Market Commentary
Fourth Quarter 2019

PICTON MAHONEY Asset Management

Synergy American Corporate Class

David Picton, President and Portfolio Manager
Michael Kimmel, CFA, Portfolio Manager

Class F returns (in %) as at December 31, 2019	Year-to-date	1 year	3 year	5 year	10 year	Since inception (8/08/2000)
Synergy American Corporate Class	23.7	23.7	12.3	11.2	13.0	3.9

Source: Morningstar Direct, Bloomberg Finance L.P. and Picton Mahoney Asset Management, as at December 31, 2019.

Market Overview

- While investors largely focused on a trade agreement between the United States and China during the latter part of 2019, we attributed the year's strong equity performance to overall financial conditions. A very accommodative U.S. Federal Reserve seems willing to embrace a period of inflationary pressure before it raises interest rates, which suggests the bar to raise rates is far higher than it is to lower them. We feel the backdrop for equities remains constructive over the near term, given the reintroduction of what appears to be a quantitative easing program, calming of global trade tensions and potential economic stimulus in China.

Performance Summary

- Over the fourth quarter ended December 31, 2019, Class F of Synergy American Corporate Class (the "Fund") returned 4.5%, compared with 6.9% for its benchmark, the S&P 500 Index.

- The Fund underperformed primarily due to our overweight exposure to the industrials and real estate sectors. Our underweight positions in consumer staples and energy made positive relative contributions.

Contributors to Performance

- During the quarter, the Fund's top-contributing investments included Advanced Micro Devices, Inc. and Vertex Pharmaceuticals Inc.

CI Investments

2 Queen Street East, Twentieth Floor, Toronto, Ontario M5C 3G7 l **www.ci.com**

Head Office / Toronto	Calgary	Montreal	Vancouver	Client Services
416-364-1145	403-205-4396	514-875-0090	604-681-3346	English: 1-800-563-5181
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- Shares of Advanced Micro Devices have had a strong run on account of the company’s successful introduction of a new family of seven nanometer processors that quickly gained traction in the marketplace. The company’s new products offer compelling price and performance attributes relative to those of its closest peer, Intel Corp. While there was some concern among investors in October that Advanced Micro Devices wouldn’t be able to secure enough advanced manufacturing capacity from partner Taiwan Semiconductor Manufacturing Co. Ltd., these fears were disproven when the company released its third-quarter earnings report, together with a strong forecast. The company continues to have strong momentum from its design wins and has strong prospects for gains in market share in desktop, notebook and server sales, as Intel continues to encounter difficulty obtaining next-generation capacity.

- The stock of Vertex Pharmaceuticals was catalyzed in October when its triple-combo cystic fibrosis (CF) drug, Trikafta, was approved significantly earlier than expected. This new drug will essentially make nearly 90% of all CF patients eligible for treatment. On top of this, the company was able to secure reimbursements for patients in Ireland, France and the United Kingdom, solidifying growth prospects outside the United States. Finally, early CF-drug data from Vertex’s nearest competitor, Proteostasis Therapeutics, Inc. was deemed neither compelling nor competitive.

Detractors from Performance

- Our positions in ServiceMaster Global Holdings, Inc. and The Progressive Corp. detracted from the Fund’s relative performance during the quarter.

- ServiceMaster Global Holdings became a turnaround story following the pest and termite control company’s spinoff of its home-service plan business. This will transform ServiceMaster into a faster growing, higher margin, pure-play business with a less cyclical recurring revenue model. This concept features a more focused management team that should grow and consolidate an extremely fragmented market. In November, we were surprised to see the company announce significantly disappointing earnings (in earnings before interest, taxes, depreciation and amortization – EBITA – terms). The main issue was a spike in termite-damage claims in the Mobile, Alabama market. While the magnitude of the pullback was severe relative to the US$6-million in claims to date, management was unable to quantify the full extent of the financial risk due to accounting rules and pending litigation cases. This led many investors, including us, to wonder whether this could be an open-ended issue (for example, if there are asbestos issues) and we have exited our position.

- The Progressive Corp. had been a core holding in our portfolio for quite some time. However, this best-in-class auto insurer occasionally succumbs to cyclical downdrafts in which claims severity increases ahead of requisite price increases, and it appears we have reached this point. The company’s combined ratio is now climbing, driven by increasing core losses from both the personal and commercial businesses. While accident frequency trends have been favourable, it has been insufficient to offset the rise in severity. Competitors have recently lowered their coverage premiums in search of growth, thereby limiting the ability to offset loss costs with pricing. With the Progressive Corp. stock trading at a premium and just beginning to post negative estimate revisions for the first time in years, we decided it was time to exit the position and redeploy our capital in better opportunities.

Portfolio Activity

- We have increased our exposure to the financials and industrials sectors because we see a window of opportunity for cyclical and value-oriented equities to benefit from the current environment. As part of this strategy shift, we decreased allocations to both real estate and utilities, fearing defensive stocks are too expensive in this changing landscape.

Outlook

- We will continue to monitor geopolitical issues as they arise. The situation in Iran needs to be monitored for potential further escalations. A strong response in energy markets could negatively impact strong consumer sentiment and activity, which has held up well in the United States due to low interest rates. Of course, the U.S. election in November will have impact, particularly if a less market friendly Democratic candidate unseats Donald Trump.

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