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CROFT FINANCIAL GROUP

Commentary & Outlook

Another Record-Breaking Month

Having broken records to the downside in the 4th quarter of 2018, Canadian and U.S. stocks turned the tables so far in the 1st quarter of 2019 with record-breaking monthly returns.

For Canadian stocks, compared to January's stellar recovery February S&P/TSX returns were somewhat modest at 3.15%, but no less welcome. It is worth noting that year-to-date, the S&P/TSX leads most comparable international indices in Canadian dollars.

Within Canadian market sectors, Information Technology outperformed, while Materials closed the month slightly in the red.

Similarly, U.S. stocks tracked by the S&P 500 recovered a further 3.2%. Again, a relatively modest increase compared to January, but well received by investors.

This breakneck reversal in equity markets within the first two months of the year can be attributed to several factors:

- Markets were extremely over-sold versus significant longer-term technical support levels, as referenced in last month's commentary;
- The U.S. Federal Reserve maintained its *wait and see* attitude, taking the pressure off shorter-term interest rates and reducing the risk borrowing costs will rise further;
- President Trump's announced postponement of tariff increases on imports from China in context of what he considered to be *trade talk progress*;
- 70% of companies reporting beat earnings estimates;
- Computerized Trading Algorithms (CTA's) switched from net short (selling) to net long (buying) increasing the upside momentum and forcing short sellers to cover their positions.

On the commodity front, oil continued to push higher through February inspired by the announcements of further cuts from OPEC and Russia and continued unrest in Venezuela

Gold, which had rallied as a hedge against market risk during the recent correction, tapered off as investors moved back in to the stock market.

Of notable interest, copper, which is traditionally used as a gauge for the health of the global economy, added 6.6% over the month. This significant reversal of recent declines may indicate a lower risk of a contracting global economy, at least for the short term.

Fund Performance

TCG 531 Equity

The Equity Fund finished the month of February up 1.35% while its benchmark, the TSX TR Index gained 3.15%. Year-to-date, the fund has gained 9.68% while the TSX TR Index has added 12.16%.

It is worthwhile to note that the return achieved by the Equity Fund was generated with a greater than 25% net cash balance and multiple hedges in place, including put options on the S&P 500 and NASDAQ. We have adjusted these hedges higher as stocks continue to climb. In additional, we established another hedge using the VXXB,

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which is an exchange traded fund (ETF) that increases in value when volatility in S&P 500 options increases. Increases in market risk and investor concern generally raise the volatility premium factored into the price of an option contract, which means that VXXB should increase in value as more risk is factored in to the stock market.

Given global economic and geopolitical conditions, the fund remains defensive with a high allocation to cash and several hedges. Lowering company CEO guidance and earnings per share (EPS) predictions are giving investors cause to consider how much more upside can be expected in the short term.

As we continue to navigate the mature phase of the economic cycle, we expect more volatility going forward and stand ready to deploy capital as the market pulls back and opportunities present themselves. Concerns about global growth and fair market valuations skew the outlook to the downside. Under these circumstances we view protecting investor capital as a higher priority over outperforming the market.

During the month we took profits by trimming positions on several Technology sector stocks including Visa, Open Text Corp and DocuSign; in Communication Service stocks such as Activision and Google; as well as Energy stocks such as Suncor.

TCG 534 Income Fund

The Income Fund gained 1.19% in the month of February compared to its Financial Post Index - Income benchmark, which was up 0.67%. Year-to-date, the Income Fund has added 4.42% while the benchmark sits positive at 3.33%.

With equities trading at high multiples, building evidence that China and Europe may be already in a recession, and heightened trade and political conflict between US and China, the Income Fund continues to take a more conservative approach.

The Fund remains overweight in Fixed Income, with 55% of the portfolio invested in bonds and debentures as well preferred shares.

Company selection for the equity portion of the fund remains focused on finding dividend paying, low volatility stocks with a less-than-average correlation to the overall market. Cashflow is also being generated through more conservative option writing strategies, which also helps manage portfolio volatility.

Exchange Income Corporation (EIF) and Ag Growth International Inc (AFN) holdings were trimmed as a result of strong stock performance (EIF up 14% & AFN up 17%). The hedged position on Estee Lauder Companies Inc (EL) was closed out after the company reported strong sales growth in China, pushing the stock up 14.4% for the monthly of February. The covered call position on Danaher (DHR) expired in the money with the company reporting solid earnings growth.

Overall, we continue to be patient with these markets and act on selective opportunities during the pullbacks.

TCG 539 Option Writing Fund

The Option Writing Fund gained 0.75% in February, while its benchmark, the Montreal Exchange Covered Call Writers Index (MX-CWI), gained 0.87%.

Year to date, the Fund has gained 5.83% while the benchmark has added 2.44%.

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The fund continues to be managed defensively, holding approximately 13% in cash and employing an active option writing strategy to generate cash flow and help offset some of the market risk. The equity portion of the fund holds a concentrated 25% exposure to the "FAANG" holdings, which continues to rebound from the December lows. An 8.2% exposure to the Canadian Rail sector performed well by profiting from an expensive option market using a covered call strategy. The fund has also benefited from actively managing a modest exposure to the Canadian cannabis sector over the last several months. A position in Canopy Growth was re-established with the objective of continuing to benefit from the expensive options market premium.

Outlook & Expectations

The collective performance of our funds year-to-date has been accomplished while maintaining very defensive positioning overall. While the rally across U.S. and Canadian stock markets has offered welcome relief from the 2018 correction, we still see the remaining 2019 outlook as being volatile. So far, stocks have recovered well in context of a *no news is good news* mind set. However, at present upside momentum is slowing and we are seeing the current rally in both U.S. and Canadian markets meeting resistance from our technical analysis of the charts.

Markets seldom rally in a straight line, and we have maintained an overweighting to cash along with our hedges to help offset a possible pull back. In addition, we continue to trim positions as stocks become expensive with the expectation that we can deploy cash as and when a pull back brings company valuations back to more attractive levels. Overall, we will continue to manage actively in line with our outlook and remain well prepared to put some of the cash we have on the side lines to work on any temporary reversal.

R N Croft Financial Group
877.249.2884
www.croftgroup.com

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