# Market Commentary
# First Quarter 2018

HARBOUR ADVISORS

## Harbour Growth & Income Fund
## Harbour Global Growth & Income Corporate Class

The first quarter of 2018, coming a year after U.S. President Donald Trump took office, was the most turbulent of his administration thus far. In a three-month period that saw the swearing in of a new U.S. Federal Reserve governor, the departure of multiple key senior White House personnel, the appointment of a hawkish Secretary of State and an apparent declaration of (trade) war, the market had a lot to digest.

Why do we begin this note with a political observation? Simply because the actions of the public sector, whether it be elected or appointed, have never had a greater impact on investor sentiment and the short-term mark-to-market value of our positions.

As was long expected, volatility arrived – fashionably late – during the quarter, and bond yields rose while equity markets hit a couple of air pockets. Equity markets had seen a near parabolic rise in January and the balance of the quarter saw a decidedly more circumspect attitude from investors, finishing the quarter negative. As markets bounced around it was not easy to avoid the turbulence, as all stocks moved together and the market-leading technology and financial sectors both had reasons to fret – from regulatory scrutiny in technology’s (especially Facebook's) case and from a possibly flattening yield curve in the banks’ instance.

Bonds? Still not a great idea. This asset class is no longer the safety trade it once was. The ten-year yield rose 14% percent during the quarter (from 2.41% to 2.74%), costing bond owners money, and it seems probable that this trend will continue. Equities? Well, this is not quite as clear. The consensus S&P earnings figure for 2018 is 26% above where it closed last year and, for what it is worth, the 2019 estimate is another 10% above that. In this context, the equity markets aren’t overvalued, and certainly less expensive than previously, but it is the persistence of growth that has investors spooked – will growth flatten out after the tax boosted surge of 2018?

New U.S. Federal Reserve Chair Jerome Powell has a lot to think about. For the record, I prefer my job. As U.S. growth accelerates as a result of the tax bill and the economy nears full employment, Powell feels pressure to raise interest rates. That’s understandable, but it’s possible that by the time he’s got the rate deck normalized, growth will already be slowing again as the tax effect moves through. Both he, and investors, are trying to assess just how persistent the growth will be and whether corporate investments incented by the tax cut will drive productivity gains and future growth. These are not easy questions to answer.


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So what do we, at Harbour, do? We try to manage our clients' savings, as always, with a keen eye to selecting superior individual companies at fair prices and assembling them into portfolios carefully constructed to include offsetting factors. Three months might be a little short to measure that effectiveness, but over the long term, it works well.

Harbour balanced funds finished the quarter with our bonds (as always, investment grade only) of relatively modest duration, our bond weights at the lower end of our peers, and our equity portfolios comprising a balanced view of the future – not too eager, yet not too scared. For the quarter, the S&P 500 Index fell 0.76%; the S&P/TSX Composite Index fell 4.5% and as mentioned above, U.S. long bonds fell 14%. The domestic Harbour Growth & Income Fund was down 2.5%, and the foreign-focused Harbour Global Growth & Income Corporate Class was down 0.8%. It was a satisfactory result during a (short) period in which there was a lot of noise.

Among the names that contributed positively during the quarter were Microsoft and TMX Group.

To some investors, Microsoft rhymes with Facebook, although that's difficult to see on the surface. As the continuing public and regulatory scrutiny into Russian interference in the U.S. elections using Facebook's platform became more intense, all of the technology leaders suffered and endured a volatile quarter. Microsoft, our largest holding in the global fund and largest foreign holding in the domestic fund, traded within a 15% range during the quarter, twice experiencing significant swoons. Year to date however, it remains a positive contributor, up 7.8% for the quarter versus negative for the S&P 500 Index. The recent price action for this net debt-free, highly cash generative company captures the essence of what Ben Graham ("the father of value investing") refers to as the difference between a voting machine and a weighing machine. The unpredictability of the voting machine is of course something that we have all become acutely aware of. In the short term, investor sentiment can bounce around but in the long term, quality counts. Unlike Facebook's consumer focus, Microsoft is largely an enterprise company. In the past 12 months, it has generated $33 billion in free cash flow, in addition to the $54 billion it has in cash, and remains not only a stable core business, but an option on the rapidly evolving world of artificial intelligence. At a free cash yield of 5.5%, the company still looks attractive to us.

TMX Group operates the Toronto Stock Exchange and also performed well during the quarter, gaining almost 7% in a down equity market. We like this type of agency business it does not consume a lot of capital, and TMX is essentially a monopoly, with EBITDA margins of more than 50% and both stable and recurring cash flow. In late 2017, it acquired Trayport, a London-based energy trading software firm from the Intercontinental Exchange for $931 million, and in the process, improved the sectoral and geographic diversification of its revenue, of which 32% is now generated outside of Canada. We like the collection of businesses that TMX oversees and appreciate the discipline of the management team. The shares pay a dividend of 2.7% and we expect those dividends to grow over time.

Not quite as satisfactory during the quarter was the mark-to-market value of our position in Heidelberg, a name that make sense to us but – in the short term – apparently less so to everyone else (an important quality to take note of in its own right). The shares were down almost 12% in the quarter. Heidelberg, about which we have written often in our commentaries, is a straight-up cyclical company. It operates in cement and aggregates, and feeds on industrial growth, stimulus and infrastructure packages. While it would appear to be delivering on its deleveraging and debottlenecking objectives, it is progressively raising its dividend and continues to trade at what we think is an undemanding valuation (7.4% free cash yield on this year's figures). The stock is apparently waiting for something that hasn't yet happened – a possible U.S. infrastructure plan? That would certainly help – North America makes up a third of group profitability. Greater clarity around the global expansion? Ditto. In fact, Heidelberg is one of a group of stocks about which investors have been decidedly undecided. Others that wore the same stock chart last quarter also tended to be cyclical companies – like our holdings DowDuPont (a chemical company), Caterpillar (heavy equipment), and Glencore (copper, the ultimate industrial commodity) – all of which were down near double digits. For these highly cyclical names, which should be the biggest "tells" on whether global economic growth is both real and sustainable, the recent experience will tell you that investors can't decide – and these names define this tricky market in a microcosm.

We continue to work diligently for you, our clients, to both protect and grow your capital. Thank you for your continuing confidence.

*Roger Mortimer*
*Senior Portfolio Manager*
*CI Global Investments Inc.*

| **Class F Returns (in %) as at March 31, 2018** | **Year-to-date** | **1 year** | **3 year** | **5 year** | **10 year** |
|---|---|---|---|---|---|
| Harbour Global Growth & Income Corporate Class | -0.8 | 4.3 | 7.1 | 10.7 | 6.7 |
| Harbour Growth & Income Fund | -2.5 | -1.2 | 2.4 | 5.1 | 3.7 |

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