Bridgeport Asset Management Inc.
Tel: 416-849-2225 x 103
info@bridgeportasset.com
www.bridgeportasset.com

BRIDGEPORT ASSET MANAGEMENT INC.

Q1 2021

Investment Commentary

Stock markets continued to move higher in the first quarter as investors looked toward a post-COVID-19 economic recovery.

As we have discussed in prior client notes, declining interest rates have been a significant factor underpinning the rally in equities over the past several years, if not decades. This is because (i) asset values are determined by a company's expected future profits which are worth more when discounted back to the present using a lower interest rate and (ii) stocks are more popular with investors relative to bonds when the latter offer unattractively low returns.

Interest rates were a particularly hot topic in Q1 2021 as the ten-year government bond yield climbed from 0.7% to 1.6% in Canada and from 0.9% to 1.7% in the US in response to inflation concerns. While these increases caused some volatility in the equity markets, they had a more negative effect on investment grade corporate bonds which declined as much as 5%-6% in the first quarter, depending on the issuer and term.

In comparison, the Bridgeport High Income Fund was up over 3% in the first three months of the year as it is primarily invested in North American corporate bonds, convertible bonds, senior loans and preferred shares issued by less than investment grade issuers (as well as a small allocation to dividend paying stocks). While careful credit analysis in these segments is required, these investments are less sensitive to increases in interest rates as they offer higher fixed or variable yields and our portfolio is tilted toward nearer term maturities. For this reason, we are more comfortable with these exposures as compared to longer dated, ultra-low yielding bonds issued by investment grade companies and governments.

Turning to our equity portfolios, the markets have had a nice run since their low last March at the beginning of the pandemic. We still see reasonably valued opportunities in some areas of the market particularly given the low interest rate environment; however, some segments seem to be trading at non-sensical levels.

One example is Live Nation Entertainment which promotes live music events in both its own and operated venues along with managing ticketing, sponsorship and advertising. The company's business was deeply affected by COVID-19, with the company hosting 80% less events in 2020. However, despite losing $1.8 billion before tax in 2020 and adding $1.5 billion in net debt over the year, the company's stock price reached a new high this past February, an increase of 19% since before the pandemic. It is hard to reconcile how the company could have increased its total value by over $2.5 billion when a reasonable degree of pandemic uncertainty remains.

We have tried to position Bridgeport's equity funds to take advantage of the economic snapback that is expected as we emerge from the pandemic, while remaining mindful of valuations. Bridgeport's U.S. Equity Fund had a good first quarter and was up approximately 4%. The top contributor to performance in the period was Google whose share price increased 18% based on stronger than expected ad revenue. Other major contributors to the Bridgeport U.S Equity Fund's performance were Lowe's (+19% in Q1), Autozone (+18%), Berkshire Hathaway (+10%), HCA Healthcare (+15%) and 3M (+11%).

In particular, we would like to highlight our position in Warren Buffett's Berkshire Hathaway which we initiated last July. At the time of our purchase, Berkshire had mostly fallen out of favour with investors who felt that Buffett had lost his touch after several years of underperformance. Our initial investment and subsequent purchases over the next six months were based on our analysis that the intrinsic value of the company's various parts including its insurance operations, railroads, utilities, investment in Apple and other public market investments were worth far more than its share price. Buffet apparently agreed as Berkshire bought back nearly $9 billion of its own stock in the fourth quarter. The Company's share price is up 32% since early November 2020.

Holdings which negatively impacted Bridgeport's US Equity Fund return in the first quarter include Amazon (-5%) and Pepsi (-9%). Both announced better than expected earnings, but were victims of a rotation away from higher quality, defensive stocks which had performed well earlier in the post-COVID-19 period when pandemic fears were more acute than they are today.

Strong performance from Colliers (+9%), Cogeco (+18%) and Royal Bank (+11%) helped Bridgeport's Canadian Equity Fund generate a 5% return in the first quarter. There were almost no negative performers in this portfolio in the period with one exception being Couche Tard. It declined about 6% after announcing a highly questionable acquisition which ultimately did not go forward, but still managed to spook investors.

In Bridgeport's Small & Mid Cap Equity Fund, almost all our investments contributed to the fund generating a return of more than 8% in Q1. Top performers in the quarter were Clairvest Group (a private equity firm, +27%), Trisura Group (specialty insurance, +34%), Park Lawn (funeral homes, +18%) and Vici Property (casino real estate, +11%).

Bridgeport's Alternative Income Fund generated a return of approximately 2% in the quarter with strong returns generated from allocations to distressed debt, real estate lending, media finance and preferred private equity strategies.

As mentioned in our last investor commentary, we launched our Private Equity Opportunities at the end of 2020 and have made commitments to a number of strategies including those focused on purchasing secondary interests in private equity funds, investing in preferred private equity structures and making direct equity investments in growth-oriented middle market private companies. With our investments to date, the fund already has exposure to hundreds of companies in North America and Europe across a variety of industries.

Going forward, we are relatively optimistic about the long term as we expect economic activity to rebound strongly given the current backdrop of low rates and accelerating world-wide vaccination efforts. However, last year illustrated the difficulty in making predictions which is why we recommend that clients diversify across asset classes and we continue to focus our efforts on identifying quality investments that are reasonably valued based on expected future cash flows.

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We wish you all the best for a happy and healthy spring and summer. As always, please feel free to reach out with any questions about your portfolio.

Yours truly,

John Fisher