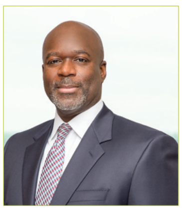
Starlight Capital

STARLIGHT GLOBAL INFRASTRUCTURE FUND

Infrastructure outperforms again



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Key takeaways

- In January, global infrastructure generated a 4.9%[1] total return, outperforming global equities and U.S. equities
- 2019 will see elevated volatility as positive economic fundamentals contrast with deteriorating economic output trends
- The top contributor to fund performance since inception is American Tower Corp., with a total return of 23.5%.

Macroeconomic Update

Heading into 2019, global risks are elevated but telegraphed. Policy risks remain the primary source of market risk as French protests, Brexit, U.S./China trade, German political succession, the Italian budget and China all pose challenges to global growth. Of these issues, U.S./China trade relations are by far the most important, given the size of the two economies and their contribution to global GDP growth. China has responded to domestic slowing by enacting over 50 unique stimulus measures (i.e. tax cuts, rate cuts, government spending, etc.), since June 2018. The U.S. has shifted from monetary stimulus to fiscal stimulus and the results have been positive to this point.

Rising global Purchasing Managers' Index (PMI) on the back of global monetary stimulus and U.S. fiscal stimulus fueled global equity markets in 2017, as they gained 23.1%[2]. However, 2017 also featured 100bps of rate hikes by the Federal Reserve Bank, which took their toll on global PMIs in 2018. Global PMIs fell for all or most of 2018[3] and global equity markets fell 8.8%[4] (both returns in USD) in sympathy. Heading into 2019, a further 100bps of rate hikes in 2018 could weigh on global PMIs in 2019[5] and induce further equity market volatility. Equity market weakness hit a cyclical climax in December of 2018 and the strong start to 2019 is part reflexive rebound from an oversold position and positive sentiment around the change in stance communicated by the Federal Reserve Bank.

[1] As at Jan 31, 2019. Source: Bloomberg LP. Global infrastructure represented by S&P Global Infrastructure Index (in CAD). [2] As at December 31, 2017. Source: Bloomberg LP. Global equity represented by MSCI World Index. [3] Source: IHS Markit. [4] As at December 31, 2018. Source: Bloomberg LP. Global equity represented by MSCI World Index. [5] Source: IHS Markit

Our belief is that 2019 will see elevated volatility as positive economic fundamentals (low unemployment, wage growth) contrast with deteriorating economic output trends (GDP growth, earnings growth). We think it unlikely that the U.S. tips into recession in 2019 or 2020 and note that most recession indicators are not signaling recession. Rising high yield credit spreads are normal near the end of central bank tightening cycles as capital flows towards better credits. Similarly, yield curves tend to flatten as decreased inflation expectations reduce the long end of the curve. Chairman Powell's recent comments on patience and flexibility make it unlikely the Federal Reserve Bank will move to end the current expansion prematurely.

In the near term, the outcome of U.S./China trade negotiations will impact market performance. An extension that delays implementing new tariffs will be welcomed by the markets, however, a deal with the elimination of existing tariffs would boost global growth expectations and equity markets. We believe strong employment levels and rising wages will support continued consumption in the U.S. while Chinese stimulus measures will stabilize growth in China. Equity markets, while volatile, should deliver solid returns given normalized market multiples, attractive dividend yields and positive earnings growth.

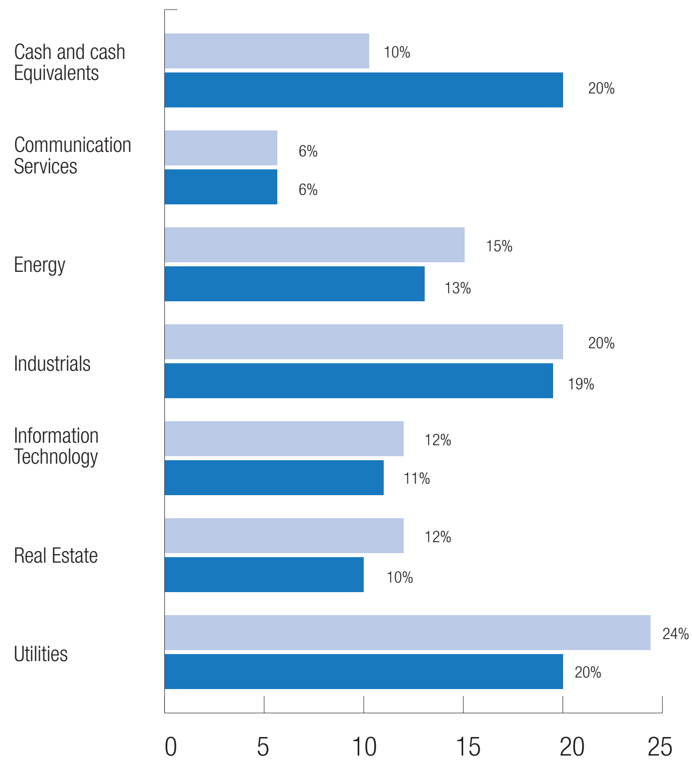
In January, global infrastructure outperformed global equities and U.S. equities (4.9%, 4.0% and 4.2% total returns[6], respectively). This extends the long-term trend of global infrastructure equities outperforming global equities and underscores the need for advisors to add a strategic allocation to their client's portfolios.

Starlight Global Infrastructure Fund

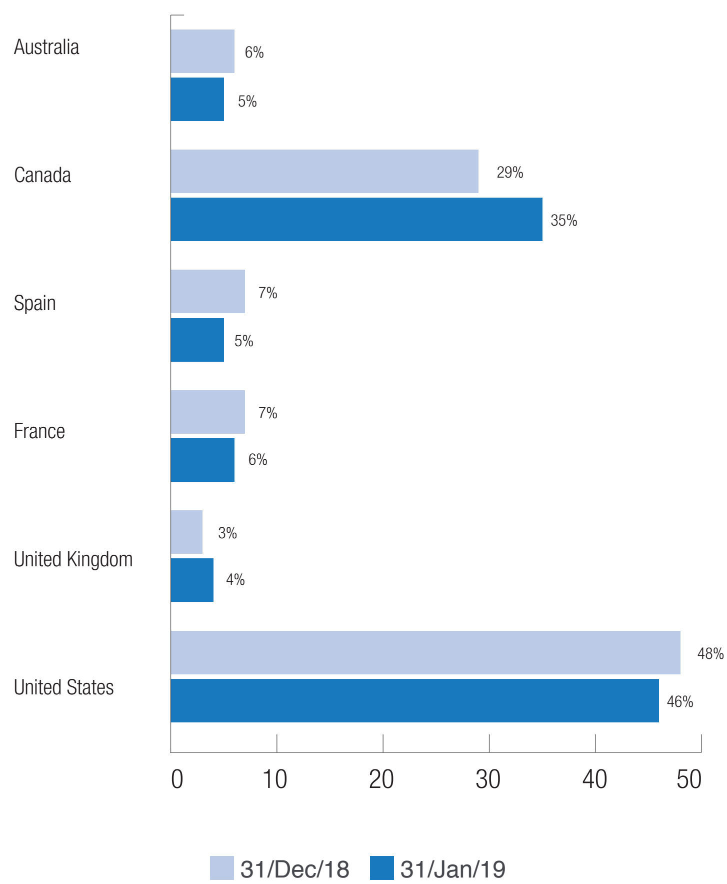
Overview

The geographic and sector allocations of the fund are shown (adjacent) here. The AUM of the Fund grew 25.4% in January and this accounts for much of the decline in European holdings. Incremental new capital was largely allocated to new North American positions. Major changes in sector allocation were also driven by capital inflows as four new industrials' positions were established in January. No positions were exited in January and the cash weighting reflects our lag in deploying lumpy capital inflows as the market rose.

Starlight Global Infrastructure Fund – Sector Allocation



Starlight Global Infrastructure Fund – Geographic Allocation



[6] As of January 31, 2019. Source: Bloomberg LP. Global infrastructure, global equities, and U.S. equities represented by the S&P Global Infrastructure Index (CAD), MSCI World Index and S&P 500 Index, respectively.

Portfolio Review

The top two contributors to fund performance since inception are American Tower Corp., with a total return of 23.5%, and Transurban Group, with a total return of 16.3%. American Tower operates the largest portfolio of telecommunications towers globally, with a significant presence in the U.S. and a growing footprint in India, Latin America and Europe. American Tower's primary business is leasing antenna space on multi-tenant towers to wireless service providers and radio and television broadcast companies. American Tower reported a strong Q3, with outperformance on both U.S. and International tower leasing. The company also raised its 2019 guidance on the back of strong organic tenant billings growth. American Tower is a direct beneficiary to the explosive growth of data consumption as well as the wireless network upgrade cycle (i.e. 4G to 5G). We still see upside to American Tower shares, though we have trimmed our exposure as a result of the strong outperformance.

Transurban Group is one of the world's largest toll road operators, with a dominant market share in Australia and a growing portfolio in the United States and Canada. Transurban's revenue has steadily grown over the past decade driven by traffic growth and toll increases, as its Australian tolls are linked to CPI. In September 2018, the company announced the acquisition of WestConnex in Sydney, a four-stage toll road concession, which will provide a significant revenue growth opportunity for Transurban over the long-term. We initiated our position after Transurban completed its equity issuance to finance the deal, as the shares had come under pressure. We believe Transurban is one of the best toll road operators in the world, with a strong pipeline of growth, though we have trimmed our exposure as a result of the strong outperformance.

Since October of 2018, eight companies in the **Starlight Global Infrastructure Fund** have increased their dividends/distributions by an average 8.6%.

The top detractor from fund performance since inception is Interxion Holding NV. Interxion is a leading data center operator in Europe, providing colocation services, equipment housing, connectivity services and performance management. The company owns and operates 50 data centers serving more than 1,600 customers across Europe, with a strong pipeline of growth for new builds as well as expansions. As with most of the data center space, Interxion sold off on concerns of diminishing pricing power and slowing demand. However, on its Q3 results, Interxion reported the largest quarterly capacity expansion in its history, while EBITDA margins came in above expectations and management reiterated the pricing environment remains stable. We believe Interxion's strategic assets in Europe provide it with an excellent platform for growth, as the European market is several years behind the United States in its development and penetration of data centers. We continue to hold the name and would add opportunistically on any further share price weakness.

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Portfolio Outlook

The Starlight Global Infrastructure Fund has grown to 27 positions and we expect to continue deploying capital into these names on an opportunistic basis. Longer-term the portfolio should hold approximately 30 names with a current targeted strategic allocation of 30% each to Europe, the U.S. and Canada. As Europe works through its legislative calendar, we will drive allocations to European infrastructure firms higher.

A sector that has delivered strong results this year is the energy space, where all of our holdings have generated double digit total returns. Our focus is on energy companies that operate in the midstream sector, as most revenues are contractual, reducing commodity price sensitivity. We believe many energy names still represent compelling value while providing strong dividend growth.

We remain optimistic with respect to the data center space and believe stock selection will be the key to generating strong returns. Our focus is on data centers that operate in growth markets as well as those that offer colocation and interconnection services, rather than wholesale data center providers which have less pricing power and are becoming more of a commoditized offering.

Conversely, we remain cautious on the utility sector, particularly in the U.S., as valuations remain elevated and growth opportunities are limited. Our strategy is to invest in utilities that have strong growth outside of the regulated franchise, whether it be midstream assets, renewable energy or emerging markets.

Overall, we believe the Fund is well positioned to participate in continued up-markets while providing protection on the downside. We will closely monitor the investment environment and will actively managed the Fund's positioning by carefully selecting individual businesses in line with Starlight Capital's proven investment philosophy.

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