MOUNT MURRAY INVESTMENT

Montréal, August 2nd, 2019

Dear investors,

Our emerging market equity strategy ended the quarter down 0.84% net of all fees and 1.35% lower than the EEM (iShares MSCI Emerging Markets ETF), now at +18.27% and 8.02% above its reference index for the year to date, a performance we felt protected our gains from Q1 for the most part despite a challenging environment in our largest geographical allocation. Our ethical equity strategy ended the quarter up 5.15% net of all fees and 1.10% higher than the URTH (iShares MSCI World ETF), supported by several strong positions including First Solar and Disney, now at +22.84% year-to-date, 5.66% above its reference index.

A colorful quarter

The second quarter was a more challenging one, as the trade war shockingly went nuclear. It wasn't lost on us that President Trump escalated the tensions to their peak on the very day[1] that Michael Cohen, his ex-lawyer and "fixer", reported to federal prison to start his three year sentence. Perhaps emboldened by his tactic, Mr Trump soon followed with a surprise threat to impose tariffs as potentially high as 25% on Mexican exports to the United States on the same day that independent counsel Robert Mueller told the Congress to "do its damn job" in investigating the President's instances of likely obstruction of justice. Are we saying escalations in the trade war would not have happened without the probe into Russian election meddling? No, but it does appear that the media-conscious Trump may have reacted this way to distract attention.

Case in point, this is a volatility phenomenon we have to work with. It has not yet become a structural problem, but currently acts as more of an irritant. The trade negotiations can be concluded with good will on both sides, as has since been done with Mexico and Canada, for example. The longer the conflict runs, however, the more its effects will be felt.

We had mentioned that the trade war could become a "careful-what-you-wish-for" case for the U.S. where China would be coerced into accelerating its economic rebalancing. This rebalancing was already underway with the clamp down on the shadow banking system and the reduction in the overcapacity of low-value add production, necessary steps that had been delayed for too long precisely because their implementation would cause growth to slow. Now, moving away from its traditional exports model and resolutely into its "China 2025" targets has become an imperative for the second largest economy to extract itself from the bottleneck. As a sign that China's best chances already are in its own economic

[1] May 6th, 2019

development plans, there are accounts that the country's 5G rollout keeps accelerating despite supply chain hurdles brought about by the U.S. This rollout supports Huaewei and a host of other significant companies in the broad value chain. While we believe that the requests on the U.S. side are generally founded - although perhaps not completely honest - we appreciate China's legitimate urge to achieve the same living standards as developed countries, and know it to be unshakeable.

Background economy keeps humming along

As scary bits keep dotting the supercycle arch that the economy and capital markets are drawing, increases in investors' cash balances and rotations to fixed income instruments work toward containing, to a certain extent, equity prices. In our opinion, this supports the expansion of the current cycle. And with interest rates around the world persistently weak, many equities remain the most attractive alternative.

A widening trade war initiated by the United States depresses global sentiment and investment, whilst distorting GDP readings. The most recent revision dropped 2018 U.S. GDP growth to 2.5% from the previous 3% estimate. While Q1 2019 growth had surprised to the upside in the U.S. on inventory accumulation and in China on soft imports boosting output, the second quarter of Chinese GDP at 6.2% was the slowest annual pace in 27 years. Elsewhere in emerging Asia, as well as in Latin America, activity has also disappointed. Despite some upside surprises compared to forecasts in headline Q2 GDP for some countries including the U.S., data more broadly paints a picture of subdued global final demand, notably in fixed investment. As predicted by the IMF, a 2019 global GDP rate of 3.2% would be the weakest since 2009; for advanced economies, growth is projected at 1.9% in 2019 and 1.7% in 2020; the emerging markets and developing economies group is expected to grow at 4.1% in 2019, rising to 4.7% in 2020[2]. This forecast reflects the May 2019 increase of U.S. tariffs on $200B of Chinese exports from 10% to 25% and the retaliation by China. While GDP data is generally already built into stock prices 6 months in advance, it's interesting to see that this may coincide with a bounce in growth.

China's manufacturing activity may be re-testing 2014/15 lows, but investment is holding up, thanks to the efforts made in cutting overcapacity so that there are no new excesses to unwind[3]. The recent slowdown in manufacturing is seen in plummeting purchasing managers indices, but overall growth is less disappointing. Retail and consumption have held up reasonably well, in the U.S. as well as in the rest of the world, as consumer confidence was supported by employment growth, thanks to the service sector activity which held up and where sentiment has been relatively resilient. While developments suggest that firms and households have been delaying large purchases (machinery and equipment/durable goods such as cars), this dynamic could turn around should the trade

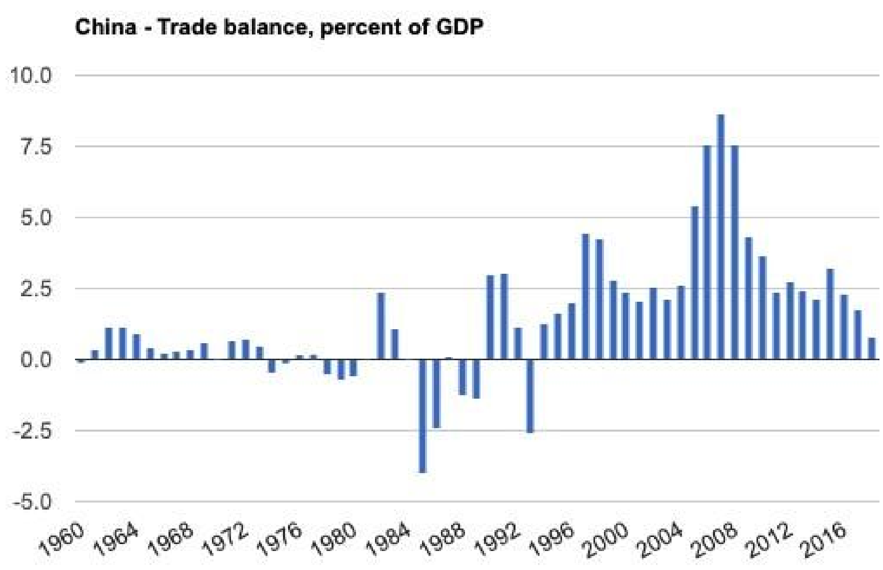
[2] IMF, World Economic Outlook, July 2019
[3] Talking Heads Macro, EM: Convergence After the Commodity Divide, June 2019

differences be worked out. Also, consistent with subdued growth in final demand, core inflation across advanced economies has softened below target (for example, in the United States) or remained well below it (Euro area, Japan). Core inflation has also dropped further below historical averages in many emerging market and developing economies, barring a few cases where we are not currently invested, such as Argentina, Turkey, and Venezuela. This opens the door once more for monetary easing, such as was recently seen in South Korea and now in the U.S. More accommodative measures should stimulate activity in the short term.

Living in interesting times

Our most important asset allocation in our long-only emerging market equity strategy, China, has drawn a lot of attention lately, so we'll focus again on the region here and will be using our next newsletters to share our thoughts on other regions.

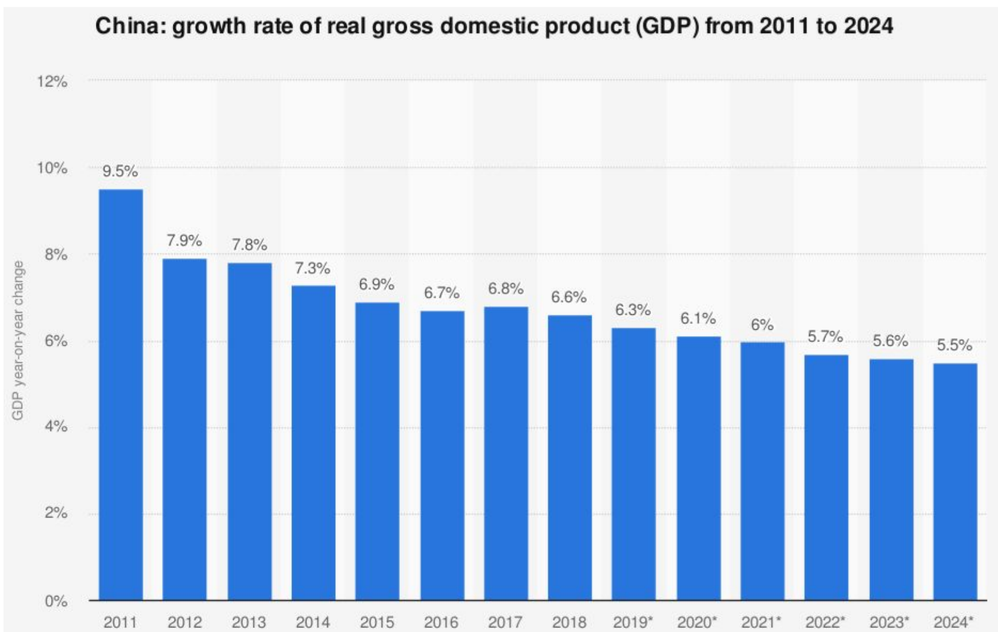
The recent release of China's second quarter GDP numbers, at 6.2% YoY growth, seems to have caused some concern. Predictably, the current inhabitant of the White House saw it as positive proof that his tariffs were working and were inflicting major pain on the Chinese economy. Any day now, the Chinese would be begging for a new deal. Other headlines were no less alarmist. Variations on the "slowest-growth-in-30-years" theme stretched from the Wall Street Journal to the Financial Times. Although technically true, the slowdown was entirely expected and should in many ways be welcomed. Hopefully, it is a headline we will continue to hear, growing incrementally to the slowest in 35 years, and then 40. It should not be interpreted as a sign of imminent collapse nor the end of the China "story".



Source: The World Bank

Given the noise over the U.S.-Chinese trade deficit, it would probably surprise many people to know that China's trade surplus for 2018 was only 0.78% of GDP, and its current account surplus was only 0.4%. This in turn explains why the tariffs on China have affected other countries as badly, if not more than they have affected their intended target; declining exports to the U.S. for instance means declining imports, including from the U.S., of the components that go into those same exports.

For an extended period, we have been using a rule-of-thumb estimate that Chinese growth would slow by around 25bp a year. As the chart below suggests, we were a little pessimistic, but not hopelessly so. Cynics might even suggest we are too optimistic, and that Chinese GDP has indeed been slowing faster than official numbers suggest. Other official statistics do seem to undermine some of the growth story.



Source: IMF

The world needs Chinese growth to slow to more mundane levels, and to do so in an orderly way. The country needs to lose its fixation with specific targets that force provincial officials to continue boosting growth at all costs, otherwise there will continue to be significant malinvestment funded by unsustainable debt, problems that the current regime has acknowledged.

We would actually be happy to see low-end "commodity" manufacturing depart China for countries like Vietnam, as it would be good for both countries. Vietnam would get much needed investment and jobs, whilst China should be able to move those jobs up the value chain. That transformation can't happen if every government official fights tooth-and-nail to hold onto every lower-end job, fearful that losing even those poor jobs would damage their own careers.

"Less strong" Chinese growth, at the headline level, therefore isn't a sign of weakness. Using purchasing power parity numbers, that low 6% per year growth currently adds the equivalent of the entire Australian economy. At the current rate of decline, 4% growth would still be adding the equivalent of an Australian economy annually too! Chinese growth is likely to be dominating global growth for many years to come.

Some of our best performing and worst performing names

This quarter, Sberbank was a notable success story, appreciating by 22.27%. It is a direct macro play on the Russian economy, especially as it recovers from the effects of President Trump's sanctions, and the rouble stabilizes. Asset quality has bottomed, and provisioning is more than sufficient to deal with any reasonable losses. Within the region, only Turkish banks appear cheaper, despite SBER having one of the highest ROEs. As a bonus, it also pays a healthy dividend equivalent to nearly 7% at current prices.

Our position in Estacio, the second largest education firm in Brazil, was initially researched for its ethical quality. Well governed, the company provides a broad range of education services in this country where 7% of the population remains illiterate, working in part toward eradication of illiteracy in the communities around the company's teaching units in the coming years. We ended up liking its stable financials so much that we included it in both our emerging markets and ethical equity strategies.

With a scalable business model in the fragmented Brazil education market, Estacio presented a high dividend yield of 6.3% coupled with a low valuation - P/E NTM under 10x and PEG NTM under 1x - projected net income around 20% and earnings growth that we estimated at approximately 10% for the next 3 years. The stock appreciated by 11.53% in the quarter and remains with a P/E NTM of 12.5 and PEG NTM of 0.9.

Sunny Optical (2382 HK) was one of our weaker stocks during the second quarter, down by 12.79%. The company is a major supplier of camera components to the smartphone and automotive industries. As such, it benefits from such trends as rear-view cameras in cars and the increase in camera modules in phones. It has contracts with all the major manufacturers. Although it's the major supplier to Samsung for their high-end smartphones, Huawei still makes up 22% of its total sales. This means that Sunny is highly vulnerable to changes in sentiment arising from the U.S.-Sino trade war generally, and to any threat to ban Huawei specifically. Consequently the stock was badly hurt in the middle of the second quarter on the back of President Trump's anti-Huawei tweets. Since then, however, it has started to recover.

Across the Pacific in Chile, Soquimich (SQM US) also did us few favors with a performance of -17.54%. The stock is a major supplier of specialty fertilizers, but more importantly one of the world's largest suppliers of lithium, the key ingredient in the rechargeable batteries that are an essential component of modern life, from cell phones to Teslas. We had expected lithium to bottom out around the beginning of the year and that sentiment towards the stock would turn with the announcement of various “mega factories” to build batteries for the rapidly growing EV market. Although the announcements came, they have so far failed to turn around sentiment/lithium pricing. We have thus closed the position.

In our ethical strategy, our position in Cerner Corp rose 28.39% in the quarter, an upshoot similar to that of our other positions First Solar (+24.30%) and Disney (+25.77%). While Cerner and First Solar benefited from results beating estimates, Disney enjoyed the materialization, to an extent, of our base case for a highly competitive streaming platform that would integrate its hard efforts of the past few years at developing a deeper entertainment portfolio relevant in today’s landscape. Disney has yet to deliver its initial streaming service on November 12th, but we were comforted by the initial key points announced, which were also in line with our assessment of the company’s responsible and sustainable holistic offering: accessible, furthering diversity and highly mindful of its social impact on youths. Our base case for many of the stocks we take positions in is for the significant probability of a major unaccounted for growth vector to materialize in the coming years, and this was a good example.

On the flip side of our ethical portfolio, Infineon Technologies suffered by 10.79% in the quarter. The German national champion of semiconductors was no doubt hurt by the external environment of falling trade, as well as by its own challenges in expanding its footprint in the U.S. to secure its long term growth in components for the internet of things. Its approved purchase of Cypress is consistent with this and we think that there is much potential for Infineon in the industry when volumes come back, which they absolutely will.

Introducing our alternative emerging markets strategy

In line with our leitmotiv to further our offering of relevant long term vehicles for our clients’ capital, we have launched an alternative emerging markets strategy designed to benefit from our top equity stock picks while controlling downside volatility. With the constant appreciation in asset prices, volatility is bound to keep surprising and in this regard, we view this investment strategy as an enviable alternative to more traditional asset classes and geographical allocations that would offer limited yields while hiding large quantities of risk.

We expect emerging markets to continue to outperform most developed markets in the long run due to converging forces in income levels, living standards, social benefits, interest rates, and general economic opportunities. Because of market inefficiencies, we believe emerging and frontier markets present ample mispriced assets, and aim to seek long term capital appreciation through investments in larger capitalization stocks listed in those markets, while controlling the strategy’s volatility with systematic short positions in equity and equity derivatives, and occasional positions in fixed income and other asset classes. The strategy is actively managed through a bottom-up selection of undervalued stocks with high growth potential as determined by assessing business strategies, management teams and fundamental measures, combined with a four-pronged macroeconomic analysis of political environment, economic tendencies, long-term valuations and market sentiment. In addition, our macroeconomic analysis provides a systematic component to reduce overall volatility by limiting net market exposure.

This strategy was always in the works and we completed our first active quarter. While it's been a challenging period and we're constantly working on the portfolio composition, it produced a slightly positive return of 0,13% net of all fees and an annualized downside volatility close to our objective of 10%. The strategy's goal is to offer stable capital appreciation, and keeping risk in check, it also mainly offers us several tools to take advantage of opportunities and our best ideas, in true hedge fund form.

Best regards,

Mount Murray Investment