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BRIDGEPORT
ASSET MANAGEMENT INC.

Looking back, 2016 was a year of surprises. Whether it was the U.K. voting to leave the European Union (Brexit), Donald Trump winning the U.S. presidency or the rebound in commodity stocks, not much went according to script (including the plumbing in our office building after our neighbour caused a small flood on our floor).

Stock markets in the U.S. and Canada had a good year. More precisely, there were three strong periods for stock investing in 2016: (i) in February, after the market's dismal start to the year, (ii) the weeks immediately following the Brexit vote in late June and (iii) after the U.S. election in November and into December. Market timers who missed these windows of opportunity had disappointing results.

The U.S. election demonstrated the inherent limitations of political analysis as a guide for investment decisions, especially when compared to the bottom-up, fundamental, individual company approach we use at Bridgeport.

For example, as the election approached and the FBI announced it had reopened its investigation into Hillary Clinton's emails, the S&P 500 Index dropped on fears that the news could lead to a Trump victory. When the FBI cleared Clinton in the days before the election, the market began to rebound as Clinton's fortunes seemed to brighten. Then, on election night, with a Trump win imminent, stock market futures plunged 5%, suggesting stocks were in for a rough ride.

Against this backdrop, few would have predicted that the market would surge following Trump's election victory. But that's exactly what happened. In fact, approximately 40% of the 2016 gain in the S&P 500 Index occurred between the day after the election (November 9) and the end of the year.

As with any new administration, it's difficult to say whether Trump will implement the major elements of his campaign agenda. He generally has a more pro-business tilt than the previous administration. His promises to (i) lower corporate tax rates, (ii) encourage the repatriation of vast sums of capital held offshore by corporate America and (iii) work towards U.S. energy independence may help to create jobs, boost the economy and continue the bull run in stocks. On the other hand, generating higher economic growth won't be easy, as the U.S. population is aging, the inevitable growth of automation will continue to leave unskilled workers behind and the cutting of "better" trade deals will be easier said than done in an interconnected, globalized world where trade wars could be crippling.

The conventional wisdom is that Trump's policies are going to reflate the economy and accelerate interest rate increases. While we do expect rates to rise, we think a more cautious view is warranted until Trump's plans are better understood. In any event, it's clear that predicting interest rate increases is a tricky game at the best of times: witness Goldman Sachs' emphatic call in early 2016 that we would see four rate increases in 2016, when, in fact, we only saw one.

Overall, the surprise events of 2016 confirmed our longstanding view that macroeconomic calls are of little value when it comes to investing. We think it's far better to spend time conducting thorough fundamental research and speaking with individual companies' management teams.

Unlike prior years, 2016's stock market returns were driven significantly by commodities. In particular, sharp increases in the prices of oil, natural gas and many metals led to massive gains in the energy sector and mining sub-sector.

We think the energy sector will be an interesting area to watch in the months and years ahead, given President Trump's goal of increasing U.S. drilling activity and his looser views on the environment. In the coming years, there will likely be plenty of business opportunities in the oil and gas industry, but increases in supply could have a negative impact on prices unless global demand can keep pace.

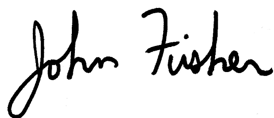
Given our continued lack of exposure to the oil, gas and metal sectors, our portfolios did not benefit much from commodity gains in 2016 – just as we avoided significant losses in prior years as prices plunged. While this lack of exposure dampened our 2016 returns, it has enabled us to generate much more stable investment performance than the wider stock market over the longer term. We recently calculated that our equity portfolios have been at least 30% less volatile than North American stock markets since Bridgeport's inception in 2007.

There will be many uncertainties for investors to navigate in 2017. In a world where the U.S. President can move markets with a few dozen keystrokes on Twitter, and where news outlets are required to fill a 24-hour news cycle speculating on what it all means, Bridgeport remains committed to uncovering and investing in high-quality, stable and growing businesses at attractive prices.

Finally, on the staffing front, we continued to build out our team in 2016, bringing on Sandra Edmonds as our Director, Finance & Operations, from another asset management firm and Cory Capland as an Investment Research Analyst from credit rating agency DBRS. In addition, Michelle Woo joined us in a client administration role, replacing Melissa Di Mambro, who decided to go into an entirely different line of business by purchasing a retail lingerie store in Forest Hill Village. FYI – Melissa tells us she welcomes visitors so feel free to stop by her store to say hello!

We thank you for your continued support in 2016 and wish you a happy, healthy and successful 2017!

Yours truly,



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