Market Commentary
Second Quarter 2020

CI American Small Companies Fund

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Class F returns (in %) as at June 30, 2020	**Year-to-date**	**1 year**	**3 year**	**5 year**	**10 year**	**Since inception (2000-08-08)**
CI American Small Companies Fund	-9.3	-4.0	0.1	3.5	11.8	3.9

Source: Epoch Investment Partners, Inc., as at June 30, 2020.

Market Overview

- Stocks rebounded from the first quarter's sell-off, which hit its low point on March 23. Sentiment improved as the rate of COVID-19 infections declined and countries began gradually reopening their economies, although infections in the United States picked up again in June. Stocks also got a lift from the U.S. Federal Reserve (the Fed), which unveiled plans to lend directly to municipalities and businesses, and to buy bonds issued by companies that had recently lost their investment-grade status. Investors looked past a steep drop in earnings, and escalating tensions between the United States and China. In addition to retaliatory trade restrictions on each side, the United States said it would no longer treat Hong Kong as an autonomous entity after China approved a plan to implement new national security laws in the city, bypassing the Hong Kong government.

- Economically sensitive sectors had the best results during the quarter. The consumer discretionary, information technology and materials sectors were among the strongest performers, along with the energy sector as oil prices stabilized in May and then steadily crept higher. Consumer staples and utilities lagged.

- Gross domestic product in the United States fell at a 5% rate in the first quarter, which was a steeper drop than expected. Continuing jobless claims jumped into the tens of millions—an unprecedented level—while unemployment surged to 14.7%, the highest since the Great Depression. Consumer spending plummeted in April and partially rebounded in May. Banks reported they were bracing for a higher level of loan defaults.

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EPOCH Investment Partners

Performance Summary

- CI American Small Companies Fund Class F (the Fund) returned 19.7% during the second quarter, outperforming its benchmark, the S&P 1000 Total Return Index, which returned 18.2% over the same period.

- Security selection in the financials and industrials sectors were the main contributors to results. These gains were partially offset by weak selection in the consumer discretionary and information technology sectors.

Contributors to Performance

- In financials, Credit Acceptance Corp. rose by over 60% during the quarter. The company reported first-quarter revenue of US$389.1 million, up 10% year-over-year. The increase was largely driven by a rise in customer finance charges. While the company has increased its reserves for loan losses by a large amount due to the COVID-19 pandemic, investors appeared buoyed by recent insider buying activity. Credit Acceptance has a positive long-term track record in the difficult business of indirect subprime auto lending. Since going public 25 years ago, the company lost money in only one year (1999). During the financial crisis in 2008/2009, the company was able to grow profits at a double-digit rate because their loan portfolio held up extremely well and they were able to take significant market share from weakened competitors.

- In industrials, shares of XPO Logistics Inc. were up over 58% for the quarter. The company reported strong free cash flow generation in the first quarter after taking definitive action to realign its cost structure in response to the onset of the COVID-19 pandemic. At the same time, the company acted quickly to protect its employees by enacting health protocols, and increasing compensation and paid-leave benefits. The company also improved its liquidity profile by issuing US$850 million in new debt and securing a US$350-million senior secured credit facility. The company expects to generate hundreds of millions of dollars of free cash flow this year on the resiliency of its e-commerce capabilities, intelligent automation in its warehouses, a digitally connected transportation platform, and the unique ability to maintain a high degree of visibility into its operating environment. In our opinion, the company is in a position to rebound strongly during the post-pandemic recovery phase.

Detractors from Performance

- In health care, Universal Health Services, Inc. shares declined after the company reported first-quarter earnings that came in below consensus expectations. The drop-in income came as the health system saw its business in the acute-care segment plummet—much like other health systems around the country—in the latter half of March, as emergency room visits declined and elective procedures were cancelled due to the pandemic. Looking ahead though, recent activity data points to an early but encouraging recovery in Universal Health Services' acute hospital and resilient behavioural business. The impact of the pandemic will most likely create accelerated demand for behavioural health services.

Portfolio Activity

- Since the advent of the COVID-19 pandemic, we have sought to actively practice both risk mitigation and opportunistic investing simultaneously within the Fund. We have sold any company whose business model has been impaired over the longer term. We have invested in new ideas, companies whose business models should perform well both during the current period, but also during the eventual post-pandemic recovery. We used the period to add to positions in some of our highest-conviction ideas at a reduced price. We have taken advantage of the decline in stock prices to purchase companies that we have admired historically but were previously deemed too expensive from a valuation perspective.

- In consumer staples, BJ's Wholesale Club Holdings, Inc., a warehouse club and gas station operator, was added to the Fund. The company provides various products, such as television and electronics, furniture, computers and tablets, appliances, food products and others. BJ's Wholesale Club Holdings should outperform other retailers and benefit from the pandemic given the lower price points and focus on perishable/grocery. Management has been focused on a turnaround over the past few years, and there is still focus on improving profit margins and reinvesting in systems/people to help drive the business forward.

- Added in information technology, Sabre Corp. is a software and technology company that powers the global travel industry. The company connects the world's leading travel suppliers (airlines, hotels, car rental brands, rail carriers, cruise lines and tour operators) with travel buyers (online travel agents and traditional travel agencies). In normal times, Sabre benefits from a superior competitive position and favourable industry dynamics. We anticipate that the company will start to see COVID-19 relief on bookings in the second half of 2020 and in 2021. The company expects to surpass 2019 revenue, adjusted profits and cash generation by 2023. We assume that the company will realize market-share gains during competitor renewal periods. As a result, we believe that level of sustainability of free cash flow growth undervalued.

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Outlook

- Despite the magnitude of the current economic downturn, the combination of highly negative sentiment and attractive valuations makes this a rewarding time to invest, in our opinion. We expect the recession to be short lived, with recovery likely starting in the second half of the year. And while earnings and cash flows will undoubtedly fall in the months ahead, many stocks currently have cash flow yields in the high single-digits, making them attractive on a relative basis.

- Already there are signs that the economy is beginning to recover. A better-than-expected jobs report in June indicated that 4.8 million jobs had been added and the unemployment rate had fallen to 11.1%. We expect that the Fed will keep monetary policy accommodative for the foreseeable future and inflation isn't an immediate threat.

- Another significant takeaway from the quarter is that growth surpassed value, and equity factors were very volatile. This should present an opportunity for active managers who focus on stock picking, as the main winners year-to-date were speculative growth stocks trading at high valuations.

- As a result, we believe it is important to continue to invest in high-quality companies with stronger balance sheets, high return on invested capital and positive cash generation. Many are now trading at more attractive valuations as a result of the recent market sell-off. Companies that fit this profile will be in a better position to recover quickly when the economic recovery commences.

Source: Bloomberg Finance L.P.; Morningstar Direct; and Epoch Investment Partners, Inc.

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