THORNMARK
ASSET MANAGEMENT INC.

Perspective

Daniel L. Bain
Chief Investment Officer and CEO

2020 Outlook Receives Boost from Trade Truce and U.S. Election

STARTING THE NEW YEAR ON A HIGH NOTE

As we begin 2020, North American equity markets are near all-time highs. Interest rates are at generational lows, trade wars wane, inflation remains low, and economic growth and corporate earnings are poised to improve. While Australia burns, environmental activist Greta Thunberg warns of global warming. Despite headline risks, investors seem desensitized to geopolitical tensions, which dissipate almost as quickly as they materialize.

With the global economy well-positioned to gain momentum and volatility increases, this is an ideal environment to create value from fundamental research and tactical investing – Thornmark's expertise.

GOING GREEN PAID DIVIDENDS IN 2019

At Thornmark, ethics are paramount and at the core of our business. And that includes taking care of our planet by reducing our impact on the environment and carbon footprint. Even if the global warming naysayers end up being correct, which we doubt, the consequence of being wrong is catastrophic. Therefore, making changes now to protect our planet is the right thing to do.

Our words align with our actions. We continue to take steps to reduce Thornmark's carbon footprint, both in our operations and in the way we invest. Moving to paperless systems in 2018 enabled us to reduce our paper consumption by roughly 85%. It also makes document handling easier for clients and improves document retention and security. As of 2019, with the help of Bullfrog Power, we offset our office's carbon footprint by investing in green energy projects to inject clean power into the electrical grid. Our office electrical usage is now carbon neutral.

Our ultimate environmental goal is for Thornmark's operations to be carbon negative. Rather than take a neutral position, we are a proud advocate of environmental protection. However, our green initiatives go beyond our business operations – they also include the way we invest.

	Performance (annualized)			
Tactical Strategy	2019	5yr	Incep	Since
Thornmark Dividend & Income Fund	9.0%	3.5%	6.8%	Dec-98
Thornmark Enhanced Equity Fund	16.7%	7.8%	10.3%	May-93
Thornmark Alpha Fund	19.0%	8.0%	7.6%	Dec-05

"O" class net of all fees and expenses for the period ending December 31, 2019

As it turns out, taking care of our planet is also a good investment policy that pays dividends. We've been shifting some portfolio holdings away from traditional hydrocarbon energy in favour of sustainable energy and businesses. In this way, we help to influence capital allocation, encouraging others to show more respect for our fragile planet.

We continue to investigate more ways to help protect our planet. We'll share developments as they materialize. In the meantime, we continue to do our part to help protect the planet earth. And this is reflected in our 2019 investment results. As shown in the performance table on this page, all of the Thornmark Investment Funds delivered strong, absolute returns. In every Fund, sustainable investments added to the positive investment performance.

TRADE TRUCE - BABY STEPS

The fourth quarter's NAFTA rework, known as USMCA, was finalized. China finally reached a "phase 1" trade agreement with the U.S. The arrangements fall short of Trump's ambitious bilateral trade strategy; however, the baby steps are a move in the right direction and will help prime the 2020 global economic engine for improving output over the year ahead. These agreements are tailwinds to the global economy as we head into the new year.

THE ONLY THING TO FEAR IS FEAR ITSELF

Well, more appropriately, we should only fear irrational fear!

Despite trade wars, migration challenges around the world, ongoing and uncertain Brexit, and rising tensions in the Middle East, North American equity markets have been resilient. That shouldn't come as a surprise. After all, the impact of geopolitical risks tends to be short-lived unless it fundamentally shifts the growth dynamic.

For example, the 2019 drone attack on the Saudi Abqaiq-Khurais oil processing facility, and the U.S.

assassination of Iranian general Qasem Soleimani both created significant oil price spikes. A sustainable oil price shock affects the global economy via lower consumer demand, higher inflation, and heightened risk aversion. While these events shocked the world, the economic impact was negligible, as the shock was transitory. However, without shock and awe, last year, gasoline prices quietly rose around 15% in North America. Yet, that didn't stop people from spending, as personal consumption expenditures rose 3.9% in the U.S. Consumer spending continued to increase in the face of higher energy cost because, on balance, fundamental economic conditions remained positive, as employment and wage growth were strong.

There will be additional shocks to the investment landscape. Therefore, we must remain vigilant but not fearful. Fear is an emotional reaction to uncertainty, whereas discipline is the necessary response that elicits understanding and precipitates a rational outcome.

PRESIDENTIAL ELECTIONS = GOOD RETURNS

If history is any indication, as it should be, stocks are poised to keep rising over the next 12 months with an incumbent president in the White House. Since 1952, the Dow Jones Industrial Average has increased an average of 10% during election years when a sitting president is running for reelection, as is the case now. The prospect of a second term means less uncertainty for investors, even in the case of Trump.

Typically, in the years leading up to an election, sitting presidents tend to roll out new policies or push for lower taxes to bolster the U.S. economy. As history predicts, the Republican administration is working on its tax cut 2.0 and trade deals to offset the tariff pain.

Since it was created, the S&P 500 has moved higher in 82% of election years. Despite those very favourable odds, populism and voter migration toward leading candidates with extreme positions increase tail risk. Volatility into the 2020 election is likely to increase, creating both challenges and opportunities.

No matter how the election results pan out, it will have long-lasting implications for all market participants. In the meantime, it is likely to yield positive market performance, as it has in most election years.

ECONOMIC MOMENTUM BUILDS IN 2020

As the new year gets underway, economic and market conditions are aligning for equity markets in North America - again. As discussed above, shocking weather events and environmental changes are leading to meaningful consumption and capital allocations changes. For alert investors, this is an opportunity to invest in the future via companies like Beyond Meat, Tesla, and Drone Delivery Canada, to name a few.

At the same time, trade truces re-ignite economic partners and cross-border consumption when global growth is aligning and improving. Despite reducing the outlook modestly, the International Monetary Fund's 2020 World Economic Outlook sees sequential global GDP in 2020 and 2021. In the low three percent range, this is the Goldilocks environment where growth is reasonable, but not too strong. A more robust economy risks excesses, leading to higher inflation and interest rates, harbingers of the end of the cycle.

Turning to North America, GDP growth remains positive but muted, around 2%. This level of output is acceptable in an extended economic cycle. However, after last year's market advance, earnings need to grow to support further multiple expansion. At year-end, the S&P 500 was trading around 18.5 times consensus 2020 EPS estimates. While interest rates remain low, it is reasonable to expect the multiple to increase to 20 times EPS. With the benefit of U.S election based fiscal stimulus and tax cut 2.0, the earnings may well exceed current forecasts. This double dose of multiple expansion and earnings growth sets the stock market up for another year of double digits returns.

Using the same logic, the Toronto Stock Market is woefully undervalued, trading at only 15.1 times 2020 consensus EPS. Using a discount to the U.S., it would be reasonable for the TSX to trade at 19 times EPS for a return well excess of 20%. In both cases, there is upside to our targets if geopolitical uncertainty subsides and trade reignites more quickly than we currently expect. Therefore, tactical asset allocation remains skewed towards equities, with favour to Canada in the year ahead.

THORNMARK ASSET MANAGEMENT INC.
Office: 416.204.6200
Toll-Free: 877.204.6200
Email: info@thornmark.com
Website: www.thornmark.com