MOUNT MURRAY INVESTMENT

Montréal, March 30th, 2020

Dear investors,

We understand that these can be difficult times and we express our best wishes of health to all of our readers. In this letter, we inform you of the end of year 2019 in our strategies and explain our understanding of the current market turmoil.

Our emerging market equity strategy finished the last quarter of 2019 with a return of 11.73%, bringing its one-year return to 31.09%, which outperformed the EEM (iShares MSCI Emerging Markets ETF) by 13.42% net of all fees. The year-to-date 2020 figures look lower than the overall market by approximately 2.96%.

Our ethical equity strategy ended the final quarter up 11.66%, 3.06% higher than the URTH (iShares MSCI World ETF), for a 2019 net return of 39.89%, which was 11.81% above its reference index. The YTD performance appears higher than the overall market by approximately 5.40%.

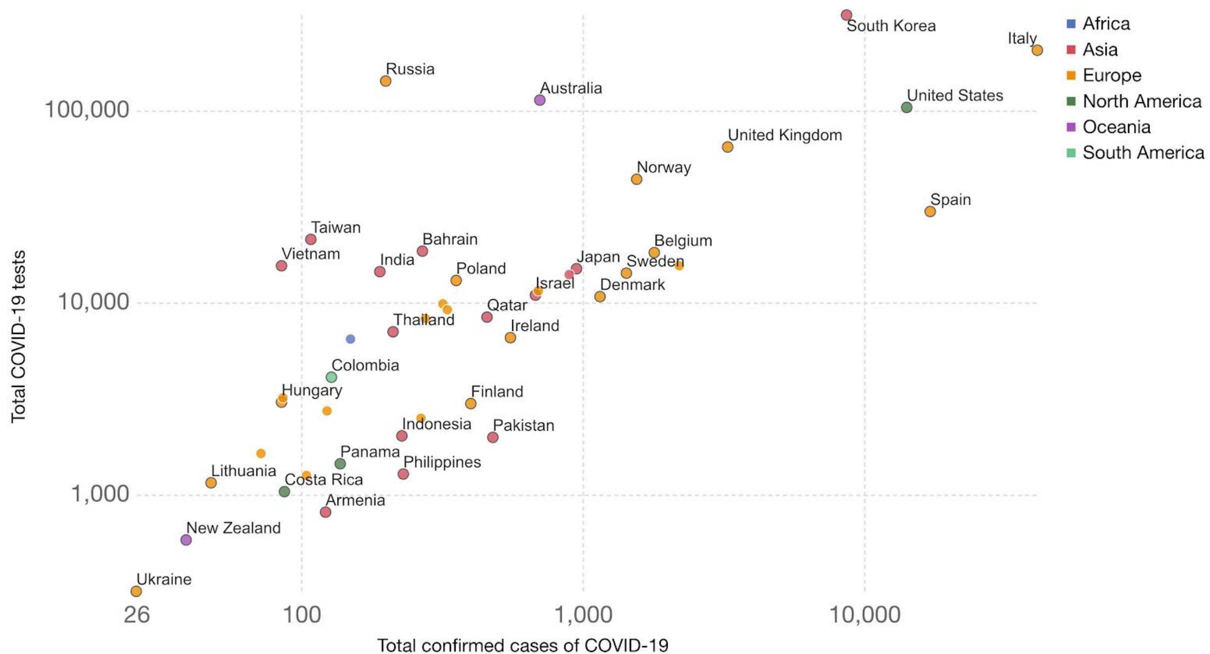
Our alternative emerging markets strategy ended the year - its first active 9 months - at 7.58% net of all fees, which was 4.24% above its benchmark “risk-free” Canada 5 year bond yield raised by a 3% premium, and produced an annualized downside deviation of 7.83%, within its 10% limit. The YTD results are in line with our beginning of year stance regarding a positive world economy and thus at this point the portfolio was less hedged during the correction than in 2019, bringing the negative performance to approximately -32.03% as of March 27th.

COVID-19 - *Emerging markets never cease to make headlines*

What a year it has been. Between the trade war that affected expectations in most countries and the Chinese economic slowdown/rebalancing that was already underway, emerging markets as a whole managed to deliver a return in the high teens in 2019, which was - momentarily, in our opinion - wiped out in the COVID-19 pandemic crisis, as were the returns of most assets globally. Interestingly, emerging market stocks corrected less initially, although the outbreak originated in China, but eventually most regions followed in line with developed markets except China. Chinese market benchmarks notably continued to outperform their U.S. equivalents, probably because China demonstrated its ability to stabilize despite a devastating epidemic ravaging the entire country.

Despite its early denial of the problem (doctors in Wuhan had apparently determined that the first reported infection in early December had transmitted to a second human, in contradiction to the official position until late January[1]), China then reacted forcefully, ensuring its work force would be back to business as soon as feasible. This alleviated the blow to its market with minimal monetary intervention, as opposed to most developed countries. The coronavirus problem was taken by the horns after an early public outcry at the sluggishness of unsuspecting authorities - at best, politically biased at worst. As we saw, political motives got in the way of an effective defense elsewhere too - irresponsible governments' initial scrambling reactions that cost invaluable weeks[2] will be a note to history. Not so much in South Korea, which had a praiseworthy, well-organized response. In the end however, although too late, the situation has generally been addressed with all the seriousness it deserves. The whole world has come to a grinding halt, but we see light at the end of the tunnel.

In addition to lockdowns, an important element of the solution is to administer a sufficient number of tests in order to detect the spread of the virus. Most countries are now moving toward the upper left area of the following graph.



1 National Review, March 23rd, 2020
2 The Washington Post, March 20th, 2020

It’s clear that SARS-CoV-2 is both a supply shock and a demand shock, that it hurts both internal and external demand, that it distorts the economy by bringing both inflation and deflation pressures, and that it creates mass layoffs. More importantly, it instills fear in most people, everywhere on the planet. The cost of the virus itself to date, while devastating, has now become insignificant compared to the cost of the crisis in confidence. While we are as shocked as everyone by the gravity of the unfolding story on human lives, we have since the onset of the outbreak seen the cost of commercial activity as an exogenous factor to a previously structurally sound global economy, which, with help, will get over its panic.

2008 isn’t far in people’s minds and this to us explains the sheer violence of the corrections we witnessed in capital markets. The ill-timed Russian-Saudi-U.S. shale producers’ tug of war over the oil price certainly added to the panic in markets, but as we had seen previously during the various trade war scares, there was some pent up investor anxiety waiting to resurface. The economic recovery period since 2009 had been extended and despite the constructive transformation of certain industries, there was a general “too good to be true” feeling. We have the view that this does not bode well for the repricing that will inevitably unravel at some point in the future, but we do not believe we have reached this phase yet.

The war on the virus is being waged. We have already seen that it can be won relatively rapidly in China. To calm markets and stop/slow a payment default avalanche in the hardest hit industries (airlines, tourism, hotels and restaurants, which we fortunately didn’t own), 2008 serves as a very useful lesson. All the tools of governments and institutions are available and recent years have seen ample debates on the best ways to address another calamity. Unprecedented fiscal and monetary stimuli around the world add massively to the already stimulative pre-crisis stance. While this is by no means an assurance to avoid the severity of a major global recession that would be due to pervasive asset repricings, it’s certainly a positive aspect of the current environment. The deterioration in confidence happened extremely fast and the reconstruction could happen fast. This is now a unanimous problem.

Meanwhile, global valuations have been discounted and now seem more than reasonable.

Global Indices: Snapshot on Earnings & Valuations (March 23, 2020)

	12M Fwd. P/E		6M Change in		P/BV	Dividend	Country
	Now	LT Avg.	Fwd. P/E	Fwd. EPS*	Ratio	Yield	Weighting***
MSCI AC World	**10.9**	**15.7**	**-4.4**	**2.7%**	**1.6**	**3.4%**	**100%**
Developed (23 Countries)	11.3	16.0	-4.7	2.9%	1.7	3.4%	87%
Emerging (23 Countries)	9.0	13.0	-3.0	-0.3%	1.1	3.6%	12%
North America							
S&P/TSX	10.0	14.5	-4.6	-2.5%	1.2	4.6%	2.6%
S&P 500	12.7	15.2	-4.4	0.1%	2.5	2.7%	56%
Dev. Europe (15 Countries, US$)	9.7	13.7	-4.1	-1.0%	1.3	5.1%	18%
U.K.	9.1	13.1	-3.1	-8.6%	1.2	7.2%	3.9%
Germany	9.3	14.6	-3.7	-1.4%	1.0	4.5%	2.3%
Dev. Pacific (5 Countries, US$)	10.2	21.4	-3.7	-0.6%	1.0	3.8%	11%
Japan	10.8	26.6	-2.5	-1.4%	1.0	3.1%	6.9%
Australia	11.7	13.9	-4.8	-5.2%	1.4	6.6%	1.7%
EM Asia (8 countries, US$)	9.8	13.9	-2.8	4.1%	1.2	3.0%	9.7%
China	9.9	12.1	-1.4	2.5%	1.4	2.4%	4.7%
South Korea	7.8	11.1	-3.3	8.1%	0.6	3.2%	1.4%
India	11.8	14.6	-5.5	3.4%	1.9	2.2%	1.0%
EM EMEA** (11 countries, US$)	6.4	9.7	-2.9	-8.7%	0.9	6.4%	1.6%
Russia (US$)	4.1	6.9	-1.6	-14.2%	0.5	10.4%	0.3%
South Africa	7.4	11.7	-4.8	6.0%	1.3	4.7%	0.5%
Latin America (6 Countries, US$)	7.3	11.3	-5.3	-12.4%	1.0	5.3%	1.1%
Brazil	7.7	9.4	-4.6	-3.5%	1.0	5.4%	0.7%
Mexico	10.3	13.2	-3.2	-0.2%	1.2	4.4%	0.2%
Chile	8.7	15.3	-7.5	8.6%	0.8	5.8%	0.1%
Colombia	5.3	12.6	-5.8	6.7%	0.6	8.4%	0.0%
Peru (US$)	7.4	12.0	-5.7	2.3%	1.2	6.1%	0.0%

*Local Currency unless specified **Europe, Middle East & Africa ***May not add up due to rounding error

Source: Scotiabank GBM Portfolio Strategy, Bloomberg, Thomson Financial.

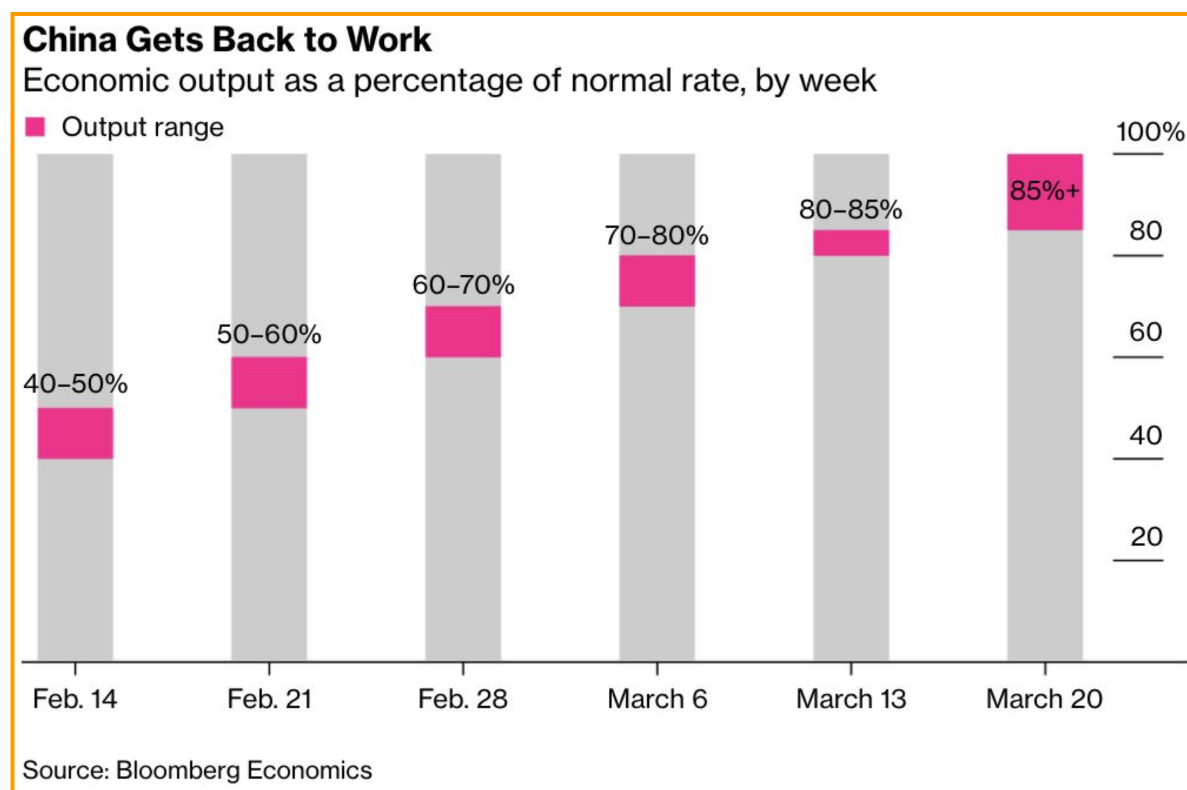
The lost quarters

There is certainly a severe economic recession unfolding in various parts of the world as we write this letter. The self-inflicted rebalancing of the Chinese economy toward consumption was already underway when China was further injured by commercial attacks by the Trump administration and the U.S. was also feeling the pain of the fight. Europe was going through yet another period of economic softness before being put to the ultimate test. Canada was going through an oil shock that has suddenly taken apocalyptic proportions, on top of its historically high household debt levels. As the world rises to the challenge of stopping the pandemic however, it does so collectively. Governments, while seemingly isolated at first, over just a few days took similar decisions and borrowed from

each other's playbooks. And most importantly, all recognized the absolute need to protect what was until now a buoyant job market.

In our opinion, the capacity to protect against massive layoffs will keep the commercial recession from turning into a deeper recession, with the key ingredient of consumer confidence standing a solid chance of emerging from this crisis at robust levels. If China, South Korea and Japan can serve as examples of controlling the contagion, and with the warmer weather that's coming to the Northern hemisphere helping, the pandemic will be stopped and businesses will return to normal within months. Now, this rosy outlook still hinges on the absence of unforeseen consequences to the market havoc that has been unleashed, but our indicators suggest a strong possibility of a rebound. We don't think that the major global reckoning so many have feared would return in the aftermath of the Great Recession will happen now. We believe investors will be able to look beyond the present damage.

On the bright side, according to Bloomberg, China's medical supplies factories as well as repurposed ones have been running nonstop to fill an avalanche of orders from overseas. Demand for ventilators is 10 times the capacity. Face masks and other supplies are also mass produced by Chinese industrial companies as the government wishes to alleviate early international tensions and help countries in dire need, rescuing Europe if it can, as a test of made-in-China efficiency. In addition to this, the whole country is getting back to work as the chart below indicates.



Fear - anxiety - panic

Everywhere, discrepancies and extrapolations abound. Biased underestimates too, to be sure. While possibly useful in scaring people into taking appropriate actions to contain the contagion, numbers tend to exaggerate the death rate (by usually not accounting for unreported cases) and add to the public angst. Being closely related to an emergency doctor on the front line of the war against the coronavirus has its informational advantages - albeit not a low risk of infection! My wife is an ER doctor at CHUM, the University of Montreal Hospital that's the busiest emergency in the province of Québec and, not unlike my grandfather who was already an officer in the army when WWII erupted, she was called to simply carry on with her work which now involves examining COVID-19 cases. Taking her eyewitness account of events as a piece in the mosaic, I can mention that she has treated some confirmed "COVID" patients so far. That is, patients with conditions bad enough to require hospitalization. They are increasing every day, but so is the quality of the organizational procedures to inform, detect, receive and treat. While this in no way minimizes the threat that the virus would represent without appropriate measures, the reality is thousands of cases in the province of Quebec, with the vast majority surviving, and no panic in the healthcare system (so far, anyway). We've been lucky, but we can also venture that the measures being put in place are effective.

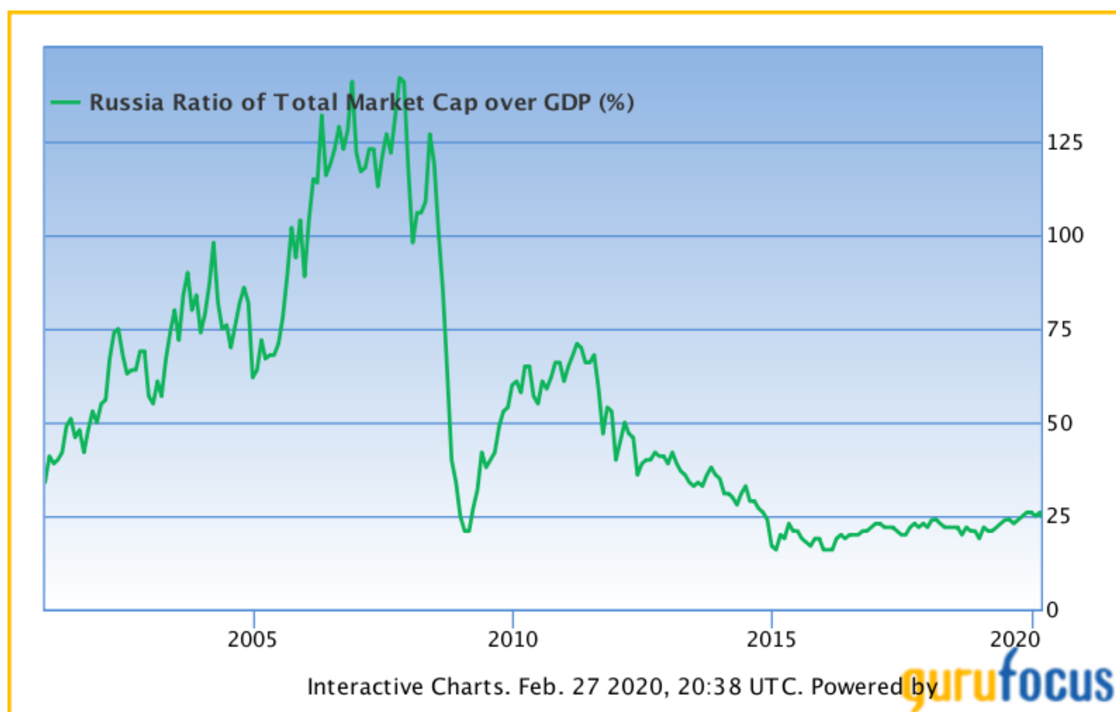
While social distancing measures are extremely useful when community contagion is reached (i.e. the virus spreads beyond directly identifiable travelers), they are a very heavy toll on economies that would have been much better off had authorities been quiet heroes and had effectively handled the threat beforehand. A delay of a few weeks while the information was available and there was already an outcry by the intelligence and scientific communities (since as far back as early January, by several accounts), is all it took to plunge economies and markets into this turmoil. The system had been "blinking red" for a while. Calls for elected officials' heroism are not in order when responsibility to the public has so clearly failed. There will be many hard lessons to be taken once this health crisis subsides.

Russia and the oil price war - Everything has a price

Russia is typical of so many emerging markets in that people rarely give it much thought, until it makes the headlines, too often for the wrong reasons. To be fair, Russian officials don't do themselves any favours, whether they are interfering in U.S. presidential elections, or propping up failed regimes like Nicolas Maduro's Venezuelan kleptocracy. In terms of weaning themselves off their over-dependence on commodities, they have done a worse job than Canada. And now they have entered into an oil price war with Saudi and American shale producers.

Prior to this outbreak of hostilities, Russia's return to stability, coupled with falling interest rates, sparked a major rally in the stock market. In the 2019 calendar year, ERUS, the iShares ETF for the Russian market, was up 48.35% including reinvested dividends. It was a

strong overweight in our emerging markets strategy. Last year, the country was still "cheap", as the chart below shows.



So why did Russia get into the lose-lose match just as things were looking better? Strangely enough, from the Russian perspective, there will probably never be a better opportunity, and it is a genuinely strategic one for the country. Russia is unquestionably smarting at having its oil companies sanctioned for doing business in Venezuela, even as the U.S.' Chevron continues to operate there. The ruble is now free floating, which means that some of the price drop can be offset by a weaker currency, giving some protection to the domestic market. Chris Weafer, at Macro-Advisory, has calculated that at the current 75 RBL/USD rate, the break-even price for the Russian budget is around $40 per barrel, down from $115 in 2013.

The Saudi Riyal has been pegged at 3.75 to the USD practically since we lived there (which was decades ago), so Saudis can't drop their currency to offset the weaker oil price. Doing so would be an admission of failure by Mohammad Bin Salman Al Saud. Again, according to Chris Weafer, Saudi Arabia needs $85 a barrel to sustain the budget, giving Russia the upper hand in this one. U.S. shale producers have been one of the largest issuers of high yield bonds, accounting for approximately 11% of the high yield market. According to the Financial Times, Moody's has estimated there is $86 B of high yield debt from North American exploration and production companies due before 2024. Those kinds of numbers make them susceptible to any seizing up of credit caused by a price collapse, especially as those markets freeze due to the COVID-19 slowdown.

But what of the collateral damage? Who else in emerging markets is going to be affected? The simple answer is everyone.

- Obviously, major oil producers like Angola, Nigeria, and even Ecuador will be badly hurt. We don't invest in any of those markets – of the three, only Nigeria has a real stock market, but we have avoided it for quite some time.
- India is a major oil importer, where Reliance Industries is the second largest stock in the iShares INDA ETF. Mukesh Ambani, the controlling shareholder, has been using the firm's up-till-now strong cash flows to fund expansion into telecoms and online shopping. So, India might benefit through an improvement in their terms of trade but lose a major source of investment if RIL doesn't have the cash flow. Net -net we think the fall in prices is positive for the country.
- China appears to be using the weakness in price to build up its reserves. Currently, the pipeline from Eastern Siberia to Daqing appears to be operating normally. By having the pipeline, Russia is strategically well positioned to continue selling into China.
- Mexico is one of the countries we invest in where oil forms a material part of government finances. The country was already suffering because their oil production had been falling for several years, and it now seems unlikely that will end soon. Perversely, this may force President Lopez-Obrador to abandon some of his less orthodox plans and introduce policies that help diversify the economy better. Given the supply chain disruption that the coronavirus has caused, this would be an opportune time to better position Mexico as a low-cost supplier to the US.
- Brazil's BNDES development bank sold approximately $5.2 B of Petrobras stock in early February, reducing the Government's overall stake. Petrobras itself has been divesting non-core assets as it has tried to get out from underneath the massive debt burden inflicted upon it by the Rousseff administration. A chronically low oil price will complicate this task, which no doubt explains a large part of the company's underperformance during this period. During market crashes, Brazil often suffers more because of the sophistication of its financial markets, which offer the liquidity investors suddenly seek. Sifting through the rubble, we feel that sections of this market have become significantly oversold, including, in our view, Petrobras.

Nothing cures low oil prices like low oil prices, and at some point, Saudi and Russia have to be less irrational. At the current date, the U.K., U.S., Germany and Canada have announced massive fiscal stimulus plans, with no doubt others due to follow suit. This will either induce a major recovery or massive inflation. Either way, the price of oil will probably be higher in 12 months' time, so we have reduced our exposure to raw materials stocks that have outperformed on a relative basis and marginally increased our exposure to Petrobras as one of the stocks with the most leverage to the price recovery, when it arrives.

Some of our best and worst contributing positions

It's a potentially uninteresting exercise to this date to detail our 2019 contributions to portfolio returns, as we would do in a normal end-of-year newsletter, thus we can share what has held on better and worse than the market from the last year throughout the onset of the COVID-19 panic.

In our EM equity strategy, Alibaba (+53.54% in 2019) has been performing well, still bolstered by cloud services and by its online retail might which is much needed in a lockdown, achieving strong double digit revenue growth in each of its business segments through year end. The pandemic has apparently not stopped it from pursuing a partnership with Apple amid an ongoing drive to tap on the international market. Apple Pay will reportedly support Alipay when the iOS 14 is released, possibly in June.

Taiwan Semiconductors (+62.96% in 2019) enjoyed the results of strong iPhone 11 sales, growing revenue and an improving ROE, and has held on relatively well in the current environment. Samsung (+47.03% in 2019) also advanced thanks to its sustained strategic presence in the smartphone market. All three companies enjoy strong global brands, innovation-led cultures, and strong balance sheets (with ample cash balances). They are truly global leaders in their respective industries. Anta Sports Products (+88.72% in 2019), the Chinese athletic wear multi-brand conglomerate, which we have written about in our previous letters, is also becoming a world leader.

On the flip side, Banco Santander (-21.88% in 2019) was affected by the sudden increase in social unrest in Chile which resulted in a stepwise drop in the value of the Chilean Peso, and the continued unrest has kept it weak. This surge in social unrest is unprecedented as Chile has enjoyed a well deserved reputation for pragmatism and stability since the return to democracy in the early 1990s, which had resulted in its market trading at a premium to other Latam markets. It seems unlikely Chileans will abandon that stability now, although there will have to be some degree of accommodation. The government is starting a process to review the constitution, with a view to find workable solutions that won't imperil long-term fiscal stability. Going forward, we think the bank is a very sound blue chip that will enjoy solid growth when uncertainty diminishes.

China Communications Construction Company (-13.63% in 2019), despite an undemanding valuation and a clear commitment by management to strengthen its balance sheet, failed to find favour with investors seemingly focused on a relatively narrow list of technology names. We had expected the stock to benefit from continued orders coming from China's one belt-one road project, but it simply became a value trap. Even expectations of a significant Chinese stimulus following the country's COVID-induced shutdown failed to rally the stock, so we have decided to exit the position to fund better ideas.

Kasikorn Bank (-12.83% in 2019) is one of Thailand's premier banks. The country was hit by a double whammy last year: first, a political uncertainty stemming from the election process, exacerbated by the weak position of the new king; second, a reduction in outbound tourism from China, making it an early casualty of the global coronavirus slowdown. At the same time, the bank fell somewhat out of favour with Thai investors as it slowed its dividend increases to preserve capital for its ambitious digital growth story. As a result, it ended 2019 trading at valuations below those seen in the global financial crisis of 2008, but with a much stronger balance sheet.

Arca Continental (-3.55% in 2019) is the Coke system franchisee for Northern Mexico, parts of South America and the Southern U.S., making it the second largest Coke bottler in Latin America. It also has a food and snacks business serving Latam and the U.S., where products are aimed at the hispanic market. The change in government in Argentina and the political unrest in Ecuador had a bigger effect on the share price than on results, which in the 4th quarter actually came in ahead of expectations: flat in local currency terms, but down in USD terms less than expected. After the results came out, we sold our position as the broader markets fell, and as other stocks became significantly cheaper on a relative basis. We would expect to buy back our position when relative valuations become more favourable.

In our ethical equity strategy, Apple had the best contribution (+97.39% in 2019). While no large corporation can be ethically perfect in all regards, we chose Apple for its approach to product design, having been an effective pioneer of friendly and reliable access to the positive potential of the internet, a protector of clients' privacy and a well-governed enterprise. For these reasons, Apple continues to dominate the high end consumer technology space. In addition to its iconic products like iPads and iPhones, we are also seeing strong growth in streaming services such as music and TV. The iPhone 11, and even the higher end 11 Pro, proved more popular than many analysts had forecasted. The company continues to consider the security of customer data as a high priority. We therefore expect it to continue to enjoy higher margins than its competitors, whilst its substantial cash reserves will enable it to afford sustained dividend payments.

Tesla was also a notable addition to our portfolio (+73.28% in 2019) given its indisputable (and overdue) shaking up of the auto industry. Tesla is an iconic stock with an iconic leader who holds sway on his followers. We don't mind it and although we like the underlying concept, we have been cautious about the state of its finances - particularly the cash burn given the leveraged state of its balance sheet. The equity issue last year shored that up and was a great opportunity for us to build a position. While we were initially worried about its capacity to stabilize, we were impressed by the execution of its plan and profited from the volatility in the stock price to obtain a comfortable margin of safety. The stock will probably continue to be volatile for several years to come and liquidity issues may well reappear. We will continue to monitor it closely, but we currently feel that its valuation is reasonable.

Danish Vestas Wind Systems was also an important contributor to the strategy (+37.45% in 2019). It is one of the world's most successful wind turbine manufacturers and installers, with an installed base of 113 GW worldwide, or just under 20% of the installed global capacity. As such, we regard it as a core holding in our ESG portfolio. Over time, we expect revenues from maintenance and servicing to grow within the sales mix, resulting in gradually expanding margins. Also, the planet seems to be becoming windier.

Finally, Stoneco (+91.23% in 2019) and TSMC, which made the cut from our emerging markets strategy into our ethical stock list, were among the top performers for the year due their stellar results in technologies that make businesses and lives more efficient and less wasteful. Stoneco has been a volatile stock in the rout, hurt by the value of the Brazilian real and the market dynamics mentioned earlier, which we believe to be transitory.

Difficult positions included Pearson (-9.61% in 2019), the more traditional British educational publishing company which was going through a changing environment that proved too adverse for its current management to sufficiently bend its business model. We exited Pearson early in Q1. Chinese electric mass transit vehicle maker BYD also disappointed (-14.93% in 2019), a leading Chinese manufacturer that Berkshire Hathaway has a significant stake in - and is currently the world's largest face mask producer with the capacity to churn out 5 million masks daily. We believe BYD to remain an interesting long term strategic position for sales both in China and internationally .

Our alternative emerging markets strategy

Who would have thought the global COVID-19 situation would wreck complete havoc on markets? Well, not us either. Our alternative strategy had initially been designed as an opportunistic strategy that had the ability to reduce volatility. The crisis broke as we were considering postponing our recently expired protective options overlay in order to reduce its cost in the new year. Needless to say, this wasn't opportune as our objective to profit from an expected and probably quick pullback proved more arduous. The pullback morphed into a correction, which morphed into a bear market within a few days - the fastest such event on record - with volatility closing in on 2008 levels. It was not the time to buy extremely expensive insurance and we instead became net sellers of volatility. Our systematic country shorts alleviated the downward impact seen in our very concentrated long portfolio positions, and we covered those shorts to harvest profits a few days ago. The market then gave way to the fastest three day ascension since the 1930s.

While the strategy was profitable in 2019, it has lagged the market so far this quarter given its concentration. We however do not think this is the end of the line for these positions and see it more as an elastic, providing opportunities for reweightings and a better hedging setup later on. We like to see the current episode as a dress rehearsal for a type of "2008

phase II" that could come in the future, the sheer velocity of which will also be surprising to everyone. But the deep structural elements that led to 2008 - or to 1929 as some observers would suggest - are not present yet. The Great Recession and the Great Depression happened with a perfect storm of bad events, including a tightening of monetary policy and mounting irreversible job losses from structurally flawed industry dynamics. If the virus can be controlled in a timely manner, therefore, we remain constructive within the year.

Best regards,

Mount Murray Investment