MM Fund

Spartan Fund Management

July 2019

Spartan Overview

Spartan, established in 2006, is a Toronto-based investment management company that specializes in niche investment strategies managed by experienced investment managers with proven track records. Spartan's infrastructure adheres to institutional standards with independent risk management and compliance, and well-known third party service providers. This allows our investment management teams to focus on investing and provides investors with the comfort that their money is being managed to the same standard as larger funds.

Fund Overview, Objectives and Strategy

The MM Fund invests utilizing a "core and more" approach. The core portfolio consists of sustainable high yielding or dividend paying Canadian equity securities and, to a lesser extent, real estate investment trusts, convertibles, debt securities, preferred shares and U.S. equity securities.

The "more" consists of equity and debt, plus potentially warrants, small and micro capitalization stocks, that will likely have more volatility but a higher potential for capital gains. We will focus on inexpensive secular growth securities or beaten down stocks that have turnaround potential, because of new management, or because of an improvement in their macro-economic factors. We may also look to shorter-term event driven trading opportunities around, for instance, earnings, politics, war, famine, scandal, seasonality, apathy, etc. Investments will mostly be made in Canadian equity securities and, to a lesser extent, debt securities and U.S. equity securities. The holdings in the core portfolio will typically be held for longer periods.

Monthly Performance[1]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	TSX
2019	+7.98%	+7.53%	+4.11%	+0.81%	-4.35%	+1.08%	+0.93%						+18.90%	+16.62%
2018	+0.18%	-2.09%	-1.89%	+1.97%	+1.52%	-0.24%	+0.27%	-1.27%	-1.31%	-9.60%	-4.81%	-6.09%	-21.54%	-8.89%
2017	-0.75%	+1.52%	+0.66%	+5.43%	+4.21%	+0.77%	-1.67%	-0.69%	+1.43%	+2.36%	+2.77%	+0.59%	+17.69%	+9.10%
2016	-7.00%	+5.44%	+4.12%	+0.65%	+3.51%	+0.48%	+0.95%	+5.75%	+3.49%	+3.15%	+1.04%	+1.67%	+25.13%	+21.08%
2015							-2.26%	-7.10%	-4.19%	+7.05%	+4.11%	+1.13%	-1.95%	-9.93%

Statistics[1]

	MM Fund	TSX
Cumulative Return (since inception)	34.71%	26.42%
Annualized Compound Return	7.65%	5.97%
1-Year Return	-6.37%	3.05%
Sharpe Ratio	0.58	0.65
Avg. Monthly Gain	2.69%	1.93%
Avg. Monthly Loss	-3.46%	-2.15%
Max. Drawdown	21.68%	11.64%
Annualized Std. Deviation	13.09%	9.19%
% of Winning Months	67.35%	65.31%
Correlation	0.67	

Fund Information

RSP Eligible?	Yes
Minimum Investment	$500
Invest/Redeem Frequency	Weekly
Short Term Trading Fee	2% if < 30 days
Redemption Notice	1 day
'A' Class Fees (SPA520)	2.00% pa
'D' Class Fees (SPA522)	1.25% pa
'F' Class Fees (SPA521)	1.00% pa
Incentive Fee	10%
Hurdle	TSX Total Return Index

Service Providers

Advisor	Spartan Fund Management Inc.
Custodian	Laurentian Bank Securities
Auditor	Deloitte LLP
Administrator	SGGG Fund Services
Legal Counsel	Borden Ladner Gervais

NAV/Unit

- Class A	130.6893
- Class D	134.7106
- Class F	137.1080

*1 Performance numbers are for the period commencing July 15, 2015 for the Class D units. Returns and statistics for other classes are available on request. '**Monthly**' returns are simple returns and are not annualized. '**Annualized Std. Deviation**' is the standard deviation, which measures the amount of variability of returns that has historically occurred relative to the average return. '**Max. Drawdown**' is the maximum percentage decline, from the highest point to the lowest point. '**Sharpe Ratio**' is the Annualized Compound Return divided by the Annualized Std. Deviation, both measured since inception. **Correlation** measures the degree to which two securities move in relation to each other.*

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Unless otherwise indicated, rates of return for periods greater than one year are historical annual compound total returns including changes in unit or share value and reinvestment of all distributions, and do not take into account any sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Monthly Commentary

After hiking rates four times in 2018, the US Federal Reserve made a sudden U-turn to “patience” regarding further rate hikes in January. A further weakening of leading indicators like manufacturing and housing pushed the Fed to lower rates by 25 bps in July, its first rate cut in eleven years. Markets were disappointed that Chairman Powell did not signal further rate cuts at his news conference. President Trump ramped up the pressure on China (and the Fed), the next day by threatening 10% tariffs on a further $300B worth of goods. Markets now expect 3 more rate cuts this year, giving Trump the rate cuts he has been calling for.

Trade escalation and Fed disappointment resulted in a 3.1% drop in the S&P 500 the last week of July, the worst week of the year. The Dow plunged 767 points the following Monday, August 5th, which was the worst day of the year, as China’s currency fell through critical levels, suggesting a trade war was moving to a currency war, whatever that means. We are skeptical because a country facing tougher competition from tariffs would naturally allow its currency to depreciate, so this is the natural process of adjustment.

Further rate cuts would help, but bond yields have already done the heavy lifting for both the economy and markets, as US bond yields have fallen 50% to 1.6% from 3.25% last fall when the Fed was steadily raising rates by ¼ point per quarter. This dramatically lowers the long-term borrowing costs for companies, and more importantly the drop in mortgage rates is hugely stimulative to the US housing market.

Despite weakness in Europe and China, likely caused by Trump’s targeting of China with tariffs, the US economy continues to expand with 2.1% growth in Q2. The June US jobs report blew away expectations as the U.S. economy created 224,000 new jobs in June, above expectations of 170,000 jobs, and compared to only 75,000 jobs in May. The U.S. economy created a respectable 164,000 jobs in July.

The Conference Board’s Consumer Confidence Index jumped to 135.7 from 124.3 in June — a much higher than expected increase. Consumer spending accounts for 68% of the U.S. GDP. The ISM non-manufacturing index fell to 53.7 in July, from 55.1 the month before, suggesting that services, which accounts for about two-thirds of the U.S. economy, is growing slower than previously. The services sector is growing at its slowest pace in three years.

China is more vulnerable from the trade war as it has a huge trade surplus with the U.S., and it sells almost five times more than it imports. Exports to the U.S. have dropped 12% in the first half of the year, and Mexico and Canada have overtaken China as the U.S.’s top trading partner. Companies are relocating production to Vietnam, and its exports to the U.S. have soared 33%.

S&P 500 earnings growth has stalled out this year, after a U.S. tax cut induced torrid 26% growth in 2018. However, even without earnings growth stocks are now more attractive than last year as growing dividend yields of 2.0%, compares favorably to fixed income bond yields of about 1.6%. This brings back the TINA (There Is No Alternative (to stocks)) argument for the stock market of the last ten years. Dividends on stocks are even more attractive on global terms as bonds in Europe and Japan have negative yields where investors are not paid, but actually have to pay interest to invest in bonds. Globally $16 trillion in bonds now have negative yields, making US stocks and bonds with 1.6% yields relatively attractive compared to negative yields.

Moreover, the S&P 500 hit new highs in July, but it is more broad-based then the FAANG and MAGA leadership of the last few years. Microsoft is the only mega-capitalization technology stock to hit new highs this year. A more broad-based rally is positive for MM, as Alibaba (a new holding) is the only mega-cap tech holding.

The industrials sector is the largest sector for the MM Fund with almost a 20% weight, and it consists of a disparate set of companies. For example, the Fund owns a forestry building products company, two airline stocks, an electrical transformer company, and a small capitalization defense contractor.
Financials is the second largest sector with a 17.1% weight, and is made up of U.S. and European financials, a mutual fund company, and some small Canadian financial services companies. Health care is the third largest sector for the Fund, with about half invested in U.S. health care services companies, and the rest in cannabis, with about half of that in debt of U.S. cannabis companies. Our focus in cannabis is the U.S. and international, where valuations are lower, regulations are generally lighter, and opportunity is greater.

Real estate is a 14.3% weight, with all the exposure divided between U.S. rental, and high yielding European office REITs. European REITs are a big beneficiary of ECB quantitative easing (bond buying), as they can get mortgages for less than 2%.

The next largest sector in the Fund is consumer discretionary with a 12.1% weight. We initiated a position in Aritzia in March, and this Canadian women’s fashion retailer had 18% revenue growth in the most recent quarter and same store sales growth of 7.9%. A&W is a long standing “core” holding, with a 4.4% yield, that was just increased 3.3% in July. Increasing dividends for A&W is driven by increasing same store sales, that were up a first quintile 10.3% year-over-year in the most recent quarter. Alibaba, China’s “Amazon” and largest e-commerce company is a new position for MM this year, and it is considered a consumer discretionary company.

We sold our pure-play Canadian energy producers in the fall of 2018, because of continuing pipeline issues, and wide differentials for Canadian produced oil. We took profits in Transcanada in Q2, leaving the Fund with a 9.2 % weight in energy, about half the TSX index.

We have been increasing our weighting in high yielding bonds and preferred shares to 11.5% from 10.5% a year ago. The portfolio has an overall yield of 4.3% so we are paid nicely to wait, during what is often the more challenging end of summer and fall period. Dividend protection did not work last year when the Fed was hiking and bond yields shot up over 3%. This year however the Fed is cutting and the 4.3% dividend yield of the Fund compares nicely to U.S. bond yields that have fallen 50% over the last year, to about 1.6%.

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The above returns are net of management and performance fees for the 'D' series of units, but do not take into account early redemption fees if investments are held less than 1 year. Please review the most recent offering memorandum for a detailed description of the Fund's strategy, objectives and risk factors. The above is provided for informational purposes only and is qualified in its entirety by way of the most recent offering memorandum, which is only available to qualified investors. Prospective investors should consult with a professional financial advisor before investing. Past performance cannot predict future results. Share value and yields will fluctuate. There can be no assurances that any of the Fund's objectives will be met. See Terms and Conditions of our website (www.spartanfunds.ca) for important information and qualifications regarding the use of benchmarking and indices. The index above was chosen as it is a widely used benchmark of the Canadian equity market. While the Fund uses this index for long-term performance comparisons, it is not managed relative to the composition of the index. There are differences which include security holdings, geographic and sector allocation which impact comparability. As a result, the Fund may experience periods when its performance differs materially from the index.

The Fund is a related and connected issuer of Spartan Fund Management Inc. Spartan may act as dealer in connection with the distribution of securities of the Fund and will also receive management and performance fees from the Fund.