Market Commentary
Fourth Quarter 2018

EPOCH Investment Partners

CI American Value Fund

Stocks experienced a sharp downturn, falling by double-digits in U.S. dollar terms, and pulling returns for the full year into negative territory. Investors grew concerned about a slowing global economy, higher costs pressuring profit margins, a hawkish U.S. Federal Reserve Board (Fed), and the escalating trade dispute between the U.S. and China. Small cap and Nasdaq stocks fared worse than the broad large cap indexes. Growth indexes declined more than value indexes.

The energy, financials, industrials, and materials sectors had the steepest drops. Energy stocks tumbled, with crude oil falling into a bear market on fears of weakening demand combined with oversupply; production rose in Russia and the U.S. and hit an all-time high in Saudi Arabia prior to OPEC and Russia agreeing to production cuts in December. The U.S. became the world's largest oil producer in 2018. Within financials, banks suffered under a flattening yield curve as the Fed raised short-term interest rates for the fourth time in 2018 while 10-year Treasury yields fell by 54 basis points from early November through December. In contrast, utilities and health care stocks had strong positive returns.

While security selection was positive in the communication services and consumer discretionary sectors, selection in other sectors more than offset that advantage. Certain holdings within the financials, health care, and industrials sectors detracted from relative results. Seven of 11 sectors posted negative returns for the period. Against this backdrop the fund's less-than-index weight in defensive sectors, including communication services, consumer staples, real estate, and utilities, detracted from results.

For the quarter, the top contributors to the fund's results included Starbucks, whose shares rose after the company reported better-than-expected earnings and same-store sales growth during its fiscal fourth quarter. In the U.S. and Americas, sales at stores open for at least a year grew 4%. It was the company's strongest same-store sales growth in the U.S. in five quarters. The results, combined with management's forward guidance, increased confidence that the company could meet growth expectations going forward. In the future, the company expects to realize revenue growth of 5% to 7%, and 3% to 5% in same-store sales growth. Over the next two to three years the company expects to return over $15 billion in cash to shareholders in the form of dividend increases and share buybacks.

The largest detractor from returns for the quarter was Apple. Apple's shares declined due to concerns over waning demand for the iPhone based on previously published reports from supply-chain vendors. The company subsequently reduced its guidance for quarterly revenue for their fiscal first quarter ending in December. Most of the shortfall is due to anticipated iPhone weakness in China. Most likely Apple is suffering from a recent decline in market share due to price sensitivity and the emergence of low-cost competitors. As smartphone demand has slowed, Apple has attempted to hold share by adding innovation, while increasing prices in order to drive revenue and earnings growth. Price sensitivity is likely highest in China, and brand loyalty now lower due to an increase in competitive offerings from Huawei and other local competitors. Apple did note that other hardware and services revenue growth remains solid including Apple Services, which is growing at 20%. Importantly, Apple's installed base of iPhones is still growing. The installed base consists of new phone sales, used phones, and upgraded phones. The base is still expected to grow by 12% in fiscal 2019 and 8% in fiscal 2020, which will continue to fuel robust growth in services revenue. The company's stock price is now trading at a compelling single-digit multiple on revised forward-cash-flow estimates. In addition, almost 20% of the company's market capitalization is in net cash, which Apple has already indicated would continue to be used to buy back stock. In our opinion the advent of new form-factor models, including foldable or bendable phones, represents an opportunity for the company to once again expand upon its track record for innovation. The technology is advancing rapidly and could be ready within the next two years, which would represent another important growth opportunity in Apple's iPhone product cycle.

The fund added CVS Health, Linde, and NVR during the period. CVS Health has vertically integrated one of the largest retail pharmacy chains in the U.S. with one of the largest pharmacy benefit managers. This combination makes it one of the premier health care firms in the U.S. The company processes approximately 1.3 billion prescriptions per year and operates more than 9,500 retail pharmacies across the U.S. The firm is now seeking to acquire Aetna. The Aetna acquisition creates a path for CVS to return to its historical growth profile and create a fully integrated health-care delivery channel. We envision a two-stage growth trajectory including accelerating profit growth from synergies with Aetna's membership with CVS's pharmacy programs, followed by the creation of a new health-care delivery model as CVS can leverage existing real estate to create local health-care hubs leading to additional revenue synergies. Tax reform will create a significant increase in cash flow that will enable the company to reinvest in business integration and customer retention.

The fund sold out of investments in Johnson Controls International, Ecolab, and Hanesbrands.

As we enter a new year we are mindful that the quantitative easing, which supported valuations and suppressed volatility, is now moving in the other direction. And industries whose profit margins have benefited from global trade are grappling with setbacks. At the same time, companies that can successfully apply new technologies will be able to operate with less capital. Each of these trends will influence industries and individual companies in markedly different ways. We believe our investment approach is well suited to this environment, where investment returns are more closely linked to company fundamentals. As always, we seek companies that can generate a growing stream of free cash flow and can allocate that cash effectively for the benefit of shareholders.

Market Commentary
Fourth Quarter 2018

Class F Returns (in %) as at December 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
CI American Value Fund	-1.8	-1.8	4.7	10.0	11.4

Published January 2019.