Fulcra's "Top 10"

The end of the 2nd quarter this year marked Fulcra's 10-year anniversary. The annualized return after fees since inception was 7.63 percent[1]. In dollar terms, $100,000 invested in July 2009 was worth $209,000 at the end of June 2019.

Having the opportunity to invest with an independent mindset would not have been possible without the support of our investors who share the patient, value-based investment philosophy the company was founded on.

Nostalgia sparkles during times like these so we thought it would be appropriate to provide our "Top 10" rules.

1. **Rating Agencies should not be relied upon to determine the value of an investment**. While they can articulate the positive and negative business attributes of a company, they generally attach little value to strategic and / or non-cash flow generating assets in their ratings assignments. However, most importantly, the credit rating agencies do not take into consideration the price of a bond in their due diligence process. The most important driver of value is completely ignored!

   Even though the rating agencies omit the most important part of the value equation from their analysis, they possess enormous influence over how institutions and mutual funds invest their fixed income assets.

2. **Benchmark / rigid siloed investing is a disadvantage** – especially during down markets. Regardless of whether it is a broad market sell off or an idiosyncratic event specific to a single company, it is very important to have the flexibility to make judgements on what and how much to own.

3. **Own the due diligence**. Investment ideas can come from lots of different sources but the path to the investment conclusion (buy, sell, hold or avoid) must be free of outside biases and owned by you / the firm alone.

4. **Be prepared to take advantage of falling prices**. Seems obvious but having liquidity available at the right time when prices are "on sale" is important. Fulcra's short duration thinking is built around the fact that the future is unpredictable. In the mark to market world of credit investing (opposed to the private lending business) being prepared to take advantage of falling prices due

[1] Fulcra Credit Opportunities Fund - Class B

to the irrational behaviour of investors and inflexible mandates (i.e. Exchange Traded Funds and Collateralized Loan Obligations) can be a great source for value creation. Similarly, yet more valuable when discovered and executed on, an idiosyncratic event from a single company that creates an outlier of an opportunity can happen at any time.

5. **Conviction needs to be properly weighted**. Position size is a critical differentiator. When an outlier opportunity is presented it is important to pursue aggressively. The opposite but of equal importance is avoiding investments that are over-valued.

6. **Unintended consequences are ever present**. Some obvious others less so. Thinking through the probability of future outcomes helps with bet sizing investments and portfolio construction. More precisely, the future is impossible to predict.

7. **Enjoy the Hunt.** Discovering misunderstood unloved investments is a lot of fun. Being passionate about what you do every day is an important component to being happy in life. Investing can be exceptionally creative and intellectually rewarding if your fund mandate does not have the constraints of a traditional index benchmark.

8. **Not caring to care**. Be willing to make decisions others aren't. This can be difficult and sometimes leaves you exposed to criticism. Being a contrarian for contrarian sake is not smart. However, shutting out the noise of others during the investment process is an advantage. Enduring investment performance is driven by investing where others don't and investing where others do but during times when they can't or don't want to.

9. **Entrepreneurialism helps you as an investor**. Success as a business operator requires skills that are transferable to investing. Decisions that need to be made running a business helps frame, during the investing due diligence process, how to think about the revenue drivers and cost structures of companies in different industries.

10. **Investor partners that are patient and understand the value proposition are the most important component of success.** Thinking and investing in a way we believe is unique would not be possible without the commitment from investors. Like any business our customers are the critical factor that allow us to do what we do.

While we hope we've left you with some ideas to chew on before you hear from us again, we would be remiss if we didn't speak to the current yield environment. To start, the benchmark 10-year Gov't of Canada bond (2.25 percent due June 1st, 2029) returned 10.6 percent in the first 2 quarters of the year. Going from a 1.96 percent yield to a 1.46 percent yield over that time frame.

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Given that this "interest rate" is used to price everything from stocks to real estate investments in this country we think it is worth bearing in mind that if the yield were to drop another 50 basis points it would match the lowest yield ever for the Canada 10 year gov't bond … from way back at the end of September 2016!?

Yes, we are close to the all-time low on risk-free rates … again! A 50-basis point move in either direction, over a reasonable time frame, could lead to negative volatility in riskier assets due to concerns about either a recession or a pickup in inflation. Faced with these potential outcomes and the absolute level of rates currently, we think investor behaviour could be a tad disjointed.

Rates could stay low for a longer period as central banks try to manage this state of suspended animation. Always a discriminating eye, we think the riskier parts of capital markets, however, require the utmost caution.