Empire Life Investments

Market Update on Empire Life's Asset Allocation Fund– Apr. 17 2020

We are living in a strange time. A time we could not envision a year ago, never less three months ago. As everyone is aware of the shutting down of the economy has caused dislocations in security prices and volatility in the markets not seen since the 2008-2009 timeframe. The portfolio management team has a lot of years of experience and in times like this the most important qualities are to stay calm, stay balanced, follow your investment process and ultimately take advantage of the dislocations taking place in the market. Businesses will reopen and people will travel again. While this may be a gradual process, as it occurs optimism will return to both the economy and the stock market.

We are managing all our funds including the Asset Allocation Fund under the premise that excellent companies are on sale. Thus we have been slowly adding to stocks during this downturn. No one can effectively catch the ultimate bottom so our buying has been somewhat slow and gradual. As we started the year our breakout of assets was 55% equities (34% Canada, 16.6% US and 4.4% International), 34.4% bonds and the 10.6% cash. As of today, we are 58.7% equities (38.1% Canada, 15.9% US and 4.7 % International), 35.9% bonds and 5.4% cash, meaning that we have been very active in this market environment, opportunistically gaining exposure to high-quality companies. In addition, our bond portion is predominantly short term corporate focused.

We have added and initiated on a number of high quality companies during this selloff taking advantage of stocks trading well below our intrinsic value. A few examples include: Restaurant Brands International, BRP Inc. and Onex Corporation.

Restaurant Brands International operates and franchises over 27 thousand quick service restaurants in over 100 countries. The company's brands include Tim Hortons, Burger King and Popeyes. During the recent downturn, the stock was cut in half as many stores around the world have either temporarily closed down or partially closed down only allowing take out or drive thru. While there is no doubt sales will be severely impacted in the near term, approximately 100% of their restaurants are franchised which means corporate operating costs are low and the company should be able to do a good job preserving the bottom line. All three of these iconic brands have been around for multiple decades, building value year after year and we feel the company has the liquidity to weather this storm and that the longer term fundamentals remain intact.

BRP Inc. manufactures and markets power sports vehicles and propulsion systems with a portfolio of brand that include Ski-Doo and Lynx snowmobiles, Sea-Doo Personal Watercraft, Can-Am Off-Road Vehicles and Can-Am Spyder Roadsters. While this is a recent new holding for us, we have a long history with this name and it was previously owned in the Asset Allocation Fund. We originally started a position in BRP in Dec 2018 at around $36.00 and eventually exited our position in Sept 2019 at around $52.00, making a very healthy return as the stock was approaching our fair value. Over the past couple of months the stock has declined around 60% peak to trough, allowing us to re-establish a position. While sales of large priced discretionary items like power sport vehicles will be impacted in the short term, taking a longer term approach has allowed us to invest in a high quality global industry leader at a discounted valuation. This is a great example of how our deep investment experience and knowing our companies well, has allowed us to tactically take advantage of market dislocations.

Onex is a leading private equity and asset manager with $38B in AUM and $7.2B of shareholder capital. While many of Onex's private equity operating companies have high leverage and will be impacted by this downturn, Onex has no debt at the corporate level and currently holds around $2B USD of cash on their balance sheet. At one point during this selloff, the net cash at the corporate level represented around 75% of the market cap and if you added the value of their public stock holdings, you were essentially getting their entire private equity portfolio, credit and asset management business for free, which was valued at over $3B USD on their most recent financial reports at 2019 year end. During a broad sell off, often times selling pressure is indiscriminate and our deep understanding and analysis of Onex gave us a compelling opportunity to add to our existing position.

Finally, we feel very confident in the positioning of the Asset Allocation Fund as we own high quality companies at very attractive valuations. The pipeline of new ideas is very active in both Canada and around the world. We believe our strategy of increasing the equity weight during this downturn when stocks are on sale will prove to be the right strategy taking a longer term view.

We appreciate your support.

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