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Investors continued to shrug off Britain's impending split from the European Union as most stock market indices advanced in the third quarter. Incredibly, Britain's benchmark stock market index (FTSE) has climbed 13% since the Brexit referendum, notwithstanding the fact that the path toward a negotiated exit from the EU appears increasingly complicated and Europe continues to post weak economic data. Meanwhile, currency investors have taken a different view of the situation as the pound has depreciated 21% relative to the US dollar over the same period.

In Canada, the energy and metal sectors have propelled the TSX forward as oil and certain metal prices have rebounded from 2015 levels. While we continue to have limited exposure to commodities in our Canadian Equity Fund and therefore have not fully benefited from this rebound, our portfolio has been significantly less volatile than the market as we did not suffer from the commodity downturn last year. We remain comfortable owning a collection of interests in reasonably valued companies which operate in stable industries like banking, utilities, software and rail transportation.

In the U.S., 2016 investment returns have been modest as corporate earnings growth remains challenged and valuation multiples have already expanded. In addition, our year-to-date Canadian dollar returns for the US portfolio have been negatively impacted by a 5% increase in the value of our currency relative to the US dollar. Although we continue to evaluate the potential hedging of our US dollar exposure, the divergence between the central banking narrative in the US and Canada could result in a stronger US dollar once again.

While much investor cash continues to sit on the sidelines in fear of another 2008-style stock market correction, it is ironic that investment grade government bonds continue to be seen by many as a safe place to "park" money. Yields on these bonds remain at such low levels that if interest rates were to rise even modestly, the value of these securities would decline significantly. For example, a 1% increase in the current 10 year government of Canada bond yield of 1.2% would result in a 9% loss on investment. From our perspective, there is a lopsided risk/reward ratio to any investment where your long term upside is only 1% per year, but your short or mid-term downside could approach 10%.

Of course, the question on the minds of both bond and stock investors is whether and when central bankers will actually begin to raise rates. In the U.S., the market appears to be pricing in a 65% probability of a Fed rate hike in December, while the Bank of Canada remains cautious. We expect a rate hike to initially create some short term stock market volatility; however a gradual and orderly increase in rates over the long term would signal a return to a more normal economic and monetary environment, which could be beneficial for many asset classes (excluding government bonds).

We have recently fielded questions from some of you regarding the impact of the upcoming US election on financial markets. The short answer is that market volatility tends to increase during the period leading up to the election, although post-election investment returns have historically not differed much whether a Republican or Democratic administration takes office. That being said, the conventional wisdom this time around is that investors favor Clinton as markets like predictability and stability (attributes Trump is not known for).

In the last quarterly letter, we communicated our cautious stance regarding residential real estate, particularly in the overheated markets of Toronto and Vancouver. While this topic has been discussed extensively in the mainstream media, governments and regulators are finally beginning to take action. In August, British Columbia introduced a foreign home buyer's tax, and in early October the Liberal federal government announced four major changes that will attempt to curb the allowable debt capacity for homebuyers. It is too early to measure the effect of these new rules, but we take some comfort from the fact that the government is taking action. Of note, while we have limited direct exposure to Canadian residential real estate in our portfolios, we are not necessarily bearish on other segments of the real estate sector. For example, we retain exposure to commercial real estate assets where we still see pockets of value.

Within our investment funds, we remain extremely patient. Over the past few months, we have spoken to over a dozen management teams and completed extensive research on several new potential investments. Our cash positions remain reasonable as we wait for opportunities to surface. The areas we are currently looking at fit the characteristics of a classic Bridgeport investment: stable operating environment, high margins and return on capital, competent and aligned management and strong free cash flow generation.

As always, we look forward to hearing from you should you have any questions about your portfolio.

Yours truly,

John Fisher, CPA, CFA