CI PRIVATE POOLS™

CI Global Equity Alpha Private Pool
Second-quarter 2019 Commentary

Market Overview

- Investors entered 2019 shouldering a host of concerns, including slowing economic growth, lower corporate profitability, geopolitical uncertainty and heightened global trade tensions. Nonetheless, global markets went on to achieve positive results during the first half of the year, so it appears that all is well and good. How did this happen? While uncertainties remain, investors have embraced the prospect of renewed monetary policy stimulus from global central banks, as well as on optimism for progress in U.S.-China trade negotiations.

- Interestingly, assets across the risk spectrum rallied during the first half of 2019. The outlook for interest-rate cuts and liquidity to support growth and a return to a “lower-for-longer” rate policy at central banks led to gains across most asset classes for the first half of the year. In U.S.-dollar terms, the MSCI All Country World Index gained 16.2% over this period, led by the more cyclical sectors. Investors continued to prefer the U.S. market, which outperformed equities elsewhere. Within fixed-income markets, U.S. high-yield issues performed well, as did U.S. Treasuries at the opposite end of the risk spectrum.

Fund Holdings

- Holdings of CI Global Equity Alpha Private Pool (the “Fund”) during the second quarter of 2019 included Altran Technologies S.A.; HeidelbergCement AG; Schneider Electric SE; Glanbia PLC; Criteo S.A.; and Murata Manufacturing Co., Ltd.

Portfolio Activity

- During the quarter, three new holdings were added to the Fund: Alibaba Group Holding Ltd., DKSH Holding AG and Fomento Economico Mexicano, S.A.B. de C.V. (FEMSA).

- Alibaba Group Holding is a Chinese multinational holding company specializing in e-commerce, retail, internet and technology. Its three main websites – Taobao, Tmall and Alibaba.com – have hundreds of millions of users and host millions of merchants and businesses.

- DKSH Holding is a Switzerland-based holding company that provides market expansion services in Thailand, Malaysia, Singapore, greater China and internationally. The company offers services including sourcing, research and analysis, marketing and sales, distribution and logistics, and after-sales services. The company operates in four business segments: health care, consumer goods, performance materials and technology.

- FEMSA is a Mexico-based multinational beverage and retail company. It operates the largest independent Coca-Cola bottling group in the world, as well as a chain of Oxxo convenience stores, which is the largest convenience-store chain in the Americas by store count. The company is also the second-largest shareholder in Heineken N.V., a leading brewer globally.

- There were four outright sales of Fund holdings during the quarter: Asics Corp., Carnival Corp., Henry Schein Inc. and Woodward Inc.

- Henry Schein is the world's largest provider of health-care products and services to office-based dental and medical practitioners. The company recently sold off its animal-health business to focus on dental and medical practitioners.

- Woodward is a leading global designer, manufacturer and service provider of control systems for the aerospace and industrial markets.

- Both Henry Schein and Woodward were sold from the Fund's portfolio because of strong market performance that reduced their future return potential.

- Carnival, the world's largest cruise-line operator, and Asics, a global sports apparel company based in Japan, were sold from the Fund's portfolio to pursue other opportunities.

Outlook

- While the truce in the trade war between the United States and China is a positive development, it does not solve the more immediate concerns over moderating global economic growth. Moreover, an immediate resolution to the trade tension is unlikely as the Americans' tougher stance with China includes addressing issues such as intellectual property rights and cybersecurity, which will take longer to negotiate.

- The global bond market is offering up its own warning signs on the global economy. Proposed extensions to quantitative-easing measures by central banks have delayed the reversion to the mean in interest rates and has resulted in a record-high US$13 trillion in negative-yielding global debt across Europe and in Japan. While U.S. interest rates are comparatively higher – and not in negative territory – they have declined, resulting in an inverted yield curve, which for many investors indicates a greater risk of a recession.

- While eased monetary policies around the world continue to bode well for equity markets over the short term, this situation will eventually lead to a reduction in operating margins and returns on capital for most companies. Almost free and ubiquitous capital has lowered barriers to entry for many businesses. Along with rapid technological change, it may be the case that companies' life cycles are now shorter than ever. New entrants have largely adopted policies to spend as much as possible to gain market share at any cost.

- Low interest rates and low inflation have supported higher equity market valuations, which will lead to below-average returns. There is also a notable valuation gap between the U.S. and international markets. The latter currently offer a more attractive valuation and potential returns. The U.S. market has also become dominated by growth-oriented companies, the share prices of which have been driven up by the strong stock market.

- Investors have been willing to chase high near-term growth, but corporate profitability is distant in this investment environment. This is particularly evident in the U.S. initial public offering market, where companies are being valued on multiples of sales, which makes them more marketable as many are significantly unprofitable. The S&P 500 Index trades at an average price-to-sales multiple of 1.9 times trailing 12-month sales, and the S&P 500 Index's information technology sector trades at an average price-to-sales of 3.7 times. By comparison, valuation levels are excessive for many companies that have recently gone public. (For example, Beyond Meat Inc.'s price-to-sales ratio was 83.7 times, CrowdStrike Holdings Inc.'s was 54.5 times and Slack Technologies Inc.'s was 41.6 times.) Even with an optimistic promise of above-average growth and potential profitability over the next decade, there is considerable downside risk.

- It is also notable that there is a record US$2.5-trillion stockpile of private equity capital on the sidelines, which has led to larger and more aggressive privatization deals, with rising valuation levels and increased use of leverage.

- If this scenario endures, our concern is that current monetary policies may result in a loss of investor confidence.

- As always, we will continue to look past the market noise and use volatility to our advantage as we invest the Fund in winning businesses at attractive valuations. For Black Creek Investment Management Inc., successful investing requires evaluating companies that are interesting on a fundamental basis, and having the patience to take a long-term view.

Sources: Bloomberg L.P., MSCI Inc., S&P Dow Jones Indices, Morningstar Research Inc., StatPro Group plc and Black Creek Investment Management Inc., as at June 30, 2019.

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