Starlight Capital

# Mutual Fund Portfolios

Semi-Annual Update
As of December 31, 2020

# Market Review

Brexit, the Organization of the Petroleum Exporting Countries (OPEC), COVID-19 and the U.S. elections all contributed to the extreme volatility investors experienced in equity, bond, currency and commodity markets in 2020. The wide dispersion of returns between geographic markets, strategies and sectors is largely the function of the disparate effects of the pandemic on various industries (i.e. airlines vs. communications). The resulting decline in global growth favoured businesses with resilient, predictable and/or transparent growth and markets with greater representation from those businesses performed better.

COVID-19 has significantly impacted the global economy as countries have enforced shelter-in-place orders to slow the spread of the virus. The shelter-in-place orders and subsequent shuttering of businesses has resulted in severe economic contraction in many global economies. Governments and central banks have responded with significant monetary and fiscal stimulus programs designed to stabilize economic conditions and bridge the gap in economic activity. The U.S. fiscal stimulus programs account for 26.3% of total global fiscal stimulus in 2020 and demonstrate the importance of U.S. fiscal stimulus to the global economic recovery.

The global distribution of vaccines developed by Pfizer, Moderna and AstraZeneca has generally fallen behind schedule. The challenges around logistics (refrigeration), adoption (rapid development, new technology) and acceptance (anti-vaxxers, marginalized communities) have slowed the vaccination process and put the timeline for re-opening global economies in jeopardy. We anticipate that Purchasing Managers' Indices' and economic activity will be closely tied to vaccination rates and re-openings.

Global credit markets have also seen similar levels of volatility as investors question the ability of some businesses and industries to remain liquid and solvent during the economic shutdown. Global long bond yields have fallen to historic lows as investors flock to safe havens and prioritize capital preservation over capital compounding. When the year started, Credit Suisse forecasted 2020 consensus earnings per share (EPS) growth of 10.1%. Consensus analyst expectations are now for global growth to contract by -3.9% in 2020 followed by an expansion of +5% in 2021.[1] Much of this rebound can be traced to base effects, as the global economy laps earlier periods of extreme weakness.

The bulk of global and U.S. equity market returns have been driven by multiple expansion as long bond yields, credit spreads and policy rates have all decreased. There are three sources of return for global equities – dividend yield, earnings growth and multiple expansion. In this environment, earnings growth becomes a priority as market returns will shift from being driven by multiple expansion to being driven by earnings growth. Companies trading at elevated multiples are vulnerable and companies with compromised business models are vulnerable. Stock selection will be key.

1 Bloomberg LLP, January 18, 2021

# Performance VS Benchmark

| | 2020 | Since inception |
|---|---|---|
| **Starlight Global Real Estate Fund - Series F** | **-5.1%** | **4.0%** |
| *FTSE EPRA/NAREIT Developed Total Return Index (CAD)* | *-9.7%* | *3.4%* |
| Starlight Outperformance | 4.6% | 0.6% |
| **Starlight Global Infrastructure Fund - Series F** | **3.8%** | **11.6%** |
| *S&P Global Infrastructure Index (CAD)* | *-7.3%* | *5.6%* |
| Starlight Outperformance | 11.1% | 6.0% |

Source: Bloomberg LLP and Starlight Capital as of December 31, 2020. Inception date as of October 2, 2018.

# Portfolio Contributors and Detractors

**Starlight Global Real Estate Fund**

The top contributing real estate sectors to the fund's performance during the period were Industrial REITS, Specialized REITs and Residential REITs with the Real Estate Development sector being the top detractor from performance.

Major geographic weights were in Canada and the United States (U.S.) representing about 77% of the net asset value at period-end. Preference was given to countries with the ability to maintain strong fiscal stimulus to their economies for the duration of the pandemic. Significant sector allocations included Residential, Industrial and Specialized REITs which had an average portfolio weight of 30.0%, 18.6% and 16.1%, respectively.

Two of the top contributors to the fund's performance for the period were Brookfield Property Partners and Safehold Inc. One of the top detractors from the fund's performance was American Tower Corp.

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FOCUSED INVESTING

**Starlight Global Infrastructure Fund**

The top contributing infrastructure sectors to the fund's performance during the period were Real Estate, Utilities and Industrials with the ETF hedges being the top detractor from performance.

Major geographic weights were in Canada and the U.S. representing approximately 74% of the net asset value at period-end. Preference was given to countries with the ability to maintain strong fiscal stimulus to their economies for the duration of the pandemic. Significant sector allocations included Utilities, Real Estate and Industrials which had an average portfolio weight of 24.1%, 16.3% and 14.4%, respectively.

Two of the top contributors to the fund's performance during the period were Boralex Inc. and NEXTDC Limited. Direxion Daily Small Cap 3X was one of the top detractors during the period.

# Portfolio Dividend or Distribution Increases

| | 2020 | Since inception | Average increase Since Inception |
|---|---|---|---|
| **Starlight Global Real Estate Fund** | 26 | 60 | 6.1% |
| **Starlight Global Infrastructure Fund** | 29 | 69 | 9.3% |

Source: Bloomberg LLP, Starlight Capital as at of December 31, 2020. Inception date as of October 2, 2018.

# Outlook and Positioning

Looking forward, 2021 will be heavily impacted by the rollout of COVID-19 vaccines and the change in administration after the U.S. election. These two issues will determine the pace of reopening global economies and the legislative agenda for the U.S. congress, respectively.

We believe the Federal Reserve Bank ("Fed") will continue to maintain an accommodative monetary policy stance through the end of 2023 and that the Fed's quantitative easing program will continue at its current pace through the end of 2022. Other global central banks continue to support their domestic economies with accommodative monetary policy and we do not expect these policy stances to change during 2021.

First half of 2021 global growth is likely to be supported by federal stimulus programs, including direct subsidies to global households and enhanced unemployment benefits. Second half growth is likely to be supported by the reopening of global economies as vaccination campaigns ramp up.

Market returns will shift from being driven by multiple expansion to being driven by earnings growth. Active management and stock selection will be key. In response to the volatility driven by the COVID-19 pandemic, portfolios have been concentrated into geographies with the fiscal capacity to continue to stimulate their domestic economies should the outbreak last longer than anticipated and in businesses with resilient, predictable and/or transparent growth.

**Starlight Global Real Estate Fund**

The portfolio has been concentrated into four global sectors that we believe will collect a significant portion of their monthly rent based on historical performance and current observation.

The industrial sector has proven to be very resilient as long-term structural drivers have been accelerated by COVID-19. Consumers have been forced to adopt e-commerce at a faster pace. In April of 2020 alone, 40 million U.S. citizens purchased items online for the first time. The increased demand for logistics and warehouse space to support global e-commerce should allow industrial real estate to continue to experience rising rents and cash flows for many years.

The multi-family sector has historically proven to be very resilient during economic downturns. In contrast to other real estate subsectors, tenants actually live in the real estate they lease. This has historically resulted in greater occupancy and revenue stability during economic downturns and appears to be the case during this downturn. Many of the fiscal stimulus programs enacted by global federal governments include direct payments to households to subsidize their rents as they shelter in place. The global pandemic has shaken investors' belief in the resiliency of this subsector and appears to be overly discounting fears of mass unemployment leading to significant declines in rent collection depressing the market with many REITs trading at a -10% discount to their net asset value. This provides an opportunity for patient investors to realize significant returns when the market recovers.

Finally, data centre and cell tower REITs have largely benefited from COVID-19, as traditional in-person interactions have been replaced with digital interactions. The pandemic has demonstrated the critical nature of digital communications technology and accelerated the growth rate of businesses that support this industry. The increased demand for digital storage capacity, access and communication has driven utilization rates higher and pulled corporate expansion plans forward, driving strong performance of data centre and cell tower businesses.

**Starlight Global Infrastructure Fund**

The portfolio's weighting in four global sectors has been adjusted to reflect the reality of global equity markets after COVID-19. The Industrial weighting has been repositioned to reduce the portfolios exposure to transports which have been negatively impacted by COVID-19. Instead, the industrial weighting has been shifted to more resilient subsectors such as waste collection and cargo delivery.

The portfolio was underweight Utilities going into the downturn as the sector was trading at historically high valuations. The COVID-19 driven downturn allowed us to allocate more capital into global utility companies, with a focus on renewables. Global investment in renewable energy has surged over the last 17 years to U.S. $304 billion in 2020.[2] The outlook for renewable energy remains very strong driven by higher targets from industrialized nations, further investment from government and business and greater support among global populations. As strong as returns have been in recent years we expect continued investment to drive strong total returns in 2021 and beyond.

The Energy underweight of the portfolio was maintained in 2020 as the demand destruction caused by COVID-19 was expected to overwhelm any supply cuts engineered by OPEC. The reduced return/risk ratio of the sector and higher volatility made the sector less attractive.

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[2] Bloomberg NEF Energy Transition Investment Trends, January 2021

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