



## Q2 2017 Investment Commentary

The Canadian stock market produced meagre returns in the first half of 2017. Bridgeport attributes this underperformance to two primary factors.

First, capital has favoured US markets where investors are anticipating tax reforms and stronger earnings. While we have recently begun to see the Canadian dollar strengthen due to positive sentiment displayed by the Bank of Canada, investors have shown greater confidence in the US thus far in 2017.

Second, Canada's underperformance can be partially attributed to the construction of our main stock market index, the TSX Composite, which suffers from outsized exposure to the financial and energy sectors (cumulatively over 55% of its composition). Both of these industries generated lacklustre results in the first half of 2017. Financial sector stocks increased by 2.5% while the energy sector was down over 13%, resulting in the TSX's near 1% decline through June 30th.

Despite the US market outperforming Canada, 40% of the S&P 500's return in the first half of 2017 has been driven by the so-called "FANG" stocks – Facebook, Amazon, Netflix and Google. While these companies are clearly powering the new economy, they come with some risk, not the least of which are high valuations. The FANGs sport price-earnings multiples between 30x and 200x so the risk of multiple contraction and investment losses are real, should growth rates ever moderate.

While Bridgeport missed out on the strong performance of FANG stocks, our portfolios benefitted in the first half of 2017 from our continued aversion to investing in the energy and materials sectors. We also managed to avoid the carnage in mortgage lending stocks in the wake of the Home Capital debacle. Our exposure to residential lending in Canada has been very modest due to our long held view that asset values in many major markets are stretched.

As we head into the back half of 2017, investor attention continues to focus on expected GDP growth in both Canada and the US and the pace with which central banks will raise interest rates. At the end of the quarter, the governor of the Bank of Canada surprised market watchers with a sharply positive view of the Canadian economy and followed it with a 0.25% rate hike in July, causing the value of the Canadian dollar to unexpectedly surge 6% against its US counterpart.

A stronger Canadian dollar results in lower investment returns for our domestic client portfolios as the value of the US assets they hold has gone down in nominal Canadian dollar terms. The impact of this movement has been partially mitigated by currency hedges that we implemented in May and June in some of our funds, but our portfolios have still absorbed some notional currency losses.

While movements in currency are dependent on many factors and notoriously difficult to predict, our current view is that currency investors are over-estimating the strength of the Canadian economy and the speed with which our central bank will raise rates. Overall, the Bank of Canada's decision to raise the rate in July did surprise us. Canada's inflation rate in May (most recent full month report) was quoted at 1.3%, hardly a signal that the economy is in overdrive. Moreover, three of the top five industries experiencing growth in Canada are closely tied to real estate (financial services, construction and real estate). Interest rate hikes could impede growth in these industries and others so we believe that the Bank will be very measured in its path to move rates higher going forward.

From a portfolio perspective, we made a handful of changes in our various funds during the quarter. In our Equity Funds, we added positions in two companies, Cogeco Inc. and Entercom Communications. Cogeco is a holding company with controlling interests in the fourth largest cable and internet provider in Canada (operating in Ontario and Quebec), a leading cable and internet business in the US as well as several other valuable assets. Entercom is a company that is focused exclusively on radio station ownership in the US. After completing a pending deal to buy all of CBS' radio stations, Entercom will be the 3rd largest radio player in the US market and should be able to boost earnings through planned costs cuttings and market share growth. We are enthusiastic about both investments as we believe they are undervalued based on their future cash flow generating ability.

In Bridgeport's High Income Fund, we added one investment during the quarter, purchasing bonds issued by Advanced Disposal which provides non-hazardous waste collection, transfer, recycling and disposal services to several million residential, commercial and municipal customers in the US. We view Advanced as a stable business and believe their bonds, which yield approximately 5%, represent a reasonable investment within the context of the current interest rate environment.

Finally, for those of you who are interested, we will be rolling out our new website in the coming weeks at [www.bridgeportasset.com](http://www.bridgeportasset.com). Bridgeport intends to utilize our new online home as a content hub where will share our thoughts on the market, discuss changes in our portfolios and blog about other topics of value to our clients. You may also notice on your statement that our logo has undergone a bit of redesign. Some people think that if you stare hard enough at the new symbol beside our name, you can see a bridge and a port joined together!

We wish you all the best for an enjoyable summer and, as always, please feel free to call with any questions.

Yours truly,



John Fisher, CPA, CFA