# FAIRCOURT SPLIT TRUST

**Fourth Quarter 2018**

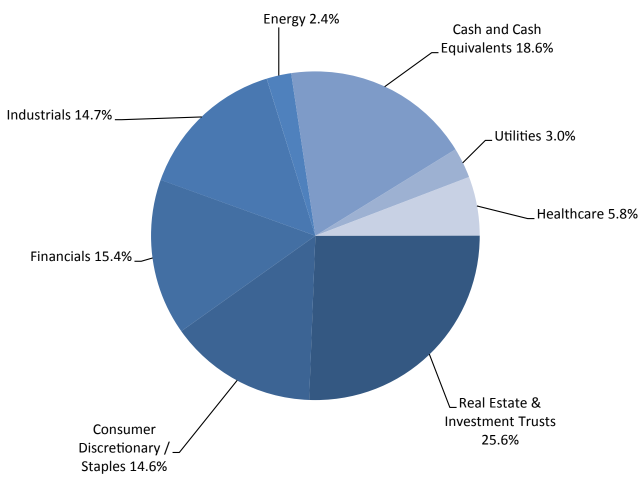
**Inception Date:** March 17, 2006
**Fund Manager:** Faircourt Asset Management Inc.
**Portfolio Advisor:** Faircourt Asset Management Inc.
**TSX Symbols:** FCS.UN & FCS.PR.C

**Faircourt Split Trust** was created using a dual security structure, consisting of Trust Units and Preferred Securities, to provide investors with leveraged capital growth potential based on a portfolio of North American equity securities.

## TOP TEN HOLDINGS as at December 31, 2018

- Alimentation Couche-Tard Inc.
- Bank of Nova Scotia
- Brookfield Asset Management
- CAP REIT
- Canadian Pacific Railway
- InterRent REIT
- Prologis Inc.
- Toronto-Dominion Bank
- Walt Disney Co.
- WPT Industrial REIT

## PORTFOLIO ALLOCATION Based on % of Portfolio, Net of Options




## Investment Objectives

The investment objectives of the Trust are to achieve a balance between the objectives of the Preferred Securityholders and Unitholders, subject to the prior rights of Preferred Securityholders.

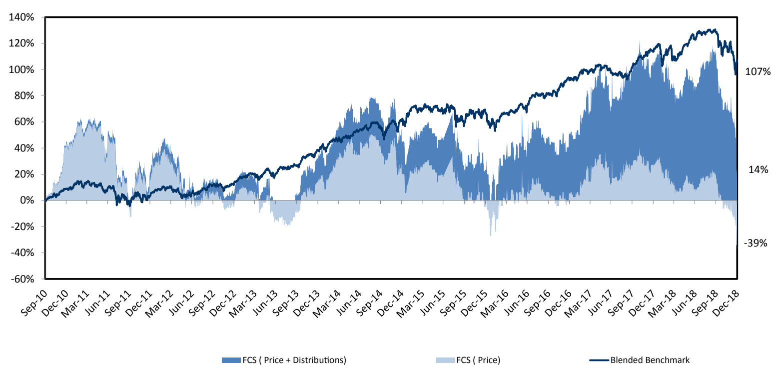
The investment objectives with respect to the Preferred Securities are (i) to provide Securityholders priority distributions of interest in the amount of $0.15 per quarter ($0.60 per annum to yield 6.0% per annum on the subscription price of $10.00); and (ii) to repay to Preferred Securityholders, on June 30, 2019 in priority to any return of the original subscription price to Unitholders, the original subscription price of the Preferred Securities.

The investment objectives with respect to the Trust Units are: (a) to provide Unitholders with a stable stream of tax efficient monthly cash distributions currently $0.06 per Trust Unit per month to yield 25% (market price as at December 31, 2018), a portion of which is tax-deferred; and (b) to return to Unitholders, on December 31, 2019 at least the original subscription price of the Units.

The following shows the returns since the merger for the trust units ending September 30, 2010. The returns are calculated in Canadian dollars.

## PERFORMANCE SINCE SEPTEMBER 30, 2010
## PAST PERFORMANCE

The Benchmark for the Fund is composed of the S&P TSX Composite Index (weight of 70%) and the S&P 500 in Cdn dollars (weight of 30%)




Source: Bloomberg. Data is based on price and includes distributions.

### Returns for Year Ended December 31, 2018

| | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception* |
|---|---|---|---|---|---|
| FCS Price (1) | -44.36% | -2.50% | -2.90% | N/A | 1.63% |
| FCS NAV (1,3) | -32.90% | -1.77% | -2.29% | N/A | 1.22% |
| FCS Index (CAD) (2) | -5.12% | 7.07% | 7.05% | N/A | 8.25% |

Notes:
(1) Assumes reinvestment of distributions;
(2) Source: Reuters
(3) Based on Basic NAV; Source: Faircourt Asset Management

*FCS since inception is from period September 30, 2010 (Date of merger with FIG)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Management fees and expenses are associated with an investment in the fund. The performance data provided assumes reinvestment of distribution only and does not take into account redemption charges or income taxes payable by any security holder that would have reduced returns. An investment in the fund is not covered by the Canada Deposit Insurance Corporation or any other government deposit insurer. There can be no assurance that the fund will be able to maintain its net asset value per security at a constant amount or that the full amount of your investment in the fund will be returned to you. Past performance may not be repeated.

FAIRCOURT

# SPLIT

## Faircourt Split Trust: December 2018 Update

The second half of the year was dominated by trade negotiations between the United States, Mexico and Canada. NAFTA was originally created to eliminate barriers to trade and investment between the US, Canada and Mexico. President Trump has argued that NAFTA favored Mexico and Canada and pledged during his presidential run in 2016 to re-negotiate the agreement. At times the negotiations were described as intense and fractious but on September 30th Canada and the U.S. announced a tentative new trilateral trade deal with Mexico with a new name, the United States-Mexico-Canada Agreement (USMCA). Concessions were made by all three parties and now must wait for full government approval from all parties. Given the change in balance in the US House of Representatives and in the US Congress, it is by no means a legally binding agreement.

The 10-year equity bull market in the United States had been extended to the second half of the year aided by a few key measures. U.S. corporate tax cuts lowered the tax rate for businesses thereby adding cash flow to corporate coffers intended to be re-invested back into US based businesses. The tax cuts also allowed the repatriation of capital on a penalty reduced basis that has been added to business investment, capital expansion and infrastructure in many industries. In addition, protectionist trade measures have led to more jobs and higher wages in some sectors, which in the short term are going to keep the USD strong, while US employment will remain stable and consumption continues to improve.

However we are already seeing the unintended results of a US focussed policy shift, such that the IMF and other global economic agencies have downgraded global growth and have suggested that down the road, this combination turns into inflationary pressure along with global economic dislocation and a slow-down caused by protectionism. In particular, there is heightened awareness and concerns with respect to how US-China trade relations spill over to the broader health of the global economy.

Canada's economic outlook is not clear. GDP growth in H218 began to weaken as the effects of trapped western Canadian oil production along with lower global energy prices have had a weakening effect on the overall Canadian economy. Since early 2017, Stephen Poloz, the Governor of the Bank of Canada has been raising the BoC's key lending rate which now sits at 1.75%. The concern was a perceived strengthening of the employment picture leading to wage inflation. However, this concern may be based on misleading statistics as a key metric in the availability of jobs and the buoyancy of the economy paints a different picture as 2018 ends. The labour participation rate a key measure of employment strength, analyzes the percentage of people who are either working or actively looking for work. The labour participation rate has fallen to 65% from 65.7% in just one year, symbolic of the changing demographics of society, rather than a measure of full employment. For instance, 2.7 million Canadians age 15-24 are in the labour force vs 3.4 million Canadians aged 55-64 years of age. Those in the latter category are less likely to be actively seeking employment and simply leave the workforce. This change can be misleading as it may show that the unemployment rate is low, and not reflecting the more correct interpretation which is that some people have merely given up looking.

That has led to a healthy debate about whether the BoC is too hawkish given the future of the Canadian economy within the framework or a newly formulated USMCA, the new trade pact enacted by the US, Mexico and Canada. There are several changes to the previous NAFTA framework that may cause challenges to Canadian manufacturing where content rules within the auto sector and other industries may cost Canadian jobs. At the time of writing, it is uncertain what the full effect of the new agreement will be and as a result, some analysts worry about the sustainability of the Canadian economy and the decision to raise interest rates at this time.

Adding to a clouded outlook for the Canadian economy is a national economic policy that isn't as focused on growth and jobs as it is focused on economic equality among provinces and environmental measures. In addition, the most recent Federal Budget has increased personal tax rates, that is having negative effects on consumption. The situation in Western Canada is also challenging as the energy sector deals with both weakening moderate global prices for oil, and pricing discounts resulting from the oil supply (in Canada) being trapped due to a lack of pipeline distribution to major global markets. Overall, our concern is the country's competitiveness, and so our portfolio is slightly more tilted in favour of US vs Cdn equities.

A big concern is the energy sector, with prices still in the mid-$30 range for Western Canadian Select. The price of WCS is in that range only due to Alberta Premier Notley's recent intervention establishing production cuts. Expansion of US shale oil production combined with uncertainty over global growth sits as a cloud over the energy sector. The implication is the energy industry's contribution to overall economic growth was materially weaker than expected during the first half of 2018. As a result, Canada's oil patch adds to a list of challenges that threatens to stall efforts by the Bank of Canada to get its key interest rate back up to more normal levels.

The central bank kept its key lending rate unchanged in early December after five rate increases since the middle of 2017. The Governor of the Bank of Canada, Steven Poloz stated that there are significant negatives which could slow the pace of future rate hikes, including the steep price discount on Canadian crude, uncertainty over the final outcomes in the USMCA, and implications around business investment in the US-China trade show down.

As a result of these noted challenges, equity markets turned negative in the final quarter of the year, eliminating gains for the year from most sectors and indexes. For the year, the Dow Jones Industrial Average fell 5.6%; the S&P 500 ended the year down 6.2% while the Nasdaq Composite shed 3.9%, marking the worst annual performance for all three indices since 2008. Canadian equity markets have seen similar weakened performance. The TSX saw its peak mid-July and ended the year off by 12%. The last 12 weeks of the year has been significant in not only eliminating gains but it has also significantly changed investor sentiment. This is a time when nerves are tested, while valuations offer select opportunities.

The Fund uses a diversified approach to North American equities maintaining exposure in many, but not all, of the sub-sectors within the S&P/TSX and S&P 500. The Fund will continue to focus on holding a diversified, but concentrated portfolio of leading companies, many of which generate stable and growing distributions. Criteria we look for are sound business models, long term steady demand for products or services, growing positive cash flow, minimal need for debt or need to raise significant amounts of capital as well as having a lower dividend payout ratio. Core positions such as, CP Rail, Prologis Inc., Walt Disney Co., Brookfield Asset Management, TD Bank, InterRent REIT, and Canadian Apartment Properties REIT., meet these criteria and are expected to continue to make up a healthy weighting in the portfolio going forward.

A company that has done well and is levered to the growth of the North American economy is CP Rail. CP Rail is a transcontinental railroad company which owns and operates approximately 12,500 miles of tracks operating in Canada and in the Northeast and Midwest of the United States. While the outlook for the North American economy is becoming more clouded, demand and pricing trends remain robust, and margins should continue to benefit from operating leverage and ongoing margin expansion efforts. In addition, transportation of crude oil by rail can provide a demand buffer should industrial demand fall off with a weakening economy. In our view, even considering the risks to the economy, CP trades at a discount to its rail peers and its earnings growth is above average and should be positioned for accelerating dividend growth and/or increased share repurchases as financial leverage improves. CP Rail was up 6.6% in 2018.

A new position in the Fund we have introduced during the second half of the year is Brookfield Asset Management Inc. Brookfield is a global alternative asset manager focused on asset management, global real estate, renewable power, infrastructure and private equity. It's asset management platform should continue attracting capital and generate recurring fee revenues, and with institutional investor's appetite for real assets increasing we feel comfortable investing alongside Brookfield and their abilities to rotate capital and earn less volatile and more diversified risk adjusted returns. Brookfield has been a stable performer in the portfolio, holding its value during the market downtown since the peak in mid-July.

The Manager continues to see positive contributions from residential REIT's in Canada due to strong population growth, economic strength and declining housing affordability. On the supply side, the expansion of rent controls in Ontario along with a lack of land supply and rising development costs continue to discourage the construction of affordable rentals. The Fund maintains key holdings in Canadian Apartment Properties REIT ("CAP REIT"), and InterRent REIT (InterRent). CAP REIT is the largest apartment landlord in Canada with a 78% weighting in Ontario and Quebec, while maintaining an 11% weight in the British Columbia. It currently manages over 44,000 suites with an overall 98.7% occupancy rate. InterRent operates in select eastern Canadian markets featuring the Greater Toronto Area, Montreal and Ottawa and is focused on buying properties that are re-positioned creating growth and sustainable distributions for investors. It currently manages approximately 9,000 suites with an overall 96.7% occupancy rate. Our bullish thesis is based on the landlord favourable fundamentals, both REIT's operating high-quality portfolios in major apartment markets in Canada having low vacancy rates which could last for a significant period of time given the outlook for rising immigration. InterRent was up +46.5% and CAP REIT was up +22.5% respectively in 2018. We continue to hold our positions enthusiastically.

During the fourth quarter, the Fund added a position in RioCan REIT. RioCan is trading at a discount to NAV despite overall good execution recently. We believe that investors are focusing too much on the challenges faced by big-box retailers and underappreciating the high grade, premier location inventory of assets that RioCan holds and has been actively upgrading. Over the past several years, RioCan has sold off second tier assets, and primarily focused on top tier locations. We are excited by the redevelopment potential in the portfolio, especially with the addition of multi-family residential opportunities within existing prime locations. While RioCan returned a modest 3.7% during the year, we see double digit return potential for the REIT over the next several years.

The Fund's small but rising exposure to the stable industrial real estate class continues to perform well with rising rents and lower capitalization rates driving returns. In the US, income growth is benefiting from the roll up of expiring leases to higher market rents. On average, quality industrial product remains in high demand. Looking ahead, we will look to increase our exposure to this asset class as industrial rents are poised to increase in many markets as supply constraints and rising land costs limit options for expanding logistics tenants' growth needs. The Fund's industrial exposure is primarily through its investments in Prologis Inc. and WPT Industrial REIT. Prologis provides efficient logistics real estate solutions to the world. WPT Industrial REIT's portfolio currently includes 54 industrial properties and one office property consisting of approximately 18 million square feet of gross leasable area located in 15 U.S. states.

To generate additional returns, rebalance the portfolio and reduce risk, the Fund writes covered calls on securities held in the portfolio and cash secured put options on securities desired to be held in the portfolio. Since inception of the option-writing program in 2009, the Fund has generated significant income from option premium of approximately $11.51 million or $5.44 per weighted average number of Trust Units outstanding. For the year ended December 31, 2018, the Fund generated income from option writing of approximately $1.03 million or $0.94 per weighted average number of Trust Units outstanding declaring regular monthly distributions totaling $0.72 per Trust Unit.

For the year ended December 31, 2018 the Trust returned -32.9% based on NAV versus the benchmark performance of -6.64%. The steep downturn in the final weeks of 2018 led to this underperformance but we are comfortable with our underlying investments and anticipate improved performance in 2019. As we enter the quarter of 2019, we will continue to use our option writing program to re balance our portfolio weightings and generate a monthly income stream that we pay out to shareholders. The Fund will continue to manage its risk by not overpaying for growth and hold a concentrated portfolio of its best ideas that will navigate the Fund through these cautious markets.