Market Commentary
Fourth Quarter 2018

Harbour Fund
Harbour Global Equity Corporate Class
CI Canadian Investment Fund

"I hope the people over at the Fed will read today's Wall Street Journal Editorial before they make yet another mistake. Also, don't let the market become any more illiquid than it already is. Stop with the 50 B's. Feel the market, don't just go by meaningless numbers. Good luck!"

So tweeted Donald Trump on December 18, 2018. Who knew that "The Donald" was such an expert on the inner workings of quantitative tightening? Then again, it is true, he does have previous experience with debt markets. Indeed, Trump seems to be very much in tune with the rapid decline in broad monetary aggregates that has been the result of central bank actions. "Don't let the market become any more illiquid than it already is" could be referring to several things but most likely has to do with the rapid decline in the growth rate of the U.S. and global monetary base and the related growing scarcity of U.S. dollars globally.

In plain English, the amount of money in the financial system is declining rapidly, a condition that usually happens at the end of an economic cycle and one where a significant amount of caution is warranted. The decline has come about as a result of several intertwined factors:

1. China is no longer taking in massive amounts of U.S. dollars, a significant change to how money has flowed around the globe for most of the last 25 years. This means that the Chinese central bank is no longer compelled to print their own currency (RMB) to soak up those U.S. dollars and prevent the RMB from appreciating. Furthermore, previously, the Chinese recycled their U.S. dollars back into U.S. Treasury bonds – again this activity has stopped in recent years since there are not as many U.S. dollars to invest.

   The result of this significant change in the U.S./China monetary relationship is two-fold. First, the growth rate of the Chinese monetary base (the amount of RMB in the system) is no longer expanding and on some measures is actually in decline (the first such decline on record). Second, the distorting bid into U.S. Treasuries has been removed, meaning other investors must step up to fund massive (and seemingly, ever-growing) U.S. deficits.

2. The U.S. Federal Reserve Board (Fed) is unwinding its quantitative easing program, which means it is allowing the bonds it purchased to "run off." The U.S. dollar proceeds from bond maturities are taken out of bank reserves, meaning that the growth of the U.S. monetary base is in decline.

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If you are bewildered by the arcane art of central banking and money, don't worry – Trump seems to be on top of it! In all seriousness, the only thing an investor really needs to know is that financial conditions are tight and getting tighter. The price and availability of money is getting more challenged. Theoretically, this means that short-term rates rise, growth slows, and equity valuations come down. Not coincidentally this is exactly what happened through 2018.

In my opinion, the usual macro headwinds, such as the U.S./China trade dispute, Brexit, and the U.S. government shutdown, have not been the driving determinants in the slowdown to global growth that we witnessed in 2018. The top three worst-performing global stock indexes in 2018 were Turkey, Greece, and South Africa, posting miserable returns of -39%, -20%, and -19%, respectively. The reason for their economic and stock market deterioration had nothing at all to do with any trade war but had lots to do with declining liquidity (granted, all three countries have their own idiosyncratic problems that did not help matters). In this way, the trade dispute should not be thought of as the primary problem but rather as a situation that is exacerbating already existing problems.

"There is no recession in sight" was perhaps the most common refrain from market strategists throughout 2018. Similarly, analysts covering individual stocks frequently pointed to compelling value but prefaced their forecast with, "assuming that we do not have a recession…." There was one participant who seemed to disagree, or at least offered a more nuanced prognosis of the economic picture: Mr. Market. Thus, stocks and asset classes deemed to be representative of global growth such as semiconductor stocks, big banks, Nasdaq growth darlings, and copper all came under significant selling pressure in the fourth quarter of 2018. In a few cases, recessionary conditions already appear priced into valuations; such is the case with U.S. large cap banks.

Against this backdrop, as 2018 progressed, and our understanding of the situation improved, we took a wait-and-see approach in the Harbour equity funds (which include Harbour Fund, Harbour Global Equity Corporate Class, and CI Canadian Investment Fund) as outlined in our Q2 commentary. This approach was a drag on relative performance during the second and third quarter in 2018 as markets begrudgingly ground back towards their early 2018 highs. The strategy served us well, however, during the market volatility in Q4 as the funds outperformed their respective benchmarks and brought overall 2018 relative performance in line to slightly ahead of global indexes.

Digging into performance more deeply, Harbour Fund (-7.9%) and Canadian Investment Fund (-8.0%) beat their benchmark, the S&P/TSX Composite Index (-10.1%) for the quarter. From a sector standpoint, energy was by far the largest contributor, achieved by having a drastic underweight and thus avoiding most of the dreadful 2018 performance. Consumer discretionary and financials also

broadly contributed to positive relative performance. Underperforming sectors included materials and real estate, however these were small weights so the negative impact was minimal. On a stock-specific basis, O'Reilly Automotive, Thomson Reuters, and Keysight Technologies all contributed positively to performance. Detractors included Lundin Mining, Boralex, and Cobalt Capital.

Harbour Global Equity Corporate Class (-6.9%) outperformed its benchmark, the MSCI World Total Return Index (-8.64%, in Canadian-dollar terms) for the quarter. On a sector basis, financials provided good outperformance on account of being underweight big banks, which posted terrible performance in the fourth quarter. Solid stock-picking within consumer discretionary contributed positively to performance as did an underweight to the technology sector. Top individual performers were Keysight Technologies, O'Reilly Automotive, and Pfizer. Top detractors included Constellation Brands, Brookfield Asset Management, and DowDuPont.

The first section of this commentary is obviously a tad heavy on the macroeconomic side of things, especially for an investment group that spends the majority of its time working on bottom-up, value-oriented stock ideas. While doing our bottom-up work, however, we still strive to understand the environment around us. There are some companies where a macro "call" is not necessary; however, there are others where it is. Buying the stock of a high-quality auto supplier blindly, for example, without any regard for the cycle, is a dangerous strategy indeed.

Before diving back into the stock market it is worth contemplating the following: are valuations compelling enough that the risk of a continued economic deterioration is priced in, thus giving investors a required margin of safety to buy strictly on valuation? Or, are the macro drivers that caused the downdraft improving? Or, if the macro drivers are not improving, is there an argument to be made that they will going forward within a reasonable time frame?

Unfortunately, the answers to these questions are still unknown (to me, at least!). In fact, by most measures, economic data is still steadily deteriorating with little sign of bottoming. Is there a thesis that this decline will slow and/or steady in a reasonable time frame? Well, such a thesis would likely rest on the actions of central bankers who, at the time of this writing, are still tightening financial conditions. In this way, we have come full circle back to Trump, who seems to share the same view based on the tweet that opened this comment. It should be said that Jerome Powell, Chairman of Fed, has kicked off a furious rally that continues into January 2019 by hinting that the Fed may be open to not tightening as much if fundamentals deteriorate. This is a pretty long way from the loosening that I am sure Trump has in mind!

Our defensive posture, therefore, continues at the time of this writing. The rally that is currently under way is one of the strongest rebounds ever recorded, however, we question whether the growth problems of the world could so easily and quickly be fixed. We therefore intend on maintaining our wait-and-see strategy for the time being.

Thank you for your continued support.

Ryan Fitzgerald, CFA
Senior Portfolio Manager

Class F Returns (in %) as at December 31, 2018	**Year-to-date**	**1 year**	**3 year**	**5 year**	**10 year**
Harbour Fund	-6.6	-6.6	0.3	0.6	5.3
Harbour Global Equity Corporate Class	-1.9	-1.9	2.0	3.8	9.8
CI Canadian Investment Fund	-5.3	-5.3	5.2	4.0	8.1

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