FULCRA
ASSET MANAGEMENT INC.

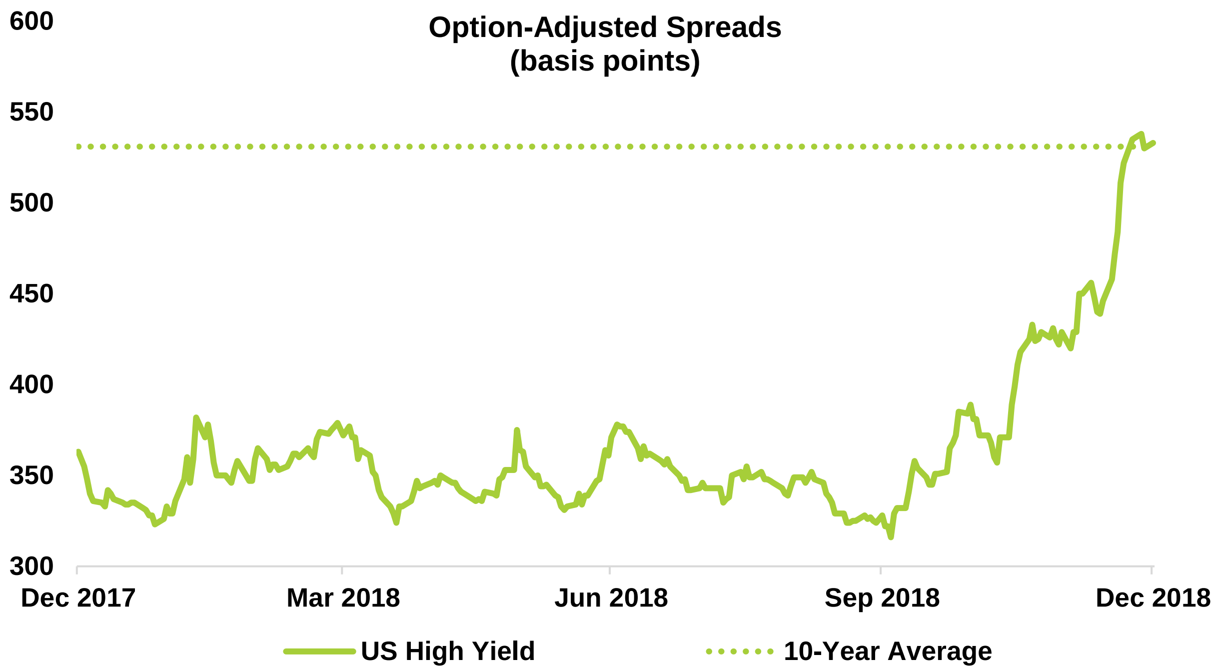
January 21, 2019

Recency Bias to the Rescue

While the Fund was flat for the year (up 20 basis points) versus the negative return of many peers and indices, the 4th quarter was a taxing one for Fulcra. Like the experience of many indices and funds, the Fulcra Credit Opportunities Fund (the "Fund") experienced a negative return (-1.86 percent) in the final quarter of the year.

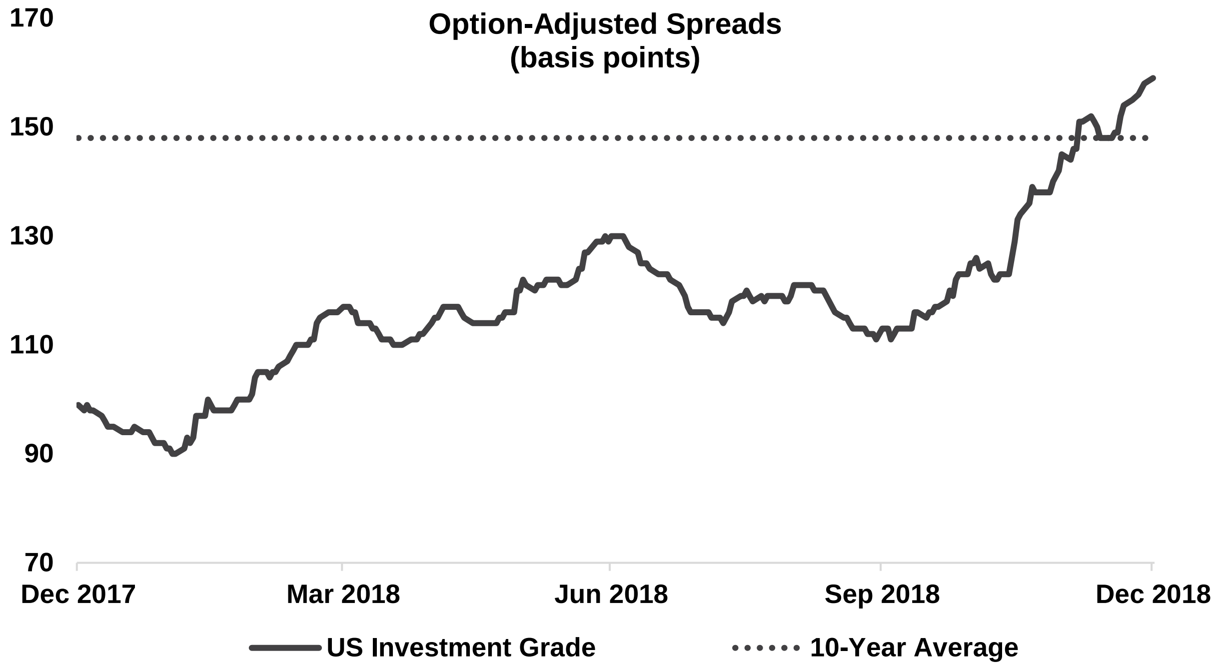
Recency bias, the behaviour of individuals putting greater emphasis on recent events than those in the near past, seemed to be in force during the last few months of the year. As the decline in the price of risk assets from the end of the 3rd quarter continued well into December (i.e. S&P 500 down 18.9[1] percent from September 28th to December 24th) some investors fixated on recent negative volatility and continued to sell.

This was an opportunity for Fulcra because we were prepared. This preparation mindset developed throughout 2018 in the form of scepticism of the near record small risk premiums (yield spread) that most corporate bonds offered.



Source: ICE BofAML Bond Indices

[1] Including dividends reinvested in the Index



Source: ICE BofAML Bond Indices

As this scepticism matured into a full-blown emotional withdrawal (ok, that might be a bit extreme…but you get the picture) through the year we focused on buying yield to call, short maturity, and tendered bonds. While these investments don't produce Fulcra's customary returns, they do protect capital and provide an attractive return for a short period of 30 to 90 days.

Ever-ready for our beloved idiosyncratic investment opportunity, this time, the fourth quarter broad-based sell off, where no security was immune, provided the buying impetus.

Shooting fish in a barrel it was not. The tail end of 2018 did, however, provide the opportunity to buy more of our favourite bonds at very attractive prices. Over the last 3 months of the year, eight of the Fund's top 15 positions had an aggregate negative 2.1 percent impact on the Fund. We responded by buying more of every one of these bonds in the last 2 months of the year.

What did this do to the bond metrics of the Fund you may ask…

Well, at the end of the 3rd quarter the Fund possessed a current yield of 5.8 percent, yield to maturity of 5.9 percent, duration of 1.6 years and cash / government securities of 16.8 percent.

By the end of the 4th quarter the Fund had a current yield of 6.5 percent, yield to maturity of 7.9 percent, duration of 1.7 years and cash / government securities of 18.0 percent.

Cash remained high at the end of the year, in part, due to the early redemption, on December 20th, of the Funds position in the Urban One 9.25% bonds, 14 months before maturity.

Urban One is the largest operator of African American radio stations in the US. Several years ago, they invested into a new hotel / casino business with MGM Resorts International. Urban One's stake in this business became valuable enough to use as collateral against a privately arranged bond. Proceeds of which were used to take out the 9.25% bonds.

While not essential to an investment thesis, minority equity investments can turn out to be sources of value that the market may not appreciate.

What is particularly advantageous for us is that rating agencies will generally not ascribe value to them unless they generate some meaningful dividends. With this in mind, we are aware that many corporate bond investors will rely solely on the rating agencies and a simpleton cash flow multiple valuation view of a company.

This take out of Urban One's debt was executed in December when there was not one high yield bond issued in the US. The last time there was not a single high yield bond issued in a month was November 2008.

Despite December's negative volatility, the Fund closed out a successful investment and generated liquidity without having to rely on the market to sell.

Not all companies need "the market" to refinance their obligations and those that don't are, quite frankly, the most attractive investments to Fulcra.

While capital markets ended 2018 with a thud, the start of 2019 has been the opposite; equity and HY credit indexes are up 6.63 and 3.92 percent respectively[2]. The play of recency bias highlighted fearful behaviour of markets in December while highlighting the opposite in January. Call it Fear and Greed or Quant models rebalancing, short term market behaviour is noise but can create the fertile ground for which future returns can be reaped - I am sure this analogy has never been used before…right ? Happy farming!

[2] Index close on December 31st, 2018 to close on January 18th, 2019. Equity index is S&P500 with dividends reinvested. HY Credit index is the Bank of America / Merrill Lynch Master II. Both in USD.