FAIRCOURT
Asset Management Inc.

3rd Quarter Commentary

The second half of the year continues to be dominated by the global governmental and central bank response to the largest macro economic and health shock in a century. Federal stimulus programs aimed at dealing with the COVID crisis, first enacted in April, have continued to levels and duration that may have wide ranging and concerning implications on economies, governments and general indebtedness. With the pandemic now exceeding eight months, most governments and central banks have discussed the need for more stimulus. Stimulus packages should be looked at as cash injections for a finite period of time to provide assistance but not for driving consumption. We are concerned by the fact that since the Financial Crisis of 2008, country by country debt to GDP ratios have moved to extreme levels with little planning to mitigate this rising trend. Based on where interest rates currently sit, governmental stimulus will probably be the primary tool for lifting the economy out of the hole brought to light by COVID.

At the beginning of the third quarter we began seeing weaknesses growing as countries re-opened. In the US some states re-opened too quickly, some did not mandate wearing masks, and as a result by the end of the September, flair ups of winter COVID are beginning and re-opening plans are being curtailed. Parts of Europe are headed into restrictive economies again with France and Germany going as far as declaring a public health state of emergency and announcing curfews. Parts of Canada are slowly implementing regional lockdowns.

What we have found is in the initial lockdown human consumption patterns changed rapidly and were destructive to regional economies. Our view is that the impact of the virus is a challenge that will be present for the next few quarters until such time as effective medications are developed, testing is accomplished effectively and people take the spread of the virus more seriously.

With respect to the United States, the real economy and capital markets continue to move in opposite directions. Capital markets just seem to want to power forward and look for a positive excuse to head higher. It is our view that along with the consistency of the Fed's quantitative participation in the markets **(see Chart A below)**, stimulus needs and subsequent delivery by Congress is what is currently powering the markets.

The economic reality is that labour markets remain stressed, consumption capacity is falling, **(see Chart B below)** banks are reluctant to lend, and corporate earnings risk is rising relative to market expectations. Adding to our concerns are subsequent stimulus packages adding to already bloated government deficits. Notwithstanding that markets can sustain momentum over the short term, it is our view that the US is in a period of low to no growth making the economy more reliant on stimulus and thus more exposed to economic shocks in the future.

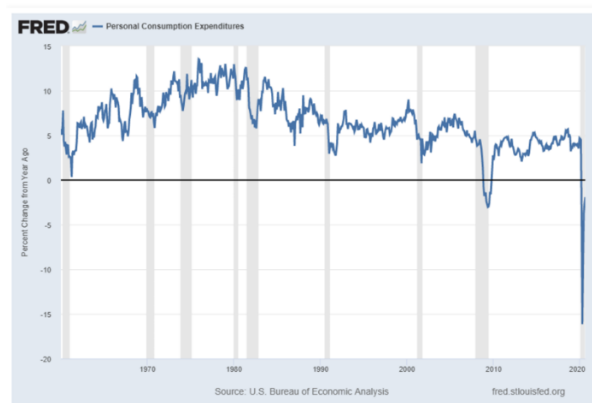
Chart A: Expansion of Fed Balance Sheet (2010-2020)

Source: Board of Governors of the Federal Reserve System

While markets can sustain momentum over the short term, if there is a major shift in economic fortunes, the ability of the markets to resist that shift dissipates and downside risks rise in probability.

We acknowledge that banks in North America are in better capital positions and ample liquidity offers comfort but the intermediate term remains fraught with uncertainty.

Chart B: Personal Consumption (1970-2020)

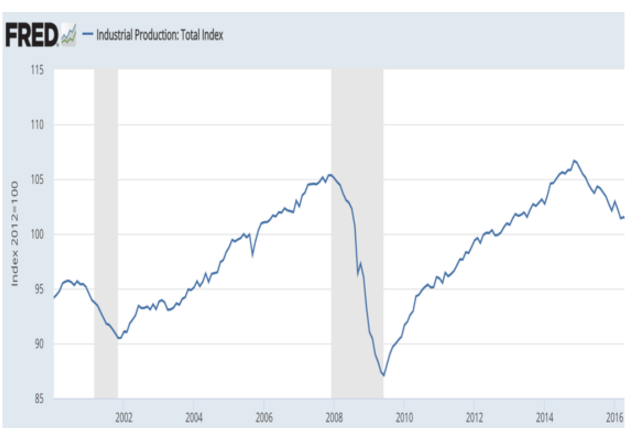


Source: US Bureau of Economic Analysis, FRED

Capital markets can adjust to good news and bad news but have no easy way to price in true uncertainty. These banks, traditional levered plays on economies, have been reluctant to offer loans and are still struggling with provision adequacy for loans still on their books. The credit quality in the corporate space is simply evaporating. We will continue to monitor the banks in North America and judge their loan loss provision adequacy if worsening economic fundamentals continue. On the state of credit we expect charge offs to increase accompanied by a lower reserve build out as with all estimates. Such an outlook is entirely dependent on the duration of the recession and path of the recovery. In the meantime, we continue to risk manage our financials exposure.

When we analyze manufacturing activity, we continue to see weakening in growth or a decline in production activity. **Chart C** (see below) depicts "Industrial Production", measuring output of the industrial sector of the economy, including manufacturing, mining, and utilities. The chart below paints a picture of manufacturing weakness.

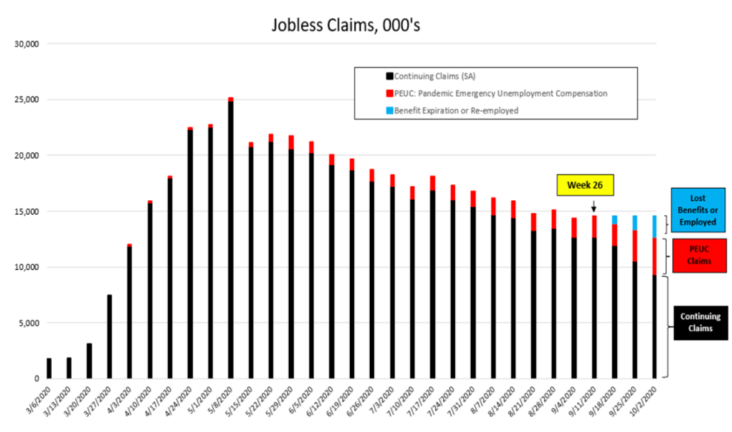
Chart C: Industrial Production: Total Index



Source: Board of Governors of the Federal Reserve System

With the pandemic now exceeding eight months it has become challenging to monitor the weekly jobs data without noticing US unemployment continues to remain elevated. Job losses that were thought to be temporary may have become permanent. As of late September, continuing claims were 11 million, currently 1.7x the previous high of 6.6 million set during the financial crisis of 2008-09. At present, jobless claims and unemployment levels are so severe there is no precedence (**see Chart D below**). Income security has deteriorated for millions of Americans.

Chart D: Jobless Claims



Source: Hedge Eye

The cure for a weak economy has generally been a reliance on the consumer to bail out the North American economy. Some combination of low interest rates, relaxed mortgage terms, a wealth effect from rising stock and bond markets and access to credit card debt has generally been enough to get the consumer spending. In this instance, the consumer is generally under-employed and over extended. Businesses have been delaying investment in plant and equipment and will do so as long as the consumer remains unhealthy. In this environment we are sticking with our disciplined proven approach. In fact, given the heightened risk in the market, we believe it is more important than ever to maintain investment discipline and not chase performance. The outsized impact of just five technology names on the market is just one example of the concentration and risks facing investors in the broader market right now.

Our strategy continues to focus on consumer needs relative to wants; and movement of goods and services over unsustainable fads. We believe that companies that exhibit core strengths in providing goods and services will prove beneficial in this environment and after this period.

While we cannot ignore the headlines around the world that will surely generate continued volatility in global equities and currencies, we will continue to focus on holding a diversified, but focused portfolio of leading companies, many of which generate stable and growing distributions. Criteria we look for are sound business models focusing on cash flow generation; long term steady demand for their products or services; growing cash flow; disciplined in its need to raise capital; as well as having a lower dividend payout ratio. Core positions we highlight in this report include **Dollar General, Americold, Prologis,** and **Fortis.** These companies meet our criteria and are expected to continue to make up a healthy weighting in our portfolio going forward.

Dollar General Corporation (DG) has been a high quality, defensive and well managed core holding of ours for many years. It is a straightforward predictable business model. DG has been delivering value to shoppers for more than 80 years by offering products that are frequently used and replenished, such as food, snacks, health and beauty aids, cleaning supplies, basic apparel, housewares at low prices in 16,400 stores in 45 states in the US. Despite the risks noted above DG has had double digit same-store sales growth during past economic downturns (1991/2001/2008/2020). The company is led by an experienced management team that has delivered strong financial results and have captured growth opportunities in a financially responsible way. Management has also executed on high-margin, value-added services like Western Union and FedEx desks to serve customers, especially those that live in rural areas, with little-or-no access to banking and shipping services. We continue to be overweight and long term holders.

A key player in the food supply chain and the only publicly listed owner / operator of temperature-controlled warehouses is **Americold Realty Trust**. Cold storage fundamentals are strong, historically predictable, and the services offered are mission critical to worldwide food distribution. The refrigerated storage industry possesses attractive fundamentals, with demand increasing at a healthy pace, thanks to population growth, urbanization, and a shift towards fresh foods. Americold has an industry leading 27% market share in the United States and approximately 5% global market share.

Its customers include such leading food producers such as Conagra, McCain and Danone and retailers such as Safeway, Kroger and Grocery Outlet. Based on our "needs" theme, food consumption is vital, and during the pandemic we are also witnessing a shift from food away from home to food at home with Americold operations benefitting. Americold is a company we currently own and has benefited immensely during this pandemic, and we remain enthusiastic about the company's long-term secular growth story.

The e-commerce shift and changing buying behavior caused by COVID closures has re-emphasized a dynamic happening in retail with traditional brick and mortar stores to omni-channel retailing. The changes to retail were occurring on a secular basis before the pandemic, COVID has simply moved it forward at a faster pace. Ecommerce as a percentage of retail sales has been increasing steadily. Global e-commerce retail sales are forecasted by eMarketer to double to ~US$7T by 2023, which may support improving leasing demand for modern, high-quality industrial real estate across the world that is well-located in proximity to transportation infrastructure, large populations, and deep labour pools. The global industrial real estate sector could recover faster than other property sectors due to accelerating e-commerce retail sales penetration. Our industrial exposure is primarily through a few strong players, one being **Prologis Inc.** Prologis provides efficient logistics real estate solutions globally operating in 9 countries, has a very strong balance sheet, limited near term lease expiries, thousands of tenants and no concentration risk, and attractive e-commerce related exposure that could be positioned for rewarding long-term growth. Prologis offers investors close to a 3% dividend yield, is USD $ denominated, is self-funding and run by experienced qualified management. We continue to be long term holders.

In keeping with our needs over wants approach we thought we would look beyond our shelter, food and movement of goods and services names and provide an example in the utilities space that would be considered a core holding for us. **Fortis Inc.** is a North American utility operating in five Canadian provinces, nine US states and three Caribbean countries (Cayman Islands, Mexico and Turks and Caicos) with assets north of $57 billion and revenues approaching $9 billion. Fortis has 99% regulated operations electric, gas, transmission, long term hydro generation and natural gas storage. Overall, its business mix and regulated operations gives us comfort in its predictable cash flows and abilities to service its debt levels and pay increasing dividends. Speaking of dividends, Fortis has a history of 46 years of consecutive common share dividend payment increases and has pledged to grow dividends annually, on average, by 6% through 2024. Fortis also has a blueprint for growth. It has recently released its five year capital budget and one can label it low risk as its $18.3 billion price tag is geared towards regulated, smaller projects and allocated 54% US, 41% Canada and 5% Caribbean. More importantly, 73% will be financed from operations and 27% from debt. Its leverage levels, debt outstanding and maturities are manageable and not of concern in this lower for longer rate environment. We continue to be long term holders in this utility company.

Risk and volatility tends to develop slowly and then all at once. We keep making lower highs on the S&P and on reduced volumes alongside elevated volatility. Volatility is a leading indicator of price. The current market volatily and volume tells us there is little conviction, typical of a bull market long in the tooth.

The current opportunity which exists, given current volatility levels, is to use our option strategy to allocate capital to equities. Current volatility levels ahead of the US election are offering us a rare opportunity to earn additional returns on otherwise cash that would not be invested. Prior to this year, volatility was at record lows allowing an investor to simply buy portfolio insurance at a low cost and ride this current uncertainty out until it fades away. This is not available today. Uncertainty is at elevated levels making protection buying very expensive. Instead we can use the volatility to our advantage and for as long as it is elevated we can sell options, generating significant option income, and on a stock by stock basis consider buying options on companies that may offer us a levered return to the upside when markets return to more normal consumption patterns. Our downside is limited to the net premium paid. Investing with defined downside and upside we consider to be a very good form of risk management.

Finally, we are convinced with the durable nature of the critical infrastructure assets and necessity based goods and services of our investment portfolios. Inevitably, market volatility creates opportunities and this time may be no different. It is precisely when investors who maintain a long term view, balancing risk and opportunity, can position themselves to be rewarded. We will stay invested by navigating this economic cycle we are in, preserving our capital, looking for opportunities in the options market, making decisions based on our risk tolerance and return expectations and compounding our returns on a risk adjusted basis. This situation will only become normalized after people feel no fear of contracting COVID. The real economy impacts may eventually arrive, however with the Fed continuing to meddle in the price action and discovery as a result of providing support there doesn't appear to be enough negative or surprising upcoming news to derail the surprising gains seen in the markets. The second wave and US election are events that will add to risk expectations and we will price into navigating our portfolio allocations and putting capital to work. Either way we are relatively no longer surprised by the volatility and market moves but we are also fully aware of the risks that exists heading into the final quarter of 2020 and calendar year 2021.

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Sincerely,

The Portfolio Management Team

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