Bridgeport Asset Management Inc.
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BRIDGEPORT ASSET MANAGEMENT INC.

Q4 2018
Investment Commentary

The term annus horribilis, meaning "horrible year" in Latin, was popularized by Queen Elizabeth II when she used it to describe 1992 – the year that the marriages of her two sons (Charles and Andrew) broke down, her daughter Ann officially divorced and Windsor Castle caught fire.

While hopefully no one's house burned down, 2018 could certainly be classified as an annus horribilis from an investment perspective. The year was unusual in that virtually everything declined in value including stock and bond markets around the world and most commodities including oil, gold and silver. It was reported toward the end of the year by Deutsche Bank that 2018 was the worst year for returns in over 100 years with almost 90% of all asset classes registering declines.

From an equity perspective, the benchmark U.S. S&P 500 declined 6.2%, while the TSX Composite in Canada dropped 11.6% and MSCI World index plunged 10.4% in 2018. Small and mid-sized public companies fared even worse as the Russell 2000 index lost 12.2%, while the BMO Small Cap Index declined 20.3%. Comparatively speaking, our portfolios have fared better than the broader stock market indexes as shown on your client portfolio statement and returns are trending up nicely so far in early January as markets rebound.

In years where equities deliver negative returns, investors are often able to find solace and safety in the bond market, although they had no such luck in 2018 which also saw broad US, Canadian and International Bond indexes decline between 0.5% and 6.5%.

Challenges in the bond market were largely attributable to Central Bank interest rate increases which depressed prices as investors demanded higher rates of returns on previously-issued bonds. While this led to negative returns for bonds in 2018, it could lead to higher bond returns in 2019 as (i) yields have now increased significantly in some areas of the market and (ii) central banks in Canada and the US appear to be taking a more cautious stance toward interest rate increases given concerns over slowing economic growth.

On the equity side of things, the S&P 500 index has generated negative annual returns in 30 of the past 90 years so stock market losses are unfortunately relatively routine, and from that perspective, there is nothing particularly unusual about 2018. Interestingly, following a negative return year for the S&P 500, our 90-year review indicates that 72% of the time the index generated a positive return in the next year and that the median positive return in those years was 13.4% (with a wide range of returns from 0.1% to 45%).

We are beginning to see compelling value in many of the stocks we own in our portfolios as well as those we have been monitoring and waiting for a price decline. While impossible to predict in the short term, we think more attractive valuation levels and the probability of a more a stable interest rate environment should make for a better return environment going forward.

Amidst this backdrop, we intend to stick to our philosophy which focuses on investing in high quality, strong cash-flow generating businesses at attractive valuations. To that end, we note that many overhyped investments like marijuana and certain technology stocks (which we avoid) delivered great returns at the beginning of 2018 only to suffer much more severe declines compared to the overall market in the latter part of the year as investors began to question their long terms prospects and inflated valuations.

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We would also like to highlight the launch of our Bridgeport Alternative Income Fund in Q4 which we mentioned in our last report. This fund is designed to have minimal correlation to daily price movements in stock and bond markets as it is investing in a diversified set of income-generating private asset strategies. We think this fund may represent a useful addition to many of our client portfolios as it is expected to provide a buffer against market volatility, while delivering solid returns from diverse asset categories. Please feel free to reach out to us if you are interested in discussing this portfolio option.

Finally, we would like to thank those who recommended Bridgeport to their families and friends over the year. We always appreciate your thinking of us.

We wish everyone all the best for a healthy, happy and prosperous 2019!

Yours truly,

John Fisher

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