JUNE 2020

Q2 report

Despite the difficult headlines, negative economic numbers, and declining earnings in many sectors of the economy, the second quarter was a strong period for the equity markets.

For Barometer, our investment process allowed us to participate in this market as the quarter progressed with some of our more growth-oriented pools outperforming as our market models led our exposures towards outperforming sectors. Elevated levels of cash in the Barometer portfolios from the first quarter were deployed into leadership groups as the second quarter progressed. However not all sectors were treated equally.
For example, income securities lagged making it a more challenging environment for the Income Pool.

For the time being, the markets have chosen to look beyond the current crisis and focus on the recovery, and sectors that have benefited from this period. Broadly speaking, companies exhibiting above average revenue growth outperformed other stocks. With global economic data looking very weak for much of the quarter, concerns about growth remained at the forefront of investors' minds. As a result, the price investors were willing to pay for companies with durable revenue growth increased and in turn, traded at relatively high multiples.

Also, the market has been supported by the historic policy response of both fiscal and monetary support, which to date has been sufficient to offset the estimated initial shock from the pandemic and spillover to the full economy. The Federal Reserve through the announcement of their $750bn primary and secondary credit market facilities was able to stave off the severe credit market stress. Credit markets were buoyed by the knowledge that the Federal Reserve was watching and providing support where necessary. In effect, this indirect bailout provided U.S. companies needed access to credit markets during the second quarter.

Companies that pay dividends broadly underperformed during the quarter. With loose monetary policy driving yields to near generational lows, equity risk premium, the amount of excess return investors should expect to receive from owning equities vs. government bonds widened substantially. In addition, investors remained concerned about the durability of dividends during such a potentially difficult period for earnings.

However, the market remains resilient with fiscal and monetary support – as well as strength in leading sectors. As the world begins to open their economies, one country at a time, we begin to see some key economic indicators begin to tick up once again.

Barometer Tactical Balanced Mandate

The Barometer Tactical Balanced Pool entered the quarter with defensive positioning given elevated market volatility in the first quarter. Traditionally defensive equity sectors like utilities and communication services were sold down throughout the quarter in favour of economically sensitive sectors like financials and technology.

The pool benefitted from exposure to the technology sector, as many of the mega-cap tech names held by the pool performed well. Microsoft Corporation (MSFT:NASDAQ) outperformed as they saw strength in Office 365 driven by work-from-home and strength in Azure as cloud adoption accelerated rapidly. Kinaxis Inc (KXS:TSX) had a strong quarter as the value of robust supply chain management software became more apparent given disruptions seen in the first two quarters. Materials exposure contributed positively as well with gold miners such as Franco Nevada Corp (FNV:TSX) and Newmont Corporation (NEM:NYSE) benefitting from higher gold prices.

The pool's exposure to government bonds contributed slightly negatively to performance during the quarter as yields rallied slightly. Industrials sector exposure also contributed slightly negatively to performance during the quarter

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as the positive impact of demand for industrial products troughing early in the quarter was outweighed by the negative impact of delayed reopening later in the quarter. Trane Technology (TT:NYSE) (formally named Ingersoll and Rand) was sold out of the portfolio after it exhibited weakness.

Barometer Tactical Income Pool

The Barometer Tactical Income Pool entered the quarter with overweight allocations to cash, fixed income, and traditionally defensive equity sectors. As the market began to rally and adopted a risk-on posture, exposure to technology, materials and industrials were increased, while exposure to cash, government bonds and utilities were decreased.

The pool's exposure to information technology and materials contributed most positively to performance, as the pool owned Microsoft Corporation (MSFT:NASDAQ) throughout the quarter and added Adobe Inc.(ADBE:NASDAQ) and NVIDIA Corporation (NVDA:NASDAQ) which performed well as changes in consumption habits driven by social distancing efforts provided a tailwind. Within the materials sector, the pool owned Newmont Corporation (NEM:NYSE) and Franco Nevada Corp (FNV:TSX) during April and May. These large gold miners rallied as the price of gold rallied for much of the beginning of the quarter.

Exposure to traditionally defensive sectors like telecommunications and utilities contributed negatively to performance, with AT&T Inc (T:NYSE) and NextEra Energy Inc (NEE:NYSE) lagging indices. In the second quarter, exposure to the dividend growth factor contributed negatively to performance as the ability of companies to continue growing or even to continue paying their dividends came into question given economic weakness. While exposure to the dividend growth factor remains the focus of the strategy, throughout the quarter exposure to dividend growth was tactically reduced in favour of companies exhibiting strong revenue growth, such as Paypal Holdings Inc (PYPL:NASDAQ) and Lam Research Corporation (LRCX:NASDAQ)

Barometer Global Tactical Equity Pool

The Barometer Tactical Equity Pool entered the quarter defensively positioned with a large cash weight given the volatility seen during March. This cash was quickly put to work as leadership themes emerged and exposure to information technology, materials, and health care was increased. Given the generationally weak economic data seen during the quarter, concerns about growth were at the forefront of investor's minds. Consequently, during the quarter as growth became scarce its price was bid up.

The Pool sought exposure to growth throughout the quarter holding names like Sea Limited (SE:NYSE), a Singapore based tech conglomerate that runs an e-commerce platform and develops and publishes video games in South East Asia that grew revenue by triple digits, NVIDIA Corporation (NVDA:NASDAQ), the world's leading GPU manufacturer seeing explosive growth selling GPUs into datacenters, Kinaxis Inc. (KXS:TSX) a Canadian supply chain management software company that continues to win clients, and Veritone Inc. (VERI:NASDAQ) an AI platform for audio and video analytics that is growing strong. These names contributed most positively to performance during the quarter, as did materials sector exposure driven by exposure to the gold miners Newmont Corporation (NEM:NYSE) and Equinox Gold (EQX:TSX).

Selective energy sector exposures were put on after signs of exhaustive selling pressure were seen, Cenovus Energy Inc. (CVE:TSX) and Tourmaline Oil Corp. (TOU:TSX) contributed negatively to performance and were sold out of the portfolio quickly as they began to underperform. Financials sector exposure was kept low throughout the quarter but did detract slightly from the performance as the Pool sold Brookfield Asset Management (BAM.A:TSX) and Intact Financial Corporation (IFC:TSX).

Barometer Long Short Pool

The Barometer Long Short Pool returned 42% during the second quarter, this performance was driven primarily by exposure to the growth factor, with a notable contribution from exposure to gold miners as well. The Pool entered the quarter with a large cash weight given the turbulence encountered during the first quarter, but this cash was quickly put to work in the information technology and materials sectors as it became apparent that the market had seen a tactical bottom.

Growth factor exposures included Sea Limited (SE:NYSE), which the Pool owned throughout the quarter. Sea is a Singapore based tech conglomerate that runs an e-commerce platform and develops and publishes video games in South East Asia. Sea grew revenue by 160% in 2019 and is set to grow by triple digits again in 2020. In an environment where growth is scarce, companies with explosive growth like Sea are deserving of higher multiples. The Pool also held a position in Veritone Inc. (VERI:NASDAQ) throughout the quarter. Veritone is a small-cap, California-based company that has built an AI platform for video and audio analytics and grew revenue 84% last year. Veritone is the single position that contributed most positively to the Long Short pool's performance during the quarter, rallying over 500%.

From a sector perspective, tech exposure and exposure to gold miners contributed most positively. Great Bear Resources Ltd (GBR:TSXV) and Dundee Precious Metals Inc. (DPM:TSX) rallied during the quarter as the underlying commodity rallied as well. Selective energy sector exposures were put on after signs of exhaustive selling pressure were seen, Cenovus Energy Inc. (CVE:TSX) and Meg Energy Corp (MEG:TSX) contributed negatively to performance and were sold out of the portfolio quickly as they began to underperform.

Global Macro

The Barometer Global Macro Pool increased exposure to economically sensitive equities and commodities throughout the quarter and reduced the cash weight held to mitigate some volatility seen in the first quarter. Technology sector exposure contributed most positively to performance as cloud and semiconductor themes outperformed. The pool also benefitted from exposure to the healthcare sector as the biotech and medical devices industries rallied. The pool had exposure to precious metals throughout the quarter which helped performance as both gold and silver rallied.

The biggest negative contributor to performance was the pool's short position on S&P 500 futures as an index hedge to mitigate volatility and a long position in the volatility ETF VXX held for a short amount of time at the beginning of the quarter.

Looking Forward

As always and especially important this year, we are maintaining a high level of flexibility in our portfolios. In the first quarter, we raised a lot of cash to mute market volatility which has allowed us to re-invest as the market recovered. However, as we enter the third quarter, we remain vigilant to market risks. A potentially slower reopening and sluggish economic recovery has the market on alert, and we will take defensive action if warranted.

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