Market Commentary
Fourth Quarter 2018

Synergy American Corporate Class

Looking back

Markets continued to follow a late-cycle roadmap and they passed an ominous milestone in the fourth quarter when most global equity markets either entered or approached bear market territory (defined as a 20% correction from market highs). Equity market leadership faltered in the quarter with the NYSE FANG+ Index entering a bear market, while more defensive sectors outperformed. Massive outflows from fund redemptions and/or rules-driven portfolio de-risking only exacerbated the issues, driving volatility up to very uncomfortable levels as indexes plunged.

Deteriorating economic realities have begun to hit home in capital markets as the global tightening process (led by the U.S.) bares its teeth. The global economy is clearly decelerating, and many countries are either in recession or are close to entering one. In Europe, for instance, Q3 GDP was negative in Turkey, Germany, and Italy, reinforcing our view that this region is especially vulnerable. One sure sign that all is not well was the yield curve continuing to flatten in the fourth quarter as the bond market grappled with early October comments from U.S. Federal Reserve Board (Fed) Chairman Jerome Powell suggesting the central bank was “a long way” from getting rates from stimulative to neutral. While these comments contributed to the swoon in equity markets, they also drove a flight to the quality of U.S. Treasuries and the reduction in long-term interest rates versus short-term rates. Historically, the inversion of the yield curve has been a harbinger of recession. When the ratio of 18-month to three-month Fed Funds Futures goes negative, the market thinks the Fed has gone too far in raising rates. After the Federal Open Market Committee meeting in December, this ratio fell to zero.

Stock markets now embed a much higher probability of a global recession than they did only three months ago. The key question will be whether central banks recognize the risks in time to minimize further economic deterioration as previous tightening measures continue to work their way into the system.

In this environment, the Fed appears to be at a crossroads. The central bank has been right to try and normalize the excessive liquidity conditions that existed for most of this cycle. If the Fed had done nothing to normalize liquidity, excesses including highly inflationary conditions could have been stoked – just as they were in the late 1960s. The runaway inflation that followed in the 1970s required massive policy arrest, and thus big recessions, to begin easing inflationary pressures by the early 1980s. However, shorter-term indicators including recent market stresses are suggesting that the pace of this normalization may have been too aggressive.

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PICTON MAHONEY Asset Management

Looking at fund-specific performance
For the quarter ended December 31, 2018, Synergy American Corporate Class returned-10.8%, underperforming the -8.6% return of the S&P 500 Total Return Index (C$). Our underweight positioning in consumer staples and utilities detracted from relative performance. The largest individual detractors were HealthEquity and Michael Kors Holdings. Our underweight positioning in energy and overweight in real estate added to relative performance. Top-performing holdings were Facebook and Exxon Mobil.

Looking ahead
We continue to believe that the U.S. economy has reached the later stages of the cycle and the ongoing strength in the U.S. economy is forcing a tightening cycle that the rest of the world may not be able to afford. With the Fed's focus on raising rates to normalize liquidity, it may be underestimating the impact of deteriorating global growth. By the time the impact is felt within the U.S. economy, it could be too late to right the course of the global economy. However, if the Fed acknowledges stresses around the globe and pauses the rate hike cycle, equity markets should react favourably as evident in past cycles.

Class F Returns (in %) as at December 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Synergy American Corporate Class	1.9	1.9	5.3	10.2	11.1

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