Bridgeport Asset Management Inc.
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BRIDGEPORT
ASSET MANAGEMENT INC.

Q3 2019

Investment Commentary

As students of financial markets, we are always fascinated when investor behaviour repeats or at least rhymes with the past. Of note, this year has seen a large number of Initial Public Offerings (IPOs) backed by venture capital come to market. In the U.S., over $20 billion for such offerings has been raised so far in 2019 which is about double the annual rate raised in recent years, and interestingly, more than was raised during the late 1990s dot-com mania.

Unsurprisingly, many of these venture capital backed IPOs have performed poorly as public companies. Despite having impressive growth metrics, they are largely unprofitable, with little or no positive cash flow. The combination of these attributes, along with extremely high valuations, has resulted in significant losses for public market investors. Recent examples of this phenomenon include Uber (down 33% since its IPO), SmileDirectClub (-40%) and Lyft (-50%).

Even more to the point, WeWork (a workspace sharing company) pulled its IPO in September, as public market investors questioned not only its lack of profitability but poor corporate governance and unprofessional leadership (the CEO was recently forced to step down). The lack of public market interest in the IPO is particularly noteworthy given that private investors had previously been pouring money into the company at ever increasingly hard to justify valuations. Canada is not immune to this phenomenon either, as we have pointed out the shortcomings of cannabis stocks (which have also suffered similar losses) in prior letters. While the companies change, investor behaviour often does not. Today's profitless and highly valued companies coming back down to earth is reminiscent of the late 1990s tech bust.

We believe that the type of stocks described above are best avoided. Our long standing methodology when investing in equites has us focused on investing in companies with long term track records of positive cash flows and proven business models with a competitive advantage. We favor companies with strong growth prospects but only if such growth is profitable and generates reasonable returns on invested capital.

While equity markets in Canada and the U.S. were mildly positive for the third quarter of 2019 (the exception was modestly negative returns for the small cap Russell 2000), we note some interesting investor positioning. For example, most macro-economic indicators continue to confirm a slow-down in the economy as Trump's trade war rhetoric and associated tariffs dampen economic growth. To deal with these challenges, investors have bid up low growth defensive stocks to the point where one has to begin to question their defensive characteristics given lofty valuations. Fortunately, for us, as active investment managers, we can be very selective when constructing concentrated portfolios, in order to drive investment returns.

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We are pleased to report that Bridgeport's Alternative Income Fund continues to grow and make allocations to low volatility, private credit strategies. During the quarter we added exposure to a Canadian private corporate debt manager who specializes in opportunistic lending. Their niche is one where there are few competitors, which allows them to extract better lending terms with good asset protection. To date, the Alternative Income Fund has invested in six core private investment portfolios in the US and Canada which range from real estate and corporate credit to preferred private equity, providing our investors with exposure to several thousand individual assets/loans. We continue to evaluate several unique opportunities to further diversify the Fund's portfolio before year-end.

On the corporate front, we recently strengthened our team by adding two new executives. Michael Brown joins us as Vice President, Investments. He is a CPA and CFA charterholder with over 13 years of experience at another investment management firm where he managed an equity portfolio of over $1 billion. Mike, as part of the investment team at Bridgeport, will perform bottom-up fundamental research, assess valuation and assist with portfolio construction.

Michael Harber, also a CFA charterholder, joins us as Director, Business Development & Investment Strategy. Prior to joining Bridgeport, Michael gained more than 12 years of financial markets experience, serving as a Director of institutional sales at a leading Canadian investment bank and a Partner at one of Canada's largest hedge fund portfolio management firms. Michael will be focused on expanding Bridgeport's client base and assisting the investment team with broader market and portfolio strategy.

As always, please feel free to call us should you have any questions.

Yours truly,

John Fisher

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