ISSUE
09
FEB
2019

CROFT FINANCIAL GROUP

Commentary & Outlook

Welcome Relief

January offered significant relief for investors as both the U.S. and Canadian stock markets regained a portion of what was lost to the uncertainties of 2018.

The welcome reversal was driven by two main catalysts:

First, stocks were oversold and had approached significant long-term support levels. These technical levels tend to encourage short sellers to buy back equities to cover their positions and lock in profits. Investors also come off the sidelines to take advantage of the opportunity to buy their favorite companies at what might be considered a bargain, based on valuations.

Second, the U.S. Federal Reserve stepped back from raising rates, taking a more "wait and see" stance and easing investors' fears of an impending recession (at least for the time being). A move that surprised many.

All things considered, both U.S. and Canadian stock markets were largely driven by negative headlines and the resulting uncertainty in the 4th quarter of 2018. With January's headlines being relatively positive (or at least not quite as negative), market sentiment shifted to a more "risk-on" mind set.

For the month of January, the S&P/TSX, Canada's main index, added 8.74%. Bolstered by its weighting towards a recovering energy sector as well as a whopping 43.3% jump in Healthcare, thanks mostly to cannabis stocks.

The S&P 500 added 8.00%, influenced by a pause in interest rate hikes, better than expected earnings, a jump in industrials as well as an impressive rally in the energy sector based on OPECs agreement to cut production.

Fund Performance

TCG 531 Equity

The Equity Fund finished the month of January up 8.22%

As discussed in last month's commentary, the fund has been repositioned to be more defensive, accomplishing January's recovery while holding 30% cash and two hedging positions on the S&P 500 and Nasdaq indices.

Many of the under-performers were purged from the portfolio and profits were locked in on the outperformers.

The Investment Committee has been paying close attention to the latest round of earnings reports. The performance of a company in the previous quarters economic conditions and how they communicate their expectations moving forward (known as forward guidance) have a significant impact on the share price and is a metric that influences investment decisions.

So far, the earnings numbers have been tamer than expected. While there have been several bottom-line beats, fewer companies are beating on revenue expectations, and the profit guidance from management has been lower than in the past. While we will continue to capitalize on any upside opportunity, this further re-enforces our expectation that 2019 is going be a challenging one for stocks.

Given our expectations, the Equity Fund will continue to remain defensive by raising cash, moving into securities with Quality and Low Volatility attributes, and using additional option strategies that are more suitable to reducing downside risk in the current market environment.

TCG 534 Income Fund

The Income Fund gained 3.19% in the month of January

The Investment Committee took significant action to provide stability for what is projected to be a turbulent 2019.

The fixed income exposure within the fund was increased to 55%. Within this fixed income allocation, the preferred share exposure was reduced from 20% to 15%. This adjustment was accomplished by selling the entire exposure to the preferred share ETF's that had exhibited significant volatility last quarter. Less volatile individual preferred shares now make up this component of the fund.

Convertible debentures were increased to 6.4% up from 3% by adding two new positions; Fiera Capital Corp (FSZ.BD) and Ag Growth International (AFN.DB.E). The fund initially held the Ag Growth International stock but switched to the convertible debenture, which provides more stability but still participates in long-term up side opportunity.

Sector exposure transitioned to lower volatility holdings in Utilities, Telecom, and Healthcare while reducing exposure to higher volatility sectors such as Information Technology and Financials.

The fund closed out Facebook, Alibaba and Micron and added a hedged QQQ option strategy that profits from the time decay of short term Put options. The QQQ is the ETF that tracks the Nasdaq index.

Healthcare exposure was also increased to 8.55% by adding Danaher Corp (DHR) and Medtronic (MDT). Estee Lauder was added to the Consumer Discretionary exposure with a long term Put to protect the position in the event of another market sell off.

The covered call position on the gold sector was re-established; gold companies traditionally increase in price during market downturns as investor look for “safe” investments.

TCG 539 Option Writing Fund

The Option Writing Fund gained 5.04% in January. The fund is currently 90% invested in equities with a 10% cash buffer.

During January, some of the cash held towards the end of 2018 was put to work to capture an anticipated bounce in early 2019, as the market was then considered to be oversold. Within the overall portfolio, 63% of the stock positions have an option writing strategy overlay to support cash flow requirements. 27% of the equity positions were left uncovered to capture the upside opportunity during the market recovery.

The fund was still overweight Financials in January, but exposure had been reduced by 20% from December. Exposure to Consumer Discretionary, Industrials, Telecommunications, Information Technology and Healthcare was increased, while fund exposure to Energy and Materials was decreased.

Outlook & Expectations

We continue to maintain our view that despite the recent correction the U.S. secular bull market is still intact, as evidenced by this weekly chart of the S&P 500 showing support along the 200-week moving average and associated trendline from the 2009 low.

S&P 500 Weekly Chart – www.tradingview.com

However, as stated last month, the economy is in the mature phase of expansion and market fundamentals are late-cycle.

Certainly, the Federal Reserve backing off on future rate hikes and taking a more wait-and-see attitude has had a significant impact on investors’ risk appetite. This move has made current company valuations appear even more attractive and has turned investor sentiment from fear to greed, at least for the short term.

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All that considered, geopolitical risks and concern for slowing global economic growth remains as a significant undercurrent.

We continue to expect 2019 to be a volatile year for stocks and, as such, we will maintain a defensive stance relative to each of our fund's objectives while remaining positioned to capitalize on any movement to the upside. The tactics employed include actively trading our equity and options positions to lock in profits, holding higher allocations to cash and fixed income as well as managing a more active hedging program.

R N Croft Financial Group
877.249.2884
www.croftgroup.com

Investment Review Committee

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