# Market Commentary
# Fourth Quarter 2018

## Sentry Growth and Income Fund

Happy new year to you and good riddance to the fourth quarter of 2018, which brought an escalation of volatility and steep declines in North American stock markets. Concerns over economic growth, higher interest rates in the U.S., and headlines regarding the China–U.S. trade dispute drove market behaviour. The macro headlines driving the market are evidenced by the fact that selling in October and December was broad based as was the buying activity in November, which produced a positive-return month but was insufficient to offset the substantial declines of October and December. Our broader view continues to be that we are in a prolonged period of modest economic growth. However, we know the economy, like stocks, does not move in a steady pattern but is prone to periods of over- and underperformance. We believed the accelerated growth in the U.S., brought on by tax cuts, was not sustainable and thus the U.S. is returning to more modest growth. The U.S. consumer remains healthy with strong employment and wage gains becoming evident. The Canadian economy has been more moderate, as employment is solid while consumer debt remains high on a historic basis.

What can exacerbate the natural ebbs and flows of the economy is the constant media attention, which often involves an overdramatization of the impact of current events. The result can be an overreaction from investors reflected in stock market volatility, and bond yields for that matter. Our view is that market commentators overstate the magnitude of the issues a majority of the time and occasionally understate, or miss, the magnitude of a true crisis. Thus, a majority of the time we remain disciplined in constructing a balanced portfolio working to take advantage of volatility, not necessarily avoiding it. In fact, as muscle pain cannot be avoided to benefit from exercise, volatility cannot be avoided to benefit from equity markets. Similarly, occasionally, activity should stop to avoid an injury and likewise there are occasions where becoming highly defensive is necessary to avoid prolonged capital loss from equities. The point is, we have not taken the view that this is one of those crisis times but rather a time to maintain a disciplined approach and it is in this context that we can frame our activity throughout 2018 and particularly in the fourth quarter with the heightened volatility, driven by macro events.

We had become increasingly defensive in the third quarter which included taking profits where we believed valuations were excessive and we went so far as to buy puts on the S&P/TSX Composite Index, the view being that in a modest growth environment, stocks were starting to look expensive. This continued early in the fourth quarter as we trimmed our U.S. technology positions (Apple, Alphabet, and Microsoft), sold down the Canadian railways as well as Caterpillar, and eliminated Wabco Holdings, an industrial company that provides components to the trucking industry. As the volatility, and declines, took hold in late October, we closed out our puts on the S&P/TSX Composite Index at a tidy profit and became buyers as prices corrected. We re-bought in December, as the decline took hold again. We bought back stock in Caterpillar and Apple, we added to Parker Hannifin, a U.S. industrial, Dollarama, the Canadian dollar store, and Brookfield Property Partners, an operator of U.S. retail properties. We also initiated positions in Onex, a private equity firm, as well as TMX Group, owners of the Canadian

stock exchange. Thus, we were highly active, relying on our in-house estimates of fair value to direct our buying and selling activity.

Looking back on what helped and hurt during the quarter, CME Group (Chicago Mercantile Exchange) was the top contributor, as hedging activity, which increases with higher interest rates and volatility, is good for CME. This was followed by Thomson Reuters, provider of information services, and Alimentation Couche-Tard, operator of gas stations and convenience stores. The largest detractor was Maxar Technologies, as the company switched from a Canadian to a U.S. domicile, triggering a net selling from Canadian index investors. Apple was a top detractor despite our trimming early in the quarter as was Gilead Sciences, a U.S. health-care company. We remain believers in Apple and Gilead. The result of our activity, and positioning, was that the fund was down for the quarter. Broadly, we moved with the markets in October and December and had a very strong positive return in November.

Reflecting on the full year, there are elements of our approach worth highlighting. Firstly, concentration is the tool of choice to add value, and benchmark construction does not play into portfolio construction. Rather, we have a quality and value bias keeping the core of the portfolio in companies with strong operating models and resilient balance sheets built to survive the full economic cycle. This can result in performance that deviates significantly from the S&P/TSX Composite Index, as it did during the second and third quarter, which were periods where energy led the index higher then lower, respectively. Energy companies rarely meet our quality criteria and thus we were under-exposed to this sector. Secondly, when we take additional risk, on an individual company basis, we do so expecting a higher return but are still careful and limit the size of the position to contain the risk. Thus, when a position such as Maxar Technologies, which we identified as a higher business risk, goes poorly, it doesn't dominate the performance of the portfolio. With all positions, quality and return prospects factor into the weighting such that we maintain a discipline of selling down positions as price increases if return prospects are coincidently decreasing, consistent with some of the selling activity discussed above. Finally, we hope you've experienced a high degree of transparency with us. We aim to provide insight into our thinking and how the portfolio is constructed to align with those views. Candor is important as we will continue to discuss our actions whether they be additive or subtractive from performance.

Looking ahead, it does appear a slowdown is upon us. It is possible the U.S. Federal Reserve Board (Fed) has raised rates too far, and/or too fast, given the strong U.S. growth was a temporary circumstance fuelled by the tax cuts. The risk of a technical recession (two quarters of negative GDP growth) is higher than it was a few months ago but, at this point, if that were to happen we would view this as a short-term period of underperformance in a longer-term environment of prolonged modest growth. We are forever on the lookout for a crisis and do not believe one that requires a mass re-positioning is evident. The Fed claims to be data dependent and a pause in rates would likely be positive for the stock market. Currently the rhetoric from Trump and China is that both sides are motivated to put together a trade deal, which has the possibility of being highly constructive but, of course, if no deal is realized that will certainly be a negative. The reality is that the range of outcomes is wide. We do consider the degree of exposure to global supply chains when we invest in a business. The importance of this factor may need to be magnified if progress is not evident. Corporate capital investment will likely not pick up until a

deal, and the terms of trade, are finalized. A near-term positive may come from fourth quarter consumer spending as the employment picture in Canada and the U.S. was strong through the important holiday spending season. As fourth quarter results are reported, and company guidance given for 2019, we will be busy updating our views and models. We will continue to apply our quality and price discipline, looking to take advantage of opportunities as they arise. This may mean elevated cash levels, from time to time, as strong buys and disciplined sells rarely happen on the same day.

Finally, and most importantly, we wish everyone a healthy and prosperous 2019.

| **Class F Returns (in %) as at December 31, 2018** | **1 year** | **3 year** | **5 year** | **10 year** |
|---|---|---|---|---|
| Sentry Growth and Income Fund | -8.8 | 3.6 | 3.7 | 10.3 |

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