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CROFT FINANCIAL GROUP

September 2019 Commentary & Outlook

What's Changed?

There has been an overriding question raised during our investment committee meetings over the past several months "what's changed?" and to this point the answer continues to be a resounding "nothing"

The U.S. and China went tit for tat during the month of August as both sides introduced a new round of tariffs. Economic data came in somewhat weaker than expected and once again, the U.S. treasury bond market "inverted" and thereby flashed another recessionary signal.

Despite these seemingly bearish signs, damage to both Canadian and U.S. stock markets was relatively limited. On average, stocks remained caught in a range just below the year's highs, as day-to-day headlines sparked fits of buying followed by selling at the slightest sign of negativity. Sound familiar? Again, nothing has really changed.

Part of the support for the stock market is coming from the expectation that the U.S. Federal Reserve will intervene to counteract the risk of a recession through their interest rate policy. All eyes were on the meeting between the global central bank leaders at Jackson Hole the end of August, however very little came out of this, adding to the continued uncertainty.

Of course, that did not go unnoticed by Trump as he took to twitter once again, to berate the Fed's inaction with comments like "as usual, the fed does nothing!" and "My only question is, who is the bigger enemy, Jay Powell or Chairman Xi?"

So, now well into September, we are left with a yield curve inversion predicting a possible recession, no resolution to the trade war, although markets are currently rallying based on a scheduled meeting between Trump and Xi in October; and we are left with a Central banking policy in Canada and the U.S. that has, more or less, taken a "wait-and-see" approach, all suggesting caution.

At the same time, economic indicators on average, corporate bonds (which anticipates company risk) and stocks for the most part, lean towards a recession being a low probability.

Growth Portfolios

Given the directional uncertainty of the overall market, our growth-focused portfolios remain both defensive and hedged. As stock prices, in general, remain caught in a range we continue to buy individual companies on the dips and sell into the rallies. We are also writing options to enhance returns and offset portfolio volatility.

Within the TCG531 Equity Fund, we continued to write puts on higher-volatility cyclical technology stocks such as Salesforce (CRM) and Square (SQ) that offer above-average premiums. We also use covered calls on existing holdings such as Canada Goose (GOOS) and Premium Brands Holding Corp (PBH) to collect premiums and provide some downside protection. Also, we made a few select purchases to top up some of our lower-volatility holdings such as CCL Industries Inc. (CCL.B) and H&R Real Estate Investment Trust (HR.UN).

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Conservative Portfolios

Our conservative, income-focused portfolios also remain defensive, with a higher allocation to bonds and fixed income securities. We continue to buy companies with low correlations to the overall market, which have done well in slower economic environments, and we have been purchasing shares of these companies on market pull backs as their share prices have become more attractive.

Our option writing strategies continue to add value as we are generating income on range-bound stocks as share prices trade between "support" and "resistance" levels. The ongoing increase and decrease of market volatility also benefit this approach as we are receiving a higher premium for the contracts we sell.

To date, there has been no significant change in sector allocation with in our TCG534 Income Fund. New additions include TJX Companies Inc (TJX) and Berkshire Hathaway Inc (BRK.B). We acquired TJX after the company reported slower same-store sales that were below analysts' estimates. We saw this as an opportunity as market overreaction drove the stock down 4%. Berkshire Hathaway Inc was trading at attractive valuations when it was added to the fund in line with our "buy good companies on pullbacks" approach.

We took profits on Algonquin Power & Utilities (AQN), Agilent Technologies Inc (A) and Cineplex Inc (CGX) as a result of strong price appreciation.

The Fund also continues to employ a weekly Bear Put Calendar spread on Beyond Meat (BYND) and a Monthly Bear Put Calendar spread on the QQQ ETF, which tracks the NASDAQ index.

Looking Forward

Once again, in reviewing our analysis of global economic conditions and the risk of a slowdown, we have concluded that nothing has really changed. Stock prices in general continue to be caught in a range while investors wait for some defining signal supporting a new direction. This further re-enforces our defensive stance and continued active management, using discriminating security selection and, most importantly, patience.

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