Bridgeport Asset Management Inc.
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BRIDGEPORT
ASSET MANAGEMENT INC.

Q2 2018

Investment Summary

The technology sector, including the "FAANG" tech stocks (Facebook, Amazon, Apple, Netflix and Google), continued to dominate equity markets in the second quarter.

The S&P 500 index is up 2.6% through the end of June 2018, but 99% of that return was generated by the FAANGs and Microsoft (i.e. six stocks). Amazon, on its own, accounted for a whopping 36% of the S&P 500's total return. The remaining 494 companies included in the index generated no meaningful return in the first six months of the year.

Clearly, this is a tale of two markets as growth-oriented, technology stocks drive returns, while everything else languishes (including most value-oriented equities). At times, it seems as if the two market segments are functioning independently of each other, based on totally different investment principles.

Not to take anything away from the new economy which will clearly continue to reshape and disrupt old industries, but we have seen this all before. Investors in some parts of the technology sector seem to believe valuation doesn't matter and that investors should own certain stocks at virtually any price. We think saying valuation isn't a factor in determining future investment return is like saying your current age has nothing to do with your remaining lifespan! Investors will eventually become more discerning, business models will be more closely scrutinized relative to long term profit potential and value-oriented, steady-eddy businesses will again gain investor appreciation relative to momentum-based stocks.

As value-oriented investors, we can neither ignore price as an important element of the investment selection process, nor fixate on it so much that we fall into the trap of buying inexpensive stocks of rapidly declining, bad businesses. To paraphrase Warren Buffet, just because a cigar butt on the ground is free, doesn't mean it is worth picking up and smoking! Rather, our goal remains to invest in high quality companies at attractive or fair prices.

Amidst this market backdrop and escalating fears of a global trade war, we have been selectively adding companies to our portfolios with strong growth profiles and durable business models, while maintaining a discipline around valuation. In our Bridgeport Equity Funds, we added a number of positions during the quarter including shares of Onex Corp. and Brookfield Asset Management (Canadian Equity Fund), VICI Properties, Liberty Braves, KAR Auction Services and SS&C Technologies (Small & Mid Cap Equity Fund) and Lowes (US Equity Fund).

Onex and Brookfield Asset Management are well-known Canadian investment managers with leading alternative private asset management franchises. In addition to profiting on investments made using their own capital, they earn recurring portfolio management fees from pension funds, sovereign wealth funds and other institutional investors. We have been tracking both companies for some time and acquired shares at attractive valuations following the market dip in Q1 2018.

Our investments in VICI (among the largest landlords on the Las Vegas strip) and Liberty Braves (owner of the Atlanta Braves baseball team and surrounding real estate) represent attractive value-oriented opportunities and offer a number of areas for upside, especially with the U.S. Supreme Court overturning the federal ban on sports betting which clears the way for states to open up their sports betting industries.

In addition to these individual holdings, we decided to obtain additional technology exposure by investing a portion of the US Equity Fund in the Nasdaq 100 index, while protecting the portfolio against any decreases in the index through the use of derivatives (i.e. a put option). The combination of these two investments allows us to fully participate in any gains in the index (and tech stocks) over the next 9 months with limited downside. We believe this strategy makes sense given the current market context, our concerns on valuation and the relatively inexpensive cost today of implementing the derivative strategy which limits our downside. We have also executed a similar structured strategy in the Canadian Equity Fund to gain some modest exposure to the mining and energy sectors which seem poised to generate gains.

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The last few months have also seen a number of portfolio changes in Bridgeport's High Income and Strategic Income funds. Recent interest rate increases have depressed asset prices in these funds, but also created opportunities for us to redeploy cash into new investments with higher returns as existing investments mature. We are obviously mindful of the prospect of further interest rate increases so we have added shorter term investments in the form of American Express and Goldman Sachs "fixed-to-floating" preferred shares, variable rate loans from veterinary clinic operator PetVet and short-dated bonds issued by Diversified Royalty (owner of Mr. Lube). Other new investments include bonds issued by MGM Resorts and Heartland Dental and the common shares of Keg Royalties.

We wish you all the best for the balance of the summer. As always, please feel free to call should you have any questions.

Yours truly,

John Fisher

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