

New Decade and The Search for Value Continues...

February 6th, 2020

The US Federal Reserve's shift to a more dovish interest rate stance in early 2019 helped fuel the S&P 500 to a return of 31.8 percent for the year¹. Similarly, other risk markets like the US High Yield bond market performed with equal aplomb, up 14.4 percent².

This robust return left the S&P 500 at the end of 2019 with a trailing price earnings multiple of 21 times. Once all S&P 500 constituent companies have reported their Q4 earnings, earnings growth is expected to be flat to slightly negative for 2019³.

Equity Valuations very rich ...

However, analysts' expectations are for earnings to rise well above 10 percent in 2020. Specifically, as of Friday January 24th, 2020, the S&P 500 was trading at an index level of 3,295, which based on expected earnings for 2020 of \$175, is trading at approximately 19 times forward earnings. At this level stocks are trading at levels not last seen since the internet bubble era 20 years ago³.

as well as US High Yield corporate bonds.

Not surprisingly the US High Yield bond market is also trading at an equally lofty valuation. At year end High Yield was yielding 5.4 percent⁴. This represented 370 basis points of additional yield ("spread") above US government bonds.

Interestingly, the yield on January 24th, 2020, was also 5.4 percent⁴ but given a decline in government yields since the beginning of the year the spread was 384 basis points. Not a meaningful pick up in spread but the equity market (S&P 500) was up 2.41 percent over this period. To spare you doing the math, this is the equivalent of a 41.41 percent annualized return. Think Ben Johnson, Seoul Olympics. The drug? Lower interest rates.

Yes, the current spread today is higher than the low levels of additional yield the US high yield bond market was offering in 2007 when spreads were below 300 basis for several months. Back in the days before the great recession, the yield on US High Yield bottomed at 7.3 percent and government yields were substantially higher at 4 to 5 percent for the 10-year US Treasury bond compared to 1.5 to 2.5 percent for this past year⁵.

¹ Dividend Reinvested | Source: Bloomberg Finance L.P.

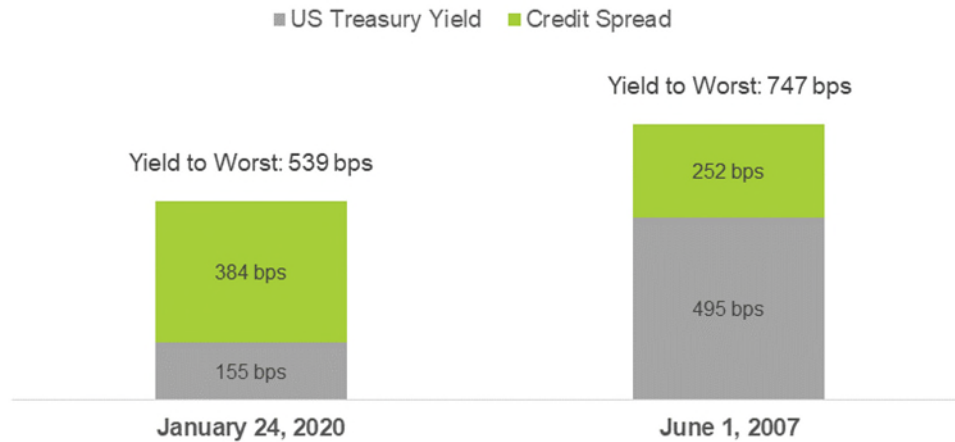
² ICE BofAML US High Yield Index | Source: Bloomberg Finance L.P.

³ Source: Bloomberg Finance L.P.

⁴ Yield to Worst; ICE BofAML US High Yield Index | Source: Bloomberg Finance L.P.

⁵ Source: Bloomberg Finance L.P.

US High Yield Risk Premia: Present vs. Past Basis Points (bps)



Source: Bloomberg Finance L.P.

Investment Grade and High Yield corporate bond leverage at all-time highs

According to Goldman Sachs Credit Strategy Research, net leverage ratios for the median non-financial Investment Grade and High Yield (ex-commodity) companies was close to 2-decade highs at the end of Q3 2019. Interestingly, this was not a result of an increase in debt but a result of weak profitability. Not a surprise given the flat to negative earnings growth seen in S&P 500 companies in 2019. While companies may be able to service their debt today, at some point in the future when the time comes to refinance this debt, higher interest costs, or the perception of them, will make it punitive for companies to roll over debt at the coupon and maturity they were expecting.

Credit market volatility to pick up with rates or recession

We make the point frequently that given the higher level of debt in the High Yield asset class, we believe investors should target absolute compensation not relative. This may seem contradictory to yield focused bond investors, but High Yield corporate bond investors can't expect to receive any more at maturity than an investor that owns a US Treasury bond. At times when prices are high, like the current environment, any risk of fears due to a recession or risk on trend resulting in higher rates could disproportionately affect this market. While the risks of macro trends always loom and can create opportunities, so too can the repricing of risks in a certain sector or specific company that can be little correlated to the overall market.

Selective purchases and additions in last 2 months

As we touched on in our fall report in 2019, the Lysander-Fulcra Corporate Securities Fund (the "Fund") held cash and cash proxies (treasuries and investment grade bonds) of 49 percent at the end of the 3rd quarter. In the later weeks of 2019 and into 2020, we purchased a few new select positions while adding to existing ones,

bringing down the cash proxy weight to 36 percent and increasing the yield to maturity to 7.4 percent from 6.7 percent at the end of the 3rd quarter, while keeping duration at 1.4 years.

The one sector of the High Yield bond market that did not experience double digit returns in 2019 was the energy sector. As a result, we observed a high level of indiscriminate selling of corporate bonds in this sector, regardless of quality. Fulcra owns one energy producer, NuVista, and we used this opportunity to add to the Fund's position.

NuVista is an intermediate oil and gas producer primarily focused on the condensate rich Montney formation. Condensate, a by-product of natural gas production, is approximately 30% of NuVista's production yet accounts for more than 60% of revenue. Condensate, critical to maintaining proper viscosity for the efficient movement of Canadian oil through pipelines, is generally priced at a premium to oil because Canada is a net importer of condensate from the US.

While the company's focus on the condensate market makes strategic sense, it is their ability to turn on and off their capital expenditures to grow production, based on the commodity pricing environment, that will allow it to protect its current low leverage of 2.0 times.

The Fund's most recent purchase of the only Nuvista bond outstanding (CAD \$220mm) due March 2023 was at a yield of 8.6 percent. This compares very favorably to recent bond new issues from both MEG Energy (leverage 4.5 times) and Baytex (leverage 2.2 times) with yield / maturity of 7.125 percent / February 2027 and 8.75 percent / April 2027 respectively. Given Nuvista's strong credit metrics and valuable untapped asset base, we believe that the company could utilize the bank / secured market to refinance bonds if required.

All said, with the purchases we have made over the last couple of months, the Funds accessible liquidity is still historically high at 36 percent of the Fund. As we go to press, the coronavirus is taking the steam out of risk markets. It is human nature to anchor to a historic event (i.e. SARS) to help create a narrative for present day. Unfortunately, this attitude can get investors into trouble if treated too cavalierly. Today, interest rates are lower, the stock market is trading at a higher valuation and China represents a much bigger part of the global economy. These are all risks that need to be treated with respect.



This document has been prepared jointly by Lysander Funds Limited ("Lysander") and Fulcra Asset Management Inc. ("Fulcra") and has been prepared solely for information purposes. Information in this document is not intended to constitute legal, tax, securities or investment advice and is made available on an "as is" basis. Lysander and Fulcra do not make any warranties or representations regarding the information herein. Information in this document is subject to change without notice. Lysander and Fulcra do not assume any duty to update any information herein. Certain information in this document has been derived or obtained from sources believed to be trustworthy and/or reliable. Lysander and Fulcra do not assume responsibility for the accuracy, currency, reliability or correctness of any such information. Nothing in this document should be considered a recommendation to buy, sell or short a particular security.

Lysander is the investment fund manager of Lysander-Fulcra Corporate Securities Fund (the "Fund").

Fulcra is the portfolio manager of the Fund.

In this document, "we", "us", and "our" means Fulcra.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Investment funds are not guaranteed, their values change frequently, and past performance may not be repeated.

This document may contain forward-looking statements. Statements concerning a Fund's or entity's objectives, goals, strategies, intentions, plans, beliefs, expectations and estimates, and the business, operations, financial performance and condition are forward looking statements. The words "believe", "expect", "anticipate", "estimate", "intend", "aims", "may", "will", "would" and similar expressions and the negative of such expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements are subject to various risks and uncertainties that could cause actual results to differ materially from current expectations. Readers are cautioned not to place undue reliance on these forward-looking statements. While Lysander and Fulcra consider these risks and uncertainties to be reasonable based on information currently available, they may prove to be incorrect.

Nothing in this presentation should be considered a recommendation to buy, sell or short a particular security. Any specific securities discussed are intended as an illustration of the portfolio manager's security selection process. The Fund may sell these securities at any time, or purchase securities that have previously been sold. The securities or short positions may increase or decrease in value after the date hereof, and the Fund may accordingly gain or lose money on the investment in the securities. The statements by the portfolio manager in their commentaries are intended to illustrate their approach in managing the Fund, and should not be relied upon for any other purpose.

The source of all ICE BofAML Indices is ICE BofAML Indexes. Any unauthorized use or disclosure is prohibited. Nothing herein should in any way be deemed to alter the legal rights and obligations contained in agreements between any ICE Data Services entity ("ICE") and their clients relating to any of the Indices or products or services described herein. The information provided by ICE and contained herein is subject to change without notice and does not constitute any form of representation or undertaking. ICE and its affiliates make no warranties whatsoever either express or implied as to merchantability fitness for a particular purpose or any other matter in connection with the information provided. Without limiting the foregoing ICE and its affiliates makes no representation or warranty that any information provided hereunder are complete or free from errors omissions or defects. All information provided by ICE is owned by or licensed to ICE. ICE retains exclusive ownership of the ICE Indices including the ICE BofAML Indexes and the analytics used to create this analysis ICE may in its absolute discretion and without prior notice revise or terminate the ICE information Indices and analytics at any time. The information in this analysis is for internal use only and redistribution of this information to third parties is expressly prohibited. Neither the analysis nor the information contained therein constitutes investment advice or an offer or an invitation to make an offer to buy or sell any securities or any options, futures or other derivatives related to such securities. The information and calculations contained in this analysis have been obtained from a variety of sources including those other than ICE and ICE does not guarantee their accuracy. Prior to relying on any ICE information and/or the execution of a security trade based upon such ICE information you are advised to consult with your broker or other financial representative to verify pricing information. There is no assurance that hypothetical results will be equal to actual performance under any market conditions. THE ICE INFORMATION IS PROVIDED TO THE USERS "AS IS." NEITHER ICE NOR ITS AFFILIATES NOR ANY THIRD PARTY DATA PROVIDER WILL BE LIABLE TO ANY USER OR ANYONE ELSE FOR ANY INTERRUPTION INACCURACY ERROR OR OMISSION REGARDLESS OF CAUSE IN THE ICE INFORMATION OR FOR ANY DAMAGES RESULTING THEREFROM. In no event shall ICE or any of its affiliates employees officers directors or agents of any such persons have any liability to any person or entity relating to or arising out of this information analysis or the indices contained herein.