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Q2 2016
Investment Commentary

The second quarter was dominated by news of the Brexit referendum and the UK's surprising vote to leave the European Union (EU). While stock markets dipped sharply in late June on the news, many in July are now saying "Brexit? What Brexit?" as investors embrace the famous British mantra "Keep Calm and Carry On" and move back into stocks and other risky assets.

In our opinion, the near term impact of the UK leaving the EU is not particularly significant as Britain accounts for only a small portion of global economic output and a weakening Great British Pound may strengthen the country's competitive position, potentially mitigating the otherwise negative impact on U.K. trade from separating.

We also do not discount the possibility that the UK may actually remain within the EU, notwithstanding the results of the vote. The UK will likely face friction while attempting to negotiate favourable trade deals in a post-Brexit world, while Scotland's overwhelming desire to remain part of the EU could lead to its own schism with Britain (not an exciting prospect). These obstacles and others may lead to the next UK national election being fought over the question of continuing EU membership.

The longer term impact of the Brexit vote is potentially more concerning. The outcome has emboldened separatist movements in other European countries and recent terror attacks are fueling extreme anti-immigrant sentiment. In particular, many voters in France are already calling for a "Frexit" referendum. If the trend toward separation spreads to other countries and ultimately leads to more restrictive worldwide trade and mobility of people, the impact on the global economy and markets would undoubtedly be negative.

We are keeping a watchful eye over these longer term issues to see how events unfold and to assess any impact on our portfolio holdings. In the meantime, we took advantage of chaotic markets in late June to add to many of the investments in Bridgeport's pooled funds at attractive prices.

On the fixed income front, bond yields have continued their descent downwards in 2016 with the 10 year Government of Canada bond yield declining from 1.4% to 1.1% today and the comparable US 10 year bond yield moving from 2.2% to 1.5%. While these returns may seem paltry, they actually remain attractive relative to the $12 trillion worth of government bonds which offer negative yields (i.e. bond holders are actually paying to lend the Japanese and European governments money). As a side note, if anyone is interested in lending us money here at Bridgeport and then paying us for the privilege, please let us know as we would be happy to oblige!

Our High Income Fund continues to perform well in this low interest rate environment with most of our holdings yielding more than 5% on an annual basis. Of note, we have recently purchased a number of Canadian preferred shares in the fund as we believe they currently offer an attractive risk-reward opportunity after recent price declines.

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Performance in Bridgeport's Equity Funds has been uneven thus far in 2016, although we have seen strong performance in the first few weeks of July. For our Canadian investors, Canadian dollar returns from our Canadian Equity and Small & Mid Cap Equity Funds have outpaced the performance of our U.S. Equity Fund as the US dollar lost of some of its strength this year. Our international investors have seen stronger results as they generally have less exposure to Canadian dollar assets and their returns are measured in US dollars.

The one asset segment we are particularly bearish on at the moment is Toronto and Vancouver residential real estate. Like many others, we believe these markets are overheated and being artificially buoyed by cheap money (which at some point will come to an end). When rates do rise, history suggests that there will be many homeowners unable to afford their mortgage payments which may lead to house price declines. Stay tuned.

We expect the next few months to continue to be volatile. We have built up modest cash reserves in most of our pooled funds which we hope to utilize to take advantage of opportunities as they arise.

We wish you all best for the rest of the summer and thank you for your continued support.

Yours truly,

John Fisher

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