns over the health of the economy, however over the final few months of the year we began to put some of this cash to work given the broad based stock price declines and increasingly attractive valuation levels. We continue to have higher than normal cash levels, ranging from 10%-18% of the funds, as we anticipate additional volatility and want to be ready to take advantage of it.

While we continuously monitor the macro economic trends, our focus across the NCM small cap funds remains on bottom up investing. We continue to focus on investing in and uncovering high quality, cash flow generative companies that are trading at attractive valuations. While the inefficiencies of the small cap market has enabled us to be truth GARP investors in the past, the recent underperformance of small caps coupled with a meaningful decline in liquidity levels in the sector has resulted in valuation levels not seen in many years, providing the potential for increased investment opportunities for the funds.

**For more information on NCM Small Cap Investing, contact your local NCM Sales Representative or visit [ncminvestments.com](http://ncminvestments.com).**



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