Market Commentary
Second Quarter 2019

PICTON MAHONEY
Asset Management

Synergy American Corporate Class

Performance Summary

- For the second quarter of 2019, Class F of Synergy American Corporate Class (the "Fund") returned 4.3%, outperforming the 2.0% return (in Canadian-dollar terms) of its benchmark, the S&P 500 Total Return Index, over the same period.

- Outperformance relative to the benchmark is primarily attributed to the Fund's material underweight position in energy. An overweight position in the health care sector detracted from relative returns.

Contributors to Performance

- Tableau Software, Inc. is a data visualization platform company that transforms large chunks of data into easy-to-digest graphics. On June 11, 2019, the company was acquired by Salesforce.com, Inc. in an all-stock transaction valued at US$15.3 billion (a 42% premium), creating the No. 1 player in customer relationship management software with a leading analytics platform.

- HEICO Corp. derives strong organic growth from aviation aftermarket parts and couples this with merger-and-acquisition to produce consistent double-digit top-line growth. The company is a leader in parts manufacturer approvals (PMAs), which are non-original equipment manufacturer (OEM) replacement parts for aircrafts and engines that are approved by the Federal Aviation Administration. HEICO is the global leader in PMAs, which are valued given their approximately 30% price discount relative to OEM replacement parts. With PMA penetration at approximately 4% of the maintenance, repair and overhaul industry, we expect many more solid quarters ahead. On May 29, the company reported solid results, including 17% organic growth, its best growth rate since 2011. Management noted that they were seeing the best industry conditions in their 29 years in the business.

Detractors from Performance

- The Fund initiated a stake in Qualcomm, Inc. following its royalty settlement with Apple Inc. The deal removed a significant overhang that had threatened the Qualcomm business model and vaulted it into a leading and inexpensive play on the emerging 5G buildout theme. However, just weeks after the settlement was reached, a judge in a Federal Trade Commission (FTC) antitrust case against Qualcomm ruled in favour of the FTC's claim that Qualcomm used its dominant position in the industry to charge excessive licensing fees on its customers. The judge ordered Qualcomm to license patents to other chipmakers at appropriate prices and limit the practice of signing exclusive supply agreements with smartphone makers. The case is being appealed, and the Fund has maintained its position in Qualcomm.

- HealthEquity Inc. is a leader in the emerging health savings account (HSA) market. Growth has been brisk as more companies embrace these accounts in the workplace. However, two concerns materialized in the quarter. First, HealthEquity can “sweep” the cash balances in the HSA accounts and generate a return on the cash. This makes for an attractive business when interest rates are rising. However, the pivot by the U.S. Federal Reserve (the “Fed”) towards a loosening stance limits the earnings contribution potential from this business. Additionally, a hostile takeover attempt for the much slower-growing WageWorks, Inc. announced during the quarter led to fears of top-line dilution and concerns that the overall HSA market was slowing.

Portfolio Activity

- We have held a cautious view on trade negotiations between the United States and China. We expect the Chinese are in this for the long game, and demands by the Americans do not align with their long-term objectives. As such, the Fund’s portfolio has been positioned with limited cyclicality in mind. The Fund does not have large exposure to either semiconductors or heavy machinery. Our investments have been more focused on idiosyncratic or domestically focused growth stocks. With the pivot by the Fed to a more cautious stance on interest rate hikes, we have low conviction in banks. Two years ago, banks were preferred given a more favourable regulatory regime, reduced tax rates, capital return, improving economy, exposure to rising rates and cheap valuations. Many of those opportunities have now become challenges, and we have moved the Fund to be underweight in the banking sector.

- In the months ahead, the Democratic Party debates in the U.S. need to be monitored as leftist candidates promote their agendas. The tone is unlikely to be market-friendly and could negatively impact the financials and health care sectors, and large-cap technology companies. All of the Fund’s potentially affected positions are being monitored or have been trimmed accordingly.

Outlook

- During the second quarter of 2019, equity markets shifted expectation from a Fed that would hold interest rates steady to possibly three rate cuts this year.

- The Fed has not countered these extremely dovish expectations; thus, risk assets continued to rally as U.S. Treasury yields fell, while the U.S. dollar retreated.

- Over the next several months, our probability-weighted base case expects the following: 1) macroeconomic and earnings data will continue to disappoint; 2) cyclical sectors and themes will remain under pressure and drag equity markets lower; and 3) market declines will be limited to low double-digits, setting the stage for a rally into the 2020 U.S. presidential election.

- Since the 1980s, the Fed has not cut interest rates while corporate credit spreads remain relatively behaved, equity markets are close to highs and economic data is not deteriorating dramatically. A pre-emptive cut would be unprecedented. So, too, would the decision not to cut interest rates, as it would disregard market expectations, which have been firmly priced-in of late.

Class F returns (in %) as at June 30, 2019	**Year-to-date**	**1 year**	**3 year**	**5 year**	**10 year**	**Since inception (08/08/2000)**
Synergy American Corporate Class	16.9	10.2	13.5	11.9	13.0	3.7

Sources: Bloomberg L.P. and Picton Mahoney Asset Management, as at June 30, 2019.

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