Starlight Capital

STARLIGHT GLOBAL INFRASTRUCTURE FUND

Mean reversion leads to strong gains in the global infrastructure market

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Key takeaways

- Year-to-date global infrastructure equities have generated a 15.5%[1] total return
- One of the top contributors to Fund performance in June was Deutsche Post AG with a total return of 8.2%[2]
- Global infrastructure equities generated a 2.1%[3] total return in June

Macroeconomic update

Central bank intentions and actions have once again emerged as the dominant driver of market sentiment. Federal Reserve expectations have moved from four rate hikes in 2019 to two rate cuts. The European Central Bank has reintroduced targeted longer-term refinancing operations (TLTROs) and Mario Draghi's language today mirrors his "…whatever it takes…" comments in 2012. China has introduced well over 60 stimulus measures in the last year. All this dovish activity has resulted in a collapse in developed market long bond yields over the course of Q2 and into Q3. While we can understand the move in yields, we do not believe any of the major developed economies are headed towards a sustained and meaningful recession. Therefore, the move in yields, while understandable, is not sustainable and should reverse during Q3 and into Q4. This anticipated reversal in yields is as positive as we expect it to be driven by rising Purchasing Managers Indices (PMIs) and inflation as global stimulus from central banks finally begins to impact economic output.

The S&P 500 generated total returns of 3.6%[4] during the month of June but only 2.2%[5] for all of Q2. Global equities similarly generated total returns of 3.2%[6] in June but only 2%[7] for all of Q2. These datapoints correlate strongly with the path of long bond yields and highlight the market's sensitivity to near term rate cut expectations. So, while economic datapoints should trough in Q3 and rise into Q4, equity markets are likely to consolidate during that time period as leadership shifts from growth stocks to value stocks, developed markets to emerging markets and from large cap stocks to small cap stocks.

[1] From December 31, 2018 to June 28, 2019. Source: Bloomberg LP. Global infrastructure represented by the S&P Global Infrastructure Index (CAD). [2] Source: Bloomberg LP. [3] As of June 28, 2019. Source: Bloomberg LP. Global infrastructure represented by the S&P Global Infrastructure Index (CAD). [4] As of June 28, 2019. Source: Bloomberg LP. S&P 500 Total Return Index (CAD). [5] From March 29, 2019 to June 28, 2019. Source: Bloomberg LP. S&P 500 Total Return Index (CAD). [6] As of June 28, 2019. Source: Bloomberg LP. Global equities represented MSCI World Index (CAD). [7] From March 29, 2019 to June 28, 2019. Source: Bloomberg LP. Global equities represented MSCI World Index (CAD).

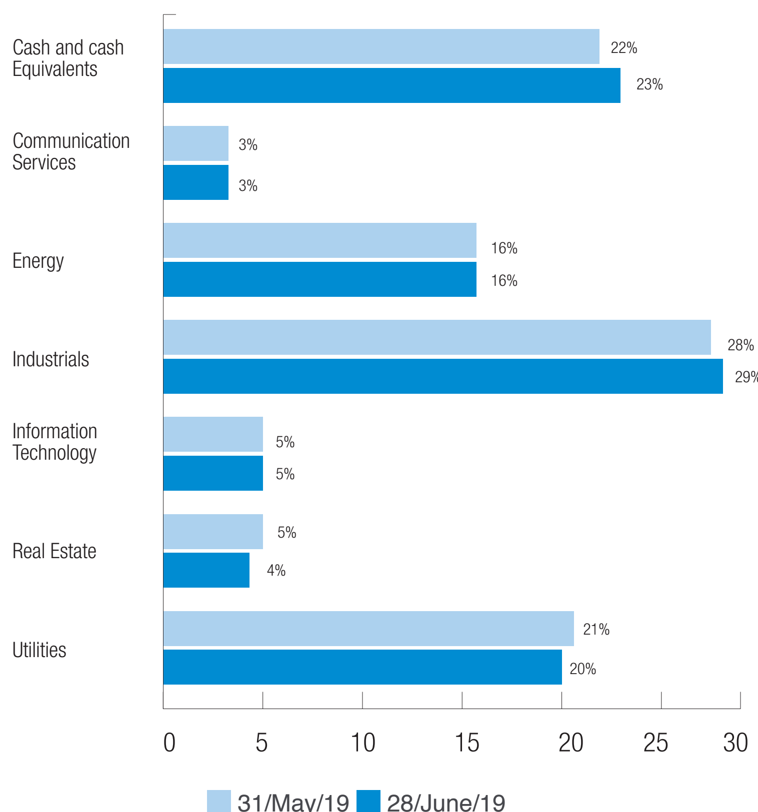
In June, the global PMIs was flat at 52.1. The small dip in Manufacturing to 49.4 was exactly offset by the small uptick in Services to 51.9. Neither number is very robust, but the global economy remains under pressure from tariffs and Brexit. U.S. PMIs were down slightly but the weakness was concentrated in Orders, with some additional weakness in Manufacturing Prices Paid and Services Employment. Eurozone PMIs were up slightly with Manufacturing at 47.6 and Services at 53.6. Eurozone Manufacturing PMIs remain depressed with France showing some signs of life. Eurozone Services PMIs traction was again driven by France with Spain showing some gains as well. Chinese PMIs were flat at 49.4 for Manufacturing and 54.2 for Services. We would expect the resolution of the trade war with the U.S. to be the final stimulus to drive Chinese PMIs, and subsequently global growth, higher.

Consensus estimates for 2019 S&P 500 EPS growth are now 2.6%. Q2 is anticipated to be the trough quarter at -0.2% but if the current trend of beats continues then Q2 could be as high as 3.1%, factoring in share buybacks. However, Q3 is unlikely to see meaningful EPS growth as consensus estimates are now 0.8%. Building off the poor finish to last year, Q4 EPS growth should rebound to 7.0% bringing 2019 to the estimated 2.6% EPS growth for the year.

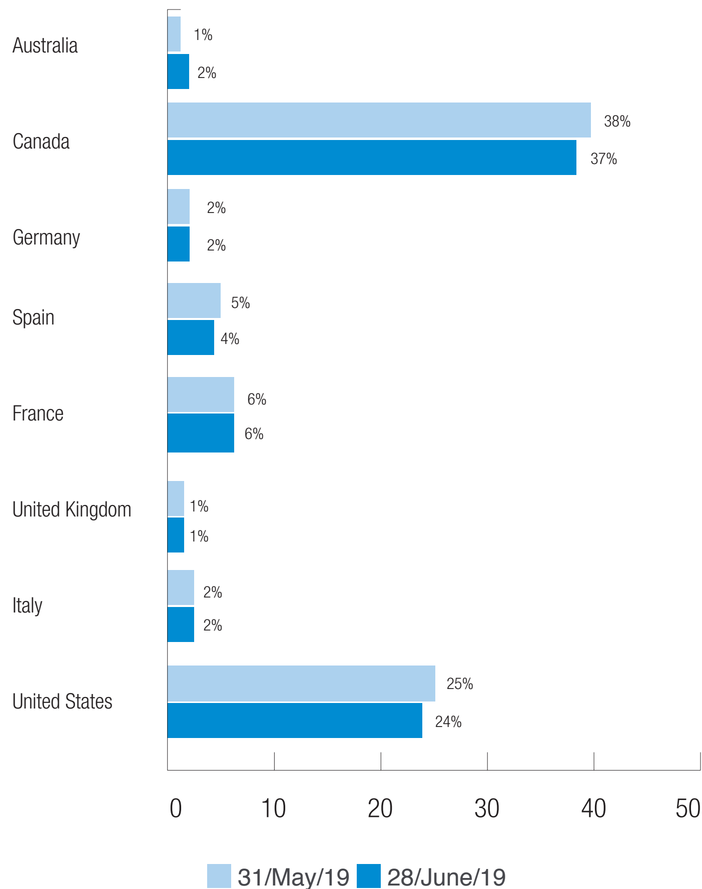
The FAANG stocks continue to weigh on the S&P 500 as do Energy and Materials stocks. Absent these three sectors, EPS growth is much more robust. More domestically focused U.S. companies continue to outperform their globally focused peers, demonstrating the continued strength of the U.S. economy. The 2020E P/E multiple for the S&P 500 has recovered to 16.2x and the current dividend yield is 1.9%. Mid to high single digit total returns from this point would seem to be in order, but with a continued uptick in market volatility.

In June, global infrastructure trailed global equities and U.S. equities (2.1%, 3.2% and 3.6% total returns[8], respectively). Year-to-date global infrastructure equities have generated a 15.5%[9] total return and this performance underscores the need for advisors to have a strategic allocation to infrastructure in their clients' portfolios.

Starlight Global Infrastructure Fund – Sector Allocation (%)



Starlight Global Infrastructure Fund – Geographic Allocation (%)*



*excludes cash & cash equivalents

[8] As of June 28, 2019. Source: Bloomberg LP. Global infrastructure, global equities, and U.S. equities represented by the S&P Global Infrastructure Index (CAD), MSCI World Index (CAD) and S&P 500 Index (CAD), respectively.

[9] From December 31, 2018 to June 28, 2019. Source: Bloomberg LP. Global infrastructure represented by the S&P Global Infrastructure Index (CAD).

Starlight Global Infrastructure Fund Overview

The Fund's geographic and sector allocations are shown on the previous page. Assets Under Management (AUM) rose 11.7% in June. Incremental new capital was allocated to existing positions, with portfolio allocations remaining largely the same. No new positions were added during the month and no existing positions were eliminated. The Fund's cash weighting reflects our lag in deploying lumpy capital inflows as the market continued to rise.

> Year-to-date, 21 companies in the **Starlight Global Infrastructure Fund** have increased their dividends or distributions by an average 9.8%.

Portfolio Review

One of the top contributors to Fund performance in June was Boralex Inc. ("Boralex") with a total return of 6.7%[10]. Boralex is an independent power producer whose core business is the development and operation of renewable energy assets. Boralex assets are primarily located in Canada and France, with the largest exposure to offshore wind, followed by hydroelectric energy. Boralex has a high-quality set of renewable assets, with more than 95% of its capacity fully contracted, providing long-term cash flow visibility. In June, the company held its inaugural investor day, where it reaffirmed the positive outlook for onshore wind development in France, as well as its entry into the solar and battery technology sectors. We believe the pipeline of growth in France is not being valued by the market, as the company has more than 1,000 MW of development projects in various stages. Despite the strong performance in June, we still see strong upside in the name due to the robust growth pipeline combined with an undervalued asset base. Boralex remains a core holding for the Fund.

Another top contributor to fund performance was Deutsche Post AG, Europe's largest postal service as well as one of the world's leading providers of express delivery, freight transport and supply chain management. In Germany, its post-eCommerce-parcel (PeP) division delivers more than 55 million letters and 5.0 million packages per day, where it has more than 60% market share. The stock had been oversold in May after reporting mixed results for Q4/2018. However, the company maintained its guidance for 2019 and 2020, which will see free cash flow generation improve substantially. The company also sold-off on worries of a global trade war given its exposure to shipments and business activity. Our patience was rewarded by holding on to the stock during this time of unwarranted weakness, and we continue to hold the name as we believe the valuation is compelling and the company is positioned well to benefit from growing eCommerce penetration. However, we have reduced our weight after the 8.2%[11] total return in June.

Pinnacle Renewable Energy Inc. ("Pinnacle") was the top detractor in June. Pinnacle is a Canadian-based industrial wood pellet manufacturer and distributor. These wood pellets are used by global utilities and power generators to produce renewable baseload power. Pinnacle reported weak Q1/19 results, driven by outages at its Entwistle facility which reduced revenue during the quarter and impacted margins. While the magnitude of the impact from the Entwistle outage was larger than we anticipated, we view this as a one-time occurrence as the company guided for the Entwistle facility to be re-commissioned by Q4/19. The company will also upgrade its Williams Lake and Meadowbank facilities, which should increase efficiency and capacity. We believe the stock has been oversold on short-term concerns, and the valuation discount to peers is too large given Pinnacle's strong production capacity and backlog of growth. We took the opportunity to add on the weakness in the name and continue to see upside over the medium term.

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[10, 11] Source: Bloomberg LP.

Portfolio Outlook

The Starlight Global Infrastructure Fund holds 38 positions, unchanged since May. Longer-term the portfolio should reach a targeted strategic allocation of 30% each to Europe, the U.S. and Canada, supplemented by opportunistic investments in Asia, Australia and Latin America. As Europe works through its legislative calendar, we will increase allocations to European infrastructure companies.

Data centres have delivered strong results this year and all of our holdings in this sector have generated double-digit total returns. We focus on data centre companies that concentrate on interconnection and co-location services in highly dense geographies, as these assets tend to possess better pricing power and strategic value. We believe data centres represent compelling value over the long-term as demand for data and connectivity continues to grow however, stock selection will remain key within the space.

We remain optimistic with respect to the energy infrastructure space, despite the weakness in oil prices experienced in June. We focus on energy companies that operate in the midstream sector, as most revenues are contractual, reducing commodity price sensitivity. We believe the growth pipeline for several of these companies is not currently reflected in valuations.

Conversely, we remain cautious around the utility sector, particularly in the U.S., as valuations remain elevated and growth opportunities are limited, particularly for pure-play regulated utilities. Our strategy is to invest in utilities with strong growth outside of the regulated franchise, whether it be midstream assets, renewable energy or emerging markets.

Overall, we believe the Fund is well positioned to participate in continued up-markets while providing downside protection. We will closely monitor the investment environment and actively manage the Fund's positioning by carefully selecting individual businesses in-line with Starlight Capital's proven investment philosophy.

Certain statements in this document are forward-looking. Forward-looking statements ("FLS") are statements that are predictive in nature, depend upon or refer to future events or conditions, or that include words such as "may," "will," "should," "could," "expect," "anticipate," "intend," "plan," "believe," or "estimate," or other similar expressions. Statements that look forward in time or include anything other than historical information are subject to risks and uncertainties, and actual results, actions or events could differ materially from those set forth in the FLS. FLS are not guarantees of future perfor mance and are by their nature based on numerous assumptions. Although the FLS contained herein are based upon what Starlight Capital and the portfolio manager believe to be reasonable assumptions, neither Starlight Capital nor the portfolio manager can assure that actual results will be consistent with these FLS. The reader is cautioned to consider the FLS carefully and not to place undue reliance on FLS. Unless required by applicable law, it is not undertaken, and specifically disclaimed that there is any intention or obligation to update or revise FLS, whether as a result of new information, future events or otherwise. Commissions, trailing commissions, management fees and expenses all may be associated with investment funds. Please read the prospectus before investing. Investment funds are not guaranteed, their values change frequently, and past performance may not be repeated.

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