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BRIDGEPORT
ASSET MANAGEMENT INC.

Q3 2021
Investment Commentary

Most stock markets advanced marginally in the third quarter after strong gains in the first half of the year. The quarter was an uneven affair in that stocks showed nice gains in July and August before dipping in September.

There are several factors that may have been behind September's weakness including (i) fear that the collapse of China's second largest property developer (The Evergrande Group) could have a domino effect, (ii) concern that recent inflation may be more persistent and not merely a transitory impact attributable to COVID-19 and short-term supply chain issues and (iii) political uncertainty in Washington over raising the US debt limit.

Notwithstanding these issues, equities have rebounded so far in October and many North American stock indices are once again near their all-time highs, fueling a fresh wave of market skepticism. In a world where everyone is waiting for a market decline, being bullish or even neutral on stocks almost seems to be a contrarian view these days.

We have written about the temptation to market time before but think it is topic worth revisiting now given how critical it is in terms of ensuring clients achieve their investment objectives. First, it is important to understand that just because a particular stock market is at an all-time high, it doesn't mean a crash is imminent. In fact, there are always new market highs as the general direction of the market over longer periods of time is upward. For example, from 1950 to 2020, the broad US equity market set 1,130 new highs so market peaks are nothing unusual and trying to avoid market lows often leads to missing out on gains.

Second, history has proven the old market adage that "time in the market" is far more important than "timing the market". This is borne out by an analysis we recently performed comparing two investment strategies. Starting January 1988 and ending September 2021, the first strategy involves a hypothetical investor making regular and equal monthly investments in the S&P500 index at the end of each month– this is commonly known as "dollar cost averaging". In the second strategy, an investor would make an entire year's worth of the same contributions at the end of the month that turned out to be the low point for the S&P500 in each year. Over this nearly 34-year period, we found that the investor with perfect yearly timing capability would end up with a portfolio worth about 9.5% more than the dollar cost averaging investor.

While this difference is not trivial, it could only be obtained with perfect hindsight as it is nearly impossible to know ahead of time the month within each year over a 34-year period that will represent the low in the stock market. We do not think this strategy can be realistically achieved, nor is it worth pursuing given the risk of missing out on market gains which often follow market bottoms (which can only be known after-the-fact). In practice, we have found that investors are far better off dollar-cost averaging by investing at established regular intervals as opposed to attempting to time their market entry based on their perception of market conditions. As one well-known British fund manager has said: "there are only two types of investors: those who can't time the markets and those who don't know they can't time the markets".

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It is important to keep all this in perspective when watching the next market commentator on TV advising to sell stocks ahead of a predicted crash. Even those experts who predict one crash rarely repeat their performance. For example, few people today remember the name of stock analyst Elaine Garzarelli, although she was a market darling in 1987 when she predicted the stock market crash in October of that year (known as Black Monday). Garzarelli has faded into history as she made several subsequent market calls that were incorrect. In addition, her investment fund was one of the worst performers in 1988 and continued to do poorly in the ensuing years, despite her investors actually avoiding losses from the 1987 crash.

We have always believed that a better investment approach than market timing is to focus on what we can control, namely ensuring our clients have access to a diverse set of asset classes that reduce volatility and market correlation and focusing our efforts on ensuring we select attractive, high-quality investments within each of those asset segments.

This is why we focus on analyzing business fundamentals for all of the individual stocks and bonds included in our publicly traded portfolios and investing in only the select few we feel are the most attractively priced relative to their future prospects. This strategy has worked well for us and our clients over the past 14 years.

We have also seen the need, however, for clients to diversify a portion of their portfolios out of public investments into other areas such as private assets. This is something that large institutional investors have now been doing for decades in order to maximize investment returns and reduce volatility and we believe individual investors can benefit in the same way. Ignoring areas such as private equity, real estate, infrastructure and lending would also be imprudent as it would effectively mean restricting our opportunity set to a small fraction of the total available investment universe.

As you know, over the last several years we have launched Bridgeport's Alternative Income and Private Equity Opportunities funds to provide diversified exposure to private asset segments. Both funds are performing well and made a number of interesting investment allocations during the quarter including strategies focused on global health care / pharmaceutical royalties and lending, US small business lending and North American and European private equity and venture capital.

Finally, we would like to welcome two new Bridgeport team members. Stephanie Kremer joined us in September to head up our business development and investor relations efforts. Stephanie has extensive experience with both traditional and alternative strategies with a number of other Canadian investment managers. Reshmi Mitra-Marshall started with Bridgeport in October from another financial advisory firm and will be working with Mark Yestrau and myself as part of our client service team, focused on handling private client administration.

We wish you all the best as we head into the final stages of 2021. As always, please feel free to call should you have any questions.

Yours truly,

John Fisher