MOUNT MURRAY INVESTMENT

January 28th, 2019

Dear investors,

We are pleased to announce that Mount Murray Investment is now established and actively investing in global public markets. We are a team strong of five investment professionals working on strategies that we find relevant for investors with a long term perspective.

This letter is the first of our regular quarterly and flash publications where we will mention brief firm updates, recent activity in our portfolios and provide specific ideas and opinions on the latest market developments. We hope you will enjoy reading them.

Emerging markets are an important component of an investment portfolio and have now been so for several years, whether as direct investments in local emerging market companies or through the significant operations of most western multinationals. This year, India will overtake the UK to become the fifth largest economy in the world. China is in second place, closing in on the US for the top spot, and Brazil moves up to ninth place. By 2050, according to PricewaterhouseCoopers[1], these emerging markets will dominate global GDP rankings. Napoleon allegedly said: "China is a sleeping lion. Let her sleep, for when she wakes she will shake the world." As Chinese President Xi told an audience that included French President Francois Hollande in 2014: "Today, the lion has woken up." In fact, by 2050, China should be the world's economic superpower, with an estimated GDP more than 50% larger than second-placed US, and with India not far behind, followed by Indonesia. We think emerging market companies will keep increasing their global footprint and join the ranks of leaders in their industry.

The last months have cast doubts on the vitality of some emerging economies, but it is difficult to make the case for another 1990s Asian crisis. Over the past two decades, most major emerging countries have built up significant buffers to safeguard against a balance of payments crisis: the ratio of short-term debt-to-exports is relatively benign, import coverage (the number of months of imports that can be covered with foreign exchange reserves available with the central bank of the country) is high across most countries, the ratio of foreign exchange reserves to short-term external debt is also high, and most countries run current account surpluses or small deficits – in marked contrast with the 1997 korean won debacle. Increases in debt levels and government spending are but a byproduct of the natural development of emerging economies. The majority of those countries have steadily shored up their finances as they became wealthier, especially the larger ones, which represent the majority of investable assets and where we focus our research.

[1] The Times

Our thoughts on China

What is the problem with China? This is a question we get asked a lot. Every day seems to bring new headlines and new worries. When Apple pre-announced weak earnings on the back of slowing sales in China, for instance, many people took that as definitive proof that China's economy was in deep trouble.

We are more sanguine. Much of the slowdown can be attributed to the authorities clamping down on the shadow banking system, a necessary step that had been delayed for too long; delayed precisely because its implementation would cause growth to slow. Furthermore, as the country is attempting its colossal and imperative structural shift from being the world's largest exporter of semi-manufactured goods to becoming a net importer and shedding cumbersome manufacturing overcapacity, the trade war can actually work in accelerating this process. The Apple news seems to be more of a case of "peak" iPhone, and Chinese consumers buying Chinese brands, rather than an overall problem with the economy. As emerging market investors, we like the idea of competitive emerging market brands. It is the combination of abundant capital and a massive domestic market that underpins the breadth of China's growth potential at this point.

The overall situation is not without risk however. There was evidence that consumers had been incentivised to bring forward car purchases into early 2018, and that the back-end slowdown was made worse by changes to import tariffs resulting from the US trade war – a clear case of "be careful what you wish for" in government intervention. As the impact of tariffs starts being felt, whether with Chinese consumers delaying purchases of expensive made-in-America luxury cars or American soy farmers being forced to take government handouts, the law of unintended consequences seems to be holding fast on both sides. But, it hasn't yet shown signs of causing irreparable harm.

Although it will take more investment to boost the Chinese economy than previously and any response will be slower (think supertanker rather than speed boat), the central government *will* stimulate its economy if need be. China is still a developing country with significant infrastructure needs, so if it can avoid the problem of regional governments building phantom towns or roads without cars for example, reasonable infrastructure investment can still have significant benefits. For China to break out of the "middle income trap", the private sector also needs to play a bigger role. Previously, private companies complained that they did not have sufficient access to bank funding, with too much lending going to state-owned enterprises. Recently announced measures to encourage banks to lend more over all, but particularly to the private sector, together with broad-based tax cuts, should ensure that the private sector can become once more the engine of the economy. We see the recent slowdown in foreign direct investment (FDI) as a pause rather than an end. If China is going to reform its FDI rules, it makes sense for foreign firms to delay new projects until those rules are clarified - as long as the authorities don't take too long issuing the clarification.

Overall, we remain positive on China. We believe too much pessimism has been built into asset prices in recent weeks and would add to positions amidst further weakness.

An opportunity

Emerging market stocks today are cheap when compared to their developed market peers on the basis of ratios such as CAPE (cyclically adjusted price-to-earnings ratio), price-to-book, price-to-sales, or market-cap-to-GDP, which tend to have significant long term predictive value. “If you can keep your head when all about you are losing theirs…” When analyzing risk relative to return, we know that EM CAPE was higher than US CAPE before the 1997–1998 Asian emerging markets funding crisis, while today it stands at less than half of the US CAPE with sounder fundamentals. Only a few small emerging countries have now a material risk of crisis, therefore we are of the opinion that EM equity markets seem to provide fair compensation for their average risk. We strongly believe that in order to obtain reasonably significant returns in a public equity portfolio over the next 10 years and beyond, an important allocation must be maintained in emerging market equities. In fact, our conviction is so strong that we decided to devote our entire firm to this!

About our firm

We are ex-colleagues from CDP Capital[2] who developed a shared interest to establish a team applying what we deemed best practices, to further those practices and break new ground in the industry, and to answer directly to our clients with the independence required to hold out-of-consensus positions. We are fortunate to be well supported by smart analysts (you can read our team’s bios on our website here). Our mission is simple: create value for our clients through a full market cycle and beyond with investment strategies that are relevant for the future.

Why are we different? We are a Montréal-based team focused on emerging markets, conducting deep fundamental bottom-up research. We also bring a structured quantitative framework to support our macro decisions, which we have been known to make significantly out of consensus in the past. What unites us is an acute critical sense of markets and what we have time and again found to be the deeply flawed concept of the wisdom of the crowds. We believe this extent to which we are prepared to differ from the consensus will, when our conviction is high that it can produce superior value for our clients, manifest itself again and speak louder than our words.

Combining our experience, our vision, our operational capabilities and a real desire to build a great local firm we think provides a unique proposition. At the moment, we can offer details on our investment experience and individual track records to support prospective investors’ assessment. By this quarter’s end, you can also also follow the performance of our investment strategies.

Best regards,

Mount Murray Investment

[2] Caisse de dépôt et placement du Québec

P.S.

A little about our name: our first team meetings took place on Mount Murray, one of the three hills of Montréal's Mount Royal, which is also known as the Colline d'Outremont. The city also recently named the area Parc Tiohtià:ke Otsira'kéhne (pronounced "jojagay ochira'gaynay") in recognition of Indigenous groups that used the mountain long before French settlers arrived. In Mohawk, the words mean "around the fire, on the island where the group separates". Our group, on the other hand, joined forces there as Mount Murray Investment was incorporated in 2016. General James Murray served under General Wolfe at the Battle of the Plains of Abraham in 1759. Murray believed Wolfe's plan to land the army at Anse au Foulon was foolish and absurd, and succeeded "only by Providence". He was the military commander of Quebec City after Wolfe was killed in battle and it fell to the British. French Commandant Lévis managed to defeat Murray and the British in the Battle of Sainte-Foy in 1760, but he had to abandon the siege of Quebec due to a lack of supplies and the arrival of a British relief fleet. Murray became governor of the Province of Quebec and his term was notably successful, marked with excellent relationships with the French-Canadians, who were reassured of their traditional rights and customs. Furthermore, in 1760, Murray signed a Treaty of Peace and Friendship with the Huron Nation, which in 1990 was found by the Supreme Court of Canada to still be valid and binding. As our own Scot Keith Porter said: "This story is soo Canadian!"