Market Commentary
Digital Roadshow 2017

CAMBRIDGE® GLOBAL ASSET MANAGEMENT

Keeping an eye open for quality
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- In June 2016, 10-year bonds in Canada and the U.S. were yielding 1.2 % and 1.5% respectively, a 30-year low. This meant that people were paying as much as 85 times cash flow for low-risk income streams. It was an unprecedented situation, and we knew this was a bad place to allocate capital because it wouldn't take much of an increase in interest rates to cost clients money. Since then, we have found opportunities in fixed-income securities as the credit market corrected, and our cash position in Cambridge Asset Allocation Fund is down to about 25% from 40%. We are comfortable with our cash position because we don't believe we will be compensated for taking on more risk at this time.

- We own high-quality businesses, as measured by returns, capital intensity and margins. This is what guides our decision making, and helps to ensure we don't confuse cyclical growth with secular growth. The process actually takes us to a lot of turnaround situations.

- We define growth very clearly as cash flow per share, not as revenue or market cap. The key is to identify this before everyone else does, so we can continue to deliver returns that are superior to other opportunities but with the same amount of risk or less. Longer-term growth potential is important. We want to make sure that we pay a very different price for Apple's 10% growth than we would for a company like Couche-Tard, which is 6% of the global convenience-store industry, but could double in size and still only be 12%. So, Couche-Tard's 10% growth is far more valuable to us than 10% at Apple.

- Four basic attributes we look for in a company:
  1. High returns on capital (high operating margins)
  2. Strong project pipeline (organic and inorganic)
  3. Low leverage (debt can sink a company during tough times)
  4. Capital allocation (demonstrated willingness and ability to inorganically allocate capital)

- About 15 years ago, growth meant 35% annual capital appreciation and value meant stocks at 10 times earnings. But that's not the environment we are in today. This is why our growth funds hold dividend-yielding stocks. The companies we own don't choose to pursue projects outside of their strategy just because they have a lot of cash. Whatever they can't spend on their business, they'll return to the investor, resulting in a yield of 1-2% in our growth funds. Compared to 10-

year bonds, it's pretty attractive when you consider that most of the companies we own have intrinsic value growing at 10% to 15%.

- Conversely, we're trying to find opportunities where there's not a lot of multiple compression left. We are looking in Australia, in Mexico and in the U.K. We're trying to go to areas that most investors don't like. We were in Japan last September, and we'll be headed back this fall. There a lot of really interesting opportunities coming up in Japan.

- A lot of the money that's being invested in China is supporting earlier poor investments, so the return on those dollars is impaired and the future growth prospects of those areas are impaired. President Trump has accused the Chinese of unfairly depressing their currency to win a trade war. However, in truth they are trying to defend the value of the yuan, and spent US$1 trillion to this end last year. The question is: does China want to continue to try and keep pace with the U.S. dollar, or is it willing to devalue and potentially restore the situation of five or six years ago, where two very strong economies were moving in the same direction? As a result, we're very cautious around China and global trade generally.

- We hedge the pound, the euro and the U.S. dollar on a tactical basis. It's more than looking at where the ticker is domiciled or the headquarters is. We look at revenue and cost exposures of those businesses, and decide what makes sense for our funds. This didn't work in our favour in 2015 but did add value in 2016. It's important to decouple currency from stock picking, because we claim to be above-average stock pickers, not better-than-average currency hedgers or speculators.